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Supreme Court once again decided on compartmentalization in the participation exemption

No mandatory compartmentalization is to take place in case of a change of law governing the participation exemption, the Dutch Supreme Court decided once more. This decision confirms the judgment of 14 June 2013.

Under the participation exemption regime, a private limited liability company ("BV") – or a public limited liability company ("NV") – generally does not pay corporate income tax on the income from an interest of at least 5% of the shares in another joint stock company. Both the dividend received and the gain realized on sale of the shares are tax-exempt and regular book losses are non-deductible. In the past, the court decided on the question whether the entire realized capital gain should be exempt on sale of a participation if part of this profit can be allocated to a period in which the participation exemption was not applicable. This concerned situations in which a change of applicability had taken place. At the time, the Supreme Court decided that the gain should be compartmentalized: the part of the profit relating to the period in which the participation exemption was not applicable should be taxed. This case law only concerned situations where the participation exemption was not applicable in a certain period due to a change of facts (fact compartmentalization): e.g., because the parent company first had an interest of 4% and then purchased another 1% of the shares. Case law shows that compartmentalization of the gains and book losses is obliged in all cases where a change of applicability occurs following a change of facts. It was unclear, however, whether this would also be the case for a change of applicability due to a change of law (rule compartmentalization).

(1) Similar participation

Before 2007, the participation exemption could apply to interests of less than 5% if it concerned a so called similar participation. As of 2007 the participation exemption was amended drastically. One of the changes implied cancellation of the concept of similar participation. Transitional provisions were implemented for then existing similar participations, as a result of which the participation exemption remained applicable up to and including 2009. But at the time, the government knowingly decided not to introduce a general transitional measure for - other - taxpayers that faced a change of applicability following an amendment of the law. The parliamentary treatment shows that the Supreme

Court was assumed to also prescribe rule compartmentalization in addition to fact compartmentalization.

(2) Judgment

On 14 June 2013, however, the Supreme Court decided that the participation exemption does not demand rule compartmentalization. Generally, the Supreme Court believes that following a change of applicability due to an amendment of the law, the gain realized on sale of an interest is to be taxed in accordance with the rule that applied at the time the gain was realized. In the present judgment the Supreme Court confirms this judgment. Furthermore, the present judgment shows that there is no obligation to write down an exempt participation.

(3) Change of law

The government was unhappy with the Supreme Court's interpretation of rule compartmentalization and submitted a bill last year. This bill is currently being treated in the House of Representatives. According to the proposed regulation, rule compartmentalization must be applied mandatorily with retroactive force, both for gains and for dividends. The circumstances will determine how this will work out for the companies involved and if clear, we will inform you accordingly.

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