Netherlands

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The Relationship between Preservative Tax Assessments and Netherlands Tax Treaties: Not Always *Pacta Sunt Servanda*?

This article analyses the decisions of the Netherlands Supreme Court of 20 February 2009, BNB 2009/260 through 262, and 19 June 2009, BNB 2009/263 through 266, on the relationship between the domestic concept of preservative tax assessments and previously concluded tax treaties. The author argues that some findings of the Court concerning exit taxes on substantial shareholdings are debatable.

1. Introduction

In this article the author discusses some recent decisions of the Netherlands Supreme Court on the relationship between the domestic concept of preservative assessments and previously concluded tax treaties.[1] On 19 June 2009, the Netherlands Supreme Court ruled that preservative tax assessments, imposed when a beneficiary to a pension that accumulated in the Netherlands emigrates from the Netherlands to France,[2] Korea[3] or the Philippines,[4] are not in conformity with the good faith that must be observed as regards its tax treaty partners in applying and interpreting the pensions article in the tax treaties in question, which followed Art. 18 of the OECD Model Tax Convention (OECD Model). According to the pension provision of these tax treaties, the authority to tax pensions and other similar remuneration is assigned exclusively to the recipient's residence state.

Also on 19 June 2009, the Supreme Court gave a comparable decision on the "negative expenditure for income provisions" that were applied in regard to a lump-sum payment of an annuity received after the annuity holder's emigration from the Netherlands to Belgium. The Supreme Court was of the opinion that this type of levy does not comply with the good faith that must be observed in interpreting Art. 22 of the former 1970 Belgium–Netherlands tax treaty (the "other income" provision). This other income provision designated the taxation right on these forms of annuities exclusively to the recipient's residence state (in this case Belgium).[5]

On 20 February 2009, however, the Supreme Court held that the preservative tax assessments that were imposed upon the emigration of substantial interest holders were in conformity with the good faith that the Netherlands must observe vis-à-vis its tax treaty partners when applying and interpreting the tax treaty at issue.[6]

In this article the author briefly outlines the domestic law underlying the preservative assessments that were at issue in the various decisions (see 2.). The author further provides insight into Netherlands case law regarding the observance of the principle of good faith when applying and interpreting tax treaties (see 3.). Subsequently, the author compares the decisions of 20 February 2009 and 19 June 2009 (see 4.) and analyses the reasons for the different outcome in these decisions (see 5.). Finally, the Netherlands legislature's response to the decisions of 19 June 2009 is described (see 6.).

2. Domestic Law Regime of Preservative Tax Assessments

2.1. Pension rights

Where a taxpayer/(former) employee emigrates, the market value of his pension rights[7] will be taxed as income from employment, to the extent they accrued during the period in which the taxpayer was a resident of the Netherlands (Art. 3.83(1) of the Netherlands Income Tax Act 2001 (ITA 2001 – *Wet inkomstenbelasting 2001*). Art. 3.146(3) ITA 2001 stipulates that these pension rights will be deemed to have been enjoyed at the time immediately preceding the cessation of being a resident taxpayer. Pursuant to Art. 2.8(2) ITA 2001 a preservative tax assessment is imposed and a deferral of payment is granted for a period of ten years (Art. 25(5) of the 1990 Netherlands Tax Collection Act – *Invorderingswet 1990*). Where there are no irregularities, for instance a lump-sum payment, during this deferral period, the preservative tax assessment will not be collected. After ten years, it will be waived (Art. 26(2) of the 1990 Tax Collection Act).

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1. See also Frank P.G. Pötgens and Hans C. Bol, "Fictions in the Substantial Shareholding Regime in Relation to Tax Treaties and the EC Treaty", *European Taxation* 7 (1998), pp. 198-215 and "International Tax Aspects of the 2001 Income Tax Act", *European Taxation* 1 (2001), pp. 2-17.
2. Decision of 19 June 2009, BNB 2009/263.
3. Decision of 19 June 2009, BNB 2009/265.
4. Decision of 19 June 2009, BNB 2009/266.
5. Decision of 19 June 2009, BNB 2009/264.
6. Decisions of the Netherlands Supreme Court of 20 February 2009, BNB 2009/262 (emigration to the United Kingdom); BNB 2009/260 (emigration to Belgium) and BNB 2009/261 (emigration to the United States).
7. This value, in fact, consists of the total premiums paid plus the proceeds. According to Art. 13 of the Decree for the Execution of the Income Tax Act 2001 (*Uitvoeringsbesluit inkomstenbelasting 2001*), this value represents the amount that would need to be transferred to a third party in order to cover the pension claims in question.

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2.2. Annuities

The system applicable in regard to annuities upon emigration differed to a certain extent from the emigration tax on pensions. When taxpayers emigrate, after having previously deducted premiums paid for annuity plans during their period of residence in the Netherlands, "negative expenditure for income provisions" are taken into account (Art. 3.136(1) ITA 2001). Not only are the premiums that were actually deducted in the past subject to tax but also the proceeds. The amount of the premiums and the proceeds that are taxed is determined based on the market value of the entitlement at the time immediately preceding emigration (Art. 3.137(1) ITA 2001). These "negative expenditure for income provisions" are normally included in a preservative tax assessment in respect of which a deferral of payment is provided for a period of ten years (Art. 25(5) of the 1990 Tax Collection Act). The tax will be collected and the deferral will end, however, if the annuity contract is not settled in a regular manner, for instance by surrender, within ten years. If there are no irregularities during the deferral period, the preservative tax assessment will not be collected and it will be waived after the ten years have lapsed (Art. 26(2) of the 1990 Tax Collection Act).

In BNB 2009/264 the taxpayer emigrated to Belgium in 1996 and received a lump-sum payment of the annuity in question in 2002. Under the 1964 Netherlands Income Tax Act (ITA 1964) (*Wet op de inkomstenbelasting 1964*) that was in force in 1996, negative personal obligations (Art. 45c) were accounted for when a taxpayer entitled to an annuity ceased to be a Netherlands resident taxpayer if he previously deducted the premiums from his income. At the moment immediately preceding emigration a preservative tax assessment could be imposed. This assessment would be collected in the event an irregularity occurred within a period of five years after the emigration. This emigration tax was only applicable if, in the period preceding emigration, the amount of deducted premiums exceeded NLG 100,000 (Art. 45c(3) ITA 1964). In the case underlying BNB 2009/264, the ceiling of NLG 100,000 was not reached and, as a result, a preservative tax assessment was not imposed upon emigration. The taxpayer at issue could only be confronted with "negative expenditure for income provisions" when he received a lump-sum annuity in 2002 (this lump-sum payment was subject to the ITA 2001 regime).

2.3. Substantial shareholdings

Upon emigration of a substantial shareholder a fictitious alienation occurs (Art. 4.16(1)(h) ITA 2001). This fictitious alienation occurs on the date immediately preceding the emigration (Art. 4.46(2) ITA 2001. With respect to this alienation a preservative tax assessment is imposed (Art. 2.8(2) ITA 2001) in respect of which a deferral of payment is granted for a period of ten years (Art. 25(8) 1990 Tax Collection Act). This deferral ends if the relevant shares are disposed of within ten years or the company distributes its reserves in full (or almost in full); if the company conducted a business, it must also have been discontinued (Art. 25(8)(b) of the 1990 Tax Collection Act). If these transactions do not transpire within this ten-year period then the preservative tax assessment is waived (Art. 26(2) of the 1990 Tax Collection Act). It is useful to note that the taxes upon emigration of a substantial shareholder differ from the other emigration taxes in one respect. The source state (in this case the Netherlands) grants a credit for the tax due on the substantial shareholding in the residence state, i.e. a reverse credit.

2.4. Parliamentary debate

The Under-Minister of Finance, in his role as co-legislator, indicated that he wanted to follow a "three-track policy" with respect to pensions and a "two-track policy" with respect to the other exit taxes.[8] This policy entailed (1) the revision of domestic legislation; (2) the re-negotiation of existing tax treaties; and (3) for pensions, taking an active role in the drafting and entry into force of an EU directive.[9] Existing tax treaties needed to be revised because they often allocate taxation rights to the residence state. This occurred either immediately (i.e. with regard to, inter alia, pensions (Art. 18 of the OECD Model), annuities and capital sum insurance of an owner-occupied dwelling (Art. 21 of the OECD Model)) or after a period of time, following the emigration, provided for in the tax treaty (i.e. with regard to a capital gain on the alienation of a substantial interest). As a result of these provisions, the Netherlands was often not able to tax if the income was actually realized and the person receiving it resided in a treaty partner country. Revision and renegotiation of the tax treaties would, however, have taken a considerable amount of time.[10] As a result, the domestic legislation was being revised so that a fictitious taxable event and the possibility to tax would occur while the taxpayer was still liable to tax as a resident, i.e. directly preceding the emigration.[11] Consequently, all of this would fall entirely within the period of tax liability as a resident and, thus, in the Under-Minister's view, would remain outside the scope of the Netherlands tax treaties.[12]

2.5. Miscellaneous remarks

Normally, security must be provided to be eligible for a deferral of payment under a preservative tax assessment. Because of European Court of Justice (ECJ) case law[13] the provision of security may be waived if the taxpayer

8. See also Explanatory Memorandum (MvA), Kamerstukken I, 1996/97, 24 583, No. 26, p. 8 and Additional Explanatory Memorandum (NMvA), Kamerstukken I, 1996/97, 24 583, No. 26c, p. 5.
9. Id.
10. Explanatory Memorandum (MvT), Kamerstukken II, 1998/99, 26 727, No. 3, pp. 49 and 50.
11. Art. 3.146(3) ITA 2001 for pensions, Art. 3.146(4) ITA 2001 for a capital sum insurance of an owner-occupied dwelling, Art. 3.146(6) ITA 2001 for tax-privileged annuities and Art. 4.46(2) ITA 2001 for the substantial interest.
12. Additional Report (NV), Kamerstukken II, 1999/2000, 26 727, No. 7, pp. 342 and 343.
13. ECJ, 11 March 2004, Case C-9/02, *Hughes De Lasteyrie du Saillant*. The test for whether or not the provisions of the revised Netherlands regime, are compatible with EU law was set out in the ECJ's decision in ECJ, 7 September 2006, Case C-470/04, *N*.

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emigrates to another Member State. As a result, no security was provided in regard to the 19 June 2009 cases, upon emigration to France and Belgium, and the 20 February 2009 cases, upon emigration to Belgium and the United Kingdom.

In the pension cases (BNB 2009/263, BNB 2009/265 and BNB 2009/266) a lump-sum pension was received within a period of ten years after the taxpayer's emigration, resulting in the collection of the preservative tax assessment. In the annuity case (BNB 2009/264) a preservative tax assessment was not imposed because the conditions of the former ITA 1964 were not satisfied. Upon receipt of the lump-sum annuity payment that was governed by ITA 2001, "negative expenditure for income provisions" were considered. In the substantial shareholding cases (BNB 2009/260 through 262) the shares were not alienated within the ten-year period.

3. The Observance of Good Faith in Interpreting and Applying Tax Treaties

3.1. Vienna Convention

The Netherlands Supreme Court, in case law preceding the decisions at issue, referred to the good faith that a state must observe towards the other contracting state when interpreting and applying tax treaties. This case law is discussed in 3.2. This principle of good faith is laid down in Art. 26 ("[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith") and Art. 31(1) of the Vienna Convention on the law of treaties (Vienna Convention),[14] which states that:

> [a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of a treaty in their context and in the light of its object and purpose.

Furthermore, Art. 3(2) of the OECD Model (the interpretation provision) must be regarded as *lex specialis* with respect to the interpretation provisions of Arts. 31-33 of the Vienna Convention, which are to be viewed as *lex generalis* in this respect.[15] This means that Art. 3(2) of the OECD Model prevails over Arts. 31-33 of the Vienna Convention.

3.2. Case law

BNB 2002/42 (Hungary decision)

In its decision of 7 December 2001, BNB 2002/42, the Netherlands Supreme Court ruled on the surrender of an annuity in respect of which the individual paid premiums before he emigrated from the Netherlands to Hungary. Upon emigration, the surrender value of this annuity was taxed, for Netherlands income tax purposes, by recapturing "negative personal obligations". The Supreme Court was of the opinion that this taxation was outside the scope of the 1986 Hungary-Netherlands tax treaty because the deductibility of the premiums was granted on the dissoluble condition that the annuity would be executed in a regular manner. In this respect, the surrender was a form of irregular execution with the result that the dissoluble condition was fulfilled. The tax treaty in question did not cover the recapture of the premiums deducted. Moreover, the Supreme Court did not view the negative personal obligations as items of income that fell within Art. 22 of the 1986 Hungary–Netherlands tax treaty (other income).

The Netherlands Under-Minister of Finance was initially of the opinion that the abovementioned approach could also be applied to pensions that were irregularly executed, for example, paid out in a lump-sum. According to the Under-Minister of Finance, the consequence of the irregular execution is not that the pension claim is taxed but instead that the facility that was previously granted is recaptured. According to Art. 19b(2) of the Wage Withholding Tax Act (*Wet op de loonbelasting 1964* – WWTA) a transfer of pension rights from a Netherlands insurance company to an insurance company residing in another jurisdiction is equated with a lump-sum pension payout. In line with this characterization, the Supreme Court held, in its decisions of 23 January 2004 (BNB 2004/132 and BNB 2004/132) that a transfer of pension capital from a Netherlands to a Belgian insurance company, while the beneficiary to the pension is a resident of Belgium, fell under Art. 18 of the former 1970 Belgium–Netherlands tax treaty (pension article) with the result that Belgium had the exclusive taxation right. A classification under Art. 15 of that treaty (income from dependent personal services) was denied because it would be based on a domestic deeming provision included in Netherlands tax law (Art. 19b(2) WWTA) after the conclusion of the tax treaty in question, resulting in a shift in the allocation of taxation rights between the Netherlands and Belgium. As a result, the Supreme Court rejected the Under-Minister's view and it did not regard this transfer as recapturing facilities or benefits enjoyed in the past.

BNB 2003/380 (surrender of pension under the Netherlands–Singapore tax treaty)

The Netherlands Supreme Court, in its decision of 5 September 2003, BNB 2003/380 (lump-sum payment of a pension under the 1971 Netherlands–Singapore tax treaty), held that a tax treaty provision giving the residence state, i.e. Singapore, the exclusive authority to tax pensions and other similar remuneration (Art. 18 of the 1971 Netherlands–Singapore tax treaty) cannot be

14. The Vienna Convention was concluded on 23 May 1966. It entered into force for the Netherlands on 9 May 1985. Pursuant to Art. 4 of the Vienna Convention, it only applies to treaties concluded after it came into effect in the relevant contracting states. It is generally accepted, however, that the interpretation rules of the Vienna Convention (Arts. 31-33) can be regarded as a codification of existing customary law. As a result, these interpretation rules can also be applied to tax treaties concluded before the Vienna Convention entered into force in both contracting states; compare the decision of the Netherlands Supreme Court of 29 June 1990, NJ 1992, p. 106, *Gabriëlle Wehr* (see also P.J. Wattel and O. Marres, "Characterization of Fictitious Income under OECD-Patterned Tax Treaties", *European Taxation* 3 (2003), p. 70). Compare also the decisions of the Netherlands Supreme Court of 29 September 1999, BNB 2000/16 and 17 re: the 1959 Germany–Netherlands tax treaty and 28 October 1998, BNB 1999/47 re: the 1980 Netherlands–UK tax treaty (the Vienna Convention entered into force in the United Kingdom on 27 January 1980).

15. J.F. Avery Jones et al., "The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model", *British Tax Review* 1 (1984), p. 17.

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eroded or evaded as a result of the source state subsequently enacting a domestic law provision that operates at the treaty level after that treaty's conclusion. BNB 2003/380 involved Art. 19b(1)(b) WWTA. This provision was introduced into domestic law effective 1 January 1995 and stipulates that if a pension claim is commuted in whole or in part in consideration for a lump-sum payment, it is no longer the lump sum that is taxed. Instead, the fair market value of the total claim is taxed as income from employment. As a result of this fiction, the commutation of a pension in consideration for a lump-sum payment is reclassified as income from former employment that is deemed to have been enjoyed at the time immediately preceding this commutation (the final part of Art. 19b(1) WWTA). The consequence of applying these fictions (Art. 19b(1)(b) in connection with the final part of Art. 19b(1) WWTA) to the 1971 Netherlands–Singapore tax treaty would be that the lump sum at issue would not fall under Art. 18 (pensions) but under Art. 15 (income from employment). This type of shift in the allocation of taxation rights is incompatible with the good faith that must be observed in the interpretation of Art. 18 of the 1971 Netherlands–Singapore tax treaty. The Supreme Court referred explicitly to Art. 31(1) of the Vienna Convention, which contains the good faith principle in regard to the interpretation of treaties. Consequently, the Supreme Court held that the application of these fictions to the 1971 Netherlands–Singapore tax treaty contravenes Art. 18 of that treaty.

BNB 2003/379 and 381 (fictitious salary)

The decisions of the Netherlands Supreme Court of 5 September 2003, BNB 2003/379 and 381, involve the fictitious wage concept (a fictitious wage was attributed to a resident of Belgium who was a substantial shareholder of a Netherlands resident company, besloten vennootschap – BV). This concept has been part of Netherlands legislation since 1 January 1997.[16] The Netherlands Supreme Court held that an unlimited application of this fictitious wage concept to the former 1970 Belgium–Netherlands tax treaty would result in the classification of fictitious income under Art. 15 (income from dependent personal services) or Art. 16 (directors' fees) of that treaty. Such classification would assign the taxation right to the Netherlands, whereas the income would normally accrue to the substantial shareholder as a dividend (Art. 10) or capital gain (Art. 13). Different distributive rules apply to dividends and capital gains than those applicable to income from employment. This fiction, including the notion that the substantial shareholder is deemed to have enjoyed a normal wage, would bring about a shift in taxing rights between the Netherlands and Belgium. Consequently, the Supreme Court concluded that the application of the fictitious wage tax to the existing tax treaties, i.e. those concluded before 1 January 1997, should be reversed because it is precluded by Art. 3(2) of the 1970 Belgium–Netherlands tax treaty, which follows the OECD Model, and, in particular, by the context of that provision.

The Supreme Court found support for this conclusion in the 1992-1995/2008 Commentaries on Art. 3(2) of the OECD Model. Art. 3(2) is intended to provide a satisfactory balance between the need to ensure permanency of commitments entered into by the contracting states, in order to prevent a state from making the treaty partially inoperative by subsequently amending the scope of terms not defined in the treaty under domestic law, and the need to be able to apply the treaty in a convenient and practical way over time.[17] The first viewpoint is expressed in the reservation referring to the context of Art. 3(2). This context is violated if the principle of reciprocity, on which the treaty is based, no longer has a basis in the domestic tax legislation that also forms part of the context in which the treaty operates.[18] The need to ensure the permanency of commitments can be regarded as the equivalent of good faith.[19]

BNB 2005/232-235 (transfer of a pension-BV)

The decisions of the Netherlands Supreme Court of 13 May 2005 (BNB 2005/232-235) deal with the transfer of the actual management of a pension company from the Netherlands to Belgium in circumstances where the beneficiary of these pensions – who was also the director/sole shareholder of the company – either resided in Belgium at the moment the actual management was transferred or emigrated to Belgium at the same moment when the actual management was transferred (according to the Supreme Court there was no material difference between these two situations from a tax treaty perspective). From 1995 the Netherlands tax legislation has provided for two ways of taxing the fair market value of the pension rights at the moment immediately preceding the transfer of the actual management of the pension company, i.e.:

16. Art. 12a WWTA provides that an individual (resident or non-resident) who owns a substantial shareholding in a company that is resident in the Netherlands, and who performs personal activities for this company, should earn for wage tax and individual income tax purposes (via Art. 3.81 ITA 2001) at least the "normal wage" (there are rules on how to determine the normal wage). If such a wage is not being paid, the taxpayer will be deemed to have received this amount.

17. Compare Para. 13 of the 1992-1995/2008 Commentary on Art. 3 of the OECD Model.

18. Para. 12 of the 1992-1995/2008 Commentary on Art. 3 of the OECD Model.

19. Compare also point 2.26 of Advocate General Wattel's Opinion accompanying the decisions of the Netherlands Supreme Court of 5 September 2003, BNB 2003/379 and 381 (fictitious wage). Advocate General Wattel translates 'the need to ensure the permanency of commitments' into '*pacta sunt servanda*'. This principle is laid down in Art. 26 of the Vienna Convention. Art. 31(1) of the Vienna Convention provides that good faith must also be observed when interpreting a treaty. Advocate General Wattel refers to Art. 31(1) of the Vienna Convention in point 4.9 of the aforementioned Opinions. F. van Brunschot (one of the Netherlands Supreme Court judges), "The Judiciary and the OECD Model Tax Convention and its Commentaries", *Bulletin for International Taxation* 1 (2005), p. 5 et seq. similarly confirmed that the Supreme Court intended to refer to the principle of good faith in the fictitious wage decisions. See also F.A. Engelen, *Interpretation of Tax Treaties under International Law*, Doctoral Series, No. 12 (Amsterdam: IBFD, 2004), pp. 489-502 and F. Pötgens, "Ficties en Belastingverdragen", *Tijdschrift voor Fiscaal Recht* No. 265 (2004), pp. 670-673.

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(1) the company could be subject to corporate income tax on the fair market value of the accrued pension rights at a special rate of 52% (Art. 23a of the Corporate Income Tax Act 1969); or

(2) the beneficiary of the pension could be subject to wage withholding tax and individual income tax because the transfer of the actual management of the company could be regarded as a redemption of the pension rights.

An amount equal to the fair market value of those rights could be taxed as deemed income from employment at the moment immediately preceding this redemption (Art. 19b (1)(a) in connection with the final part of Art. 19b(1) WWTA). BNB 2005/232 and BNB 2005/233 held, in respect of the situation in (2), that applying this deeming provision in regard to the tax treaty in question would contravene the principle of good faith that must be observed when interpreting and applying the tax treaty in question (Art. 31 of the Vienna Convention). BNB 2005/234 and BNB 2005/235 held that the corporate income tax levy of 52% (under (1)) should be waived on similar grounds as those set out in BNB 2005/232 and BNB 2005/233. In this respect, the corporate income tax levy is in the nature of an individual income tax on the fair market value of the accrued pension rights, with the unique characteristic that the taxation is not imposed on the recipient of the pension but on the company insuring the pension rights. As a result, the aforementioned regulations did not affect the former 1970 Belgium–Netherlands tax treaty. The Supreme Court in BNB 2003/380 (lump-sum payment of a pension under the 1971 Netherlands–Singapore tax treaty) came to a similar decision. A different result would have meant that the right to levy tax would have shifted from Art. 18 (pensions) to Art. 15 (income from dependent personal services), which would not be in accordance with the good faith that must be observed in interpreting and applying the tax treaty.[20]

3.3. Pattern

The following principles can be derived from the aforementioned decisions and the literature analysing these decisions:

(1) A tax treaty is, in principle, not being applied and interpreted in good faith if a potential shift in the allocation of taxation rights between the contracting states is caused by a fiction that is introduced in the domestic legislation of one of the contracting states subsequent to the conclusion of the tax treaty in question.[21]

(2) A domestic deeming provision may affect a tax treaty provided that that treaty was concluded after that provision's introduction into the domestic legislation.[22]

(3) The principle of reciprocity, which includes situations where a domestic deeming provision has an equivalent in the legislation of the other contracting state (reciprocity of legislation),[23] may be consistent, in certain circumstances, with the observance of good faith vis-à-vis the other contracting state.[24]

(4) It is possible for contracting states to enact a specific regulation that has such a wide scope and enjoys such legitimacy that the domestic deeming provision will continue to have effect on the tax treaty in question, despite the fact that the conclusion of the tax treaty preceded the deeming provision in question.[25]

The exit tax decisions build further on this pattern.

4. The Exit Tax Decisions

4.1. The decisions of 20 February 2009: emigration of substantial shareholders

The systematization of the exit taxation of substantial shareholders is more nuanced than that of the other exit taxes (as source state the Netherlands grants a credit for the tax that the residence state levies upon alienation) and, moreover, under its treaties, the Netherlands often has a taxation right for a given period following the emigration.[26] In its judgments of 20 February 2009, BNB 2009/260 to 262, the Supreme Court held that, in these cases, the good faith that is to be observed was not being violated in regard to the application and interpretation of tax treaties as no benefits were taxed that, in view of their true nature, were allocated to the immigration state for taxation (Belgium, the United Kingdom and the United States). According to the Supreme Court, the aim of the Netherlands provisions is only to tax the appreciation of shares that make up a substantial interest where that appreciation took place in a domestic context.[27] This is also in accordance with the fact that a step-up is

20. This means that BNB 2005/234 and BNB 2005/235 similarly involve "a circuitous characterisation of income categories" with a view to unilaterally influencing the tax treaty allocation (see also below). Consequently, this characterization could not be effectuated under the tax treaty in question because of the shift in the allocation of taxation rights resulting there from. Another view is apparently followed by R.P.C. Cornelisse, in "Trust me", *Weekblad fiscaal recht*, No. 6834 (2009), p. 1391.

21. Compare the following decisions of the Netherlands Supreme Court: 18 June 2004, BNB 2004/134 (fictitious interest); 13 May 2005, BNB 2005/232-235 (transfer of the actual management of pension companies to Belgium) and 23 June 2004, BNB 2004/132 and 133 (transfer of pension capital from a resident Netherlands insurer to a Belgian resident insurer).

22. See, for instance, the decision of the Netherlands Supreme Court of 5 September 2003, BNB 2003/379 and 381 (fictitious wage). Compare also Engelen, note 19, p. 494.

23. The decisions of the Netherlands Supreme Court of 5 September 2003, BNB2003/379 and 381 (fictitious wage).

24. Annex to Advocate General Wattel's Opinion accompanying the decisions of the Netherlands Supreme Court of 5 September 2003, BNB 2003/379 and 381 (fictitious wage), point 2.16.

25. Id.

26. Compare the decision of the Netherlands Supreme Court of 20 November 2009, BNB 2010/41; the substantial shareholder at issue opted to pay the preservative tax assessment that was imposed when he emigrated to Belgium. After his emigration, but within the period of five years that was included in Art. 13(5) of the former 1970 Belgium–Netherlands tax treaty, the taxpayer alienated his substantial shareholding in the Netherlands resident BV. Art. 13(5) of the tax treaty in question assigned the right to tax this alienation to the Netherlands. This right also included the increase in value that accrued in the period after the emigration.

27. That this system is not entirely perfect is demonstrated by BNB 2010/41, with the result that an increase in value relating to the situation after emigration is taxed in the Netherlands.

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granted upon immigration. Moreover, the concept of alienation in Art. 13 of the OECD Model (capital gains) is not inconsistent with the conclusion that, in taxing a capital gain, a state may recognize a gain that has not been realized through alienation. This same view is found in the Commentary on the OECD Model.[28]

4.2. Decisions of 19 June 2009: emigration of pension and annuity holders

4.2.1. *General remarks*

Emigration touches upon what is regarded as "multiple residence taxation". This multiple residence taxation, i.e. levy of a tax by subsequent residence states (partly) on the same tax object, is, in principle, not covered by a tax treaty.[29] The Supreme Court also recognizes this point of departure; it held that, in circumstances where the income is deemed to have been enjoyed at the time the former employee or annuity holder is still a resident of the Netherlands,[30] the taxpayer cannot invoke the rights of the tax treaty granted to residents of the state to which he emigrates. In other words, according to the Supreme Court, a tax treaty does not address these types of situations, with the result that the former employee or annuity holder cannot derive any rights from that tax treaty. In the Supreme Court's opinion, however, this will not hold true where an exit tax is levied on a benefit that, according to its true nature, is taxable in the immigration state by virtue of the tax treaty between that state and the Netherlands. Consequently, the levy of this type of tax is not in accordance with the good faith that must be observed in the interpretation and application of the tax treaty between the new residence state and the Netherlands. The Supreme Court followed Advocate General Wattel's approach in his Opinions accompanying these decisions. Although a tax treaty is not applicable to situations of subsequent residence, the principle of good faith that must be respected when interpreting and applying the tax treaty in question, i.e. between the Netherlands and the immigration state, implies that the emigration state (in these cases the Netherlands) may not attempt to frustrate – via a "trick" in its domestic legislation – the taxation rights the immigration state has under the respective tax treaties when this income is actually realized after emigration.

4.2.2. *The pension decisions (BNB 2009/263, BNB 2009/265 and BNB 2009/266)*

The Supreme Court stipulated that the tax treaties that were at issue in the relevant decisions, which were based on the OECD Model, contain two distributive rules for pension claims: (1) the income from employment article (corresponding to Art. 15 of the OECD Model) and (2) the pension article (corresponding to Art. 18 of the OECD Model). These distributive rules have to be applied consecutively and are mutually exclusive. The Court held that the granting of the pension claim constitutes employment income in the sense of Art. 15 of the OECD Model. As a result of this provision, the Netherlands has the authority to tax the claim if and insofar as it relates to an employment that is exercised in the Netherlands. The Netherlands, however, unconditionally exempts this claim if it constitutes a regular pension scheme covered by the WWTA. Income resulting subsequently from the pension claim falls solely under Art. 18 of the OECD Model.

The Supreme Court clearly outlined the relationship between Arts. 15 and 18 of tax treaties based on the OECD Model as regards pensions. The pension claim must only be classified under Art. 15 at the time it is granted. The Netherlands does not exercise its taxation right because at that time it exempts the pension claim if the conditions of the WWTA are satisfied in this respect. After the claim is granted the pension is, therefore, governed by Art. 18.

Subsequently, the Supreme Court tested the exit tax with respect to pensions against this framework. The Court observed that the previously exempt claim is not taxed under the exit tax rules. Instead, the fair market value of the accumulated pension rights is taxed based on a fiction. As the pension claim only falls under Art. 15 when it is granted, the consequence of the aforementioned fiction cannot be that that treaty is inapplicable to the exit tax due to facts arising after the granting of the claim.

Finally, the Court held that without the exit tax provisions and the fictions included therein, all income resulting from pension claims after the (former) employee's emigration would be taxable in the new states of residence pursuant to the pensions article of the tax treaties between the Netherlands and those states, which follow the OECD Model. Those pension articles, as well as Art. 18 of the OECD Model, allocate the taxation right on pensions and similar payments exclusively to the residence state. In the Court's opinion, and with reference to BNB 2003/380 (surrender of pension under tax treaty with Singapore, see 3.2.), a fiction, including that the value of the accumulated pension rights may be taxed as wages in the Netherlands at the moment immediately preceding the emigration, is not in accordance with the good faith that must be observed in the interpretation and application of the tax treaties in question. According to the Supreme Court, this conclusion is not altered by the fact that the (former) employees were resident in the Netherlands at the time ITA 2001 deemed the taxation to take place. Because the allocation of taxation rights pursuant to Art. 18 of tax treaties patterned after the OECD Model was applied immediately after deeming the taxable moment, the Supreme Court equated this scenario with a situation where a fiction would be linked with events taking place at a moment the (former) employee no longer resides in the Netherlands. In both situations the functioning of the allocation of the taxation right is

28. Paras. 2 through 9, Para. 12 and Para. 29 of the Commentary on Art. 13 of the OECD Model.
29. Advocate General Wattel's Opinion of 31 January 2008 accompanying the decision of 19 June 2009, V-N 2009/29.9, point 6.13. The expression "multiple residence taxation" is also used in the OECD Report "Cross-border income tax issues arising from employee stock option plans", Paras. 37-46. This Report indicated that tax treaties do not address multiple residence taxation.
30. Arts. 3.146(3) and Art. 3.137(1) ITA 2001, respectively.

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frustrated unacceptably. Based on this conclusion, the Court held that Art. 3.83(1) ITA 2001 could not be applied in the cases at issue.

4.2.3. Annuity decision (BNB 2009/264)

The findings of the Court in the annuity decision were similar to those in the pension decisions. In its annuity decision, the Court devoted attention to BNB 2002/42 (Hungary decision; see 3.2.). The Court correctly observed that pursuant to the "negative expenditure for income provisions", the proceeds derived as a result of the annuity premium deduction were also taxed. From that perspective, the "negative expenditure for income provisions" differed from the negative income provisions (that were at issue in the Hungary decision) because, in the former case, the deductibility of the premiums was not granted under the dissoluble condition of the annuity's regular execution. As a result, the surrender of the annuity at issue constituted an item of income within the meaning of the other income article (Art. 22) of the former 1970 Belgium–Netherlands tax treaty. An item of income was absent as regards the annuity that was the subject of the Hungary decision, which was taxed under the negative income provisions. The other income article of the former 1970 Belgium–Netherlands tax treaty allocated the right to tax the surrender of the annuity exclusively to the residence state, Belgium.[31]

During the proceedings, the tax inspector was willing to restrict the levying of taxes to the amount of the previously deducted annuity premiums, i.e. without taking into account the proceeds from these premiums. This restriction that the tax inspector was willing to apply lacked, however, a legislative basis. Therefore, the Supreme Court was right in solely taking into consideration the legislative regulation that was applicable. This legislative regulation (Art. 3.133 ITA 2001) not only took the previously deducted premiums into consideration but also the proceeds therefrom. These deeming provisions (Art. 3.133 in connection with Art. 3.137 ITA 2001) had, as a consequence, that the claim's value was taxed in the Netherlands at the moment immediately preceding the surrender. Consequently, the Supreme Court held that the good faith that must be observed in the interpretation and application of the other income provision of the former tax treaty with Belgium would be evaded or eroded if the aforementioned deeming provisions had effect under the tax treaty in question.

4.2.4. Reciprocity of legislation

The Supreme Court, in its annuity decision (BNB 2009/264), also devoted attention to the reciprocity of legislation, which can entail that under certain circumstances good faith is observed. The Netherlands Under-Minister of Finance referred, in the appeal, to the fact that Belgium had included, after the conclusion of the tax treaty in question, a provision in its domestic legislation that was probably comparable to the Netherlands deeming provisions in question. The Under-Minister pointed to Art. 364bis of the Belgian Income Taxes Code 1992 (ITC 1992). This provision contains a domestic fiction that taxes the lump-sum payout of a pension or an annuity of persons who become resident in another state and for which a tax facility was claimed in Belgium. This taxation is achieved by deeming the payment or granting of the lump sum to occur at the moment directly preceding the transfer of fiscal residence to the other state.

The Supreme Court correctly held that such a domestic deeming provision, introduced into Belgian legislation subsequent to the conclusion of the treaty in question, does not imply that Belgium intended to relinquish its exclusive taxation rights based on that treaty. According to the Court, this relinquishment cannot be derived from the sole circumstance that the other contracting state, i.e. Belgium, extended the possibility to levy taxes unilaterally in its domestic legislation and in a manner that is comparable to the Netherlands (via Art. 364bis ITC 1992). This circumstance also does not mean that the Netherlands measure becomes compatible with the other income provision of the former tax treaty with Belgium. The author is of the opinion that the Supreme Court followed Advocate General Wattel's Opinion in this respect. The Advocate General stated that the principle of good faith does not allow for a treaty-frustrating deeming provision, included in the domestic legislation of a contracting state (the Netherlands) after conclusion of the relevant treaty, to be justified on the basis that a comparable fiction was subsequently included in the domestic legislation of the other contracting state to that treaty (Belgium). This is even more so the situation where the equivalent fiction is, according to Belgian case law, also incompatible with tax treaty obligations.[32] The author endorses the Supreme Court's reasoning. The principle of reciprocity of legislation in bilateral relations cannot be used to justify domestic legislative amendments included subsequent to the conclusion of the tax treaty in question that disturb the allocation of taxation rights between the states simply because both contracting states have enacted such provisions.

5. Comparison of the Decisions of 20 February 2009 and 19 June 2009

Some authors have claimed that the exit tax on substantial shareholdings is in accordance with Netherlands tax treaties and with the principle of good faith, within the meaning of the Vienna Convention, because what is involved is not a "circuitous characterization of income categories" with a view to unilaterally influencing the

31. In the same sense, see P.H.G. Albert in his annotation accompanying the annuity decision, *Nederlands Tijdschrift voor Fiscaal Recht* 2009/1437, p. 43.
32. Compare the decision of the Belgian Supreme Court of 5 December 2003, *Fiscoloog Internationaal* 2003, No. 241, p. 3 et seq. In this decision the Court came to the conclusion that pursuant to Art. 18 of the France–Belgium tax treaty France had the exclusive authority to tax the pension. As a result, the application by Belgium of Art. 364bis was incompatible with that treaty. The Supreme Court's approach differed from that of the Court of Appeal of Brussels in it decision of 15 February 2002, *Fiscale Koerier* 2002/263. Contrary to the Brussels Court of Appeal, the Supreme Court did not refer explicitly to Arts. 26 and 27 of the Vienna Convention.

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treaty allocation.[33] Moreover, the Netherlands grants taxation rights to the state of residence by means of a reverse credit if, following emigration, substantial shareholding gains are realized due to alienation of the interest and it becomes a matter of actually paying (collecting) tax.[34] The Supreme Court, in the meantime, endorsed this view in its judgments of 20 February 2009, BNB 2009/260 through 262.[35] This is regrettable. Although a treaty, in principle, does not cover situations of multiple residence,[36] one cannot deny that this exit tax also has the aim of frustrating the undesirable effects of tax treaties by introducing a technical trick into the domestic legislation as a consequence of the aforementioned two-track policy (see 2.4.).[37] Although the reverse credit gives this exit tax a less than robust character, this does not change the initial aim of the exit tax, i.e. altering the allocation of taxation rights, since, as a result, the Netherlands may tax, inter alia, possible dividend payments even though the taxation rights under the relevant tax treaties (the former treaty with Belgium and the treaties with the United Kingdom and the United States) were allocated to the residence state of the recipient of the dividends and only a limited taxation right was granted to the Netherlands.[38] This can be seen in the design of the preservative tax assessment imposed immediately prior to emigration of the substantial shareholder; it is not so much aimed at taxing the appreciation that is related to the period of domestic tax liability, but at taxing (a part of) the profits actually realized upon alienation. After all, the tax that is owed on the capital gains on the shares at the time of emigration is cancelled fully if the shares are not sold by the substantial shareholder within ten years from the date of emigration. The reverse credit that the Netherlands grants for the tax owed in the new state of residence under a tax treaty with the Netherlands, if the shares are sold within ten years of emigration, can be considered to be a recognition of the taxation rights of the residence state.[39] In its judgments of 20 February 2009, BNB 2009/260 through 262, the Supreme Court was, nevertheless, of the opinion that the aim of the exit tax on a substantial shareholding is different, namely the taxation of the appreciation of a substantial shareholding during the domestic period.[40] In any event, the sanctioning of the exit taxation of a substantial shareholding does not conflict with earlier case law on the good faith to be observed in the application and interpretation of treaties, such as HR 5 September 2003, BNB 2003/379 and 381 (fictitious salary), HR 5 September 2003, BNB 2003/380 (surrender of pension by a resident of Singapore), HR 18 June 2004, BNB 2004/134 (fictitious interest) and HR 13 May 2005, BNB 2005/232 through 235 (transfer of seat of a pension BV).[41] Also, see 3.2.

6. Under-Minister of Finance's Reaction to the Decisions of 19 June 2009

Obviously, it is understandable that the Secretary of State for Finance would be frustrated with the fact that taxpayers in the Netherlands are able to build up tax-privileged pensions and, at the moment the pension benefits are paid out and Netherlands taxation is imminent under the reversion rule, i.e. the payment of pension premiums by, for instance, the employer is tax exempt while the later payments are taxed (Art. 11(1)(c) WWTA), the Netherlands is not able to effectuate its tax claim because the taxation rights on the pension payments are allocated under a tax treaty to a new state of residence. One could argue, however, that the Netherlands should renegotiate its treaties if it determines that its tax claims are insufficiently guaranteed. The Under-Minister of Finance has, nevertheless, once again chosen a different route in reaction to the decisions of the Supreme Court of 19 June 2009, BNB 2009/263 through 266, by immediately proposing legislation that has retroactive effect to the date it was submitted to the Second Chamber, i.e. 29 June 2009. The entire parliamentary proceedings took only eight days. On the government side, it was thought that there was room to adapt the preservative tax assessment for pensions and annuities in such a way that it,

33. It *could* be said that there is a circuitous characterization of income categories with a view to unilaterally changing the treaty allocation in HR 5 September 2003, BNB 379 and 381 (fictitious salary); HR 5 September 2003, BNB 2003/380 (surrender of pension under the Singapore tax treaty); HR 23 January 2004, BNB 2004/132 and 133 (transfer of pension rights to a Belgian resident insurer) and HR 13 May 2005, BNB 2005/232 to 235 inclusive (transfer of seat of a pension BV). A different view as regards BNB 2005/234 and BNB 2005/235 is apparently held by Cornelisse, see note 20, p. 1391.

34. Compare Advocate General Wattel's Opinion of 10 June 2008, V-N 2008/39.10, point 5; of 4 June 2008, V-N 2008/39.9, point 6; of 31 January 2008, V-N 2008/20.8, point 6.13 and of 4 October 2006, V-N 2007/4.13, points 4.40 et seq., as well as, although somewhat less outspokenly, F.G.F. Peters, "De aanmerkelijk belangregeling in internationaal perspectief", *Fiscale Monografieën*, No. 123 (Deventer: Kluwer, 2007), pp. 260 and 261 and J.W.J. de Kort, "Ontwikkelingen emigratieheffing bij aanmerkelijk belang", *Weekblad fiscaal recht*, No. 6765 (2008), p. 551 et seq., section 3.

35. No conclusions could be drawn in this regard from the judgment of the Supreme Court of 24 October 2003, BNB 2004/257 since it involved the relationship between the exit tax on a substantial shareholding and Art. 12 of the Tax Regulation for the Kingdom (*Belastingregeling voor het Koninkrijk* – BRK). Art. 12 BRK allowed the Netherlands to tax the capital gain on the shares up to the moment of emigration and, moreover, the BRK is not a tax treaty but an Act of the Kingdom. The BRK is considered a *lex specialis* and is not of a higher order than domestic legislation. The BRK thus only has priority if the specific character of the regulation provides grounds for this. A breach of the BRK is permitted if a Netherlands domestic law has a more specific character, which is the case with Art. 4.16(1)(h) ITA 2001. This is why it is understandable that the Supreme Court did not view the latter provision as an unacceptable breach of Art. 12 BRK. In this regard, Art. 12 BRK and the predecessor to Art. 4.16(1)(h) ITA 2001 both entered into force on the same date, i.e. 1 January 1997, so that from this perspective as well there cannot be said to be a breach of Art. 12 BRK. See also E.C.C.M. Kemmeren, "Nederlandse exitheffingen anno 2005 zijn onhoudbaar, maar een passend alternatief is denkbaar", *Weekblad fiscaal recht*, No. 6650 (2005), p. 1613 et seq., section 7.

36. See also F.G.F. Peters, "Emigratieheffing ab: eindoordeel geveld maar eindstation nog niet bereikt", *Nederlands Tijdschrift voor Fiscaal Recht* 2009/1415, p. 4.

37. See also D.S. Smit in his annotation to the decision of the Netherlands Supreme Court of 20 February 2009 (emigration to the United Kingdom), *FED Fiscaal Weekblad* 2009/65, section 3.

38. Nevertheless, the Supreme Court did not follow this view in its judgments of 20 February 2009. The Supreme Court based its judgments on the OECD Commentary and made a link with the character of the exit tax on substantial shareholdings, i.e. a taxation of capital gains in the form of appreciation of the substantial shareholding that accrued to a resident of the Netherlands. Compare also D.S. Smit, note 37, section 2.

39. Compare also F.A. Engelen, *Over waarden en normen. Het beginsel van de goede trouw in het (fiscale) verdragenrecht* (Deventer: Kluwer, 2006), pp. 33 and 34.

40. However, see also the aforementioned decision of the Netherlands Supreme Court of 29 November 2009, BNB 2010/41 and the criticism formulated by E.J.W. Heithuis in his annotation to this decision.

41. Compare, as well, S.W.C. Douma in his annotation to the decisions of the Netherlands Supreme Court of 20 February 2009, *Nederlands Tijdschrift voor Fiscaal Recht* 2009/466, p. 33.

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nevertheless, would remain within the limits set by the Supreme Court and thereby could be considered to be in accordance with the good faith to be observed in the interpretation and application of tax treaties. A solution was seen in the Supreme Court's Hungary decision (BNB 2002/42; see 3.2.). For pensions, as well as annuities, Art. 3.136(2) and (3) of the ITA 2001 provide that if the exit taxes on surrender cannot be effectuated as a result of a tax treaty (because a provision based on Art. 18 or Art. 21 of the OECD Model allocates the taxation rights on pensions and annuities exclusively to the state of residence), then the tax benefits that had been granted earlier are recaptured because "negative expenditures for income provisions" exist. The Council of State has rightly pointed out that the recapture of the deduction of pension premiums, based on the regulation on the order of precedence under domestic legislation, is a form of wage and not a "negative expenditure for income provision". The Council of State noted that if the system of "negative expenditures for income provisions" were to be effectuated in this respect, a major intervention in the domestic system would be needed.[42] The tax treaty classification, taking into account Art. 3(2) of tax treaties based on the OECD Model and the judgments of 19 June 2009, will fall under Art. 18 without any limitation.[43] The Council of State and the members of the First and Second Chambers[44] explicitly asked why the Under-Minister of Finance thought the judgments of 19 June 2009 would allow for such a "repair". This reasoning was not provided. Therefore, it remains questionable whether or not this "repair" is sufficient. It cannot be ruled out that the Netherlands Supreme Court will have to give its view on this renewed regime in the near future and may once again come to the conclusion that the Netherlands did not respect good faith in regard to certain tax treaty jurisdictions.

7. Conclusion

The author has highlighted the findings of the Netherlands Supreme Court in the decisions of 19 June 2009, BNB 2009/263 through 266 with respect to the relationship between the exit taxes on pensions and annuities, which were introduced into Netherlands tax legislation via ITA 2001, and previously concluded tax treaties. The Court held that effectuating these exit taxes under tax treaties concluded earlier substantially erodes the taxation rights of the other states where they have, pursuant to the relevant tax treaty, the exclusive authority to tax the surrender of a pension or an annuity after emigration. According to the Court, this action is not in accordance with the good faith that must be observed when interpreting and applying these tax treaties. BNB 2009/263 through 266 follow the lines that the Court set out in its earlier case law which is also analysed in 3.2.

The author has criticized the decisions of the Netherlands Supreme Court of 20 February 2009, BNB2009/260 through 262. In these decisions, the Court held that the exit tax on substantial shareholdings is in line with good faith. According to the Court, the allocation of taxation rights is not disturbed, the exit tax on substantial shareholdings constitutes a coherent system (given the fact that a step-up is granted upon immigration) and the Commentary on Art. 13 of the OECD Model would permit the application of Art. 13 of the OECD Model to unrealized increases in value. The author has indicated that the Supreme Court's reasoning in this regard is questionable.

42. Advisory Opinion Council of State and Additional Report, Kamerstukken II, 2008-2009, 31 990, No. 4, p. 6.

43. See, along the same lines, E.C.C.M. Kemmeren, "Exitheffing bij pensioenen: Financiën is hardleers", *Weekblad fiscaal recht*, No. 6820 (2009), p. 881 et seq. (sections 6 and 7). According to the author, Para. 13 of the Commentary on Art. 18 of the OECD Model should not be understood such that, in line with the Supreme Court's decisions of 20 February 2009, BNB 2009/260 through 262 and the Commentary on Art. 13 of the OECD Model, the emigration state has a right to recapture the previously granted facility. That Para. 13 is an introduction to, and shall be read in the context of, the specific tax treaty provisions contained in Para. 15 of the Commentary on Art. 18 of the OECD Model. A different view is held by I.J.J. Burgers in the annotation under BNB 2009/265, point 4.

44. Advisory Opinion of the Council of State and Additional Report, Kamerstukken II, 2008-2009, 31 990, No. 4, p. 6 and Additional Report (NV), Kamerstukken II, 2008/09, 31 990, No. 7, pp. 5 and 6; Further Additional Report (NNV), Kamerstukken II, 2008/09, 31 990, No. 9, p. 1 and Explanatory Memorandum (MvA), Kamerstukken I, 2008/09, 31 990, B, pp. 2 and 3.

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