

## Landmark case on deductibility of intercompany interest

**On 16 July 2021, the Dutch Supreme Court released its judgement on the application of the abuse of law to the deductibility of interest. The case concerned a private equity firm which acquired the Dutch Hunkemöller-group. The outcome of the case provides new insights in the scope of the abuse of law doctrine as developed by the Dutch Supreme Court and can impact the deductibility of interest on intercompany loans.**

### The case at hand

The case at hand concerned the acquisition structure used by a private equity investor. In 2011, the French private equity firm acquired Hunkemöller ("Target"), a Dutch retail group. The shares in Target were acquired via four French FCPRs. A FCPR is treated fiscally transparent under French law, however as non-transparent from a Dutch tax perspective.

In order to acquire Target a Dutch holding company ("BidCo") was incorporated by the FCPRs. BidCo acquired all the shares in Target. To fund the acquisition of the shares in Target, the FCPRs provided BidCo with equity and a substantial amount of long term convertible loans. The convertible loans had a maturity of 40 years, could be converted by the borrower and the interest was paid in kind at a rate of 13%. A smaller portion of the received convertibles was used to grant a loan to a subsidiary of the Hunkemöller group.

After acquiring Target, a fiscal unity was formed between BidCo and Target. This would ensure the interest paid on the convertible instruments from the FCPRs could be deducted from the profits realized by Target.

The Dutch Tax Administration argued that the interest was non-deductible as the loans in fact should qualify as equity, were in scope of rules that limit the deductibility of interest and finally that the principle of abuse of law would deny the deduction of the interest payments.

### The Supreme Court's decision

According to the Supreme Court, abuse of law prevented the actual interest deduction.

Therefore, Supreme Court did not decide on the other positions taken by the Dutch Tax Administration.

According to the Supreme Court there were business reasons behind the acquisition of the Dutch retail group, hence it was a third party acquisition. However, the financing of the acquisition was considered to be set-up for tax reasons. This especially given that the interest was deductible at the level of Target, but not taxed at the level of the FCPRs. The Supreme Court also considered the debt financing useless from a business perspective. Given that the financing was solely tax driven and useless from a business perspective, the interest deduction was denied in full. Also the deduction of the interest used to provide financing to a subsidiary was denied.

### Take Away

Following this case it is paramount that not only the pricing of intercompany debt financing is benchmarked, but also the business reasons to enter into these financing arrangements are business driven and properly documented.

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