

## Introduction withholding tax on interest and royalty payments

**In line with previous proposals, the Dutch Ministry of Finance announced to introduce a conditional withholding tax on interest and royalty payments as of 2021. Under the new Withholding Tax Act 2021 (“WHTA”) a withholding tax will be levied on interest and royalty payments made to certain recipients: to corporate entities that (i) have control and (ii) are residing in a low-taxed jurisdiction. There will be an anti-abuse rule for conduit companies. The WHTA also contains other measures that will amend the Corporate Income Tax Act and the Dividend Withholding Tax Act.**

The WHTA is intended to strengthen the Dutch tax base and to prevent that the Netherlands is used as a hub to route interest and royalty payments to tax havens.

### Framework

Under the WHTA, as of 2021 a withholding tax (“WHT”) of 21.7% will be levied on interest and royalty payments made by Dutch resident corporate entities or that are attributable to a Dutch permanent establishment (“PE”). WHT will only be due if the recipient qualifies as a “taxpayer” under the WHTA. In brief this is the case if the recipient is:

- a corporate entity that;
- is a related entity (e.g. a group entity); and
- is residing in a low taxed jurisdiction (a statutory rate of less than 9%).

Below we will elaborate on the various elements described above.

### Related party

The WHT will only be levied in case of related entities. The rationale is that avoidance is more likely in related party transactions. An entity is “related” if one of the following conditions is met:

- The entity has a qualifying participation in the paying entity. A participation is a qualifying participation if the shareholder can, directly or indirectly, influence the activities of the related party. This will in any event be the case if the participation in the Dutch entity represents at least 50% of the statutory voting rights.
- The paying entity has a qualifying participation in the recipient entity.
- A third party has a qualifying participation in the paying entity and the recipient entity.

The recipient will also be related if a third party or the paying entity does not have a qualifying participation, but belongs to a group that belongs to a cooperating group that together has a qualifying participation.

### Residing in a jurisdiction with a low-taxed jurisdiction

Within the meaning of the WHTA, a low-taxed jurisdiction is:

- a jurisdiction with a statutory CIT rate of less than 9%; or
- a jurisdiction that is on the EU-list of non-cooperating jurisdictions

(together to be referred as a “low-taxed jurisdiction”).

The Dutch Ministry of Finance will publish each year a list of jurisdictions that meet these



requirements. This is an exhaustive list; in case a country is not included in the list, no WHT is due on interest and royalty payments, even if the company is effectively low-taxed in the jurisdiction of residence.

As a grandfathering rule, jurisdictions with which the Netherlands has concluded a double tax treaty and that have a statutory rate of less than 9% will not be considered a low-taxed jurisdiction during the first three years after the WHTA has become effective.

Further, payments to a related entity that is not residing in a low-taxed jurisdiction, but that are attributable to a permanent establishment in a low-taxed jurisdiction, will be subject to the WHT.

Payments to an entity that is residing in a low-taxed jurisdiction, but that are attributable to a PE in a country that does not qualify as a low-taxed jurisdiction, are still subject to WHT.<sup>1</sup> When the PE is located in the EU, we doubt whether such approach is in accordance with EU law.<sup>2</sup>

Also payments to hybrid entities can be subject to WHT in case the hybrid is not a tax resident of any jurisdiction or in a low-taxed jurisdiction.

### **Anti-abuse rule**

The WHT will also apply in case of mere artificial structures that are intended to avoid Dutch WHT.

Under this anti-abuse rule, WHT will be levied if the following two conditions are met:

- The recipient entity is entitled to the payments with the main purposes or one of the main purposes to avoid taxation for someone else (subjective test); and
- It concerns a wholly artificial arrangement or transaction or series of arrangements (objective test), whereby:
  - An arrangement or transaction can consist of multiple arrangements; and
  - An arrangement, transaction or series thereof will be considered artificial if it is not based on valid business reasons that reflect economic reality.

### Subjective test

To assess whether one of the main purposes is to avoid WHT a comparison has to be made between the WHT due in the structure at hand and the scenario whereby the conduit is ignored ('look through approach'). In the event the WHT due in the first scenario is lower, an avoidance motive is deemed to be present. If the WHT due in the first scenario due is not lower than in the case at hand, no avoidance motive is present.

In case there is no related entity in the structure that is residing in a low-taxed jurisdiction or has a PE in a low-tax jurisdiction, there will not be an avoidance motive and the anti-abuse rule should not apply.

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<sup>1</sup> Even if that PE is located in the Netherlands.

<sup>2</sup> Following the Saint Gobain Judgment from the European Court of Justice dated 21 September 1999. Case C-307/97.

### Objective test

The objective test should be assessed on the substance and valid business reasons of the structure. The criteria for the objective test will be set out in a decree, based on which valid business reasons are present if:

- a) At least half of the statutory and competent board members of the company are resident in the jurisdiction where the intermediary is residing;
- b) The board members residing in the country of residence have the required professional qualifications to adequately fulfil their tasks, which at least include taking decisions – on the basis of the company’s own responsibility and within the scope of normal group management – on the transactions (to be) entered into by the company, and executing those transactions;
- c) The company has qualified personnel for the adequate execution and registration of the transactions (to be) entered into by the company;
- d) The management decisions are taken in the jurisdiction where the intermediary company is residing;
- e) The company’s main bank accounts are kept in the jurisdiction where it is residing;
- f) The company’s bookkeeping is done in the jurisdiction where it is residing;
- g) The company has to incur the Dutch equivalent of at least € 100,000 in relevant salary expenses annually in relation to its intermediary activities; and
- h) The company must have and use its own office space, which is appropriate for its activities, for at least 24 months.

If these criteria are met, the structure should - as a main rule - not be considered abusive. However, the tax authorities still have the possibility to prove that the structure is abusive (burden of proof is on Dutch tax authorities).

This could for instance be the case if the recipient entity is a mere conduit entity that does not perform any economic activity. This has to be assessed on the actual facts and circumstances and in accordance with case law from the European Court of Justice.

### **Taxable base**

The taxable base for the WHT is the gross interest or royalty amount. The gross amount has to be assessed in accordance with the arm’s length principle. This means that ‘deemed interest’ on interest free loans can also be subject to WHT.

### Interest

Interest is to be defined as any remuneration under a loan agreement. A loan agreement can regard a regular loan, but also (without being limited to) a financial lease. Further, interest needs to be interpreted from an economic perspective. One example given concerns zero coupon bonds that have a higher repayment value than the subscription value. The implied interest will be

taxable every year.

### Royalties

The definition of royalties resembles the definition of the definition of the OECD Model tax convention. The payments for the following intangibles will be considered a royalty:

1. The use or the right to use any copyright of literary, artistic or scientific work including movies and software;
2. A patent;
3. A trade mark;
4. A design or model;
5. A plan;
6. A secret formula or process, or
7. Information concerning industrial, commercial or scientific experience.

### **Procedure**

The WHT has to be withheld and paid to the Dutch tax authorities within a month after the calendar year in which the payment has been made ended.

### **Other measures – Corporate Income Tax act and Dividend Withholding Tax Act**

#### Controlled foreign companies

The Corporate Income Tax Act contains substance requirements that apply to controlled foreign companies (“CFCs”). The substance requirements are the same as described above. Under current law, when a CFC meets the substance requirements, the CFC rules do not apply. Going forward a CFC will - as a main rule - not be considered a CFC if the substance requirements are met.

However, the tax authorities get the possibility of counter evidence: if they can prove the structure is abusive, the CFC rules still apply – if even case the substance requirements are met.

#### Intermediary holding companies

The Corporate Income Tax Act and the Dividend Withholding Tax Act also contain substance requirements that apply to intermediary holding companies. Also these substance requirements are similar. In line with the WHT on interest and royalty payments and with the CFC, the Dutch tax authorities have a counter evidence that the structure is abusive even if the substance requirements are met.

A welcome clarification is that the substance requirements are in principle a ‘safe harbour’ in any structure (unless counter evidence). Whilst this previously was only the case for a so-called ‘linking shareholder’.

### **Concluding**

It is highly advisable to analyse what the impact of the WHTA might be on your company structure and/or contemplated transaction.