



## **Supreme Court decides on US-Dutch tax treaty and the prevention of double taxation**

According to Dutch law individual and corporate taxpayers may deduct taxes levied on income outside the Netherlands, unless a measure for the prevention of double taxation is applicable for the taxpayer. On 12 August 2005, the Supreme Court decided in the following case. In 2000 a US citizen, X, was resident in the Netherlands for tax purposes. His income for that year included royalties from the US for books written by him. X was taxed in the Netherlands on this income on the basis of his residence. X was also taxed in the US on this income on the basis of his US citizenship. The US granted him a tax credit for the taxes paid in the Netherlands, but due to the Alternative Minimum Tax (AMT) regime, X still had to pay tax in the US (in spite of the Dutch tax rates being higher than the US rates).

X wanted to deduct the additional US tax in the Netherlands and argued that such should be allowed on the basis of the following arguments:

- There is no measure for the prevention of double taxation stemming from the AMT.
- Article 24 of the US Dutch treaty allows the US to levy tax from US citizens resident in the Netherlands; article 25 requires the US to provide US measures for the prevention of double taxation. The Dutch rule preventing a cost deduction concerns a Dutch measure for the prevention of double taxation, not a US measure. Interpreting it otherwise would force the Dutch measure to be read as saying that "taxpayers may deduct taxes levied on income in the US, unless a measure for the prevention of double taxation on the US tax is applicable for the taxpayer in the US" which is nonsensical.
- Said Dutch rule only applies to the extent that double taxation is prevented.
- The legislative history of the Dutch limitation (stemming from before 1964) is so short and outdated that it has not any and can not give any guidance on the questions raised by this case.

In a short and sparsely motivated decision, the Supreme Court determined that no deduction was allowed, since another measure for the prevention of double taxation exists in the form of the US-Dutch tax treaty. According to the Court this rule applies even if that measure is not (fully) effective or concerns the prevention of double taxation in the US and not in the Netherlands. Naturally, these considerations ought to apply for corporate taxpayers as well. Since Dutchtax.net was involved in litigating the case before the Supreme Court, we will refrain from comments on the Supreme Court's decision.

## **Q&A published on the 2004 US/Dutch treaty protocol**

On 26 August 2005 the Ministry of Finance published answers given to questions of the First Chamber on the US/Dutch treaty protocol. The questions answered dealt with dividend distributions from a legal person resident in the Netherlands to a partnership; the application of article 24, fourth paragraph (the basis of taxation for hybrid entities); and the catch-all provision of the article 26 on limitation of treaty benefits. In response to these questions the Dutch authorities answered that:

- when determining whether a hybrid entity holds a direct interest or is an ultimate beneficiary, the basic starting points are those which have been laid down in the 1999 OECD report, "Application of the Model Tax Convention to Partnerships". This means that the qualification the receiving (residence) country gives the entity that receives the dividend, generally (also) determines the status of the dividend distribution. Therefore, if a Dutch dividend is taxed in the US, the one receiving the dividend and paying US tax on the dividend is treated as direct shareholder or ultimate beneficiary for Dutch tax purposes;
- the condition of being subject to tax under article 24, fourth paragraph, is fulfilled if a taxpayer can show this by a tax return filed with the Internal Revenue Service or by an advance tax ruling concluded between the taxpayer and the competent authorities in the US;
- as far as possible timing differences exist between the moment in which taxation would have taken place in the Netherlands and the moment when it takes place in the US, it will always be seen if and whether a dividend distribution coming from the Netherlands is (has been) taxed. Only in instances where taxation takes place in the US (or has taken place), will the Netherlands apply treaty benefits. It is interesting to note that the Dutch authorities do not deal with the possible future taxation of the relevant income by the US at all. It is unclear to Dutchtax.net whether this means that the future US taxation of income is irrelevant for Dutch tax purposes;
- although this generally does not happen, it is possible to have discussions with the US authorities prior to deciding upon a request for the application of the catch-all provision of the limitation on benefits article;

In a sparsely motivated decision, the Supreme Court determined that no deduction was allowed, because of the US-Dutch tax treaty.

Several questions were asked by the First Chamber to which answers are still outstanding.

- in dealing with a request for application of the so-called catch-all provision under the limitation on benefits article, all relevant facts and circumstances are taken into consideration, such as the nature and size of the activities of the dividend distributing entity in the Netherlands, the moment upon which these activities were started or extended and the considerations on the basis of which it has been decided to have the activities take place in the Netherlands or be run via the Netherlands.

A translation of the decree is available to [subscribers](#) of Dutchtax.net.

Questions asked by the First Chamber, but not answered by the State Secretary, include:

- whether a group with a Dutch parent holding a US participation prior to 1 October 1998 could lose its right to 0% dividend tax through a reorganization whereby a fully owned Dutch intermediate holding is inserted after 1 October 1998;
- whether a differentiation must be made with regard to facts / transactions taking place before or after 1 October 1998 (publishing policy in US), 21 February 2002 (announcement treaty negotiations) or 8 March 2004 (signing Protocol) when applying the catch-all provision under article 26;
- whether a reference to a “dividend equivalent amount” has been omitted for applying the 0% percent rate under the branch profit tax article of the treaty;
- whether a reference to permanent establishments set up after 1 October 1998 has been omitted in article VIII of the Memorandum of Understanding to the Protocol;
- whether a reasonable application of the tax treaty has not been obliterated in many circumstances due to article 24, fourth paragraph as introduced by the 2004 protocol and whether further information should not have been given in view of the fact that this would annul 12 years of Dutch policy with regard to US situations; and
- what the tax rate is under the treaty if dividend is received by a company who does not qualify for the treaty benefits itself, but who can rely on the fact that its shareholders would have qualified for a reduction of tax when one of those shareholders (60%) is a company and the other an individual (40%). Does the 5% or the 15% dividend withholding tax rate then apply or neither?

## **Decree on filing electronic requests for dividend tax refunds**

On 24 August 2005 the Dutch Ministry of Finance published a decree on how certain intermediaries can file electronic request for refunds of dividend tax on behalf of the ultimate beneficiaries of the dividends. According to the decree representatives who annually file large amounts of requests for the refunds of Dutch dividend tax with regard to portfolio dividends can file these requests electronically without simultaneous filing of a paper version of the requests together with the dividend note.

The following conditions are attached to participation in this special arrangement:

- The representatives enlist as participant with the Dutch tax authorities;
- The requests are filed on behalf of the ultimate beneficiaries;
- The representative timely arranges for legal proxies to representation and also carries the responsibility for the communication with the beneficiaries;
- The proxy to be presented by the representative includes the approval of the beneficiary to the integration of the decision in one file and the integrated payment to the representative;
- The requests satisfy the (technical) conditions set by the Revenue Service;
- For efficiency reasons an electronic filed request should hold at least 25 requests;
- At the request of the Dutch tax authorities the representative allows insight into its administrative organisation and internal controls as well as the automated support with regard to the filing and processing of dividend tax refund requests;
- Regardless of recourse on the beneficiaries, the representative unconditionally agrees with repayment to the Dutch tax authorities of refunds which are given unjustly or for to high an amount;
- If errors or contradictions are found with a representative with regard to the execution of the arrangement, the authorities may exclude the representative from participation in the arrangement with immediate effect.

This Decree enters into force as of 1 September 2005. A translation is available to [subscribers](#) to Dutchtax.net

## **Supreme Court classifies temporary repurchase of shares**

On 12 August the Dutch Supreme Court decided in the following case: A Dutch listed IT group wanted to acquire another listed IT group. The shareholders of the target wanted to sell their shares partially against cash and partially against shares in the acquirer. The acquirer did not want to issue new shares and decided to repurchase some existing outstanding shares instead. Under Dutch law the redemption of shares is treated as a deemed partial liquidation and the difference between the purchase price of the shares and the average equity paid up on the shares is subject to Dutch dividend tax; this does not apply to shares that are only repurchased as a temporary investment.

To test the tax consequences of the planned repurchase, the Dutch acquirer purchased 2.000 shares. For 1.000 it booked the par value of the shares as an investment in securities, the difference between the purchase price and the par value it booked against share premium (recognised for tax purposes). The other 1.000 shares were fully booked as an investment in securities. The High Court determined that it was clear that both groups of shares were repurchased with a view of acquiring the target. However, due to the difference in accounting treatment it determined that only the shares that were not booked against share premium could be treated as being acquired as

The Supreme Court determined that only the purpose of the repurchase, not its accounting treatment, was relevant.

A temporary investment. Only the repurchase of those shares were exempt from dividend tax. The Supreme Court overturned the High Court decision, determining that only the purpose of the repurchase and not the accounting treatment determined the tax consequences of the repurchase. Therefore dividend tax was not due on any of the repurchased shares.

A translation of the main considerations of the Supreme Court is available to [subscribers](#) to Dutchtax.net

## Other points of interest

- ❖ The Dutch Supreme Court referred a case on individual income tax on 12 August 2005. Interesting point was the argument of the tax inspector that when a creditor allows a receivable to lapse under civil by doing nothing apparent to prevent the lapse, this constitutes taxable income for the debtor. The question referred by the Supreme Court is whether the debtor was able to redeem its liability.
- ❖ On 24 August 2005 the Dutch tax authorities published an extensive Q&A decree on the 30% tax facility according to which certain expatriate employees are allowed to receive a tax free cost allowance of up to 30% of their taxable income. Since we do not specialize in individual income taxes no translation of this decree will be available on our site. However, should you be aware of such a translation elsewhere, we would be happy to provide a link to it.
- ❖ In another decision of 12 August 2005, the Dutch Supreme Court determined that if a taxpayer concludes an agreement with the tax authorities and if policy is published thereafter, which is more favourable for the taxpayer, then the taxpayer may rely on the subsequent policy instead. This is subject to the condition that the tax assessment for the relevant year / transaction has not become irreversible yet. In the particular case, the published policy specifically offered the revision of assessments. However the Supreme Court also determined that “if, ... policy is issued with a more positive effect for the taxpayer, that policy acquires a similar effect as the offer mentioned here before”.

## What happened to the previous newsletter?

Many of our readers have received an email for our previous newsletter, without any attachment or an attachment which could not be opened (some even got a virus warning). Here is what happened: Those emails were sent out in Rich Text Format – a seemingly harmless feature of Microsoft Outlook. It turns out that many, but not all, mail servers see such emails as a security risk, each of them dealing with this in their own way. It was impossible to tell how many readers received the newsletter in readable format, which left us with two choices: Either resending the email to everyone in HTML format, at the risk of many people receiving the newsletter twice and not being happy about it, or only resending the newsletter to those people who let us know that they had problems. We chose the latter. If you did not receive our newsletter and would still like to see it, you can find it [here](#).

Likewise, if you, upon receipt of the newsletter sent us an email to receive the newsletter directly in future, please do so again.

## EU related tax developments

### Supreme Court rules on capital duty levied from immigrated company

In 1997 a Netherlands Antilles company immigrated to the Netherlands and paid Dutch capital duty on its equity upon immigration. It subsequently appealed against the capital duty paid arguing among others that:

- levying capital duty from immigrating NA companies but not Dutch companies is prohibited by the non-discrimination article of the tax arrangement for the Kingdom of the Netherlands (basically the NA/Dutch tax treaty);
- levying capital duty in this case is in contravention of the free movement of capital under the EC treaty.

The Supreme Court rejected both arguments. With regard to the first, it argued that the difference in treatment is justified by the different positions of both companies before and after the immigration to the Netherlands. With regard to the second, it argued that the rule that capital duty is levied from companies immigrating to the Netherlands (unless it was resident in the EU directly before), is the correct implementation of article 4<sup>1</sup>e of the EC Capital Duty Directive (69/335/EEC). In view of article 57 of the EC treaty which provides grandfathering for any restrictions which exist on 31 December 1993 under Community law and determines that the Council may adopt measures on the movement of capital (such as the Capital Duty Directive) to or from third countries involving establishment, which constitute a step back in Community law as regards the liberalisation of the movement of capital to or from third countries, the Supreme Court saw no reason for referring any questions to the ECJ regarding the validity of the Capital Duty Directive.

## Hot links

- ❖ Starting their own Marks & Spencer case, the Finnish Supreme Administrative Court referred a question to the ECJ as to whether a system such as that of the Finnish group subsidy legislation in which a condition for the deductibility in taxation of a group subsidy is that both the donor and the donee of the group subsidy are companies resident in Finland. The Oy Esab case, nr. [C-231/05](#). More information on this case is available in English [here](#). Sweden has been confronted with the same question in a case by Lindex in which a Swedish company wanted to consolidate its results with its German subsidiary. In that case the Swedish court deemed

The Supreme Court rejected both arguments. First, the different treatment is justified by different positions the companies are in, second, taxation upon immigration is the correct implementation of the Capital Duty directive.

- ❖ EU law to be clear enough and to prohibit Swedish law from restricting consolidation to companies resident in Sweden only. More information is available [here](#).
- ❖ Finland requires certain non-resident persons to appoint a VAT representative in Finland, when they carry out VAT taxable transactions in Finland. The Commission took Finland to the ECJ arguing that by imposing this requirement, the Republic of Finland has failed to fulfil its obligations under Articles 21 and 22 of the Sixth Council Directive 77/388/EEC of 17 May 1977 (3) and Articles 28 EC and 49 EC. Case [C-249/05](#). More information is available [here](#).
- ❖ Following the ECJ decision in the Cura Anlagen car lease case ([C-451/99](#)), the High Court of Den Bosch referred a question to the EU Court of Justice on 31 May 2005 on the question whether the Netherlands may levy a car tax on a car leased from a Belgian lessor, the tax being equal to approximately 50% of the adjusted value of the car. See Coevering Case ([C-242/05](#)).
- ❖ As is the case with the Italian IRAP, the Hungarians also seem to have a possible alternative turnover tax. On 29 April 2005 the Hungarian County Court of Komárom-Esztergom asked the ECJ which criteria allow a tax to be characterised as a turnover tax; if a tax the taxable basis of which is the net turnover can be regarded as a turnover tax; if only a single tax having the nature of a turnover tax may be maintained in a member state; and finally, if two or more turnover taxes are maintained in a Member State after accession to the EU, whether the assessment, with retroactive effect, relating to a period before accession is allowed. See Lakél Kft., Pár-Bau Kft. and Rottelma Kft. V Komárom-Esztergom Megyei Közigazgatási Hivatal (Case C-261/05).

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