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Overview: Reshaping the Dutch Corporate Income Tax System

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Abstract

Globally, the Netherlands is known for its (attractive) corporate income tax system. Examples are, but not limited to, the fiscal unity regime with full tax consolidation for group companies and the full participation exemption for capital gains and dividends from qualifying domestic and foreign participations.

However, mainly due to the international BEPS project and measures of the European Commission, the Dutch corporate income tax system has been under pressure lately. There has been criticsm, both nationally and internationally, arguing that the Dutch tax system leads to aggressive tax planning and that it is a tax heaven. The Netherlands wants to get rid of this reputation without endangering the attractive Dutch competitive position for foreign investments. This article provides an overview of the measures taken by the Dutch government that influence the Dutch corporate income tax system.

Keywords: corporate income taxation; Dutch; tax heaven; BEPS.

1. Introduction

In general, the corporate income tax system of the Netherlands is well-known for certain features. Examples are the fiscal unity regime with full tax consolidation for group companies (with a participation of 95% or more) and a full participation exemption for capital gains and dividends from qualifying domestic and foreign participations (with a participation of 5% or more). For active (business and labor) income, the Netherlands applies the principle of capital import neutrality, leading to an exemption of foreign income. This system fits best in an open economy as the Netherlands. For passive income the principle of capital export neutrality applies, leading to the possibility of tax credits to avoid double taxation.

Very attractive in this respect is also the extensive number of tax treaties concluded by the Netherlands to avoid double taxation (and double non-taxation).

Besides, companies have the possibility to opt for regimes that treat e.g. patent income or investment vehicles favorably. Moreover, another important aspect of the Dutch corporate income tax system is that there is currently no withholding taxation on interest or royalty payments made by

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taxpayers. Also, the differences in the rules for determining taxable profit in the Netherlands and the rules in accounting standards (e.g., IAS/IFRS) are attractive for individual entrepreneurs and companies because of the flexibility these differences offer.

Another important advantage of the Dutch tax system has always been the possibility for taxpayers (especially foreign companies) to get rulings from the tax administration leading to certainty about the tax consequences of planned activities in the Netherlands and the possibility for companies to conclude enforcement covenants with the tax administration (cooperative compliance) which lead to less bureaucracy and time consuming audits and much more possibilities to discuss with the tax inspector possible tax issues.

All these aspects have been very favorable for foreign investments in the Netherlands. On the other hand, mainly because of the BEPS-project and measures from the European Commission, some aspects of the Dutch tax system have been criticized because they could lead to aggressive tax avoidance structures using inter alia letter box companies and tax rulings. The Dutch government tries to get rid of this bad reputation without endangering the attractive Dutch competitive position for foreign investments.

In the last quarter of 2018, important domestic and international developments have affected Dutch international tax rules. On a domestic level, the 2019 Dutch Tax Package was introduced. It contained a proposal to abolish the Dividend Withholding Tax Act and to replace it with a withholding tax on dividends, interest and royalties in cases of misuse. Shortly after publication however, the proposal to abolish the Dividend Withholding Tax Act was withdrawn and a new withholding tax on interest and royalties was announced. In addition, new policies and procedures on the Dutch tax ruling practice were introduced.

In order to obtain a ruling severe substance requirements have been introduced. Also, the risk of a procedure in which the ruling is considered as forbidden state aid by the European Commission (see e.g. the Starbucks and Apple cases) has reduced the attractiveness of rulings.

On an international level, it is generally known that (draft) legislation of the European Commission and proposals of the OECD, affect corporate income tax systems all over the world with a breakneck speed. The Dutch corporate income tax system is no exception in this regard and is therefore constantly subject to change. For example, where the European Commission was publishing draft legislation with respect to the second Anti-Tax Avoidance Directive (hereafter: ATAD II), the Netherlands was still coping with the implementation of ATAD I. As a consequence, an important part of the 2019 Dutch Tax Package dealt with the implementation of ATAD I into domestic law.

To illustrate the domestic and international developments that are influencing the Dutch corporate income tax system, the Dutch corporate income tax (hereafter: CIT) rules that will be affected are described in this article. In this light, the 2019 Dutch Tax Package will be used as a starting point.

1.1. The Reduction of CIT Rates

The standard CIT rate currently stands at 25%. There are two taxable income brackets. The first income bracket consists of taxable income up to € 200,000. Taxable income up to € 200,000 is taxed at a lower rate of 19%. The excess of taxable income (€ 200,000 and more) is taxed at the standard rate of 25%.

The CIT-rates will be gradually reduced as follows:[1]

Taxable income	2019	2020	2021
Up to € 200,000	19%	16,5%	15%

1. Parliamentary documents II 2018/2019, 35028, no. 3, p.18-19. Although these rates may change in the nearby future, these are the applicable rates as upon completion of this article (summer 2019).

Taxable income	2019	2020	2021
From € 200,000	25%	22,5%	20,5%

1.2. Counterbalance: broader tax base

In order to finance the revenue loss from the lowered CIT rate, several measures were introduced to counterbalance the loss by broadening the tax base.[2]

As a first measure, the rules on loss settlement were changed. Starting in 2019, losses may be carry backed to be set off against profits of the preceding year and carried forward for 6 years, down from 9 years (art. 20 (2) of the Corporate Income Tax Act, hereafter: CITA).

Additionally, the amortization of real estate was limited to 100% of the value according to the Dutch Real Estate Valuation Act. This value is set annually by the relevant municipality (for the purpose of a local real estate tax) and is an estimation based on recent sale prices of similar lots.

The government has argued that the measures to broaden the tax base are mainly aimed at multinational enterprises (MNEs) while both MNEs and small and medium enterprises (SMEs) benefit from the lower tax rate. This means that SMEs will see their tax liability decreasing. At the same time however, the personal income tax rate for income from major share ownership (at least 5%) will increase from 25% to almost 27%.[3]

1.3. Changes to Dividend Tax Rules and the Introduction of Withholding Tax on Interest and Royalties

As stated in the introduction, the initial 2019 Budget Plan included a proposal to entirely abolish the current Dutch Dividend Withholding Tax Act. This proposal was brought as a result of the government's ambition to improve the Dutch investment climate. It was specifically meant to attract headquarters of multinational enterprises, including Unilever. The expectation was that Unilever — if the proposal were adopted — would decide to relocate its headquarters from the United Kingdom to the Netherlands.[4]

The abolition was proposed in combination with the introduction of a new withholding tax on dividend, interest and royalty payments in cases of misuse. Cases of misuse would occur if dividend, interest and royalty payments are made to entities situated in low-tax jurisdictions (i.e. countries with a statutory CIT rate of less than 9%) and countries on the EU list of non-cooperative jurisdictions. The government would publish an exhaustive list of qualifying jurisdictions, whereby the list itself — as well as the statutory rate of the jurisdictions on it — would be reviewed annually.

This is in line with the intention of the Dutch government to improve the fiscal reputation of the Netherlands by taking a fierce stance against the use of letterbox companies and payments to offshore jurisdictions. By doing so, the government tries to improve the Dutch investment climate and to prevent the use of the Dutch tax system as a transit port to offshore jurisdictions.

2. Ibid. p.19-27. Next to the measures mentioned here, there are other measures concerning financial institutions.

3. Parliamentary documents II 2018/2019, 35026, no. 3, p.15-16.

4. The controversy surrounding this consideration was widely reported on in Dutch media, for example *Afschaffen dividendbelasting was harde eis van Unilever*, Financieele Dagblad 24 November 2018, https://fd.nl/economie-politiek/1279504/afschaffen-dividendbelasting-was-harde-eis-van-unilever. See also *A dubious tax cut for Dutch multinationals*, The Economist 29 September 2018, https://www.economist.com/europe/2018/09/29/a-dubious-tax-cut-for-dutch-multinationals.

However, Unilever's final decision to not relocate to the Netherlands led to heavy discussions in Parliament and dominated the public debate.[5] As a result, the proposal to abolish the Dividend Withholding Tax Act was withdrawn. This meant that the Dividend Withholding Tax Act would continue to exist in 2019 and that an additional withholding tax on certain interest and royalties payments (as explained above) will be introduced as from 2021.[6]

2. The Implementation of ATAD I into Domestic Law

With effect from 1 January 2019, the Netherlands has adopted and abolished several rules in order to implement the ATAD I Directive into domestic law. This includes an earnings stripping rule, a (minor) reform of exit taxation rules for CIT purposes, and a controlled foreign company (hereafter called: CFC) rule. These new rules will be explained below.

2.1. An Earnings Stripping Rule

With effect from 1 January 2019, an earnings stripping rule applies.[7] Under this rule, the net interest deduction is restricted to 30% of the earnings before interest, taxes, depreciation and amortization (hereafter called: EBITDA) as determined under the fiscal accounts and laid down in art. 15b CITA. The net-interest expenses are defined as the difference between the amount of interest paid and the amount of interest received. The earnings stripping-rule has a threshold of € 1 million. Furthermore, it includes an unlimited carry-forward rule that applies for non-deductible, excess interest expenses. With respect to the deduction, the FIFO ("first in, first out") method is applicable. Moreover, when there is a change of control in a company for 30% or more, any unused interest is lost.

With respect to the possibility provided by ATAD I to opt for a group ratio rule, as well as exceptions for separate entities and financial institutions and the grandfathering rule for existing loans, it should be mentioned that the Netherlands has decided not to implement them.

The Dutch incorporation of the earnings stripping rule goes further than ATAD requires. With the stricter rules, the Dutch government wants to prevent tax avoidance; also it wants less discrepancy in tax treatment of equity and debt.[8] As a result, art. 15b CITA does not have a group exemption (art. 4 (5) ATAD 1) nor an exemption for standalone entities (art. 4 (3) (b) ATAD 1). There is also no exemption for financial institutions (art. 4 (7) ATAD 1). In addition, this approach fits into the goal set by the Dutch government to get rid of the image that the Netherlands is a tax haven and that it facilitates tax avoidance.[9]

Stevens has argued that the political choices in the implementation may have adverse consequences.[10] Not only will this rule lead to economic double taxation, it may also disproportionately harm some taxpayers like startup companies that have little or no EBITDA. Additionally, the (side) goal of increasing the fiscal equality of debt and equity is not achieved convincingly, because received interest is not exempted. At the same time, the rule must be praised for its relative simplicity and the fact that non-deductible interest may be carried forward infinitely.

5. J. Akkermans & W. Vergauwen, *Dutch Drop Dividend Tax Plan After Unilever's U.K. Decision*, Bloomberg 15 October 2018, https://www.bloomberg.com/news/articles/2018-10-15/dutch-drop-plan-to-end-dividend-tax-after-unilever-u-k-decision.

6. M. Rasenberg & E. Spoelder, *Netherlands Budget Plan 2019: International Tax Update – December 2018,* Derivatives & Financial Instruments, 2019 (Volume 21), No. 1.

7. Parliamentary documents II 2018/19, 53030, 3, p.8-14.

8. Parliamentary documents II 2018/19, 35030, 3, p. 8 and Parliamentary documents I 35030, C, p. 9.

9. The current government has repeatedly expressed this goal, for example in the Fiscal Policy Memorandum published on 27 February 2018 and the State Secretary of Finance's letter to Parliament of 23 February 2018 (Parliamentary documents II 25087, no. 188).

10. S.A. Stevens, *Implementatie van de earningsstrippingmaatregel*, Tijdschrift Fiscaal Ondernemingsrecht 2019/161.2.

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The newly introduced earnings stripping rule replaces existing restrictions in Dutch tax law with respect to the deduction of "excessive interest." The rules that will be replaced as a consequence of the introduction of the earnings stripping rule will be explained below.

2.1.1. Restriction of the Deduction of Interest Related to Loans Used by Takeover Holdings to Acquire Dutch Subsidiaries (art. 15ad CITA)

Art. 15ad CITA restricted the deduction of interest (including costs and currency exchange results) on excess acquisition debt if the acquired company subsequently joined a Dutch fiscal unity with the taxpayer. This restriction applied if:

(i) the amount of interest on such loans exceeded € 1 million; and

(ii) the interest paid was higher than the profits of the acquired company.

However, the acquisition debt was only considered to be excessive if it exceeded 60% of the price of the acquired company. This meant that interest was still fully deductible as long as the loan did not exceed 60% and the loan was repaid over the 7-year period following the takeover. The article also contained several anti-abuse measures.

2.1.2. Restriction of the Deduction of Excess Interest Related to "Acquisition Loans" (art. 13l CITA)

Art. 13l CITA restricted the deduction of excess interest on debts that were deemed to be related to the financing of acquisitions (so called: "acquisition loans"). The amount of the "excess participation interest" was equal to the interest and costs incurred in relation to the acquisition, multiplied by a fraction made up of the average participation debts, divided by the average loans at the beginning and the end of the financial year. The so called "participation debt" was defined by the amount by which the purchase price of the participation exceeded the parent company's equity.

However, a few exceptions applied. For example, the cost prices of the participations that at the time of the initial acquisition led to an extension of the operational activities of the group were not taken into account by determining the "participation debt." Furthermore, the "participation debt" could consist of both loans from affiliated and third parties. Moreover, the first € 750,000 of interest was deductible. Like art. 15ad CITA, art. 13l CITA also contained some anti-abuse measures.

2.2. A (minor) reform with respect to the Dutch exit tax

If a corporate entity (or its Dutch branch) migrates from the Netherlands, any untaxed gains and goodwill will be subject to Dutch corporate income tax (a so-called "exit tax"). Currently, Dutch taxpayers that migrate to an EU/EEA Member State have the possibility to choose between one of the following alternatives:

(i) paying the exit tax in ten equal, annual terms, or;

(ii) paying when the tax would have been charged if the taxpayer had not migrated from the Netherlands.

ATAD I changes this, as from 1 January 2019, choosing (i) or (ii) is no longer possible. For Dutch corporate taxpayers that migrate to an EU/EEA Member State from 1 January 2019, the deferred payment of the exit tax is available upon request, but limited to payment of the exit tax in five equal terms instead of ten.[11] The deferral will expire if the tax were to be charged if the taxpayer had not migrated from the Netherlands. Deferral can be subject to interest and the obligation to provide security.[12]

11. Parliamentary documents II 2018/19, 53030, 3, p.16.

12. Idem.

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2.3. Controlled Foreign Company ('CFC') Rules

From 1 January 2019, a CFC regime applies in the Netherlands. This regime has been laid down in art. 13ab (3) CITA and applies to income generated by controlled companies established in jurisdictions that:

(i) have a statutory corporate income tax rate of less than 9%; or

(ii) are on the EU-list of non-cooperative jurisdictions.

For the application of these CFC rules, a controlled company is defined as a company in which another company (alone, or together with related persons) directly or indirectly holds an interest of more than 50% in the capital, voting rights or an entitlement to the profits.

According to art. 13ab (1) CITA. the CFC rules apply to the following types of income:

- interests or other benefits from financial assets;
- royalties or other benefits from intangible assets;
- dividends and capital gains derived from the sale of shares;
- benefits from finance lease activities;
- benefits from insurance, bank or other financial activities; and
- invoicing activities which add little or no economic value.

The total amount of income from the categories listed above is reduced by any related costs. According to art. 13ab (2) CITA, any remaining income is only allocated to the controlling company to the extent that it is not distributed before year-end.

The CFC rules do not apply if:

- in general, less than 70% of the controlled company's revenues fall in the aforementioned categories (art. 13ab (4) (a) CITA); or
- the subsidiary carries on legitimate business activity (art. 13ab (5) CITA).

Art. 7 ATAD leaves members states free to choose either model A or B for the implementation of the CFC rules. However, model B was practically already in place in the Netherlands in the form of art. 8b CITA which is a codification of the arm's length principle. That meant that the Dutch government could have chosen not to implement model A or to implement it loosely. In the same spirit as the implementation of the earning stripping rule, the Dutch government chose to take a harsh approach by implementing model A fully. It did, however, implement the possible exemption for financial activities and companies whose passive income is less than 30% of its total revenues, according to art. 13ab (4) CITA.

The main point of criticism in literature is the required control over the subsidiary. This is because the ownership of shares is not calculated proportionately with respect to indirect holdings. For example, according to art. 13ab sections 3, 8 and 10 CITA, if Dutch company A BV holds 30% of the shares in an American company B Ltd that owns 60% of the shares in a Bermudan C Ltd which receives royalties (Bermuda being a designated country), the CFC rules apply even though A BV only really owns 18% of the shares in the CFC and is not even in control of the intermediary, let alone the CFC.

3. ECJ-cases – 'per element approach' (fiscal unity regime)

In the *Groupe Steria* case of 2015 (C 2015/524) , the European Court of Justice ruled that a French deduction granted to parent companies of subsidiaries that were included in a fiscal unity was a violation of the freedom of establishment. The rationale was that foreign subsidiaries could never

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be included in a fiscal unity and could therefore never receive this benefit. The French government argued, unsuccessfully, that this deduction was an inherent part of the fiscal unity regime and therefore could not be judged on its own. The ECJ disagreed, asserting that every element of the fiscal unity regime may be individually judged to be in violation of the fundamental freedoms.

Following this case, the Netherlands Supreme Court (in case 15/00194) asked preliminary questions to the ECJ regarding a Dutch interest deduction limitation (art. 10a CITA) that targets base erosion. This rule restricts the deductibility of interest paid on a loan from a connected entity, if that loan was used to finance, inter alia, a capital contribution to a subsidiary. Because of the purpose of the article, the limitation does not apply if, simply put, (1) the debt and transaction reflect the economic reality, or (2) the interest benefit is taxed at a reasonable level. However, if the debtor and recipient of the capital contribution are in a fiscal unity, that transaction is disregarded and the interest deduction is not limited.

In this case, there was a capital contribution to a subsidiary based in Italy, funded by a loan from a connected enterprise. The deduction limitation therefore applied and could not be avoided through the fiscal unity regime because the Italian subsidiary could not join the fiscal unity. Invoking its ruling in the Groupe Steria case, the ECJ decided that the deduction limitation was a violation of the freedom of establishment because the foreign subsidiary could not be included in the fiscal unity (C-398/16 and C-399/16).

Subsequently, many authors rejected the ECJ's ruling. Advocate-General Wattel said in his advice to the Supreme Court that the ECJ had given "an incorrect response, based on incorrect assumptions, to an incorrect question."[13] In his view, the Supreme Court and the Court of Justice had disregarded the purpose of art. 10a CITA, which is to prevent base erosion and safeguard the proper tax collection on the Dutch profits. In light of this and the escapes that were mentioned earlier, it is to be expected that this provision applies most often to international transactions, because the benefits of purely domestic transactions will usually be taxed at a normal rate. While this may be an infringement of the fundamental freedoms, it is justified by the fair distribution of taxing rights and territoriality principle. Additionally, the A-G pointed out that even if the anti-abuse motive was not accepted, there still would not be any discrimination. If the Netherlands had allowed foreign parent and subsidiary companies to join the fiscal unity, the loan that was used to fund the capital contribution would have had to be attributed to the Italian branch of the fiscal unity, meaning that the interest would be exempted in the Netherlands and would therefore be non-deductible.

The Supreme Court, however, did not contradict the ECJ and ruled that the deduction limitation could not apply because that would be a violation of the freedom of establishment.

In response, the Dutch government announced a bill to retroactively close the newly created loophole by disregarding the fiscal unity for the application of certain provisions of the CITA, including the interest deduction limitation. As a result, the limitation now applies even in situations for which it was not designed, such as a wholly domestic set of transactions, in which case there is no risk of base erosion. This reparation is meant to be replaced in future as part of a larger revision of the Dutch fiscal unity regime that will likely take place in the near future.[14] Possibilities for the new regime include limiting the benefits of the fiscal unity to loss settlement like the British group relief regime, or allowing non-domestic group entities to join the Dutch fiscal unity, effectively treating the foreign companies as branches of the fiscal unity.

It remains unclear if the earningsstripping rule (art. 15b CITA) that was introduced as a result of ATAD 1 will share the fate of art. 10a, because that limitation is also calculated at the level of the fiscal unity and as a consequence any internal loans are disregarded, while a Dutch subsidiary borrowing money from a foreign parent may not be able to deduct that interest.

13. Conclusion A-G Wattel, ECLI:NL:PHR:2018:624, for Netherlands Supreme Court ruling 19 October 2018, ECLI:NL:HR:2018:1968.

14. Parliamentary documents II 2018/19, 34959, 3, p. 4-5.

4. Concluding Remarks

The Netherlands government struggles with its policy to get rid of the reputation of the Netherlands as a tax haven on the one side and to keep the Netherlands attractive as a place for investments on the other side. More and more EU and international developments force the Netherlands to adapt its rather unique tax system. Unfortunately, these adaptations are often only aimed at tackling abuse and double non-taxation situations. This can lead to situations of international double taxation and to obstacles for e.g. business reorganizations (like the adaptation of the new fiscal unity regime due to case law of the ECJ). Also, the earningsstripping rules are no real solution for the problems related to the fundamental different tax treatment of debt and equity. The severe substance requirements in order to obtain a ruling and the risk of a procedure in which the ruling is considered as forbidden state aid by the European Commission have reduced significantly the attractiveness of rulings also in cases where a ruling is not meant to promote aggressive tax planning but only to give legal certainty in real cases.

What we need for the future are rules that are truly sustainable in such a way that they lead to a balanced tax system keeping the interests of both tax administrations and taxpayers into account.

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