Chapter 20

Netherlands

by Reinout De Boer and Frederik Boulogne[1]

20.1. Introduction

This report describes the taxation of intercompany dividend distributions under Dutch domestic law, EU law and tax treaties insofar as these involve Dutch companies.

Where original Dutch language texts have been quoted, the authors have provided an informal translation into English.

20.2. The meaning of "dividend" under domestic non-tax law

The scope of this section is limited to private limited companies (*besloten vennootschappen*, BV) and public limited companies (*naamloze vennootschappen*, NV) organized under Dutch law.

20.2.1. General rules on distributions

Dutch corporate law does not contain a statutory definition of the term "dividend". However, Book 2 of the Dutch Civil Code (*Burgerlijk Wetboek*, DCC) deals generally with civil law rules applying specifically to (the organization of) legal entities) and provides for rules on (formal and interim) profit distributions by BVs and NVs.[2] The respective provisions for BVs and NVs substantially read the same:

> Art. 216 [*105*][3]
>
> 1. Save as otherwise provided by the articles, the profits shall accrue to the shareholders.
>
> 2. A company [*limited by shares*] may make distributions to the shareholders and other persons entitled to distributable profits only to the extent that its net assets exceed the sum of the amount of the paid and called up part of the capital and the reserves which must be maintained under the law or the articles.
>
> 3. Any distribution of profits shall be made after the adoption of the annual accounts from which it appears that the same is permitted …
>
> 4. A company may make interim distributions only if the articles so permit and the requirement of the second paragraph has been met.…

Generally, the articles of a BV or NV specify that the decision to make profit distributions rests with the general meeting of shareholders of such company. In principle, for both BVs and NVs no profit distributions are allowed to the extent that such distributions would affect tied-up capital and reserves. Under a pending law proposal, this requirement is relaxed for BVs and, once this law proposal is enacted, a BV will be able to make

---

1. Reinout De Boer is a tax lawyer at Stibbe Amsterdam and a researcher at the Amsterdam Centre of Tax Law (University of Amsterdam). His PhD research relates to anti-abuse measures in EU tax law. Frederik Boulogne is a tax advisor at PwC Amsterdam (EU Direct Tax Group) and a PhD fellow at the VU University, Amsterdam. The topic of his PhD research is "Shortcomings in the EU Merger Directive". The authors are grateful to Dr Sjoerd Douma, Aad Rozendal and Dr Jan van de Streek for their valuable input.
2. For a comprehensive overview of the Dutch corporate law rules in respect of dividend distributions by BVs and NVs, reference is made to Huizink, J.B. (ed.), *Rechtspersonen*, *Groene Serie Rechtspersonen*, Deventer: Kluwer, loose-leaf.
3. Art. 2:105 DCC applies to NVs and Art. 2:216 applies to BVs. The text quoted here applies to both BVs and NVs, with the text between square brackets and in Italics only applying to NVs.

distributions to the extent its capital exceeds its tied-up reserves.[4] The term "paid and called up part of the capital" as used in paragraph 2 of the above cited provisions refers to the (formal) authorized capital and not to share premium reserves or informal capital contributions added to the share premium reserves.

Literature suggests that the term "distributions" as used in the above provision should be interpreted broadly[5] and, apart from distributions in cash, should also encompass distributions in kind[6] and constructive dividend distributions (e.g. in the form of non-arm's length interest rates on loans made to shareholders).[7] Some authors suggest that the rules for distributions – notably the (capital maintenance) limitation in respect of tied-up capital and reserves – also extend to repayment on shares in cases of reduction of (formal) capital.[8]

From a capital maintenance perspective, a repurchase of shares by a BV or NV (*inkoop van eigen aandelen*) is found to be similar to a (dividend) distribution and similar capital maintenance rules apply, as is clear from Art. 2:98(2) and (3) (for NVs) and Art. 2:207(2) and (3) (for BVs) of the DCC:

> 2. A company may only acquire fully paid up shares in its own capital gratuitously or if its net assets less the acquisition price are not less than the sum of the paid and called up part of its capital and the reserves which must be maintained by law or under the articles.…
>
> 3. For the purposes of paragraph 2 the amount of the net assets according to the last adopted balance sheet, less the acquisition price for shares in the capital of the company and any distributions to others out of the profits or reserves that became due by it and its subsidiaries after the balance sheet date, shall be determinant. If more than six months have elapsed without adoption of the annual accounts, then an acquisition in accordance with paragraph 2 shall not be permitted.

To establish what the relevant amount of distributable profit or the permissible purchase price for a repurchase of shares is (taking into account tied-up capital and reserves), the above-quoted provisions refer to the annual accounts of the company. The annual accounts and the extent to which these demonstrate sufficient profit or capital reserves thus play a pivotal role in determining what constitutes a permissible dividend distribution or purchase price.

20.2.2. Recharacterization of financing instruments

Under Dutch corporate law for BVs and NVs (other than accounting law), there is generally no grey area as to the qualification of a financing instrument as either debt or equity. An exception generally applies to certain sham transactions (*relatieve simulatie*), in which parties, in deviation of the apparent legal form, *in fact* intend to bring about a loan rather that a capital contribution or vice versa.

Book 2 of the DCC in principle provides for an established set of rules regarding shareholder rights and obligations. This concerns on the one hand control rights (such as the right to attend meetings, voting rights, binding majority decisions, etc.) and on the other hand proprietary rights (such as the entitlement to dividends and to liquidation proceeds) and obligations (such as the liability to pay up shares). The statute leaves from the assumption, for both BVs and NVs, that, save as otherwise provided for in the articles of association, all shares in the company rank pari passu in proportion to their amount.[9] Company shares that carry special financial rights (based on the articles) are generally referred to as "preference shares". Generally, preference shares entitle the holder thereof to the annual payment of a certain percentage of the nominal paid-up capital on such shares, which entitlement takes preference over profit entitlements of holders of ordinary shares. Such profit entitlement of holders of preference shares may be cumulative, i.e. it may accumulate if in any one year the company is not profitable. Though the more or less fixed character of the annual profit entitlement of such preference shares

---

4. Art. I, Para. JJ of Law proposal No. 31 058 for the amendment of Book 2 of the Dutch Civil Code in connection with the amendment of the regulation for the organization of private limited companies (Private Limited Company Law (Simplification and Flexibilization) Act; *Wet vereenvoudiging en flexibilisering bv-recht*).
5. Huizink, J.B. (ed.), *Rechtspersonen*, *Groene Serie Rechtspersonen*, op. cit., Commentary to Art. 2:105 DCC.
6. Bier, B., *Uitkeringen aan aandeelhouders*, Deventer: Kluwer, 2003, p. 249.
7. Id., p. 271. Bier, however, cites a decision by the Tax Chamber of the Supreme Court (*Hoge Raad*) which asserted that a constructive dividend is not subject to the tied-up capital and reserves restriction mentioned in Arts. 2:105(2) and 2:216(2) DCC respectively.
8. For an overview, reference is made to Huizink, *Rechtspersonen*, *Groene Serie Rechtspersonen*, op. cit., Commentary to Art. 2:105 DCC.
9. Art. 2:92(1) (for NVs) and Art. 2:201(1) (for BVs) DCC.

bears resemblance to (perpetual) debt bonds, for corporate law purposes such similarity does not affect its equity character.[10] The articles may also provide that special rights with regard to control of the company specified in the articles shall be vested in shares of a particular class[11] – such shares are generally referred to as "priority shares" and may, for instance, be created to ensure a qualifying minority to block hostile takeovers. The creation of such priority shares should for corporate law purposes in principle not affect the equity character of other shares, the control rights of which are limited through the existence of the priority shares.

A share in a company is generally defined as a proprietary right sui generis. The term "share" primarily relates to the legal relationship between the shareholder and the company,[12] which some authoritative authors have described as "a non-repayable corporate-law loan borne by the company".[13] The latter description illustrates that even though a share – and capital contributions made by a shareholder – imply an entitlement of the shareholder vis-à-vis the company, the relationship between a company and its shareholder in principle does not imply an enforceable repayment obligation of contributed capital. Under Dutch corporate law, a BV or NV cannot issue redeemable shares.

Under Dutch civil law, a loan agreement can generally be defined as a species of the general civil law concept of "loan for consumption" (*verbruikleen*)[14] in which "one party binds itself to provide a sum of money to the other party and in which such other party binds itself to repay the same amount".[15] Thus, a central element in a loan agreement for civil law purposes is the repayment obligation of the borrower. The loan agreement may imply interest payments from the borrower to the lender and may also imply that, as a result of mutual obligations to pay compensations, the borrower eventually repays an amount lower than the amount that was originally lent.[16]

Notwithstanding the relatively clear division between debt and equity in Dutch corporate and civil law, it is certainly possible to think of a situation in which the characterization of a financing instrument poses difficulties. A case in point is that of mandatory convertible notes. This term covers notes or bonds, issued by a company, that have a fixed term and that carry interest. At the end of the term, the notes are subject to a mandatory conversion into shares of the company, based on a fixed (range of) conversion rate(s). It has been suggested in literature that such mandatory convertible note should in fact be characterized for Dutch civil law purposes as an agreement for the issue of shares subject to a time limit, in which the cash capital contribution to the relevant shares is made in advance.[17] In this view, the latter payment is not made as a loan, but as a contribution. Nonetheless, other characterizations, keeping intact the debt character up to the moment of actual conversion, also seem to be possible under Dutch civil law.[18]

In contrast with the above-described Dutch general corporate law, accounting rules that are applicable in the Netherlands provide examples in which a debt instrument is (in part) recharacterized as equity or vice versa. The EC IFRS Regulation[19] obliges publicly traded companies to use (EU approved) International Financial Reporting Rules in drawing up their annual consolidated accounts (EU IFRS regime). In addition, under Dutch accounting law, companies may opt to use the EU IFRS regime.[20] Under the EU IFRS regime, preference shares may sometimes be recharacterized as debt (or rather a "financial liability") on the principle that "the substance of a financial instrument, rather than its legal form, governs its classification on the entity's balance sheet" (e.g. International Accounting Standard 32.18, part of the EU IFRS regime).[21] IAS 32.18 gives the following examples of preference shares that qualify as financial liabilities:

---

10. Huizink, *Rechtspersonen*, *Groene Serie Rechtspersonen*, op. cit., Commentary to Art. 2:92(1) and Art. 2:201(1) DCC.
11. Art. 2:92(3) (for NVs) and Art. 2:201(3) (for BVs) DCC.
12. For an overview of relevant literature, reference is made to Van Solinge, G. and Nieuwe Weme, M.P., *Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht*, Part 2-II*, No. 202.
13. Van der Heijden, E.J.J., *Handboek voor de naamloze en de besloten vennootschap* (Van der Grinten, W.C.L., ed.), No. 161, 1992.
14. Art. 7A:1791 DCC.
15. Van Schaick, A.C., *Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht*, Part 5-IV*, No. 37.
16. Id.
17. Eisma, S.E., "Civielrechtelijke aspecten van converteerbare obligatieleningen", *Weekblad voor Fiscaal Recht* (1995) 6159 p. 1021.
18. Huizink, *Rechtspersonen*, *Groene Serie Rechtspersonen*, op. cit., Commentary to Art. 80 DCC.
19. Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, as amended by Regulation (EC) No 297/2008 of the European Parliament and of the Council of 11 March 2008, *Official Journal of the European Communities* L 97/62, 9 April 2008 ('EC IFRS Regulation').
20. Art. 2:362(8) DCC.
21. The comments on the EU IFRS regime are substantially derived from Beckman, H, *Hoofdlijnen van het jaarrekeningenrecht,* Deventer: Kluwer, 2008, pp. 405-409.

(i) a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date;

(ii) a preference share that gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.

Though no redeemable shares exist under Dutch corporate law, a similar result can be achieved if the company and the preference shareholder agree to a repurchase of the shares (subject to a time limit). Absent an arrangement for redemption or repurchase, further characteristics should be taken into account to assess its character under the EU IFRS regime. Beckman takes the position that a preference share that entitles the holder to an annual dividend rate (calculated against the nominal amount) that corresponds to the market interest rate at the time of issue of the shares, is comparable to a perpetual, fixed rate bond and he finds that such preference shares should therefore in principle be characterized as financial liabilities rather than equity.[22]

As regards convertible bonds issued by a company (in which the holder of the bond is granted a conversion right), the EU IFRS regime (IAS 32.29) provides that from the perspective of the issuing company, such an instrument comprises two components:

(i) a financial liability (i.e. a contractual arrangement to deliver cash or another financial asset); and

(ii) an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity).

Accordingly, under the EU IFRS regime, in all cases the relevant company should present the liability and equity components (i.e. regarding the latter, the value of the conversion right, calculated by benchmarking the agreed interest rate against the market rate on non-convertible bonds) separately on its balance sheet.

Under Dutch domestic accounting rules[23] (i.e. the default rules that apply if the EU IFRS regime is not applicable), the rules on qualifying hybrid instruments differ, depending on whether consolidated or separate (*enkelvoudige*) annual accounts are concerned. As regards consolidated accounts, the general rule is that a financing instrument is characterized according to "the economic reality and in accordance with the definitions of a financial liability on the one hand and an equity instrument on the other".[24] A financing instrument generally qualifies as a financial liability if the issuing company has an effective (contractual) obligation to transfer money or other assets to the holder of the instrument.[25] As regards preference shares, these are generally characterized as financial liabilities if there is an effective obligation for the issuing company to repay the principal (including where a contractual obligation to pay (cumulative) dividends in fact implies a repayment of the principal amount).[26] Regarding convertible bonds, the company has the option to report the convertible note in its entirety as a financial liability, rather than reporting a part thereof as equity. For separate accounts, the legal form of an instrument (rather than economic reality) is in principle decisive for its qualification in the annual accounts (although hybrid instruments may have to be mentioned under separate heading).[27]

20.3. The meaning of "dividend" under domestic tax law

20.3.1. Definition of "dividend" and interrelation with other categories or subcategories of income

20.3.1.1. Definition of "dividend" for Dutch tax purposes

---

22. Id., p. 406. Reference is also made to Application Guidance (AG) 26 to IAS 32: "[W]hen preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments.…"
23. General accounting rules for Dutch corporations are laid down in Book 2, Title 9 DCC in conjunction with the *Richtlijnen voor de jaarverslaggeving* (Dutch Guidelines on annual reporting, DGAR).
24. Guideline 201 DGAR.
25. Guideline 204 DGAR.
26. Guideline 206 DGAR.
27. Guidelines 207-209 DGAR.

There is no comprehensive statutory definition of the term “dividend”. Long-standing case law, however, provides a general definition of “dividend” (or perhaps rather of “profit distribution” (*winstuitdeling*), in order to clarify that this definition not only covers formal dividends, though in this chapter, the terms “profit distribution”, “dividend” and “dividend distribution” are generally used as interchangeable terms):

> [T]he term “profit distribution” can be defined as a shift of assets [*vermogensverschuiving*] by the company to its shareholder, as a consequence of which an amount of money or other item of value, covered by profit [reserves] that is [are] part of its assets, is withdrawn from the assets of the company for the benefit of the shareholder.[28]

This definition in any case covers situations in which it is clear that the parties intend to bring about a distribution of profit reserves, such as a (formal) dividend distribution that clearly is intended and characterized as such by the parties involved or the repurchase of shares in which the paid repurchase price includes effective repayment of (a part of) available profit reserves.[29] However, the above definition also extends to constructive dividends (see 20.3.2.1. below).

The definition above might suggest, due to the use of the term “shareholder”, that for Dutch tax purposes a dividend always implies an equity participation in the distributor. However, this is not always the case, as for all intents and purposes under Dutch tax law distributions made on profit sharing certificates (*winstbewijzen*) and similar proprietary rights – which rights, contrary to shares under Dutch law, in the absence of a nominal value do not imply a capital contribution – are also treated as dividends. The equal treatment in this respect of shares and profit sharing certificates dates back to the predecessor of the current Dutch Corporate Income Tax Act 1969 (*Wet op de vennootschapsbelasting* 1969, CITA 1969), the Corporate Income Tax Regulation 1942 (*Besluit op de Vennootschapsbelasting* 1942) and the implementing regulations thereof.[30]

For intercompany dividends the characterization of a payment or transaction as “dividend” is generally relevant for the following reasons under Dutch domestic tax law:
(i) for a Dutch corporate taxpayer, dividends are in principle not deductible from its taxable income (see below 20.3.1.1.1.);
(ii) the question whether such payment or transaction is taxed or not in the hands of the recipient (see below 20.3.1.1.2.); and
(iii) dividend distributions by Dutch resident companies are in principle subject to Dutch dividend withholding tax (see below 20.3.1.1.3.).

20.3.1.1.1. *Non-deductibility of dividends in Dutch corporate income tax*

Generally, under Dutch tax law, the profit of a company for Dutch tax purposes is made up of the joint benefits derived, under whatever name and in whichever form, from its business enterprise (“overall-profit” principle; *totaalwinstbegrip*).[31] This principle implies that the overall profit of a company should be adjusted for non-deductible withdrawals (*onttrekkingen* – which increase the overall profit) from such company and for non-taxable capital contributions (which decrease the overall profit) to such company. The term “withdrawal” typically refers to profit distributions. However, the concept of withdrawal also extends to other asset transfers stemming from shareholder influences that are unrelated to the business enterprise of the company, such as repayments of contributed capital. The overall profit of a company for tax purposes should, under the overall-profit principle, thus be cleared from shareholder influences.

In addition to the overall-profit principle, the arm’s length principle has been codified in Dutch tax law. The latter principle means that transfer prices between related entities[32] should be at arm’s length (i.e. generally,

28. *Hoge Raad* 18 February 1959, No. 13 763, BNB 1959/124. Although this decision concerned personal income tax, the definition of “dividend” contained therein is widely held to apply also for Dutch corporate income tax and dividend withholding tax purposes.
29. Generally, a repurchase of shares may be deemed for tax purposes to be a cancellation of shares, in consideration of which capital attached to such shares is repaid and profit reserves connected to such shares are distributed (e.g. *Hoge Raad* 14 September 1956, no 12 894, BNB 1957/20).
30. Reference is made to Scholten W,. “Winstbewijzen”, *Weekblad voor Fiscaal Recht,* (1960) 4505 p. 443.
31. Art. 8 CITA 1969 in conjunction with Art. 3.8 of the Personal Income Tax Act 2001 (*Wet inkomstenbelasting 2001*, ITA 2001). Art. 3.8 ITA 2001 reads: “[t]he profit from a business enterprise (‘profit’ [defined term for Dutch tax purposes]) is the amount of the aggregate benefits that, under whatever name and in whichever form, are derived form a business enterprise.”
32. Contrary to the codified arm’s length principle, the overall-profit principle also applies to dealings between a company and shareholders who are individuals.

cleared from shareholder influences) and that, where necessary, adjustments should be made to the profits of such enterprises to implement the correct transfer prices for Dutch tax purposes.[33]

The principle of clearing a company's taxable profit from any or all asset transfers induced by shareholder influences also applies to the concept of "constructive dividends" – reference is made to 20.3.2.1. below.

The non-deductibility of profit distributions by companies has also been made explicit in Art. 10(1) CITA 1969, which reads, in pertinent part:

> [I]n determining the profit, the following items are non-deductible:
>
> (a) direct and indirect distributions of profit, made under whatever name and in whichever form…;
>
> […]
>
> (d) remunerations paid on a [intercompany] loan as well as fluctuations in value of such loan, if such loan is entered into under such terms that the loan in fact functions as equity of the taxpayer.

According to parliamentary history,[34] the (hybrid) loans functioning as equity mentioned in Art. 10(1)(d) CITA 1969 refer (exclusively) to so-called "participating" loans (*deelnemerschapsleningen*) – reference is made to 20.3.1.2.1. below.[35]

The fact that dividend distributions are (in principle)[36] non-deductible, does not by definition imply that all non-deductible intra-group/related party payments qualify as dividend distributions. There are a number of statutory deduction limitations in respect of related party payments that nonetheless do not qualify as dividends (e.g. interest deduction limitations in relation to certain transactions[37] and thin capitalization rules,[38] which will not be further elaborated on here).

20.3.1.1.2. *Taxability of dividends in Dutch corporate income tax*

In principle, dividends received by a Dutch corporate taxpayer form part of such taxpayer's (taxable) profit. However, there are two notable exceptions:

(i) The dividend is paid out of profit reserves that were already present at the time of the acquisition of the shareholding. Based on the principle of "sound business practice" (i.e. rules for determining a company's taxable profit as (largely) developed in Dutch case law), such "purchased" dividend should be written off against the book value of the shareholding for tax purposes.

(ii) The dividend is exempt in the hands of the recipient under the Dutch participation exemption (refer to 20.6.2.1. below).

20.3.1.1.3. *Dutch dividend withholding tax*

---

33. Art. 8b(1) CITA 1969 reads: "[I]f an entity, directly or indirectly, participates in the management of, the supervision of, or the capital of another entity and if terms – deviating from arm's length terms that would have been agreed upon between unrelated entities – are agreed upon or are imposed in respect of transactions between these entities, then the profit of these entities is determined as if the latter [arm's length] terms would have been agreed upon." This provision was introduced per 1 January 2002. Arguably, the arm's length principle already applied in Dutch law before that date through the overall-profit principle. In an administrative regulation concerning the application of Art. 8b CITA 1969, the State Secretary of Finance stated that in his opinion, the arm's length principle as codified was already part of Dutch tax law through Art. 9 of the OECD Model Convention and through Art. 3.8 ITA 2001 (which expressed the overall-profit principle) – Decision of the State Secretary of Finance of 30 March 2001, No. IFZ2001/295M, *BNB* 2001/286.

34. *Kamerstukken II*, 2005/06, 30 572, No. 3, pp. 55-56.

35. Between 2002 and 2007, the term "hybrid loan" or "participating loan" was explicitly defined in the CITA 1969 (Art. 10(1)(d) and 10(2)-(4) of the (former) CITA 1969). As of 1 January 2007, through Art. 10(1)(d), the legislator intends to refer to case law regarding participating loans. The stated reason for this was that the "old" codified rules were considered to be (too) complicated and were seldom used in practice (*Kamerstukken II,* 2005/06, 30 572, No. 3, pp. 18-19).

36. A statutory exception to non-deductibility of profit distributions may apply to certain fund-raising entities to the extent that they distribute their profits to qualifying public benefit organizations (*algemeen nut beogende instellingen*) – Art. 9(1)(h) CITA 1969.

37. Art. 10a CITA 1969.

38. Art. 10d CITA 1969.

Pursuant to Art. 1(1) of the Dividend Withholding Tax Act 1965 (*Wet op de dividendbelasting 1965*, DWTA 1965), dividend withholding tax is levied on those persons who are entitled (either directly or through depositary receipts) to the "proceeds" (*opbrengst*) of shares or profit sharing certificates in, or (hybrid) loans as meant in Art. 10(1)(d) of the CITA 1969 from, Dutch resident companies. Dividend withholding tax is calculated on the basis of the proceeds of such shares or profit sharing certificates in, or (hybrid) loans to, Dutch resident companies. Art. 3(1) DWTA 1965 gives a non-exhaustive definition of the term "proceeds".

The concept of "proceeds"

The enumeration in that provision illustrates that the term "proceeds" as used for Dutch dividend withholding tax purposes is broad in scope ("distributions of profit, made under whatever name and in whichever form") and that this term – in keeping also with the overall-profit principle – is not limited to formal dividend distributions. This broad description also covers constructive dividends (see 20.3.2.1. below). It also illustrates that Dutch dividend withholding tax is set up according to an objective system (rather than a subjective one), in which, for dividend withholding tax to become due, it is not relevant whether or not the person receiving the dividend actually receives a (subjective) benefit.[39] This objective system – which abstracts from the tax treatment of the dividend in the hands of the recipients for (personal or corporate) income tax purposes[40] – implies that any distribution by the company to its shareholders in excess of contributed capital – i.e. the aggregate profit of the company over its corporate lifespan – is in principle subject to dividend withholding tax (this concept, which leaves untaxed repayments of contributed capital, is also referred to as the basic principle (*basisconceptie*) of dividend withholding tax).[41] This system corresponds to the general definition of dividend as quoted in 20.3.1.1. Examples of cases where dividend withholding tax may due, but where the distribution in question does not lead to taxable profit in the hands of a Dutch corporate taxpayer, may include the situation where a shareholder receives a bonus share (without making a contribution) that, according to Dutch rules for determining taxable profit, is valued at cost (hence, no profit is taken into account), or where a repayment of capital (which in principle does not add to profit of the recipient, unless it exceeds the cost price of the relevant share) does not exceed the cost price of the relevant share.

In principle, the concept of "proceeds" for dividend withholding tax purposes follows the characterization of a payment or transaction as a (formal) dividend distribution for Dutch civil law purposes. However, there are exceptions. For example, for dividend withholding tax purposes a (taxable) (formal) dividend distribution can in principle only occur if the distributing company has profit reserves for Dutch tax purposes or if such profit is to be expected in short term.[42] The available profit for Dutch tax purposes, however, may at a given time not necessarily correspond with profits for civil law or accounting purposes, due to the fact that even though the (annual) profit for accounting purposes is taken as a starting point to calculate taxable profit, the tax concept of (annual) profit is determined based on an independent set of rules.[43] Another potential deviation between tax law and civil law concepts may occur where a (formal) dividend is null and void due to not meeting civil law requirements (notably Art. 2:105/216 DCC) – and is thus disregarded for Dutch civil law purposes – whereas such (null and void) dividend is in principle recognized for Dutch tax purposes (assuming the presence of sufficient profits for Dutch tax purposes and assuming the parties' intention to in fact bring about a profit distribution).[44]

The term "companies" as used in Art. 1(1) DWTA 1965

The term "companies" (*vennootschappen*) as used here covers BVs and NVs, open (i.e. non-transparent for Dutch tax purposes) limited partnerships (*open commanditaire vennootschappen*) and other companies (*vennootschappen*) the capital of which is divided into shares (Art. 1(1) DWTA 1965). For purposes of Dutch

---

39. For background on the objective system, reference is made to Marres, O.C.R. and Wattel, P.J., *Dividendbelasting*, Deventer: Kluwer, 2011, Para. 1.4.1.

40. In some cases the subjective tax treatment at recipient is relevant. For instance, for practical purposes, an exemption at source does apply in situations where dividends are paid in respect of shareholdings that qualify as a participation as meant in Art. 13 CITA 1969 (Art. 4(1) DWTA 1965).

41. *Kamerstukken II,* 1958/59, 5380, No. 3, p. 18 and *Kamerstukken II,* 1962/63, No. 19, p. 42.

42. *Hoge Raad* 1 November 1989, No. 25 512, BNB 1990/63 and 64; for an overview of relevant case law and literature, reference is made to Marres and Wattel, *Dividendbelasting*, op. cit., Para. 1.4.4.3.

43. For corporate taxpayers, such rules follow from both the statute (notably CITA 1969 in conjunction with ITA 2001 and administrative regulations as well as a court-developed set of rules know as "sound business practice" (*goed koopmansgebruik*).

44. See Marres and Wattel, *Dividendbelasting*, op. cit., Para. 1.4.4.4.

dividend withholding tax, an (open, non-transparent) so-called "fund for joint account" (*fonds voor gemene rekening*) is deemed to be a company having a capital divided into shares (Art. 1(2) DWTA 1965). The term "companies" does in principle not encompass co-operative associations organized under Dutch law (*coöperaties;* co-ops), as such co-ops in principle do not have a capital divided into shares. If structured properly, distributions by a co-op are not subject to Dutch dividend withholding tax. However, a law proposal pending before Dutch parliament at the time of writing of this chapter, as of 1 January 2012 introduces an anti-abuse provision (Article 1(7) DWTA 1965 (new)) that implies liability for Dutch dividend withholding tax for certain distributions made by co-ops (interposed in a holding structure) in cases that are perceived to be abusive. The relevant provision (if adopted, which will expectedly be the case) creates liability for dividend withholding tax[45] for distributions to a specific member of such co-op if the following conditions are met:

(i) the main purpose or one of the main purposes of the interposition of the co-op is the avoidance of Dutch dividend withholding tax or the avoidance of non-Dutch taxation of such member; and
(ii) the participation in the co-op the level of such member is not part of the assets of a business enterprise.

Through the second criterion (i.e. the requirement of a business enterprise), international groups having an active business may be safeguarded from the new anti-abuse measure for co-ops. However, even if the relevant member of a co-op does attribute its membership to the assets of a business enterprise, the law proposal provides that distributions to such member –to the extent that such distributions are made from profit reserves that were built-up prior to the interposition of the co-op - are still in principle subject to dividend withholding tax if the main purpose or one of the main purposes of the interposition of the co-op is the avoidance of Dutch dividend withholding tax. According to the explanatory note to the law proposal, the above anti-abuse measures aim to target wholly artificial transactions in which the interposition of the co-op lack any real business driver. An example given in the explanatory note of such an abusive situation in international groups is the situation where a co-op is interposed between the (non-Dutch) shareholder of a Dutch BV and such BV (solely) to avoid Dutch dividend withholding tax.[46]

20.3.1.2. Interrelation with other categories or subcategories of income

In principle, the characterization of income for tax purposes follows the (civil law) structuring thereof by parties involved. Exceptions to this general rule include sham transactions and constructive dividends, where other income may (in part) be recharacterized as dividend (for constructive dividends, refer to 20.3.2.1.). Another notable exception is where (downstream) debt financing instruments, provided by shareholders, are recharacterized for tax purposes as equity (see below 20.3.1.2.1.).[47] The (interest) remuneration paid in respect of such recharacterized financing instruments in principle qualifies as a dividend distribution for Dutch tax purposes. A further category of debt financing instruments that is affected by shareholder influences is intra-group loans in respect of which the creditor has accepted a non-arm's length debt risk (see below 20.3.1.2.2.).

A special case concerns the (potential) recharacterization for tax purposes of an equity instrument into debt. A meaningful precedent for such recharacterization is lacking. However, there is an interesting, very recent case decided by the Haarlem District Court (*Rechtbank Haarlem*),[48] which will be discussed briefly at 20.3.1.2.3.

20.3.1.2.1. *Recharacterization of debt instruments as equity*

Based on settled case law, the characterization of a financing arrangement as debt for Dutch tax purposes in principle follows the characterization of such arrangement for civil law purposes, i.e. a "formal" criterion for characterization applies.[49] There are three exceptions to this general rule, namely in case of:

(i) sham loans (*schijnleningen*);[50]

---

45 This is achieved by, in respect of relevant distributions, recharacterizing the relevant co-op as a company with a capital divided into shares and by equating the relevant membership with a share interest.

46 *Kamerstukken II* 2011-2012, 22 003, N0. 2, p. 111.

47. An upstream loan by a company to its shareholder may also subject to recharacterization for tax purposes, such loan itself then qualifying as a constructive dividend (*Hoge Raad* 29 October 2004, No. 40 296, *BNB* 2005/64).

48. *Rechtbank Haarlem*, 25 January 2011, No. 09/3391, *NTFR* 2011/1548.

49. *Hoge Raad* decisions of 27 January 1988, No. 23 919, *BNB* 1988/217, 10 August 2001, No. 36 622 *BNB* 2001/364 and 8 September 2006, No. 42 015, *BNB* 2007/104. The use of the term "formal" would in our view refer to the civil law characterization of a transaction (rather than the characterization for accounting purposes).

50. A sham loan occurs if parties only create the appearance of a loan, but in fact intend to bring about an equity contribution.

(ii) loss financing loans (*bodemlozeputleningen*);[51] or
(iii) hybrid financing loans ('participating' loans, *deelnemerschapsleningen*).[52]

If any of the above exceptions apply, the relevant financing arrangement qualifies as equity for Dutch purposes. Interest paid on a recharacterized loan qualifies a dividend distribution for Dutch tax purposes and is treated accordingly (see 20.3.1.1.1., 20.3.1.1.2. and 20.3.1.1.3.).

In addition, the existence of a repayment obligation appears to be an essential element for the *Hoge Raad* to qualify a financing arrangement as debt for tax purposes.[53]

Apart from recharacterization of debt instruments as equity (which implies non-deductibility of interest payments on such instruments), there are specific statutory interest deduction limitations in Dutch tax law. Reference is made here specifically to interest deduction limitations in respect of the certain “tainted” related-party transactions (as set out in Art. 10a CITA 1969)[54] and to Dutch thin capitalization rules (as set out in Art. 10d CITA 1969).[55] However, the statutory limitation mentioned here does not imply recharacterization of the (non-deductible) interest payments as dividends.

---

51. A loss financing loan occurs if a taxpayer in its capacity as shareholder of a company in which it holds a participation (i.e. generally, a shareholding of 5% or more), extends a loan to its subsidiary under conditions that are such that the taxpayer should have realized from the outset that the claim resulting from the loan is (in part) worthless, because the monies lent cannot (in part) be repaid, as result of which the relevant lent amount has permanently left the capital of the taxpayer (to the extent of course that such capital does not exist of shares in the relevant subsidiary). An upstream loan of a subsidiary to its shareholder may, mutatis mutandis, also qualify as a loss financing loan (and thus effectively qualify as a dividend distribution).

52. Debt is requalified as equity in case of participating loans. The following three conditions should be met: (i) the term is perpetual (i.e. it is over 50 years) or the loan is solely repayable in case of bankruptcy or liquidation of the debtor; (ii) the remuneration on the debt is entirely or nearly entirely contingent on profits; and (iii) the loan is subordinate to all creditors (*Hoge Raad* decisions of 11 March 1998, No. 32 240, *BNB* 1998/208 and 25 November 2005, No. 40 980, *BNB* 2006/82).

53. A case in point was one in which a parent company issued a EUR 25 million loan to its subsidiary to finance the latter company’s oil and gas exploration, without any guarantee (or in fact security) that the loan would ever be repaid. In its pivotal consideration, the *Hoge Raad* ruled: “[N]or the fact that a third party would not have issued the loan without security being provided by the taxpayer [i.e. the subsidiary receiving the loan] or a sister company, nor the fact that the loan was entered into on non-arm’s length terms, neither the fact that the repayment obligation is conditional [effectively upon the subsidiary striking oil or gas] and the fact that repayment is uncertain, deprive that loan of it debt characterization, which includes a repayment obligation for the recipient of the funds. Such repayment obligation lends the loan its debt character.” (*Hoge Raad* 8 September 2006, No. 42 015, *BNB* 2007/104, Para. 3.4.). Although this decision was rendered for capital tax purposes, it is generally assumed that due to its clear wording it is also relevant for corporate income tax purposes.

54. This anti-abuse provision is specifically targeted at situations that may be typified as “base erosion”. The common feature of such structures is that (group) equity is converted into debt in one or more transactions that have a somewhat artificial character (and without a valid business reason). Interest and fluctuations in value in respect of loans which are legally or de facto, directly or indirectly, owed to related entities or related individuals are not deductible, to the extent these loans relate legally or de facto effectively, directly or indirectly, to one of the following transactions (tainted transactions): (i) a distribution of profits or repayments of capital by the taxpayers (or a related entity/individual) to a related entity; (ii) a capital contribution by the taxpayer (or a related entity/individual) in a related entity; or (iii) the acquisition or increase by the taxpayer (or a related entity/ individual) of an interest in an entity that is a related entity after such acquisition or increase. This anti-abuse provision, however, does not apply if the taxpayer establishes that: (i) the debt and the related transactions are predominantly motivated by business reasons; or (ii) the interest on the loan is taxed in the hands of the recipient at a level that is sufficient determined under Dutch tax rules (i.e. at least 10%) and the recipient is not entitled to loss carry-forward or another entitlement from years preceding the year in which the debt was issued as a result of which the interest is not sufficiently taxed, unless the Dutch tax inspector substantiates that the debt was issued with the intention to offset losses or other entitlements which may arise in either the current year or any subsequent year or that debt or the related transaction is not predominantly motivated by business reasons. A “related entity” is: (i) an entity in which the taxpayer owns at least a one third interest; (ii) an entity that owns at least a one third interest in the taxpayer; or (iii) an entity in which a third party owns at least a one third interest while this third party owns at least a one third interest in the taxpayer. The term “interest” refers both to the paid in capital (financial interest) and the issued capital (voting interest) and includes direct and indirect relations. A “related individual” is an individual who (i) owns at least a one third interest in the taxpayer or (ii) owns at least a one third interest in a entity related with the taxpayer (a related entity) (Art. 10a (4) CITA 1969).

55. Generally, under Dutch thin cap rules (Art. 10d CITA 1969), if a corporate taxpayer has excess debt in a specific book year and this taxpayer is part of a “group”, such taxpayer will, pursuant to Art. 10d(1) CITA 1969, be denied deduction of a proportionate part of the interest paid in that year. An excess of debt is present in cases where (i) the average debt of a taxpayer exceeds three times the average equity (fixed ratio test) and (ii) this excess is EUR 500,000 or more. If a taxpayer does not meet the fixed ratio test, it can opt to apply the so-called “group ratio” test. Under the latter test, the company has excess debt if the debt to equity ratio on its individual commercial balance sheet exceeds the debt to equity ratio the consolidated commercial balance sheet of the group it belongs to. For purposes of the calculation under both tests the term “debt” should be construed as the balance of the outstanding amounts borrowed by the taxpayer and the outstanding amounts lent. The maximum amount of interest that may not be deducted under Art. 10d CITA is equal to the balance of the interest paid on loans that are directly or indirectly due to “related entities” and the interest received on loans lent to such entities.

20.3.1.2.2. *"Bad debt" (intra-group)*

On 9 May 2008, the *Hoge Raad* decided a much-discussed case involving an upstream loan provided by a subsidiary (a Dutch company) to one of its shareholders (BNB 2008/191).[56] The Court ruled that the creditor/subsidiary was not allowed to (partially) write down the loan, to the extent that it had accepted the underlying bad debt risk, which an independent third party would not have taken, with the intention to benefit its shareholder(s). Facts and circumstances underpinning this decision were the fact that no security had been requested or granted and that the shareholder was a holding company (without any other assets or financing) that would need to repay the loan from dividends from its subsidiaries.[57] In its decision, the Court left open a number of issues that have since been the subject of extensive academic debate and tax procedures in the Netherlands. Follow-up questions that are particularly relevant for the purposes of this report are:

(i) Does BNB 2008/191 also apply to (downstream) shareholder loans?

(ii) Should a loan be recharacterized into either a (constructive) dividend (in case of an upstream loan) or an (informal) equity contribution (in case of a downstream loan) respectively, to the extent that a bad debt risk has been accepted on non-arm's length terms?

(iii) How does one qualify interest payments in respect of a loan to the extent that a bad debt risk has been accepted on non-arm's length terms?

These questions have been addressed in a very recent case decided by the *Hoge Raad* on 25 November 2011 involving a downstream shareholder loan.[58] The first question is answered affirmatively. In response to the

---

56. *Hoge Raad* 9 May 2008, No. 43 849, BNB 2008/191. Arguably, this decision followed directly from long-standing case law regarding the application of the overall-profit principle. For an overview of relevant case law and literature, see De Boer, R.A, and Molenaars, M.L., "The tax treatment of bad debt risk in respect of intra-group loans in the Netherlands – the score so far", *Derivatives and Financial Instruments* (2010) p. 6.

57. In more detail, the facts of this case were as follows. At the instigation of its shareholders (more specifically, holders of depositary receipts representing shares in X BV and also in another company, F BV), the taxpayer, a Dutch BV (X BV) heading a group of companies, had granted loans to another Dutch company (Holding, an acquisition vehicle established by a segment of the depositary receipt holders of X BV). These loans were intended to enable Holding to buy shares in X BV and F BV and to thus (in part) take over the group headed by X BV and F BV. In several tranches, Holding acquired depositary receipts in X BV and by the end of 1997, Holding held 23.16% of the depositary receipts of X BV and 7.3% of the depositary receipts of F BV. The aggregate purchase price for these depositary receipts was EUR 10,235,760. This entire amount had been financed by an acquisition loan (booked through a current account relationship) provided by X BV. Each year, interest accrued on this loan (varying from a rate of 4.7% in 1996 to 5.63% in 2000) and by the end of 2000 the balance on the current account amounted to EUR 13,213,837. In three instalments, Holding had by the end of 2000 repaid an amount of EUR 115,030. There was no written loan agreement between the parties, nor was there a repayment schedule. Also, very significantly for the later ruling of the Court of Appeals (*Gerechtshof*) and the *Hoge Raad* in this matter, no security was either requested or provided. In each year within the period from 1996 up to 2000, the group headed by X BV had incurred losses (amounting to an aggregate commercial loss of EUR 24,619,216). X BV therefore never paid any dividends to Holding. X BV equity capital had been negative as of 1997. In 2001, X BV sold and transferred its debts claim on Holding (amounting to EUR 13,198,000) to F BV for sale price at fair market value of EUR 6,205,400. In the same year, the shares in Holding were sold for a token amount of EUR 1. In 1999, X BV had made a bad debt risk provision of EUR 5 million in respect of the loan to Holding. In 2000, X BV made an additional provision of EUR 2 million. The tax inspector did not accept the latter additional provision, citing the non-arm's length character of the loan. This position of the tax inspector, as upheld by the *Gerechtshof*, which cited the above non-arm's length features of the loan and ruled that the loan in the years 1995 to 2000 should be considered a "non-arm's length' loan (*onzakelijke lening*) and that "no third party would have granted the loan under the given circumstances".

58. *Hoge Raad* 25 November 2011, No. 08/05323, *V-N* 2011/63.10 (the preparatory conclusion in this case was provided by Advocate-General Wattel; an detailed discussion of Wattel's conclusion is included in De Boer, R.A, and Molenaars, M.L., "The tax treatment of bad debt risk in respect of intra-group loans in the Netherlands – the score so far", op. cit.). A summary of this case is as follows. This case involved a shareholder loan (downstream scenario). At the end of 1999, the taxpayer in question (X BV) transferred a portfolio of listed securities to its hundred percent subsidiary (A BV) against a debt claim (booked through a current account relationship) of around €5.3 million. At that time, A BV had an equity capital of around €18,000. At the time of granting of the loan, no written record was made of interest and repayment obligations and no security was provided for. At the beginning of 2001, X BV and A BV converted the debt claim into a formal loan through a written agreement, in which they also agreed on repayment of the loan within a 10 year term and on the charging of an annual interest at a rate of 5%. Furthermore, A BV committed itself to issue a pledge on its entire investment portfolio at the first request of X BV. In 2000 and 2001, A BV received income from its investment portfolio of around €130,000 and €154,000 respectively. The interest that accrued in those years on the shareholder loan from X BV amounted to around €264,000 and these amounts were debited to the current account of A BV. In December 2001, X BV and A BV transferred their place of effective management to the Netherlands Antilles. At the time of the transfer, the equity capital of A BV amounted to a negative amount of a little over €1.2 million. Due to the negative equity capital of A BV, the taxpayer, X BV, in the year 2001 wrote down €1.2 million on the shareholder loan to A BV. The tax inspector refused to allow this

second question, the Court rules that loans carrying a non-arm's length debt risk (which risk cannot be adjusted through the interest rate) should not be (partly) recharacterized as either a capital contribution or as a dividend distribution. The latter decision corresponds to the view, also put forward in this case by Advocate-General Wattel and explicitly endorsed by the Court, that the recharacterization of debt instruments under Dutch case law (as set out above at 20.3.1.2.1. for downstream loans and note 56 for upstream loans) form a "closed" system. As regards question (iii) on interest, the Court dismisses the view (put forward by some in literature in response to BNB 2008/191) that for tax purposes the interest should be cleared from any elements that pertain to (a certain) debt risk assumed by the creditor. Instead, the Court, for the stated reason of simplicity, has decided that as a rule of thumb the interest on a related party loan carrying a non-arm's length debt risk should be set at the interest rate that the relevant related party debtor should have had to pay on a third party loan (the terms and conditions of which would correspond to the related party debt at stake), where such third party loan would have been guaranteed by the related party creditor.

20.3.1.2.3. *Recharacterization of equity instruments*

The question whether equity instruments may be recharacterized as debt financing (other than in case of a sham transaction or relative simulation, where parties in fact aim to realize debt financing) has been subject to some debate in Dutch academic literature,[59] with authors taking opposing views.[60] Thus far, conclusive case law is absent. Recently, however, the *Rechtbank Haarlem* rendered a decision in which it ruled that redeemable preference shares held by a Dutch corporate taxpayer in an Australian Ltd. should be treated as debt for Dutch tax purposes (which resulted in the "dividend" received in respect of these shares being taxable as interest, rather than being exempt under the Dutch participation exemption).[61] The facts in this case were as follows. The Dutch taxpayer, X NV, held a direct participation in A Ltd., an Australian company. X NV had issued shareholder loans to A Ltd., the interest on which was taxable in the Netherlands. In 2004, the shareholder loans were converted into redeemable preference shares. X NV claimed that dividends received on these shares were exempt under the Dutch participation exemption. The tax inspector, however, taxed the dividends as interest. His first argument was that the redeemable preference shares should be recharacterized as debt for tax purposes – the published decision does not specify explicitly whether the tax inspector argued that the transaction amounted to a sham or whether the facts were recharacterized for tax purposes. Alternatively, the tax inspector claimed that the conversion of the shareholder loans into redeemable preference shares should be ignored based on the fact that this transaction was wholly artificial and did not have any other purpose than to avoid Dutch taxation. The *Rechtbank*, after having extensively cited the case law on recharacterization of debt instruments (see above at 20.3.1.2.1.) accepted the first argument of the tax inspector and ruled as follows:

> [T]aking into account the terms and conditions under which the shares have been issued, such as a fixed non-profit dependent interest rate (which was later to be gradually increased), a fixed term, the absence of voting rights, the Court holds that there is in fact a debt instrument in place. The fact that the transfer of shares within the [A-group] took place against a promissory note, the fact that in the annual accounts of the taxpayer the intercompany debt and corresponding

---

write down as a tax deductible cost, stating that the loan was non-arm's length. This position was maintained by the *Rechtbank* (on first appeal) and the *Gerechtshof* (on second appeal) of Arnhem. In its ruling, the *Gerechtshof* cited the above quoted consideration from the *Hoge Raad* in *BNB* 2008/191 and ruled that X BV had granted a loan to A BV under such terms and circumstances that the X BV had exposed itself to a bad debt risk that no third party would have accepted. According to the *Gerechtshof*, X BV had solely accepted his bad debt risk in its capacity of shareholder of A BV. The *Gerechtshof* ruled that there were no special circumstances that would lead to another decision. To support its decision that the shareholder loan in question was non-arm's length, the *Gerechtshof* in particular referred to the absence of substantial equity capital at A BV, the absence, at the start, of a loan agreement regarding interest payment and a term for repayment and the absence of any (meaningful) security. The *Gerechtshof* further referred to the vicious cycle caused by the fact that for lack of sufficient income from its investment portfolio, A BV would have to sell assets in order to meet its interest obligations, which would in turn further undermine it ability to service the loan. Such cycle could only be broken by a rise in the value of the portfolio. However, in fact a drop in value occurred. According to the *Gerechtshof*, a third party creditor acting on arm's length terms would not accept that the repayment of the loan and the payments of interest would only be guaranteed if the stock prices would rise. The taxpayer then appealed to the *Hoge Raad*.

59. For an overview of literature, reference is made to Bon, W. and Cornelisse, R.P.C., "Aandelen kunnen feitelijk [fiscaal] niet functioneren als vreemd vermogen", *Weekblad voor Fiscaal Recht,* (2008) 6751, at p. 137.

60. Bon and Cornelisse (id.) categorically argue that a recharacterization of (preferred) equity, even in cases of shares issued under non-Dutch civil law, should not possible under Dutch tax law (other than in cases of sham transactions or relative simulation). Bruins Slot, for example, takes another view and argues, in respect of cumulative preference shares, that such shares should qualify as debt if the holder thereof is entitled to repayment of the principal amount or if the holder thereof still has power of disposition in respect of such amount (other factors, such as the fixed and periodical nature of dividends, subordination and control rights, according to him are only of secondary interest) – Bruins Slot, W., "De bank als houder van cumulatief preferent aandelenkapitaal", *Weekblad voor Fiscaal Recht* (1996) 6220, p. 1625.

61. *Rechtbank Haarlem* 21 January 2011, No. 09/3391, *NTFR* 2011/1548.

> intercompany debt claim have been consolidated, the fact that in the annual accounts the shares are represented as a long term debt claim on the relevant subsidiary and the dividends paid on the shares are accounted for as debt income and the fact that in the annual accounts of [A4 – i.e. the relevant subsidiary] the shares are represented as long term debt also point to the conclusion that the shares qualify as equity only as to their form, while in fact the taxpayer and [A4] intended to bring about a debt instrument.

The wording of this cited paragraph suggests that the *Rechtbank* was of the opinion that the conversion amounted to a sham transaction or relative simulation. We think that this judgment may be subject to criticism, as the *Rechtbank* may have failed to appreciate that the (Australian) civil characteristics of the redeemable preference shares were real and appeared to have been respected by the parties involved. Thus, there would not seem to be a sham (unless the *Rechtbank* referred to Dutch civil law – in which the concept of a redeemable preference share is unknown – rather than Australian civil law in characterizing the instrument). An explanation for the *Rechtbank*'s arguably not entirely justified reference to a sham, may perhaps be that it was hesitant, absent precedents, to explicitly decide that the redeemable preference shares in the present should for tax purposes be recharacterized as debt. In an obiter dictum, the *Rechtbank* also accepted the alternative argument of the tax inspector in ruling that the taxpayer, X NV, in converting the shareholder loans into redeemable preference shares, had acted in *fraudem legis* that accepting an exemption of the dividend payments would be contrary to object and purpose of Dutch tax law. The taxpayer has lodged an appeal against the decision (which is currently pending) and the further outcome of this case is to be awaited. In the authors' view, given the very specific circumstances of this case, the eventual outcome may not necessarily be representative for all (redeemable) preference share situations.

20.3.2. Constructive dividends, tax recharacterization of non-profit reserves, anti-abuse rules relating to dividend arbitrage schemes

20.3.2.1. Constructive dividends

The general definition of dividend from BNB 1959/124 cited above in 20.3.1.1. – a shift of assets by the company to its shareholder covered by profit reserves – illustrates that Dutch tax law refers to a material concept of dividend rather than that a formal approach is used, under which only formal reductions in the net equity of the distributing company – generally, formal dividend distributions – qualify as dividend. This is in line with the overall-profit principle under Dutch tax law, which clears a company's profit from withdrawals induced by shareholder influences. For such withdrawal to qualify as a dividend, long-standing case law by the *Hoge Raad* requires that the distributing company "wanted to favour its shareholder in that capacity" and also "that the shareholder wanted to accept such benefit" (subjective requirement of mutual intention).[62] Over the course of the past six decades, the *Hoge Raad* has allowed for objectification of this subjective requirement, for instance, by allowing the tax inspector to demonstrate that such mutual intention is deemed to be present if a subsidiary transfers an asset to its shareholder for a consideration substantially below the fair market value of such asset – in effect an application of the arm's length principle.[63] The codification of the arm's length principle in Art. 8b of the CITA 1969 as of 1 January 2002 implies that this subjective requirement was further objectified in case of non-arm's length terms in transactions between related parties. When introducing this provision, the legislator stated its assumption that a non-arm's length transfer price amounts to presumptive evidence that there is a mutual intention of benefiting the shareholder.[64]

20.3.2.1.1. *Repayment of capital and repurchase of shares*

Under Dutch tax law, through the overall-profit principle, a repayment of capital that is recognized for Dutch tax purposes does not affect the profit determination for corporate income tax purposes of the distributing company. Although such repayment of capital does not qualify as a dividend for corporate income tax purposes, a partial repayment of paid-in capital, if and to the extent that there are net profits (*zuivere winst*), does qualify as a taxable dividend under the DWTA 1965, unless the general meeting of shareholders has resolved in advance to make such a repayment and provided that the nominal value of the shares concerned has been reduced by a corresponding amount by way of an amendment of the articles of association of the company (Art. 3(1)(h)

---

62. A landmark case in this respect is *Hoge Raad* 30 December 1953, No. 11 555, BNB 1954/61.
63. Refer e.g. to *Hoge Raad* 4 September 1997, No. 31 067, BNB 1997/42.
64. *Kamerstukken II* 2000/01, 28 034, No. 3, p. 21.

DWTA 1965). Although at the level of the shareholder a repayment of recognized capital is in principle not taxed as a dividend for corporate income tax purposes, a repayment of capital may add to taxable profit (presuming the participation exemption is not applicable), generally to the extent that such repayment exceeds the tax book value of the relevant shares. Generally, under the sound business principle in Dutch tax law, a corporate taxpayer should value a share interest at the lower of either the cost price or the value in use (*bedrijfswaarde*).[65] The value in use may generally refer to the intrinsic value (i.e. the value based on a company's assets)[66] or the (stock) market value.[67]

From the perspective of a company repurchasing its shares, a repurchase of shares (other, generally, than in cases where such shares are repurchased as temporary investment) qualifies as a redemption of such shares[68] for both corporate income tax and dividend withholding tax purposes, and thus leads to both a repayment of recognized paid-in capital and as a distribution of profit reserves connected to such shares.[69] An indirect repurchase of shares, whereby a subsidiary (re)purchases shares of its parent company from the shareholders of the latter company in principle qualifies as a taxable repurchase of shares by such company for dividend withholding tax purposes.[70] The *Hoge Raad*'s reasoning behind this is that the indirect repurchase in fact amounts to a transfer of assets by the parent company to its shareholders (through a reduction of the value of its interest in the repurchasing subsidiary). Some authors have argued that such indirect repurchase could only lead to a taxable dividend in situations in which the relevant parent company holds a majority interest in the subsidiary that repurchases such parent company's shares.[71] From the selling shareholders' perspective, a repurchase of shares is in principle construed as a taxable transfer and, unless the participation exemption applies, taxable profit is recognized to the extent the repurchase price exceeds the tax book value of such shares.

20.3.2.1.2. *Constructive dividends through non-arm's length terms in related-party transactions*

There is a plethora of situations in which constructive dividends in the above-captioned sense may occur further to the overall-profit principle, the arm's length principle or under the broad definition of Art. 3(1)(a) DWTA. This ranges from the transfer of an asset by a subsidiary to its shareholder (or for that matter, to a sister company (ultimately) held by the same parent) for a consideration below fair market value (or vice versa, where a subsidiary purchases an asset from its shareholder or a sister company held by such shareholder for a price exceeding fair market value),[72] to non-arm's length financing, such as upstream "loss financing loans" (see above 20.3.1.2.1.) and upstream interest-free loans.[73]

Both at the level of the distributing company and the corporate shareholder, the relevant (transfer pricing) adjustments are in principle[74] accounted for as taxable dividend distributions, both for Dutch corporate income tax and dividend withholding tax purposes (generally unless the participation exemption should apply).

20.3.2.2. Recharacterization of non-profit reserves

In case of a distribution of non-profit reserves, the question may arise whether such distribution may nonetheless qualify as a dividend distribution for tax purposes. Under Dutch tax law, a case in point is the repayment of paid-in capital (recognized for tax purposes) to the extent that the distributing company has net profits. For purposes of dividend withholding tax, such repayment may qualify as a taxable dividend (refer to the above discussion of Art. 3(1)(h) DWTA 1969).

---

65. See, inter alia, *Hoge Raad* 17 June 1963, No. 117/1963, BNB 1963/311.
66. Refer e.g. to *Hoge Raad* 10 February 1960, No. 14 178, BNB 1960/108.
67. See, inter alia, *Hoge Raad* 17 June 1963, BNB 1963/311.
68. Even if for civil law purposes such shares are not (yet) in fact amortized.
69. *Hoge Raad* 14 November 1956, No. 12 894, BNB 1957/20.
70. *Hoge Raad* 14 March 1979, No. 19 023, BNB 1979/153.
71. See e.g. Den Boer, P., in his annotation to BNB 1979/153.
72. See, inter alia, *Hoge Raad* 25 November 1992, No. 27 519, BNB 1993/41.
73. See, inter alia, *Hoge Raad* 7 January 1970, No. 16 279, BNB 1970/62 and *Hoge Raad* 14 April 1999, No. 34 137, BNB 1999/326.
74. There is some discussion in Dutch academia as to whether case law of the *Hoge Raad* (notably *Hoge Raad* 14 June 2002, No. 36 453, BNB 2002/290) would allow for a category of expenses not related to the business enterprise of a corporate taxpayer (*onzakelijke uitgaven*) that would not qualify as being done for the benefit of the shareholder and thus not qualify as a dividend distribution.

Another relevant example of such effective recharacterization of non-profit reserves may occur in situations where a company effects loss absorption by reducing the nominal value of its shares or by reducing its contributed capital recognized for tax purposes (including. share premium and informal capital contributions). Based on case law by the *Hoge Raad,* such loss absorption leads to a reduction of recognized capital for tax purposes[75] and, as a consequence, a subsequent repayment of such capital qualifies as a taxable dividend distribution for the purposes of dividend withholding tax. Marres and Wattel label this a (unwarranted) breach of the basic principle (*basisconceptie*) underlying Dutch dividend withholding tax that implies that capital repayments remain untaxed.[76]

20.3.2.3. Domestic anti-abuse measures relating to dividend arbitrage schemes

Since 2001, the CITA 1969 (Art. 25(2)) and the Dutch Dividend Tax Act 1965 (Art. 4(7)) contain a negative definition of the term "beneficial owner" targeted at countering dividend stripping situations.[77] The consequence of not qualifying as beneficial owner of a dividend under Art. 25(2) CITA 1969 is that the relevant Dutch taxpayer cannot credit Dutch dividend withholding tax as a pre-levy of Dutch corporate income tax against corporate income tax. As for Art. 4(7) DWTA 1965, the result of being denied beneficial ownership of a dividend is that the relevant taxpayer or withholding agent is not entitled to either an exemption at source, a refund or a rebate (the latter being applicable to withholding agents in case of certain onward distributions), as the case may be, of Dutch dividend withholding tax. The anti-dividend stripping rules in the DWTA 1965 are also intended to apply in tax treaty situations via Art. 3(2) of tax treaties based on the OECD Model Convention. See 20.7.1.2. and 20.8.5.3. respectively of this report for a discussion of EU and international tax law aspects.

The Dutch anti-dividend stripping provisions purport to achieve that a shareholder who is the recipient of dividends will not be considered the beneficial owner of the dividends if, as a consequence of a combination of transactions, a person other than the recipient wholly or partly benefits from the dividends, whereby such person retains, whether directly or indirectly, an interest in the shares on which the dividends were paid and such person is entitled to a credit, reduction or refund of the dividend withholding tax that is less than that to which the recipient is entitled. The burden of proof rests with the tax inspector. The provision specifically targets dividend stripping schemes following predetermined steps. For purposes of practical flexibility, it does not give an exhaustive definition of dividend stripping scheme.

Examples of targeted schemes[78] are share repurchase agreements, stock lending, the sale of shares in combination with "deep-in-the-money" put options[79] and also equity swaps.[80] In each case, for the anti-dividend stripping rules to apply, the dividend recipient has to have an obligation to pass on all or part of the dividend to the original shareholder. Generally, the anti-dividend stripping rules are thought to apply only in evident cases of dividend stripping – notably because the tax inspector may in cases where dividend stripping was not parties' (primary) intention not easily be able to proof that the transaction amount to dividend stripping, e.g. in cases of stock lending where the shares lent are immediately transferred by the lender to a third party pursuant to a transfer obligation under a (forward) share sale. In principle, intra-group (re)structuring is targeted by the anti-dividend stripping provision only if the (re)structuring amounts to last-minute tax planning.[81] In each case, the

---

75. *Hoge Raad* 30 September, No. 33 668, BNB 1998/362.

76. Marres and Wattel, *Dividendbelasting*, op. cit., Para. 1.4.3.2.

77. Art. 25(2) CITA 1969 reads as follows: "Contrary to Paragraph 1, dividend withholding tax is not taken into account as a pre-levy [of Dutch corporate income tax] if the taxpayer for the account of whom the dividend withholding tax has been withheld is not also the beneficial owner of the proceeds in respect of which dividend withholding tax has been withheld. A person is not considered to be beneficial owner if such person in connection with the received proceeds has paid a consideration as part of a combination of transactions, in which it is plausible that:
(a) the proceeds have wholly or partially, directly or indirectly, benefited an individual or an entity who is entitled to a reduction, refund, or credit of dividend withholding tax that is less than that to which the person having paid the consideration is entitled; and
(b) such individual or entity [as meant in sub-paragraph(a)] directly or indirectly remains to hold or acquires a position in shares, profit-sharing certificates or [hybrid] loans as meant in Article 10(1)(d) of the CITA 1969 that is similar to its position in similar shares, profit-sharing certificates, or [hybrid] loans before the start of the combination of transaction [as meant above]."
The negative definition of beneficial owner in Art. 4(7) DWTA 1965 reads substantially the same.

78. Explanatory Note to the relevant law proposal, *Kamerstukken II*, 2001/01, 27 896*,* No. 3, p. 2*.*

79. In a case applying to a period before the introduction of the statutory anti-dividend stripping rules, the *Hoge Raad* had refused to apply *fraus legis* to exactly such sale of shares in combination with a deep-in-the-money put option. *Hoge Raad*, 21 February 2001, No. 35 415, BNB 2001/196.

80. For an overview and description of such targeted transactions, see Van IJlzinga Veenstra, A.T.R. and Eenhorst, Q.M.A., "Dividendstripping in 2001", *Weekblad voor Fiscaal Recht* (2000) 6143 pp. 271-282.

81. See also Decision of the State Secretary of Finance of 15 January 2011, No. DGB2010/8223M, *V-N* 2011/9.15.

tax inspector is obliged to take into account the result of the transactions as well as at the relevant circumstances. The anti-dividend stripping provision may also apply if the purchaser of shares is not aware of entering into a transaction with a seller having dividend stripping in mind (which includes (anonymous) transactions through a stock exchange).[82] However, this seems at odds with parliamentary history, in which the State Secretary of Finance has expressed that unsuspecting purchasers should not be affected.[83]

20.4. Tax treatment of dividend distributions under special tax regimes in domestic law

20.4.1. Fiscal unity (corporate income tax)

Art. 15 CITA 1969 provides a tax consolidation regime ('fiscal unity') for Dutch corporate income tax purposes. Benefits of the fiscal unity regime include: "horizontal" offsetting of profits and losses, tax-exempt transfers of assets and liabilities between companies included in the fiscal unity and a decreased administrative burden as only the parent company of the Dutch fiscal unity is required to file a Dutch corporate income tax return.[84] In order to be regarded as a fiscal unity, a parent company should have the legal and economic ownership of at least 95% of the shares of the subsidiary.[85] An indirectly held subsidiary (sub-subsidiary) may be included in a fiscal unity, provided that the intermediate subsidiary is also included in the fiscal unity.[86] Both resident and non-resident companies may opt for the Dutch fiscal unity regime.[87] Similar to other intercompany transactions, dividend distributions between companies included in a fiscal unity are also ignored for Dutch corporate income tax purposes.[88]

20.4.1.1. Fiscal unity and participation exemption

The question arises whether or not forming a fiscal unity provides additional possibilities compared to applying the Dutch participation exemption to avoid economic double taxation (profits are taxed at the level of the distributing subsidiary and at the level of the receiving parent company) on a dividend distribution. When taking as an example a fiscal unity between a Dutch resident parent company and its resident subsidiary, in certain circumstances the possibilities of avoiding economic double taxation through a fiscal unity turn out to potentially be more restricted compared to those under the Dutch participation exemption regime. For instance, Art. 15(3)(e) CITA 1969 requires that in order to qualify for the Dutch fiscal unity regime, a subsidiary should be "a BV, an NV, or a comparable organization by reason of its nature and its manner of formation that is incorporated under the law of the collection area within the Kingdom [of the Netherlands] or State referred to in [Art. 15(3)] subpart d." A Dutch cooperative society (*coöperatie*), for instance, is not listed in Art. 15(3)(e) CITA 1969. Accordingly, a *coöperatie* cannot be included in a fiscal unity as subsidiary.[89] By contrast, income received from the membership in a *coöperatie* may be exempt under the Dutch participation exemption.[90]

In pertinent part, Art. 13(1) in conjunction with Art. 13(2)(a) CITA 1969 provides that the benefits derived from a participation are exempt from Dutch corporate income tax, provided that the taxpayer holds as least 5% of the nominal paid-up capital of a company of which the capital is wholly or partly divided into shares. If the parent company of a fiscal unity (company A) and its subsidiary (company B, also included in the fiscal unity), each have 3% of the shares in company C (not included in the fiscal unity), the question arises whether or not company A can apply the participation exemption to the benefits derived from the joint 6% shareholding in company C. In the authors' view, that question should be answered affirmatively: as a result of the fiscal

82. See Art. 25(3) CITA 1969 and Art. 4(8) DWTA 1965, which were introduced to explicitly cover transactions involving listed securities.
83. *Kamerstukken II*, 2001/02, 27 896, No. 5, pp. 4-5.
84. For an overview of the benefits of the Dutch fiscal unity regime, see Advocate General Kokott's Opinion, 19 November 2009, Case C-337/08, *X Holding v. Staatssecretaris van Financiën*, Para. 23.
85. Art. 15(1) CITA 1969.
86. Art. 15(2) CITA 1969.
87. Arts. 15(3)(c) and 15(4) CITA 1969.
88. See Kok, Q.W.J.C.H., "De fiscale eenheid met een buitenlandse dochtermaatschappij", *Weekblad voor Fiscaal Recht* (2003) 6535 p. 1027.
89. It is observed that a *coöperatie* can be included in a fiscal unity as the parent company, see Art. 15(3)(d) CITA 1969.
90. Art. 13(2)(c) CITA 1969.

consolidation, the shareholdings of company A and company C are taken together. Accordingly, company A, the taxpayer on behalf of the fiscal unity, is able to apply the Dutch participation exemption.[91]

20.4.1.2. Fiscal unity and tax treaties

One may ask what the position is of a subsidiary that is included in a fiscal unity when it concerns its access to (benefits contained in) tax treaties. This question is especially relevant since Dutch corporate income tax is levied as if there is only one taxpayer (i.e. the parent company). Also, the assets and activities of the subsidiary are considered to be part of the assets and activities of the parent company. To avoid a lack of clarity, the legislator has stressed that a subsidiary that is included in a fiscal unity continues to have a "subjective" tax liability.[92] Accordingly, the subsidiary can be considered to be a "resident" within the meaning of tax treaties and may therefore be entitled to a reduction of withholding taxes on dividends received from another state.[93] Art. 15ac(4) CITA 1969 confirms that the reduction of taxation pursuant to the provisions on the avoidance of double taxation is calculated as if the companies included in the fiscal unity are one taxpayer.[94] Art. 15ac(4) CITA may therefore be either advantageous or disadvantageous to companies included in a fiscal unity who seek to obtain relief from double taxation, depending on their actual fiscal position. For instance, a profit-making subsidiary which seeks to credit foreign withholding taxes on its foreign-sourced income may be hindered from doing so if the parent company of the fiscal unity is in a loss-making position and, consequently, the fiscal unity is in an overall loss-making position.[95] On a stand-alone basis (i.e. without the fiscal unity), the subsidiary would have been able to obtain a credit for the foreign withholding tax. As a side note, it is observed that some tax treaties concluded by the Netherlands make the reduction of dividend withholding tax by the source state dependent on a minimum holding percentage by the parent company in the residence state. For instance, Art. 10(2) of the 2005 Netherlands–South Africa treaty reads:

> [H]owever, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
>
> (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds at least 10 per cent of the capital of the company paying the dividends; or
>
> (b) 10 per cent of the gross amount of the dividends in all other cases.

If the parent company of a fiscal unity (company A) and its subsidiary (company B, also included in the fiscal unity), each have 6% of the shares in South African company C, the authors submit that South Africa will not be obliged to recognize the existence of a Dutch fiscal unity (and the joint shareholding of 12% following from that). Accordingly, South Africa will not be held under the treaty to reduce domestic withholding tax (if any) to 5% of the gross amount of the dividends.

20.4.1.3. Art. 4(1)(b) DWTA 1965: Exemption from dividend withholding tax in case of a fiscal unity

Contrary to the CITA 1969, the DWTA 1965 does not contain a tax grouping regime. As the *Hoge Raad* held in BNB 1986/282[96] that a shareholding within a fiscal unity could not be regarded as a participation within the meaning of the Dutch participation exemption regime,[97] the consequence appeared to be that dividend withholding tax would have to be withheld on distributions within a fiscal unity. Art. 4(1)(b) DWTA 1965 was therefore inserted and contains an exemption to the obligation to withhold dividend withholding tax if "the

---

91. See Strik, S.A.W.J. and De Vries, N.H., *Cursus Belastingrecht (Vennootschapsbelasting) (electronic edition)*, Deventer: Kluwer, 2010, Part. 2.9.1.B.b3.V.
92. *Kamerstukken II*, 2000/01, 26 854, No. 6, p. 6.
93. Id., No. 7, p. 13.
94. Id., No. 8, p. 2.
95. Pursuant to Art. 36(6) of the Decree for the Avoidance of Double Taxation (*Besluit voorkoming dubbele belasting* 2001, DADT 2001), the maximum credit for foreign withholding taxes is the amount of Dutch corporate income due. In a loss year, that amount is nil. Pursuant to Art. 37 DADT 2001, the unused foreign tax credits may be carried forward indefinitely.
96. *Hoge Raad* 4 June 1986, No. 23 381, BNB 1986/282.
97. In which case an exemption to the obligation to withhold dividend withholding tax exists pursuant to Art. 4(1) DWTA 1965.

beneficiary of the income and the taxable person are part of the same fiscal unity as referred to in Article 15 CITA 1969 and the shares, profit-sharing bonds, and loans belong to the capital of its enterprise carried on in the Netherlands". A Decree of 15 March 2011 provides that the issuance of a dividend note, which is required pursuant to Art. 9 DWTA 1965, may be dispensed with in case of a fiscal unity.[98]

It is observed that inclusion of a parent company and its subsidiary in a fiscal unity does not necessarily entail an exemption to the obligation to withhold dividend withholding tax at the level of the subsidiary. Firstly, the parent company will not necessarily be regarded as the "beneficiary" to the dividend within the meaning of the DWTA 1965. Secondly, various authors have put forward that a Dutch resident parent company which holds 100% of the shares in a Dutch resident sub-subsidiary through a subsidiary that is resident in an EU Member State should be able to be part of a fiscal unity pursuant to the freedom of establishment of Art. 49 TFEU.[99] In that case, the beneficiary, the intermediate non-resident subsidiary, will not be part of the same fiscal unity as the "taxable person" within the meaning of the DWTA 1965.

Marres and Wattel discuss a potential controversy in case a subsidiary that is included in a fiscal unity holds the shares in a sub-subsidiary that is not included in the fiscal unity.[100] The exemption to the obligation to withhold dividend withholding tax of Art. 4(1)(a) DWTA 1965 applies if the Dutch participation exemption applies to the benefits enjoyed by the beneficiary. The beneficiary for dividend withholding tax purposes, however, is the subsidiary, whereas the company applying the Dutch participation exemption is the parent company of the fiscal unity. Nevertheless, Marres and Wattel argue that Art. 4(1)(a) DWTA 1965 should apply because the participation exemption applies to the benefits enjoyed by the beneficiary (not at the level of the subsidiary, but at the level of the parent company).[101]

Art. 10(1) of Fiscal Unity Decree 2003 is aimed at the specific situation in which the parent company of a fiscal unity (company A) has the legal and economic ownership of less than 100% (but at least 95%) of the shares in its subsidiary, company B. The remainder of the shares in company B are held by another shareholder, company C. As the assets and activities of company B are considered to be part of the assets and activities of the company A, a dividend distribution by company B to company C is strictly speaking a "payment" by company A to company C. As this "payment" by company A does not qualify as an advantage given to company A's shareholder(s), it would normally be a deductible expense at the level of the fiscal unity. Because of this, Art. 10(1) of Fiscal Unity Decree 2003 reads: "[D]ividends made payable on shares in a subsidiary to shareholders which are not part of the fiscal unity are regarded as distributions of the profit of the fiscal unity."

The so-called "distribution facility" is laid down in Art. 11 DWTA 1965. Ordinarily, bilateral tax treaties, the Dutch unilateral rules (i.e. the DADT 2001) and EU primary and secondary law (i.e. the Parent-Subsidiary Directive) will ensure that dividends paid to a Dutch company are exempt from dividend withholding tax. Nevertheless, in some cases, distributions to a Dutch company remain burdened with dividend withholding tax: the required minimum holding percentage is not met, the distributing company is not an EU-resident, or it is not resident in a developing country.[102] In situations where the received dividends are exempt under the Dutch participation exemption, the foreign withholding tax is an actual fiscal burden for the Dutch shareholder, i.e. the foreign withholding tax cannot be credited against Dutch corporate income tax. To alleviate the burden of the Dutch shareholder, the distribution facility was introduced in Arts. 11 and 12 DWTA 1965. In essence, this measure entails that the Dutch shareholder may credit part of the foreign withholding tax against the amount of Dutch dividend withholding tax it is required to withhold if it "distributes" dividends to its own shareholders. Accordingly, the distribution facility is only advantageous to the Dutch shareholder if its distributions are subject to Dutch dividend withholding tax. The measure will thus have no effect in case of a distribution to a German GmbH with a 100% shareholding in the Dutch shareholder: this distribution is exempt from Dutch dividend withholding tax pursuant to the Dutch implementation of the Parent-Subsidiary Directive (Art. 4(2) DWTA 1965). It is noted that the distribution facility merely entails an advantage for the taxable person (it may

98. Decree of the Minister of Finance of 15 March 2010, No. DGB2010/1869M, *V-N* 2010/16.20, p. 1.

99. See, inter alia, Boulogne, G.F., "Art. 15, vierde lid, Wet Vpb 1969: strijdigheid met de vrijheid van vestiging en de non-discriminatiebepalingen", *Weekblad voor Fiscaal Recht* (2010) 6864 pp. 840-849. It is noted that a request to form a fiscal unity between a Dutch resident parent company and its Dutch resident sub-subsidiary, which was held through two German intermediate subsidiaries, was granted by the Haarlem District Court, see *Rechtbank Haarlem* 9 June 2011, No. 10/2288 (available at www.rechtspraak.nl).

100. Marres and Wattel, *Dividendbelasting*, op. cit., p. 76.

101. For an opposing view, see Brandsma, R.P.C.W.M., *Cursus Belastingrecht (Dividendbelasting)*, Deventer: Kluwer, 2005, loose-leaf edition, Para. 2.1.1.g.

102. Residency in a developing country by the distributing company is a requirement in Art. 36(1) DWTA.

transfer less tax to the Dutch tax collector) and should not reduce the (potentially) creditable amount of withholding tax at the level of the shareholder.[103]

Art. 11(4) DWTA 1965 solves a potential problem occurring upon a distribution to a Dutch shareholder that is included in a Dutch fiscal unity as a subsidiary. A subsequent distribution to the parent company of the fiscal unity is exempt from Dutch dividend withholding tax pursuant to Art. 4(1)(b) DWTA 1965, hence rendering the credit of Art. 11 DWTA 1965 useless. Furthermore, the parent company of the fiscal unity cannot apply the distribution facility as it is not the company which received the foreign dividend income. To avoid that the distribution facility is to no avail in case the recipient of the foreign dividend income is included in a fiscal unity as a subsidiary, Art. 11(4) DWTA provides that the foreign dividend income is considered to be received by the parent company of the fiscal unity.

20.4.1.4. Allocation of shares in a Dutch resident company to a Dutch permanent establishment

The exemption to withholding Dutch dividend withholding tax of Art. 4(1)(b) DWTA 1965 applies also if the beneficiary, which is part of the same fiscal unity as the taxable person, is a non-resident company.[104] Accordingly, by including a Dutch resident company with a contingent dividend withholding tax claim on its profit reserves in a fiscal unity with a non-resident parent company,[105] it may be possible to diminish the Dutch dividend withholding tax claim on these profit reserves. In such a situation, no dividend withholding tax is due on the distributions of the Dutch holding company to the permanent establishment (PE) pursuant to Art. 4(1)(b) DWTA 1965. Also without a fiscal unity, no dividend withholding tax is due on the distributions of the Dutch resident company to the Dutch PE, provided that the Dutch participation exemption applies to the shareholding in the Dutch resident company (Art. 4(1)(a) DWTA 1965). The participation exemption will only apply if the shares in the Dutch resident company can be allocated to the Dutch PE. The criteria for the allocation of shares to a PE are laid down in two Decrees of 2004.[106] These decrees also provide the framework within which the Dutch tax authorities are willing to provide certainty in advance on the allocation of the shares to the PE. Para. 4.2 of the Decree of 15 March 2010 states that the Dutch tax authorities do not provide certainty in advance on the allocation of the shares to the permanent establishment if the structure is aimed at bringing the contingent Dutch dividend withholding tax claims of the Dutch resident company outside the scope of the DWTA 1965. If head office activities are transferred from the Dutch resident company to the Dutch PE, the State Secretary of Finance is of the opinion that the structure is aimed at avoidance of the contingent dividend withholding tax claim.

20.4.2. Change of corporation form

Art. 2:18 DCC governs the conversion of legal persons. All legal persons under Dutch law are (potentially) subject to Dutch corporate income tax.[107] Art. 28a(1) CITA 1969 explicitly refers to Art. 2:18 DCC and provides that a legal person which is converted into another legal form pursuant to that provision is deemed to be liquidated. Furthermore, its assets are deemed to be distributed to the persons entitled to these assets in proportion to their entitlement. Finally, the assets are deemed to have been contributed by these persons to the "new" legal person. Art. 28(2) CITA 1969 provides that the first section is also relevant for the assessment of personal income tax and dividend withholding tax. Art. 28a(3) CITA 1969 provides for the possibility of a "silent" or tax-neutral conversion. If certain requirements are met, the balance sheet values of the "old" company may be transferred to the "new" company and an immediate dividend withholding tax claim may be deferred. In a Decree of 4 April 2011,[108] the State Secretary of Finance set out the conditions under which he is prepared to facilitate the conversions.

---

103. The State Secretary of Finance has confirmed that the amount of dividend withholding tax that has been withheld, rather than the amount of dividend withholding tax that has actually been transferred to the Dutch tax collector, constitutes the creditable withholding tax. See *Kamerstukken II*, 1994/95, 23 980, No. 3, p. 9.

104. *Kamerstukken II*, 2001/2001, 30 572, No. 9, p. 15.

105. Art. 15(4) CITA 1969 requires that the shares in the Dutch resident subsidiary can be allocated to the Dutch PE of the non-resident parent company.

106. Decree of the State Secretary of Finance of 25 February 2004, No. DGB2003/6662M, *NTFR* 2004/415 and Decree of the State Secretary of Finance of 11 August 2004, No. DGB2004/1337M, *BNB* 2004/375.

107. See Van de Streek, J.L., *Omzetting van rechtspersonen*, Deventer: Kluwer, 2009, p. 65.

108. Decree of the State Secretary of Finance of 4 April 2011, No. BLKB2011/511M, *V-N* 2011/32.13 (which replaces the Decree of 9 March 2006, No. CPP2005/2571M, *BNB* 2006/146).

Art. 28a(1) CITA 1969 does not apply to the conversion of an NV into a BV and vice versa or the conversion of an association (*vereniging*) into a foundation (*stichting*) and vice versa. Both types of conversions do not have effect on the imposition of dividend withholding tax as the fiscal claims on the hidden reserves remain secured. All other 24 types of conversions of legal persons[109] potentially affect the levy of dividend withholding tax as dividend distributions by a legal person taking either the "old" legal form or the "new" legal form may not be subject to Dutch dividend withholding tax.

A type of conversion which potentially results in the loss of a claim of dividend withholding tax is the conversion of a Dutch BV into a *coöperatie*. Contrary to a distribution by a BV, a distribution by a *coöperatie* is not subject to Dutch dividend withholding tax: a *coöperatie* is not a listed company in Art. 1(1) DWTA 1965 nor does it have a "capital divided into shares".[110] In Para. 6 of the Decree of 4 April 2011, the State Secretary of Finance indicates that, although fiscal facilitation of the conversion may be possible for corporate income tax and personal income tax purposes, a request pursuant to Art. 28a(3) CITA 1969 for dividend withholding tax purposes will be rejected. It is observed that in Para. 5 of the Decree of 9 March 2006, the State Secretary of Finance had still indicated that the fiscal facilitation for corporate income tax and personal income tax purposes would be disallowed merely because of the loss of the claim of dividend withholding tax. Van de Streek, however, has discussed a practical case in which the State Secretary was nevertheless prepared to grant fiscal facilitation to a conversion for Dutch corporate income tax and personal tax purposes as no claim of dividend withholding tax in fact existed.[111]

A reverse conversion, a *coöperatie* converts into a BV, does not result in the loss of a claim of dividend withholding tax. Nevertheless, complications may arise with the calculation of the paid-up share capital of the BV. In Para. 4, subpart c, of the Decree of 4 April 2011, the State Secretary of Finance observes that to the extent the (former) members of the *coöperatie*, now shareholders of the BV, do not perform an additional capital contribution to the BV, the share capital of the BV remains unchanged.[112] Van de Streek has criticized this outcome, which results in the creation of a previously non-existing claim of dividend withholding tax, and submits that in his view, the paid-up share capital of the BV should be calculated on the basis of the fair market value of the assets and liabilities of the *coöperatie* at the time of conversion.[113]

After the ECJ's judgment in the *Cartesio* case,[114] various authors have concluded that an outbound conversion of a legal person under Dutch law into a legal person under the law of another EU/EEA Member State should be possible.[115] Even if the conversion does not result in the transfer of assets and activities to the other Member State, the Netherlands will lose the right to levy dividend withholding tax if the real seat of the companies is transferred abroad.

20.4.3. Tonnage tax regime

Under the Dutch tonnage tax regime (Arts. 3.22, 3.23, and 3.24 ITA 2001), profit derived from sea shipping activities are determined on the basis of the tonnage of the ships with which these profits are realized. Art. 3.22(4) ITA 2001 defines the term "profit derived from sea shipping activities". Dividend income does not qualify as "profit derived from sea shipping activities" and is therefore ordinarily taxed. Dividend distributions by a company applying the tonnage tax regime are treated as ordinary distributions.

20.4.4. EII/FII

---

109. See Van de Streek, *Omzetting van rechtspersonen*, op. cit., p. 66.
110. It is submitted that in some cases, a *coöperatie* may be considered to have a "capital divided into shares". See Snel, F.P.J., "Classificatie van rechtsvormen, in het bijzonder een vennootschap met een in aandelen verdeeld kapitaal", *Weekblad voor Fiscaal Recht* (2010) 6850 p. 189.
111. See Van de Streek, *Omzetting van rechtspersonen*, op. cit., p. 160.
112. In that respect, the State Secretary of Finance refers to *Hoge Raad* 20 June 1956, No. 12 790, BNB 1956/244.
113. See Van de Streek, *Omzetting van rechtspersonen*, op. cit., p. 221.
114. ECJ, 16 December 2008, Case C-210/06, *CARTESIO Oktató és Szolgáltató bt.*
115. See, inter alia, Veen, W.J.M. van, "Grensoverschrijdende omzetting volgens het Cartesio-arrest (I)", *Weekblad voor Privaatrecht, Notariaat en Registratie* (2010) 6840 p. 330.

CITA 1969 contains specific rules for two types of investment funds: the “exempt investment institution” (*vrijgestelde beleggingsinstelling*, EII) within the meaning of Art. 6a CITA 1969 and the “fiscal investment institution” (*fiscale beleggingsinstelling*, FII) within the meaning of Art. 28 CITA 1969. An EII is exempt from Dutch corporate income tax whereas an FII is subject to a corporate income tax rate of 0%. Accordingly, dividend income received by an EII is exempt from Dutch corporate income tax whereas dividend income received by an FII is subject to a corporate income tax rate of 0%.

For its exemption from Dutch corporate income tax, it has been observed that an EII will not be considered to be “liable to tax” within the meaning of Art. 4(1) of the OECD Model Convention.[116] Accordingly, the EII cannot be a “resident of a Contracting State” within the meaning of that provision. As the FII is subject to Dutch corporate income tax, albeit against the special 0% rate, it is held that the FII can be a “resident” for tax treaty purposes.[117] As explanation for the fact that only the FII is entitled to tax treaty benefits, Peters[118] considers the so-called “distribution obligation”,[119] which entails that profits of the FII have to be distributed annually to its participants (and are taxable at that level).[120] By contrast, the profits of the EII may be hoarded indefinitely. It is observed that the Government's Notice on Tax Treaty Policy of 11 February 2011 contains the ambition to regard both the EII and the FII as residents for tax treaty purposes. Interestingly, it is also indicated in the Notice that the Netherlands is willing to agree that the EII is not eligible to some tax treaty benefits, such as the reduction of dividend withholding tax on distributions to the EII.[121] It is noteworthy that Art. 10(2)(a)(1) of the new tax treaty between the Netherlands and the United Kingdom,[122] which was ratified by the Dutch House of Representatives in December 2010, provides the source state with the right to levy 15% dividend withholding tax on distributions by a “Real Estate Investment Trust” ('REIT'). It is evident that an FII within the meaning of Art. 28 CITA 1969 may qualify as a REIT.[123]

In a domestic situation, dividend income received from an EII or an FII qualifies as income from an “investment participation”, which is in principle not exempt under the Dutch participation exemption pursuant to Art. 13(9) CITA 1969. Nevertheless, income received from an EII or an FII may be exempt if the assets held by the EII or FII, for instance real estate, are reasonably taxed within the meaning of Art. 13(13) CITA 1969.[124] Dividend distributions by an EII are exempt from Dutch dividend withholding tax pursuant to Art. 1(4) DWTA 1965.[125] Dividend distributions by an FII are not exempt from Dutch dividend withholding tax. However, the amount of Dutch dividend withholding tax that has to be withheld by the FII is reduced by the amount of Dutch dividend withholding tax and foreign withholding tax on payments made to the FII (Art. 11a(1) DWTA).

20.5. Dividend taxation for indirect tax purposes (VAT, transfer tax etc.) and procedural issues relating to intercompany dividend taxation

20.5.1. Dividend and VAT

116. *Kamerstukken II*, 2005/2006, 30 533, No. 3, p. 4.
117. For an overview of different views regarding the tax treaty entitlement of an EIT or FIT, reference is made to Paras. 6.11-6.13 of the Commentary to Art. 1 of the OECD Model Convention (update of 22 July 2010).
118. Peters, F.G.F., “Bepaling van de woonplaats onder belastingverdragen”, *Opinie NTFR* (2008) 1177 p. 3.
119. In Dutch: *doorstootverplichting*.
120. Art. 28(2)(b) CITA 1969.
121. Government's Notice on Tax Treaty Policy of 11 February 2011, Para. 2.2.1., available at www.minfin.nl.
122. Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital signed on 26 September 2008, *Tractatenblad* 2011, p. 7.
123. Vermeulen, H., “REITs under the New Netherlands-United Kingdom Tax Treaty”, *European Taxation* (2011) 4 p. 161.
124. Vermeulen, H., “De behandeling van vastgoed in de nieuwe regeling van de beleggingsdeelneming”, *Weekblad voor Fiscaal Recht* (2010) 6874 pp. 1182-1191. Art. 13(12) CITA 1969 provides that real estate does not qualify as portfolio investment if the real estate is not owned by an EII or FII.
125. It is noted that Art. 1(5) DWTA contains a specific anti-abuse measure which aims to prevent that dividend withholding tax claims which originate from the period when a company qualified as an FII disappear when such company qualifies as an EII. See *Kamerstukken II*, 2005/06, 30 533, No. 3, p. 14. Borsboom, J.H.J., *Fiscale beleggingsinstellingen*, Deventer: Kluwer, 2010, pp. 52-53 refers to discussions in Dutch parliamentary history concerning the fact that Art. 1(5) DWTA entails that an EII may be obliged to withhold dividend withholding tax, even though the EII may not be regarded as a “resident” for tax treaty purposes. Consequently, it may not be possible to credit the Dutch dividend withholding tax in the state of residence of the recipient of the dividend income. See, inter alia, *Kamerstukken II*, 2006/07, 30 533, No. 42, pp. 2465-2474 and *Kamerstukken I*, 2006/07, 30 533, No. 38, pp. 1242-1648.

20.5.1.1. Introduction

Concerning dividends and VAT, two questions will be addressed in this section. Does dividend constitute a consideration for the shareholder activities performed? Are dividends relevant for the purposes of the pro-rata deduction of input VAT?

20.5.1.2. Dividend as consideration for shareholder activities?

If this question is answered affirmatively, VAT may be due on the amount of the dividends. The imposition of VAT presupposes that the shareholder qualifies as a taxable person for VAT purposes and that the services supplied by the shareholder – for which the dividends are the consideration – are not exempt.

A landmark case in this light is the *Polysar* case.[126] In that case, in answering questions raised by the Arnhem Appeal Court (*Gerechtshof Arnhem*), the ECJ held that:[127]

> [T]he mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis because any dividend yielded by that holding is merely the result of ownership of the property.

After this case, various (Dutch) authors considered it evident that the receipt of dividends could not be regarded as "consideration for the supply of services" within the meaning of Art. 2 of the VAT Directive.[128] Two years after the *Polysar* case, the ECJ held in the *SATAM* case that: "[S]ince the receipt of dividends is not the consideration for any economic activity within the meaning of the Sixth Directive, it does not fall within the scope of VAT."[129]

Although this quotation appears to confirm the ECJ's ruling in *Polysar*, some Dutch authors argued, on the basis of the deviating Dutch language version, that the ECJ appeared to have cleared the way for the view that, under circumstances, dividends could be regarded as a "consideration for the supply of services".[130] Such circumstances could perhaps exist where a shareholder also performs services vis-à-vis its shareholding which exceed its capacity as shareholder.[131] In the *Welthgrove* case, in which the *Hoge Raad* eventually referred preliminary questions to the ECJ (which were later withdrawn),[132] the question arose whether dividends received by a parent company that was actively involved in the management in its subsidiaries constituted a "consideration for the supply of services". The Hague Court of Appeals (*Gerechtshof 's-Gravenhage*) ruled that:[133]

> [A]ccording to Court's judgment, this dividend should be regarded as the consideration for the active involvement in the management of these subsidiaries. It is impossible to accept that in a similar situation the receipt of the dividend originates from the sheer ownership of the shares. This leads the Court to conclude that, on the one hand, the taxpayer should be considered as a taxpayer within the meaning of the VAT with respect to those activities, on the other hand, contrary to the appeal of the taxpayer, these activities are performed for the benefit of the subsidiaries and not for the benefit of the taxpayer's shareholders.

Subsequently, the *Gerechtshof* held that these services were exempt from VAT under Art. 11(1)(i)(2°) VATA 1968, which is the Dutch implementation of Art. 13b(d)(5) of Directive 77/388/EEC.[134] That provision, in pertinent part, contains an exemption for "transactions, including negotiation, excluding management and

---

126. ECJ, 20 June 1991, Case C-60/90, *Polysar Investments Netherlands BV v. Inspecteur der Invoerrechten en Accijnzen.*
127. Id., Para. 13.
128. See, inter alia, Bijl, D.B., "De houdstermaatschappij in de omzetbelasting", *Weekblad voor Fiscaal Recht* (1991) 5977, pp. 1301-1309 and the authors cited by Norden, G.J., *Het concern in de BTW*, Deventer: Kluwer, 2007, p. 356.
129. ECJ, 22 June 1993, Case C-333/91, *Sofitam SA (anciennement SATAM SA) v. Ministre chargé du Budget*, Para. 13.
130. See, inter alia, Norden, *Het concern in de BTW*, op. cit., p. 356 and Braakman, T. and Van Kesteren, H.W.M., "De BTW-positie van de moeiende houdstermaatschappij", *Weekblad voor Fiscaal Recht* (1998) 6281, p. 326.
131. See, inter alia, Hilten, M.E. van, *Bancaire en financiële prestaties in de Europese BTW*, Deventer: Kluwer, 1992, pp. 254-255.

133. *Hof 's-Gravenhage*, 11 July 1997, No. 96/0360, *V-N* 1997, p. 4604, Para. 6.1.
134. Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment, OJ L 145, 13 June 1977.

safekeeping, in shares".[135] After the Supreme Court had referred, inter alia, the following preliminary question to the ECJ:[136]

> [I]n light of the judgment in *Polysar*, particularly paragraphs 13 and 14, where a parent company involves itself in the management of a subsidiary, is the receipt of dividends from that subsidiary to be deemed to constitute consideration for such involvement within the meaning of Article 11A(1)(a) of the Sixth Directive?

the ECJ threw light on the matter in another case, *Floridienne and Berginvest*, when it held that:[137]

> [I]n view, specifically, of the fact that the amount of the dividend thus depends partly on unknown factors and that entitlement to dividends is merely a function of shareholding, the direct link between the dividend and a supply of services (even where the services are supplied by a shareholder who is paid dividends), which is necessary if the dividends are to constitute consideration for the services, does not exist.

Finally, having withdrawn one preliminary question, the remaining preliminary question by the Supreme Court in the *Welthgrove* case was dealt with by Order of the ECJ.[138]

20.5.1.3. Dividends and deduction of input VAT

A company that only holds shares and does not receive any income besides dividends does not carry on an economic activity and hence is not entitled to a deduction of input VAT. In case a company holds shares as part of or besides its economic activity, the question arises whether and to what extent the receipt of dividends affects that company's entitlement to the deduction of input VAT.

That question was first addressed by the ECJ in the *SATAM* case.[139] SATAM SA, a "passive" French holding company, received dividends from its subsidiaries and also performed activities vis-à-vis its subsidiaries which were subject to VAT, such as the leasing of immovable property. The matter of dispute was whether the dividends received by SATAM SA affected the calculation of its pro rata within the meaning of Art. 19(1) of Directive 77/388/EEC.[140] The ECJ held that: [141]

> [I]n the light of those considerations, the answer to the question referred to the Court must be that Article 19(1) of the Sixth Council Directive (77/388/EEC) of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes (Common system of value added tax: uniform basis of assessment) must be interpreted as meaning that share dividends received by an undertaking which is not subject to VAT in respect of the whole of its transactions are to be excluded from the denominator of the fraction used to calculate the deductible proportion.

Clearly, the ECJ's line of reasoning in *SATAM* elaborates on the *Polysar* judgment: dividend income is not income derived from an economic activity, it is therefore outside the scope of VAT and should thus not affect a taxpayer's right of deduction of input VAT.[142] In *Floridienne and Berginvest*, the ECJ held that dividends received by an actively involved parent company only fall within the scope of VAT if these dividends are capable of being regarded as consideration for the economic activity in question. Commonly, however, it is accepted that dividends do not constitute a consideration for a supply and hence, should be excluded from the

---

135. It is observed that The Hague Court of Appeals' reasoning why the management services performed by the shareholder were exempt from VAT Art. 11(1)(i)(2°) VATA 1968 was based on the ECJ's decision of 6 February 1997 in Case C-80/95, *Harnas & Helm CV v. Staatssecretaris van Financiën*. In his annotation to *V-N* 1997, p. 4604, W.A.P. Nieuwenhuizen criticises that consideration as, in his view, the exemption from VAT in case of active management activities does not (automatically) follow from the *Harnas & Helm* case.

136. *Hoge Raad* 28 April 1999, No. 33 562, BNB 1999/256.

137. ECJ, 14 November 2000, Case C-142/99, *Floridienne SA and Berginvest SA v. Belgian State*, Para. 23. The ECJ's ruling in *Floridienne and Berginvest* was reconfirmed in ECJ, 27 September 2001, Case C-16/00, *Cibo Participations SA v. Directeur régional des impôts du Nord-Pas-de-Calais*.

138. ECJ, 12 July 2001, Case C-102/00, *Welthgrove BV v. Staatssecretaris van Financiën*. It is observed that the ECJ's decision to dispose of the remaining preliminary question by Order, having reference to settled case law, has been criticised by P.J. Wattel, "*Köbler*, *Cilfit* and *Welthgrove*, we can't go on meeting like this", *Common Market Law Review* (2004) 41, p. 183.

139. ECJ, 22 June 1993, Case C-333/91, *Sofitam SA (anciennement SATAM SA) v. Ministre chargé du Budget*. For an extensive discussion of the *SATAM* case, see Swinkels, J.J.P., *De belastingplichtige en de Europese BTW*, Den Haag: Koninklijke Vermande, 2001, pp. 182-186.

140. ECJ, *Sofitam*, id., Para. 7.

141. Id., Para. 15.

142. See also, Farmer, P. and Lyal, R., *EC Tax Law*, Oxford: Oxford University Press, 2003, p. 113, and Vanistendael, F., in *Liber Amicorum Walter van Gerven*, Deurne: Kluwer, 2000, p. 488.

denominator when calculating the pro rata.[143] Nevertheless, the ECJ decided in *Securenta* that a company is not entitled to deduct input VAT to the extent expenses relate to, for example, a shareholder activity that is carried out besides (i.e. not in the course of) its economic activity. From the so-called "holding decree" (*houdsterresolutie*),[144] one could infer that in *Securenta* situations, a taxpayer would still be entitled to a deduction of input VAT according to the pro-rata for its economic activity.

20.5.2. Dividend and real estate transfer tax

Dutch real estate transfer tax (*overdrachtsbelasting*) is levied upon the acquisition of immovable property situated in the Netherlands or of property rights at a rate of 6% against the fair market value of the immovable property.[145] Art. 4(1)(a) ATLR, in pertinent part, deems as immovable property the shares in companies with a capital divided into shares, of which the assets largely consist on a consolidated basis of immovable property and at least 30% of the assets consist of Dutch immovable property and the immovable property as a whole is used entirely or for at least 70% for the acquisition, disposal or exploitation of that immovable property (a so-called "real estate entity", *onroerendzaaklichaam*). Robben provides an example of a company that distributes its shares in an *onroerendzaaklichaam* to its shareholders.[146] In principle, if the shareholder acquires an interest in the *onroererendzaaklichaam* as a result of which the shareholder holds an interest of at least one third, the shareholder will be subject to Dutch real estate transfer tax. If, however, the distributing company and the receiving company belong to the same group of companies within the meaning of Art. 15(1)(h) ATLR in conjunction with Art. 5b of the Decree implementing the taxes on legal registrations (*Uitvoeringsbesluit belastingen van rechtsverkeer*), an exemption from real estate transfer tax may apply.[147]

20.5.3. Selected procedural issues relating to intercompany dividend taxation

As a discussion of the myriad procedural issues that relate to intercompany dividend taxation would greatly exceed the scope of this section, a selection has been made of three interesting procedural issues which have been addressed in case law.[148]

20.5.3.1. Refund terms and the EU general principle of effectiveness

A recent Supreme Court decision[149] concerned a request by a Scottish pension fund for a refund of Dutch dividend withholding tax which was levied in 2002.[150] In 2002, Art. 10 DWTA 1965 provided that a legal person that was resident in the Netherlands and which was not subject to Dutch dividend withholding tax was entitled to a refund of Dutch dividend withholding tax. Pursuant to Art. 21c of the Regulation implementing the General Tax Act (*Uitvoeringsregeling Algemene wet inzake rijksbelasting*, RGTA), a request had (and has) to be filed within 3 years after the calendar year in which the dividend was distributed. As it had become clear after the *Denkavit* case[151] that the imposition of a liability to tax on dividends paid to a non-resident parent company and granting an exemption from such tax on dividends paid to resident a parent company constitutes a discriminatory restriction on the freedom of establishment, the Scottish pension fund had filed a request for a refund of the Dutch dividend withholding tax on 17 December 2007.[152] As the claim for the refund was declared inadmissible by both the Dutch tax inspector and the *Rechtbank Haarlem*, the Scottish pension fund argued that

---

143. See Braun, K.M., *Aftrek van voorbelasting in de BTW*, Deventer: Kluwer, 2002, p. 278.
144. Decree of the State Secretary of Finance of 18 February 1991, No. 91/347, *FED* 1991/266.
145. Art. 2(1) in conjunction with Art. 14 of the Act on the taxes on legal registrations (*Wet op Belastingen van rechtsverkeer*, ATLR).
146. See Robben, M.T.E., *Overdrachtsbelasting en onroerendezaaklichamen*, Deventer: Kluwer, 2006, p. 228.
147. Id.
148. It is noted that none of the procedural issues the authors were asked to address provide much food for thought in the Netherlands.
149. *Hoge Raad* 13 May 2011, No. 10/01742, V-N 2011/26.14.
150. For an overview of various procedural regulations on the refund of Dutch dividend withholding tax in tax treaty situations, see Decree of the State Secretary of Finance of 18 July 2008 (reduction, exemption of refund of dividend withholding tax under tax treaties), No. CPP2008/1527M, V-N 2008/42.13.
151. ECJ, 14 December 2006, Case C-170/05, *Denkavit Internationaal BV and Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie*, Para. 41.
152. In the case at hand, the request was based on (the current) Art. 63 TFEU.

the 3-year term in Art. 21c RGTA was in breach of the EU general principle of effectiveness.[153] The *Hoge Raad* dismissed that appeal, arguing that nothing had prevented the taxpayer from filing a timely request for a refund (i.e. within 3 years). Furthermore, the *Hoge Raad* considered that no grounds existed why a longer term for a refund request should apply to a non-resident taxpayer compared to a resident taxpayer. Finally, referring to, inter alia, the *Emmott* case,[154] the *Hoge Raad* appeared to only leave room for an appeal on the principle of effectiveness if the taxpayer had received information from the public authorities that, through its incorrectness or incompleteness, had hindered the taxpayer in become aware of his rights under EU law (*quod non*).[155] In *V-N* 2011/26.14, the editors of *Vakstudienieuws* note that the Court's judgment appears to supersede the judgment of the *Rechtbank Haarlem* of 3 August 2010[156] in which a foreign taxpayer seeking a refund of Dutch dividend withholding tax was entitled to an extended 5-year term.

20.5.3.2. Dividend withholding tax returns and residency permits

In their practical experience, the authors have frequently encountered the administrative burdens arising out of requests for a residency permit to qualify for a reduction or exemption of dividend withholding tax. In some instances, the process of obtaining a residency permit may take months, whereas reasons of business economics may dictate a swifter distribution of the funds. *NTFR* 2005/1620[157] involved a dividend distribution by a Dutch taxpayer to its Netherlands Antilles shareholder on 31 December 2002. In order to qualify for the reduced 8.3% rate under the Taxation Arrangement for the Kingdom of the Netherlands (*Belastingregeling voor het Koninkrijk*, TAKN),[158] the shareholder had requested a residency permit with the Netherlands Antilles tax authorities, which was not issued until 3 March 2004. Thereafter, Dutch dividend withholding tax was transferred to the Dutch tax collector on 17 December 2004. Pursuant to Art. 19(3) of the General Law on national taxation (*Algemene wet inzake rijksbelastingen*, GLNT), however, the Dutch dividend withholding tax should have been transferred to the Dutch tax collector within 1 month after the dividend distribution. Consequently, the Dutch tax inspector had imposed a penalty,[159] against which the Dutch taxpayer appealed, who claimed in mitigation inter alia the late date of issuance of the residency permit. The *Rechtbank Haarlem* dismissed the taxpayer's claim and held that in order to avoid the penalty, it should have withheld dividend withholding tax on the basis of the (then) statutory 25% rate, followed by a request for a refund of 16.7% (25% less 8.3%) dividend withholding tax upon receipt of the residency permit.[160]

20.5.3.3. The 1-month payment term of Art. 19(3) GLNT

It is not uncommon that the date on which a company's general meeting of shareholders approves a dividend distribution deviates from the date on which the dividends are actually paid to the shareholders. The question arises which of the two dates is relevant when calculating the commencement date of the 1-month period in Art. 19(3) GLNT. The *Rechtbank 's-Gravenhage* held in a recent case that the former date is relevant.[161] The *Rechtbank* reasoned that pursuant to Art. 7(3) DWTA 1965, the obligation to withhold dividend withholding tax arises when the dividend is made available to the shareholder. Based on a legal analysis, the court reasoned that the dividend becomes claimable at that date and considered it irrelevant that the dividend was actually paid to the shareholder at a later date.[162] Accordingly, the *Rechtbank* held that the 1-month payment term had commenced at the date of the approval by the general meeting of shareholders.

---

153. That appeal was based on ECJ, 12 December 2006, C-446/04, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue*, Para. 203, in which the ECJ held that: "it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided, first, that such rules … do not render virtually impossible or excessively difficult the exercise of rights conferred by Community law (*principle of effectiveness*) [emphasis added]".
154. ECJ, 1 December 1998, Case C-208/90, *Theresa Emmott v. Minister for Social Welfare and Attorney General.*
155. *Hoge Raad* 13 May 2011, No. 10/01742, V-N 2011/26.14, Para. 3.3.2.
156. *Rechtbank Haarlem* 3 August 2010, Nos. 08/5180, 09/2310, 09/3860, and 09/3861, V-*N* 2010/52.20.
157. *Rechtbank Breda* 18 May 2005, No. 05/1444, NTFR 2005/1620.
158. Which, generally speaking, may be characterized as the double taxation convention between the Netherlands and the Netherlands Antilles.
159. Pursuant to Art. 67c GLNT.
160. Pursuant to Art. 5 of the *Uitvoeringsvoorschriften artikel 11 BRK.*
161. *Rechtbank 's-Gravenhage* 23 April 2010, No. 09/9179, NTFR 2010/1531.
162. Referring to, inter alia, *Gerechtshof Amsterdam* 7 April 1999, No. 97/22152, V-N 1999/35.13.

As was noted above, the failure to transfer Dutch dividend withholding tax to the Dutch tax collector within 1 month after the dividend distribution may result in the imposition of a penalty.

20.6. Selected issues in the tax treatment of cross-border inbound and outbound dividends under domestic law

20.6.1. Issues relating to entitlement to a foreign tax credit for inbound dividends

20.6.1.1. Outline

This section addresses various issues relating to the avoidance of juridical and economic double taxation under Dutch domestic law. First, the avoidance of juridical double taxation under the unilateral rules is discussed (20.6.1.2.), followed by an analysis of the entitlement to a foreign tax credit under Dutch tax treaties (20.6.1.3.) and, lastly, the avoidance of economic double taxation is dealt with in 20.5.1.4.

20.6.1.2. Unilateral avoidance of juridical double taxation

The DADT 2001 contains unilateral rules for the exemption of foreign dividend withholding tax (see below 20.6.1.2.1.). These rules only come into play when the avoidance of double taxation has not been provided for in another way.[163] That requirement will be met if a tax treaty or the TAKN is applicable.[164] Questions arise whether or not the DADT 2001 applies in situations in which the applicable tax treaty is incomplete. As an example, Van Raad discusses the situation in which the competent authorities do not settle by mutual agreement the residence of a dual-resident company under the tax treaty between the Netherlands and the United States.[165,166] If that dual-resident company receives a dividend from its US subsidiary, the dual-resident company will not be entitled to a tax credit for the US dividend withholding tax.[167] In that case, the DADT 2001 should be applicable.[168] Both in situations in which the DADT 2001 applies and in situations in which the DADT 2001 does not apply, a taxpayer may also opt for the deduction of the foreign dividend withholding tax as a deductible expense (see below 20.6.1.2.2.).

20.6.1.2.1. *Unilateral exemption*

Art. 36 DADT 2001 provides for an exemption of foreign dividend withholding tax if two requirements are met:[169]

(i) the company distributing the dividends is resident in a developing country;[170]

(ii) the dividends are subject to an income tax that is levied by that country whether or not at source.

The maximum amount of dividend withholding tax that may be credited against the amount of Dutch corporate income tax due is the lowest of the following two amounts:[171]

(i) the amount of dividend withholding tax levied by the other state in the relevant year (the so-called 'first limit'

---

163. Art. 1(2) DADT 2001.

164. See, inter alia, the explanation of Art. 1(1) in the explanatory notes (*nota van toelichting*) to the DADT 1989, *Staatsblad* 1989, 594, V-N 1990, p. 293.

165. Convention between the Kingdom of the Netherlands and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed on 18 October 1992, *Tractatenblad* 1993, p. 77.

166. Van Raad, C., *Cursus Belastingrecht (Internationaal Belastingrecht)*, Deventer: Kluwer, 2009, (student edition), Para. 2.2.0.B.d.

167. Art. 4(4) Netherlands–US treaty.

168. As the United States is not a "developing country" (as required by Art. 36 DADT 2001), only the deduction of the US dividend withholding tax as a deductible expense will be possible. See *Kamerstukken I,* 1993/94, 23 220, No. 84a.

169. Art.36(1)(a) and (b) DADT 2001.

170. Art. 2 of the Regulation implementing the implementing the taxes on legal registrations (*Uitvoeringsbesluit belastingen van rechtsverkeer*) contains an exhaustive list of "developing countries". In his contribution "Over (niet) aangewezen ontwikkelingslanden en Europees recht", *Weekblad voor Fiscaal Recht* (2010) 6874, pp. 1622-1631, E. Nijkeuter addresses the (in his view) unclear criteria for qualification as a "developing country" and argues that freedom of capital movement of Art. 63 TFEU implies that the list of "developing countries" should be extended to those countries that satisfy the OECD's definition.

171. Art. 36(2) DADT 2001.

(*eerste limiet*);[172]
(ii) the amount of Dutch corporate income tax that would have been due with respect to the dividend (the so-called 'second limit' (*tweede limiet*).

Pursuant to Art. 36(4) DADT 2001, the *tweede limiet* is reduced by the expenses related to the dividends.[173] Furthermore, Art. 36(6) DADT 2001 limits the maximum amount of the tax credit to the amount of Dutch corporate income tax due. A credit for the foreign withholding tax is only granted if the dividend is included in the profit as defined in Art. 8 CITA 1969.[174] If the dividend is exempt under the Dutch participation exemption (Art. 13 CITA 1969), the dividend is not included in the profit and hence no credit is granted for the withholding tax. From the case BNB 1998/17,[175] it should be inferred that so-called "purchased" dividend (dividend that is received after the acquisition of a shareholding, reference is made to 20.3.1.1.2.), which reduces the fiscal cost price of the shareholding and hence does not contribute to Dutch taxable profit, does not give rise to a tax credit for the corresponding dividend withholding tax.

Four issues relating to the unilateral entitlement to a foreign tax credit will be addressed below:
(i) the definition of "dividend" in Art. 5(a) DADT 2001;
(ii) the requirement that the dividend is subject to an "income tax … whether or not at source";
(iii) the reduction of the *tweede limiet* by expenses "related to the dividend"; and
(iv) timing mismatches between the payment of the (withholding) tax in the source state and the taxation of the dividend in the Netherlands.

The term "dividend" is defined in Art. 5(a) DADT 2001 as "income from shares, jouissance rights, or other rights, excluding debt-claims participating in profits of companies of which the capital is wholly or partly divided into shares".[176]

The definition of the term "dividend" in Art. 5(a) DADT 2001 differs from the definition in Art. 10(6) of the 1987 Netherlands Model (*Nederlands standaardverdrag 1987*, NM 1987): income from debt claims participating in profits is classified as interest' pursuant to Art. 5(b) DADT 2001, whereas such income is explicitly classified as "dividend" in Art. 10(6) NM 1987 and the majority of current Dutch tax treaties.[177]

The subject-to-tax requirement in DADT 2001 is a deviation from tax treaties, in which such requirement is not imposed.[178] As Van Raad observes, the requirement of an "income tax … whether or not a source" almost seems to be a contradiction in terms: generally, withholding taxes (levied at source) are levied at a gross basis, whereas incomes taxes are by definition levied at a net basis.[179]

With respect to the reduction of the *tweede limiet*, a distinction is drawn in the DADT 2001 between, on the one hand, dividends and interest and, on the other hand, royalties. The amount of dividends/interest is reduced by all expenses "related to the dividend", whereas the amount of royalties is only reduced by the "directly chargeable" expenses.[180] Examples of expenses that may be related to the dividend are management expenses[181] and interest expenses.[182]

A recent Supreme Court decision concerned a Dutch resident taxpayer that had granted USD-denominated loans

172. Art. 36(3) DATD 2001 limits the maximum amount of the *eerste limiet* to 25% of the dividend.
173. Pursuant to the second sentence of the fourth paragraph, expenses incurred by associated companies or natural persons are also taken into account.
174. This requirement is referred to as the "taxable base requirement" (*grondslageis*).
175. *Hoge Raad* 27 August 1997, No. 32 439, BNB 1998/17.
176. For a discussion of the definition of the term "dividend" in Art. 5 DADT 2001, see Van Raad, C., *Cursus Belastingrecht (Internationaal Belastingrecht) (student edition)*, Deventer: Kluwer, 2009, Para. 2.3.3.
177. See Avery Jones, J.F. et al., "The definitions of dividends and interest in the OECD Model: Something lost in translation", *World Tax Journal* (2009) 2 p. 44 and *British Tax Review* (2009) 4 p. 451.
178. Bender, T., *De vrijstellingsmethode ter voorkoming van internationaal dubbele belasting*, Deventer: Kluwer, 2000, p. 286.
179. See Van Raad, *Cursus Belastingrecht (Internationaal Belastingrecht)*, op. cit., Para. 2.4.5.G.
180. Art. 36(4) DADT 2001.
181. See, inter alia, *Hoge Raad* 11 March 1992, No. 26 101, BNB 1992/170, in which the Court held that the auditing, advisory, management and administrative expenses reduced the *tweede limiet*.
182. See, inter alia, *Hoge Raad* 11 February 1976, No. 17 819, BNB 1986/88, in which the Court held that the gross income from Belgian immovable property should be reduced by the interest on loans that were taken out to acquire that income. For a discussion of relevant case-law, see Bender, *De vrijstellingsmethode ter voorkoming van internationaal dubbele belasting*, op. cit., p. 363.

to a Brazilian related company (C S.A.).[183] The question arose whether or not a foreign exchange rate loss (FOREX loss) on the USD-denominated loans – the dollar had depreciated vis-à-vis the euro – reduced the Dutch tax credit for the Brazilian interest withholding tax.[184] The Amsterdam Appeals Court (*Gerechtshof Amsterdam*) had held that the expression "interest included in the profit" (Art. 36(1) DADT 2001) should be taken to mean the same item of income that may be taxed in Brazil pursuant to Art. 11(1) of the 1990 Netherlands–Brazil treaty. Subsequently, the *Gerechtshof* had drawn a distinction between (i) FOREX results on the principal, which are not covered by Art. 11(1), and (ii) the interest, which is a "fruit" for the disposal of the principal. The *Gerechtshof* had also found support for its view in a literal reading of Art. 11(1), which refers to "interest … paid to" and which therefore does not include items of income that are not paid in that capacity, such as FOREX losses. Finally, the *Gerechtshof* had held that the *tweede limiet* should not be reduced by FOREX losses as, according to the *Gerechtshof*, the use of the expression "expenses related to the dividend" indicates that the legislator only referred to current expenses, such as management expenses and interest expenses. The *Hoge Raad* entirely followed the judgment by the *Gerechtshof*.

In the *China lease* case,[185] a Dutch resident parent company had taken out a loan to finance its Dutch resident subsidiary. The subsidiary, which was equity-funded, received operational lease instalments from China. The question arose whether or not the interest expenses of the parent company had to be taken into account with the calculation of the *tweede limiet* of the subsidiary. The *Gerechtshof* answered that question in the negative and held that: "[I]n general, only the profits and the costs of the taxpayer, at whose level these profits are taxed, should be taken into account."

As a reparation of the outcome in the *China lease* case, Art. 36(4) DADT 2001, in pertinent part, now provides that costs incurred by associated companies or associated natural persons[186] should also be taken into account.

It may be possible that timing mismatches exists between the year in which a dividend is taxed in the source state and the year in which that dividend is subject to Dutch corporate income tax.[187] For example, the dividend may be taxed in the Netherlands on accrual basis in year x, while the foreign tax may not be withheld until the actual distribution of the dividend in year $x + 1$. In such a situation, it will not be possible to offset the foreign dividend withholding tax in year x as the *eerste limiet*, the amount of dividend withholding tax levied by the other state in that year, will be nil. In year $x + 1$, it may not be possible to offset the foreign dividend withholding tax either as the *tweede limiet*, the amount of Dutch corporate income tax due on the foreign income, may also be insufficient.

To solve the impossibility to credit foreign withholding taxes as a result of timing mismatches, the State Secretary of Finance approved in a Decree of 18 July 2011[188] that the foreign tax may be credited in the year in which that tax was actually withheld by analogy to the relief that would have been granted if the taxation of the dividend with Dutch corporate income tax and the withholding of the foreign tax had taken place in the same year.

20.6.1.2.2. *Cost deduction*

Art. 38 DADT 2001 offers taxpayers the possibility to suspend the application of Art. 36 DADT 2001 and grants them the right to elect – through a written request – for cost deduction.[189] In that case, the prohibition of 10(1)(e) CITA 1969 on the deduction of (foreign) income taxes is left aside and the amount of foreign (withholding) taxes on the dividend income may be deducted against the Dutch taxable base. Although a tax credit is generally more advantageous then cost deduction, cost deduction may be advantageous in situations in which a tax credit will effectively not be utilized as a result of a low amount of foreign income and hence a low

183. *Hoge Raad* 17 June 2011, No. 10/00076, V-N 2011/32.13.
184. The obligation to provide a tax credit existed under Art. 11 in conjunction with Art. 23 of the Convention between the Kingdom of the Netherlands and the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed on 8 March 1990, *Tractatenblad* 1991, p. 176.
185. *Gerechtshof Amsterdam* 19 November 1997, No. 95/4864, V-N 1998/15.8.
186. Within the meaning of Arts. 10a(4) and 10a(5) CITA 1969 respectively.
187. See Van Dun, M., "Over Aristotelische eenheden en de verrekening van buitenlandse (bron)belasting", *Nederlands Tijdschrift voor Fiscaal Recht* 2004/1536.
188. Decree of the State Secretary of Finance of 18 July 2008, No. CPP2007/664M, V-N 2008/39.7, Para. 3.3.
189. See Bender, T. and Rouwers, R.W.G., "Enkele aspecten van kostenaftrek als methode ter voorkoming van dubbele belasting", *Weekblad voor Fiscaal Recht* (1992) 6001 pp. 393-403.

tweede limiet.

20.6.1.3. Avoidance of juridical double taxation under tax treaties

Art. 24 of the NM 1987 departs from Art. 23 of the OECD Model. To ensure that the Netherlands can apply the methods for the avoidance of double taxation, the first paragraph of Art. 24(2) of the NM 1987 provides that the Netherlands may include in its taxable base the items of income which may be taxed in the other contracting state. The third paragraph states the rules for the credit method.

In a Decree of 21 January 2004, the State Secretary of Finance set out the conditions under which a Dutch PE of a company that is resident in either (i) an EU Member State or (ii) a state with which the Netherlands has concluded a tax treaty with a non-discrimination provision similar to Art. 24(3) is eligible to a tax credit.[190]

Similar to Art. 36(2) DADT 2001, the maximum amount of tax that may be credited against the amount of Dutch corporate income tax due is the lowest of the amount of the foreign tax paid (*eerste limiet*) and the amount of Dutch corporate income tax that would have been due with respect to the dividend (*tweede limiet*).

Various tax treaties concluded by the Netherlands contain a so-called tax sparing credit,[191] as a result of which a Dutch taxpayer may offset a higher amount than the actual amount of foreign tax paid (*eerste limiet*). Tax sparing credits have been the subject in several judgments by the *Hoge Raad*.[192] BNB 2009/228 concerned a taxpayer that received dividends, interest and royalties from its subsidiaries in both EU Member States and third states. The taxpayer had claimed that it was eligible to a similar tax sparing credit as provided in Art. 23(4) in the 1990 Netherlands–Brazil treaty and Art. 25(5) in the 1981 Netherlands–Greece treaty, arguing that an infringement of Art. 56 of the EC Treaty (now Art. 63 TFEU) existed if source income received from other countries than Brazil and Greece was treated less favourably than source income from those two countries. The *Gerechtshof Amsterdam* had relied on the ECJ's judgment in the *D* case and had held that situations in which source income is received from Brazil or Greece are not comparable to situations in which source income is received from other states. Accordingly, the *Gerechtshof* held that there was no unequal treatment of similar situations.[193] The *Hoge Raad* upheld the verdict by the *Gerechtshof* and held that:[194]

> [I]t is not open to reasonable doubt that if a different treatment should be ascribed to a tax treaty, and therefore not to a rule that was independently realised by a Member State, the limited scope of the tax treaty is a relevant distinguishing factor, which prevents aligning situations which are and which are not covered by the tax treaty.

BNB 2009/310 concerned a Dutch resident NV that had received NLG 9 million of interest on deposits held with Brazilian branches of various banks in 1997. The tax sparing credit provision in Art. 23(4)(b) of the 1990 Netherlands–Brazil treaty provided that the amount of Brazilian withholding tax, the *eerste limiet*, was deemed to be 20%. In 1997, the taxpayer did not have a positive taxable result and hence its *tweede limiet* was nil. In 2001, the taxpayer had a positive taxable result but did not receive any foreign income, and requested the utilization of the 1997 tax sparing credit. The *Hoge Raad* held that that tax sparing credit could only be utilized in a year in which a taxpayer actually receives foreign income and thus dismissed the taxpayer's request. The Court also stated that neither the OECD Model Convention nor the OECD Commentary offers support for the view that withholding tax which cannot be credited in one year due to a loss position of the taxpayer is creditable in the next year in which tax is due. Van Weeghel has considered that outcome "unsatisfactory" as the Brazilian interest income had reduced the amount of the loss in 1997 and, through a reduction of compensating losses, had contributed to the positive taxable result in 2001.[195] It is observed that Para. 2.15.2. of the Dutch government's Notice on Tax Treaty Policy of 11 February 2011 expresses the policy intention not to agree with the inclusion of a tax sparing credit in future tax treaties due to doubts on their economic benefit and the risks of abuse.

---

190. Decree of the State Secretary of Finance of 21 January 2004, No. IFZ2003/558M, V-N 2004/10.8.
191. Inter alia, the tax treaties with Brazil (1991), China (1988), Greece (1981) and India (1989).
192. See, inter alia, *Hoge Raad* 8 August 2003, No. 38 087, BNB 2004/22, 10 October 2008, No. 43 619, BNB 2009/228 and 9 October 2009, No. 00 315, BNB 2009/310.
193. *Gerechtshof Amsterdam* 6 September 2006, No. P04/02259, V-N 2006/63.18.
194. *Hoge Raad* 10 October 2008, No. 43 619, BNB 2009/228, Para. 4.3. The *Hoge Raad* referred to ECJ 12 December 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*.
195. See the annotation of S. van Weeghel to *Hoge Raad* 9 October 2009, No. 00 315 in BNB 2009/310.

In situations covered by treaties that were concluded after 1980, the tax credit is calculated on the basis of the per country method instead of the overall method.

Pursuant to the Decree of 18 July 2008, the possibility to carry forward non-utilized tax credits of Art. 37 DADT 2001 has also been made applicable to tax treaty situations.[196]

Similar to situations in which tax relief is unilaterally granted by the DADT 2001, the *tweede limiet* is calculated on a net basis.

Pursuant to the Decree of 18 July 2008, a taxpayer may opt for the possibility of cost deduction, which is granted on a per country basis, for the joint amount of interest, dividend and royalty income.[197]

The concurrence of the credit method (for royalty income) and the exemption method (for PE income) came up in the *Japanese Royalty* case.[198] A Dutch BV developed and exploited trademarks, know-how and patents. Ninety per cent of the income derived from these activities was attributable to a Swiss PE. In essence, the question was whether or not, in addition to granting an exemption for the Swiss PE income, the Netherlands was obliged to provide a tax credit for the Japanese withholding tax on the royalty income attributable to the Swiss PE. The *Hoge Raad* held that the purpose of the *tweede limiet* in Art. 24(2)(c) of the 1970 Netherlands–Japan treaty was to prevent that the Netherlands would have to grant a higher tax credit than the amount of Dutch corporate income tax that it would levy on the royalty income without the tax treaty. Since, due to the 1951 Netherlands–Switzerland treaty, 90% of the royalty income would not actually be subject to Dutch corporate income tax, the Court came to the conclusion that granting a tax credit for (the Japanese withholding tax on) the royalty income attributable to the Swiss PE would come into conflict with the purpose of the *tweede limiet* in the 1970 Netherlands–Japan treaty. Accordingly, the Netherlands was only obliged to grant a tax credit for 10% of the Japanese royalty withholding tax.[199]

20.6.1.4. Avoidance of economic double taxation

Economic double taxation is avoided through two mechanisms:
(i) the participation exemption of Art. 13 CITA 1969 (*deelnemingsvrijstelling*); and
(ii) the participation credit of Art. 13aa in conjunction with Art. 23c CITA 1969 (*deelnemingsverrekening*).

If the Dutch participation exemption applies, income derived and capital gains derived from the disposal of a qualifying subsidiary are exempt at the level of the taxpayer.[200] The same applies to costs incurred with the acquisition or disposal of the participation[201] and FOREX results.[202] The benefits of the participation exemption are granted unilaterally. Whereas, in pertinent part, Art. 13(2)(a) CITA 1969 requires a minimum shareholding of 5% in the nominal paid-up share capital of a company of which the capital is wholly or partly divided into shares, Art. 13(3)(3) CITA 1969 provides that if a taxpayer holds shares in a company that is resident in an EU Member State with which the Netherlands has concluded a tax treaty that provides for the reduction of dividend withholding tax on the basis of the number of voting rights, the shareholding also qualifies as a participation if the shares held by the taxpayer represent at least 5% of the voting rights.

Income derived from a so-called non-qualifying investment participation[203] is exempt under the credit rules of Art. 13aa in conjunction with Art. 23c CITA 1969 rather than the participation exemption rules of Art. 13 CITA 1969. In general, the shareholder of a non-qualifying investment participation will be entitled to a fixed tax

---

196. Decree of the State Secretary of Finance of 18 July 2008, No. CPP2007/664M, V-N 2008/39.7, Para. 3.2.1.
197. Id.
198. See, inter alia, Bender and Engelen, "Hinken op twee gedachten in een driehoekssituatie", op. cit., pp. 1461-1470. The *Hoge Raad*'s judgment in the *Japanese Royalty* case was maintained in *Hoge Raad* 11 May 2007, No. 42 385, BNB 2007/230, which concerned a Dutch BV with a Belgian PE, to which receivables from Brazilian and Italian group companies were allocated.
199. *Hoge Raad* 9 October 2009, No. 00 315, BNB 2009/310, Paras. 3.4-3.6.
200. In general, on the participation exemption, see Albert, P.G.H., *Deelnemingsvrijstelling*, Den Haag: Sdu Uitgevers, 2011 and Van der Geld, J.A.G., *De deelnemingsvrijstelling*, Deventer: Kluwer, 2011.
201. Art. 13(1) CITA 1969.
202. See *Hoge Raad* 9 June 1982, No. 21 142, BNB 1982/230. Various authors, including S.C.W. Douma in "Valutaverlies op een deelneming: aftrekbaar!", NTFR 2008-2327, have argued that FOREX losses on a participation that is resident in an EU Member State should be deductible on the basis of ECJ 28 February 2008, Case C-293/06, *Deutsche Shell. v. Finanzamt für Großunternehmen in Hamburg*. In the present authors' view, a similar analysis should apply to FOREX losses on dividends.
203. See Art. 13(9) in conjunction with Art. 13(11) CITA 1969.

credit of 5% of the income derived from the participation. No tax credit is granted if the participation is not subject to any corporate income tax.[204] To comply with the Parent-Subsidiary Directive,[205] dividends received from a subsidiary that qualifies as a company of a Member State within the meaning of Art. 2(1) of the directive may opt for a tax credit on the basis of the actual amount of corporate income tax paid in that Member State.[206]

Non-resident taxpayers also have access to the participation exemption and the participation credit regime.[207]

20.6.2. Domestic anti-abuse rules with respect to dividends sourced in tax havens

The Netherlands does not have CFC legislation in place to ward off (perceived) abuse, if any, of holding and financing structures involving tax-haven companies held by Dutch corporate taxpayers. However, there are rules that deny the application of the participation exemption to certain passively held and insufficiently taxed participations.

20.6.2.1. Criteria for application of the participation exemption

Under the participation exemption regime, income and capital gains derived by corporate taxpayers from qualifying participations are in principle exempt from Dutch corporate income tax. There is no requirement as to the duration of the period in which the participation should be held by the parent company. In principle, all shareholdings of at least 5% of the nominal paid-up capital, irrespective whether in domestic or foreign companies, will qualify as "participations". The participation exemption regime generally applies to such a participation, if one of the following conditions is met:

(i) the participation is not held as passive investment (motive test);[208]
(ii) it is subject to a reasonable profit-based tax by Dutch tax standards (i.e. generally it is subject to a statutory rate of at least 10%, reasonable taxation test); or
(iii) less than 50% of the participation's directly or indirectly held assets consist of lowly-taxed free portfolio investments (*laagbelaste vrije beleggingen*, asset test).[209]

The reasonable taxation test is met if the participation is subject to a profit tax that results in a real taxation in accordance with Dutch standards. However, differences between the Dutch taxable base and the taxable base in the country of residence that are caused by, for example, a local participation exemption that is significantly broader than the Dutch participation exemption, will be taken into account for this test.[210] The reasonable taxation test is in principle applied on a case-by-case basis. There is no official black or grey list of jurisdictions or regimes that would not meet the test.

The State Secretary of Finance has indicated in legislative history that if a (foreign) subsidiary has a PE in another state, the reasonable taxation test is applied by calculating the aggregate tax imposed on both the

---

204. Art. 13aa(7) CITA 1969. Which will be the case with a shareholding in an EII or an FII.
205. Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 7/41, 13 January 2004 (Parent-Subsidiary Directive).
206. Art. 23c(3) CITA 1969.
207. Pursuant to Art. 17(3)(a) in conjunction with Art. 18 CITA 1969.
208. Under the motive test, a participation is held as a passive investment if the taxpayer holds the participation with the intention to generate a return that can be expected from normal asset management (so-called passive investment participation; *beleggingsdeelneming*). If the taxpayer has a mixed motive, the predominant motive is decisive. A participation is generally not held as passive investment if the subsidiary is engaged in the same line of business as the taxpayer. Furthermore, if there is active management/involvement from the holding company with the subsidiary, the participation will generally not be considered to be held as a passive investment.
209. Generally, the asset test will be met if the taxpayer can demonstrate that less than 50% of the assets, directly and indirectly, held by its participation generally consist of passive assets that are not subject to a reasonable levy of tax (*laagbelaste vrije beleggingen*). Passive assets (*vrije beleggingen*) are defined as portfolio investments other than those that are reasonably considered necessary within the scope of the activities carried out in the active business enterprise of that participation. However, investments consisting of real estate, including any rights directly or indirectly owned in connection with such real state, which are not owned by an entity that is considered to be a FII or an EII are not considered passive assets.
210. *Kamerstukken II*, 2009/10, 32 129, No. 3, p. 62.

subsidiary and the PE. The test is not met if the aggregate rate is below 10% due to unilateral or bilateral measures to avoid or limit double taxation.[211]

If the motive test is not met, but either the reasonable taxation test or the asset test is, the participation exemption will be applicable (a qualifying investment participation).

If none of the above tests is met (a non-qualifying investment participation), the participation exemption does not apply and income and gains derived from such passively held and insufficiently taxed participations is in principle taxable in the hands of the corporate shareholder. A participation credit regime may apply in respect of non-qualifying investment participations. The participations credit regime generally aims to effectively tax the underlying profit of the participation at the Dutch profit tax level. In addition, annual mark-to-market rules apply in respect of certain non-qualifying investment participations.

The stated rationale of the participation credit regime and the mark-to-market rules is "to avoid that income from mobile capital that is located in low-tax jurisdictions, is received on a tax-exempt basis through the Dutch participation exemption."[212] This reasoning bears a clear link to CFC type regulations.

20.6.2.2. Participation credit regime for non-qualifying participations

The participation credit regime operates through two mechanisms:
(i) a gross-up of income and gains derived from the participations with underlying foreign profit tax at a fictitious rate of 5% (Art. 13aa CITA 1969); and
(ii) a subsequent credit for such underlying foreign tax against Dutch tax (Art. 23c CITA 1969).

The participation credit regime does not apply to a non-qualifying participation that:
(i) is exempt from profit tax or is subject to a profit tax without an actual levy of tax; or
(ii) qualifies as an investment institution.

In principle, the gross-up is calculated by multiplying the income and gains (which generally include dividend distributions for Dutch tax purposes, capital gains and revaluation pursuant to mark-to-market rules), calculated jointly for all non-qualifying investment participations, by a factor 100/95 (Art. 13aa(2) CITA 1969) (grossed-up income).

If the joint grossed-up income is positive, the taxpayer may apply the credit mechanism set out in Art. 23a CITA 1969 (Art. 13a(5) CITA 1969). If the joint grossed-up participation income is negative, the profit of the taxpayer in the relevant tax year is increased with that amount multiplied by a factor 5/25.5 (the denominator of this factor relating the general tax rate of 25.5% in 2007, at the time of the introduction of the arrangement; the current general corporate income tax rate is 25%). The latter increase of the profit in case of a negative grossed-up amount is put in place instead of a loss recapture mechanism and should thus, according to the legislator, serve to simplify the gross-up mechanism.[213] However, it has been pointed out in literature that this simplification may not be effective and lead to overkill in a situation in which the (positive) grossed-up profit in subsequent years (in aggregate) never matches the grossed-up loss.[214]

The gross-up mechanism generally leads to an additional amount of Dutch tax payable (tax being calculated against the grossed-up amount at a general corporate income tax rate of 2%5 – 20% for the first EUR 200,000 of profit – rates for 2011). The credit mechanism of Art. 23a CITA 1969 provides for a credit against Dutch tax. This amount of credit is in principle calculated as 5% of the grossed-up amount – the rate of 5% corresponding to a fictitious rate of foreign profit tax paid by the non-qualifying investment participations.

To ensure compatibility with the EU Parent-Subsidiary Directive, a taxpayer may elect to take into account the actual amount of taxes (indirectly) paid by the non-qualifying participation to determine the amount of the available credit (EU election). The EU election may also be made in respect of similar payments made by certain designated EEA countries (at present Norway and Iceland). In case of an EU election, the gross-up in

211. Id., p. 64.
212. *Kamerstukken II*, 2005/06, 30 572, No. 3, p. 13.
213. *Kamerstukken II*, 2009/10, 32 129, No. 3.
214. Kok, Q.W.J.C.H., "Enkele aspecten van het wetsvoorstel 'Werken aan winst'", FED (2006) 88.

respect of the relevant income is amount of actual (indirectly) underlying tax, rather than the fictitious tax rate of 5%. The EU election should take place upon a request and may only take place if the taxpayer can demonstrate that underlying taxes are actually paid. In addition, this election is only available with respect to profit distributions received by the taxpayer and is therefore not available with respect to any capital gains/losses (including gains through mark-to-market rules) that relate to the taxpayer's non-qualifying investment participations. The available amount of credit through an EU election not only relates to profit taxes paid by the taxpayer's directly owned subsidiary itself, but also extends to such taxes paid by its indirectly owned subsidiaries. However, with respect to the latter, such taxes are only taken into account if and to the extent that the taxpayer demonstrates that generally the following conditions are met:
(i) the direct ownership interest between every level of the taxpayer's directly and indirectly owned subsidiaries is at least 5%;
(ii) all such subsidiaries qualify for the EU Parent-Subsidiary Directive or are resident in the designated EEA countries; and
(iii) the amount of taxes paid by such subsidiaries can be attributed to the taxpayer's income derived from its directly owned non-qualifying investment participations.

The credit amount is capped to the lower of two limits. Each limit derives from the 'grossed-up' income derived by the taxpayer with respect to its non-qualifying investment participations. The first limit equals an amount of 5% of grossed-up income. The second limit equals an amount of the Dutch corporate income tax rate (in 2011: 25%) calculated against the grossed-up income. This second limit is based on a net income calculation. This means that in the calculation of the grossed-up income taken into account, the income derived by the taxpayer with respect to its non-qualifying investment participations should be reduced with the amount of costs that have been deducted by the taxpayer with respect to its non-qualifying investment participations in the same year in which the income is derived.[215]

20.6.2.3. Mark-to-market rules (annual revaluation)

A corporate taxpayer is obliged to annually revaluate its shareholdings in Dutch and non-Dutch investment participations against market value if the following three cumulative criteria are met:
(i) the taxpayer, whether or not together with a related entity, owns a shareholding of at least 25% in a subsidiary;
(ii) the subsidiary is not subject to a reasonable profit tax by Dutch tax standards; and
(iii) the assets held by the subsidiary consist for at least 90% of low-taxed free portfolio investments.

If the revaluation results in (positive or negative) income, such income is taken into account in determining the taxpayer's profit and is taxed against the regular Dutch corporate income tax rate (subject to the participation credit regime).[216]

20.6.3. Issues relating to the application of domestic withholding tax on outbound dividends

Pursuant to Art. 1(1) DWTA 2001, Dutch dividend withholding tax of 15% is levied from those persons – residents or non-residents – who are entitled (either directly or through depositary receipts) to the "proceeds" (*opbrengst*) of shares or profit-sharing certificates in or (hybrid) loans as meant in Art. 10(1)(d) CITA 1969 to Dutch resident companies.[217]

A non-resident company that holds a substantial interest (*aanmerkelijk belang*)[218] (i.e. at least 5% of the issued share capital of a company of which the capital is wholly or partly divided into shares) in a Dutch resident company is subject to Dutch corporate income tax for the dividends received from that company (*reguliere voordelen*) if the substantial interest cannot be allocated to the company capital of an enterprise.[219] In that case,

215. This second limit is never lower than nil.
216. For a critical review of the participation credit regime and mark-to-market rules from the perspective of the TFEU freedoms, see Van der Vegt, P.C., "Bescherming van Europese winstbelastingjurisdicties tegen misbruik", *Weekblad voor Fiscaal Recht* (2006) 6816, Para. 4.1.
217. See 20.3.1.2. in this report.
218. The term "*aanmerkelijk belang*" is defined in Art. 4.6-4.11 ITA 2001.
219. Art. 17(3)(b) CITA 1969. This provision does not apply if the Dutch resident company is an EII.

the Dutch dividend withholding tax (15%) is an advance levy and may be credited against the Dutch corporate income tax (25%) due at the level of the shareholder.[220]

Pursuant to Art. 4(2) DWTA 1965, an exemption from the obligation to withhold dividend withholding tax applies if the beneficiary (*opbrengstgerechtigde*) is resident in an EU or EEA Member State and, had it been a Dutch resident company, would have had a shareholding in the distributing company that qualifies as a participation as defined in Art. 13 CITA 1969.[221] As the Netherlands does not levy a branch profit tax, it may be attractive for a foreign shareholder who is not able to profit from the above exemption to hold the shares in a Dutch company through a Dutch PE. After all, if the participation exemption applies to the shareholding in the Dutch company, dividends flowing to the foreign shareholder are exempt from Dutch dividend withholding tax. To combat the avoidance of Dutch dividend withholding tax through such structures, a Decree has been issued with (strict) conditions under which the Dutch tax authorities are willing to offer certainty in advance on the allocation of the shares in the Dutch company to the Dutch PE.[222]

Art. 10(2) DWTA 1965 offers the possibility of a refund of Dutch dividend withholding tax to a company that is resident in an EU or EEA Member State that is not subject to any income tax in that state and which would not have been subject to Dutch corporate income tax had it been resident in the Netherlands.[223]

The so-called distribution facility of Art. 11 DWTA 1965 was addressed above in 20.4.1.3.

20.7. Selected issues of dividend taxation under EU law

20.7.1. Open issues in the implementation of the Parent-Subsidiary Directive

20.7.1.1. The “subject to tax condition” under Art. 2(1)(c) of the Directive

To qualify as a “company of a Member State” for purposes of the Parent-Subsidiary Directive, Art. 2(1)(c) requires that a company is subject to one of the taxes listed in that paragraph, “without the possibility of an option or of being exempt … or to any other tax which may be substituted for any of the above taxes.”

Neither the Parent-Subsidiary Directive nor primary EU law contains any leads on the interpretation of the term “subject to tax” in Art. 2(1)(c). The ECJ has not (yet) interpreted this term either. Dutch scholars have put forward two different interpretations of this term:

(i) a company should be subjectively subject to Dutch corporate income tax (i.e. it should have one of the legal forms listed in Art. 2 CITA 1969);[224] or

(ii) a company should both be subjectively and objectively subject to Dutch corporate income tax (the profits realized by the company must be subject to tax, i.e. no exemption).[225]

In a Dutch context, questions may arise whether the subject to tax condition is met by an:

(i) open limited partnership (*open commanditaire vennootschap*, only subject to *vennootschapsbelasting* for the share of its limited partners);[226]

(ii) association (*vereniging*), a foundation (*stichting*) and an other than public-law corporation (only subject to *vennootschapsbelasting* to the extent it carries on an enterprise);[227]

---

220. Art. 25(1) CITA 1969.

221. A legal form requirement and subject-to-tax requirement, similar to Art. 2(1)(a) and 2(1)(c) of the Parent-Subsidiary Directive, were abolished in December 2009, as that would stem from ECJ 18 June 2009, Case C-303/07, *Aberdeen Property Fininvest Alpha Oy*. See *Kamerstukken II*, 2009/10, 32 129, No. 8, V-N 2009/54.5. It is observed that Art. 4(3) and (4) DWTA 1965 contains exceptions to the exemption to the obligation to withhold dividend withholding tax of Art. 4(2) DWTA 1965.

222. Decree of the State Secretary of Finance of 16 March 2007, No. CPP2006/1783, BNB 2007/158, Para. 4.3.

223. The possibility of a refund does not apply to entities that fulfil a similar function as an EII or FII.

224. See, inter alia, Lambooij, M.V., “De moeder-dochterrichtlijn en de Nederlandse wetgeving”, *FED Fiscale studieserie* (1991) p. 153 and Noordenne, C.W. van, “De Europese Moeder-Dochterrichtlijn”, *Weekblad voor Fiscaal Recht* (1991) 5955 p. 443.

225. See, inter alia, Van der Geld, J.A.G. , “Het wetsvoorstel tot implementatie van de Moeder-Dochterrichtlijn”, *Weekblad voor Fiscaal Recht* (1991) 5985, p. 1635 and Van den Hurk, H.T.P.M., “Onderworpenheid en compartimentering; Europees geïnterpreteerd”, *Weekblad voor Fiscaal Recht* (1994) 6121 p. 1434.

226. See *Hoge Raad* 7 July 1982, No. 20 655, BNB 1982/268. See also Stevens, A.J.A., *Fiscale aspecten van de Commanditaire Vennootschap*, Deventer: Kluwer 2002, Para. 5.4.

227. Art. 2(1)(e) CITA 1969.

(iii) EII (objectively exempt from *vennootschapsbelasting*);[228]
(iv) FII (subject to *vennootschapsbelasting* at a rate of 0%).[229]

Through a teleological interpretation of Art. 2(1)(c) of the Directive, Fibbe and Stevens conclude that an *open commanditaire vennootschap* only meets the subject to tax condition to the extent that it is subject to Dutch corporate income tax.[230]

To the extent the a corporation taking one of the legal forms listed in Art. 2(1)(e) CITA 1969 is objectively subject to *vennootschapsbelasting* (i.e. it carries on an enterprise), there should be no doubt that the subject to tax condition is met. To the extent such a corporation is not objectively subject to *vennootschapsbelasting*, one may nevertheless argue that such a corporation is subjectively subject to *vennootschapsbelasting* and therefore meets the subject to tax condition. One may counter this view by arguing that the objective of the Parent-Subsidiary Directive – the elimination of double taxation arising with dividend payments and other profit distribution by subsidiary companies to their parent companies in other Member States[231] – seems to offer support for the view that such a corporation would not meet the subject to tax condition as no economic double taxation could occur. Furthermore, one may argue that such a corporation is exempt within the meaning of Art. 2(1)(c) of the Directive and therefore does not meet the subject to tax condition. It is submitted that the *Hoge Raad* has held that a *vereniging* that did not carry on a enterprise could not be regarded as a resident of the Netherlands within the meaning of Art. 4(1) of the 1992 Netherlands–US treaty. The Court did not consider the *vereniging* to be liable to tax in the Netherlands.[232] The analysis of the Court was founded on a systematic interpretation of the tax treaty between the Netherlands and the United States. The question remains whether or not the subject to tax condition in the Directive should be interpreted similarly.

Various authors conclude that an EII, which is exempt from Dutch corporate income tax, does not meet the subject to tax condition as it is exempt from Dutch corporate income tax.[233]

According to the Dutch legislator, an FII has "the possibility of an option or of being exempt" within the meaning of Art. 2(1)(c) of the Directive and therefore does not meet the subject to tax condition.[234] Weber criticizes this interpretation; as the FII regime mandatorily applies to a company which satisfies the requirements of Art. 28 CITA 1969, that company lacks an option to be exempt from *vennootschapsbelasting*.[235]

When one considers the objective of the FII regime, ensuring equal treatment between investment through an FII and direct investment by the participants, it could be questioned whether or not the source state should indeed be obliged to reduce its taxing rights, especially since in the case of direct investment most participants would (probably) not have been entitled to a reduction of (withholding) taxes by the source state.

20.7.1.2. Anti-abuse provisions

Art. 1(2) of the Parent-Subsidiary Directive reads: "[T]his Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse."

Art. 3(2) of the Directive grants Member States the option of imposing a minimum holding period of 2 years. Several current and previous anti-abuse measures are discussed in this article. When it concerns the relationship

---

228. See 20.4.4. of this report.
229. Id.
230. Fibbe, G.K.G. and Stevens, A.J.A., "De toepassing van de communautaire Richtlijnen op het gebied van de directe belastingen op personenvennootschappen", in Albregtse, D.A. and Kavelaars, P., *Maatschappelijk heffen. De wetenschap*, Deventer: Kluwer, 2006, p. 256.
231. See Para. 2 of the Preamble to Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 7/41, 13 January 2004.
232. *Hoge Raad* 4 December 2009, No. 07/10383, BNB 2010/177. For a discussion of the case, see De Graaf, A.C.G.A.C. and Pötgens, F.P.G., "Worrying Interpretation of 'Liable to Tax': OECD Clarification Would Be Welcome", *Intertax* (2011) 4 pp. 169-177.
233. See, inter alia, Van der Burght, G.C., *De bedrijfsfusie in de Wet op de vennootschapsbelasting 1969*, Deventer: Kluwer, 2009, p. 34.
234. *Kamerstukken II,* 1991/92, 22 334, No. 3, p. 5.
235. Weber, D.M., *Cursus Belastingrecht (Europees Belastingrecht)*, Deventer: Kluwer, 2011, electronic ed., Part 7.1.5.E.

between Art. 1(2) and 3(2) of the Directive, the ECJ held in *Denkavit* that:[236]

> [I]t is to be noted that Article 1(2) of the Directive is a provision of principle, the content of which is explained in detail in Article 3(2) thereof. Thus, Article 3(2), and this is not disputed by any of the parties which have submitted observations to the Court, is aimed in particular at counteracting abuse whereby holdings are taken in the capital of companies for the sole purpose of benefiting from the tax advantages available and which are not intended to be lasting. In those circumstances, it is not appropriate to refer to Article 1(2) of the Directive in interpreting Article 3(2).

According to the Court, Art. 3(2) of the Directive can therefore be characterized as a *lex specialis* rule compared to the *lex generalis* rule of Art. 2(1). The Netherlands has chosen not to implement a minimum holding period rule in either the CITA 1969 or the DWTA 1965. It is therefore questionable whether the Dutch tax authorities are still able to deny the benefits of the Parent-Subsidiary Directive to a company which, allegedly, was merely temporarily interposed with the aim of obtaining these benefits.

Art. 4(7) of DWTA 1965 contains a specific anti-dividend stripping provision. According to the State Secretary of Finance, the measure is a specific anti-abuse regulation that falls within the ambit of Art. 1(2) of the Directive.[237] Brandsma has raised the question whether Art. 4(7) of DWTA 1965 may be too generic to qualify as a suitable anti-abuse regulation within the meaning of the Directive.[238]

Art. 4(3)(c) of DWTA 1965 provides that the exemption from the obligation to withholding dividend withholding tax in situations covered by the Parent-Subsidiary Directive does not apply if:

> [P]ursuant to a regulation for the combating of fraud and abuse that is included in a convention for the prevention of double taxation concluded between the Netherlands and the State of residence of the beneficiary, the beneficiary would not be entitled to the reduction of the taxation on dividends in that convention.

According to the State Secretary of Finance, the reference to the anti-abuse regulations in the tax treaties concluded by the Netherlands is merely a clarification and does not mean that that abuse in situations covered by the Parent-Subsidiary Directive could not be covered by domestic anti-abuse regulations.[239] Nevertheless, the question arises whether or not Art. 1(2) of the Directive also permits for court-made anti-abuse doctrines, such as the Dutch *fraus legis* doctrine, which is basically a court-made substance-over-form rule.[240] Wattel and Marres[241] take the position that EU law (and Art. 1(2) of the Directive) should allow such court-made anti-abuse measure to apply. These authors refer to the position of Member States that may not have any codified anti-abuse measures in certain areas and that strictly use court-developed rules. Brandsma points to the ECJ decisions in *Kofoed*[242] with respect to the EU Merger Directive and submits that this decision confirms that abusive situations may be targeted by general domestic principle prohibiting abuse of law to the extent that such principle can be interpreted in line with the anti-abuse provision in the Directive.

The tax treaties concluded by the Netherlands contain various anti-abuse regulations (see below at 20.8.5.).

The wording of Art. 2(1)(c) of the Directive does not seem to require that a company is subject to tax in the same Member State in which it is resident.[243] In various provisions in the CITA 1969 and the DWTA 1965 (inter alia Art. 4(2)(3°) DWTA 1965), however, the word "there" was inserted, requiring that a company had to be subject to tax in the same Member State in which it was resident. According to the State Secretary of Finance, this measure was necessary to prevent abuse of the exemption from the obligation to withhold Dutch withholding tax in situations covered by the Parent-Subsidiary Directive.[244] In recent years, however, this restriction has been lifted. Nevertheless, this requirement can still be found in situations covered by the Merger

236. ECJ, 17 October 1996, Joined cases C-283/94, C-291/94 and C-292/94, *Denkavit International BV, VITIC Amsterdam BV and Voormeer BV v. Bundesamt für Finanzen*, Para. 31.
237. *Kamerstukken II*, 2000/01, 27 896, No. 5.
238. Brandsma, R.P.C.W.M., *Cursus Belastingrecht (Dividendbelasting)*, Deventer: Kluwer, 2011, electronic ed., Part 2.1.4.E.j.
239. *Kamerstukken II*, 1991/92, 22 334, No. 7, pp. 12-13.
240. For an extensive explanation of the doctrine in the Netherlands, see IJzerman, R.L.H., "Branch report – Netherlands", in IFA, *Form and substance in tax law, Cahiers de droit fiscal international,* 2002, Vol. LXXXIIa, p. 451 (56th Congress of the International Fiscal Association, Oslo, 2002).
241. See also Marres and Wattel, *Dividendbelasting,* op. cit., p. 218 and Brandsma, *Cursus Belastingrecht (Dividendbelasting)*, op. cit., Para. 2.1.4.E.j.
242. ECJ 5 July 2007, Case C-321/05, *Hans Markus Kofoed v. Skatteministeriet.*
243. Weber, *Cursus Belastingrecht (Europees Belastingrecht)*, op. cit., Para. 7.1.5.E.
244. *Kamerstukken II,* 1991/92, 22 334, No. 7, p. 4.

Directive,[245] which contains a similar subject to tax condition.[246]

Finally, Art. 4(4) of DWTA 1965 states that the exemption ex Art. 4(2) is not applicable if the recipient of the dividends is not the beneficial owner (*uiteindelijk gerechtigde*). Art. 4(7) of DWTA 1965 contains a negative definition of beneficial owner targeted at dividend stripping situations (see 20.3.2.3. above). The State Secretary of Finance has taken the view that these anti-dividend stripping rules can also pertain to cross-border situations under the EU Parent-Subsidiary Directive.[247] This position has been met with criticism,[248] however, as the anti-dividend stripping rules arguably qualify as general, categorical measures and this characteristic may likely defy the principle set out in the *Leur-Bloem* case that abuse should be targeted on a case-by-case basis.[249]

20.7.1.3. Definition of "distribution of profit"[250]

The Parent-Subsidiary Directive does not contain any leads on the interpretation of the term "distribution of profit" as used in the Directive.[251] Rather than being a term of national law, most authors share the view that the term is an autonomous term of EU law which should be interpreted by the ECJ.[252] Weber has therefore criticized the approach by Advocate General Mischo in the *Lankhorst-Hohorst* case,[253] who tested the payment of "excess" interest under the German thin capitalization rules, which was requalified as dividend under German national law, against the Parent-Subsidiary Directive.[254] In Weber's view, the requalification under national law of excess interest as dividend does not mean that such a payment is (automatically) a distribution of profit within the meaning of the Directive. Weber holds it conceivable that the ECJ will have reference to the definition of the term "dividend" in Art. 10(3) of the OECD Model Convention.[255] On the basis of Art. 4(1) of the Parent-Subsidiary Directive, which does not impose an obligation on the Member State of the parent company to avoid double taxation upon distribution of profits when the subsidiary is liquidated, various authors conclude that a liquidation distribution will qualify as a distribution of profit.[256] Terra and Wattel put forward that:

> [I]n our view, "distributions" also encompasses disguised or constructive dividends, for example payments labelled "interest" on the above-mentioned "loan" from the parent company, through which the parent in fact fully participates in the entrepreneurial risks of its subsidiary, and which must therefore be recharacterized as equity capital for tax purposes.

In his Opinion in the so-called *Prêt participatif* case (BNB 2006/82),[257] Advocate General Overgaauw discussed in detail whether or not payments on a profit participating loan (*prêt participatif*) by a French subsidiary to its Dutch shareholder could be regarded as a distribution of profit within the meaning of the Parent-Subsidiary Directive.[258] In case of an affirmative answer, it would follow from Art. 4(1) of the Directive that these payments had to be exempt under the Dutch participation exemption.[259] Overgaauw concluded that the question at issue remained unanswered on the basis of the existing case law of the ECJ and therefore suggested referring preliminary questions to the ECJ in case the exemption of the payments could not be established under national law. The *Hoge Raad* ruled that the *prêt participatif* could be regarded as a profit participating loan

---

245. Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310/34, 25 November 2009.
246. See, inter alia, Art. 3.55(5) ITA 2001.
247. *Kamerstukken II*, 2000/01, 27 896, No. 5.
248. See, e.g. Peters, M.J., "De dividendstrippingmaatregel getoetst aan het EG-recht", *Weekblad voor Fiscaal Recht* (2004) 6564 p. 239.
249. ECJ 17 July 1997, Case C-28/95, *A. Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*.
250. See Vleggeert, J., *Aftrekbeperkingen van de rente in het internationale belastingrecht*, Deventer: Kluwer 2009, Para. 11.6.2.
251. For an extensive discussion of the term "distribution of profit" in the Parent-Subsidiary Directive, see De Broe, L. and De Boeck, R., "De Moeder-dochterrichtlijn: Europese fiscale piecemeal engineering op weg naar harmonie", in Peeters, B., *Europees Belastingrecht*, Brussels: De Boeck & Larcier NV, 2005, pp. 401-411.
252. See, inter alia, Terra and Wattel, op. cit., p. 354.
253. Advocate General Mischo's Opinion, 26 September 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, Para. 100.
254. Weber, "Debt-equity ratio om thin capitalisation problemen te voorkomen?", op. cit., p. 316.
255. Weber, *Cursus Belastingrecht (Europees Belastingrecht)*, op. cit., Para. 7.1.4.A.b.
256. See Helminen, M., *The dividend concept in international tax law*, London: Kluwer Law International, p. 356.
257. *Hoge Raad* 25 November 2005, No. 40 990, BNB 2006/82.
258. This question had already been raised by, inter alia, Brandsma, R.P.C.W.M., Gooijer, J. and Tuyp, M.B.J.M., "Enige capita selecta inzake de fiscale behandeling van hybride leningen", *Weekblad voor Fiscaal Recht* (2002) 6486 p. 867.
259. Id.

within the meaning of the case BNB 1998/208. As a result, the payments were exempt under the participation exemption and no questions were referred to the ECJ.

20.7.1.4. Procedural issues

When it concerns the application of the Parent-Subsidiary Directive to inbound dividend payments, a distinction is drawn between the participation exemption and the participation credit. The application of the participation exemption to benefits derived from a taxpayer's EU participations may simply be "checked" in its corporate income tax return. In case the participation credit applies, a taxpayer may state in its corporate income tax return the tax credit on the basis of the actual amount of corporate income tax paid in that Member State. Any unused tax credits may be carried forward to the next year, provided that the amount to be carried forward is confirmed by the tax inspector in a decision which is subject to appeal.[260]

In situations covered by the Parent-Subsidiary Directive, an exemption from the obligation to withhold Dutch dividend withholding tax applies (i.e. exemption at source instead of a refund procedure).[261] Art. 4b of DWTA 1965, which required the distributing company to give security in case the 1-year holding period had not been met, has been repealed for its possible invalidity under the Directive.[262]

20.7.2. Issues of compatibility of domestic law with EU law

20.7.2.1. Introduction

This section addresses the compatibility of the Dutch tax rules governing the taxation of inbound dividends (20.7.2.2.) and outbound dividends (20.7.2.3.) under the Parent-Subsidiary Directive and primary EU law (the freedom of establishment of Art. 49 TFEU). The Dutch tax rules on dividends received from companies in third countries and dividends paid to companies in third countries in the light of the freedom of capital movement of Art. 63 TFEU is discussed at 20.7.2.4.

20.7.2.2. Inbound dividends

We discuss here a selection of various aspects of the participation exemption (20.7.2.2.1.) and participation credit (20.7.2.2.2.) rules that are possibly in breach of EU law. The tax credit for foreign withholding taxes granted by the Netherlands in a triangular case is discussed in 20.7.2.2.3.

20.7.2.2.1. *Participation exemption*

As set out in 20.6.2.1., one of the safe harbours for application of the participation exemption is the reasonable taxation test of Art. 13(11)(a) of CITA 1969. That test is met if the participation is "subject to a profit tax that results in a real taxation in accordance with Dutch standards". In purely internal situations, the reasonable taxation test will almost always be met, unless, for instance, dividends are distributed by an FII.[263] In a cross-border situation, however, various reasons exist why the reasonable taxation test may not met by the participation. For example, the test may not be met due to "excessive" notional interest deduction (Belgium) by the participation, less-restricted interest deduction in comparison with the Netherlands and a broader exemption of dividends received by the participation in comparison with the Netherlands.[264] As the reasonable taxation test results in a dichotomy between Dutch participations (participation credit almost never applies) and EU

260. Art. 23c(7) CITA 1969.
261. Art. 4(2)-(4) DWTA 1965.
262. The invalidity of the old Art. 4b DWTA 1965 under the Parent-Subsidiary Directive could be derived from ECJ 17 October 1996, Joined Cases C-283/94, C-291/94 and C-292/94, *Denkavit International BV, VITIC Amsterdam BV and Voormeer BV v. Bundesamt für Finanzen*, Para. 36, in which the Court held that "[a] Member State may not make grant of the tax advantage … subject to the condition that, at the moment when profits are distributed, the parent company must have held a minimum of 25% of the capital of the subsidiary for a period at least equal to that set by that Member State".
263. See Snel, F.P.J., "Deelnemingsvrijstelling: goede bedoelingen, weinig visie en nog enkele knelpunten", *Weekblad voor Fiscaal Recht* (2006) 6678 pp. 787-796.
264. See Strik and De Vries, *Cursus Belastingrecht (Vennootschapsbelasting)*, op. cit., Para. 2.4.3.B.e4.

participations (participation credit may apply in various situations), Kiekebeld and Van Eijsden argue that Art. 13 of CITA 1969 may be in breach of the freedom of establishment.[265] In their view, the fact that the participation exemption does not apply if the reasonable taxation test and the asset test (the assets of the participation – directly or indirectly – generally consist for less than 50% of lowly-taxed free portfolio investments) are not met, does not automatically constitute a wholly artificial transaction (cf. *Cadbury-Schweppes*)[266] as the holding of (portfolio) investments may constitute a genuine economic activity. Indeed, as Kiekebeld and Van Eijsden observe, the participation exemption does apply to an active financing company within the meaning of Art. 2a of the Implementation decision corporate income tax 1971 (*Uitvoeringsbeschikking vennootschapsbelasting 1971*). As a consequence, the participation may only not apply to a lowly-taxed passive financing company. Nonetheless, the distinction between active and passive financing companies cannot be equated with genuine economic transactions and wholly artificial transactions.[267]

Formerly, the old Art. 13(1) of CITA 1969 limited the deductibility of participation expenses (e.g., interest expenses on loans that were raised to fund the (acquisition of) a participation) to Dutch participations. Participation expenses incurred with foreign (EU) participations were not deductible. After the *Bosal* case,[268] in which the ECJ held that the freedom of establishment precludes rules that make costs in connection with a foreign (EU) participation subject to the condition that such costs be indirectly instrumental in making profits which are taxable in the Netherlands, the deduction of participation expenses has been extended under Art. 13(1) of CITA 1969 to foreign participations.

20.7.2.2.2. *Participation credit*

As Bellingwout observes, Art. 4(1) of the Parent-Subsidiary Directive permits the existence of a credit method for (lowly-taxed passive participations) parallel to an exemption method (for active or sufficiently taxed participations). It is settled case law, however, that the possibility offered by the Directive to choose between an exemption regime and a credit regime "may be exercised only in compliance with the fundamental provisions of the Treaty".[269] In that light, reference is made to the *FII Group Litigation* case, in which the ECJ held that:

> [T]he fact that nationally-sourced dividends are subject to an exemption system and foreign-sourced dividends are subject to an imputation system does not contravene the principle of freedom of establishment laid down under Article 43 EC, provided that the tax rate applied to foreign-sourced dividends is not higher than the rate applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the tax charged in the Member State of the company receiving the dividends.

The ECJ's reasoning in *FII Group Litigation* is sensible when considering the objective of the tax rule(s) at issue: both the exemption method and the credit method are suitable methods for the purposes of avoiding economic double taxation and, in that light, they are "equivalent". As Wattel observes, if the aim is to achieve capital export neutrality, applying the exemption method to domestic dividends and the credit method to foreign dividends theoretically does not result in a more burdensome treatment of the cross-border situation.[270] However, Wattel also touches upon three issues, which in his view have not been properly explained/clarified by the ECJ. First, it is not clear why, if the participation credit applies to cross-border dividends, the ECJ does not also require the application of that method (rather than the more favourable exemption method) to domestic dividends. Wattel speculates that the explanation seems to be an implied premise by the ECJ that the taxation at the level of the domestic subsidiary will be equal to the taxation at the level of the domestic parent company (in which case, the exemption method and the credit method have a similar effect). Second, it is not consistent with the aim of capital *export* neutrality that Member States only grant an ordinary tax credit and hence merely ensure capital *import* neutrality if the foreign corporation tax is higher than the domestic corporation tax rate. Third, not only dogmatically, but also practically, the ECJ's judgment in *FII Group Litigation* has left

---

265. Kiekebeld, B.J. and Van Eijsden, A.J.R., *Nederlands belastingrecht in Europees perspectief*, Deventer: Kluwer, 2007, p. 75.
266. ECJ 12 September 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Para. 51.
267. See also Bellingwout, J.W., "Passieve deelnemingen", *Weekblad voor Fiscaal Recht* (2004) 6596 pp. 1511-1513.
268. ECJ 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën*. See Weber, D.M., "The Bosal Holding Case: Analysis and Critique", *EC Tax Review* (2003) 4 pp.220-230.
269. See, inter alia, ECJ 18 September 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën*, Para. 26 and ECJ 23 February 2006, Case C-471/04, *Finanzamt Offenbach am Main-Land v. Keller Holding GmbH*, Para. 45.
270. See the extensive annotation of P.J. Wattel to ECJ 10 February 2011, Joined cases C-436/08 and C-437/08, *Haribo Lakritzen Hans Riegel BetriebsgmbH (C-436/08) and Österreichische Salinen AG (C-437/08) v. Finanzamt Linz* in BNB 2011/165.

taxpayers/judges/scholars questioning. Should the statutory or the effective foreign corporation tax rate be taken into account when calculating the amount of the tax credit? Does the tax credit only concern corporation tax at the level of the direct subsidiary ('first-tier indirect credit') or also the corporation tax at the level of the distribution indirect subsidiaries (further-tier indirect credit).[271] For completeness sake, Art. 23c(3) and (4) of CITA 1969 provide for an further-tier indirect credit.

What *FII Group Litigation* has not clarified either, and what also remains unclear after the *Columbus Container Services*[272] and *Haribo*[273] cases, is the validity under EU law of the unequal treatment of a subsidiary that is subject to an 11% corporate income tax rate by Dutch standards (full participation exemption) and a subsidiary that is subject to a 9% corporate income tax rate (9% participation credit). The highly unequal treatment of both subsidiaries is attributable to the switch-over from participation exemption to participation credit and cannot be explained in the light of the objective of avoiding economic double taxation.

Finally, not only does the question arise whether or not the participation credit system is in itself compatible with EU law, it should also be considered whether or not the manner in which the participation credit rules are applied complies with EU law. Van de Streek has identified three potential bottlenecks.[274] One, it is not possible in all situations to obtain a tax credit for the actual amount of tax paid in the Member State of the participation. Two, it is not possible to obtain a tax credit for foreign withholding taxes in cases not provided for by tax treaties. Finally, granting the participation credit on a net basis while applying the participation exemption on a – more favourable – gross basis affects the equivalence of the credit and the exemption rules.

20.7.2.2.3. *Triangular case*

Company R is resident in State R. Company R holds 100% of the shares in Company S, resident in State S. The shares in Company S are allocated to a PE of Company R in State P. Pursuant to the tax treaty between State S and State P, State S may tax dividends distributed by Company S at a rate of 10%. Pursuant to the tax treaty between State S and State R, State S may tax dividends distributed by Company S at a rate of 15%. The Netherlands is State P. State R is an EU Member State. State S is a third country. All tax treaties are drafted in conformity with the OECD Model. The Dutch participation exemption does not apply to the shareholding in Company S.

If Company S distributes a dividend, State S will withhold dividend withholding tax pursuant to the rate in the State S–State R tax treaty (15%). The Netherlands, as State P, is allowed to tax the dividend income. However, on the basis of the *Saint-Gobain* case[275] and pursuant to the non-discrimination provisions in tax treaties corresponding with Art. 24(3) of the OECD Model, State P should also grant a tax credit for the withholding tax levied by State S. The *eerste limiet* of the tax credit will be maximized at the lowest of the rate in the tax treaty between (i) State R and State S (15%) and (ii) State P and State S (10%), pursuant to a Decree of 21 January 2004.[276] There is therefore a disbalance between the amount of dividend withholding tax withheld by State S (15%) and the amount of the tax credit granted in State P (10%). The choice of establishment in the Netherlands through a PE or through a subsidiary is thus decided to the advantage of a subsidiary: had the Netherlands PE been a subsidiary, the amount of dividend withholding tax withheld by State S and the amount of the tax credit would be the same (10%) and juridical double taxation (on 15% – 10% = 5%) would have been avoided.

In the authors' view, it is an unresolved issue whether or not this violation of the "freedom to choose the appropriate legal form in which to pursue activities in another Member State"[277] is a breach of the freedom of establishment that is attributable to the Netherlands. *Stricto sensu*, the Netherlands grants a 10% tax credit to both a PE and a subsidiary and treats both forms of establishment equally. As a result, it should not be blamed

271. The High Court of Justice (England and Wales) has therefore again referred preliminary questions to the ECJ in the *FII Group Litigation* case, C-35/11.
272. ECJ 6 December 2007, Case C-298/05, *Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt*.
273. ECJ 10 February 2011, Joined cases C-436/08 and C-437/08 , *Haribo Lakritzen Hans Riegel BetriebsgmbH (C-436/08) and Österreichische Salinen AG (C-437/08) v. Finanzamt Linz.*
274. Van de Streek, J.L., "De nieuwe deelnemingsverrekening: verhouding to internationaal en Europees belastingrecht (deel 2)", *Weekblad voor Fiscaal Recht* (2007) 6725 pp. 683-692.
275. ECJ 2 March 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*.
276. Decree of the State Secretary of Finance of 21 January 2004, No. IFZ2003/558M, V-N 2004/16.10.
277. ECJ 23 February 2006, Case C-253/03, *CLT-UFA SA v. Finanzamt Köln-West*, Para. 15.

for leaving juridical double taxation in place.[278] Some authors, however, have interpreted the obligation to grant the PE of a company of a Member State national treatment,[279] as stipulated by the ECJ in *Saint-Gobain*, as entailing that all taxes withheld by State S should be creditable, even if they exceed the rate in the tax treaty between State S and State PE.[280] In addition, one may argue that the Netherlands infringes the freedom of establishment by concluding a tax treaty with State S which only provides for a reduction of dividend withholding tax on dividends paid to a resident in the Netherlands but does not contain a reduction for dividends which may be allocated to a PE in the Netherlands. The Netherlands could, and perhaps should, have agreed to inserting a provision in the tax treaty similar to Art. 25(2)(b) in the tax treaty between France and Italy.[281] It is submitted that the government's Notice on Tax Treaty Policy of 11 February 2011 expresses the policy intention to enter into agreements with tax treaty partners on the granting of tax treaty benefits to permanent PEs.[282]

20.7.2.3. Outbound dividends

Art. 4(2) of DWTA 1965 contains a fairly wide exemption from the obligation to withhold dividend withholding tax. In pertinent part, the exemption of Art. 4(2) of DWTA 1965 applies if the beneficiary is resident in another EU or EEA Member State according to the tax laws of that state and the beneficiary, at the time that the proceeds are put at its disposal, holds an interest in the withholding agent to which the participation exemption of Art. 13 of CITA 1969 or the participation credit of Art. 13aa of CITA 1969 would have applied had the beneficiary been resident in the Netherlands. In the authors' view, it is not entirely clear whether the requirement of application of the participation exemption or participation credit should be interpreted *lato sensu*, covering also any interests in the participation within the meaning of the *Falcons* doctrine,[283] such as a call option right to purchase a participation.

In recent years, various taxpayers have successfully challenged the validity of Dutch tax rules on outbound dividends before Dutch courts. After the European Commission had formally requested the Netherlands and five other Member States to amend its rules on outbound dividends on 25 July 2006,[284] the Dutch legislator has taken several measures to ensure compliance with EU law. As these measures have become effective as of 1 January 2007, these cases (generally) concern the tax rules on outbound dividends that were applicable up to 1 January 2007.

Up to that date, foreign companies that were exempt from corporation tax were not entitled to a refund of Dutch dividend withholding tax, whereas such a refund was available to Dutch exempt companies. The unequal

---

278. Although concerning an Italian example, this view is shared by M. Tenore in his draft version of the Italian national report in "The EU and Third Countries: Direct Taxation", Lang, M. and Pistone, P. (eds.), *The EU and Third Countries: Direct* Taxation, Deventer: Kluwer 2008, who refers to Offermans, R. and Romano, C., "Treaty Benefits for Permanent Establishment: The Saint Gobain Case", *European Taxation* (2000) 5 p. 188.

279. "In the case of a double taxation treaty concluded between a Member State and a non-member country, the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies." (ECJ 2 March 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*, Para. 58).

280. See, inter alia, Gusmeroli, M., "Triangular cases and the Interest and Royalties Directive: Untying the Gordian knot? – Part 2", *European Taxation* (2005) 2 p. 48, who refers to Aramini, F., "Triangular cases under the OECD Model Convention and the European Court of Justice's Case law", *Diritto e Pratica Tributaria Internazionale* (2002) 1 p. 102.

281. Convention between the government of the French Republic and the government of the Italian Republic for the avoidance of double taxation with respect to taxes on income and on capital and for the prevention of fiscal evasion and fraud signed on 5 October 1989. Art. 25(2)(b) reads: "[W]here a permanent establishment situated in a State receives dividends, interest or royalties arising in the other State and pertaining to property or rights effectively connected with its activities, such income may be taxed in the State in which it arises in accordance with the respective provisions of Paragraph 2(b) of Article 10, Paragraph 2 of Article 11 and Paragraph 2 of Article 12. The State in which the permanent establishment is situated shall eliminate double taxation in accordance with the conditions provided in Paragraph 1(a) or Paragraph 2 of Article 24, disregarding the last clause. This provision shall apply wherever the enterprise of which the permanent establishment is a part has its place of management."

282. Notice on Tax Treaty Policy of 11 February 2011, Para 1.3.5. (available at www.minfin.nl). In his answer to questions raised by the Dutch Order of Tax Advisors, the State Secretary of Finance indicated that the draft provision in Para. 70 of the Commentary to Art. 24 OECD Model will be the starting point in discussions with treaty partners (24 June 2011, No. IFZ/2011/383 V-N 35.9).

283. In the *Falcons* case, *Hoge Raad* 22 November 2002, No. 36 272, BNB 2003/34, the Court held that options which form a participation after they are exercised should be brought under the participation exemption. In general, on the *Falcons* doctrine, see Hiemstra, R., "De Falcons-doctrine: het gesplitste belang bij de voordelen uit hoofde van een deelneming", *Weekblad voor Fiscaal Recht* (2010) 6863 pp. 804-813.

284. *European Commission*, 25 July 2006, No. IP/06/1060.

treatment especially affected foreign pension funds. As of 1 January 2007, Art. 10(2) of DWTA *expressis verbis* grants the right to a refund to EU/EEA companies that are exempt in their state of residence and that would have been exempt in the Netherlands had they been resident in the Netherlands.

NTFR 2011/2635 concerned a Belgian resident shareholder which held a 2.1% shareholding in a Dutch resident company.[285] Dividend payments by the company were subject to 15% dividend withholding tax. The shareholder was not eligible for a tax credit under Belgian law. Under Dutch law, a Dutch resident shareholder with a 2.1% shareholding would have been taxed on a flat rate basis (a deemed 4% yield, taxed against 30%). A Dutch resident shareholder, however, would have been able to offset the amount of withholding tax against his personal income tax liability. The *Rechtbank*, therefore, decided that the imposition of dividend withholding tax on the distributions to the Belgian resident shareholder should be reduced to the amount of personal income tax that would have been allocable to these distributions.

On 6 June 2011, the *Rechtbank Breda* decided a case in which a Finnish resident investment fund, which was exempt from Finnish corporation tax and which held several Dutch portfolio investments, had requested a refund of Dutch dividend withholding tax.[286] That request had been denied by the Dutch tax inspector. The Finnish fund had argued that the refusal of a refund of Dutch dividend withholding tax constituted a restriction on the free movement of capital as the fund should be compared to (i) a Dutch FII (in which case a payment deduction applied, Art. 11a of DWTA 1965) or (ii) a company that is exempt from Dutch corporate income tax (which is entitled to a refund of Dutch dividend withholding tax pursuant to Art. 10(1) of DWTA 1965). The *Rechtbank* dismissed the comparison with a Dutch FII: the Finnish investment fund was not obliged to distribute its entire profit to its shareholders. Accordingly, the *Rechtbank* held that the investment fund should be compared to a Dutch investment fund that is subject to Dutch corporate income tax and, accordingly, is not entitled to a refund of Dutch dividend withholding tax.

On 3 August 2010, the *Rechtbank Haarlem* handed down a judgment in a case in which a French resident taxpayer had claimed a refund of Dutch dividend withholding tax which had been withheld on dividends received on blocks of shares of less than 5% in Dutch stock-listed companies.[287] The French taxpayer carried on stock broking activities in France and banking activities in the Netherlands through a PE. In its judgment, the *Rechtbank* addressed four requests by the French taxpayer. First, the *Rechtbank* dismissed one request which was based on the argument that the levy of Dutch dividend withholding tax as such was in breach of the fundamental freedoms. Subsequently, the *Rechtbank* addressed the argument that the effective tax burden would have been lower in a purely internal situation in comparison with the existing cross-border situation. In a purely internal situation, the dividend withholding tax may be offset against the amount of corporate income tax due, which is calculated on a net basis (i.e. expenses related to the dividend are deductible). In a cross-border situation, however, the amount of dividend withholding tax due is calculated on a gross basis. Since, due to the high amount of expenses attributable to the dividends, the effective tax burden in a purely internal situation would have been lower than in the case at hand, an infringement of the free movement of capital was argued. Contrary to what the tax inspector had argued, the *Rechtbank* was of the opinion that when comparing internal and cross-border situations, the imposition of corporate income tax at the level of the recipient should also be taken into account.[288] Subsequently, the *Rechtbank* quoted settled case law in which the ECJ held that "it cannot be excluded that a Member State may succeed in ensuring compliance with its obligations under the Treaty through the conclusion of a convention for the avoidance of double taxation with another Member State".[289] However, the Netherlands, as source state, should ensure that non-resident shareholder companies are subject to the same treatment as resident shareholder companies.[290] The set-off of the Dutch dividend withholding tax against French corporation tax should not only be possible under the 1973 Netherlands–France treaty, but should also be guaranteed by French legislation.[291] As the Dutch dividend withholding tax on dividends paid in the period between 2000 and 2007 was effectively offset against French corporation, the *Rechtbank* held that there was no infringement of the free movement of capital for that period. As regards Dutch dividend withholding tax on dividends paid in 2008, the *Rechtbank* held that the taxpayer had failed to show that the

285. *Rechtbank Breda*, 14 September 2011, No. 10/1918.
286. *Rechtbank Breda*, 6 June 2011, No. 10/1251.
287. *Rechtbank Haarlem*, 3 August 2010, Nos. 08/5180, 09/2310, 09/3860 and 09/3861.
288. The *Rechtbank* referred to, inter alia, ECJ 19 January 2006, Case C-265/04, *Margaretha Bouanich v. Skatteverket*.
289. ECJ 8 November 2007, Case C-379/05, *Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam*, Para. 79.
290. ECJ 12 December 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*, Para. 70.
291. ECJ 19 November 2009, Case C-540/07, *Commission of the European Communities v. Italian Republic*, Paras. 37-39.

expenses attributable to the dividends would have exceeded 40% of the gross dividends[292] and hence no infringement of the freedom of capital movement could be established.

In a case of 3 March 2010, the *Rechtbank Breda* awarded a Scottish pension fund the compensation of interest loss as, in 2004, Dutch dividend taxation had unlawfully been withheld.[293] Although the Dutch tax inspector had agreed to a refund of the Dutch dividend withholding tax in 2009, he did not agree to paying damages for any interest lost. Furthermore, before the *Rechtbank*, the tax inspector also argued that the Scottish pension fund was not entitled to a refund as it lacked legal personality, a requirement which also applied to Dutch exempt companies. The *Rechtbank* held that the absence of legal personality was not a relevant objective difference to justify the unequal treatment between a Dutch and a Scottish pension fund. In addition, the requirement of legal personality constituted an infringement of the free movement of capital in itself. The *Rechtbank* awarded the compensation loss for the period between the date of withholding and the date of the refund of the dividend withholding tax.

On 2 October 2008, the *Rechtbank Haarlem* decided a case that concerned a Canadian shareholder which received dividend payments in 2005 from its wholly owned Dutch resident subsidiary.[294] Pursuant to Art. 10(2)(a) of the 1986 Netherlands–Canada treaty, 5% Dutch dividend withholding tax had been withheld. The taxpayer had argued that withholding dividend withholding tax on dividend payments to companies that are resident in third countries, while exempting dividend payments to Dutch resident companies and other EU resident companies, was in breach of the free movement of capital. The *Rechtbank* held that it was not possible to review the validity of the Dutch rules in the light of the freedom of capital movement as the shareholder, through its 100% shareholding, had definite influence over the company's decisions and allowed the shareholder to determine the company's activities. Any restriction on the free movement of capital was therefore an unavoidable consequence of any restriction on freedom of establishment and could not justify separate examination of the Dutch rules in the light of (the current) Art. 63 of TFEU.

BNB 2008/103[295] concerned a Luxembourg resident company that had received dividends on its 2.25% shareholding in a Dutch resident company in 2000 and 2003. The dividends were exempt under the Luxembourg participation exemption. In a purely internal situation, the dividends would have been exempt from Dutch dividend withholding tax pursuant to Art. 4(1) of DWTA 1965 as the income on the shareholding would have been exempt under the Dutch participation exemption.[296] The *Hoge Raad*, referring to the ECJ judgment in *Denkavit*, held that the Netherlands should be refrained from withholding dividend withholding tax as no dividend withholding tax would have been withheld in a purely internal situations and the dividend withholding tax could not be offset in Luxembourg.

In BNB 2006/254,[297] a Dutch resident taxpayer sought to deduct general expenses in 2000 and 2001 with respect to various subsidiaries, among which a 100%-held Polish subsidiary (at that time, Poland was still a 'third country'). The taxpayer had argued that the limitation of the deduction of these expenses under the then applicable Art. 13(1) CITA 1969 was in breach of (the current) Art. 63 TFEU. The taxpayer had contended that Art. 13(1) CITA 1969 was not saved by (the current) 'stand-still provision' of Art. 64(1) TFEU as, although the limitation of the expenses under Art. 13(1) CITA 1969 already existed on 31 December 1993, that provision had also undergone changes after that date (i.e. its scope was extended to FOREX results). Therefore, the taxpayer argued, the entire provision of Art. 13(1) CITA 1969 had come within the scrutiny of Art. 63 TFEU. The *Hoge Raad* held, however, that the limitation of the expenses pursuant to Art. 13(1) CITA 1969 already existed on 31 December 1993. The fact that the Art. 13(1) CITA 1969 had undergone changes after that date, and to that extent was possibly partly in breach of (the current) Art. 63 TFEU, was not considered relevant by the *Hoge Raad*, as these changes did not affect the case at hand.

---

292. The *Rechtbank* had assumed a weighted average Dutch corporate income tax rate of 25%. If the (deductible) expenses attributable to the dividends would have been 40% of the gross proceeds, the "effective corporate income tax rate" would have been 15%, i.e. equal to the amount of dividend withholding tax.

293. *Rechtbank Breda*, 3 March 2010, Nos. 08/4709-08/4713.

294. *Rechtbank Haarlem* 2 October 2008, No. 07/5334.

295. *Hoge Raad* 30 November 2007, No. 42 679, BNB 2008/103.

296. Up to 1 January 2007, the old Art. 13(3) of CITA 1969 provided that the Dutch participation exemption also applied to a shareholding of less than 5% if that shareholding was held in line with the normal exercise of the business carried on by the taxpayer.

297. *Hoge Raad* 14 April 2006, No. 41815, BNB 2006/254.

20.7.2.4. Third countries

In BNB 2010/292,[298] a Dutch taxpayer had distributed a dividend to its 70%-shareholder J NV, resident in the Netherlands Antilles. Pursuant to Art. 11(3) of the TAKN, the taxpayer had withheld (and transferred) 8.3% Dutch dividend withholding tax. First, the taxpayer had argued that withholding Dutch dividend withholding tax infringed Art. 47(1)(b) of a Council Decision regarding the association of overseas countries and territories with the European Community.[299] The *Hoge Raad* held that that the scope of that provision only encompasses certain specifically listed capital transactions and does not cover dividend distributions. Although Art. 47(1)(b) does cover the direct investment by an overseas country into a Member State, the Court found that that investment was not restricted as a result of a distinction in the state of residence of the subsidiary between domestic and cross-border dividend distributions. Further, it rejected claims of discrimination, arguing that a dividend distribution to a company that is subject to Dutch taxation and a distribution to a company that is not subject to Dutch taxation are two incorporable situations. Finally, the *Hoge Raad* also dismissed the claim of an alleged violation of (the current) Art. 63 of TFEU. It held that the volume of the shareholding was such that the shareholder had a "definite influence over the company's decisions and allows him to determine its activities"[300] and hence fell within the scope of the freedom of establishment. Accordingly, referring to case law in which the ECJ addressed the concurrence of the freedom of establishment and the freedom of capital movement, the *Hoge Raad* held that there was no justification for an independent examination of the Dutch legislation in the light of (the current) Art. 63 of TFEU.[301] In a decision of 17 December 2010, which concerned a dividend distribution by a Dutch BV to a Netherlands Antilles NV, the *Gerechtshof Amsterdam* held that the relation between the Netherlands and the Netherlands Antilles should be regarded as a "purely internal" situation to which neither (the current) Art. 63 of TFEU nor Art. 47(1)(b) of the Council Decision applied.[302]

20.8. Selected issues of dividend taxation under tax treaties

20.8.1. Definition of the term "dividend"

20.8.1.1. Introduction

In spite of a definition of dividend in Art. 10(3) of the OECD Model, domestic law plays a role in the interpretation of various elements contained in that definition. An example is "income from shares", which, as Van Raad notes, is not defined in the OECD Model and hence should be interpreted on the basis of domestic law (Art. 3(2) of the OECD Model).[303]

20.8.1.2. Constructive dividends/interest on "sham loans"

Constructive dividends are regarded as "dividends" under the DWTA 1965 and are also regarded as "dividends" for tax treaty purposes.[304] That treatment is in conformity with Para. 28 of the 2010 Commentary to Art. 10(3) of the OECD Model: "[P]ayments regarded as dividends may include … disguised distributions of profits". According to Marres and Wattel, payments on loans that are requalified into equity for being "sham transactions" (see 20.3.1.2.1.) also qualify as "dividends".[305]

20.8.1.3. Purchase by a company of shares in its capital/liquidation distribution

---

298. *Hoge Raad* 9 April 2010, No. 08/04160, BNB 2010/292. Reference is made to the extensive annotation to this case by Geursen, W.W. in FED 2010/76.
299. 2001/822/EC: Council Decision of 27 November 2001 on the association of the overseas countries and territories with the European Community, *Official Journal of the European Union* L 314, 30 November 2001.
300. ECJ, 13 April 2000, Case C-251/98, *C. Baars v. Inspecteur der Belastingen Particulieren / Ondernemingen Gorinchem*, Para. 22.
301. See, inter alia, ECJ, 17 September 2009, Case C-182/08, *Glaxo Wellcome GmbH & Co. KG v Finanzamt München II*, Para. 51.
302. *Gerechtshof Amsterdam* 17 December 2010, No. 08/01179.
303. See Van Raad, *Cursus Belastingrecht (Internationaal Belastingrecht)*, op. cit., Para. 3.4.3.B.e.3.
304. See, inter alia, *Gerechtshof Arnhem* 18 June 1990, No. 1004/89, FED 1990/891 and *Hoge Raad* 9 February 2007, No. 43 203, BNB 2007/141.
305. Marres and Wattel, *Dividendbelasting*, op. cit., p. 161.

Two *Hoge Raad* cases address the qualification, for tax treaty purposes, of the purchase by a Dutch resident company of shares in its capital.[306] In the first case, BNB 1994/219,[307] a Dutch BV had purchased shares from its shareholder, which had Dutch nationality but was resident in Spain. The shareholder was taxed in the Netherlands as a non-resident: its gain was taxed as income from movable capital and 15% Dutch dividend withholding tax was withheld. The Dutch tax authorities had argued that the gain should be regarded as capital gain within the meaning of Art. 14(5) (capital gains) of the tax treaty between the Netherlands and Spain rather than Art. 10(2) (dividends).[308] The former provision seeks to prevent the avoidance of Dutch substantial interest taxation by emigration of the shareholder, followed by a disposal of the shares.[309] The *Hoge Raad* held that neither the other provisions of the treaty nor the Explanatory Notes thereto contain any clues that Art. 14(5) should be regarded as a *lex specialis* rule which prevails over the *lex generalis* rule of Art. 10(2), which grants the Netherlands the right to tax the income up to 15%. Accordingly, the Court dismissed the appeal by the Dutch tax authorities.

In the second case, BNB 2004/123,[310] a Dutch BV had purchased shares from its shareholder, which had Dutch nationality but had migrated to Belgium more than 5 years previously.[311] Through a step-by-step analysis, the *Hoge Raad* came to the conclusion that the income from the purchase of shares qualified as a capital gain under the tax treaty between the Netherlands and Belgium. First, the Court held that the purchase by a company of its shares has a “hybrid character”. Therefore, purely on the basis of the nature of the transaction, it is not possible to classify the income therefrom as “income from shares” (Art. 10) or as a “gain derived from the alienation of immovable property” (Art. 13). From the option granted to the source state by the OECD Commentaries to both the 1963 and 1977 OECD Models to tax the income under either of the two categories, the *Hoge Raad* derived that the way the income is classified (and taxed) under domestic law is decisive. As the income of the purchase of shares was taxed as a “gain derived from the alienation of shares” under Art. 20a(6)(a) of the Income Tax Act 1964 (*Wet op de inkomstenbelasting* 1964), the Court concluded that the income could not be classified under Art. 10 of the tax treaty between the Netherlands and Belgium.

In BNB 2007/41,[312] the *Hoge Raad* followed exactly the same analysis as in BNB 2004/123, with respect to the qualification of a liquidation distribution under the tax treaty between the Netherlands and Belgium.

To repair the undesired effects of the above-discussed cases, the protocols to a number of tax treaties concluded by the Netherlands explicitly qualify income received in connection with the liquidation (in whole or in part) of a company or a purchase of own shares by a company as “dividends”. See, inter alia, Para. 15 of Protocol 1 to the 2001 tax treaty between the Netherlands and Belgium or Para. VI of the Protocol to the new treaty between the Netherlands and the United Kingdom.

20.8.1.4. “Dividends” under a domestic abuse of law concept

In BNB 1994/294,[313] a Belgian resident shareholder (A) had transferred the shares in one Dutch BV (Y BV) to another Dutch BV (X BV), which it held indirectly (through a Netherlands Antilles NV). Arguing that the transactions were designed to avoid Dutch dividend withholding tax and were therefore in breach of the object and purpose of the DWTA 1965, the tax inspector had requalified the facts into a direct dividend distribution by Y BV to A (subject to 15% Dutch dividend withholding tax). The *Hoge Raad* held that neither the text of the tax treaty between the Netherlands and Belgium nor the Explanatory Notes thereto by the tax treaty partners show

306. See, inter alia, Betten, R., “Tax Treaty Interpretation: Income from the purchase of shares by the issuing company: Dividend and capital gain?”, *European Taxation* (1993) pp. 424-426 and Huiskes, T., “Netherlands: Capital gains on a company's repurchase of shares”, *European Taxation* (1994) pp. 472-474.
307. *Hoge Raad* 25 May 1994, No. 28 959, BNB 1994/219.
308. Convention between the Kingdom of the Netherlands and the Government of the State of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital signed on 16 June 1971, *Tractatenblad* 1971, p. 144.
309. See, inter alia, Ellis, M.J., “Een rammelend ab-voorbehoud”, *Nederlands Tijdschrift voor Fiscaal Recht* 2003/603, pp. 1-2.
310. *Hoge Raad* 12 December 2003, No. 38 461, BNB 2004/123.
311. Accordingly, the anti-avoidance rule Art. 13(5) of the Convention between the Government of the Kingdom of the Netherlands and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation with respect to Taxes on Income and on Capital and for the Settlement of some other Questions on Tax Matters signed on 19 October 1970, *Tractatenblad* 1970, 192, did not apply.
312. *Hoge Raad* 9 June 2006, No. 41 376, BNB 2007/41.
313. *Hoge Raad* 29 June 1994, No. 38 461, BNB 2004/123.

that they had the intention to classify as dividends what is classified as "dividends" under an abuse of law concept by the source state. Furthermore, the Court held that neither the text of the treaty nor the Explanatory Notes support the view that non-taxability of the income at issue would repudiate the object and purpose of the tax treaty.

20.8.1.5. Dividends paid by a "company"

Para. 24 of the 2010 Commentary to Art. 10(3) of the OECD Model provides that: "[T]he notion of dividends basically concerns distributions by companies within the meaning of sub-paragraph(b) of paragraph1 of Article 3. Therefore the definition relates, in the first instance, to distributions of profits the title to which is constituted by shares." Para. 26 of the Commentary states that: "[D]istributions of profits by partnership are not dividends within the meaning of the definition". The phrase "income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident" in Art. 10(3) of the OECD Model ensures that distributions of profits by companies that do not have a capital divided into shares but which are subject to a fiscal treatment that is substantially similar to those companies also fall within the scope of the term "dividend".

Pursuant to Art. 1(1) of DWTA 1965, dividend withholding tax is levied from those persons who are entitled to the "proceeds" of shares or profit sharing certificates in, or (hybrid), loans as meant in Art. 10(1)(d) of CITA 1969 from Dutch resident companies. The term "companies" refers to companies of which the capital is divided into shares. Pursuant to Art. 1(2) of DWTA 1965, a so-called "fund for joint account" (*fonds voor gemene rekening*) is deemed to have a capital divided into shares. The treaty definition of the term "company" does not appear to restrict the imposition of dividend withholding tax under domestic law.

20.8.1.6. Debt claims participating in profits

The definition of the term "dividend" in Art. 10(6) of NM 1987 and in the majority of Dutch tax treaties includes income from debt claims participating in profits and excludes the reference to them in the definition of the term "interest":[314]

> [T]he term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights participating in profits, *and income from debt-claims giving rights to participate in profits*, as well as income from other corporate rights assimilated to income from shares by the taxation law of the State of which the company making the distribution is a resident.[315] (emphasis added)

The Netherlands does not levy withholding tax on interest payments but does levy dividend withholding tax. Art. 10(6) of the tax treaty between the Netherlands and the United States refers to the more restrictive "income from debt claims that is subjected to the same taxation treatment as income from shares". As the State Secretary of Finance observes, debt claims participating in profits which do not qualify as hybrid loans within the meaning of Art. 10(1)(d) of CITA 1969 cannot be classified under that provision, nor under Art. 12 of that treaty (the definition of "interest" in Art. 12(2) excludes income from debt claims "carrying a right to participate in the debtor's profits") and thus will fall within the scope of the other income provision, Art. 23.[316]

Interest that is not deductible under the limitations on interest deduction of Art. 10a, 10b, and 10d of CITA 1969 is not requalified into dividend.[317]

20.8.2. Income tax treatment of the distributing or the receiving company

314. See Avery Jones et al., "The definitions of dividends and interest in the OECD Model: Something lost in translation", *World Tax Journal* (2009) 2 p. 44 and *British Tax Review* (2009) 4 p. 451.
315. Art. 10(5) of the Convention between the Kingdom of the Netherlands and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital signed on 8 May 1968, *Tractatenblad* 1968, p. 76.
316. *Kamerstukken II*, 2004/05, 29 632, No. 7, p. 7.
317. See, Marres and Wattel, *Dividendbelasting*, op. cit., p. 161.

Generally, tax treaty benefits are granted irrespective of the income tax treatment of the distributing or the receiving company. As Art. 10 of the OECD Model applies to "dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State", the granting of tax treaty benefits will depend on the qualification of the distributing or the receiving company as a "resident of a Contracting State". As was set out above in 20.4.4., the government's Notice on Tax Treaty Policy contains the ambition to regard both the EII and the FII as residents for tax treaty purposes. Interestingly, the Netherlands is willing to agree that the EII is not eligible to some tax treaty benefits, such as the reduction of dividend withholding tax on distributions to the EII.

As was also set out in 20.4.4., it is noteworthy that Art. 10(2)(a)(1) of the new treaty between the Netherlands and the United Kingdom provides the source state with the right to levy 15% dividend withholding tax on distributions by a REIT (which includes an FII within the meaning of Art. 28 of CITA 1969).

Certain tax treaties concluded by the Netherlands, such as that between the Netherlands and Singapore,[318] contain a so-called "remittance base" provision.[319] In certain states, income is only subject to tax to the extent that income is actually remitted to or received in that other state. To avoid that the Netherlands withdraws its taxing rights while the income is not actually taxed in the other state, the remittance base provisions provide that the relief to be granted by the Netherlands shall apply only to so much of the income as is remitted to or received in the other state.

In case the shares in a Dutch resident company are held by a hybrid company (i.e. transparent from the perspective of the Netherlands, non-transparent in its state of residence) it should be reviewed whether or not the participants in the hybrid company are eligible to the treaty benefits.[320] A "reverse hybrid" shareholder (non-transparent from the perspective of the Netherlands, transparent in its state of residence) is in principle not entitled to tax treaty benefits as it is not "liable to tax" within the meaning of Art. 4(1) of the OECD Model. Nonetheless, a Decree of 19 March 1997 provides that the Netherlands will grant tax treaty benefits to the extent the participants would have had access to those benefits had they held the shares in the Dutch resident company directly.[321]

20.8.3. Triangular cases

The right to levy Dutch dividend withholding tax in triangular cases has been the subject matter in various cases before the *Hoge Raad*. BNB 1992/379 concerned a BV incorporated under the laws of the Netherlands with its place of effective management in Ireland.[322] The BV distributed a dividend to its US resident shareholder. The Dutch tax inspector levied an additional dividend withholding tax assessment. Pursuant to Art. 1(3) of DWTA 1965, the BV remained resident of the Netherlands under domestic law but was a resident of Ireland under the tax treaty between the Netherlands and Ireland. The *Hoge Raad* inferred from the Commentary to Art. 10(5) of the OECD Model (corresponding with Art. 8(9) of the treaty), that that provision excludes an "extra-territorial taxation of dividends", which, although drafted for states levying a secondary withholding tax (a state taxes distributions by non-resident companies of profits arising in them) applies a fortiori if the distribution company does not receive any income from that state (i.e. the Netherlands). As a consequence, the *Hoge Raad* annulled the tax assessment.

In BNB 2001/295,[323] a BV incorporated under the laws of the Netherlands with its place of effective management in the Netherlands Antilles distributed a dividend to its Belgian resident shareholder. Pursuant to the tiebreaker rule in Art. 34(2) of TAKN, the BV was considered to be resident in the Netherlands Antilles for

318. Art. 5 in conjunction with Art. 10 of the Convention between the Government of the Kingdom of the Netherlands and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital signed on 19 February 1971, *Tractatenblad* 1971, p. 95.

319. On remittance base provisions in Dutch tax treaties, see Engelen, F.A., "Het belastingverdrag met het Verenigd Koninkrijk: driemaal is nog geen scheepsrecht!", *Weekblad voor Fiscaal Recht* (1999) 6340 pp. 649-664.

320. It is noted that various issues which arose as a result of Art. 24(4) in the tax treaty between the Netherlands and the United States have been resolved by the Decree of 6 July 2005, No. IFZ2005/546M, BNB 2005/280.

321. Decree of 19 March 1997, No. IFZ97/204.

322. *Hoge Raad* 2 September 1992, No. 27 252, BNB 1992/379.

323. *Hoge Raad* 28 February 2001, No. 35 557, BNB 2001/295. For an extensive discussion of this case, see Van Raad, C., Bender T. and Douma, S.C.W., "De Hoge Raad op een drielandenpunt", *Weekblad voor Fiscaal Recht* (2001) 6431 pp. 527-545.

purposes of the DWTA 1965.[324] The *Hoge Raad* first held that Art. 10(2) in the tax treaty between the Netherlands and Belgium only grants the Netherlands the right to tax the dividend distribution if the BV qualifies as a resident of the Netherlands within the meaning of that treaty. Subsequently, the *Hoge Raad* held that as the BV was only taxable in the Netherlands for those items of income for which the right to tax was allocated to the Netherlands under the TAKN, the BV did not satisfy the requirement of "full tax liability" in the Netherlands pursuant to Art. 4(1) in conjunction with Art. II of the Protocol to the Netherlands–Belgium treaty. Accordingly, the Court decided that at the time of the distribution the BV was not a resident of the Netherlands within the meaning of that treaty and thus was not allowed to tax the dividend distribution.

20.8.4. Beneficial ownership

Dutch tax treaties that date from after publication of the 1977 OECD Model Convention generally contain the beneficial ownership requirement in Art. 10. The term "*uiteindelijk gerechtigde*" (the Dutch translation for the term "beneficial owner") was also incorporated in the Dutch standard tax treaty of 1987 – a treaty used at the time as a template for Dutch treaty negotiations.

In correspondence with the Dutch parliament on the memorandum accompanying the 1987 standard tax treaty on the term "beneficial owner", the State Secretary of Finance stated that a recipient of income is not the beneficial owner if such recipient is under the contractual obligation to pay the largest part of the income to third parties.[325] However, this criterion seems to have been rendered obsolete through subsequent case law of the *Hoge Raad*, notably the landmark case of BNB 1994/217 on the interpretation of the term "beneficial owner".[326] That decision involved a UK resident company, a stockbroker, acting as a market maker for Royal Dutch shares. In 1985, this UK company acquired dividend coupons for a number of Royal Dutch shares (the coupons having been detached from the underlying shares) from a Luxembourg resident NV in respect of dividend that had already been declared, but had yet become available for payment for a purchase price of 80% of the of the gross nominal value of the dividends. After the dividends had become payable, the UK company received the dividends subject to 25% Dutch dividend withholding tax, Subsequently, the UK company claimed repayment of 10% of dividend withholding with the Dutch tax authorities on the basis of Art. 10(2) of the 1980 Netherlands–UK tax treaty (the reduced treaty rate for portfolio dividends being 15%). The question at stake before the *Hoge Raad* was whether the UK company qualified as the beneficial owner of the dividends, a question that had been answered in the negative by both the Dutch tax inspector on administrative appeal and by the *Gerechtshof Amsterdam*. The *Hoge Raad* reversed the decision of both the *Gerechtshof* and the tax inspector and decided that the UK company qualified as beneficial owner of the dividends it received and that the 10% dividend withholding tax should indeed be refunded. The pivotal consideration of the *Hoge Raad* was the following:

> [T]he taxpayer became owner of the dividend coupons as a result of purchase thereof. It can further be assumed that subsequent to the purchase the taxpayer could freely avail of those coupons and, subsequent to the cashing thereof, could freely avail of the distribution, and in cashing the coupons the taxpayer did not act as voluntary agent [*zaakwaarnemer*] or for the account of the principal [*lasthebber*]. Under those circumstances the taxpayer is the beneficial owner of the dividend. The treaty does not contain the condition that the beneficial owner of the dividend must also be the owner of the shares and further it is irrelevant that the taxpayer purchased the coupons at the time the dividend had already been announced, because the question who is the beneficial owner must not be answered at the time the dividend is announced, but at the time the dividend is made payable.

Thus, based on this consideration, a person is the beneficial owner of a dividend if he:
(i) is the owner of the dividend coupon;
(ii) can freely avail of the coupon; and
(iii) can freely avail of the monies distributed.

---

324. Unless the decisive reason for the transfer of the place of effective management would have been to frustrate the levying of Dutch dividend withholding tax. This was not established by the *Gerechtshof 's-Hertogenbosch*.
325. Reference is made to questions by the Permanent Finance Committee of the Second Chamber, *Kamerstukken II* 1987-1988, 20 365, No. 3 and answers thereto by the State Secretary of Finance, *Kamerstukken II* 1987-1988, 20 365, No. 5., and in particular to the second part of the State Secretary's answer to question 51: "The Netherlands takes the viewpoint that a person cannot be considered the beneficial owner if he is, for example, contractually obligated to pay the largest part of the income to third parties." For an extensive overview of the relevant discussion in parliament, see Van Weeghel, S, *The Improper Use of Tax Treaties, with Particular Reference to the Netherlands and the United States*, Series on International Taxation No. 19, The Hague: Kluwer Law International, 1998, pp. 74 and 75.
326. *Hoge Raad*, 6 April 1994, No. 28 638, BNB 1994/217.

Van Weeghel comments that the cited *Hoge Raad* consideration might be read as to leave open the question whether the freedom to avail of the coupon or of the distribution must exist in law or in fact, or both. However, according to Van Weeghel, the reference to the wording pertaining to the *zaakwaarnemer* and the *lasthebber*, seems to require a strict reading of the decision, i.e. one in which the freedom must exist in law. In Van Weeghel's view, the addition of these terms cannot be read as a further condition because, as he adds, a *zaakwaarnemer* and a *lasthebber* by definition cannot freely avail of the dividend. Thus the addition must be seen as a clarification of the conditions of free avail and the *zaakwaarnemer* and the *lasthebber* both lack that freedom in law. Van Weeghel's reading is supported by a case note to the decision by Van Brunschot.[327] Based on this reading of the decision, Van Weeghel, referring to Van Brunschot's annotation, dismisses the apparent view expressed by the State Secretary of Finance that the party who is contractually bound to pay on the largest part of a dividend cannot be the beneficial owner.[328]

Some authors take the view that the interpretation by the *Hoge Raad* of beneficial ownership in BNB 1994/217 is arguably too broad, arguing that this interpretation would (unjustly) leave room for dividend stripping scenarios (e.g. where a dividend coupon is sold to a person who is able to claim a more beneficial treaty rate, with the latter person qualifying as beneficial owner under BNB 1994/217).[329] The Dutch Explanatory Note to the 2010 Netherlands–Japan treaty also contains (implicit) criticism by the government to BNB 1994/217. The Explanatory Note mentions – matter-of-factly – that Dutch case law regularly refers to BNB 1994/217 in interpreting beneficial ownership of dividends. It then goes on to state that the OECD is currently trying to give a "clearer direction in international tax practice, in which the concept of beneficial owner is given a similar interpretation in all countries concerned", distinguishing between more permanent (re)structurings of international groups on the one hand and temporary or incidental dividend stripping situations on the other. The government subsequently reiterates its view that the OECD Commentary should be interpreted dynamically (a view shared with Japan in this instance). Taken together, these comments of the government appear to imply that it holds the view that BNB 1994/217 could (and should) be superseded by amendments to the current OECD Commentary. Whether such dynamic interpretation would hold up before the *Hoge Raad* remains to be seen. At present, the stance of the Court regarding the tenability of dynamic interpretation is not entirely clear,[330] although arguably, according to Van Brunschot, the *Hoge Raad*, in interpreting a tax treaty, would take posterior amendments of the OECD Commentary only into account to the extent that (i) these amendments form a clarification of a concept which prior to the amendment was unclear and (ii) such clarification does not "disguise a modification of the meaning of the term that is being interpreted".[331]

As set out in 20.3.2.3. above, Dutch domestic tax law also contains a statutory negative definition of beneficial owner targeted at dividend stripping in Art. 4(7) of DWTA 1965. Based on this provision, this negative definition also applies in treaty situations. Upon the introduction of these rules, the State Secretary of Finance has even taken the position that this negative definition should also apply where the relevant treaty does not contain an explicit requirement of beneficial ownership, arguing that this concept is implicit in such treaties.[332] Whether this domestic (negative) domestic concept of beneficial ownership has treaty effect is subject to debate (see 20.8.5.3. below on the application of domestic anti-abuse rules in treaty situations).

In introducing the negative concept of beneficial ownership in Art. 4(7) of DWTA 1965, the legislator took into account the *Hoge Raad's* interpretation in BNB 1994/217 of beneficial ownership of dividend coupons detached from underlying shares. Art. 4(8)(b) of DWTA 1965 therefore explicitly provides that a combination of transactions qualifying as dividend stripping under Art. 4(7) of DWTA 1965 includes a transaction that pertains to the mere acquisition of one or more dividend coupons or of the establishing of a short-term right of enjoyment in respect of shares. Also, in these cases, the viability of the statutory negative definition of beneficial ownership may arguably be put into question in treaty situations (see below 20.8.5.3.).

---

327. See the case note to BNB 1994/217, Para. 2.
328. Van Weeghel, *The Improper Use of Tax Treaties, with Particular Reference to the Netherlands and the United States*, op. cit., pp. 76 and 77.
329. For instance Brandsma, *Cursus Belastingrecht (Dividendbelasting)*, op. cit., Para. 3.2.1.A.b2.I.
330. See e.g. BNB 1996/108 (*Hoge Raad*, 28 June 1995, No. 29 435, BNB 1996/108), in which the Commentary at the time of signing the relevant treaty was referred to, but subsequent amendments to the Commentary were not addressed. However, see e.g. BNB 1999/267 (*Hoge Raad*, 9 December 1998, No. 32 709, BNB 1999/267) and BNB 2003/178 (*Hoge Raad*, 21 February 2003, No. 37 024, BNB 2003/178), where certain reference was made to subsequent amendments of the Commentaries.
331. Van Brunschot, F., "The judiciary and the OECD Model Tax Convention and its Commentaries", 59 *Bulletin for International Fiscal Documentation* 1 (2005) p. 7.
332. *Kamerstukken II* 2001/02, 27 896, No. 3.

The dividend article of the 2010 Netherlands–Japan treaty contains the general requirement of beneficial ownership but, in deviation of the OECD Model Convention, at the request of Japan also contains a sub-paragraph (Art. 10(9)) describing a specific situation in which a dividend recipient is not considered the beneficial owner:

> 9. A resident of a Contracting State shall not be considered the beneficial owner of dividends paid by a resident of the other Contracting State in respect of preferred shares or other similar interests if such preferred shares or other similar interests would not have been established or acquired unless a person:
>
> a) that is not entitled to benefits with respect to dividends paid by a resident of that other Contracting State which are equivalent to, or more favourable than, those available under this Convention to a resident of the first mentioned Contracting State; and
>
> b) that is not a resident of either Contracting State;
>
> owned equivalent preferred shares or other similar interests in the first-mentioned resident.

The question arises how this particular provision should be interpreted. Para. 2 of the Exchange of Notes (dated 25 August 2010) upon the signing of the of the treaty states that in interpreting the concept of beneficial owner for purposes of the Dividend Art., parties shall take into consideration the interpretation set out in the OECD Commentary. According to the Explanatory Note to Art. 10(9), this provision only pertains to a limited number of cases involving back-to-back conduits, namely where "a dividend is paid by a Japanese company to a Dutch company and where that Dutch company subsequently, without any involvement or added value, distributes such dividend onward to a non-Dutch parent company". The Explanatory Note also explicitly mentions the option for a taxpayer to request a mutual agreement procedure in cases where this provision would lead to unwarranted results. In addition, the Explanatory Note confirms that this provision is substantially similar to a corresponding clause in the 2003 Japan–US treaty.[333] Hofland and Pötgens raise the question whether the similarity to the 2003 Japan–US treaty implies that Art. 10(9) should be interpreted in line with the interpretation given in the US Technical Explanation, which also points to a very limited extension of the beneficial ownership requirement through this provision.[334] Hofland and Pötgens comment that the relation between Art. 10(9) of the treaty and the domestic anti-dividend stripping rules in Art. 4(7) of DWTA 1965 is unclear. The present authors expect that the State Secretary of Finance is unlikely to respond to the latter comment, given his view that Art. 4(7) of DWTA 1965 applies in full in treaty situations (even if such position may not be (fully) in line with Dutch case law regarding the unconditional application of domestic anti-abuse measures in treaty situations, see below 20.8.5.3.).

20.8.5. Anti-abuse rules

20.8.5.1. Anti-abuse rules included in tax treaties

Apart from the beneficial ownership requirement, Dutch tax treaties up to recently did not generally contain a general or specific anti-abuse measure. There are, however, sporadic exceptions. Reference is made, for instance, to the main purpose tests included in the dividend articles of the treaties with Switzerland (1951), Morocco (1977), United Kingdom (1980), Latvia (1994), Tunisia (1995), Romania (1998), Egypt (1999), Uganda (2004) and South Africa (2005). These tests generally deny application of the reduced rate for participation dividends if the relationship between the company distributing the dividends and the recipient is entered into mainly or principally in order to benefit from the reduced treaty rate. In general, the consequence of failing the main purpose test is that treaty entitlement of the recipient of the dividends falls back to the rate for portfolio dividends (which may not in all cases lead to an effective reduction, as the portfolio dividend rate may correspond to the current general statutory rate of Dutch dividend withholding tax of 15%).

However, in Dutch treaties that have been concluded in recent years, specific anti-abuse rules, in particular in respect of dividend income, seem to have become the norm rather than the exception. Main purpose tests have been included in the dividend articles of the treaties (or the agreed Protocol in respect thereof) with of the

333. *Kamerstukken II*, 2010-2011, 32 776, No. 3, pp. 11-13.
334. Hofland, D.A. and Pötgens, F.P.G., "Antimisbruikbepalingen in het nieuwe belastingverdrag met Japan – Onduidelijkheden en relatie met het Europese recht nopen tot heroverweging", *Weekblad voor Fiscaal Recht* (2011) 6888.

United Arab Emirates (2007), the United Kingdom (2008), Qatar (2008) and Switzerland (2010, not yet in force) (for LOB provisions, see 20.8.5.2. below).

The Notice on Tax Treaty Policy of 11 February 2011 contains a fair number of policy statements on anti-abuse.[335] The Notice identifies three main categories of treaty abuse:
(i) tax "escape behaviour" (e.g. emigration for tax reasons);
(ii) shopping of treaty provisions (e.g. a Dutch resident enters into artificial transactions in order to claim a treaty benefit that is more beneficial than the treaty provision that would otherwise apply, e.g. through an artificial recharacterization of income); and
(iii) treaty shopping (a third-country resident tries to gain access to a treaty benefit that is not intended to apply to such person).[336]

Categories (ii) and (iii) seem particularly relevant for dividend withholding tax. The Notice states that where a treaty partner attaches great weight to levying of (dividend) tax at source, the Netherlands is prepared to try and include anti-abuse measures, provided these measures meet the requirements of proportionality and subsidiarity.[337] This would typically occur where such source state is fearful that the Netherlands would act as a (mere) conduit state and where reducing source taxation would not be in accordance with such source state's tax system.

The Notice also comments on situations where the Netherlands acts a source state in respect of participating dividends.[338] In accordance with long-standing tax (treaty) policy, the Netherlands strives to avoid economic double taxation in respect of participating dividends and thus aims at agreeing in tax treaties on exclusive taxation in the residence state of the shareholder (i.e. 0% withholding tax). Nonetheless, the Notice states that an exclusive residence state taxation may not lead to an unconditional tax-free flow of dividend income from the Netherlands through a resident of the tax treaty state to residents of a third country. In situations where the residence state (the – envisaged – treaty partner) exempts participating dividends income from the Netherlands and where such residence state in its turn exempts onward dividend distributions to third country residents from taxation at source, the Netherlands will aim to review the conditions for the latter exemption at source in order to see whether specific anti-abuse measures may be in order. The Notice mentions that a beneficial ownership requirement may not suffice in these situations. For the form of additional anti-abuse measures, the Notice distinguishes between "entity-based" provisions – i.e. provisions targeted at the nature and activities of the person receiving the income – and "transaction-based" based provisions, which target specific transactions.[339] LOB provisions are the most prominent example of entity-based abuse measures. The Notice acknowledges that LOB provisions may be (overly) complicated provisions that may lead to overkill, even if such provisions typically provide legal certainty. Main purpose tests are mentioned as examples of transaction-based measures (although such tests may also be construed as entity-based provisions). Transaction-based provisions, according to the Notice, generally provide for less legal certainty, but the advantages are that they generally provide for a more tailored approach and that they imply less overkill. The Notice does not go into detail as to how these policy principles have been applied in recent tax treaties.

Looking at the above-cited statements in the Notice, Bender concludes that the Dutch government clearly aims to strike a balance between the traditional Dutch roles of the "merchant" and the "clergyman", by trying to position the Netherlands as an attractive (intermediate) holding jurisdiction while at the same time addressing concerns of source jurisdiction from which income flows to and through the Netherlands.

20.8.5.2. LOB provisions

The touchstone LOB provision in the Dutch tax treaty network is Art. 26 of the 1992 Netherlands–US treaty (as amended by the 1993 and 2004 Protocols), which was included at the request of the United States. The

335. For a detailed comment on the policy statements regarding anti-abuse in the 2011 Notice on Tax Treaty Policy, see Bender, T., "Antimisbruikregels in belastingverdragen: een balancing act", *Weekblad voor Fiscaal Recht* (2011) 539.
336. See Notice on Tax Treaty Policy (Avoidance of tax treaty abuse) of 11 February 2011, Para. 1.3.4.
337. Bender, op. cit,, notes that the reference to subsidiarity would not appear to refer to domestic anti-abuse measures taking preference over anti-abuse measure in the treaty – as under Dutch tax law such domestic measures would in principle not work in a treaty context, see below 20.8.5.3. – but rather to measures that leave bona fide businesses unaffected being preferred over measures containing overkill.
338. Notice on Tax Treaty Policy of 11 February 2011, Para. 2.7.
339. Id., Para. 2.20.2.

Netherlands treaty negotiators initially rejected the idea of an LOB provision – which attaches additional requirements for treaty residents to qualify for treaty benefits – as they felt that a resident of a treaty state should be entitled to treaty benefits and only be withheld such benefits in cases where treaty abuse was likely.[340] Under this LOB provision, only treaty residents who are "qualified persons" are entitled to full treaty benefits.[341] For regular Dutch corporate taxpayers (i.e. not pension funds, charity organizations or other exempt entities or funds), this generally amounts to qualifying under either of the following tests:

(i) a "direct stock exchange" test (Art. 26(2)(c)(i); i.e. principal class of shares of the relevant taxpayer is listed on recognized stock exchange, subject to the taxpayer having "substantial presence" in its residence state);
(ii) an "indirect stock exchange" test (Art. 26(2)(c)(ii); i.e. at least 50% of votes in shares in the relevant taxpayer is owned, directly or indirectly, by five or fewer persons qualifying under the direct stock exchange test);
(iii) a "shareholders" test (Art. 26(2(f); i.e. the relevant taxpayer is owned, for at least half the relevant tax year, for at least 50% by individuals, pension funds, non-profit organizations qualifying under the LOB provision or persons qualifying under the direct stock exchange test, with less than 50% of tax-deductible payments in the relevant tax year being made to non-residents of either of the treaty states);
(iv) a "derivative benefits" test (Art. 26(3); i.e. 95% or more of the taxpayer's shares are held by "equivalent beneficiaries" – i.e. certain qualifying residents of EU, EEA or NAFTA countries – with less than 50% of tax-deductible payments being made in the relevant tax year to non-equivalent beneficiaries);
(v) an "activities" test (Art. 26(4); i.e. the taxpayer conducts a qualifying active trade or business in its state of residence); or
(vi) a "headquarters" test (Art. 26(5); i.e. the taxpayer functions as a qualifying headquarters of a qualifying multinational corporate group).

Art. 26(7) of the 1992 Netherlands–US tax treaty contains a safety net provision for taxpayers who do not qualify under the above tests, in the form of a reverse main purpose test – i.e. the relevant competent (tax) authority may decide that the relevant person is entitled to tax treaty benefits, taking into account as its guidelines whether the establishment, acquisition or maintenance of such person or the conduct of its operations has or had as one of its principal purposes the obtaining of benefits under the treaty. Art. XIX of the 1992 Memorandum of Understanding specifies certain factors that may be used to apply the reverse main purpose test.

A second treaty in which an LOB provision was included at the request of the treaty partner[342] is the 2010 Japan treaty (not yet in force) (Art. 21). In contrast with Art. 26 of the 1992 US treaty, Art. 21 of the 2010 Japan treaty does not pertain to all treaty benefits but only applies in respect of the exemption for qualifying participation dividends (Art. 10(3)) and in respect of benefits under the articles on interest (Art. 11), royalties (Art. 12), and capital gains (Art. 13), and the other income article (Art. 20). In exchange for accepting the LOB clause, Japan was willing to accept, inter alia, a reduction of dividend withholding tax rates under the treaty as compared with the prior treaty, including an exemption for qualifying participation dividends in Art. 10(3). For regular corporate taxpayers (i.e. not pension funds, charity organizations or other exempt entities or funds) the following tests apply:

(i) a "stock exchange" test (Art. 21(2)(b); i.e. principal class of shares of the relevant taxpayer is listed on a recognized stock exchange);
(ii) a "shareholders" test (Art. 21(2)(e); i.e. at least 50% of the shares representing the voting rights in the relevant taxpayer is in the hands, directly or indirectly, of other persons qualifying under the LOB provision – to avoid dilution of this shareholders test, the latter category of persons does not include persons qualifying under the shareholders test);
(iii) a "derivative benefits" test (Art. 21(3) and (4); i.e. at least 75% of the shares representing the voting rights in the relevant taxpayer is in the hands, directly or indirectly, of "equivalent beneficiaries");
(iv) an "activities" test (Art. 21(5); applies with respect to specific items of income for which treaty benefits are claimed, i.e. the taxpayer must have a qualifying business enterprise in its state of residence and the relevant items of income are connected to such enterprise); and
(v) a "headquarters" test (Art. 21(6); included at the request of the Netherlands, i.e. the taxpayer functions as a qualifying headquarters of a qualifying multinational corporate group).

---

340. *Kamerstukken II*, 2003/2004, 29 632, No. 3, pp. 2-3.

341. For a further description the operation of the LOB clause of the Netherlands-US treaty, see Van der Weijden, M. and Doets, M., "The New Protocol to the Netherlands–United States Tax Treaty", 58 *Bulletin for International Fiscal Documentation* 7 (2004) pp. 304-314 and to Van Weeghel, S. and Van den Berg, J.P., "The New US–Netherlands Tax Treaty Protocol", *European Taxation*, September 2004, in particular Para. 3.2.

342. *Kamerstukken II*, 2010-2011, 33 776, No. 3, p. 11.

At the request of the Netherlands, banks and insurance companies that are established and regulated as such under the laws of the contracting state of which they are residents are also qualified persons under the LOB provision of the 2010 Netherlands–Japan treaty (Art. 21(d)(iii)). The reasons for this inclusion were that (i) banks and insurance companies may not always have a capital dividend into shares (e.g. when they are organized as cooperatives) and would then not qualify under the other tests of Art. 21(2) and (ii) having banks and insurance companies resort to the activities test would be onerous, as this test applies separately to different income items. At the counter-request of Japan, "securities companies" (i.e. in general regulated companies acting as stock brokers) were also added as qualified persons under Art. 21(5). In addition, a reverse main purpose clause has been included in Art. 21(7) as a safety net provision.

LOB provisions in tax treaties concluded by the Netherlands have also been entered into upon the request of the Netherlands. Reference is made to the treaties with Venezuela (1991, as amended by the 1995 Protocol, Art. VII of the 1991 Protocol), Macedonia (1998, Art. V of the 1998 Protocol), Kuwait (2001, Clause 5 of the 2001 Protocol), Bahrain (2008, Art. 10(9)), Panama (2010, not yet in force, Art. 10(3)), Hong Kong (2010, not yet in force, Art. 10(3)) and, through the conclusion of a 2009 Protocol (not yet in force),[343] Barbados (Art. I of the 2009 Protocol, amending Art. 10 of the treaty). The LOB provisions mentioned here are rather less intricate than the LOB provisions in the treaties with the United States and Japan. Also, these LOB provisions are limited to (the treaty exemption for) participating dividends. Generally, the purpose of the LOB provisions from a Dutch perspective is to safeguard that the exemption only applies if the recipient has sufficient (substantial) presence in its state of residence or if there is limited risk of treaty shopping (e.g. in case of listed companies receiving the dividends).[344] As is the case in the US and Japan treaties, the above LOB provisions generally contain a safety net in the form of a reverse main purpose test. It is further noted that under the Macedonia, Kuwait and Bahrain treaties, a person also qualifies for the zero percent rate for participation dividends if such person in its state of residence is subject to sufficient tax in respect of the gross amount of the received dividends.

The reverse main purpose test in the 2006 Barbados treaty (as amended through the 2009 Protocol) provides a number of concrete examples of criteria that may be used in practice to apply this test: (i) the nature and volume of the activities of the company in its country of residence in relation to the nature and volume of the dividends; (ii) both the historical and the current ownership of the company; and (iii) the business reasons for the company residing in its country of residence.

20.8.5.3. Application of domestic anti-abuse rules in treaty situations[345]

As to a potential conflict between domestic anti-abuse rules and tax treaties, Para. 9.2 of the Commentary to Art. 1 of the OECD Model Convention denies, as a general rule, the existence of such conflict:

> [T]o the extent these anti-avoidance rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability, they are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule, there will be no conflict between such rules and the provisions of tax conventions.

However, in Para. 27.7 of the same Commentary, the Netherlands made the following reservation to (inter alia) this assertion:

> [T]he Netherlands does not adhere to the statements in the Commentaries that as a general rule domestic anti-avoidance rules and controlled foreign companies provisions do not conflict with the provisions of tax conventions. The compatibility of such rules and provisions with tax treaties is, among other things, dependent on the nature and wording

---

343. Bender, op. cit,. points out that the Netherlands wanted to amend the treaty to include an LOB provision after it had become clear that through a change in domestic law, participation dividends could be conducted through Barbados tax free to third countries without proper conditions.

344. See e.g. the Explanatory Note to the 2009 Protocol to the 2006 Netherlands–Barbados treaty (*Kamerstukken II*, 2009-2010, 32 491, No. 1).

345. For an overview of relevant Dutch tax law, see Van Weeghel, S. and De Boer, R., "Anti-abuse measures and the application of tax treaties in the Netherlands", 60 *Bulletin for International Fiscal Documentation* (8/2006), Arnold, B J. and Van Weeghel, S, "The Relationship between Tax Treaties and Domestic Anti-Abuse Measures", in Maisto, G. (ed.), *Tax Treaties and Domestic Law*, Amsterdam: IBFD Publications BV, 2006, Vol. 2 EC and International Tax Law Series, Chap. 5, p. 81 et seq. and Peters, F.G. and Roelofsen, A., "Branch Report – Netherlands", in IFA, *Tax treaties and tax avoidance: Application of anti-avoidance provisions, Cahiers de droit fiscal international*, The Hague: Sdu Uitgevers, 2010, Vol. 95a, p. 551 et seq. (64th Congress of the International Fiscal Association, Rome, 2010).

of the specific provision, the wording and purpose of the relevant treaty provision and the relationship between domestic and international law in a country. Since tax conventions are not meant to facilitate the improper use thereof, the application of national rules and provisions may be justified in specific cases of abuse or clearly unintended use. In such situations the application of domestic measures has to respect the principle of proportionality and should not go beyond what is necessary to prevent the abuse or the clearly unintended use.

The above government reservation fits the reluctancy of the *Hoge Raad* to apply the domestic *fraus legis* doctrine in treaty situations involving cross-border dividends. The *fraus legis* doctrine is a general anti-abuse measure developed in Dutch case law. Under this doctrine, a tax inspector may substitute a fact pattern that does not lead to taxation by a fact pattern that does so lead if (a) the taxpayer has created a situation in which tax cannot be imposed, but which approximates one in which tax could be imposed; (b) tax avoidance is the taxpayer's predominant motive; and (c) the purpose and intent of the tax law would be frustrated if the non-taxable fact pattern is not treated as a taxable fact pattern. The Dutch tax authorities have repeatedly tried to apply *fraus legis* in treaty situations in order to safeguard the levy of Dutch dividend withholding tax, thus far to no avail. For instance, in BNB 1994/259 and BNB 1994/294,[346] the tax authorities attempted to have a capital gain upon a sale of shares be converted into a dividend (subject to Dutch dividend withholding tax) by invoking the *fraus legis* doctrine. The tax authorities argued that this conversion of income should also extend to the application of the 1948 Netherlands–US treaty and the 1970 Netherlands–Belgium treaty respectively, thus allowing for Dutch dividend withholding tax under the relevant dividend article (rather than exclusive residence taxation under the capital gains article, which left the Netherlands empty-handed). The *Hoge Raad* denied the application of *fraus legis*, arguing that the application of *fraus legis* would not follow from either the text of the relevant treaty or the object and purpose thereof as evident from (mutual) explanations of the contracting states. The Court reached a similar conclusion based on the reasoning of BNB 1994/259 in two other cases involving an attempted recharacterization through *fraus legis* of income into dividend income under the 1970 Netherlands–Belgium treaty (BNB 1995/150 and BNB 2003/285).[347]

The above case law makes clear that when confronted with *fraus legis* in treaty situations, the *Hoge Raad* will search for the common intention of the contracting parties as evidenced by either the text of the treaty or the explanations of the contracting states. The Court's decisions illustrate that the *fraus legis* doctrine goes well beyond a mere "determination of the facts that give rise to a tax liability" – the incantation of the OECD Commentary cited above used to resolve any potential conflict. The Dutch government holds the view that *fraus legis* can be applied in treaty situations, taking into account the (common) object and purpose of the tax treaty, although it admits that determining the common object and purpose may prove difficult.[348]

The above-cited unsuccessful attempts by the tax authorities to apply *fraus legis* in treaty situations do not warrant the conclusion that aggressive international tax planning may not be susceptible to a substance-over-form approach under Dutch tax law. From case law by the *Hoge Raad*, it appears that last-minute international tax planning involving a sudden change in the ownership structure following predetermined steps to lower Dutch dividend withholding tax may indeed be vulnerable to substance-over-form. For instance, BNB 1994/252 involved a predetermined, last-minute interposition of a Netherlands Antilles company between a Dutch BV and its Belgium shareholders prior to a planned repurchase of shares in order to ward off Dutch dividend withholding tax under the TAKN.[349] The tax inspector deemed the share repurchase to be a direct repurchase by the Belgium shareholders and imposed a deficiency assessment for the dividend withholding tax on the Dutch BV. The *Gerechtshof Arnhem* ruled that in the relevant period, the interposed Netherlands Antilles company never had the intention to be the economic owner of the shares in the Dutch BV and it found that every step in this case had been predetermined and that the interposition of the Netherlands Antilles company had the sole purpose of avoiding Dutch dividend withholding tax. The court then decided that exempting the dividends from the dividend withholding tax in this case would contravene the object and purpose of the relevant provision of the TAKN. The *Hoge Raad* confirmed the *Gerechtshof's* ruling. It should be noted that there are caveats to be taken into account when extending this decision to situations governed by a tax treaty: (i) the TAKN is strictly speaking not a tax treaty; and (ii) the substance-over-form approach used in BNB 1994/252 may have amounted to a determination of the facts for tax purposes (*fiscale kwalificatie*) rather than application of the *fraus legis* doctrine (although such distinction may be difficult to make).[350]

346. *Hoge Raad*, 15 December 1993, No. 29 296, BNB 1994/259 and 29 June 1994, No. 28 734, BNB 1994/294.
347. *Hoge Raad*, 15 March 1995, No. 29 531, BNB 1995/150 and 6 December, No. 36 773, BNB 2003/285.
348. *Kamerstukken* II, 1987-1988, 20 365, Nos. 3 and 5.
349. *Hoge Raad*, 18 May 1994, No. 28 293, BNB 1994/252. See also *Hoge Raad*, 8 January 1986, No. a23 031, BNB 1986/127 and 28 June 1989, No. 25 451, BNB 1990/45.
350. Refer also to Wattel's case note to *Hoge Raad,* 18 May 1994, No. 28 296, BNB 1994/253.

The *Hoge Raad's* stance on application of *fraus legis* may have been nuanced by its decision in BNB 2003/379. Based on this case, which concerned the question whether a Dutch domestic arrangement for taxation of notional income extended under the 1970 Netherlands–Belgium treaty,[351] Van Weeghel and De Boer deem it a legitimate question whether *fraus legis* and can have treaty effect if either (a) the particular application thereof existed when the treaty was concluded or (b) the treaty partner has an equivalent rule.[352]

As regards the treaty effect of the anti-dividend stripping rules contained in Art. 4(7) of DWTA 1965, the State Secretary of Finance has contended that this specific anti-abuse measure does not contravene tax treaties and can indeed be unconditionally applied in treaty situations. The State Secretary underpins these assertions by referring to the lack, as of yet, of a precise international meaning of the beneficial owner concept and by referring to the more economic approach included in the 2003 revisions of the OECD Commentary (current Paras. 12 and 12.1 of the Commentary to Art. 10).[353] Notwithstanding the State Secretary's position, it should be noted that under the Netherlands' Constitution (Art. 94) treaty provisions supersede contravening domestic law provisions. Thus, it is submitted that a Dutch court may well find that the anti-dividend stripping rules do not hold up under a specific treaty.[354] Likely, the court would then refer back to rules set out in BNB 1994/217. The above-mentioned test for tenability of treaty effect of domestic anti-abuse measures inferred from BNB 2003/379 should, in the present authors' view, apply mutatis mutandis to the statutory anti-dividend stripping rules.

351. *Hoge Raad*, 5 September 2003, No. 37 651, BNB 2003/379.
352. Van Weeghel and De Boer, "Anti-abuse measures and the application of tax treaties in the Netherlands", op. cit. See also Peters and Roelofsen, op. cit., p. 562.
353. *Kamerstukken I*, 2001-2002, 27 896 and 27 246, No. 117b.
354. Van Weeghel and De Boer, op. cit. and Peters and Roelofsen, op. cit., p. 569.