

Bill on withholding obligation holding cooperative and expansion of withholding exemption

We previously informed you about the proposed changes to remove the difference in treatment between profit distributions by holding cooperatives (in principle not subject to dividend withholding tax) and private limited liability companies (BVs)/public limited companies (NVs) (in principle subject to tax). These changes are not limited to distributions by cooperatives: the withholding exemption in participation situations has also been amended.

More background to this can be found in [our memoranda of September 20, 2016](#), [December 19, 2016](#) and [May 17, 2017](#). On Budget Day (September 19, 2017) the bill on the 'Withholding obligation for holding cooperatives and expansion of the withholding exemption Act' (hereinafter: the bill) was presented to the Lower House. The bill is broadly in line with the draft bill that was opened for public consultation on May 16, 2017. The intention is to have the Act take effect on January 1, 2018.

General

The Cabinet points out that the cooperative is increasingly being used in international structures and proposes eliminating the difference between BVs/NVs and holding cooperatives, partly in light of the State aid risk. The basic assumption here is that within the EU/EEA and in treaty situations no dividend withholding tax should be levied in participation structures. Tax restrictions within a business structure should be avoided as much as possible. This is subject to the precondition that real cooperative businesses are not affected. According to the Explanatory Notes, these measures are in line with the strategy of the Netherlands to, on the one hand, take a proactive approach on international tax avoidance and, on the other, retain an attractive tax and business climate.

Main features of the bill

The bill contains three key elements: the expansion of the withholding obligation for qualifying interests in holding cooperatives, the extension of the withholding exemption to third countries and bringing the current national anti-abuse provisions in line with EU law and treaty anti-abuse provisions. Each of these elements is discussed below.

Expansion of withholding obligation

In principle, dividend withholding tax will also be levied on holding cooperatives, but only if they have qualifying membership rights, i.e. membership rights that grant an entitlement to at least 5% of the annual profit or to at least 5% of the liquidation dividends. In assessing whether there is a qualifying membership right, the membership rights of a member and the individuals and entities related to that member will be taken into account. If, for example, there are two members in a holding cooperative, one of which has a 1% interest and the other a 99% interest, then the withholding obligation does not, in principle, apply to the member with the 1% interest. This is however different if both members form a cooperating group. In that case, the

withholding obligation will apply to both members. A cooperating group is present when portfolio interests are bundled together in a coordinated manner.

A holding cooperative is defined as a cooperative whose actual activity in the preceding year generally consisted primarily (i.e. for 70% or more) of the holding of participations or the direct or indirect financing of related entities or individuals. The Explanatory Notes state that a top holding company with more than 70% of participations on its balance sheet, but which actively holds these participations, employs staff and performs other head office functions will not be regarded as a holding cooperative. It is also pointed out that in certain circumstances it is conceivable that a cooperative used in a private equity structure where the total assets on the balance sheet consist for more than 70% of participations, is nevertheless not regarded as a holding cooperative due to other factors, such as number of employees, office space and the active involvement in the business of the participations.

Extension of withholding exemption

Dutch treaty policy aims at agreeing an exemption for participation dividends in the source country. However, the Netherlands does not always realize this aim. That is why the bill extends the withholding exemption to third countries. This extension only applies if the beneficiary to the income is established in a state with which the Netherlands has concluded a tax treaty with a dividend provision.

The bill also includes anti-abuse rules. These are in line with the general anti-abuse provision in the EU Parent-Subsidiary Directive and the principal purpose test (PPT) in Action 6 of the BEPS project. There is abuse if – in short – the shares in the company or holding company established in the Netherlands are held for the principal purpose of, or one of whose principal purposes is avoiding dividend withholding tax being levied on another party (subjective test) and in addition to this there is an artificial structure or transaction (objective test).

In performing the subjective test, at the time the distribution is made it will be assessed whether *less* dividend withholding tax is payable by the taxpayer (the entity entitled to the income from shares of membership rights) than would be payable by the underlying participant(s) had they directly held the shares, membership rights, etc. (the 'disregard principle'; *wegdenkgedachte*). If that is not the case, then there will be no avoidance of dividend withholding tax at another party.

In the case of the objective test, the assessment establishes whether there is an artificial structure or transaction. That is the case where a structure is *not* set up on the basis of valid commercial reasons that reflect economic reality. Valid commercial reasons are present, for example, if the entity holding the interest carries on a substantive business and the interest in the Dutch company is a functional part of the business assets of that entity, but also where the shareholder fulfills a linking function and has relevant substance. There is relevant substance if the intermediate holding

company in the country where it is established cumulatively meets a number of conditions. In addition to all the known substance requirements that took effect on January 1, 2016, the following two new conditions are proposed: firstly, a payroll expense criterion of at least EUR 100,000 (whereby this amount must be a fee for the linking function activities) must also be met and, secondly, during a period of at least 24 months the company must have its own office equipped with the usual facilities for performing holding activities. The two new requirements will only apply as of April 1, 2018.

If the interest in the Dutch company is held by a hybrid entity, then specific provisions will apply for the purposes of the withholding exemption. If, for example, the shareholder is *non-transparent* according to Dutch standards, but transparent according to foreign standards (and thus not subject to tax there), then the underlying participants can apply the withholding exemption in proportion to their interest in the hybrid entity (provided they would all individually qualify for the withholding exemption if they held their interest in the Dutch company directly). It is also possible that the hybrid entity holding the interest in the Dutch company is *transparent* according to Dutch standards (e.g. a closed limited partnership; CV), but non-transparent according to the standards of the country where the participants in the hybrid entity are established (which means that the participants are not themselves subject to tax there). In such a situation, the participants are not regarded as the beneficiaries to the income for the purposes of the exemption. Under certain circumstances, recourse could be made to a treaty. In practice, this will be of particular importance to CV-BV structures in relation to the United States. For the purposes of the exemption, the hybrid entity is deemed to be the beneficiary to the income if the hybrid entity is regarded as the beneficiary to the income in its state of residence; in that case the withholding exemption can be applied if the entity complies with all the conditions.

Amendment of anti-abuse provisions

The bill brings the current national anti-abuse provisions in line with EU law and treaty anti-abuse provisions. The foreign substantial interest rules in corporate income tax will in future only apply if the taxpayer holds the substantial interest for the primary purpose of, or one of the primary purposes being the avoidance of *personal income tax* at another party (the avoidance of dividend withholding tax is, after all, countered in the Dividend Withholding Tax Act 1965. In those cases, both the regular benefits and the capital gains will be part of the taxable base. Because the income definition for the substantial interest that appears in the Personal Income Tax Act is used, the deduction of costs is possible. Tax is levied at the corporate income tax rate (20%-25%). Any withheld dividend withholding tax can be deducted.

Effective date

The intention is to have the Act take effect on January 1, 2018.

Conclusion and comments

Many cooperatives that currently do not have to withhold dividend tax will have to do so as of January 1, 2018 if their actual activity primarily consists of the holding of participations or the financing of related entities. Unfortunately neither the Act nor the Explanatory Notes provide clear, practical guidelines to assess this. The proposals are expected to have a significant impact on the use of cooperatives in international structures and on investment structures in which companies established in the EU/EEA invest in Dutch companies. The new provision on hybrid entities is currently not expected to have a negative impact on existing CV-BV structures in relation to the United States.

A positive aspect is that a withholding exemption for business structures will, in principle, be included in treaty situations, both for companies with share capital and holding cooperatives.

Please feel free to contact your regular contact at Meijburg & Co if you have any questions or comments.

Meijburg & Co
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