



Publication of the Tax System Study Committee's report

1. Introduction and background

In the 2010 Budget, the Cabinet reported that it had commissioned a Study Committee to carry out a preliminary study into the possible, budget-neutral modernization of the tax system. The reasons for the preliminary study were the current desire for stability in tax revenues, and the questions of whether the various tax bases offered viable tax bases for the future, and whether simplification is possible. After consultation in 2009, a few issues surrounding interest in corporate income tax were added to the Tax System Study Committee's mandate. The Study Committee was asked, among other things, to examine whether, and how, a better spread of the corporate income tax burden between companies that operate nationally and those that operate internationally could be achieved, by making fundamental changes. The precondition to this was that the corporate income tax climate must remain internationally attractive.

The preliminary study was conducted by a mixed group of civil servants, external experts, and the Netherlands Bureau for Economic Policy Analysis, and its completion was initially planned for the second quarter of 2010. The fall of the government and the elections planned for June 9, 2010, have led to the Study Committee completing its work earlier. Their report was presented to the Lower House on April 7, 2010.

We emphasize here that it is ultimately up to the new government and the new composition of the Lower House to determine which of the Study Committee's conclusions and recommendations will result in concrete measures.

Below we set out the most obvious issues from the Study Committee's report for you.

2. Corporate income tax

Interest measures

The Study Committee reached the following conclusions with regard to the interest issues in corporate income tax.

- The report does **not** recommend to **disregard** interest for tax purposes. This would mean that all interest owed is not deductible and all interest received is not taxed. The Study Committee was particularly apprehensive of responses from abroad. There is also general apprehension about the effect that disregarding interest would have for foreign investors who invest in "real" activities in the Netherlands.

- The Study Committee's preference is for the introduction of a **notional net-worth deduction** instead of disregarding interest, inspired by the Belgian notional interest deduction. This would result in more equal treatment of equity and loan capital and offer tax stimulation in favor of financing from equity. The Study Committee assumes a notional deduction on a scale, for example, of 4% of the equity for tax purposes. This will have to be adjusted. The value for tax purposes of any participations, both domestic and foreign, must be deducted from the equity for tax purposes. The report does not comment on the reduction of equity by the value of a permanent establishment abroad, which is the case for the Belgian measure.
- If the balance of equity minus the value of the participations for tax purposes is negative, the notional net-worth deduction becomes a **notional addition to income**. Effectively, this part of the measure, if there are participations, boils down to the cancellation of the interest deduction considered to refer to the financing of these participations, even if it were a notional percentage. The measure bears some similarity to the Bosal reparation, a limitation on the deduction of interest on loans related to foreign participations covered by the participation exemption, proposed last year.

The Study Committee stated that, following the acquisition of a company by an acquisitions holding company that then enters into a fiscal unity after the acquisition with the enterprise that has been acquired, with extensive hidden reserves and/or goodwill, there will often be negative equity and, therefore, also a notional addition to income.

In order to offer assistance to structurally loss-making companies, consideration may be given, according to the Study Committee, to increasing the equity by the amount of the loss yet to be set off.

- Any notional net-worth deduction/addition to income could lead, according to the Study Committee, to the lapse of the **existing interest deduction restrictions**. Although the Study Committee does not state this explicitly, this concerns the abolition of Section 10a of the Corporate Income Tax Act of 1969 ("CITA"), and the thin-cap provision in Section 10d of the CITA. It appears that the Study Committee considers it unnecessary to further examine the measures the Ministry of Finance proposed for introduction last year, such as the earnings-stripping rules, or the tightening of existing measures, to counter excessive interest deduction.

Financing the notional net-worth deduction

- The Study Committee expects that, on balance, the introduction of the notional net-worth deduction/addition to income will cost the government money. In order to solve this budgetary problem, the Study Committee believes that consideration could be given to abolishing the stepped rate of corporate income tax and to make use of resources already reserved for the introduction of an Interest Box.
- The Study Committee also believes that consideration should be given to partially financing the notional net-worth deduction from the proceeds from amending the current exemption (with progression) for foreign permanent establishments into a full exemption as suggested



by the then Deputy Minister of Finance. That earlier proposal would lead to corporate income tax developing a more “territorial” character, and losses from permanent establishments abroad would no longer be deductible in the Netherlands.

- Finally, the Study Committee suggested that the notional net-worth deduction could be partially financed by an increase in VAT.

Other corporate income tax measures

- Ways of bringing the determination of profit for tax purposes closer to the generally accepted accounting principles could, according to the Study Committee, be considered.
- The Study Committee is not in support of additional taxation for the financial sector.

3. VAT

The Study Committee reached the following conclusions with regard to VAT:

- Increasing the VAT portion of the tax mix will further bolster the solidity of the tax system. It could lead to an improvement in the tax system’s efficiency. The proceeds could be used to reduce direct taxation and to finance the Study Committee’s other proposals.
- One single VAT rate of 19% would contribute to these goals. At the same time, prosperity would increase. This means that the reduced VAT rate would disappear.
- Tidying up VAT exemptions should be considered within the EU.

4. Environment

Taxes are, in principle, an efficient instrument in giving shape to environmental policy. The Study Committee judges that this instrument is often correctly wielded. More extensive use of this, however, must be considered together with other instruments. The Study Committee has made a number of concrete recommendations along these lines.

5. Various

- The Study Committee did not produce any concrete proposals in the area of dividend withholding tax.
- The Study Committee proposes raising insurance premium tax.
- The Study Committee proposes that the mortgage interest deduction in personal income tax be gradually reduced.
- The Study Committee believes that increasing the highest rate of personal income tax only has symbolic value, and therefore rejected this proposal.

6. Conclusion

The Study Committee concedes that it cannot make any statement on how its proposals could be implemented, mainly because this is dependent on predominantly political issues and government policy in the broadest sense. The Study Committee strongly suggests that any changes be introduced gradually in order to prevent any shocks. A follow-up study will have to be carried out.



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In any case, the Lower House will hold a round-table discussion with the Study Committee on April 21, 2010.

We will, of course, keep you informed.

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