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Tax Lawyers

Tax Plan 2012 passed by Upper House

On December 20, 2011, the Upper House passed the Tax Plan 2012. This bill includes measures in respect of corporate income tax and dividend withholding tax. The most important developments in these areas that have taken place since our last memorandums on the Tax Plan are discussed below.

1. Corporate income tax

1.1. General/participation interest

One of the questions raised by the Upper House related to the complexity of corporate income tax, and whether the Cabinet plans to completely revise the Corporate Income Tax Act 1969 (“CITA”). In his Memorandum of Reply, the Deputy Minister of Finance indicated that the Cabinet is not intending to propose a general revision of the CITA.

The Deputy Minister once again confirmed that the current interest deduction limitations for corporate income tax will be reviewed in the future bill on participation interest (Bosal costs), also in combination with the acquisition holding company provision (see below). At that time, the interest deduction limitation for acquisition holding companies and the participation interest measure will be checked to ensure they are consistent. The Deputy Minister expects any amendments to the first measure to be primarily technical. The Cabinet’s position is to subsequently leave corporate income tax undisturbed. A separate bill on participation interest is expected in the first half of 2012. However, if this is not attainable, the Deputy Minister will send a letter to parliament, so that the content can in any case be debated.

1.2. Interest deduction limitation acquisition holding companies

As you are aware, the Tax Plan 2012 includes a measure in respect of the deduction of interest by acquisition holding companies (Section 15ad CITA, “Section 15ad”). For further information on Section 15ad, please refer to our memorandum of November 16, 2011, in which we discussed the provision, now passed by parliament, as formulated after the fifth Memorandum of Amendment. During the debates in the Upper House various questions were raised and answered. These are set out below.

- In relation to. In reply to the question which debts will, in practice, qualify as acquisition debt, the Deputy Minister stated that this will obviously be determined in the same way as applicable under the old acquisition holding company provision that was abolished as of January 1, 2007. At that time, no ‘capacity rule’ was applied. Such a rule may regard loans taken out within a certain number of months before the acquisition or expansion as being related to the acquisition or expansion. The Deputy Minister is clearly not choosing this option. The relationship between

debt and the acquisition or expansion of an interest must therefore be determined in the same way as required by the old acquisition holding company provision. It is not entirely clear what the Deputy Minister means by this, but the term ‘relationship’ was broadly interpreted under the old provision, and required that the factual situation be looked at.

- Own profit. The Deputy Minister indicated that a profit split must continue to be made even after seven years, if, pursuant to the provision, the acquisition debt has been repaid to 25% of the acquisition price. The profit of an acquired company for which the acquisition debt has been repaid to 25% of the acquisition price will still not be regarded as the ‘own profit’ of the acquiring company.
- Available cash flow. The Deputy Minister indicated that the taxpayer is free to use the available cash flow as it sees fit. One possible consequence of a taxpayer not using the cash flow to repay acquisition debt, is that the acquisition debt for the year in question will be higher than that permitted under the acquisition holding company provision. As such, the deductible acquisition interest could be limited.
- ‘Dowry’. The Deputy Minister discussed the – rather unique – situation whereby the acquirer of a participation receives a ‘dowry’ from the vendor. If this dowry causes the consideration provided in exchange for the acquisition of a participation to be reduced, for the application of the acquisition holding company provision a corresponding reduction in the acquisition price applies.
- Adding together. The Deputy Minister confirmed that the acquisition debt and the acquisition price of all subsidiaries included in a fiscal unity in any one year must be added together, *insofar* as the relevant tax year involves acquisition debt.
- Refinancing. The Deputy Minister was requested to clarify the following situation. An acquisition holding company acquires a target and finances the acquisition with debt (loan 1, acquisition debt). Section 15ad is applicable. The target subsequently takes out an external loan (loan 2), and uses this to distribute a dividend to the acquisition holding company, that subsequently uses the dividend to repay part of loan 1. According to the Deputy Minister, in this case loan 2 also falls under the deduction limitation for acquisition holding companies.
- Acquisition price. The Deputy Minister confirmed that the acquisition price paid for the acquisition or expansion of an interest should be understood as the consideration provided in exchange for the acquisition increased by the costs incurred by the acquirer.
- Unused ‘deduction capacity’. The Deputy Minister indicated that he does not intend to amend the act at the first opportunity so that acquisition interest that is non-deductible in any year, could still be credited in that year, if and to the extent that the maximum capacity for the interest deduction was not fully applied in a preceding year. According to the Deputy Minister, this proposal by the Dutch Association of Tax Advisors (*De Nederlandse Orde van Belastingadviseurs*, “NOB”) would result in numerous additional implementation costs and would increase the administrative burden for small and medium-sized enterprises in particular.



- Expansion. The question whether the situation whereby the parent company of a fiscal unity uses a loan to make an informal capital contribution that is then used by the subsidiary to finance its business operations, should not be regarded as an expansion of an interest, is answered affirmatively by the Deputy Minister.
- Effective date. The Deputy Minister once again stated that the date on which the fiscal unity between the acquiring and the acquired company was formed will determine whether an acquisition will fall under the deduction limitation for acquisition holding companies as of January 1, 2012. If the fiscal unity was formed on or after November 15, 2011, then the acquisition will fall under the deduction limitation as of January 1, 2012. The moment that the acquisition transaction commenced or became final is therefore not decisive.

1.3. Source exemption permanent establishments

The parliamentary debates that took place after Budget Day primarily dealt with the ‘why’ of the source exemption, technical details, and what has *not* been changed, for example, the treatment of the head office’s foreign exchange results or the allocation of assets to a permanent establishment. No noteworthy amendments have been made since the bill was submitted. Please refer to our memorandum dated September 16, 2011, for a short substantive explanation of this part of the Tax Plan 2012.

In light of the new source exemption, it is advisable to assess, as soon as possible, the tax efficiency of existing structures that include permanent establishments, if this has not already been done. Where necessary, benefits can be achieved or disadvantages can be prevented by taking action before January 1, 2012, or before the commencement of a new split financial year. For example, actions that ensure the early realization of deferred or potential losses, such as the sale of an asset, the decision to cease business operations, the decision to reorganize, or the legal completion of a contract. In other cases, action does not necessarily have to be taken before the new financial year, but preferably as soon as possible. Depending of the specific situation, this could mean including subsidiaries with a foreign permanent establishment in the fiscal unity, or having them leave the fiscal unity, converting permanent establishments into subsidiaries, or transferring a permanent establishment’s assets to the Netherlands. Worth considering are those structures that currently result in an interest burden in both the country where the permanent establishment is established and in the Netherlands, and structures that currently result in an interest burden in the country where the permanent establishment is established, without corresponding revenue being directly or effectively taxed in the Netherlands. There are various solutions available that would limit or neutralize the consequences of the implementation of the source exemption for these structures. Please contact your tax advisor to discuss them.

1.4. Research & development deduction

On November 15, 2011, we informed you about an attractive additional deduction to be available to businesses as of 2012, i.e., for obligations assumed after January 1, 2012: the research and development deduction (“RDA”). The reason for doing this was the announcement of the draft general administrative order (*Algemene maatregel van bestuur*, “AMvB”). During the debates in the Upper House some comments were made about this tax relief measure. The most important comments are listed below.

- The Deputy Minister reconfirmed that the RDA is an additional deduction to be made against profits, but that it can result in a loss if no profit is available. If also in future years no profit is earned, then this loss will expire after nine years.
- Initially, the RDA was to be introduced as a temporary measure. However, it was decided against doing this, due to the desire to ensure a stable business investment climate. Many investments require long-term decisions. Therefore, by stating in advance that the RDA would be limited, for example to a five year period, investors in innovative long-term projects would be denied certainty. The RDA will be evaluated before the end of 2016, and monitored in the intervening period.
- In addition to the RDA, an RDA+ had previously been announced. This rule is specifically aimed at stimulating private-public joint initiatives. The final proposal for a RDA+ will be published after the existing rule that provides for the lowering of labor costs for research and development work (referred to as WBSO; *Wet Bevordering Speur- en Ontwikkelingswerk*) has been evaluated, probably in February 2012.
- AgentschapNL, and not the Dutch Revenue, will be primarily responsible for executing the RDA; this is already the case for the WBSO. This means that AgentschapNL will determine the volume of the deduction item based on its own rules. The Dutch Revenue will only be responsible for the set off of the deduction item in the tax return.
- An independent terminology will apply to the RDA, which, in final instance, will be interpreted by the Appeals Board for Trade and Industry.
- The RDA is determined by multiplying the qualifying costs and expenditure (for example, investments in laboratories, materials, or equipment) by a specific percentage; in 2012: 40%. The percentage can, in due course, be adjusted, for example, because of budgetary considerations. For practical reasons, it was proposed that this RDA percentage be laid down in a Ministerial decree. At the request of the Upper House, the Deputy Minister gave his assurance that he would argue for having the percentage included in the AMvB.

As previously mentioned, a draft AMvB has already been presented to the Lower House. The AMvB contains a more detailed explanation of which costs and expenditure qualify for the RDA. The draft AMvB was subsequently presented to the Council of State (Raad van State), that has recently issued



its advice on the draft. It is expected that this advice and the final AMvB will be available before January 1, 2012.

1.5. Avoidance of loss expiry

As of January 1, 2007, the until that moment applicable unlimited loss carry forward was exchanged for a limited loss carry forward of nine years. If insufficient profit has been generated, the losses still available for set off will expire after this period. In practice, it is only logical that taxpayers have been looking for ways to avoid this loss expiry. During the debates on the Tax Plan 2010, the previous Deputy Minister stated that he did not have a problem with taxpayers who tried to avoid loss expiry as long as this remained within the limits of the law and case law, and that the Dutch Revenue would thereby act in a reasonable and constructive manner. The CDA members of the Upper House subsequently raised questions about this statement during the debates on the Tax Plan 2012. They had received information that, in practice, the Dutch Revenue does not allow the revaluation of real estate as a means of avoiding loss expiry.

In his reply, the Deputy Minister noted that any new regime must be in accordance with sound business practice and must involve a consistent course of action. The commitment given in 2009 should be understood to mean that tax inspectors should not regard a system change to avoid loss expiry as being aimed at the achievement of an incidental tax benefit. According to Supreme Court case law, the latter is a deterrent to a regime amendment. In general, the Deputy Minister regards the valuation of business assets at their actual value as being contrary to sound business practice. This is also the case for the valuation of real estate and an *incidental* revaluation at fair market value.

The Deputy Minister subsequently pointed out that other methods to avoid loss expiry were permissible, for example, allowing for a 'realization moment', such as the sale of the relevant business asset to a newly incorporated subsidiary or a legal division without rollover. The Deputy Minister also does not consider the sale lease back of a business asset after a sale or division, possibly followed by the creation of a fiscal unity, as problematic. According to the Deputy Minister, this approach ensures that the reasonable and constructive manner envisaged by his predecessor is given maximum substance.

The CDA members of the Upper House subsequently indicated that they do not agree with the assertion that revaluation without sale is not in accordance with sound business practice. They argued that there are good arguments to be found in case law and the literature on this issue, supporting the assertion that revaluation without sale is in accordance with sound business practice. Although the Deputy Minister admitted that case law could possibly shed another light on his position, he did not give any further assurances. He will however send a memorandum on the principles of sound business practice to the Upper House.



1.6. Non-resident tax liability in case of substantial interest

Under existing law, foreign entities with more than a 5% interest in a Dutch resident company or cooperative are subject to Dutch corporate income tax if the interest held does not form part of the business assets of the foreign entity (foreign substantial interest rules). The Tax Plan 2012 proposes that the Netherlands only maintain its right to levy tax in specific situations of abuse.

Where previously the foreign substantial interest rules were applicable if the interest did not form part of the business assets, as of January 1, 2012, a double requirement will apply. These rules can only apply if (i) the interest does not form part of the business assets, and (ii) the primary objective, or one of the primary objectives of holding the interest is the avoidance of dividend withholding tax or personal income tax of another party.

In actual fact, this is a liberalization. Previously, the application of the foreign substantial interest rules could only be avoided by stating that the interest formed part of the business assets. Under new legislation, the application of the foreign substantial interest rules can also be avoided if it is clear that the primary objective, or one of the primary objectives of holding the interest is not the avoidance of dividend withholding tax or personal income tax.

2. Dividend withholding tax - withholding obligation for cooperatives

2.1. General

Based on the Tax Plan 2012, cooperatives have a withholding obligation in certain situations, i.e. situations defined as abuse situations. Please refer to our memorandum dated October 12, 2011, for a general description of this rule, and also our memorandum of October 26, 2011.

Below we summarize some of the additional clarifications and amendments that have since been made as a result of the parliamentary debates.

2.2. No profit-sharing certificate but a share

In the original bill, membership of a cooperative in abuse situations was equated with a profit-sharing certificate. This has now been amended. A membership right in abuse situations is now equated with a share. The reason for the change is that a membership right in a cooperative requires a capital contribution and is attributed voting rights, which is comparable to a share. Due to this amendment, it is no longer possible to always repay the capital deposited into the members' capital account without levying dividend withholding tax. The cooperative has no nominal capital; therefore writing down the shares in order to repay nominal capital without levying dividend withholding tax is not possible.



2.3. No accumulation with anti-dividend stripping rules

It has been confirmed that, in the situation where anti-dividend stripping rules are applicable to a distribution by a Dutch private limited liability company (“BV”) to a cooperative, accumulation with the new legislation is extremely unlikely. In effect, this means that if pursuant to anti-dividend stripping rules, dividend withholding tax is owed on the distributions made by a Dutch BV to a cooperative, no dividend withholding tax will be owed on the distributions made by the cooperative to its members.

2.4. Effect on third party transactions

The examples of abuse situations listed in the Explanatory Notes to the bill involved existing structures in which a cooperative was interposed. It therefore seemed probable that the proposed legislation would not be applicable to third party transactions, whereby the cooperative was used as a means to acquire new Dutch or foreign participations. This position was modified during the parliamentary debates. It was noted that a cooperative could indeed be subject to dividend withholding tax in situations involving third party transactions, in particular those situations involving, in respect of the vendor, an effective dividend withholding tax claim on the BV’s profit reserves, and whereby the cooperative had no ‘real substance’.

2.5. Additional clarification of abuse situations

The cooperative can become subject to dividend withholding tax if the primary objective, or one of the primary objectives, of its holding shares, profit-sharing certificates, or loans is the avoidance of tax (‘abuse situations’). It has now been made clear that the assessment of this objective will involve looking at whether the cooperative performs an actual function and what the motives of its members are. The following is of importance in assessing the actual situation: the location of its effective management, the substance, and the actual risks run by the cooperative. In order to determine whether the reason for using the cooperative was to avoid Dutch dividend withholding tax or foreign tax, a comparison must be made between the situation whereby the cooperative holds the shares, profit-sharing certificates, or loans, and the situation whereby the ultimate participants hold the shares, profit-sharing certificates, or loans directly, i.e. without the interposition of the cooperative (‘the exclusion idea’; *wegdenk-gedachte*). It was stated that the actual function and reasons must be continually assessed, and therefore not only at the time the structure was set up. Finally, the Deputy Minister confirmed that avoidance of foreign tax is only relevant if the cooperative holds a direct interest in a foreign company, i.e. the avoidance of foreign tax is not at issue, if the interest in the foreign company is held indirectly through a Dutch BV.

2.6. Distributable profit

If the membership rights in the cooperative form part of the business assets, then any dividend withholding tax obligation the cooperative has will be limited to the amount of the distributable profit of the underlying Dutch company recorded at the moment that the membership rights were



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acquired. Distributable profit has now been defined as including not only existing profit reserves, but also untaxed gains and reserves. This definition of distributable profit follows the definition found in the Dividend Withholding Tax Act 1965. The aim is to prevent an existing dividend withholding tax claim on the distributable profit of a Dutch company in which a cooperation holds an interest, being lost. It has also been confirmed that an ‘avoidance reason’ is not relevant in those situations where the cooperative acts as acquirer of this Dutch company, if the vendor of this Dutch company had no dividend withholding tax claim.

It was also stated that the anti-abuse nature of the rule appears to make a transitional rule unnecessary. This means that distributions of distributable profit that took place before the implementation of the withholding obligation for cooperatives will not be taken into account. The example given was: In 2007, a cooperative acquired shares in a Dutch company with a distributable profit of 100. In 2007 through 2011 the Dutch company made an annual dividend distribution of 20, which amount the cooperative redistributed to its members. If, based on the new rules, the cooperative becomes subject to dividend withholding tax, the withholding obligation will apply to the amount of the distributable profit recorded by the Dutch company at the time of the acquisition, in this case 100. According to the Deputy Minister, the distributions made in 2007 through 2011, cannot be deducted from the distributable profit.

2.7. Ruling policy

The Deputy Minister has indicated that the existing Advance Tax Rulings (“ATRs”) in respect of the tax treatment of cooperatives will be maintained. After an existing ATR has expired, the structure in question must be assessed on the basis of the new legislation. The Deputy Minister also noted that the proposed legislation is a continuation of the basic assumptions underlying current APA/ATR policy. As such, it seems reasonable that under the new legislation existing ATRs will be extended. Time will tell if the statements made by the Deputy Minister on this issue will be so experienced by taxpayers.

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The information contained in this memorandum is of a general nature and does not address the specific circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.