Tax Alert
Dutch Government presents the 2017 Budget

September 2016

On 20 September 2016, the Dutch government presented the 2017 Budget. As part thereof legislative proposals were submitted to Dutch Parliament on the amendment of certain tax laws in the Netherlands. Below, we will summarize some of the rules which are relevant for internationally oriented corporate taxpayers, that will apply as from 1 January 2017. Please note that the summary is based on the current version of the legislative proposal which is still subject to parliamentary approval.

In addition to the 2017 Budget proposals, the Dutch Secretary of Finance sent a letter to Dutch Parliament regarding the proposed changes to the Dutch dividend withholding tax ("**DWT**") treatment of cooperatives as from 1 January 2018.

Corporate income tax:

(i) Extension of first corporate income tax bracket

At present the corporate income tax rate is 20% on the taxable amount up to EUR 200,000 and 25% on the excess. The legislative proposals extend the 20% bracket to EUR 250,000 in 2018, to EUR 300,000 in 2020 and to EUR 350,000 as from 2021.

(ii) Broadening the scope of certain interest deduction rules by expanding related entity concept

The Corporate Income Tax Act ("**CITA**") contains a "related entity" concept. This concept is amongst others relevant for the application of the interest deduction limitation rules included in the CITA. Such rules in principle disallow the deduction of interest paid on a loan by a Dutch company to a related entity to the extent that the loan is related to certain transactions such as acquisitions of shares in related entities, and dividend distributions and capital contributions to related entities (tainted transactions).

According to the current rules, an entity is considered a "related entity" vis-a-vis a Dutch taxpayer if, amongst others: (i) the Dutch taxpayer has at least a one third interest in such entity, (ii) such entity has at least one third interest in the Dutch taxpayer, or (iii) a third party has at least one third interest in both the Dutch taxpayer and such entity.

Under the proposed rules the definition of a "related entity" is expanded to also include, amongst others, a company that is part of a cooperating group of companies holding a total combined interest of at least one third in a Dutch company. Whether such cooperating group exists will have to be determined on a case-by-case basis. An example of a cooperating group included in the explanatory memorandum is where multiple private equity funds are managed by the same general partner. Each such fund may be a related entity of the Dutch company on the basis of the proposed rules if the general partner has, amongst others, certain control over (the investment in) the Dutch company. The expansion of the related entity concept relates to the anti-base erosion rules (mentioned above) and the acquisition debt rules (mentioned in part (iii) below). This change to the "related entity" concept may, therefore, result in the disallowance of the deduction of interest paid by a Dutch company to a related company that is a member of a cooperating group were such interest deduction may not be restricted under the current rules.

(iii) Interest deduction limitations regarding acquisition debt

The CITA disallows the deduction of interest expenses relating to (deemed) excessively leveraged acquisitions if the target is subsequently included in a fiscal unity for corporate income tax ("CIT") purposes. If the acquiring company has no profits on a stand-alone basis, the deductibility of interest expenses on debts is limited to 60% of the purchase price of the target in the first tax year the target company is included in the fiscal unity and this limitation is reduced by 5 percentage points annually to – ultimately and after seven years – 25%.

The proposed amendments address certain perceived loopholes in the current legislation. The amendments include (i) stricter rules regarding the calculation of the stand-alone profit of the acquiring company aimed at avoiding optimization of interest deduction by way of certain debt push down structures, (ii) stricter rules that should result in an effective application of the seven years period and (iii) a stricter application of grandfathering rules enacted in 2012 (year of introduction of acquisition debt rules).

Similar amendments are proposed in order to avoid that the acquisition debt rules can be circumvented by way of a legal merger or demerger.

The proposed rules may lead to the disallowance of the deduction of interest paid by a Dutch company whereas under the current rules, such interest would be deductible. This may have an impact on existing structures. In this regard the Dutch government announced that the acquisition debt rules may be abolished once earnings stripping rules based on the EU Anti-Tax Avoidance Directive are implemented in the Dutch CITA (likely in 2019, but no later than in 2023).

(iv) Innovation box

The 2017 Budget also introduces changes to the Dutch innovation box. The Dutch innovation box regime creates an attractive research and development environment in the Netherlands by allowing certain profits derived from qualifying intangibles to be taxed at an effective 5% rate insofar as those benefits exceed the production costs of the intangibles. The innovation box regime, therefore, leads to a significant reduction of the general CIT rate of 25%. Following the OECD's BEPS Action 5 (Countering Harmful Tax Practices More Efficiently), states are required to implement changes to their intellectual property ("**IP**")-tax regimes concerning the access to such regimes and economic substance.

The proposed changes include the so-called 'modified nexus' approach. The essence of such approach is that solely intangible assets developed by the taxpayer itself (i.e. excluding intangible assets for which the taxpayer outsourced the development) will qualify for application of the innovation box. To this end, a new formula will be introduced to determine which part of the income will qualify for application of the innovation box. In addition, a new distinction is made between small taxpayers and large taxpayers. For large taxpayers additional entry requirements for the innovation box are proposed. A large taxpayer is a taxpayer who, over a five year period, has a profit from qualifying IP of more than EUR 37.5 million and total (group) sales of more than EUR 250 million.

The proposed rules contain detailed grandfathering rules for entities currently applying the innovation box rules.

(v) Dividend withholding tax

Under the proposed changes to the DWT treatment of cooperatives, distributions by international holding cooperatives to members that have an interest of 5% or more in the cooperative will in principle become subject to DWT at the standard 15% rate. However, a Dutch domestic exemption will apply in active business structures that are not abusive. The letter also proposes to effectively extend this exemption to shareholders that have a shareholding of 5% or more in the nominal paid-up capital of NVs and BVs.

The equation of holding cooperatives with NVs and BVs in combination with the proposed amendment of the Dutch domestic exemption means that NVs and BVs on the one hand and international holding cooperatives on the other hand will be treated the same for DWT purposes; in principle there is an obligation to withhold DWT, but with respect to qualifying participations an exemption applies if the shareholder/member is located in an EU/EEA or treaty jurisdiction, and provided there is no abusive situation.

This suggests that the exemption for cooperatives will not apply if members are located in non-tax treaty jurisdictions (e.g. the Cayman Islands, Bermuda, etc.). If so, distributions by international holding cooperatives to such members would become subject to 15% DWT without any exemptions therefrom being available, irrespective of whether or not it concerns an active business structure that is (currently) not abusive. This would be a departure from the current situation where in these type of active business structures that are not abusive, distributions by international holding cooperatives are not subject to DWT at all.

Contact

Michael Molenaars
Partner Amsterdam

Jeroen Smits
Partner Amsterdam

Maarten de Bruin
Partner Amsterdam

Emile Bongers
Counsel Dubai

Reinout de Boer
Counsel Amsterdam

Robert Jean Kloprogge
Senior Associate New York