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International Tax

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Draft bill published on implementation of amended EU parent-subsidiary directive

On 15 September 2015, the Dutch government published legislative proposals for the implementation of the amended EU parent-subsidiary directive (PSD) that are expected to take effect as from 1 January 2016. The PSD amendments require EU member states to implement an anti-hybrid rule and a general anti-abuse rule (GAAR) by 31 December 2015.

The draft law contains the following proposed changes, which would apply to both EU and non-EU situations:

- The Dutch domestic participation exemption would not apply to remuneration/payments received if these are tax deductible at the level of a group company (“anti-hybrid rule”); and
- The GAAR would be implemented in the foreign substantial shareholder regime (FSS regime) in the Dutch corporate income tax act and in the Netherlands dividend withholding tax act in the context of cooperatives (coops). This generally would entail a technical alignment of the current rules with the GAAR.

No changes with respect to the PSD GAAR are proposed to the participation exemption and, hence, the application of the exemption would not be limited as a result of the Dutch implementation of the GAAR.

The draft law also contains some beneficial measures for taxpayers, including a step-up in the case of cross-border mergers and an alignment of existing R&D incentives in the Dutch wage tax regime. Other legislative proposals include implementation of the country-by-country reporting and transfer pricing documentation proposals in the OECD base erosion and profit sharing (BEPS) initiative. These proposals are not addressed in this alert.

Anti-hybrid rule

The Dutch participation exemption provides for a full exemption (without any minimum holding period requirement) for income from EU and non-EU subsidiaries that are (in short) either sufficiently active or sufficiently subject to income tax. The amended PSD requires member states to disallow the benefits of the directive in the case of hybrid mismatches. The proposed Dutch rule would disallow the application of the participation exemption for payments received that are tax deductible at the level of a group company. With reference to the OECD BEPS project and the global scope of the participation exemption, the Dutch government did not intend to limit the scope of the anti-hybrid rule to EU situations, so the rule also would apply to non-EU participations.

In essence, the rule would aim to catch income received under hybrid financing arrangements, such as certain types of profit-participating loans and preferred share arrangements. However, capital gains and foreign exchange results in relation to these instruments would continue to be exempt under the participation exemption, since these items generally will not lead to a deduction.

Specific rules would apply where a hybrid instrument is acquired with existing accrued dividends: such dividends, when paid out, would not be credited against the value of the investment (which generally is not a taxable event), but instead would be treated as taxable income.

GAAR in the FSS regime

Under the proposals, the GAAR would not be implemented in the Dutch dividend withholding tax act, but, instead somewhat surprisingly, in the FSS regime, which may apply to both dividends and capital gains. The FSS regime may apply where a foreign entity owns a substantial interest (5% or greater) in a Dutch company and the main purpose, or one of the main purposes, of the foreign entity for holding the substantial interest is the avoidance of Dutch dividend withholding tax or personal income tax and, at the same time, the (series of) arrangement(s) is considered artificial.

Based on the explanatory notes to the proposals, the artificiality of a structure would be determined based on the existence of valid business reasons underlying the arrangement(s), under which relevance would be given to the substance of the foreign shareholder. Shareholders that carry on business activities or that qualify as a top-tier holding company (performing governance, management and/or financial activities with respect to the Dutch entity) would not be considered part of an artificial arrangement. The substance of foreign intermediary holding companies that do not themselves perform business activities would be tested along the lines of the existing substance requirements applied to Dutch holding companies applying for a ruling from the Dutch tax authorities.

The proposed rules are not expected to result in a substantial change in practice, compared to the current FSS regime, which already contains a similar form of a GAAR. The new substance requirements for the substantial interest holder would apply only where the substantial interest-holder itself is not an active company.

The proposals specifically acknowledge that tax treaty protection would not be limited through the GAAR, absent specific anti-abuse measures in the relevant treaty. Therefore, situations in which the effects of the FSS regime currently are mitigated under a tax treaty would not be affected. Finally, no changes with respect to the GAAR are proposed to the participation exemption and, hence, the application of the participation exemption would not be limited as a result of the Dutch GAAR implementation.

Withholding tax regime for coops

Profit distributions by Dutch coops generally are not subject to Dutch dividend withholding tax, unless there is a tax avoidance motive in an artificial structure, in which case, withholding tax may apply.

As in the case of the FSS regime, the proposed rules are not expected to result in a substantial change in practice since the current rules contain a form of a GAAR, unless a foreign member in a coop is not an active company and the coop is not considered as having a "real economic function." In that case, similar substance requirements may apply (similar to the FSS regime).

Coops with a real economic function do not fall under the withholding tax regime in any case. The explanatory notes to the proposals mention that a coop that carries on an active business would be considered to perform a real economic function. The notes provide a welcome clarification: in practice, a coop that has employees on the payroll and has an office at its disposal would be considered to carry on an active business.

Comments

The changes to the Dutch participation exemption would be limited to an anti-hybrid rule that would apply to both EU and non-EU situations where payments potentially have been tax deductible at the level of a group company. Companies should identify any appropriate action needed (if any) before the proposal's anticipated effective date of 1 January 2016.

The implementation of the PSD GAAR into Dutch law, to a large extent, would involve only technical amendments, since a similar GAAR already applies under the current FSS regime and under the dividend withholding tax act in the context of coops. However, entities should review existing structures to determine whether substance requirements for a foreign substantial interest holder or coop member may become relevant.

Coops with a real economic function (office and employees) would be expected to become an increasingly attractive platform for corporate structures and various types of investment structures.
