Dutch district court allows 25 % tax sparing credit on Brazilian interest on net equity

Earlier this month (on 1 May 2023), the Dutch district court in Breda ("Court") decided that the Dutch taxpayer X BV has the right to apply a tax sparing credit of 25 % in relation to the "interest on net equity" ("IoNE") it received from a Brazilian subsidiary. This because, according to the Court, unclarity on the qualification of the IoNE (as dividend or interest) should not lead to adverse tax consequences for taxpayers; they should be entitled to the most beneficial position.

Background & key considerations Court

During fiscal year 2018-2019 ("**Year under Review**"), X BV received IoNE from a Brazilian subsidiary in which it nearly holds all shares. According to the Dutch tax authorities, a tax sparing credit of 20 % should be applied on the IoNE, as it constitutes interest within the meaning of article 23-4-b of the Netherlands-Brazil tax treaty ("Treaty"). X BV argues that it is entitled to a tax sparing credit of 25 % as the IoNE should be considered as dividend based on article 23-4-a of the Treaty.

The key consideration underlying the Court's decision is that the uncertainty about the text of the Treaty and the qualification must be for the risk and account of the contracting states (i.e., Brazil and the Netherlands). Where reasonable uncertainty about the Treaty text exists, it must not be interpreted in an adverse manner for taxpayers.

Bound to the outcome of a MAP?

The decision of the Court is interesting because it is the first time that a Dutch taxpayer effectively challenged the consensus that was reached by the Brazilian and Dutch competent authorities by way of a Mutual Agreement Procedure ("**MAP**") on the qualification of IoNE for tax treaty purposes. For more information about this MAP, or the relevancy of the tax sparing credits, we refer to the newsflash that we published last year which can be assessed here.

The outcome of the MAP in 2022 resulted in a consensus between the competent authorities that for the purpose of applying the Treaty, and in accordance with (i) Brazilian tax law and (ii) a unilateral Dutch Decree first published in 2020, IoNE should be considered interest. For sake of completeness: Brazil applies the interest withholding tax of 15% on IoNE payments.

Now, in the first court case after the outcome of the MAP, the Court rules differently. This underlines the prevailing doctrine in the Netherlands that courts and taxpayers are not strictly bound by the outcome of MAPs.

Impact Court decision

With the Court decision in mind, a Dutch taxpayer arguably has a “reportable position” (in Dutch: “pleitbaar standpunt”) when claiming a tax sparing credit of 25 % for IoNE (from Brazilian subsidiaries) in its corporate income tax return. This means that – pending further case law – Dutch taxpayers should be protected from penalties if the position would be reversed after all, leading to an increase of the taxable basis. Where taxpayers have applied the interest tax sparing credit of 20 % and the final assessment has not yet been imposed, it may be worthwhile to file an objection letter.

It is still unclear whether certain facts may be decisive for the decision of the Court. For example: would the Court have decided differently if the outcome of the MAP would already been available during the Year under Review? We can imagine the Dutch tax authorities will file an appeal to this decision of the Court. Future decisions from higher courts should further clarify this matter.

If you have any questions or comments, we are happy to assist.

Contact Information

Eli van Exel
T. +31 615 331 923
E. eve@atlas.tax

Ivo Kuipers
T. +31 627 034 971
E. ik@atlas.tax