



International Tax

European Union Tax Alert

5 June 2014

CJEU declares Netherlands dividend withholding tax compatible with EU law

Contacts

Hans van den Hurk
Hvandenhurk@deloitte.nl

Harm van den Broek
Havandenbroek@deloitte.nl

Jasper Korving
jkorving@deloitte.nl

The Court of Justice of the European Union (CJEU) issued a decision on 5 June 2014, concluding that the imposition of Dutch withholding tax on dividend distributions by a Dutch company to its 100% parent company resident in the (former) Netherlands Antilles is compatible with the free movement of capital principle in the Treaty on the Functioning of the European Union (TFEU) (joined cases C-24 and 27/12). Advocate General Jääskinen of the CJEU issued an opinion on 16 January 2014 reaching the opposite conclusion.

Applicable Dutch law and background

Under the tax arrangement for the Kingdom of the Netherlands (which effectively operated as a treaty between the Netherlands and its Caribbean territories), an 8.3% withholding tax was levied on dividend distributions to a Netherlands Antilles parent company that held a qualifying participation in the subsidiary distributing the dividends. The 8.3% withholding tax was required to be remitted to the treasury of the Netherlands Antilles. Had the recipient parent company been a Dutch (or an EU) resident, the dividend distribution would have been exempt from withholding tax under Dutch domestic tax legislation.

At the time the dividends were paid in the cases before the CJEU, the Netherlands Antilles was an autonomous Caribbean country within the Kingdom of the Netherlands. For EU law purposes, the Antilles qualified as an Overseas Country and Territory (OCT) to which special rules apply under the OCT Decision. The decision includes provisions comparable to the TFEU freedoms, although their wording is narrower in scope than the wording of the equivalent provisions in the TFEU. In principle, the TFEU freedoms are not applicable in relation to OCTs, unless explicitly determined otherwise.

In 2005, the year at issue, the Netherlands Antilles consisted of five island territories: Bonaire, Curaçao, Saba, Sint Eustatius and Sint Maarten. However, due to a constitutional reform of the Kingdom, the Antilles subsequently was dissolved as a jurisdiction. As from 10 October 2010, the Netherlands Antilles no longer exists as its own country; two new jurisdictions— Curaçao and Sint Maarten—came into existence as separate constituent countries (with a status comparable to that of Aruba. The three other islands (Bonaire, Sint Eustatius and Saba) became special overseas municipalities of the Netherlands.

The TFEU was not amended following the Dutch constitutional change, so it continues to refer to the Netherlands Antilles. The amendments to Dutch public law regarding the country's relationship with the former Netherlands Antilles are irrelevant for EU law purposes and, for these purposes, all islands still can be referred to as the Netherlands Antilles.

Facts of the cases

The cases involved a situation where, in 2005, two Dutch companies paid dividends to their respective 100% parent companies in Curaçao, from which the 8.3% tax was withheld and remitted to the treasury of the Netherlands Antilles. Both parent companies took the position that the dividend withholding tax violated the free movement of capital principle in the TFEU, which, in certain cases, applies to capital transactions to and from EU member states *and* third countries (and not just to transactions between EU member states, as would be the case under the freedom of establishment provision, or for other TFEU freedoms). If the CJEU were to qualify the Netherlands Antilles as a third country for purposes of the free movement of capital, this freedom could apply, irrespective of the 100% shareholding, based on the CJEU decision in the *FII* case. That case held that where legislation does not apply exclusively in situations where a parent company exercises "decisive influence" over a subsidiary paying dividends, that legislation can be evaluated against the free movement of capital principle (even, if in the case concerned, the parent *does* own 100% of the subsidiary). If the free movement of capital principle could be applied, the withholding tax exemption for dividends paid to a Netherlands (or EU) parent company could equally apply to dividends paid to a parent company in the (former) Antilles.

The two cases were heard by several Dutch courts, and the Netherlands supreme court eventually referred the cases to the CJEU to rule on the legal status of OCTs, such as the Netherlands Antilles, for purposes of the free movement of capital principle. In other words, the CJEU was asked to rule on (i) whether an OCT should be considered a "third country," and (ii) whether the relationship between an OCT and the country of which it is an OCT is purely "internal" (which would prevent the free movement of capital principle from applying to transactions between an EU member state and one of its own OCTs).

CJEU decision

The CJEU concluded that since the TFEU specifically refers to the Netherlands Antilles as an OCT, the TFEU freedoms can be invoked only to the extent that the scope of these freedoms is extended to OCTs. According to the CJEU, the TFEU does not extend any TFEU freedom to an EU member state's relationship with an OCT.

The OCT Decision, on the other hand, does refer to the free movement of capital. According to the CJEU, the scope of this provision is close to the scope of the TFEU free movement of capital, since in essence it prevents all restrictions on payments on the current account and capital account of the balance sheet, including the payment of dividends.

However, the OCT Decision includes a tax carve-out clause specifically aimed at preventing tax avoidance. According to the UK, this was included in the OCT Decision because numerous OCTs were considered tax havens. Since the objective of the Dutch rule, according to the CJEU, was to prevent excessive

capital flow to the Netherlands Antilles and to diminish the Antilles' attractiveness as a tax haven, the free movement of capital principle in the OCT Decision could not be applied. The Dutch Supreme Court should decide whether the Dutch rules pursue that objective in an effective and proportionate manner.

Comments

The immediate effect of the CJEU decision is that, subject to EU requirements relating to the proportionality principle, the Netherlands may levy dividend withholding tax on payments made to parent companies in the (former) Netherlands Antilles. The CJEU seems to be contradicting its earlier case law, in which it did apply the TFEU free movement of capital. Although those cases involved the relationship between an OCT and a non-related EU member state, it would appear that the qualification of an OCT as a third country should apply where the relationship concerned involves a related EU member state. However, as a result of the CJEU decision, an OCT can be treated differently in relation to a related or non-related EU member state.

From a practical perspective, it would seem to be necessary to examine each specific situation on a case-by-case basis to determine whether the levy of dividend withholding tax on a dividend distribution is appropriate to prevent tax abuse.

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