

Dutch Supreme Court: interest on loan from Belgium coordination center is non-deductible

On Friday, January 16, 2016 the Dutch Supreme Court rendered a final judgment in a long-running case concerning the deduction of interest on a loan provided by a Belgium group financing entity which had been used for an acquisition. In an earlier stage of these proceedings, the Dutch Supreme Court had asked the Court of Justice of the European Union ('CJEU') for a preliminary ruling on the interpretation of EU law. The judgment now rendered is a final judgment, in which the Supreme Court ruled with due observance of the answers from the CJEU. The Supreme Court ruled that tax motives were the basis for providing the group loan via the group financing entity and therefore the interest was non-deductible pursuant to Section 10a Corporate Income Tax Act 1969 ('CITA 1969'). It also made clear that, in terms of the business-motivation test, the rebuttal provision in Section 10a CITA 1969 is in line with EU law.

Background: acquisition debt from a Belgium 'coordination center'

A Dutch BV had financed an acquisition with loans from a Belgium group financing entity. The group company had the status of 'Coordination Center' in Belgium, which meant that at the time it fell under a specific favorable tax regime. At issue was the 2007 tax year, in which the taxpayer had deducted the interest on the acquisition loans, but this had not been accepted by the tax inspector pursuant to Section 10a CITA 1969.

If a loan falls within the scope of the interest deduction limitation of Section 10a CITA 1969 and the interest income is not subject to sufficient compensatory tax, then the interest can only be deducted if the taxpayer convincingly demonstrates that both the acquisition and the financing were primarily business-motivated. In dispute in these proceedings was whether the Dutch BV had convincingly demonstrated that such business motivation was present.

It follows from Dutch Supreme Court case law that a loan is, in principle, (primarily) business-motivated if the funds are not *diverted* within the group. If there is an intra-group diversion, the loan is in principle (primarily) non-business motivated – unless the taxpayer can convincingly demonstrate otherwise. Both the District Court and the Court of Appeals had ruled that there was such a *non-business motivated diversion* of the funds in the present case, because the loan had in fact been financed from capital that the shareholder of the coordination center had contributed shortly before the loan was provided. The Court of Appeals and the District Court therefore concluded that the Dutch tax authorities were right in refusing to accept the interest deduction pursuant to Section 10a CITA 1969. The Supreme Court followed these judgments and clarified in this respect two aspects of the interest deduction limitation of Section 10a CITA 1969: the non-business motivated financing and the pivotal financial function, and the EU law aspects of the interest deduction limitation.

Potential business-motivated financing: pivotal financial function

In 2023 the Supreme Court had ruled that a loan cannot have been subjected to a non-business motivated diversion if it was provided by a group company with a *pivotal financial function* and the group company did not merely act as a *conduit* for the relevant loan. In the present judgment, the Supreme Court noted that – even if the coordination center were to fulfill a pivotal financial function – the coordination center

acted as a conduit for the funds provided to the Dutch BV because it did not fulfill any actual financing role with regard to *that specific loan*.

What stands out in this respect is that the Supreme Court in its previous judgment for referral to the CJEU about this case, considered the non-business motivation of the loan to be so evident that it sufficed with a reference to Section 81 Judiciary (Organization) Act. Nevertheless, in the present judgment the Supreme Court chose to state the reasons why the conditions for having a pivotal function had not been met in these proceedings. Further to the Opinion issued by the Advocate General, the Supreme Court referred in this respect to the fact that the coordination center acted as a conduit for the loan provided to the Dutch BV. As such, it is not possible to successfully invoke the fulfillment of a pivotal function. In ruling that there was a conduit, the Supreme Court implied that the contribution of equity capital followed by the provision of a loan can also mean there is a conduit and thus a non-business motivated diversion of funds.

Prior to this judgment, it was by no means certain whether there was a conduit only if funds were directly borrowed and onlent. The judgment has made clear that there can also be a conduit if there is a contribution of capital followed by the provision of a loan.

Section 10a CITA 1969 is in line with EU law

In an earlier stage of these proceedings, the Supreme Court had asked the CJEU for a preliminary ruling on whether Section 10a CITA 1969 is in accordance with EU law. Based on a previous judgment by the CJEU, there were doubts as to whether the interest deduction limitation would apply if the conditions of the loan were, in themselves, at arm's length. The CJEU answered this by stating that despite such arm's length conditions, a loan could still be wholly artificial and therefore the interest deduction limitation was justified. The business-motivation test of Section 10a CITA 1969 would thus not be contrary to EU law.

After the preliminary ruling had been rendered, the taxpayer argued that in respect of convincingly demonstrating the required business motivation for the purposes of Section 10a ('*primarily* business-motivated') more stringent requirements apply than are necessary under the relevant EU rules, for which it would be sufficient if there is 'some connection to economic reality'.

In the present judgment the Supreme Court ruled that a correct interpretation of EU law implies that it must be convincingly demonstrated that tax considerations were not the decisive factor for entering into a transaction; the existence of (more) compelling commercial considerations therefore does not have to detract from the conclusion that there is a *completely* artificial arrangement. According to the Supreme Court, the wording of the CJEU should therefore not be interpreted so strictly and the relevant question is whether tax motives were the decisive factor for the transaction – regardless of whether there may have also been commercial considerations.

KPMG Meijburg & Co comments

Following the [Spectacles case](#) and the [Coffee case](#), the present judgment brings to an end another long-running case about interest deduction. The Supreme Court also

seems to have used this moment to clarify various aspects of the interest deduction limitation.

The Supreme Court ruled that the business-motivation test in Section 10a CITA 1969 is not contrary to EU law. Taking into consideration that the CJEU will not have intended the words 'completely artificial' to be interpreted too strictly and by also addressing in detail the CJEU's other legal considerations, the Supreme Court ruled that Section 10a is in accordance with EU law. In doing so, the Supreme Court seemed to be anticipating potential future proceedings on the possibility of conflict with EU law.

It also further elaborated on the pivotal financial function and the conduit. So far, the notion of the pivotal financial function – that would be a kind of safe harbor within the playing field of Section 10a – seems to have not been so easily accepted in case law. To date, it has either failed in terms of providing the practical burden of proof for the presence of the pivotal function, or in respect of the conclusion that – as in the present case – an entity did not act as a financial hub for the financing in question, because with regard to the loan it was a conduit.

Lastly, this judgment also shows that a complex playing field now exists for assessing whether financing can be regarded as business-motivated in the light of Section 10a CITA 1969, and who bears the burden of proof for this. Various terms specifically formulated for Section 10a now apply, such as diversion, pivotal financial function, parallelism, and conduit. Also given the various other interest deduction limitations found in CITA, it remains important when raising funds to carefully assess whether the interest can be deducted for tax purposes.

If you would like to know more, feel free to contact us or your usual Meijburg tax advisor.

KPMG Meijburg & Co
January 20, 2026

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