IFA/ 2012 GERMANY-NETHERLANDS TAX TREATY

EXIT TAXES/EMPLOYMENT INCOME

PROF. DR. FRANK PÖTGENS (VU University Amsterdam/De Brauw Blackstone Westbroek)

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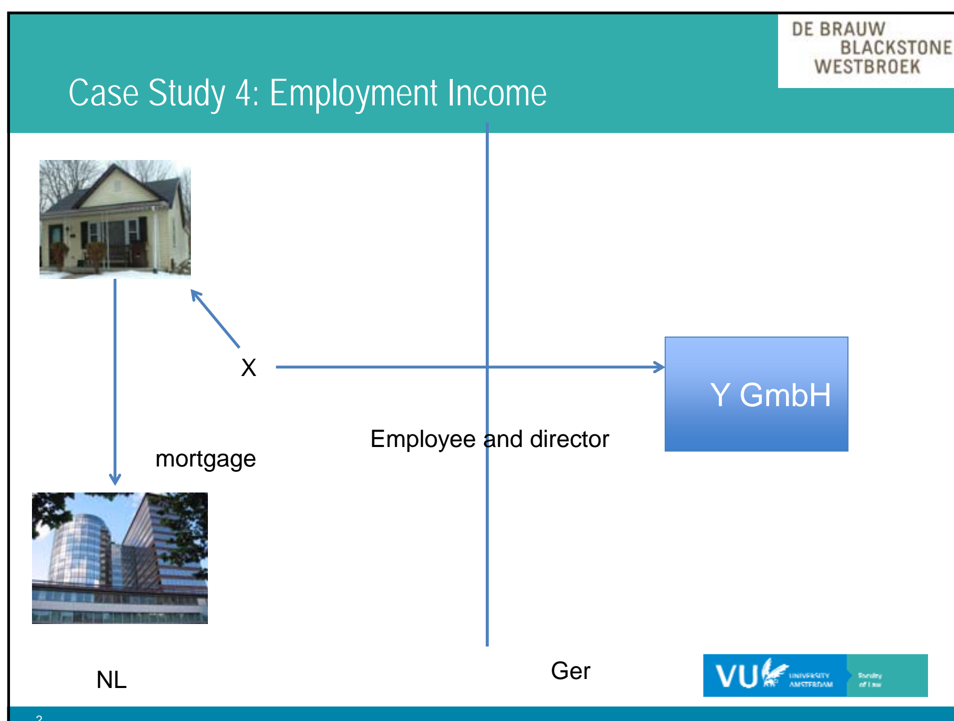
LOOKING FURTHER



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Case Study 2: Employment Income

- X is a resident taxpayer of the Netherlands
- X is employed by Y GmbH and he is also member of the board of directors of Y GmbH
- He receives a salary covering both his activities as employee and as director
- X performs his activities entirely in Germany
- X owns a dwelling in the Netherlands on which a mortgage is concluded with a Dutch resident Bank; X pays interest on this mortgage

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Case Study 2: Employment Income

- Current treaty:
- No distinction between employment income and directors' fees
- The taxation right on the salary is assigned to Germany (pursuant to Art. 10(1) of the 1959 Treaty)
- The Netherlands has the authority to tax X's dwelling based upon the other income provision (Art. 16 of the 1959 Treaty)
- Result; there is no Dutch income effectively taxed in the Netherlands against which the mortgage interest can be set off

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Case Study 2: Employment Income

- New treaty:
- Distinction between employment income (Art. 14) and directors' fees (Art. 15); dual role -> in the capacity of member of the board of directors(Dutch Supreme Court; formal approach) -> distinction is confirmed by the Dutch Supreme Court -> relevance: Art. 22(2)(c) provides credit for directors' fees (Decree of 18 July 2008; irrespective of the wording of a treaty one can claim an exemption if its is demonstrated that a non-resident director is not taxed more favorably in Germany than a non-resident employee and there is no evasion of taxes) and for German resident directors of Dutch resident companies

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Case Study 2: Employment Income

- New treaty:
- Dutch Supreme Court: for a directors' fee it is required that company where the director's duties are fulfilled bears the equivalent fee in an individually identifiable manner (director group company A and employee group company B)
- The effects of the mortgage interest deduction may be taken into account based upon the compensation arrangement included in Protocol XII(1) –> comparable to Art. 27(1) of the 2001 Netherlands-Belgium tax treaty and announced in the 2011 Memorandum on the Dutch tax treaty policy -> attempting to achieve equality with X's neighbor (working and residing in NL)

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Case Study 2: Employment Income

- Resident of NL receiving income falling under, inter alia, Art. 14 and 15 -> taxation right assigned to Germany -> opt for a relief of Dutch taxes and state social security premiums -> drafting an alternative calculation; determining the tax and state social security premium consequences if the income falling under Art. 14 and 15 would have been taxable and subject to state social security premiums solely in the Netherlands -> if alternative calculation leads to conclusion that tax and state social security contributions are lower than was the case when paying taxes and social security premiums in Germany (account is taken of effect mortgage interest deduction), X receives a relief for the difference between the outcome of the alternative calculation and the tax and social security contributions paid in Germany ->

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Case Study 2: Employment Income

- Effect: X (working in Germany and residing in NL) is assessed for income tax and state social security premiums purposes in an identical manner as an employee/director living and working in NL
- Effectuated: regarding the German tax, contributions and premiums due by X as Dutch wage tax -> crediting with the income tax and state social security premiums due in the Netherlands

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Case Study 2: Employment Income

- X is married with Y
- Y lives with X in the joint dwelling
- Y is employed by a Dutch company and earns half of X's salary, but his/her entire salary is subject to Dutch income tax

- Under the current tax treaty, the German joint tax assessment (*Splittingverfahren*) was not applicable by which the applicable tax rate for X's earnings is reduced (due to the increasing tax rates in Germany); the German sourced earnings are less than 90% of the total earnings, namely 75% (on the 90% requirement see §§ 1 (3) sent. 2, 1a (1)(2) sent. 2 of the German Income Tax Act)
- X and Y can in future claim the joint tax assessment pursuant to Art. 24 of the new treaty (in connection with No. XVI of the Protocol): It is only required that the individual who receives German sourced income exceeds the 90% threshold with its own total income

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Case Study 3a: Dutch exit taxation

- Individual X owns 100% of the shares in a Dutch resident Y BV
- X has a debt claim on Y BV
- X emigrates to Germany in 2013
- In 2014 (after the new treaty expectedly will enter into force) a regular dividend is distributed by Y BV to X
- In 2015 X sells the debt claim to a German bank
- In 2016 X sells 100% of the shares in Y BV to Z GmbH

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Case Study 3a: Dutch exit taxation

X

Debt claim

100%

2013: X emigrates to Germany

Y BV

X

2014: Dividend distribution

2015: X sells debt claim to German Bank

Z GmbH

2016: X sells the shares to Z GmbH

NL

Ger

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Case Study 3a: Dutch exit taxation

•Legal analysis according to Dutch domestic law (source state):

1.**Emigration to Germany in 2013**:

Shares: fictitious alienation (Art. 4.16(1)(h) ITA 2001) -> occurs on date immediately preceding emigration (Art. 4.46(2) ITA 2001) -> preservative tax assessment is imposed with respect to fictitious alienation (Art. 2.8(2) ITA 2001) -> deferral of payment for a period of 10 years is granted (Art. 25(8) 1990 Tax Collection Act); deferral ends if (i) shares are disposed of within 10 years or (ii) company distributes its reserves in full or almost in full (Art. 25(8)(a and b) 1990 Tax Collection Act) -> if (i) and (ii) do not transpire within 10 year period then the preservative tax assessment is waived (Art. 26(2) 1990 Tax Collection Act).

Debt claim: income from other activities (Art. 3.92 ITA 2001)

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Case Study 3a: Dutch exit taxation

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-> taxed against progressive rates + quasi profit regime, i.e. certain provisions for business income regime are applicable -> Art. 3.95 ITA 2001 including exit tax of Art. 3.60/3.61 ITA 2001: relevant whether non-resident tax liability in NL and whether taxation right is assigned to the Netherlands pursuant to a tax treaty (see below)? -> in case of exit tax National Grid Decree (14 December 2011) applicable? -> possibility of postponement until realization

2. **Dividend distribution in 2014**: X is a non-resident taxpayer of the Netherlands + dividends are taxed as substantial interest income (Art. 7.5(1) ITA 2001) against a rate of 25% (assuming that the shareholding does not belong to X's business assets). The dividends are also subject to Dividend Withholding Tax (X= taxpayer. Y BV is dividend withholding agent; rate= 15%). The Dividend Withholding Tax is creditable against the personal income tax (Art. 9.2(9) ITA 2001) ->

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Case Study 3a: Dutch exit taxation

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-> taxation on dividends decreases preservative tax assessment (Art. 26(4) 1990 Tax Collection Act)

3. **Sale of the debt claim in 2015**: non-resident tax liability in the Netherlands: income from other activities in the Netherlands (Art. 7.2(2)(c) ITA 2001) -> broad source rule in Art. 7.2(3) ITA 2001 includes debt claims put at the disposal of a Dutch resident company -> capital gain taxed at progressive rates -> repercussions for possible exit tax?

4. **Sale of the shares in 2016**: end of deferral preservative tax assessment (see 1); Art. 25(8)(a) 1990 Tax Collection Act + non-resident tax liability substantial interest (Art. 7.5(1) ITA 2011), but step-up of the acquisition price to FMV when X emigrates to Germany (Art. 7.6(1) ITA 2001) + account is taken of decreases in value after the emigration and possible German tax paid on the sale of the shares if Germany has a taxation right based upon the treaty (see below)

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Case Study 3a: Dutch exit taxation

- German domestic law consequences:

1. Emigration 2013: step up for the shares and the debt claim to FMV
2. Dividend 2014: income tax in Germany + credit for Dutch taxation
3. Sale of debt claim 2015: assuming that the debt claim does not belong to X's business assets a capital gain is in principal not taxed unless the gain contains an interest element, e.g. a zero bond (step-up)
4. Sale of shares in 2016: personal income tax in Germany

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Case Study 3a: Dutch exit taxation

- Tax Treaty

1. Art. 13(5) assigns Germany a taxation right as regards the alienation of the debt claim and the shares
2. Art. 13(6) gives the Netherlands the authority to tax the capital gains realized on the shares and the debt claim if and in so far they accrued during the period that X was a resident tax payer of the Netherlands, i.e. the Netherlands can effectuate its preservative tax assessment on the shares and its non-resident tax liability on the debt claim -> Germany excludes this from its tax base
3. Dividend distribution: according to Art. 10(6) the Netherlands is allowed to tax the dividends because X is taxed on the capital gains on the shares in NL ->

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Case Study 3a: Dutch exit taxation

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-> and an assessment on the appreciation of capital, i.e. preservative tax assessment, is still outstanding -> credit in Germany pursuant to Art. 22(1)(b)(aa) of the Treaty

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