KPMG Meijburg & Co Tax Lawyers

Internet consultation on bill amending the liquidation and cessation loss rules for corporate income tax purposes

Lower House MPs Snels (Groen Links), Leijten (SP) and Nijboer (PvdA) intend to submit a private members' bill amending the liquidation and cessation loss rules in the Corporate Income Tax Act 1969. On April 16, 2019 an internet consultation was opened on this, giving interested parties the opportunity to respond to the consultation document comprising the draft bill and a draft Explanatory Memorandum. The draft bill is aimed at preventing misuse of the liquidation and cessation loss rules and at expanding the tax base.

The liquidation and cessation loss rules

Benefits from a participation (in short: an interest of at least 5%) are, in principle, exempt. This means that dividends and capital gains are not taxed. The downside is that losses are non-deductible. An exception to this basic assumption is made for liquidation losses. Under certain conditions, these losses can be deducted. This prevents losses from effectively not being able to be taken into account anywhere.

The same mechanism applies to benefits derived from a foreign permanent establishment. In principle, an exemption (for both profits and losses) applies, but cessation losses may be deducted under certain conditions.

The bill opened for consultation

Under the draft bill, a liquidation loss on a participation will only be deductible if:

a. the participation is established in the Netherlands or in another EU/EEA state (territorial limitation); and
b. the Dutch taxpayer holds a qualifying interest in the subsidiary (material limitation).

Additional conditions for deducting the liquidation loss also apply. For example, the loss must be attributable to the period in which the conditions under a) and b) were met. Also of importance is that the draft bill discourages lengthy deferrals of the moment when the liquidation loss can be recognized for tax purposes (temporal limitation, see below).

There is a qualifying interest if the parent company is a shareholder of more than one-fourth of the nominal paid-in capital and/or the taxpayer convincingly demonstrates that as a parent company it can determine the activities of the subsidiary due to the influence it exercises on decision-making.

The limitations of a) and b) have been proposed in order to limit the liquidation loss rules to cases covered by the EU/EEA freedom of establishment.

The temporal limitation has been proposed because, according to the initiators, the rules are being misused by deferring the deduction to any desired moment. That is currently possible by deferring the completion of the settlement of the assets of the subsidiary. It has therefore been proposed to only take the liquidation loss into account if the settlement of the assets of the liquidated entity is ultimately settled in – in short – the third calendar year following the calendar year in which the subsidiary's business ceased operations or the calendar year in which a decision thereto was taken. An exception applies if the taxpayer convincingly demonstrates that the decision to complete the settlement at a later date was business-motivated.

The draft bill contains an efficiency threshold of EUR 1 million: the limitation to participations established in the Netherlands or in the EU/EEA in which the taxpayer holds a qualifying interest, will only apply insofar as the liquidation loss exceeds EUR 1 million. A liquidation loss incurred on a non-qualifying interest is thus deductible up to a maximum of EUR 1 million per participation.

The draft bill also contains a measure combating misuse of the liquidation loss rules through the use of intermediate holding companies, for example where the liquidation loss is attributable to a participation in a sub-subsidiary that has since been liquidated in which the taxpayer did not hold a qualifying interest, or that was established in a third country.

As additional measure, similar amendments have been proposed for the corporate income tax cessation loss rules. Under the draft bill, it will only be possible to deduct cessation losses incurred on:

(1) permanent establishments in the EU/EEA;
(2) immovable property in certain treaty countries that is held as an investment;
(3) a co-entitlement to the assets of a business (for example, interests as a limited partner in a closed limited partnership (*besloten commanditaire vennootschap*), or interests as a limited partner in a limited partnership) in certain treaty countries that is held as an investment.

The investments in third countries referred to under 2 and 3 have been proposed to avoid a potential conflict with the free movement of capital. An efficiency threshold of EUR 1 million has also been proposed here.

Draft transitional rules
The initiators of the bill intend to have it take effect as of January 1, 2021, provided that the temporal limitation applies for the first time to the liquidation losses of companies whose business ceased operations or virtually ceased operations on or after January 1, 2021 or a decision thereto was taken on or after that date (and to cessation losses if the activities in the other state ceased on or after January 1, 2021 or the decision thereto was taken on or after that date). It has also been proposed to allow the liquidation loss incurred on participations whose business ceased operations or virtually ceased operations before January 1, 2021, to be taken into account through to December 31, 2023, or even later if it is proven that the decision to take the liquidation loss into account at the later date was business-motivated. Similar transitional rules have been proposed for deferred cessation losses.

The internet consultation
Interested parties have until May 16, 2019 to respond to the consultation document. They are also invited to answer a number of more specific questions about the various options chosen. Another question concerns how the asymmetry of the Dutch participation exemption should be assessed in light of the debate about harmful tax competition.

Meijburg & Co comments
At present, it is difficult to say how much support there is for the draft bill. In response to a recent request, the government had indicated that it was not intending to limit the liquidation loss rules. This does not necessarily mean that the government parties will not support the bill. If the final bill is eventually published in the Government Gazette (*Staatsblad*), it could have a major impact on Dutch businesses with foreign investments. Especially relevant is that interests of 25% or less and interests in third countries would be excluded from the liquidation loss rules and the cessation loss rules as of 2021. At the group level, this measure would trigger more economic double taxation, because, on balance, more profit would be taxed than is realized by the group as a whole.

We will, of course, keep you informed of developments. Please feel free to contact your Meijburg & Co advisor if you have any questions or would like to discuss the above matters.

Meijburg & Co
April 2019