

# Proposed changes to Netherlands tax regime

An extract from Rain or Shine? January 2009

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On December 16, 2008 the Dutch Ministry of Finance announced a groundbreaking upcoming tax reform.

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In summary, the measures may include a significant reduction of the corporate tax rate, the de-fiscalisation of interest received or paid on related party debt and restricted deductibility of interest on debt taken out to finance participations. The aim is for the new rules to enter into effect as from January 1, 2010.

Globally governments are seeking to strike a balance between encouraging investment and maintaining tax base. In the Netherlands this trend has for instance led to an ever increasing jungle of regulations dealing with the tax treatment of interest expenses.

Going forward the proposed measures are expected to boost inbound investment due to the significant reduction in the corporate tax rate. Inbound investments may be further boosted if Dutch dividend withholding tax is abolished; in the announcement this remained unclear. The tax efficiency of Dutch holding and financing structures will also be positively affected as the reform will enhance the flexibility of the capital

and financing structure of a Netherlands based holding and financing company. The latter is mainly driven by the tax neutralization of shareholder debt (i.e. interest income and expenses on related party debt are not taxable). The effects on the existing Dutch leveraged structures will change the future of strategies which use related party and bank debt.

Furthermore, the impact of the Tax Reform, if enacted, is that interest expenses on related party debt may no longer be tax deductible in the Netherlands as from January 1, 2010. Also bank debt used to acquire shares in a company may be restricted. The aforementioned may have adverse consequences in particular in situations whereby the cash flow model and debt covenants (e.g. leverage ratio, interest cover ratio etc.) assumed (full) deductibility of interest expenses on shareholder and bank debt. A review of the impact of the proposed reform on the cash flow and tax model should thus be performed to determine the impact on the existing financing, including debt covenants, and capital structure and to identify alternative structures.

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