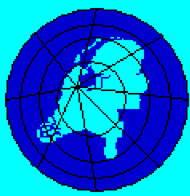

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High Court rules on interest to Belgian Coordination Center

In a decision of 4 May 2004 the Dutch High Court of Arnhem ruled in the following case. BSA, listed and resident in France held all the shares in XBV, which held all the shares in ANV, a Belgian Coordination Centre. In September 1988, XBV contributed NLG 30 million in cash and NLG 6 million in kind into ANV. ANV thereafter extended a loan of NLG 30 million to BSA, which lent NLG 36 million to XBV in December 1989 to acquire a subsidiary from an unrelated party. XBV subsequently borrowed NLG 30 million from ANV between 1990 and 1992 (NLG 22 million in 1992) to redeem its debt to BSA.

As of 1997, article 10a, second paragraph of Dutch Corporate Income Tax Act (CITA), disallows interest deductions on payments made to related parties to the extent the underlying loan concerns a contribution of equity by the taxpayer, directly or indirectly to the entity to whom the loan is due. This limitation does not apply if the loan is made for business reasons or if the interest income is subject to an income tax, which is reasonable by Dutch standards. Based on this legislation, the tax inspector denied the interest deductions on the 1998 interest payments made by XBV to ANV. The taxpayer appealed against this arguing that there is no link between the equity contribution and the debt, that if there is, the transaction is made for business purposes and even if it is not, the interest is still taxed at a reasonable rate in the hands of ANV; finally the taxpayer argued that article 10a is not EU compliant because it would not apply to a Dutch creditor and therefore constitutes restrictions on the freedom of establishment and the free movement of capital.

The taxpayer argued that … article 10a is not EU compliant

The High Court of Arnhem decided for the tax inspector arguing that there is a link, that the transaction was not primarily motivated by business reasons and that compared to the 7% tax levied in first instance from Dutch group finance companies at the time, the 1.6% Belgian corporate income tax paid by ANV was not reasonable by Dutch standards. In doing so, the Court decided to disregard the additional 8.3% coordination tax paid by ANV arguing that this was not an income tax since it is based on the number of employees of ANV. It then went on to determine that article 10a CITA is EU compliant, because if ANV was resident in the Netherlands, then the condition that the receiver of the interest should be subject to a reasonable tax would still be applicable and that an interest deduction would also not be available for taxpayer if the interest was paid to a company resident in the Netherlands where the interest received would only be subject to an income tax of 1.6%. We find this final consideration of the Court perverse first, because this line of argument could be used to justify virtually any form of discrimination based on differences between national and foreign law and second, because it is false: if there was a 1.6% regime for finance companies in that Netherlands, then 1.6% would have been a reasonable rate by Dutch standards.

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The taxpayer appealed against the decision. Subscribers can find a summary of the BCC case on our site.

Non-deductible acquisition costs for participations

On 24 December 2003, a proposal of law was made to deal both with the much needed relief from the overkill in the Dutch rules on debt conversion and to deny the deduction of acquisition costs of participations qualifying for the participation exemption (see our January 2004 newsletter for further details). The Dutch Parliament then requested the Cabinet to stop combining legislation (stick and carrot approach) and to split the legislation into two parts. On 26 February 2004 a notice of amendment to the proposed legislation has been submitted to parliament. The amendments strip the current proposal of everything but the denial of the deduction of acquisition costs of participations qualifying for the participation exemption. This remainder of the original proposal was once again amended by a second notice of amendment, of 7 June 2004.

Fortunately, this amendment removes some of the retroactive effect the original proposal had with regard to the denial of the above-mentioned cost deduction. To understand these amendments, the following dates are important: on 24 May 2002 the Dutch Supreme Court reversed its own previous case law, by determining that the acquisition costs of a Dutch participation is deductible in the year of the acquisition and on 13 December 2002 the Dutch authorities announced that they will implement legislation to reverse the Court's decision. The proposed rules with regard to the retro-active effect are:

- Participations acquired before 1 January 2000: costs are only deductible if a notice of objection was filed against any assessment before the Supreme Court decision of 24 May 2002. Should final assessments have already become irrevocable, corrections over these years will be made on the first subsequent year that is still open.
- Participations acquired after 1 January 2000 of which the acquisition costs were made on or before 13 December 2003: costs are deductible if the appeal period for any final assessments has not expired yet.

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we do not see why the Supreme Court decision of 24 May 2002 should serve as a cut off date

- Participations acquired after 1 January 2000 of which the acquisition costs were made after 13 December 2003: in view of the announcement of the legislation on 13 December 2002, no costs are deductible.

Although Dutchtax.net applauds the amendment's limitation of the retro-active effect of the proposed law, we do not see why the Supreme Court decision of 24 May 2002 should serve as a cut-off date at all or how irrevocable final assessments could retro-actively be effectively made revocable and preliminary; we continue to believe (however naïve that may be) that justice and legal certainty should prevail over making budgetary ends meet, when making law. The amended proposal is available on our website under proposed legislation.

Indonesian court declares Dutch conduit bonds null and void

In a decision that may make it necessary to restructure a lot of conduit financing to Indonesia and which could dramatically increase the costs of foreign funding for Indonesian business and other debtors an Indonesian Court ruled on 12 May that the issue of bonds through a Dutch finance company is illegal. Consequently the Indonesian debtor did not have to meet its obligations to its bondholders.

Indonesia levies a withholding on interest payments from Indonesian residents of 20% under national law, which is reduced to 0 under a number of treaties. Since (part of) the costs related to such a withholding tax is transferred to the debtor in the form of higher interest, it is quite common for Indonesian companies to use a Dutch (or other) finance company for the issue of bonds into the international market and to thereby reduce their costs of funding. In a process instigated by Tri Polyta, an Indonesian district court granted Tri Polyta's claim that underwriters broke Indonesian law by issuing the bonds through a special purpose financing company set up in the Netherlands. Follow these links for more information on this case, a similar pending case and a petition to the Indonesian government for intervention in order to safeguard the Indonesian investment climate.

Q&A Decree on Dutch roll over provisions

On 14 May 2004 the Dutch Ministry of Finance issued a Q&A Decree on the Dutch rules with regard to the roll over of capital gains into future replacement assets. Under Dutch law such roll over relief is available as long as the intention exists to replace a lost or disposed asset within that year or during the next three years. At the time of the acquisition of the replacement asset the rolled over gain has to be booked against the cost price of the replacement asset. Additional conditions apply with regard to assets that are depreciated in more than ten years.

The decree discusses various scenario's, many of which are primarily applicable to individual entrepreneurs. Those applicable to corporations include:

- a realised gain can be split into one part which is rolled over and another which is not, provided that the part rolled over is intended for the acquisition of a replacement asset;
- if ABV sells an asset and is then consolidated with BBV and its subsidiary CBV with retro-active effect, the gain realised by ABV can not be rolled over and be used by CBV for the acquisition of a replacement asset. On the basis of case law and this decree it would have been possible for CBV to roll over a capital gain realised by it, if ABV held the intended replacement asset and BBV and CBV were going to acquire ABV and incorporate it into its consolidated group;
- the roll over relief may also be applicable in situations where Dutch real estate is exchanged for foreign real estate (in the EU?), provided that the real estate performs the same economic function within the taxpayer's enterprise. However, according to the Decree, under the Dutch exemption rules the taxpayer's Dutch worldwide taxable income would then be calculated on the basis of the cost price of the replacement asset, less the rolled over gain (resulting in lower depreciation and a higher taxable income per annum), whilst foreign income will be calculated on the basis of the historic cost price of the replacement asset only (resulting in higher depreciation and a lower exemption);
- if a partnership disposes of an asset, and one of the partners acquires a replacement asset for its own use, then it could be possible to roll over that partner's profit in the asset disposed by the partnership and to set it off against the cost price of the replacement asset; and
- it is possible upon the demerger of a company to transfer the roll over reserve to certain of the acquiring companies.

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EU related tax developments

Cross border tax consolidation

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On 11 May 2004 the Dutch State Secretary of Finance issued a decree which allows companies incorporated under foreign law and resident in the EU to form part of a consolidated group under the old tax consolidated group regime which applied to all financial years starting before 1 January 2003, provided that the consolidation request was filed before the end of that financial year. Companies incorporated under Dutch law and resident in other EU member states already had this privilege. The State Secretary allowed this for companies incorporated under foreign law because he feared that denying these companies the tax consolidation may contravene EU law.

The decree only applies under the old consolidation regime. Under the new regime, neither non-resident companies incorporated under Dutch law, nor foreign companies incorporated under foreign law can form part of a consolidated group, unless they have a permanent establishment in the Netherlands. It remains to be seen whether the Dutch authorities would also be forced to allow cross border tax consolidation under the Marks & Spencer case, currently pending before the ECJ. This decree and its full motivation can be found on our website.

Dutch Supreme Court denies share merger facility

On 14 May 2004 the Supreme Court decided in a case where the facts were as follows: Taxpayer held all the shares in ABV and in BBV. D held all the shares in E Management BV (hereafter "EBV"), which held all the shares in FBV. In connection with a joint venture between ABV and EBV, the interested parties decided that:

- taxpayer would transfer its shares in BBV to ABV via a share merger (merger 1), directly after which ABV would transfer the shares in BBV to GBV under the asset merger facility of article 14, of the Corporate Income Tax Act, against the issue of 40 percent of the shares in GBV,
- EBV would transfer its shares in FBV to GBV, also against the issue of 40 percent of the shares in GBV, and
- the remaining 20 percent of the shares in GBV would be issued to H Management BV and J Management BV against cash contributions.

Unless this was a qualifying share merger, taxpayer would be taxed on the gain realised through merger 1. The question was therefore whether the share merger facility under article 4.44, first paragraph, of the Personal Income Tax Act 2001 was available and in particular whether the condition that the merger resulted in ABV obtaining more than half the voting rights in BBV was satisfied. The Supreme Court argued that eventhough the reason why a share merger takes place is irrelevant, it was nonetheless necessary that all the agreements made in connection with the share merger are taken into account and that such an interpretation is in line with the EC Merger Directive. It concluded that merger 1 formed part of a series of legal transactions and that this series prevents ABV from effectively obtaining more than half of the voting rights in BBV. Therefore, merger 1 did not qualify for the share merger exemption. Contrary to the Dutch Advocate's General advice, the Supreme Court decided that it was not necessary to seek a preliminary ruling from the EU Court of Justice in this matter. Subscribers can read the relevant parts of this decision on our website.

Hot link

- All eyes are on the EU Council in their race against the clock to get Monaco, Andorra, San Marino, Switzerland and the UK and Dutch dependent territories in line to finalise all discussions around the Savings Directive. In order for the Directive to be applied as of 1 January 2005, agreement has to be reached with these other countries before 1 July 2004. Personally, we believe that unless the EU plans to take on the world and close down every country in the world for rogue investors, this whole exercise only results in migrating Euro's. We bet on Hong Kong as the final safe haven and look forward to watching the EU ultimately trying to muscle China into submission. The latest update from the Commission is available here

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