2018 Dutch Tax Plan - changes to Dutch dividend withholding tax

Global Tax Alert

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The Dutch Ministry of Finance has published the 2018 Budget and, in connection with it, the 2018 Tax Plan. The 2018 Tax Plan contains a number of already anticipated changes to Dutch tax legislation effective as of January 1, 2018.

The main tax proposals that are relevant for international investors with a Dutch structure are:

1. New dividend withholding tax obligation for Dutch “holding cooperatives”
2. Expansion of full dividend withholding tax exemption
3. Change in scope of the non-resident corporate income tax rules for substantial shareholdings in Dutch entities and
4. Tightening of conditions to deduct interest on intercompany debts funded by connected loans from third parties.

These tax proposals are currently subject to discussion in the Dutch parliament and therefore may be amended. If adopted, these proposals should enter into force on January 1, 2018.

The proposed changes to the Dutch Dividend Withholding Tax Act (DWTA) are based on a preliminary proposal
The implementation of the EU Anti-Tax Avoidance Directive (ATAD) is not part of the 2018 Tax Plan. It is expected that in the first quarter of 2018 the Dutch government will present a formal proposal to the Dutch parliament.

**New dividend withholding tax obligation for Dutch holding cooperatives**

The Dutch government previously announced that it wants to bring the dividend withholding tax treatment of Dutch cooperatives more in line with the treatment of Dutch corporate entities (ie, NVs and BVs). In order to achieve this objective, the Dutch government has proposed changes to bring Dutch cooperatives into the scope of the Dutch dividend withholding tax rules if the below conditions are both met:

1. the cooperative is a "holding cooperative" – ie, its actual activities in the year preceding the profit distribution consisted primarily (that is, for 70 percent or more) of the holding of participations or the direct or indirect financing of related entities or individuals and
2. the members of the cooperative have "qualifying membership rights" – ie, membership rights that grant an entitlement of at least 5 percent of the annual profits or at least 5 percent of the liquidation profits. In assessing whether there is a qualifying membership right, the membership rights of a member and the entities and individuals related to that member will be taken into account.

Non-holding or "real" cooperatives (cooperatives running a business enterprise and/or with a large group of members) will remain exempt from dividend withholding tax.

Companies that currently use a Dutch cooperative in the Netherlands should carefully review the potential impact of these proposed new rules to their structure. It is expected that private equity and similar structures could be particularly affected by these proposed rules. The explanatory notes state that, under some circumstances, it is conceivable that a cooperative used in private equity structures would not qualify as a "holding cooperative." This could be the case if the Dutch cooperative actively manages investments and has sufficient related substance like employees and office premises in the Netherlands.

It will be possible to get certainty in advance from the Dutch tax authorities on whether a cooperative qualifies as a holding cooperative.

**Expansion of full dividend withholding tax exemption**

**The new withholding tax exemption**

In addition to the existing dividend withholding tax exemption in respect of EU/EEA shareholders, the Dutch government proposes to expand the dividend withholding tax exemption for dividends distributed by Dutch companies to third countries where their non-resident shareholder is an entity that:

1. holds an interest of at least 5 percent in the Dutch company and
2. resides (for tax treaty purposes) in a jurisdiction that has concluded a tax treaty, including a dividend article, with the Netherlands.

The second condition may also be met by members/shareholders that are hybrid entities. The condition is met if the direct member/shareholder of the hybrid entity would individually qualify for the withholding exemption and income of the hybrid is picked up as income at the level of that member/shareholder (specific mention was made of US LLC structures).

If the income of the hybrid entity is not picked up by its member/shareholder, then the exemption will not be applicable and the situation defaults back to the current situation, allowing the possibility of tax treaty application to reduce Dutch dividend withholding tax. In the explanatory notes, specifically CV/BV structures were mentioned as examples of such scenario.
In addition to the examples in our previous Global Tax Alert, the hybrid entities situations can be best explained by the following two examples.

**Example 1: US LLC**

An important example is a dividend distributed to a US LLC that is transparent for US tax purposes but opaque for Dutch tax purposes. Such LLC and its participants may benefit from the exemption under the amended proposals.

*Figure 1*

Under the structure illustrated in Figure 1, dividends distributed by the Dutch company to the LLC that is not considered to be resident for the tax treaty between the Netherlands and the United States still may be exempt from Dutch dividend withholding tax. The new domestic exemption applies if US Inc, as a direct participant of the LLC, would individually qualify for the withholding exemption if (i) it was a direct shareholder of the Dutch entity and (ii) the dividend income is included for taxation purposes at the level of US Inc.

**Example 2: CV/BV**

In the reverse situation, where the recipient of the dividend is transparent from a Dutch tax perspective but non-transparent from a US tax perspective the withholding exemption only applies if the reverse hybrid entity (i) is resident in its country of establishment and (ii) the dividend income is included for taxation purposes at the level of the hybrid entity.

*Figure 2*

Under the structure illustrated in Figure 2, CV is transparent from a Dutch tax perspective and the dividend income is not included for taxation purposes in its country of establishment (i.e. the Netherlands). Thus, the US Inc as partner of CV is not able to apply the withholding exemption under the proposed rules.

However, even if US Inc cannot apply the withholding tax exemption, dividends distributed by the Dutch company to CV may, if certain conditions are met, still be exempt under the tax treaty between the Netherlands and the United States.
A new anti-abuse rule

In addition, a new anti-abuse rule will be introduced in the DWT A, according to which the exemption will not apply if:

1. the interest in an entity is held with the principal purpose, or one of the principal purposes, of avoiding dividend withholding tax from being levied and
2. the interest in an entity is part of an artificial structure or transaction or series of transactions, which will be the case if there is no valid business reasons.

The anti-abuse provision is in line with the general anti-abuse provision in the EU Parent-Subsidiary Directive (EU PSD). The proposed rules clarify that there are valid business reasons in the situation where the non-resident shareholder carries out a business to which the interest can be attributed. Valid business reasons can also apply to a non-resident shareholder that does not have a material business but acts as an intermediate holding company. In such a scenario, the indirect shareholder should carry out a material business and should also have qualified for a dividend withholding tax exemption in case that shareholder would have held the shares in the Dutch company directly. It is important to note that the non-resident intermediate holding company will need to meet certain substance requirements in its jurisdiction of residence.

The current substance requirements, which have already taken effect from January 1, 2016, will be expanded with two further requirements. Under the proposed rules, non-resident shareholders that function as intermediate holding company must, among other things, have:

1. a payroll expense of at least €100,000 related to the intermediate holding activities (which may be recharged) and
2. premises at their disposal (for a period of at least 24 months) in the country of establishment from which they actually carry out their intermediate holding activities.

Due to the anticipated changes in the DWT A, existing Advance Tax Rulings of Dutch entities will be terminated as of January 1, 2018. A new Advance Tax Ruling needs to be obtained which are subject to the new substance requirements being fulfilled. Transitional provisions will be in place which gives taxpayers till April 1, 2018 to comply with the new substance requirements without losing the withholding tax exemption.

Change of scope of the non-resident corporate income tax rules for substantial shareholdings in Dutch entities

The scope of Dutch non-resident corporate income tax rules for substantial shareholdings will be modified as a result of the proposed changes to the dividend withholding tax rules. A non-resident entity will only be taxed on income (capital gains as well as dividends) from such shareholdings if there is an avoidance of the Dutch personal income tax liability of an indirect shareholder of the Dutch entity. Avoidance of dividend withholding tax no longer triggers non-resident corporate income tax for a shareholder, because such avoidance is already dealt with in the amended dividend withholding tax rules. The existing provision where non-resident taxation does not apply when a structure is set up for valid business reasons will continue to apply. Going forward, the interpretation of valid business reasons will be aligned with the interpretation under the revised anti-abuse rule for dividend withholding tax purposes.

Tightening conditions to deduct interest on intercompany debts funded by linking loans from third parties

The anti-base erosion rules in article 10a of the Dutch Corporate Income Tax Act provide for a limitation of the deductibility of interest on intercompany debt, if such debt is connected with a tainted transaction such as certain acquisitions, dividend distributions or capital contributions. Article 10a does not apply if business reasons predominantly underlie (i) the intercompany debt and (ii) the tainted transaction.

The Dutch Supreme Court ruled on April 21, 2017 that this “business reasons” exception is met for both the intercompany debt and the tainted transaction if the intercompany debt on group level is funded by connected loans from third parties.

Under the proposed rules, the taxpayer still needs to demonstrate that the tainted transaction is predominantly motivated by valid business reasons, even if the intercompany debt is funded by connected third-party loans.
Since no grandfathering rules are proposed, taxpayers that currently rely on ultimate third-party financing need to show valid business reasons for the tainted transaction as of January 1, 2018, even if the tainted transaction was entered into long before that date.

**Miscellaneous**

The 2018 Tax Plan contains a number of other measures:

- The CIT bracket of 20 percent shall apply to the first €250,000 of taxable profit
- Repayment of membership contributions by a Dutch cooperative shall be exempt of dividend withholding tax
- A provision that temporarily allows voluntary filing of a country-by-country report (CbCR) or parent surrogate filing by the ultimate parent entity located in a country that has not implemented CbCR on a timely manner for financial years starting on or after January 1, 2016.

**Comments**

The expansion of the dividend withholding tax exemption further strengthens the position of the Netherlands as an attractive holding company location offering additional flexibility in terms of repatriating profits in a post-BEPS environment. It is very interesting to note, in particular, that US LLCs may benefit from the dividend withholding tax exemption.

For international investors and more specifically US-based investors, the Netherlands remains one of the most attractive holding company jurisdictions from which to structure their foreign investments, for example, into other countries in the European Union. Next to the dividend withholding tax exemption, key elements of the favorable Dutch tax regime continue to be the full participation exemption and absence of interest and royalty withholding tax.

Contact the authors to find out more about the implications of this development.

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