THE NETHERLANDS[1]

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Over the past few decades, the Netherlands has been a prime location for holding companies. The main benefits of the Dutch holding company regime remain access to an extensive tax treaty network (almost 80), a large network of bilateral investment treaties (almost 90), the Dutch tax ruling practice, the absence of Netherlands source taxation for interest and royalty payments, the absence of a capital duty, and the transparency of the holding regime. In this respect the Netherlands is often used as a flow through country, through which dividends, interest, and royalty streams flow from one tax jurisdiction to another. In the year 2011, the number of holding and flow through companies situated in the Netherlands was estimated at around 13.000.

It must be pointed out that a number of countries have copied the Dutch participation exemption system with more and less success.

The Netherlands holding regime, however, has two faces. On the one hand the Netherlands wants to maintain an interesting and challenging entrepreneurial tax climate for companies. On the other hand, it has introduced various forms of tax legislation to combat excessive interest deductions in take-over situations.

It should also be kept in mind that the Netherlands has enacted a major change in its civil company law as of the 1st of October 2012[3]. For private limited liability companies no minimum share capital is required anymore - a share capital of € 0.01 is sufficient.

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1 This material was partly derived from a publication in TaxAnalysts, dating from the year 2011, concerning the Dutch national report on outbound acquisitions: European holding companies structures.

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3 Flex-bv legislation.

A. Corporate Income Tax – General

In principle, all income of a holding company will be subject to Dutch corporate income tax at the rate of 25% for profits exceeding € 200,000. Profits up to € 200,000 are taxed at a rate of 20%. This lower tax rate is especially aimed at small and medium sized companies (family businesses). However, because of the Dutch participation exemption, a Dutch resident holding company will often have little or no taxable income as revenues from participations, domestic as well as foreign, are in principle tax exempt, irrespective of the level of corporate income tax. This applies to participations/holdings in which an actual business is carried out. In situations of holdings with only passive investments in low tax jurisdiction, a tax credit method applies instead of an exemption method.

B. Location of a Netherlands company and substance requirements

When looking at the Netherlands holding regime, one first has to establish the criteria under which a holding company for tax reasons is a resident of the Netherlands. A company with a capital divided into shares and which is established according to Dutch civil law is deemed to be a resident of the Netherlands (Article 2, Paragraph 4 Corporate Income Tax Act 1969, hereinafter called CITA). However, the actual place of tax residence is the jurisdiction where the actual management and day-to-day business decisions take place.

With respect to holding companies, the question is what kind of substance demands are required from the point of view of the Netherlands tax administration. The administration works with substance requirements which are not laid down in bilateral tax treaties nor in national Netherlands tax law.

In the Netherlands parliament, at regular intervals, questions have been raised, particularly by the more left wing political parties, whether the Netherlands tax policy with regard to holding companies is in conformity with international standards e.g. the standards of the OECD. And furthermore, given the fact that a vast number of holding companies are located at the same postal addresses in the Netherlands, whether the State Secretary of Finance can explain that. Moreover, there is criticism from some political parties that the Netherlands tax policy on holding companies is to the detriment of the tax revenues of developing countries.
In a very detailed letter to the Netherlands parliament[4], the State Secretary once again explains the Netherlands tax policy position in this respect. Although formal substance requirements in the Netherlands do not exist, the State Secretary admits

4 Letter of 25 June 2012, nr. IFZ/2012/85U, *'Uitvoering motie leden Braakhuis en Groot betreffende de 'substance'-eisen in de Nederlandse belastingwetgeving'.*

that absence of substance may lead to the abuse of a bilateral tax treaty. Indirectly, he admits the substance criteria are relevant for the following tax issues in bilateral tax treaties:

- Residency;
- Beneficial ownership;
- Limitation on benefits; and
- Main purpose test.

Furthermore, substance requirements also play a role in the arm's length principle, as far as APA[5]'s and ATR[6]'s are concerned.

The state secretary argues that he is very reluctant to apply the substance criteria to a private limited liability company with a share capital that is established according to Netherlands civil law. That company in itself is a prima facie situated in the Netherlands.

Another question is how much profit can be attributed to Netherlands activities. It is furthermore for the source country to acknowledge the residency in the Netherlands of the Netherlands holding company. The State Secretary states that the Netherlands tax administration is and will be fully cooperative with regard to questions from tax administrations in other countries concerning the residency of specific Netherlands holding companies.

In the year 2011 the Netherlands tax administration has issued residency declarations in more than 100.000 cases. Around 12.500 residency declarations were issued by the '*Belastingdienst Rijnmond*' - the tax administration competent for concluding APA's and ATR's.

Article 8c Corporate Income Tax Act

This Article stipulates that received and paid interest and royalties by a Netherlands resident flow through entity are ignored if the company does not suffer any real economic risks. This does not apply, and the company is deemed to be suffering real economic risks, if the amount of equity is at least 1% of the money lent out (as assets) or at least € 2,000,000.

5 Advance Pricing Agreements.

6 Advance Tax Rulings.

Substance requirements flow through entities

Substance requirements for Netherlands companies that render services by means of a flow through entity are laid down in a decree of the State Secretary of Finance.[7] The detailed requirements read as follows:

- At least half of the total of the statutory and authorized board members is living or established in the Netherlands;
- The board members living or established in the Netherlands have the necessary professional skills and knowledge to carry out their tasks;
- The main board decisions are taken in the Netherlands;
- The (main) bank account of the entity is kept in the Netherlands;
- Bookkeeping of the entity is kept in the Netherlands;
- The company has fulfilled all its tax obligations concerning corporate income tax, wages tax, VAT etc.;
- The company is situated in the Netherlands and is, for taxation matters, not resident of another country;
- The company carries out its activities with sufficient equity capital and suffers a valid economic risk. This is the case if the amount of equity is at least 1% of the money lent out (as assets) or at least € 2,000,000.

It should be kept in mind that while detailed substance requirements exist in situations of service entities (flow through entities), such substance requirements are absent as far as the holding companies are concerned.

Substance requirements holding companies

It is standard tax policy of the Dutch tax administration that in order for it to issue a ruling to a Netherlands holding company the holding company must finance its participations with a minimum of 15% of equity. Even when an advance tax ruling is not obtained, it is advisable to observe this (non statutory) debt/equity ratio of 85/15.

7 Decree of the State Secretary of Finance of the Netherlands of 11 August 2004, nr. IFZ2004/126M.

C. Participation Exemption

In General

Under the participation exemption as laid down in Article 13 CITA ("CITA") dividends (including dividends in kind and "hidden" profit distributions) and capital gains derived from qualifying shareholdings are exempt from Dutch corporate income tax. When a participation is sold, both capital profits and capital loss on the sale are tax exempt as the participation exemption applies.

Capital losses by means of liquidation proceeds are deductible only under special circumstances. This type of loss relief, also with regard to foreign losses, seems in broad terms to be in conformity with the ruling of the ECJ in the famous Marks & Spencer ruling[8].

No minimum holding period is required, although in a short term buy-and-sell transaction, part of the tax exempt capital gain realized may be requalified as a taxable service fee. This especially applies to transactions by banks with regard to cash-box companies.

The participation exemption only applies if the interest held by the Dutch resident taxpayer qualifies as a participation ("*deelneming*"). A participation exists if the Dutch taxpayer:

- Holds at least 5% of the nominal paid-up capital of a company with a capital divided into shares;
- Holds an interest in an "open" limited partnership which gives entitlement to at least 5% of the profits realized by the open limited partnership;
- Holds at least 5% of the participating certificates of a fund for joint account;
- Is a member of a cooperative; or
- Holds at least 5% of the voting rights in a company which is resident in an E.U. member state with which the Netherlands has concluded a tax treaty that provides for a reduction of Netherlands dividend withholding tax on the basis of voting rights.

In addition, if a Dutch holding company holds a qualifying participation in a subsidiary, under the so-called "drag along rule" a hybrid loan granted to that

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8 ECJ 13 December 2005, Marks & Spencer II, case C-446/03, [2005] ECR I-10837, with an Opinion dated 7 April 2005 by Advocate General Poiares Maduro.

subsidiary or a profit sharing right in that subsidiary will qualify as a participation as well.

If a Dutch taxpayer holds a shareholding of less than 5% in a company, or has granted a hybrid loan to a company or holds a profit sharing right in a company and a company related to the Dutch taxpayer holds a qualifying participation in that company, such smaller shareholding, such hybrid loan or such profit sharing right will qualify for the participation exemption based on the so-called "pull along rule."

Please note that the term "related" is statutorily defined and refers to a share ownership of at least one-third.

D. Credit method instead of Participation Exemption

The participation exemption does not apply to participations which are held as a mere passive investment (the "motive test"). However, if a participation does not pass the motive test, the participation exemption will nevertheless be applicable if (i) the participation is subject to a "realistic levy" according to Dutch tax standards (the "subject to tax test") or/and (ii) the assets of the participation do not consist directly or indirectly of more than 50% of the so-called "low-taxed free passive assets" (the "asset-test"). If the participation exemption does not apply, the credit method apples instead of the exemption method.

Motive test

In principle, a participation is considered to be held as a mere passive investment if the shareholder's objective is to obtain a return that may be expected from normal active asset management. If the shareholder has a mixed motive, the predominant motive is decisive. A participation is not considered to be held as a mere passive investment if the business conducted by the participation is in line with the business of the shareholder. Furthermore, a participation held by a Dutch top holding company that conducts an active management function for the benefit of the business activities of the group will pass the motive test. This is generally the case if the top holding company fulfills – on the basis of its activities – a substantial role in the field of administration, policy making and finances for the benefit of the business activities of the group.

The foregoing also applies to Dutch intermediate holding companies. If a Dutch intermediate company carries out a linking function between the business activities of the (active) participation and the business activities of the (active) top holding company, the participation of the Dutch intermediate company will pass the motive test. The motive test is in any event deemed not to be met if the predominant function of the participation is to act as a group finance company, or if more than half of the participation's consolidated assets consist of shareholdings of less than 5%.

Subject to tax test

The subject to tax test will be met if the domestic tax system where the company in which a participation is held is subject to a realistic levy *according to Dutch tax standards on the basis of Dutch tax rules*.

This is generally the case if the subsidiary is subject to a profits based tax at a regular statutory rate of at least 10%.

A tax system with tax base deviations, such as special investment deductions, different depreciation rules, or tax consolidation rules, does not necessarily cause that tax system to fail the subject-to-tax test. However, tax systems with base deviations caused by tax holidays, deductible dividends, and participation exemption regimes which are significantly broader than the Dutch system may result in failing the subject to tax test.

Asset test

The asset test stipulates that the taxpayer must demonstrate that the assets of the participation usually do not consist directly or indirectly of more than 50% of free passive low-taxed assets. For this purpose, the assets must be taken into account at fair market value. The term "usually" implies that the participation exemption remains applicable if the assets of the participation consist of more than 50% of free passive low-taxed assets for a short period of time only.

Assets which qualify as free passive assets are:

- Passive assets which are not necessary for the business activities of the entity holding the assets. Interest bearing bank accounts, loan receivables, passive investments such as bonds and shares could, amongst others, qualify as free passive assets. In this respect it should be noted that real estate -including rights over real estate- is not considered to be a free passive asset, unless the real estate is held by a Dutch exempt investment institution, or a Dutch 0%-taxed investment institution.
- Inter-company receivables, unless they are used by an active group finance company or are financed entirely or almost entirely (90% or more) by third party debt.

- Assets leased to a group company, unless they are used by an active group leasing company or are financed entirely or almost entirely (90% or more) by third party debt.

  As mentioned above, both direct and indirect assets of the participation must be taken into account. Consequently, assets of companies in which the participation holds an interest of at least 5% must be pro rata allocated to the participation. Interests below 5% are in any event deemed to be passive assets. Furthermore, if less than 30% of the assets held by a company consist out of free passive low taxed assets, all assets -excluding participations- of the company can be allocated to the participation as "good assets".

  Free passive assets of the participation only qualify as "bad assets", if the assets are considered to be low taxed. This is generally the case if the income derived from these assets is not subject to a realistic levy according to Dutch tax standards. In relation hereto, a similar approach as the subject to tax test applies.

Earn-out and balance guarantee arrangements

Earn-out and balance guarantee arrangements agreed upon the sale of a qualifying participation are also covered by the participation exemption. Consequently, future payments or earnings under such arrangement are exempt from Dutch corporate income tax with the Dutch purchaser of the participation or non-deductible with the Dutch seller.

Expiring participation

If a qualifying participation falls below the 5% threshold as a consequence of a sale of shares or an issue of new shares to a third party, the participation exemption remains applicable for an additional period of 3 years, provided that the qualifying participation was held for an uninterrupted period of at least 1 year.

Non-Qualifying Participations

In the event that the shareholding will be deemed to be a low-taxed portfolio participation to which the participation exemption does not apply, a credit system is available with respect to the income derived from that shareholding.

Stock Options/Convertible Bonds

Pursuant to case law, the participation exemption also applies to options that relate to shareholdings qualifying for the exemption. In addition, the Dutch supreme court ruled that a conversion gain realized on convertible bonds is covered by the participation exemption, if the conversion leads or could lead to a qualifying shareholding for the participation exemption. The court derived this from the aim and the purpose of the participation exemption being that profits should only be taxed once with corporate income tax. Option and convertible bonds can be seen as a partial economic ownership of profits related to shares and therefore, in the eyes of the Dutch Supreme Court, the participation exemption is applicable.

Hybrid Loans/Profit Rights

As was mentioned above, the participation exemption is also applicable to profit rights and hybrid loans held in combination with a qualifying participation. Loans will be treated as hybrid loans if:

- The interest on the loan is contingent on the profits of the borrower;
- The loan is subordinated to receivables of all other creditors; and
- The loan has a maturity of more than 50 years or has no maturity and is redeemable only upon bankruptcy, moratorium, or liquidation of the borrower.

If a loan qualifies as a hybrid loan, the loan will be regarded as capital for corporate income tax and dividend withholding tax purposes. Consequently, interest paid on the hybrid loan will not be deductible for corporate income tax purposes and in principle will be subject to 15% dividend withholding tax.

On the other hand, the interest and principal paid on a hybrid loan will be exempt from Dutch corporate income tax and Dutch dividend withholding tax in the hands of a Dutch resident lender if this lender owns a qualifying participation in the borrower or the borrower qualifies as a related entity of the lender. In the context of international structures, it can be noted that the exemption for interest received on a hybrid loan by a Dutch lender is not affected by the tax treatment of interest paid by a nonresident borrower.

Consequently, even if the foreign borrower is able to deduct the interest in its country of residence, the interest received will be exempt from Dutch corporate income tax.

E. Costs and Interest Deductions

Costs/Expenses/Currency results

Transaction expenses related to the acquisition and/or the sale of a participation are not deductible. The same applies to currency losses in relation to the selling of a participation. Currency gains in relation to the selling of a participation are also tax exempt under the participation exemption.

With regard to currency losses in relation to the selling of a participation, there are a number of cases pending before several tax courts claiming that on the basis of the ECJ ruling in the case of Deutsche Shell[9], those losses should be tax deductible and that the Dutch Corporate Income Tax Act as such is in violation with community law. In the respect the Dutch tax legislator has already introduced a new Article in the Dutch Corporate Income Tax Act being Article 28b. This Article stipulates that if a currency loss concerning a participation is deducted from the tax base, all future currency profits concerning a participation are taxable, irrespective of the amount of loss that has been deducted. Whether, seen from a European perspective, this rule is proportionate, seems to be highly questionable.

Base Erosion by means of Interest Deductions

If one looks at the Dutch holding companies regime there are a number of specific tax regulations applicable, aimed at fighting base erosion. Very often, if a Dutch operating company is taken over by a foreign company, a special takeover company (a special purpose vehicle) is used. Such a takeover company can in principal be established in any tax jurisdiction. Very often, however, for tax reasons, the Netherlands is chosen. The takeover company, the holding company as such, is established according to Netherlands civil law and for tax purposes situated in the Netherlands (on the assumption that the substance requirements are met). This company is financed with an enormous amount of debt, primarily from associated (sister) companies, sometimes situated in a low tax jurisdiction. These excessive interest deductions have the primary aim to erode the tax base in the Netherlands of the Netherlands target company by means of extensive interest deductions.

Therefore a series of specific tax rules to prevent excessive interest deductions in group structures apply.

9 ECJ 28 February 2008, Deutsche Shell, case C-293/06.

Base erosion by artificial lending structures from related entities

Limitations apply to interest deduction arising from transactions that could be considered to result in base erosion for Dutch tax purposes. Interest paid on loans from related entities and individuals is not deductible insofar as the loans relate to:

- Profit distributions or repayments of capital by the taxpayer or a related entity to a related entity or related individual;
- The acquisition of an interest by the taxpayer, a Dutch resident related entity or a Dutch resident related individual in a related company which after the acquisition is a related entity; or
- The contribution of capital by the taxpayer, a Dutch resident related party or a Dutch resident related individual in a related entity.

  This rule prevents a Dutch taxpayer from deducting interest on borrowing to pay a dividend, or to make an acquisition or to make a contribution to capital. The base erosion provisions contain an exception under which the interest deduction will be granted if the taxpayer can demonstrate that:

- Both granting of the loan and the business transaction are based on sound business reasons or
- The interest is subject to sufficient taxation in the hands of the recipient, and the recipient is not able to offset the interest income with losses of prior years or anticipated losses in the future, unless both the granting of the loan and the business transaction are not based on sound business reasons. Interest will be subject to sufficient taxation in the hands of the recipient if the recipient is taxed on profits determined under Dutch tax principles at a rate of at least 10%.

For the purpose of the base erosion provisions, an entity is deemed to be related if:

- The taxpayer holds at least one-third of the capital in the other entity,
- The other entity holds at least one-third of the capital of the taxpayer, or
- A third party holds at least one-third of the capital in both entities.

Thin Capitalization

Pursuant to the Dutch thin capitalization rules, interest paid on loans from related parties will be deductible if the average debt/equity ratio of the Dutch company as represented in its tax balance sheet does not exceed 3:1 (by more than €500,000) or if the average debt/equity ratio of the Dutch company as represented in its commercial accounts does not exceed the debt/equity ratio of the group to which the Dutch company belongs, as represented in the group consolidated commercial accounts. As a general rule it should be noted that the non-deductible interest will never exceed the amount of interest paid on group loans reduced by the amount of interest received on group loans. Furthermore, if a third party loan is guaranteed by a related party and the loan could not have been obtained by the borrower without such guarantee, the loan will be requalified as a related party loan. A company is considered a "related party" if it meets one of the conditions as described above.

Because of the introduction of Article 13l Dutch Corporate Income Tax Act (CITA) the Dutch thin capitalization rules will be abolished as of 1 January 2013. A relevant bill of law in that respect was sent to parliament by the Dutch State secretary of Finance on 18 September 2012.

Dutch acquisition holding company and a fiscal unity (Article 15ad CITA)

As part of the 2012 Budget, a new interest deduction limitation was introduced into the Corporate Income Tax Act (CITA) effective 1 January 2012, by means of a new Article 15ad. The acquisition of a Dutch target operating company is often structured through a Dutch acquisition holding company, which finances the acquisition partly with debt (*e.g.* third party and inter-company debt).

By forming a so-called "fiscal unity" for Dutch corporate income tax purposes, the interest expenses on the acquisition debt can be set off against the operating profits of the Dutch target company. As a result, the Dutch tax base can be significantly reduced.

On the basis of the new provision, interest at the level of acquiring company is only deductible from the profits of the fiscal unity to the extent the profits of the fiscal unity are not attributable to the target company. Assume that the interest expense on the loan to finance the acquisition of the target company is EUR 10 million. Furthermore, the profits of the fiscal unity (before deducting interest) are EUR 15 million. The full amount of that profit is attributable to the target company; the acquiring company does not have its own profits. As a result of the new provision, the interest is not deductible. If, instead, the profits of the fiscal unity (before the interest deduction) are EUR 20 million, EUR 8 million of which is attributable to the acquiring company (because the acquiring company has its own taxable income out of passive investments), the interest costs are deductible up to an amount of EUR 8 million.

There is a de minimis exemption: to the extent that the interest on acquisition loans does not exceed the acquiring companies' own profits by more than EUR 1 million, Article 15ad of the CITA will not be applicable. The purpose of this exemption is to remove small and medium-sized enterprises from the scope of application of the provision.

If the interest on the acquisition loans is higher than the taxpayer's own profits and the *de minimis* exemption does not "save" the interest deduction, the interest will still be deductible if the "60% exemption" is applicable: to the extent the acquisition loan is less than 60% of the acquisition cost, the interest deduction limitation of Article 15ad of the CITA does not apply. The "60%" – being the "acceptable" amount of debt – will be lowered by 5 percentage points each year after the acquisition reaching 25% seven years after the acquisition.

Restriction on Interest Deductibility paid by Holding companies (Article 13l CIT)

On 4 June 2012, the Dutch State Secretary for Finance presented the Lower House with draft legislation that will restrict the deductibility of interest related to participations. The aimed date of entrance into force is intended to be 1 January 2013. The draft article 13L of the Dutch Corporate Income Tax Act (CITA) aims to curb the deduction of "excessive interest expenses" on loans used to finance participations (deelnemingen) in subsidiaries.

Article 13l, Paragraph 1 states that the provision covers interest expenses in excess of EUR 1 million on loans related to participations the parent company has. Interest expenses of EUR 1 million or lower fall outside the scope of the article (i.e. a safe harbour rule).

Article 13l, Paragraph 7 determines that any income and deductions that are attributable to a foreign permanent establishment for which the recently introduced object exemption applies are also outside the scope of the article.

Article 13l, Paragraph 2 sets out the method used to calculate the non-deductible (or excessive) interest. The excessive portion of the interest is defined as the part of the interest expenses that is proportional to the ratio of "participation debts" to total debts. Participation debt is defined as the amount by which the purchase price of the participations exceeds the parent company's equity. An example to clarify:
Assume that (in EUR millions):

- the purchase price of the participation is 80;
- the parent company's equity is 50;
- the parent company's total debt liability is 90;
- the parent's profits (pre-interest deduction) are 50; and

- the total interest expenses are 60.

Under the current rules, the taxable amount would be 50 (profits) -/- 60 (interest) = -10, i.e. a loss.

Under the proposed Article 13l, the profit calculation would proceed as follows:

The participation debt is equal to 80 (the purchase price) -/- 50 (the parent's equity) = 30.

The interest over this 30 is not deductible. The interest attributable to the participation debt is calculated in the following manner:

Total interest expenses x (participation debt/total debt)

Using the numbers in the example, 20 (60 x (30/90)) of the total interest is excessive. Once the threshold of 1 is subtracted, this leaves 19 of non-deductible interest expenses. Of the total interest expenses, 41 (60 -/- 19) is fully deductible.

Under the proposed regime, the taxable amount would, therefore, be 50 (profits) -/- 41 (interest) = 9.

Article 13l, Paragraph 5 ensures that loans used to finance expansions of operational activities of participations fall outside the reach of Article 13l. This is achieved by omitting from the purchase price of the participation, the amount attributable to the expansion. Whether or not there is an expansion of operational activities depends on the facts and circumstances. Production, distribution and sales activities are considered operational activities. Investment activity is not.

Article 13l, Paragraph 6 lists 3 situations in which the exceptions of Article 13l, Paragraph 5 do not apply. Generally, these are situations where a "double dip" (i.e. the same interest expense is deducted twice) is considered to take place, or where a new acquisition by a group is placed as a subsidiary under a profitable Dutch company to take advantage of the interest deduction facility (and no real economic reason for this placement exists).

F. Innovation Box

In order to stimulate R&D activities by Dutch taxpayers, apart from expensing costs related to R&D activities in the year incurred, self-developed registered patents and certain other assets for which a so-called "research and development statement" has been requested (together, "R&D Assets") may be placed in the so-called innovation box. Trademarks are specifically excluded from this beneficial regime. Income generated by way of the R&D Assets will be subject to tax at the statutory rate of 25% until the development costs incurred in respect of such patents have been recouped. Any income received exceeding such development costs will be taxed at an effective rate of 5%. Income includes royalty income such as license fees and other income stemming from R&D Assets. The innovation box regime applies to income received from related parties and unrelated parties. A cap on the innovation box of four times the capitalized development costs of the relevant patents was abolished as per 1 January 2010.

G. Capital Losses

As mentioned above, if the participation exemption applies, a capital loss realized on e.g. the sale of a participation is generally not deductible. There is however one exception - liquidation losses may under certain circumstances be deductible.

H. Tax Rulings

In general, it is possible to obtain advance tax rulings whereby the Dutch revenue confirms, in advance, the tax treatment of a holding company. It is standard tax policy by the Dutch tax administration that the ruling is subject to the condition that the holding company finances its participations with a minimum of 15% of equity. Even when an advance tax ruling is not obtained, it is advisable to observe this (non statutory) debt/equity ratio of 85/15.

I. Dividend Withholding Tax

Distributions of profits in whatever form by Dutch resident entities, including limited liability companies, limited liability partnerships and other entities with a capital divided into shares, are subject to Dutch dividend withholding tax at a statutory rate of 15%. The rate may be reduced under an applicable tax treaty.

Under certain conditions, the dividend withholding tax payable by the distributing Dutch holding company may be reduced by 3% in order to compensate for foreign withholding taxes that cannot be claimed as a credit by the holding company because of the participation exemption.

The Netherlands does not levy a withholding tax on royalties and interest, except with regard to interest paid on a hybrid loan. (See paragraph 6.B.iv, above.)

The income tax treaty between the Netherlands and the U.S. provides, *inter alia*, for a full exemption from the dividend withholding tax if the U.S. parent company owns 80% or more of the Dutch company and certain other requirements are met. If a U.S. parent company owns at least 10% of the shares of a Dutch company, dividends paid to the U.S. parent are subject to a withholding tax of 5%. In all other cases, the dividend withholding tax rate is 15%.

No dividend withholding tax is levied on dividends paid to non-resident corporate shareholders if:

- The corporate shareholder is a tax resident of a country within the E.U or the E.E.A. (with the exclusion of Liechtenstein);
- The Dutch participation exemption would have been applicable to the shareholding in the Dutch entity distributing the dividends if the recipient of the dividends would have been a resident of the Netherlands;
- The corporate shareholder does not fulfill a similar function as a Dutch exempt investment institution or Dutch 0% taxed investment institution; and
- The corporate shareholder is the beneficial owner of the dividends.

Finally, in former years, the dividend withholding tax could be avoided altogether when a Dutch holding company is established in the form of a *cooperative*, because profit distributions by a cooperative are not subject to the dividend withholding tax. In comparison to a corporation, a cooperative is neither a limited liability company/partnership nor an entity with a capital divided into shares.

Consequently, the dividend withholding tax was not imposed. Nonetheless, a cooperative qualifies as an entity under the E.U. Parent/Subsidiary directive and is entitled to an exemption from foreign dividend withholding taxes on incoming dividends for qualifying participations in an E.U. subsidiary.

But, as of 1 January 2012, the use of a *cooperative* is no longer a valid option, because the Dutch Dividend Withholding Tax Act 1965 contains a specific anti-abuse provision to combat the use of such a legal form in order to evade Dutch dividend withholding tax. Article 2, Paragraph 7 Dutch Withholding Tax Act 1965 stipulates that if a *cooperative* directly or indirectly, holds shares, profit rights and certain hybrid loans with the most dominant or one of the most dominant reasons to evade the dividend withholding tax or a foreign tax, while at the same time the participations in the *cooperative* do not belong to an enterprise, the participations in the *cooperative* are deemed to be treated as shares and the levying of the dividend withholding tax is obligatory.

J. Capital Tax / Stamp Duties

The Netherlands does not levy any kind of capital tax, stamp duties or other registration charges in respect of the issuance or transfer of shares in a Dutch resident company, except under certain circumstances a real estate transfer tax ("RETT").

RETT is levied if a purchaser acquires 1/3 or more of the shares of a "real estate company". A company is considered a real estate company if its assets consist or have consisted one year prior to the acquisition of more than 50% of real estate used for passive investment and of at least 30% of Dutch real estate.

RETT (2% for private dwellings or 6% for other real estate) is levied over the fair market value of the real estate located in the Netherlands.

K. Epilogue

All in all it can be said that the Netherlands tax policy concerning holding companies reveals a twofold approach. On the one hand, the Netherlands tries to promote the existence of a favourable tax climate for the establishment of holding companies. On the other hand, the Netherlands Corporate Income Tax Act contains various tax provisions that are aimed at combating excessive interest deductions by holding companies in order to lower the taxable base in the Netherlands.

It should be kept in mind that while there are detailed substance requirements for service entities (flow through entities) in the Netherlands, such substance requirements are almost absent as far as holding companies are concerned.