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Legislative Proposal for Dutch Dividend Withholding Tax Act Amendments

1. Introduction

Yesterday, Sept. 19, 2017 (Budget Day), a legislative proposal was published, recommending to eliminate the difference in dividend withholding tax treatments of (i) Dutch entities with a capital divided into shares (such as BVs and NVs) and (ii) cooperatives.

This legislative proposal is based on a preliminary proposal that was published for consultation purposes earlier this year and previously announced in letters from the Dutch Ministry of Finance to the Dutch Parliament in 2016. See our earlier Alert, [Proposed Changes to Dutch Dividend Withholding Taxation](#).

In this Alert, we will briefly discuss the main aspects of the proposed changes to the Dutch dividend withholding tax rules. The Ministry of Finance aims for the changes to become effective as of Jan. 1, 2018, although they may still be amended in the course of the parliamentary process.

2. Proposal

The proposal is twofold. On one hand, the scope of the exemption from dividend withholding tax for all entities is broadened, as a result of which BVs and NVs, like cooperatives, have an increased chance of being exempt. On the other hand, so-called ‘holding cooperatives,’ that could have been exempt from dividend withholding tax in the past, are now brought into the scope of the Dutch dividend withholding tax rules.

An important change to the preliminary proposal concerns the position of hybrid shareholders/members in a Dutch entity.

2.1 Holding cooperatives

Profit distributions on qualifying membership interests in ‘holding cooperatives’ (i.e., membership rights that entitle the holder thereof to at least 5 percent of the annual profits and/or of the liquidation proceeds) will in principle become subject to Dutch dividend withholding tax.

A holding cooperative is defined as a cooperative whose activities mainly (i.e., for 70 percent or more) consist of holding participations or of group financing activities. The relevant testing period for the 70 percent test is the year preceding the profit distribution. The factual activities are primarily assessed on the basis of the balance sheet totals of the cooperative. However, other factors, such as revenue, types of assets and liabilities, time spent by employees, etc. may also be taken into account.

Cooperatives that do not qualify as holding cooperatives, i.e., cooperatives whose activities consist for more than 30 percent of other activities than holding participations in subsidiaries or directly or indirectly financing related parties, would in principle remain not subject to Dutch dividend withholding tax.

2.2 Dividend withholding tax exemption

The currently existing Dutch dividend withholding tax exemption in respect to profit distributions to shareholders of companies with a capital divided into shares that are resident of the EU/EEA is extended to shareholdings or membership rights held by companies that are (tax) resident of a state with which the Netherlands has concluded a tax treaty including an article covering dividends.

The dividend withholding tax exemption will be subject to anti-abuse rules which are to be interpreted in accordance with Action 6 of the OECD BEPS project. Under the anti-abuse rules provided for in the proposal, the dividend withholding tax exemption is denied if (i) the shareholder/member holds the shareholding/membership interest with the purpose of avoiding Dutch dividend withholding tax due by another individual or entity (the subjective test); and (ii) there is an artificial structure or transaction or a series of artificial arrangements or transactions, which will be the case if there are no valid business reasons reflecting economic reality (the objective test).

For the application of the subjective test it will have to be assessed whether the direct shareholder of the Dutch company/holding cooperative has been interposed between the Dutch company/holding cooperative on one hand, and the shareholder/member of that direct shareholder on the other hand, with the purpose to avoid dividend withholding tax. This would be the case if distributions by the Dutch company/holding cooperative would have been subject to dividend withholding tax had the direct shareholder/member not been interposed. If so, the dividend withholding tax exemption does not apply, unless the shareholder/member qualifies under the objective test.

For the application of the objective test it will have to be assessed whether valid business reasons are present in the substance of the direct shareholder or member. This is for instance the case if the shareholding or membership interest is functionally attributable to a business enterprise carried out by the direct shareholder or member. If the business enterprise is carried out by the indirect shareholder or member, and the direct shareholder or member is a foreign intermediate holding company that does not carry out a business enterprise, valid business reasons will be considered to be present if the foreign intermediate holding company has so-called ‘relevant substance.’ In addition to the current minimum substance requirements, the following conditions would have to be fulfilled: the foreign intermediary holding company would need to have wage costs of at least EUR 100,000 (relating to either own or hired group personnel) and would need to have its own office space available where it carries out its activities.

2.3 Hybrid entities

Pursuant to the input received from the public regarding referenced consultation, the legislative proposal now also addresses the situation wherein an interest in a Dutch entity is held through a hybrid entity that qualifies as non-transparent for Dutch tax purposes and as transparent in its country of residence.

The withholding tax exemption may in such scenario apply, if the hybrid entity is considered to be transparent in the country of residence of the participants and those participants would qualify for the exemption if they would have held the Dutch entity directly. An important example is a dividend received by an LLC formed under the laws of a U.S. state that is transparent for U.S. tax purposes but non-transparent for Dutch tax purposes. Such dividend can benefit from the dividend withholding tax exemption under the amended proposal.

In the reverse scenario (i.e., the scenario in which the hybrid entity is considered to be transparent for Dutch tax purposes and as non-transparent in its participants' country of residence), the hybrid entity – instead of the participants therein – is now considered to be the recipient of the distributed dividends. Accordingly, the withholding tax exemption may apply if the hybrid entity itself qualifies as a tax resident in the EU/EEA or a tax treaty jurisdiction.

We will closely follow further developments in relation to this formal legislative proposal and will keep you up to date on any more definitive changes.

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