

European Tax Newsalert

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The Netherlands publishes the Dutch Tax Package 2012

On September 15, 2011, a few days before Budget Day, the Dutch Government published the 2012 Tax Package. The plans presented reflect the Dutch government's policy for providing a solid and simple tax environment. This is illustrated, for instance, by the abolition of 7 out of 22 federal taxes.

This Newsalert summarizes the most important proposals in the Tax Package for US multinationals and funds. Since both the House of Representatives and the Senate have to approve these plans, significant changes could still occur. Most proposals included in the 2012 Tax Package are set to take effect on January 1, 2012.

Deduction for Research & Development costs

The Tax Package includes a proposal for a special research and development (R&D) deduction in order to encourage innovation in the Netherlands. Measures to stimulate innovation currently exist via the Innovation Box (corporate income tax incentive) and contribution reduction for wage costs related to R&D (wage tax incentive). The new deduction for R&D is aimed specifically at costs other than wage costs. The government is still finalizing the details of this measure. Therefore this measure will be included in the legislative proposal later by way of a memorandum of amendment.



Restrictions on interest deductions for acquisition debt in a fiscal unity

The Dutch government proposes to restrict interest deductions on acquisition debt when a company is acquired by a Dutch holding company with which it subsequently joins in a *Dutch fiscal unity*. The restriction applies to interest (including costs and currency exchange results) related to the debt with which the acquisition is financed. The proposed measure will apply to related party debt as well as third party debt, such as bank debt.

In principle, income and costs from different companies included in the fiscal unity may offset each other. However, based on the proposal interest costs incurred by the parent company on acquisition debt would no longer offset profits generated by the acquired company. Such costs can only offset profits generated by the parent company itself, which it often does not have if the parent company is a special purpose company set up to acquire the target company. The restriction will not apply to the extent that the interest expense on the acquisition debt does not exceed EUR 1,000,000. Furthermore, the restriction described above will only apply to the extent that the company is thinly capitalized.

A company is considered thinly capitalized if its debt-to-equity ratio (based on its tax balance sheet) exceeds 2:1. For purposes of this ratio test, the total book value of the company's subsidiaries that qualify for the participation exemption, and the amount of fiscal reserves, should be deducted from the equity. For purposes of the ratio test, the company's equity will be increased (subject to specific mechanical rules), to the extent that the company's equity has been reduced after forming a fiscal unity (the 'goodwill gap'). Denied interest deductions based on this measure can be carried forward to subsequent years. The Dutch government has similar proposals with respect to legal mergers and demergers. Note that the proposed measure will not apply to subsidiaries that have been acquired and included in the fiscal unity before January 1, 2012.

Dividend withholding tax for some Cooperatives

The Tax Package proposes to make, under certain circumstances, Cooperatives ("Coops") withholding agents for dividend withholding tax purposes. The measure will apply only to Coops holding shares where the main purpose, or one of the main purposes, is to avoid Dutch dividend withholding tax or foreign tax *and* where the membership rights of the Coop are not part of the Coop member's business. If the membership rights are part of the member's business, the measure can also under conditions apply if the Coop holds an interest in a Dutch company where an *existing* Dutch dividend withholding tax claim is at stake. For instance, in the situation where a foreign entity transfers shares in an existing Dutch BV to a Coop, the Coop member will be liable for tax on the BV's reserves (retained earnings/hidden reserves/fiscal reserves) available at the time of the transfer.

For legal structures that include Coops, where the Coop's membership rights are attributable to a foreign entity's business (e.g., corporate structures or private equity structures with active management involvement), no adverse consequences are anticipated provided the Coop has not been interposed to avoid existing Dutch dividend withholding tax claims. Companies may wish to review the proposal's impact on existing Coop structures implemented with or without Advance Tax Rulings.

Amendment of the rules regarding foreign entities with a substantial interest in a Dutch entity

Under certain conditions foreign entities that hold an interest of at least 5% in a Dutch company (a “substantial interest”) may be subject to Dutch corporate income tax (“CIT”) with respect to income derived from the substantial interest. This occurs if the interest in the Dutch company cannot be allocated to the business of the foreign shareholder. The Tax Package proposes to make the levy of this tax also subject to the condition that the shares in the Dutch company are not held by the foreign shareholder with the main intention (or one of the main intentions) of avoiding Dutch personal income tax or dividend withholding tax. If only Dutch dividend withholding tax is being avoided, then the rate at which CIT is levied is reduced to 15%. This additional condition highlights the anti-abuse nature of this legislation. Note that, as is currently the case, there will be no tax levy if the interest in the Dutch company can be allocated to the foreign shareholder's business. Therefore, this amendment should not affect existing structures that meet this condition and may in effect be a relaxation for certain other situations.

More territorial approach for foreign permanent establishments

Under the current regime losses incurred through a foreign permanent establishment (“PE”) can offset Dutch profits. If a foreign PE generates profits, they are, in principle, exempt from Dutch tax, unless in previous years losses incurred through the PE have offset Dutch profits. The Tax Package proposes to implement an object exemption for results generated through a PE. As a result, foreign PE losses can no longer offset Dutch profits. Profits generated through a foreign PE will be exempt. Under the proposed rules foreign PE results should, as is currently the case, initially be included in the taxpayer's worldwide profits. Subsequently, the PE's results will be eliminated from worldwide profits. Taxable or deductible foreign PE currency exchange results can still arise in the Netherlands under the proposed regime. The proposed legislation will also apply to income derived from foreign real estate.

As a general rule the object exemption will not apply to income derived from a ‘passive foreign portfolio investment enterprise’. This is a foreign PE whose activities directly or indirectly consist of more than 50% of portfolio investment or passive group financing/licensing/leasing activities and that is not subject to an effective tax rate considered genuine under Dutch tax principles. In that case the foreign PE's profits will be included in the Dutch tax base, while, under certain conditions, a (deemed) credit will be given for the underlying tax. However, the extent to which a PE's losses can offset Dutch profits will be restricted.

The application of the proposed domestic rules can differ depending on whether the foreign PE is based in a tax treaty or a non-tax treaty jurisdiction. In non-tax treaty situations an important proposal would abolish the “subject-to-tax test”. Thus, should a Dutch taxpayer hold a foreign PE with business activities in a non-tax treaty jurisdiction that does not tax the foreign PE's profits, the Dutch taxpayer is still entitled to an exemption for the profits attributable to the foreign PE. In tax treaty situations the application of the proposed rules can be affected by the specific wording of the applicable tax treaty with regard to allocation of taxing rights and relief for double taxation.

An exception to the rules described above applies to a PE's final losses. This occurs when the foreign activities have indefinitely ceased, or the foreign activities have

been sold to an unrelated party. In the latter case an additional condition applies: the incurred losses may not be transferred to the acquiring third party, which would then be able to offset these losses against future profits. Furthermore, the Tax Package includes a proposal to amend/abolish certain other measures upon implementing the object exemption for foreign PEs. For example, a proposal would abolish the specific anti-abuse measure based on which application of the participation exemption is denied if previous foreign PE losses have offset Dutch profits (the current article 13c of the Dutch CIT Act).

Extension of dividend withholding tax refund scheme

The scope of the refund scheme in the dividend tax will be extended to third countries with whom a sufficient (bilateral or multilateral) agreement on exchange of information exists. This extension applies only for investments where there is no (potential) control over the withholding company ("portfolio investments"). Notably, the proposed extension of the refund scheme will apply to exempt pension schemes that are established in qualifying third countries.

Amendment of the expat arrangement ("30% facility")

Employees who are seconded to another country or come to work in the Netherlands from another country are known as expatriates, or expats. If these employees meet certain conditions, they are eligible for a special expense allowance scheme: the 30% facility or ruling. The following amendments are proposed for the expat arrangement. The criterion of 'specific expertise' will be linked to a salary standard (2011: € 50,619) and the reference period will be extended to 25 years. Moreover, the proposal would exclude employees from the border area (within a radius of 150 kilometers from the Dutch border) from this arrangement. Alternatively, foreigners under the age of 30 who have obtained a Dutch doctorate and are employed in the Netherlands will qualify for this arrangement. A lower salary standard (2011: € 26,605) applies to this category of employees.

Impact on US multinationals and US funds

The proposed introduction of a special deduction for R&D costs, in combination with the existing measures such as the Innovation Box, should make the Netherlands more attractive for innovative activities.

The proposed restriction of interest deduction for leveraged acquisitions can affect US multinationals and funds that acquire Dutch targets after January 1, 2012 through the typical leveraged acquisition structure using a Dutch acquisition vehicle followed by Dutch fiscal unity inclusion of the target (or similar (de)merger strategies). The proposal includes safe harbor rules. Companies should consider accelerating the closing of pending Dutch acquisitions to 2011.

The proposed changes to Dutch Coops may affect specific situations, requiring careful review. Corporate structures and most private equity fund structures with active management involvement will likely not be affected (exceptions may apply).

The proposed changes for a more territorial approach for foreign PEs target specific situations of import of foreign PE losses but will lead to a significant conceptual change in the way the Netherlands deals with foreign PEs. This may affect US multinationals (in particular oil and gas companies), which hold foreign PEs through a Dutch structure.

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