

## **Building Blocks for a Better Tax System**

### **Introduction**

On May 18, 2020 the 'Building Blocks for a Better Tax System' package was published. This package of reports is the result of an initiative by the previous Deputy Minister of Finance, Menno Snel. In September 2018 he had promised to send the Lower House of Parliament specific building blocks and proposals for improvements and simplifications to the tax system. Problems would be identified and potential solutions would be offered. The reports, which together contain more than 1000 pages of text, have resulted in 169 detailed policy options on a large number of taxes – options that are, moreover, sometimes diametrically opposed. It concerns policy options proposed by officials at the Ministry of Finance, which can be used by a new government, as the recommendations will not be enacted into bills this year. The detailed policy options will obviously become part of the various election manifestos and will play a significant role in the formation of a new government after the national election in 2021.

Although this is therefore all still in the future, it is nevertheless worthwhile examining the proposed policy options. Based on this, steps can be taken, where possible, to anticipate any changes that may take place in the near future. This is particularly important with regard to policy options containing proposals for tightening or even abolishing existing concessions, certainly if these are options that can expect to receive widespread support in Parliament.

We have decided not to prepare a full summary of the reports. However, the appendix (only in Dutch) to this memorandum does list the 169 measures as these were presented by the Ministry of Finance. Important matters discussed in the reports are, in particular, the problems with the current Box system in the personal income tax regime, the tax on the transfer of assets (gifts and inheritance), the taxation of corporate profits and the role of tax in health and climate matters. With regard to the taxation of corporate profits, the policy options have adopted all the measures appearing in the report by the Ter Haar Committee that was published on April 15, 2020 (see our [memorandum](#) dated April 15, 2020), even the options on which the committee could not reach consensus.

An important lesson that politicians can learn from the reports is that using tax as an incentive for policy deemed desirable has, by definition, never actually delivered the intended result. However, that does not detract from the fact that the recommendations about climate and health matters nevertheless explore options for managing policy through tax.

In the following sections we will, in particular, briefly address the position of holders of a substantial interest (the Box 2 issue) and the proposals for gift and inheritance tax.

### **Holders of a substantial interest under fire**

An important observation in the reports has already found its way to the media. The current tax system favors holders of a substantial interest. This is mainly related to the regime of Box 2, which some refer to as a 'fun box'. Box 2 would facilitate the hoarding of profit reserves, because taxation only takes place when dividends are distributed or shares sold. The reports note that until now this 'deferral problem' has remained under the radar. That is a remarkable observation, because this point was comprehensively

addressed in 2013 in the report by the Dijkhuizen Committee entitled 'Energizing the Tax System' ('*Naar een activerender belastingstelsel*'). This committee proposed a fixed return arrangement for Box 2; a proposal that, at the time, neither the government nor Parliament acted on. It is also noteworthy that the Building Blocks reports suggest that companies in which substantial interest holders own shares are, by definition, 'savings private limited liability companies' (*spaar-bv's*). That substantial interest holders also have interests in businesses with substance, where it may be important not to distribute dividends but to have sufficient buffers to absorb setbacks (for example, the current COVID-19 crisis), is not acknowledged in the Building Blocks reports. In fact, not distributing dividends is referred to as tax avoidance. In view of the official criticism, it would have been logical to revive the proposal made by the Dijkhuizen Committee in 2013 to introduce a fixed return in Box 2.

Furthermore, it is noted that since 2001 the global balance between businesses that are subject to personal income tax/employees and director-major shareholders who carry on their business in a private limited liability company (*besloten vennootschap met beperkte aansprakelijkheid*; 'BV') has been distorted. The tax burden on carrying on a business in a BV is disrupted in terms of tax rates by the substantial reductions in the corporate income tax rate. No mention is made of the fact that the reduction of the corporate income tax rate has, in many cases, been financed by a broadening of that same corporate income tax base. Comparing the effective tax burden rather than the statutory rates may produce a more nuanced picture.

A number of measures are proposed that should lead to a change in the tax behavior of holders of a substantial interest:

- raising the amount of the normative salary;
- abolishing the step-up corporate income tax rate;
- increasing the Box 2 rate to 30% or even to 35%, possibly in combination with a step-up rate;
- limiting the opportunities for borrowing from the own BV. There is already a draft bill for this, but its presentation has been delayed due to the COVID-19 crisis. The Building Blocks reports envisage a further tightening of this bill, including a lowering of the permitted borrowing capacity and limiting the opportunity to finance the owner-occupied home with a loan from the company;
- curtailing the tax relief for the transfer of a substantial interest by means of inheritance and gifts. Curtailment could involve automatically regarding rented out property as an investment;
- even completely abolishing the tax relief for the transfer of a substantial interest is being regarded as an option. However, a broader (interest-bearing) deferral of payment arrangement could then be considered.

## **Gift and inheritance tax**

Radical policy options have also been put forward with regard to gift and inheritance tax.

### *The business succession scheme*

The Building Blocks reports claim that the current business succession scheme (*bedrijfsopvolgingsregeling*; BOR) is too generous. Since 2010 the first EUR 1 million of the going concern value of the operating assets is exempt. Of the excess, 83% is exempt. A recent internal investigation by the Dutch tax authorities shows that in 75% of the estates surveyed in 2017 there were sufficient freed up resources to be able to pay inheritance tax, even without the BOR. It is also noted that it is difficult to make a distinction between investment assets and operating assets and that the BOR particularly favors very large capital.

One policy option put forward is to reduce the exemption for the going concern value to 25%. The amount of the exemption would thereby be capped at EUR 5 million operating assets. A 10-year deferral of payment pursuant to the Tax Collection Act should, however, still remain possible. Like the tax relief for the transfer of a substantial interest in Box 2, it is proposed to automatically regard rented out property as an investment. Another proposal is to exclude 'small' substantial interest parcels that are held as class shares, options and profit-sharing certificates from the BOR.

### *Inheritance tax rate*

It has been proposed to spare small inheritances, while taxing large inheritances more heavily. This would occur by granting each heir a EUR 30,000 exemption. The threshold for the increased rate would be reduced to EUR 100,000 in combination with a third bracket from EUR 300,000, with a tax burden that is 10 percentage points higher than is now the case. The result in the highest bracket would then be rates of 30% for partners and children, 46% for grandchildren and 50% in other cases. In order to limit the impact on partners, the partner exemption would be increased to EUR 900,000 in this option.

### *Aligning the rates for children and grandchildren*

The last option mentioned is aligning the gift and inheritance tax rates for children and grandchildren. This means that it will no longer be less attractive for a testator to leave a legacy to grandchildren than to children.

## **Final remarks**

As noted, the Building Blocks for a Better Tax System contains official policy options. The ball is now in the politician's court. We expect the policy options to play a major role in the election manifestos and in the next coalition negotiations. We expect that, in particular, the tightening of the tax relief for the transfer of a substantial interest in Box 2 and the BOR in the gift and inheritance tax regime will then be placed on the political agenda. As such, it may be worthwhile to already start looking critically at existing positions to see whether steps can or must be taken in anticipation of potentially

tightened measures. We would of course be pleased to help you with this and will keep you up-to-date on further developments.

Meijburg & Co  
May 20, 2020

*The information contained in this memorandum is of a general nature and does not address the specific circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.*