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Dutch Supreme Court: Currency exchange gains on loans to which the anti-base erosion rules apply are tax exempt

On February 24, 2012, the Dutch Supreme Court issued an important decision about the tax treatment of currency exchange gains on loans to which the anti-base erosion rules of article 10a Dutch Corporate Income Tax Act ("CITA") 1969 apply ("tainted loans"). The case concerned a Dutch company which realized a currency exchange gain on a tainted loan. The Supreme Court ruled that such currency exchange gains are not taxable.

The Dutch anti-base erosion rules disallow the *deduction* of interest expenses on a related party loan if this loan is used to finance a tainted transaction and the taxpayer cannot demonstrate business motives for the transaction and the related party debt. Tainted transactions include dividend distributions, returns of capital, acquisitions of, or capital investments in, subsidiaries, etc. The anti-base erosion rules disallow not only interest expense deduction but also costs related to, and currency exchange *results* on, the tainted loan.

Since the term "*results*" includes currency exchange losses and gains, the taxpayer in this court case took the position that, despite the anti-base erosion nature of article 10a CITA 1969, the currency exchange gain realized was not taxable. The Dutch tax authorities took the position that while currency exchange losses are not deductible under article 10a CITA 1969, currency exchange gains are taxable.



In its decision the Supreme Court ruled that the term currency exchange *results* in article 10a CITA 1969 includes both currency exchange gains and losses. According to the Supreme Court, currency exchange gains realized on a tainted loan are not taxable under article 10a CITA 1969.

Impact on US multinationals and observations

Many US multinationals have Dutch entities in their integrated global structures. These Dutch entities may have financed tainted transactions with loans denominated in a currency different than the entity's functional currency for Dutch tax purposes. With the market's currency fluctuations, many of these Dutch entities may have incurred currency exchange gains on such tainted loans.

The Supreme Court's decision is favorable for all taxpayers that have taken a tax return position that a currency exchange gain incurred on a tainted loan is not taxable. Taxpayers who have not taken this filing position should consider making such a claim. If no final corporate income tax assessment has been imposed for the respective year, the taxpayer can still claim that currency exchange gains are not taxable by filing an amended tax return. If a final tax assessment was imposed taxpayers should review whether the period for appeal (generally six weeks from the assessment date) has lapsed.

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