EU Direct Tax Newsalert

Dutch government proposes amendments to substance rules following the Danish BO cases

On Budget Day (17 September 2019), the Dutch Government published legislative proposals for a new conditional withholding tax on interest and royalty payments paid to affiliated parties. It also proposed several amendments to the Dutch Corporate Income Tax Act (CITA) and the Dividend Withholding Tax Act (DWTA) per 2020. These amendments are a response to the so-called "Danish beneficial ownership cases" decided by the Court of Justice of the EU (CJEU) on 26 February 2019 (click here for our EUDTG newsalert).

Background

The Dutch Government considers that the current Dutch anti-abuse provisions, that refer to the Dutch substance requirements indicating when there is no abuse and that function as a safe harbor, are broadly in line with the abovementioned CJEU judgments. Nevertheless and to exclude any possible incompatibility with EU law, it wishes to amend the following provisions:

- the anti-abuse provision in the DWTA,
- the substance clause of the Controlled Foreign Company (CFC) measure in the CITA, and
- the substantial interest rule in the CITA.

The proposal for new withholding tax on interest and royalty payments also contains an anti-abuse provision that is in line with these amendments.

Anti-abuse provisions of the DWTA

Under the proposed provision, even if the recipient of the dividend fulfils the Dutch substance requirements, the tax inspector can still demonstrate that there is tax abuse. The tax inspector will have to demonstrate that a) the interest in the Dutch company paying the dividends is held with the main purpose or one of the main purposes to avoid the payment of dividend withholding tax and b) there are no sound business reasons that reflect economic reality. If the tax inspector can demonstrate that these two tests are met, the withholding tax exemption is not applicable. Vice versa, if the recipient of the dividend does not fulfil the substance requirements, both the payor and the recipient of the dividends have an opportunity to demonstrate that there is nevertheless no tax abuse and the withholding tax exemption is applicable.

In both cases, the Dutch tax authorities and the recipient/payor of the dividend can take guidance from the indicators of abuse included in the Danish beneficial ownership cases. Under the explanatory memorandum of the Dutch proposals, the presence or absence of economic activities may be based on all facts and circumstances. The following indicators are especially relevant: the management of the company, its balance sheet, the structure of the costs and expenditure actually incurred, the staff that it employs and the premises and equipment that it has. Furthermore, the economic activities must be relevant in the light of the holding of shares. The mere holding of shares does not classify as economic activity, according to the explanatory memorandum. In short, the same principles will apply to the substantial interest rule in the CITA.

Substance clause of the CFC measure

As from 2019, so-called CFC rules have been included in the CITA in order to implement the ATAD. In the event of genuine economic activities CFC rules will, as an exception, not be applicable (the so-called "substance clause"). The Dutch Government proposes that the CFC rules would still apply if the CFC does fulfil the Dutch substance requirements, but the inspector can still demonstrate that the main purpose, or one of the main purposes, is to be eligible for the exception. If CFCs do not fulfil the Dutch substance requirements, taxpayers will have an opportunity to demonstrate that the CFC carries out genuine economic activities. If they succeed in doing so, the CFC rules will not be applicable after all. In both cases, the Dutch tax authorities and the taxpayer can rely on the indicators of abuse included in the Danish beneficial ownership cases.

Takeaway

The amendments seek to soften the safe harbor character of the Dutch substance requirements per 1 January 2020. The new anti-abuse provision of the CFC measure will apply to fiscal years that start on or after 1 January 2020. The new conditional withholding tax on interest and royalty payments paid to affiliated parties should take effect per 1 January 2021.The proposals need to be adopted by both chambers of parliament.

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