Netherlands

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Corporate Income Tax: Marking the Passage of Time

Triggered by the international debate on aggressive tax planning and base erosion and profit shifting, the author goes back to the basic principles of corporate income tax (CIT). In this article, the author explores whether CIT, as a tax on an entity's profit in its current form, has reached its outermost limits both in the Netherlands and internationally, and whether the basic principles of CIT should be redesigned in order to reshape the future of CIT.

1. Introduction

> In recent years, however, the opinion of one individual has evolved into a veritable – discordant – chorus of criticism. It is most often aimed at the shortcomings of certain taxes, but the actual cause of the current dissatisfaction is the fact that traditional tax theory is incapable of developing satisfying principles for taxation in today's society, a society radically different from that of the past.[1]

Much like living organisms, tax systems around the world can be viewed as having their own place in the evolutionary chain. Also in the context of corporate taxation, external factors very soon forced what began as a simple concept to adjust and be refined so that it could provide answers to external threats; the relatively simple viable single-cell organism was forced to develop into a complex organism in order to survive. The question is when will this chain reach its apex and – unable to carry on in the same direction – accept the fact that external factors require it to reverse direction, tear down what was constructed and find a new direction where development and cohesion can take place? Has corporate income tax, as a tax on an entity's profit, also reached its outermost limits both nationally and internationally, thereby failing to achieve the principles ascribed to it? Some examples – or possibly symptoms – are elucidated in this article.[2,3]

2. The End of an Era

2.1. What were the basic assumptions?

With regard to the basic assumptions of Netherlands corporate income tax, Strik writes:[4]

> The raison d'être of corporate income tax as a separate tax on the profit of entities is derived from the function it fulfills: taxing those business profits that are not as such directly subject to personal income tax. After all, if entities were not subject to corporate income tax, privately owned businesses and individuals/co-owners would suffer an unacceptable form of tax discrimination, the large scale avoidance of personal income tax as a result of privately owned businesses opting *en masse* for the legal form of a private limited liability company, and a disruption of competitive relationships [...]. From this perspective, corporate income tax complements personal income tax.

As a corollary to this symbiotic development, with its concomitant anti-avoidance motive, the government made a comment during the drafting of the Corporate Income Tax Act 1969,[5] to which Strik refers, that it was already apparent during the introduction of this tax reform that "from a budgetary perspective, corporate income tax had become indispensable".[6] In line with this *raison d'être*, Strik concludes that "consensus on the fundamental principles of corporate income tax in its current form is still hard to find [...]. The only conclusion that can be drawn – and rightly so – is that corporate income tax is based on nothing more than pragmatism".[7] In the author's view, the background for this analysis can be found in the independent entity status attributed to legal forms that, as taxpayers, are subject to corporate income tax. Hofstra, writing at another point in time, took explicit account of this background in his vision of the *raison d'être* of corporate income tax as part of the classical system:[8]

> The most plausible, and in my opinion also the strongest argument for a separate corporate income tax, which cannot be credited against personal income tax [of the shareholder], is a result of having made the modern public limited company an independent entity with an existence separate from its shareholders, which independence deems it unacceptable that an important share of the national revenue realized by the public limited company is devoid of public obligations. [author's comments added]

To state the obvious: if we, as a society, were to completely ignore, for tax purposes, the independence of organizations operating under the flag and regime of certain legal forms, in other words, if we were to regard all legal forms

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1. H.J. Hofstra in his preface to *Inleiding tot het Nederlands belastingrecht* (Introduction to Dutch Tax Law), 5th ed., p. V (Kluwer 1980).
2. A slightly different version of this article was published in Dutch: *see* J.W. Bellingwout, *Van de vennootschapsbelasting, de dingen, die voorbijgaan*, in *Strikbundel* pp. 1-17 (J.L. van de Streek & J. van Strien eds., Kluwer 2014). The title is an adaptation of: L. Couperus, *Van oude menschen, de dingen, die voorbijgaan* ("The elderly: marking the passage of time"), first published in *Groot Nederland*, vol. 3, *Letterkundig Maandschrift voor den Nederlandschen stam* (Van Holkema & Warendorf 1905).
3. The author harbours no pretenses that the text represents a full and complete presentation; rather it should be regarded as an illustration, written from the subjective perspective of its holder.
4. J.L. van de Streek & S.A.W.J. Strik, *Cursus Belastingrecht (Vennootschapsbelasting)* (Tax Law course; Corporate Income Tax) p. 3 (Kluwer 2013).
5. NL: Corporate Income Tax Act 1969 (*Wet op de vennootschapsbelasting 1969*), National Legislation IBFD.
6. Streek & Strik, *supra* n. 4, at p. 2.
7. Id., at p. 21.
8. Hofstra, *supra* n. 1, at p. 143.

as tax transparent, then there would be no necessity of or reason for corporate income tax; only the individuals involved in these organizations would be subject to tax with respect to the income of these organizations. In short, the traditional basic assumptions underlying corporate income tax as a regime can be summarized as follows:

(1) the classification of the relevant legal forms as independent taxpayers, separate from the tax position of their ultimate individual stakeholders, which raises a
(2) budgetary interest in order to avoid significant tax leakage or long-term deferral of tax (a budgetary interest and anti-avoidance grounds being two sides of the same coin), which can be subdivided into:
   (a) the complementary function of corporate income tax compared to personal income tax being levied on the profit in the hands of individuals (including individuals involved with legal forms that are not regarded as corporate income taxpayers, for example, fiscally transparent partnerships); and
   (b) the role corporate income tax is to play and the form it is to take (including tax rates) as a tax on profit, which, under the classical system, is intended to culminate in personal income tax being levied on the individuals benefiting from this same profit by means of profit distributions and capital gains.

2.2. Shortcomings at the Netherlands level

In section 2.2. some shortcomings in corporate income tax in light of the basic assumptions outlined in the previous paragraph are discussed; this is done without any presumption of being exhaustive.

2.2.1. The different types of taxpayers

It goes without saying that the independence of the modern public limited company to which Hofstra refers also justifies it being regarded as a separate taxpayer in our tax system. This, therefore, primarily involves companies, now also including legal forms such as private limited liability companies, in respect of which it would be completely unthinkable and unworkable to attribute the company's profit, assets and liabilities to its ultimate stakeholders, for example, multinationals and investment funds with a large number of shareholders/participants that are, moreover, spread among various countries. This justification also applies to group companies of these large entities. The independence of private limited liability companies, which have only one or a handful of shareholders, such as a "family owned business" situation, is less self-evident and, from time to time, raises the call for a tax on business profits that is neutral as regards the legal form of the entity.[9] After 75 years of profit tax or corporate income tax,[10] we, in the Netherlands, are still not convinced as to the independent entity status of the private limited liability company in such situations. In this respect, the levying of corporate income tax is based more on a belief than on a conviction in respect of the entity status, for tax purposes, of this legal form. Equally remarkable is the struggle that ensued in respect of the proposed, but never realized, implementation in the Netherlands of the incorporated public (general) partnership (*openbare vennootschap met rechtspersoonlijkheid* – OVR). Although legal personality initially appeared to always result in entity classification for Netherlands corporate income tax purposes, the wording of sections 2(e) and 3(1)(a) of the Netherlands Corporate Income Tax Act 1969 indicates that the Netherlands legislator preferred to stick to the fiscal transparency of the OVR for corporate and personal income tax purposes.[11] This was due, in part, to the joint and several liability of the partners in the OVR.[12] By contrast, the Netherlands private limited liability company (*besloten vennootschap met beperkte aansprakelijkheid* – BV) remains subject to tax; this is so despite the flexibility of Netherlands company law, under which it is now possible to have a BV adopt a legal form similar to a general partnership with legal personality and, therefore, with shareholders who are joint and severally liable.[13] The Netherlands legislator rejected the suggestions made by various authors to allow for tax transparency of the BV in this particular situation. This does not seem to be completely consistent. As a final point, reference can be made to the Netherlands and international public debate on the taxation of BVs with low or minimal substance that act as a link in the chain of international holding and conduit structures.[14] Although the primary focus of this debate is on the right of these companies to benefit from the relevant tax

9. The last official comment on this matter was made in a letter dated 17 September 2013, sent by the then Deputy Minister of Finance, Mr Weekers, to the Upper House. The letter dealt with the tax undertakings and motions in the Upper House. In this letter, the Deputy Minister promised both Houses of Parliament that they could expect a comprehensive analysis of the pros and cons of a legal entity neutral "profit box" in the first quarter of 2014; this analysis is to be conducted by the Netherlands Bureau for Economic Policy Analysis (*Centraal Planbureau* – CPB).

10. *See* Hofstra, *supra* n. 1, at p. 142, beginning with NL: Decree on Profit Tax 1940, which was implemented with retroactive effect, to the commencement of fiscal years ending on or after 31 December 1939 (*see* sec. 39(5) Decree on Profit Tax 1940).

11. NL: Act Implementing Title 7.13 Dutch Civil Code (DCC), TK 2006-2007, 31.065, No. 2 (Bill), proposed section 7:804 DCC and the proposed NL: Personal Income Tax Act 2001, section 3.7, National Legislation IBFD in conjunction with section 8 of the Corporate Income Tax Act 1969. At the time of the original bill, the government reasoned that the legal personality of the OVR and of the incorporated closed limited liability partnership (CVR) would go hand-in-hand with tax transparency; *see* M.L.M. van Kempen, *Het wetsvoorstel Titel 7.13 BW en de fiscale transparantie van personenvennootschappen* (The bill on Title 7:13 DCC and the tax transparency of partnerships), WFR 285 (2003).

12. Act implementing Title 7.13 Dutch Civil Code, TK 2006-2007, 31.065, No. 3 (Explanatory Memorandum), p. 35: "The most important characteristic of the partnership remains nonetheless intact: the joint and several liability of the partners. In this respect, there is a major difference with the legal forms of the private limited liability company and the public limited company, which are characterized by the limited liability of their shareholders".

13. E van Horzen & J.W. Bellingwout in *Postmoderne rechtsvormen: Aanbevelingen voor verdere modernisering van het ondernemingsrecht* (Postmodern legal forms: recommendations for further modernization of business law), ZIFO series, no. 8, pp. 65-70 (Kluwer 2013).

14. M. Kerste et al., *Uit de schaduw van het bankwezen* (Out from under the shadow of the banking industry), SEO Economisch Onderzoek, 11 June 2013, Part B, Bijzondere Financiële Instellingen (Special Financial Institutions), chs. 3 (p. 49 et seq.) and 5 (p. 83 et seq.), which discusses the tax function and (presumed) tax motivation of Netherlands special financial institutions that are part of international group structures. The report is available on the SEO's website at www.seo.nl/pagina/article/uit-de-schaduw-van-het-bankwezen/.