

US Tax Treaty Newsalert

**A Washington National Tax Services (WNTS)
Publication**

June 15, 2012

*US-Netherlands competent authority
agreement allows treaty benefits for Dutch
residents receiving US source dividends
and interest through an LFMA*

On June 8, 2012, the Internal Revenue Service (the "IRS") announced that the Competent Authorities of the United States and the Netherlands had reached an agreement to clarify the treatment of a 'besloten fonds voor gemene rekening' (limited fund for mutual account or "LFMA") for purposes of the 1992 United States-Netherlands Income Tax Treaty as amended by the 1993 and 2004 protocols (the "Treaty") with respect to US source dividends and interest paid to an LFMA. The Agreement provides that a Dutch resident who derives interest or dividends through an LFMA may be entitled to the benefits of the Treaty if all other requirements are satisfied.

Observation: The Competent Authority Agreement, which entered into force upon signature by the US and Dutch Competent Authorities, completed on May 21, 2012, applies to all open tax years to which the Treaty applies. Therefore, in cases where US federal income tax previously was withheld, it may be possible for a Dutch resident to file a claim for refund.

Characteristics of LFMA's

The Agreement explains that an LFMA is not a legal entity; it is an aggregate of assets and obligations. More specifically, it is an arrangement whereby the LFMA's participants agree to pool their capital to collectively invest in various assets and to share, on a pro rata basis, investment proceeds.

Under Dutch law, an LFMA is treated as a fiscally transparent entity. Its participants are required to separately take into account on a current basis their respective shares of an item of income paid to the LFMA, regardless of whether the income is actually distributed to them by the LFMA. Participants in an LFMA are subject to tax on their proportionate share of the LFMA's income in the same manner as if they had received the income or assets directly.

An LFMA is not entitled to claim the benefits of the Treaty because, under Dutch law, it is not a person that is liable to tax in the Netherlands, and therefore is not a "resident" for Treaty purposes.

Fiscal transparency under the Treaty

Paragraph 4 of Article 24 (Basis of Taxation) of the Treaty, which incorporates a fiscal transparency rule in the Treaty, generally provides that in cases where an item of income, profit or gain is derived through a person that is fiscally transparent under the laws of either the United States or the Netherlands, the item of income, profit or gain is treated as derived by a resident of one of the two States to the extent the item is treated for that State's tax laws as the income, profit or gain of a resident. As a result, the Competent Authorities have agreed that US source dividends and interest received by an LFMA will be treated as derived by a Dutch resident to the extent such income is subject to tax as the income of a Dutch resident, and accordingly, such a Dutch resident may be entitled to the benefits of the Treaty with respect to such dividends and interest.

Observations: The US Competent Authority should be applauded for entering into competent authority agreements such as this, which provide taxpayers clarity and certainty of result, particularly in cases involving various types of contractual investment vehicles. This is the second such agreement entered into in as many months. *See PwC's May 3, 2012 US Tax Treaty Newsalert, [US-German Competent Authority Agreement addresses characterization of foreign pension funds](#).*

It is not entirely clear, however, what issues existed with respect to LFMA that prompted the Competent Authorities to enter into this agreement. It is possible that the Competent Authorities thought it necessary to clarify that an LFMA is a "person", even though not a resident of the Netherlands, as the fiscal transparency article of the Treaty (Article 24(4)) would apply to treat income received by an LFMA as income derived by a resident of the Netherlands only if the income is derived through a *person* (the LFMA) that is fiscally transparent. Treatment of a contractual arrangement as a "person" also is addressed in the US domestic tax rules on fiscal transparency. These rules provide an example which suggests that a contractual arrangement operating as a collective investment vehicle -- an arrangement similar to an LFMA -- is neither a person nor a resident of its country of organization and, therefore, cannot claim treaty benefits. In contrast to the facts in the Competent Authority Agreement, the example provides that interest holders in the contractual arrangement do not include its income until the income is distributed, and, therefore, income derived through it by its interest holders cannot be eligible for the benefits of a US income tax treaty. *See Treasury Regulation section 1.894-1(d)(5), Example 7.*

Procedures for claiming Treaty benefits

The Agreement explains that an LFMA may claim treaty benefits on behalf of its participants by filing Form W-8IMY (Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain US Branches for United States Tax Withholding) as either a withholding foreign partnership or a nonwithholding foreign partnership.

However, in the case of an LFMA whose participants are exclusively Dutch resident tax-exempt companies that fall within points 1 or 2 of Chapter IV of the August 6, 2007 mutual agreement between the United States and the Netherlands (i.e., Dutch tax-exempt companies that are constituted and operated exclusively to provide benefits under a pension plan as determined under article 3.13, paragraph 1(b) of the Netherlands income tax act, or a Dutch tax-exempt fund constituted by a Dutch labor union in order to administer tax-exempt benefits to its members on strike), such tax-exempt members of an LFMA should continue to provide Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding) to the appropriate withholding agent in order to claim the benefits of the Treaty.

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Solicitation.

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