KPMG Meijburg & Co Tax & Legal

Internet consultation on Qualification Policy for Legal Forms Act

The end of the open limited partnership and major implications for mutual funds

Introduction

On Monday, March 29, 2021 an internet consultation was launched on the proposal for a Tax Qualification Policy for Legal Forms Amendment Act. This Act is intended to qualify certain legal forms differently as of January 1, 2022 than was previously the case. This is because the current qualification policy often causes international mismatches.

However, as a result of the proposed changes, purely domestic situations in which there are no mismatches will also be affected. This is particularly the case with open limited partnerships (*open commanditaire vennootschappen*) and mutual funds (*fondsen voor gemene rekening*). As of January 1, 2022 open limited partnerships will, by definition, be transparent. Whether mutual funds will be open or closed under the new rules, depends on the new legal criteria that will then apply. This may, for example, have implications for existing investment structures in which a fund has the status of fiscal investment institution (*fiscale beleggingsinstelling*; FBI) or structures that were set up in connection with the coming into effect of the UBO register or in order to invest Box 3 investment capital in Box 2. The consultation proposal thus has a broad impact, with potentially far-reaching consequences.

If a legal form is qualified differently, this will in principle result in tax claims having to be settled. However, transitional rules offer opportunities for avoiding the settlement of these claims. Sometimes a restructuring is then required, which must take place in 2021. This may mean that there is little time left if the final bill is announced later this year, while the commencement date remains unchanged.

In this memorandum we discuss the main features of the consultation proposal. Of course, we hope that the consultation will lead to changes to this proposal.

Current qualification of (foreign) legal forms

For the purposes of Dutch tax, the qualification of foreign legal forms currently takes place on the basis of criteria laid down in case law and on the basis of the legal form comparison method laid down in a qualification decree. Under this method, certain civil-law features of a foreign legal form are compared to those of existing Dutch legal forms. The particular foreign legal form is then, in principle, treated in the same way as the comparable Dutch legal form.

For certain legal forms, in particular limited partnerships, current Dutch qualification policy differs from that of other countries, which means that mismatches in taxation may arise. That is undesirable. It has been proposed to, in principle, retain the current Dutch qualification method for foreign legal forms, which is based on the legal form comparison method, but with the following comments:

1. In future, all limited partnerships will be transparent. The open limited partnership will be removed from the Corporate Income Tax Act and the Dividend Withholding Tax Act.
2. The consent requirements will be canceled for the mutual fund, while at the same time a new legal criterion will be introduced, which means that significantly fewer mutual funds will qualify as corporate income taxpayers for Dutch purposes.
3. Two additional qualification methods will be introduced for foreign legal forms for which there is no comparable Dutch legal form.

Limited partnership

Under the draft bill, the qualification of open limited partnership will cease to exist as of January 1, 2022. Each limited partnership will, in future, be regarded as tax-transparent (not independently taxable for corporate income tax purposes and no withholding obligation for dividend withholding tax purposes). This change will also affect foreign 'limited partnership-like' legal forms.

In future, all the partners of an open limited partnership – both general and limited – will be taxed directly on their share in the limited partnership. This is already the case for general partners, but not for limited partners.

In this context, the proposed transitional rules will regulate (by fiction) that at the time immediately before an open limited partnership's taxpayer status ends, it will be deemed to have transferred all its assets to its limited partners at their fair market value. At the same time, the open limited partnership will be deemed to have stopped receiving taxable profit in the Netherlands. These fictions will result in a final settlement of the tax claim on the untaxed gains and reserves, tax reserves and goodwill. It is unclear whether making an open limited partnership transparent will also result in a liquidation for the purposes of dividend withholding tax.

Because the ratio of limited partners to limited partnership will change after the open limited partnership becomes transparent, a final settlement of the tax claim is also provided for at the level of the limited partners. A limited partner is deemed to have disposed of their share in (and receivables from) the limited partnership at fair market

value at the time immediately before the corporate income taxpayer status of that limited partnership ends.

However, the basic principle of the proposal is to as much as possible prevent taxation as a result of the ending of the corporate income taxpayer status of the open limited partnership. To achieve this, the proposed transitional rules provide for four tax facilities:

1. *Rollover facility*: the tax claims on all the untaxed gains and reserves, tax reserves and goodwill present in the business of the open limited partnership are taken over by the limited partners, so that the limited partnership does not have to settle the tax claims on the aforementioned deemed capital gain and a final settlement of the tax claim is not necessary. This facility is only available under certain conditions. For example, all the limited partners must be subject to a profit tax for entities, and both the open limited partnership and the limited partners must also be established/resident in the Netherlands, an EU Member State or an EEA Member State.
2. *Share merger:* a limited partner may contribute their share in the limited partnership to a new holding company (established in the Netherlands, an EU Member State or an EEA Member State) in exchange for new shares in that company. The capital gain realized in this respect may – again subject to conditions – be rolled over to the newly issued shares in the holding company. With regard to this rollover, the limited partner must in any case state the shares acquired in the holding company at the same value as their share in the open limited partnership.
   This facility is particularly important if the rollover facility under 1 above cannot be used because, for example, not all the limited partners are subject to a profit tax for entities. After all, by making use of the share merger facility, the rollover facility under 1 can still be used – albeit in two steps – provided the other conditions are also met. The share merger has retroactive effect to January 1, 2022.
3. *Payment in installments over 10 years:* in the situation that the aforementioned facilities cannot be (or are not) used, it will be possible to pay the resulting tax debt without interest over a 10-year period in 10 equal installments (provided sufficient security is given).
4. *Rollover facility for situations of making assets available*: in the situation that a limited partner, as substantial interest holder, makes assets available to an open limited partnership and this partner does not make use of the share merger, the period for which the assets are made available will end on the date on which the open limited partnership is no longer regarded as a corporate

income taxpayer. This will, in principle, result in a tax claim. It has been proposed to make it possible, upon request and subject to conditions, for this tax claim to (also) be rolled over by means of a specific rollover facility.

Mutual fund

As with the limited partnership, two tax variants are possible for a mutual fund: an open mutual fund (non-transparent, subject to corporate income tax) and a closed mutual fund (transparent, not independently taxable). Since, according to the consultation document, surveys have shown that in practice the current two variants of the mutual fund are both needed, it has been proposed to keep both variants, unlike with the limited partnership. However, the legal definition will be amended, as a result of which the classification of a fund as 'open' or 'closed' may change. The draft bill proposes regarding a mutual fund as open if there is a mutual fund that, in exchange for participation certificates, raises capital for collective investment, and whereby:

a. the participation certificates are traded on a regulated market as referred to in Section 1:1 of the Financial Supervision Act or a comparable trading platform; or
b. the mutual fund is obliged to, at the request of the shareholders, regularly redeem or repay the participation certificates out of the mutual fund's assets.

Exception for family funds
Under the draft bill, a mutual fund that is used to manage assets for a group of family members and relatives (family fund) is, by definition, no longer eligible for independent taxpayer status. In short, there is a family fund if the persons entitled to a share in the profit actually only transfer their participation certificates within the limited circle of family members and relatives. Therefore, family open mutual funds and their participants will, in certain circumstances, have to settle a final tax claim unless the structure is changed.

Other (foreign) legal forms: two additional methods

For foreign legal forms that are comparable to a Dutch legal form, nothing will change compared to the current situation, provided that foreign entities that are comparable to a Dutch limited partnership become transparent for Dutch purposes, just like a limited partnership. The legal form comparison method does not offer a solution for certain legal forms. This concerns situations in which there is no comparable Dutch legal form. To adequately overcome these situations, the government has proposed two additional qualification methods: the symmetrical and the fixed method.

The symmetrical method
The symmetrical or "follow method" is applied to entities for which there is no Dutch equivalent and which are subject to a profit tax in the State of incorporation. This method is used in situations where:

(i) such an entity receives income from a Dutch source;
(ii) a Dutch corporate taxpayer has an interest in such an entity.

The Netherlands then, for corporate income tax purposes, follows the tax classification of the State of incorporation of the foreign entity. If that entity receives income from a Dutch source, the entity is regarded as a foreign taxpayer. If a Dutch taxpayer has an interest in that entity, the entity is considered non-transparent and the participation exemption can apply under certain conditions.

The fixed method
The fixed method offers a solution for the situation in which an entity incorporated under foreign law for which there is no comparable Dutch legal form is established in the Netherlands. For these cases, the fixed method prescribes that this entity must always be regarded as a domestic taxpayer for corporate income tax purposes.

The explanatory notes to the draft bill include several examples of entities incorporated under foreign law with a legal form for which no Dutch equivalent is available. These are the limited liability partnership (LLP), incorporated under the laws of the United Kingdom, the unlimited company (ULC), incorporated under Irish law, and the Kommanditgesellschaft auf Aktien (KGaA), incorporated under German law.

Dividend withholding tax and withholding tax on interest and royalty payments

It has been proposed to also bring dividend withholding tax and withholding tax on interest and royalty payments in line with the intention to stop using the open limited partnership qualification. Specifically, this means that for the purposes of dividend withholding tax and withholding tax on interest and royalties the open limited partnership will cease to be a withholding agent. Consequently, the open limited partnership will no longer be a withholding agent for these taxes with regard to outgoing dividends, interest and/or royalties. The proposal does not explain whether there must be a final settlement of the dividend withholding tax claim.

Relationship with the consultation proposal on reverse hybrid entities

On March 4, 2021 the consultation document on the taxpayer status measure for reverse hybrid entities (ATAD2) was published. It proposes making entities that are transparent according to Dutch standards but which are regarded as non-transparent outside the Netherlands by at least 50% of those holding the profit or equity rights or at least 50% of those holding the voting rights (the reverse hybrid entities), subject to corporate income tax in the Netherlands. This change primarily relates to private limited liability/limited partnership (BV/CV) structures.

As of January 1, 2022 such a reverse hybrid entity will be subject to corporate income tax. A limited partnership that will be regarded as a reverse hybrid entity and an open limited partnership have many similarities, but would still have several points of difference. The consultation proposal on the Qualification Policy of Legal Forms Act will have resolved in one fell swoop any questions this could raise if the open limited partnership is simultaneously removed from the Corporate Income Tax Act.

Meijburg & Co comments

The consultation proposal ensures that there are fewer qualification differences in an international context. That is a good thing, because it means that the anti-abuse measures for combating the implications of these mismatches will also apply less often. It does not alter the fact that qualification differences may persist. Care is thus required. It remains to be seen whether the aim of the draft bill to "simplify things" will actually be realized.

Mismatches do not arise in purely national situations, but the proposal could still have a major impact on existing structures, irrespective of whether that structure is tax-driven. The proposal combats several structures the government considers undesirable. For example, open limited partnerships and open mutual funds that were set up by director-major shareholders and their families in connection with the coming into effect of the UBO register or in order to invest in Box 2 (exempt investment funds or not). In these situations one is forced to make use of other legal forms and to restructure in order to avoid having to settle the tax claims.

We expect that the proposal will be amended. On various points the text of the Act is not yet in line with the intention as it appears from the explanatory notes. Closed mutual funds (asset pooling), for example, sometimes unintentionally seem to become subject to corporate income tax. The relationship to other anti-mismatch measures is also unclear on several points. Lastly, the transitional rules are confined to open limited partnerships. No transitional rules have (yet) been included for mutual funds and also no

attention has (yet) been paid to real estate transfer tax. Real estate funds that have to change their structure may therefore be confronted with real estate transfer tax.

KPMG Meijburg & Co

March 31, 2021