



Decree on tax consolidation of foreign tax relief

On 6 July 2004, the Ministry of Finance published an Executionary decree on tax consolidation and preventing double taxation. The decree primarily deals with the order in which consolidated profits and losses can be reduced, or carried forward with regard to foreign profits and losses of consolidated members, both with regard to current tax years and pre-consolidation years.

In general the rules are written such that:

- ❖ results of a consolidated group takes priority over the pre-consolidation results of individual members thereof;
- ❖ individual members can not utilise their pre-consolidated results to a larger extent than the lower of the results realised by themselves during the current year and the consolidated results allocated to them for the current year;
- ❖ allocation of opposite results within the consolidated group takes place in order of the absolute results of the members of the consolidated group. E.g. if the consolidated group made a profit, but some members made losses, those losses are set off first against the profit of the member with the smallest positive profit, then the member with the second smallest profit, etc. and
- ❖ remaining allocation of results of the consolidated group happens such that members can maximise the carry forward of their pre-consolidation results. E.g. if the group made a profit, then that profit is allocated as much as possible to those members without pre-consolidation profits to be carried forward

The decree applies to the taxation over the first financial year of a consolidated group starting on or after 1 January 2003, unless the group opted for grandfathering under the Tax Consolidated Group 2003 legislation, which entered into force on 1 January 2003. In the latter case, the decree becomes applicable as of the second financial year starting on or after 1 January 2003, thereby it seems to follow the grandfathering regime under the Tax Consolidated Group 2003 legislation. [This decree](#) is available on our website.

Together with the rules regarding pre-consolidation profits and losses, the rules on the order of priority of foreign tax relief from treaty and non-treaty countries under the Dutch Unilateral Decree for the prevention of double taxation and the various anti-abuse rules on the allocation of income from assets moved within consolidated groups, calculating the foreign tax relief of a consolidated group has potentially become extremely complicated.

Finally, it also announced in the explanatory note to this decree that the Dutch anti-abuse rules on beneficial ownership will also become applicable with regard to pre-consolidation losses.

Extra difficult burden of proof financial institutions

A decision of the Dutch Supreme Court dated 9 July 2004 confirmed that current legislation makes it extra difficult for financial institutions to prove the origin of their funding. The case concerned the question whether a Dutch company that borrowed funds from a consortium of banks, including a related US bank, to acquire and consolidate a subsidiary, could deduct the interest payments made to the related US bank. We described the case and the decision of the High Court in further detail in our [June 2003 newsletter](#).

The bank argued before the Supreme Court that due to the very nature of its business (continuously lending money in and out, and having a low equity) it would be both unnecessary and impossible for it to demonstrate that it concluded one specific loan to make a loan to the Dutch company. It also referred to allowances promised by the government during the parliamentary history of the legislation limiting the interest deduction, specifically in connection with banks' unique position. However, the Dutch Supreme Court upheld the High Court's decision that the US bank had to, but did not manage to, prove that it financed the loan to the Dutch company with third party debt.

It is clear the Supreme Court's decision leads to double taxation. It is also clear from the parliamentary history and the court cases leading up to this legislation that the type of transactions which the legislation intends to combat are those where leveraged take-overs are financed by group equity. The outcome of this case is therefore very unsatisfactory: it severely limits the promises given by the government with regard to banking institutions and leave them with a real problem. It is difficult to determine whom to blame for this situation: the Supreme Court who is unwilling to interpret the law and its history generously, or the government for restricting the escape clauses from its anti-abuse legislation to such an extent that overkill still remain.

We wonder whether the taxpayer could argue that the litigated legislation violates the EU freedom to provide services, since institutions providing banking services are placed in a worse situation than those providing other services. However this freedom only applies to companies in the EU. The alternative would be that the law restricts the free movement of capital (which also applies to third countries), since it is easier for the Dutch company to borrow from a non-banking institution.

The decree applies for financial years starting on or after 1-1-2003 unless grandfathered.

Anti-abuse rules will apply to pre-consolidation losses.

It is difficult to determine whom to blame for the resulting double taxation: the Supreme Court or the legislator.

Proposed law on debt conversion and writing down participations

On 6 July 2004 the State Secretary of Finance filed a revised proposal of law with the Dutch Second Chamber regarding the conversion of debt to equity. The original proposal was discussed in our [January 2004 newsletter](#) and mentioned in our [June 2004 newsletter](#) and [July 2004 newsletter](#), to which we refer for background information.

Compared to the original proposal regarding the conversion of debt, the following amendments have been made.

- ❖ article 13b CIT determines that if a receivable in a participation has been written down against profits taxable in the Netherlands of the taxpayer or a related entity, and if the receivable is disposed of, then an amount equal to the amount written down is allocated to the profit of the taxpayer. The December 2004 proposal also applied this rule to indirect participations. The amended proposal applies this rule to all indirect interests of 5% or more, regardless of whether they qualify as participations under the participation exemption. The December 2004 proposal also made this rule applicable to profit sharing loans unless another recapture applied already. The amended proposal limits that exemption to the extent that the recapture applied, which seems fair.
- ❖ article 13ba CIT determines that if a written down receivable on a participation is converted into equity, waived, or otherwise come to function as equity of the debtor, a recapture of the write down takes place. Article 12 determines that such a conversion is taxable at the level of the debtor, if the debtor is subject to tax in the Netherlands, in which case the recapture rule of article 13ba does not apply. However, since the proposed law (finally) abolishes article 12, the December 2004 proposal made article 13ba applicable Dutch debtors as well. The amended proposal extends the scope of article 13ba to individuals holding a substantial interest in the debtor and who wrote down receivables; it also limits the recapture to cases in which the participation exemption applies. This is fair, because if the participation exemption does not apply, any increase in the value of the converted shares or debt that comes to function as equity should be subject to tax in any case.
- ❖ The major tax advantage of the December 2004 proposal concerning article 13ba CIT concerned the fact that a recapture no longer leads to immediate taxation. Instead, the recapture is added to a revaluation reserve that is released as the value of the debtor (hopefully) increases. The December 2004 proposal allowed for adjustments when part of the participation is sold to unrelated parties or shares are acquired from unrelated parties. The amended proposal extends these rules to contingency agreements made with regard to the sales or purchase price.
- ❖ The amended proposal extends the application of article 13ba to profit sharing loans qualifying for the participation exemption, unless another recapture rule already applies. It also extends the application to situations where the taxpayer or a related party holds an indirect interest of at least 5% in the debtor. In such situations article 13ba is then applied to the participations through which the interest in the debtor is held. The amended proposal also allows for an increase in basis of these participations for the purpose of possible future tax deductible losses from liquidation of those participations.
- ❖ Finally the amended proposal extends the scope of article 13ba to cover situations where a written down receivable on an unrelated debtor is disposed of through a transaction whereby the taxpayer or related party acquires a participation in the debtor or an indirect interest in the debtor of at least 5%. This rule does not apply to the extent that the taxpayer shows it to be likely that the acquirer of the written down receivable is subject to a decent level of taxation on any increase in value of that receivable. It seems us that the inclusion of the indirect interests, especially in combination with the above rule on the disposed receivable is bound to cause a lot of nasty surprises in practice especially within large (foreign) multi-nationals where the parties deciding on mergers and acquisitions is likely not to be aware of the existence of such rules.

Although the proposed amendment provides relief from the original law and the December 2004 proposal in many instances, the one main form of relief is still missing: in view of the often disastrous effects of the original article 12, and the criticism of this article practically right from its inception, taxpayers should have been allowed the choice of applying the proposed rules, which fixes this mishap, with retro-active effect to 1 January 2001.

Other points of interest

- ❖ Following two decisions of the Dutch Supreme Court (the last of 9 July 2004), a decree and developments at EU level, the State Secretary issued a decree on 3 August 2004 on the treatment of services provided in connection with the sale of shares for VAT purposes. The decree determines that no refund is available for the sale of shares held by holding companies not performing management activities, or not forming part of a VAT consolidated group. A translation of the [VAT Decree](#) is available on our website. Further information on the developments leading up to this decree can be found in our [September 2003 newsletter](#).
- ❖ The Netherlands signed two agreements on the exchange of information; the first with Belgium, replacing the existing agreement under the old tax treaty with Belgium; the second with Latvia. The [Belgian agreement](#) also intensifies the exchange of information with Belgium in a number of areas. The Latvian agreement, of which the authentic language is English, will be placed on website as soon as the text is publicly available.
- ❖ On 7 July 2004 the High Court of the Hague decided that a loan extended in 1995 to a 75% subsidiary and subsequently written down, did not have to be treated as equity, since the debtor was able to repay the loan at the time it was extended. The fact that there was no loan agreement, no security given, that the interest (7% per annum) was added to the principal and that there was not redemption scheme did not change this. Unfortunately the Court did not deal with the position of the 25% shareholder in this case.

New Corporate income tax 2007

Showing that we also try and come with constructive solutions, Dutchtax.net participates in the discussion about a new corporate income tax system as of 2007 (see our [March 2004 newsletter](#)). Our suggestions have been translated and posted on our site. [Your comments](#) are welcome. Dutch readers can respond [directly](#) to the forum.

The major advantage is the fact that recapture no longer leads to immediate taxation.

The main form of relief still missing is the reversing of the disastrous effects of article 12.

EU related tax developments

ECJ cases: Anneliese Lenz & Jean-Claude Weidert/Élisabeth Paulus

On 15 July 2004 the European Court of Justice (ECJ) decided in the Anneliese Lenz case ([Case C-315/02](#)). In 1996 Ms Lenz, a German national fully liable to tax in Austria, received dividends from limited liability companies established in Germany. These dividends were fully subject to income tax in Austria. However, had the companies been established in Austria, she would have had the choice between either paying a fixed rate of 25% on the gross dividend income or half the general tax due on the net income. The ECJ ruled that free movement of capital precludes legislation which allows only the recipients of dividends from Austrian companies beneficial tax treatment, while providing that dividends from companies in another Member State are subject to ordinary income tax without any facilities. It also determined that this cannot be justified by the fact that revenue from companies established in another Member State is subject to low taxation in that State. This case is especially important since it confirms that any form of allowance given by a member state to soften the double tax suffered on distributed income under a classical system implemented by that state, can not be qualified as a coherent system to be kept in tact.

On the same day, the ECJ also decided in the Jean-Claude Weidert/Élisabeth Paulus case ([Case C-242/03](#)). In 2000, Mr and Mrs Weidert-Paulus claimed income Luxembourg tax relief in relation to their subscription for 200 new shares in the capital of the Belgian company Interbrew SA. The tax authorities did not allow the claim on the ground that investment in the capital of a company that was not established in Luxembourg gave no entitlement to the relief in question. The ECJ determined that the free movement of capital preclude a legal provision that denies the availability of income tax relief to individuals for the acquisition of shares representing cash contributions in capital companies established in other Member States. Here too, the Luxembourg government claimed cohesion as a justification for the restriction on the free movement of capital. Dutchtax.net continues to be amazed at the instances in which member states throw in cohesion as a futile final remedy and we look forward to the day the ECJ declares that considering the development of EU law in the 12 years since Bachman, cohesion can no longer be accepted as justification at an individual country level, not even for one taxpayer and one tax.

ECJ Order: Jean-Claude de Baeck

When the ECJ finds that questions referred to it may be clearly deduced from its existing case-law, it gives its decision in the form of a reasoned order, rather than a judgement. This happened in the Jean-Claude de Baeck case ([Case C-268/03](#)) ruled on 4 June 2004. In 1989 Mr De Baeck sold to a French company shares in Belgian companies belonging to the Antverpia group; Mr De Baeck's family held a major shareholding in the Belgian companies belonging to the Antverpia group. Based on Belgian law, the Belgian tax authorities were of the view that the capital gain was subject to tax, since the acquiring party was not a Belgian company.

Referring to its decision in the X & Y case ([Case C-436/00](#)), the ECJ ruled that the freedom of establishment precludes legislation pursuant to which gains realised on the sale of shares, other than in the exercise of a business activity, are taxed where the transfer is made to companies established in another Member State, whereas, in the same circumstances, those gains are not taxed where that transfer is made to Belgian companies provided that the shareholding transferred gives its holder definite influence over the company's decisions and allows him to determine its activities. It further ruled that the free movement of capital precludes national legislation, as described here before, where the shareholding transferred does not give its holder definite influence over the company's decisions or allow him to determine its activities.

UK CFC system on trial

In what could become an important decision, the Special Commissioners of the UK referred a question to ECJ in the Cadbury-Schweppes Case. The question raised is whether the UK CFC legislation constitutes an unjustifiable restriction on the fundamental freedoms under the EC Treaty. A discussion of the [Cadbury-Schweppes case](#) is available on our website.

Hot links

- ❖ The Commission has requested Greece on 8 July 2004 to end discrimination against [investment funds](#) established in EEA/EFTA-countries.
- ❖ The European Commission [referred Spain](#) to the Court of Justice on 8 July 2004 because pension contributions paid to non-Spanish funds are not tax deductible while contributions paid to domestic funds are. Spain is not willing to modify its legislation until the implementation of the Pension Fund Directive that is foreseen for 23 September 2005. Commission also formally [requested the UK](#) on 8 July 2004 to amend its legislation. The Commission considers that the beneficial tax treatment of domestic schemes is incompatible with the freedoms mentioned in the EC Treaty (Articles 39, 49 and 56). Finally, the European Commission formally [requested France](#) on 7 July 2004 to amend its legislation on personal equity plans (1992 PEA Law) and to extend tax benefits to investments not only to the European Union, but also the European Economic Area (EU plus Iceland, Liechtenstein and Norway).
- ❖ In [Case C-415/02](#) the ECJ decided that the Belgian tax on subscription for new securities created when a company or fund is set up, following an increase in capital, or as part of a loan issue, is in contravention of the [EEC Capital duty directives](#). The same applies for the tax on the delivery of bearer securities after their issue.

This case confirms that relief from double taxation under a classical system can not be qualified as a coherent system to be kept in tact.

We wish that 12 years after Bachman, the ECJ declares cohesion only justifiable still at a European and not a per country level anymore.

- ❖ It seems as though Belgium did not have a particularly good EU month, tax wise. On 16 July 2004, the [Commission referred Belgium](#) to the ECJ re. the tax obligations Belgium imposes on contractors who use foreign subcontractors to provide services in the construction sector (15% withholding tax and joint responsibility for tax liabilities). The Commission argues that this constitutes a restriction on the freedom to provide services.
- ❖ On 7 June 2004, Portugal ratified the prolongation protocol to the [EU arbitration convention](#). The Italian Parliament also authorized the president of the Italian Republic to ratify this protocol beginning July as last partner to the original Convention to ratify. This lets the original Convention re-enter into force with retroactive effect from 1 January 2000, until 31 December 2004. Thereafter it will be extended automatically for another 5 years unless a Member State objects. More practical information can be found on the [EU website](#).
- ❖ On [19 July 2004](#) the Council adopted the Commission's proposal to defer the date the Savings Directive as of which member states have to apply the directive to 1 July 2005.
- ❖ End June and beginning July the Commission published various documents on "[Home state taxation](#)" within the EU. The Commission welcomes comments to these documents before 15 September 2004.
- ❖ In our [February 2004 newsletter](#) we mentioned how the Commission sued the Council for effectively reversing its decisions on State Aid by allowing new aid for paying back the illegal old aid. In case [C-110/02](#), the ECJ decided for the Commission on 29 June 2004.
- ❖ On 22 July 2004 the Commission sent [reasoned opinions](#) to seven member states requesting them to allow the application of fair values for derivatives under Directive ([2001/65/EC](#)), allowing for the application of International Accounting Standard (IAS) 39.
- ❖ The Commission proposed rules to ensure the coherent application throughout the EU of the new international capital requirements framework recently agreed by the Basel Committee on Banking Supervision ('[Basel II](#)'). It also published an accompanying [Q&A memo](#).
- ❖ On 13 July 2004 the Commission sent reasoned opinions to 6 member states for not transposing Directive [2002/47/EC](#) on financial collateral agreements to their national legislation. We wonder whether tax professionals have tested their national tax legislation to this directive (e.g. on securities lending, repo transactions and other transactions using securities as collateral).
- ❖ Interested in an overview of VAT, car tax and customs and excise duties in the various member states? [Go here](#).

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