



2006 Corporate Tax Package:

Capital Duty abolished and top corporate tax rate down to 29.6%

On 20 September 2005 the 2006 Corporate Tax Package bill was submitted to the Dutch Second Chamber. The primary purpose of this bill is to improve the Dutch investment climate by abolishing capital duty as of 1 January 2006 and further lowering the Dutch corporate income tax rate for 2006 from the anticipated 30.5% to 29.6%. This is partially financed through a limitation on the deduction for personal costs paid on behalf of employees and the abolishment of the right to the temporary tax deductible write down for participations.

- The abolishment of the 0.55% capital duty has been announced before; see our [April 2005](#) newsletter. This should be good news for business (and bad for consultants), since a lot of planning costs were involved in trying to avoid capital duty when investing into the Netherlands. What is really nice is that according to the explanatory memorandum to the bill, the government not only abolishes capital duty, but also abolishes the five year claw back period for share mergers. E.g. if a company acquires an interest of 75% or more in another company through a share merger, this acquisition is exempt from capital duty unless the acquirer disposes any of the shares during the following five years. Such a disposal leads to a full recapture of the exemption, also for shares acquired and not disposed. According to the explanatory memorandum this would not apply if a company acquired shares in an exempt share merger prior to 1 January 2006 and disposed of those shares after 1 January 2006, but within five years. We assume that it is not allowed for concrete plans to dispose to exist prior to 1 January 2006 with a deferred execution thereof to after 1 January 2006. The same should apply for asset mergers and reorganizations where there is no legal claw back but where no disposal upfront is allowed either.
- As of 1 January 2006 the corporate income tax rates will be 29.6% for profits above Euro 22.689 and 25.5% for profits up to Euro 22.689. Taxpayers with a tax year deviating from the calendar year must calculate their tax due on a pro-rated basis.
- Currently individual entrepreneurs and companies with substantial shareholders are restricted in deducting (deemed) personal expenses as business expenses for those entrepreneurs / substantial shareholders. This rule is to be extended to all corporate taxpayers for all employees. The restriction will be based on deemed personal expenses of 0.4% of an employee's taxable wages with a minimum of Euro 4.000 per company. Taxpayers are allowed to prove that the actual personal expenses paid by the company were lower.
- Companies are currently allowed to write down 25% and larger participations during the first five years after their acquisition with a recapture upon subsequent profit distributions, disposal or from the sixth through the tenth year of holding the participation. This rule is abolished with grandfathering provisions for write downs which have already taken place but have not yet been recaptured.

We believe that the abolishment of capital duty is a great improvement of the investment climate and that the means of financing it very acceptable. A translation of the bill is available for subscribers to our website under Proposed laws.

Supreme Court prevents additional assessment under ruling and determines documents tax authorities may require

Under Dutch law an additional assessment (following a final assessment) can only be made on the basis of new facts which the tax inspector can reasonably be expected not to have known at the time of making a final assessment. On 23 September 2005, the Supreme Court confirmed a decision of the High Court of Amsterdam that the facts given in a ruling request in 1995 prevented an additional assessment plus penalties over the tax year 1993 in 1998, because the ruling provided the tax inspector with the necessary information. The facts of the case were as follows.

The taxpayer, part of a group manufacturing hydraulic systems, requested a royalty ruling from the tax inspector on 6 June 1995. The tax inspector made a final assessment for 1993 on 30 March 1996. Based on the ruling request from 1995, the tax inspector requested a tax audit of the taxpayer in November 1997. Following the outcome of that audit, the tax inspector made an additional assessment on 30 September 1998 because it was argued that a part of the royalties paid by the taxpayer were not at an arm's length basis. A 25% penalty was attached to the assessment on the basis that the taxpayer should in the very least have been aware of the fact that the royalties were not deductible. The Supreme Court confirmed the decision of the High Court of Amsterdam that on 30 March 1996 the tax inspector can reasonably be expected to have known, via the ruling request of 6 June 1995, about the royalty payments made. He therefore should have awaited the outcome of the tax audit before making the final assessment. The fact that he did not do so prevents him from making an additional assessment in 1998.

What is really nice is that the 5 year claw back for share mergers is also abolished per 1 Jan. 2006

As of 1 January 2006 the CIT rate will be 29.6%

Under Dutch tax law, a taxpayer has to provide the tax authorities with the information required in order to be able to make an assessment. If the taxpayer refuses, the tax inspector may make a reasonable assessment of what he thinks the taxable amount should be and the taxpayer then carries the (difficult) burden of proof to show that this estimate is wrong.

The same taxpayer discussed hereabove was also involved in a procedure before the Supreme Court for the tax year 1994. In this case, the taxpayer refused to give copies of minutes of board meetings and advisory committee meetings to the tax authorities and the tax authorities then made an estimated assessment for 1994. The High Court determined that the taxpayer's refusal did not result in the taxpayer getting the burden proof as described hereabove, since the requested minutes would contain little if any relevant tax information. The Supreme disagreed and determined that these minutes do contain relevant information and the taxpayer's refusal leads to it getting the burden of proof that the estimated assessment is too high. However, as far as due diligence reports are concerned, the taxpayer does not have to provide the tax authorities with any documentation concerning the tax position of the taxpayer or tax advice given to the taxpayer. Documents containing both general and tax information may be cleansed of the tax information before providing them to the tax authorities.

On 23 September 2005, the Supreme Court referred the case to the High Court of Amsterdam to allow the taxpayer to prove that its assessed income was incorrect.

Advocate General opines on banking branches

On 23 June 2005 Advocate General Wattel published his opinion in case nr. 40 858 before the Dutch Supreme Court. The case concerned a Belgian bank which had a branch in the Netherlands. According to the bank the branch had a negative equity of NLG 131.000 on 31 December 1995 and a loss for the year of NLG 123.000. The branch had a debt of NLG. 267 million to its head office. The tax inspector adjusted the 1995 tax return, arguing that the branch had to have an equity. Using the so-called BIS ratio ("Bank of International Settlements ratio" used to determine the minimum equity requirement of a bank, based on the risks involved in the types of assets it holds), the tax inspector argued that the branch needed an equity of at least 10.3% of its assets, coming to an equity of NLG 21 million instead of NLG 123.000 negative. This in turn drastically reduced the deemed interest due to the head office, which lead to a taxable income over 1995 of NLG 841.000 instead of a loss of NLG 131.000.

After having lost before the High Court of Amsterdam, the taxpayer appealed to the Supreme Court on the basis of 5 arguments: Contravention of EU law; unfair distribution of the burden of proof by the High Court; wrong interpretation of article 7 of the Belgian/Dutch tax treaty (permanent establishments); the High Court had to take into account guarantee fees and licence fees between the branch and its head office; and a wrong interpretation of a tax decree from 1930. The Advocate General deals extensively with all instruments of appeal, but finally dismisses them all:

- there is no contravention of EU law. This is neither the case with regard to the Second Banking Directive (89/646 EEC) nor with regard to Investment Services Directive, since requiring an allocation of part of the bank's equity to a branch for tax purposes only does not restrict the application of these directives. According to the Advocate General there is also no contravention of the freedom of establishment, but a disparity between two national tax systems which is of no relevance for EU purposes and even if that was otherwise, a restriction would be justifiable based on the Futura Participations SA & Singer decision of the ECJ (Case C-250/95) in that it is necessary to ensure that there is an economic link between the deductible interest costs and profits allocable to the Netherlands;
- the Advocate General agrees that it is generally not acceptable to expect taxpayers to prove why the BIS ratio method should not be applied instead of e.g. a functional analysis. However, since the taxpayer was too vague in his arguments vis a vis the functional analysis method (he did not provide sufficient material for such an analysis), the High Court's decision is correct in this particular case;
- the Advocate General does not see why the Belgian/Dutch tax treaty and the theory of treating a branch as an independent enterprise should prevent a part of the equity of the bank to be allocated to the branch in order to calculate the Dutch taxable basis. The text of the treaty and the OECD commentary to the OECD model convention (on which convention the old Dutch/Belgian tax treaty was based) did not prevent such an interpretation. Besides, the Advocate General pointed out that the Supreme Court does not allow taxpayers the right to allocate for themselves the division of their equity between their head quarters and their branches, since this would be too easy a factor to manipulate (we are afterall dealing with fiction rather than reality since the branch has no legal personality and can therefore not have its own equity);
- the branch had no need to pay a guarantee fee to the head office for the fact that the equity of the head office served as collateral for the branche's liabilities, since the equity allocable to the branch likewise constituted collateral for the head office's liabilities (the 2 amounts may be uncomparable in size though – Dutchtax.net).
- the taxpayer could not rely on this decree since a minimum equity would be due under the decree itself as well.

Other points of interest

- ❖ [The bill](#) to abolish the 7% Dutch Group Financing Regime has been adopted by the First Chamber on 13 September 2005. The law entered into force with retroactive effect to 12 July 2001. Existing group finance companies may continue to benefit from the regime for a period of ten years calculated from the date of which the taxpayer could have formed a provision, provided that this measure ends no later than 1 January 2011.
- ❖ On 13 September 2005 the State Secretary gave an extensive response to the First Chamber on various questions

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and case studies regarding the 2004 bill on the conversion of debt to equity and forming a revaluation reserve for the conversion in case of the debtor being a participation. See our [April 2005](#) newsletter for more information on that bill. We hope to publish an extensive memorandum on the bill for subscribers to our website upon the enactment of thereof.

- ❖ On 23 September 2005 Advocate General Overgaauw to the Dutch Supreme Court published his opinion in case nr. 40 490 on the hierarchy between the Dutch anti-abuse rules in the Dutch unilateral Decree for the Prevention of Double taxation and the 1966 Dutch-Swiss treaty, which does not include a reference to the Unilateral Decree at all. The Advocate General concludes that the Unilateral Decree does not apply. We will follow this case with interest and report the decision of the Supreme Court when it is published.
- ❖ On 26 September 2005 the State Secretary issued a decree according to which it is possible for a newly formed subsidiary to join a tax consolidated group during the first year of that subsidiary's existence, even if the date of consolidation is not the date of incorporation of the subsidiary, but a later one. One of the conditions for consolidation is that, apart from the subsidiary's first tax year, the subsequent tax years must coincide with those of the group.

Interested in the use of hybrid entities and instruments

Join us for a hybrids conference in Nice on 20 and 21 October and come and hear top practitioners such as Fred Gander from Dewey Ballantine, Murray Clayson from Freshfields Bruckhaus Deringer and Carlo Galli from Maisto e Associati talk about the latest structures and developments. More information is available as www.sheltons-tax.dk.

EU related tax developments

State Secretary responds to questions on Parent/Subsidiary Directive

The Netherlands is still in the process of implementing the 2003 amendments to the Parent/Subsidiary Directive (most of these became effective on 1 January 2005). The amendments have for the time being, until the proposed bills have been adopted, been implemented by Ministerial Decree (see our newsletter of [December 2004](#)). On 12 September 2005 the State Secretary of Finance answered some questions regarding the Parent/Subsidiary Directive, of which we give some highlights:

- ❖ Several references are made to something called the "Motion Van Vroonhoven-Kok" (the "Motion"). The Motion stemming from parliamentary debates in 2003/4 means that European directives should not be implemented with a broader scope than required and that the Dutch law should not have more measures than that the directives require.
- ❖ The original bill contained a proposal with regard to hybrid entities. The proposal was to treat transparent entities listed in the Annex to the Directive as entities with an equity divided into shares. However, the Motion caused the reversal of this proposed amendment. Since the original text on the transparent entities is not made public, we can't say whether this proposal would have been to the general benefit or detriment of taxpayers.
- ❖ What is to the detriment of taxpayers is the State Secretary's continued opinion on the application of the so-called "*compartimentering*" which is the Dutch word for differentiating between profits from a subsidiary that do and profits which do not qualify for the participation exemption. The case discussed is the following. Say a Dutch company (ABV) held 22% of the shares in a French company (BSA) on 31 December 2004. This shareholding did not qualify for the Dutch participation exemption since it was deemed to be passive investment. BSA had 70 in distributable reserves. As of 1 January 2005 this participation does qualify for the participation exemption (minimum ownership requirement dropped from 25% to 20%). At the end of 2005 BSA distributed 100 to ABV. According to the State Secretary, 70 of the distribution will not be exempt from the participation exemption under the "*compartimentering*" doctrine. This seems wrong to us and we hope that taxpayers will take the Dutch government to court on this very soon in order to end the legal uncertainty this point of view creates.
- ❖ The State Secretary announced that "*compartimentering*" will not be applied with regard to dividend withholding tax. This means that if in the above scenario, ABV was a French resident and BSA was a Dutch resident, then the full 100 would have qualified for the benefits of the Parent Subsidiary Directive and not only 30, as is the case hereabove.
- ❖ The State Secretary also discussed the Fokus Bank Case and doubted whether it would be applicable to the Netherlands because a. it was a decision of the EFTA Court and the EU Court of Justice may decide differently (thereby forgetting about the homogeneity articles under the EEA treaty and not mentioning the Denkavit case currently pending before the EU Court of Justice – Dutchtax.net) and b. the Fokus bank concerned the Norwegian imputation system and not the Dutch credit system (which is an argument which would in effect require the ECJ to redecide every case multiple times – Dutchtax.net). The State Secretary did go on to mention that there are several Dutch dividend withholding tax cases pending before the Courts based on the Fokus Bank case.

In view of the fact that the Dutch authorities say to be very concerned about the Dutch investment climate (which they should be), whilst at the same time being aware of the restraints put upon them by the European state aid rules, we do not understand some of the above actions. Why adhere to the motion Van Vroonhove-Kok instead of trying to interpret and implement the directive as widely as possible (we are after all talking about the abolishment of economic double taxation), why not create certainty upfront on the treatment of hybrid entities and why apply the

The State Secretary's continued insistence to apply the *compartimentering* doctrine to lowered minimum interest requirements for the participation exemption hurts the Dutch investment climate and is most probably in contravention of the amended Directive itself.

2 Dutch capital duty cases

On 21 June 2005 Advocate General Niessen of the Supreme Court advised in case nr. 40.866 on the question whether the contribution of Euro 1.8 billion should lead to a capital duty assessment of Euro 18 million or not. The facts of the case were as follows.

X BV (taxpayer), was a 100% subsidiary of A BV which was a 100% subsidiary of B AG in Germany. On 24 and 25 March 1999 A BV acquired various subsidiaries from B AG plus a loan of Euro 1.8 billion. On 1 April 1999 A BV transferred all the above subsidiaries plus cash of Euro 1.8 billion to X BV without any compensation. Thereafter A BV transferred X BV to L AG a German sister company. A part of the shares in L AG were listed on 13 March 2000.

X BV argued that the total contribution of 1 April 1999 was exempt from capital duty under the exemptions for asset mergers, since all the shares together with the assets constituted an independent part of a business. The tax inspector disagreed and levied an assessment for Euro 18 million, being the value of the cash contribution to X BV. The High Court of the Hague confirmed the tax inspector's assessment on 27 April 2004. The taxpayer appealed against the decision arguing that it is contrary to article 56 (free movement of capital) of the EC treaty, that the decision of the High Court are based on arguments which can not be followed and that capital duty can only be levied in case of a contribution of equity against the issue of shares; in this case no shares were issued by X BV. The Advocate General advised against all three instruments of appeal.

The Advocate General did on to confirm that the contribution of 100% subsidiaries to X BV could be exempt from capital duty even if it does happen simultaneously with the contribution of the cash to X BV.

The taxpayer had better results in the second case decided by the High Court of Arnhem on 29 August 2005. The facts of this case were as follows. In short a Belgian NV, X NV held a Dutch subsidiary, A BV, which held another Dutch subsidiary, B BV, which held another Dutch subsidiary C BV and a German company X GmbH. C BV and X GmbH formed a German limited partnership, X GmbH & CoKG, which held Z GmbH and Y GmbH. Z GmbH held Q GmbH. On 26 November X NV bought all of the shares of Q GmbH for DM 50.000 and contributed DM 200 million to it. Q GmbH then got contributed down the chain to C BV on 21 November 2000. Q GmbH subsequently became a subsidiary of Y GmbH through a series of transactions after which Q GmbH paid out its share premium of DM 200 million to Y GmbH and Y GmbH paid it to X GmbH & CoKG. The reason for the transaction was the need for fresh equity in the German structure, without the loss of existing loss carry forwards.

The tax inspector wanted to subject the contribution of the Q GmbH shares to C BV to a capital duty charge of Euro 900.000, whilst the taxpayer argued that this contribution should be exempt from capital duty, first as the contribution of an independent enterprise under the asset merger exemption.

The High Court determined that the Supreme Court has indeed confirmed in previous decisions that the contribution of 100% of the shares of a company can qualify as the contribution of an independent enterprise, even if the assets of the contributed company consists of cash only. However, this exemption may be denied if it constitutes an abuse of law. However, the tax inspector only claimed abuse of law under the share merger exemption and not the asset merger exemption and it was not the role of the Court to apply the abuse of law doctrine spontaneously. The court therefore honoured C BV's claim to the asset merger exemption.

Hot links

- ❖ On 29 September 2005 Advocate General Léger published an opinion in Case C-210/04 on the VAT treatment of services provided between head offices and permanent establishments. According to the opinion the head office services provided by an English bank to its Italian branch does not lead to VAT on the management services charged. The branch was not an independent taxpayer in Italy.
- ❖ On 8 September 2005 the EU Court of Justice determined in case ([C-512/03](#)) that the free movement of capital does not preclude a law under which a non-resident taxpayer who receives income in a State from savings and investments and who is not insured under the social security system of that State cannot claim entitlement to tax credits in respect of national insurance, whereas a resident taxpayer who is insured under that social security system is entitled to those credits, even if he receives only income of that same kind and does not pay social security contributions.
- ❖ On 8 September 2005 the EU Court of Justice also decided in the Mobistar cases (C-544 and [545/03](#)). It determined that Article 49 of the EC Treaty does not preclude the introduction of a tax on mobile and personal communications infrastructures, which applies without distinction to national providers of services and to those of other Member States and affects in the same way the provision of services within one Member State and the provision of services between Member States. It further determined that tax measures applying to mobile communications infrastructures are not covered by Article 3c of Commission Directive 90/388/EEC of 28 June 1990 on competition in the markets for telecommunications services, except where those measures favour operators which have special rights to the detriment of new operators.
- ❖ On 7 September 2005 the Commission announced ([IP/05/1103](#)) that an Italian tax scheme for certain investment vehicles which reduces the nominal tax rate on the earnings accruing to these vehicles violates EU Treaty State aid rules and must be recovered.

The taxpayer had better results in the court case because that court refused to apply the abuse of law doctrine if the tax inspector does not specifically require its application.

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