



## **Debt conversion bill finally acquires retro-active effect**

In a parliamentary debate held in the Dutch Second Chamber on 10 March 2005, the Dutch government finally promised to give retro-active effect to the reparation of article 12 of the Dutch Corporate Income Tax Act. This article determines that if a debt is converted into equity, the difference between the par value of the debt and the market value thereof is subject to taxation. Since this article makes it virtually impossible to save any company in financial trouble without incurring a large tax bill, some relief has been promised (see our [January 2003](#), [January 2004](#), [July 2004](#) and [February 2005](#) newsletters).

The State Secretary has now promised to file a notice of amendment to the bill. According to the announcement the amendment will arrange that debt which was converted to equity between 2001 and the enactment of the bill abolishing article 12, will only be taxable to the extent that the debtor has tax deductible losses. E.g. if a company has 100 in losses carried forward and a debt with a nominal value of 200, but a fair market value of only 30 is converted into equity, then article 12 will treat  $(200 - 30 =) 170$  as taxable income. However, under the announced amendment to the bill, only 100 of that amount will actually be taxable and offset against the losses carried forward, whilst the remaining 70 will be exempt from taxation. In order to avoid double dipping the retro-active measure will not be applicable in situations where the creditor of the converted debt has also written down the receivable against its Dutch taxable income. The amendments should be published by the time our next newsletter is due. The amendments will then be discussed in detail.

## **Tax inspector ordered to pay Euro 72.000 litigation fees**

The High Court of the Hague decided that a tax inspector had to compensate a taxpayer its costs of litigation of Euro 72.002,59 due to the unreasonable attitude of the tax inspector in making an assessment and during the subsequent trial. The facts were as follows. An individual (X) moved to Canada with his family in 1980 and became a Canadian citizen in 1984. X was a director and the sole shareholder of A Ltd, resident in Canada. In 2002 the Dutch tax inspector made an assessment for 1997 and informed X that he believed that X was resident in Holland for tax purposes during 1997. The inspector further claimed that the income received by A Ltd for real estate consultancy services should be allocated to X personally. X appealed against the assessment on time. The tax inspector did not react within one year thereafter and X filed a notice of appeal with the High Court (under Dutch law, not reacting within one year can be treated as a deemed rejection of the original appeal to the tax inspector).

After filing the appeal with the High Court, X was informed that the inspector got permission from the Ministry of Finance to extend his period of response to the appeal by one more year, but that the inspector failed to inform X accordingly. The High Court determined that it could hear the case in spite of the extension, since X was not informed about the extension on time. In its subsequent decision the High Court stated that, bearing in mind the tax inspector's attitude with regard to X and to the High Court itself, it saw no reason to provide the tax inspector with any extension to respond to X's appeal or to motivate the 1997 assessment. The High Court then decided for X. It did so in view of the fact that it was abundantly clear from documentation provided by X that he could not have been resident in the Netherlands during 1997, that the tax inspector should have known this at the time of making the assessment or shortly thereafter and that the tax inspector nonetheless deliberately chose to proceed with the wrongful assessment. The High Court then determined that, considering the above and everything else X mentioned about the tax inspector's conduct towards him, the tax inspector had to refund X all costs of litigation which X had to make: this came to Euro 72.002,59. The Court also determined that the Court Fees of Euro 37 should be refunded.

This case has little to do with Dutch international corporate taxation. We discuss it nonetheless, because we hope that it will not be last time that taxpayers ask for – and get – their full costs of litigation refunded. There are cases, where the law and circumstance are unclear and a tax inspector has the obligation to assess and litigate if necessary; there are also cases where one wonders what possess a tax inspector – as an extension of government – to behave in a certain way. For those cases, this decision should give clear guidance.

## **New figures on Dutch ruling practice issued**

On 24 February 2005 the Dutch Ministry of Finance issued the 2004 statistics on the Dutch ruling practice. The figures were as follows. On 1 January 2004, the Dutch revenue service had an inventory of 155 ruling requests which still had to be finalised. The total number of ruling requests filed during 2004 was 310. On 31 December 2004, 145 request still had to be dealt with, meaning that the Revenue Service actually dealt with 320 requests in total.

The State Secretary promised retro-active effect of the relief from the abolishment of art. 12 CIT

The 2020 ruling requests (i.e. after the pre-filing stage) dealt with concerned 97 APA (Advanced Pricing Agreements) requests, 198 ATR (Advanced Tax Rulings, primarily on the application of the participation exemption and group financing activities) requests and 25 grandfathering requests. We refer to our [September 2004 newsletter](#) for a detailed description APA's, ATR's and the differences between them.

During 2004, the concept of pre-filing meetings was introduced. Under this procedure taxpayers first have a meeting with the tax inspector before actually filing a formal ruling request, in order to determine the likelihood of obtaining a ruling. During 2004, 103 pre-filing meetings were held of which 54 resulted in actual ruling requests. Only the 54 requests actually filed are included in the above mentioned number of 320. Taking into consideration the pre-filing meetings as well, the tax authorities dealt with  $(320 + (103-54) =)$  369 cases in total. Of these, 209 ended in rulings being granted, 38 in rulings being denied, 73 in ruling requests being withdrawn and 49 pre-filing meetings leading to no ruling request being filed at all.

The average time of dealing with ruling requests, once the pre-filing stage has been passed, was 87 days, being 91 days for APA requests and 59 for ATR requests. The ideal of the tax authorities remains to deal with ATR requests within 8 weeks (56 days) and to give estimates of the duration of APA requests on a case by case basis during the pre-filing meetings.

## **Other points of interest**

- ❖ On 24 February 2005 various questions were asked in parliament about the implementation of the new protocol to the US/Dutch tax treaty. These questions concern article 10 on dividends in combination with Dutch limitations on interest deductions (both for hybrid and other loans). The questions also concern the interpretation of the amended article 24 with regard to US LLC's and Dutch limited partnerships (CV's) in view of the minimum voting right requirements of article 10 of the treaty. We will report further in detail when the answers of the authorities are published.
- ❖ In an opinion issued 8 February 2005, the Dutch Advocate General advised the Dutch Supreme Court not to apply the Dutch unilateral decree for the prevention of double taxation with regard to Switzerland. The case concerned the transfer of shares in a company with exempt foreign income carried forward. The Dutch unilateral decree, to which Dutch tax treaties normally refer for the prevention of double taxation, dictates that the right to that exempt income may be lost in case of a significant change in ownership of the company combined with a substantial decrease of the company's activities (as is the case with trading companies with losses carried forward). However, the 1951 Swiss/Dutch income tax treaty does not refer to the unilateral decree; instead, the treaty provides for its own measures for the prevention of double taxation. The Advocate General therefore believes that the unilateral decree can not be applied to Dutch/Swiss relations.

## **EU related tax developments**

### **High Court rules on application Bosal to third countries**

The High Court of Amsterdam published a decision on 10 March 2005 regarding the application of the Bosal decision ([Case C-168/01](#)) of the EU Court of Justice (hereafter "ECJ") to non-EU countries. In this case a Dutch company (XBV) held shares in 25 subsidiaries, of which 12 were situated outside the European Economic Area. 1 of these was resident in Poland, 1 in Cyprus, 3 in Switzerland, 1 in the US and the rest in Canada, Cyprus, Hong Kong and South America.

Under the Dutch participation exemption as it read until 1 January 2004, costs related to subsidiaries which did not generate Dutch taxable income (generally foreign subsidiaries) were not deductible for income tax purposes, whilst costs related to subsidiaries generating Dutch taxable income were. In the Bosal decision the ECJ determined that this difference in treatment was an unjustifiable restriction of the freedom of establishment. The Dutch government subsequently amended the rule to allow costs (other than acquisition costs) to potentially be deductible for all participations, regardless of where they are situated. However, for the period up to 1 January 2004, the Dutch Government only allowed such cost deductions for subsidiaries resident in the European Economic Area. Since Cyprus and Poland only joined the EU on 1 May 2004, this meant that they were treated as third countries for purposes of the case before the High Court; that case concerned the 2000 and 2001 tax years.

XBV argued that it should get deductions for all its subsidiaries, including the 12 resident outside the European Economic area. It based this claim on two arguments. First, that the free movement of capital, which also applies with regard to third countries outside the EU, precludes a restriction on the deduction of these costs and second, that the [Europe Agreement](#) with Poland precludes such a restriction. The Europe Agreement was concluded with Poland in anticipation of Poland's accession to the EU.

The High Court denied both arguments. It denied the argument regarding the free movement of capital on the grounds that article 57 of the EC Treaty has a standstill provision which allows restrictions on the free movement of capital existing on 31 December 1993 to be kept in place as long as such restrictions are not changed substantially or renewed. The Court did not see any changes to the restriction on the interest deduction made between 31 December 1993 and 2000 as being substantial and concluded that the restriction was covered by the 1993 standstill provision.

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We wonder whether this is correct. One could argue that Bosal meant that the Dutch limitation on interest deductions had always been contrary to EU law and therefore should have been changed long ago (Bosal itself concerned interest deductions from 1993). Clearly, if Dutch law was made EU compliant on time (i.e. in 1993), then that could well have constituted a substantial change, which would have annulled the 31 December 1993 standstill provision. Effectively the High Court therefore penalises XBV for the fact that the Dutch government did not amend the interest deduction restriction earlier.

The High Court also denied XBV relying on the Europe Agreement with Poland, since the literal text of the agreement varies from the freedom of establishment article in the EC treaty. We agree with this argument since the wording of article 44 of the Europe Agreement does indeed only seem to concern the restriction by the Netherlands of inbound investments from Poland, but not outbound investments to Poland. However, we regret that the taxpayer – and the High Court – did not investigate whether the Dutch restriction on cost deductions did not contravene the free movement of capital advocated under article 60 of the Polish Europe Agreement since this article does not seem to be limited to inbound investment only. The extent of the application of the latter article during the tax years in this case would have required substantial further investigation by the High Court.

## **Possible changes of law regarding abuse of legal persons**

On 4 March 2005 the Dutch Ministry of Justice issued a press release stating that the Dutch government approved of the conclusions of a study group for amendments to the current Dutch rules on the abusive use of legal persons. The study group recommended stopping the practice of requiring a ministerial declaration of no objection before allowing a company to be incorporated under Dutch law. This should be replaced with the duty to report any incorporation. The incorporation will not be slowed down by such a declaration and the incorporated company should provide the same information through the reporting obligation as it currently provides to the Chamber of Commerce or the notary incorporating the company. Under the conclusions of the study group, the government will also not be allowed to require information from entrepreneurs which it already has via other means. The government plans to make these new requirements also applicable to foreign legal persons operating in the Netherlands. This may be in contravention of EU law if not done properly, as the Dutch government already found out when it tried to apply Dutch rules to foreign legal entities operating in the Netherlands in the Inspire Art case ([Case C-167/01](#)).

## **Hot links**

- ❖ On 17 February 2005, the Commission welcomed the adoption by the EU's Council of Finance Ministers of a proposal to amend the EC Merger Directive ([90/434/EEC](#)). The Council adopted the proposal at the [Ecofin meeting](#) of 16 and 17 February 2005. The adopted amendments were published in the [Official Journal](#) on 4 March 2005.
- ❖ On 1 March 2005 Advocate General Philippe Leger delivered his opinion in the [Ritter Case](#). This concerns a French couple teaching in Germany, having their worldwide income taxable in Germany and wishing to deduct the losses from their real estate in France. The opinion is not yet available in English.
- ❖ Direct tax cases are brought before the ECJ at an ever increasing rate. The latest cases brought before the Court concern the following:
  - ❖ [Case C-524/04](#) on UK thin capitalisation rules and claims for damages stemming from these rules.
  - ❖ [Case C-523/04](#) where the Commission takes the Netherlands to court in a new [Open Skies](#) case; will a US treaty with an LOB clause be next?
  - ❖ [Case C-522/04](#) where the Commission takes Belgium to court in a retry of the [Bachman](#) case.
  - ❖ [Case C-520/04](#) where Pirkko Marjatta Turpeinen seems to claim that the Finnish government is precluded from levying a gross withholding tax on pensions under the free movement of persons and workers. This may be an extension of the [Gerritse](#) case on German gross taxation of artistes.
  - ❖ [Case C-513/04](#) where mr. or mrs. Kerckhaert-Morres claims that the Belgian rules that allow deductions of source taxes on dividends from Belgian companies, but not other EU companies restricts the free movement of capital in the EU.
  - ❖ [Case C-509/04](#) on the Dutch implementation of the [capital duty directive](#).
  - ❖ [Case C-492/04](#) Lasertec Gesellschaft seems to be asking new questions about the German thin capitalisation rules (in relation to third countries) and on details of the 31-12-1993 standstill exemption on restrictions on the free movement of capital.
  - ❖ [Case C-470/04](#) where N asks further questions about (Dutch) exit taxes, building further on the [Hughes de Lasteyrie du Saillant](#) case.

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