

Internet consultation on taxpayer status measure for reverse hybrid entities

On March 4, 2021 the Deputy Minister of Finance launched, among other things, a [public internet consultation](#) on the taxpayer status measure for 'reverse hybrid entities' (also known as the 'reverse hybrid rule') and several related accompanying measures including for the purposes of dividend withholding tax and the withholding tax on interest and royalty payments. This draft bill is addressed below.

Background

As of January 1, 2020 several measures took effect in the Corporate Income Tax Act 1969, which serve to combat tax avoidance by using differences between tax systems ('hybrid mismatches'). These hybrid mismatch measures (largely) had to be implemented as a result of the Second EU Anti-Tax Avoidance Directive (ATAD2). In implementing these measures the Netherlands made use of the option to have the tax status measure for reverse hybrid entities only take effect as of January 1, 2022, so that it could be examined whether further accompanying measures are necessary. During the parliamentary debates on the implementing legislation, the government indicated that it would include the additional measures in a separate bill in 2021. A draft of this bill has now been opened for public consultation.

Please note that the sections of the law that were to regulate the taxpayer status for reverse hybrid entities as of January 1, 2022, which had been published in the Government Gazette (*Staatsblad*) in 2019 but had not yet taken effect, will be canceled according to the draft proposal. This also applies to the explanatory notes on those previous sections of the law.

Reverse hybrid entities

Under the draft bill, a reverse hybrid entity is a partnership entered into under Dutch law or established in the Netherlands that is not regarded as an independent taxpayer for Dutch tax purposes ('transparent') and of which directly or indirectly at least 50% of the voting rights, equity interests or profit rights are held by an entity affiliated to that partnership, which is established in a state that regards the entity as an independent taxpayer ('non-transparent').

Therefore, there can only be a reverse hybrid entity if an affiliated entity as such holds at least 50% of the voting rights, equity interests or profit rights in a partnership. Furthermore, it follows from the definition – and the explanatory notes – that (affiliated) natural persons cannot be a reason for the qualification 'reverse hybrid entity'.

If a partnership is entered into under Dutch law it will – provided the other conditions are also met – automatically be regarded as a reverse hybrid entity. Partnerships entered into under Dutch law include, for example, professional partnerships

(*maatschappen*), general partnerships (*vennootschappen onder firma*) and limited partnerships (*commanditaire vennootschappen*).

Taxpayer status measure

As already implied by the term ‘taxpayer status measure’, it is proposed that reverse hybrid entities become fully resident taxpayers for corporate income tax purposes. This means, among other things, that reverse hybrid entities will be regarded as carrying on a business with their entire equity and that they will be regarded as a treaty resident of the Netherlands (which means they are, in principle, also entitled to treaty benefits).

To avoid double taxation, it is proposed that insofar as the profit of a reverse hybrid entity is directly allocable to holders of profit rights resident or established in a state that regards that entity as transparent, that profit share may be deducted from the profit. Therefore, a reverse hybrid entity will effectively only be subject to corporate income tax insofar as there is a qualification difference. Because the Netherlands – after application of the proposed measures – is a state that regards the reverse hybrid entity as a taxpayer, the share of the profit of the reverse hybrid entity that is allocable to the Dutch participants, is non-deductible for the purposes of determining the profit of the reverse hybrid entity.

The beginning and the end of the taxpayer status of a reverse hybrid entity will be treated in the same way as the beginning and the end of the taxpayer status of other corporate income taxpayers. For example, preparing an opening balance sheet when the entity becomes subject to tax and a final settlement when its taxpayer status ends.

Exception

The taxpayer status measure does not apply to designated undertakings for collective investment in transferable securities (UCITS) and alternative investment institutions, provided they invest in securities and there is a diversified portfolio.

Dividend withholding tax

To ensure that distributions by a reverse hybrid entity can be subject to Dutch dividend withholding tax, the draft bill contains several (definition) changes to the Dividend Withholding Tax Act 1965 and the General Taxes Act (GTA) (see below). In addition, it is proposed that reverse hybrid entities become withholding agents for dividend tax purposes.

According to the consultation document, dividend withholding tax is levied on income beneficiaries who are resident or established in a state that regards the reverse hybrid entity as non-transparent. Because the Netherlands – after application of the proposed measures – is also a state that regards the reverse hybrid entity as non-transparent,

dividend withholding tax will, in principle, also be levied on the Dutch participants in reverse hybrid entities.

Furthermore, it is proposed that, for the purposes of dividend withholding tax, reverse hybrid entities are regarded as full income beneficiaries. This change intends to prevent holders of voting rights, equity interests or profit rights in a reverse hybrid entity from being independently regarded as income beneficiaries in proportion to everyone's participation in that entity. In order to prevent dividend withholding tax subsequently being saved by means of the interposition of a reverse hybrid entity, it is proposed that the dividend withholding tax exemption will not apply insofar as that exemption would not have applied if, without the interposition of the reverse hybrid entity, the underlying beneficiary would have held the interest.

Withholding tax on interest and royalty payments

To ensure that interest and royalty payments made by reverse hybrid entities fall within the scope of the Withholding Tax Act 2021, several (definition) changes to the Withholding Tax Act 2021 and (once again) the GTA are proposed (see below). In addition, it is proposed that reverse hybrid entities become withholding agents for the purposes of the Withholding Tax Act 2021 insofar as the benefit beneficiary is established in a state that regards the reverse hybrid entity as non-transparent.

Also for the Withholding Tax Act 2021 it is proposed that a reverse hybrid entity is regarded as a full benefit beneficiary for the purposes of this withholding tax. This will prevent holders of voting rights, equity interests or profit rights in a reverse hybrid entity from being independently regarded as benefit beneficiaries in proportion to everyone's participation in that entity. In order to prevent withholding tax subsequently being saved by means of the interposition of a reverse hybrid entity, it is proposed that, under certain conditions, a reverse hybrid entity be subject to tax for the purposes of the Withholding Tax Act 2021. This taxpayer status for reverse hybrid entities will apply if and insofar as the interest or royalty payments are allocable to a participant that is established in a state that regards the reverse hybrid entity as transparent and that without the interposition of the reverse hybrid entity would be subject to tax for the purposes of the Withholding Tax Act 2021.

Other changes

It is proposed regulating in the GTA that the interest of a holder of voting rights, equity interests or profit rights in a reverse hybrid entity is regarded as a 'share' for Dutch tax purposes, if this holder resides or is established in a state that regards that entity as non-transparent. Further to this, it is also proposed that, for Dutch tax purposes, a reverse hybrid entity is regarded as a company.

These changes mean, among other things, that natural persons may hold a substantial interest in a reverse hybrid entity, that a participant that is subject to corporate income tax may apply the participation exemption in respect of a reverse hybrid entity and that the non-resident taxpayer status as defined for corporate income tax purposes may apply as a result of an interest held in a reverse hybrid entity.

In conclusion

The internet consultation closes on April 2, 2021. If consent is given, the responses will then be published. After the consultation has closed, the responses will be included in a final bill. After the measure outlined here has taken effect, the Dutch tax system will become even more complex. Arrangements will have to be re-assessed and possibly modified.

Lastly, we would like to point out that the measure discussed here is part of three new measures to combat tax avoidance via mismatches. A public consultation on a bill to combat mismatches when applying the arm's length principle was also launched on March 4, 2021. We refer to our separate memorandum on this. In addition, an internet consultation will also soon be opened on the Dutch qualification policy of (foreign) legal forms. All these measures are expected to be part of the 2021 Tax Plan.

We will, of course, inform you further should developments give cause to do so.

Meijburg & Co
March 5, 2021

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