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Archive > 2018 > February > 02/22/2018 > News > Netherlands: What's At Stake as Dutch Tax Consolidation Ruling Looms?

Netherlands

What's At Stake as Dutch Tax Consolidation Ruling Looms?

By Linda A. Thompson

A highly anticipated Dutch tax ruling by one of Europe's highest courts is likely to slash the amount of paid interest group companies are allowed to deduct from their tax bills, practitioners say.

Snapshot

- Ruling against tax regime would require tax code overhaul
- Dutch lawmakers expected to restrict interest deductions to group companies

The matter (C-398/16 and C-399/16), set to be decided Feb. 22 at the Court of Justice of the European Union, revolves around the question of whether the combined effect of two tax provisions can constitute an infringement of EU rules on freedom of establishment since only one of the two—the Dutch fiscal unity regime—is open to resident taxpayers.

Under Dutch law, only domestic companies can form a tax consolidation group or fiscal unity, which treats related companies as a single entity for tax purposes.

The joined cases were referred by the Supreme Court of the Netherlands in July 2016 and pit the former Deputy Minister of Finance Eric Wiebes against two unnamed companies.

Advocate General Manuel Campos Sanchez-Bordona's Oct. 25 opinion in the case advised the bloc's highest court to rule that the Dutch legislation is incompatible with EU law. The CJEU follows the opinion of the AG in the majority of cases.

Dutch officials have previously made it clear hundreds of millions of dollars are at stake, and a ruling against them would require a serious rewrite of some the country's corporate tax provisions. Here's a preview of what to expect in the potentially explosive decision:

A Ruling Against the Netherlands:

A ruling against the Netherlands would bring significant work for companies that would have to reverse practices they implemented long before the October ruling.

The Oct. 25 ruling left Dutch lawmakers with two options: expand the benefits of the fiscal unity to group companies in cross-border situations, or rescind the tax benefits currently offered to resident related companies under the fiscal unity regime.

The government immediately announced proactive "urgency repair measures" to cancel the impact of a future ruling. Practitioners say that under those measures, a number of Dutch tax regimes would be applied as if "there were no fiscal unity"— a legislative about-face that could have far-reaching consequences for companies in the Netherlands.

Because of the repair measures Dutch lawmakers have announced, the impact of a

ruling in favor of the companies would be tremendous, said Alexander Bosman, a tax adviser at the Loyens & Loeff law firm. All resident companies who have benefited from or intend to apply the country's fiscal unity regime would be affected, he told Bloomberg Tax.

"This will have adverse effects for Dutch businesses because they will be affected by a bevy of interest limitation deductions that previously did not apply to them because the provisions of the fiscal unity applied," he said Feb. 20. "This is the painful thing about the urgency repair measures: that the Netherlands will also revoke the benefits of the fiscal unity for domestic situations, so this will affect all taxpayers."

The repair measures included an interest deduction limitation aimed at preventing profit skimming and an interest deduction limitation on excessive participation interests.

Since the formation of a fiscal unity will no longer cancel out existing interest limitation deductions under the repair measures, companies will have their homework cut out for them if the ruling goes against the Netherlands.

For every interest deduction that falls under the scope of article 10a of 1969 Law on corporation tax, an interest limitation deduction for certain group loans, "companies will have to prove that economic reasons exist for the loan or transaction, or that there is reasonable taxation according to Dutch standards," said Eric Kemmeren, a professor of international taxation and tax law at Tilburg University and of counsel to the Rotterdam branch of EY Tax Advisers. "All companies that use the fiscal unity will thus face an increased administrative burden," he said.

A Ruling In Favor of the Netherlands:

Everything would remain the same, if the ruling went in favor of the Netherlands, practitioners said.

A ruling against the taxpayers in the two conjoined cases would be a "victory for the Netherlands because the fiscal unity regime could continue to exist in its current form," Bosman said. "It would mean that the fiscal unity regime is compatible with EU law and that the benefits of the fiscal unity regime don't have to be granted in cross-border situations—which is what the Netherlands has always said."

Almost immediately following the Oct. 25 ruling, Wiebes warned in a news release that if the court follows the AG's opinion, the Netherlands stands to lose "some hundreds of millions of euros" in tax revenue in one single year. He also noted that a ruling against the Netherlands would "facilitate erosion of the Dutch tax base by companies that operate internationally."

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EU High Court Issues Death Knell to Popular Dutch Tax Regime

By Linda A. Thompson

Europe's highest court has dealt an irrevocable blow to a tax regime that allowed thousands of Dutch companies to deduct intragroup interest expenses from their taxable profits.

Some of the Dutch tax regime's provisions break European Union rules on freedom of establishment, the Court of Justice of the European Union said in the Feb. 22 decision on two conjoined cases (C-398/16 and C-399/16).

The decision against the Netherlands—which tax practitioners had anticipated—means higher tax bills and major administrative headaches for the thousands of Dutch companies that have formed tax consolidation groups. It will also require a serious rewrite of some the country's corporate tax provisions.

Snapshot

- Ruling brings end of Dutch consolidation regime
- Companies to face higher taxes, more disputes

"Companies are being saddled with a great deal of work and a great deal of uncertainty because they will have to identify all sorts of intragroup transactions and money flows that had never been an issue in the past," Alexander Bosman, a tax adviser at the Loyens & Loeff law firm, told Bloomberg Tax.

A bill introducing measures aimed at stemming the future budgetary impact of the ruling will be sent to the House of Representatives in the second quarter of 2018, according to a Feb. 22 letter from State Secretary for Finance Menno Snel. Those measures, first announced in October 2017, will retroactively activate rules limiting the deductibility of interest payments on transactions between entities in a tax consolidation group that until now didn't apply.

The Regime

The Dutch tax consolidation regime treats a group of related companies as a single entity for corporate income tax purposes. Such tax consolidation groups offer considerable tax benefits, particularly when companies with heavy debts partner up with a related profit-making entity. Under Dutch law, only resident companies can form a tax consolidation group.

Used by companies large and small across all industries, by purely domestic companies and those with extensive international operations, the Dutch tax consolidation regime is a popular one. According to figures from the Dutch Finance Ministry, 300,000 companies were part of a tax consolidation group in 2015—about 40 percent of the 745,000 entities that filed corporate tax returns that year.

Interest Deductions

The crux of the decision is article 10a of the country's corporate income tax code, an interest limitation rule under which companies with a parent or subsidiary entity in another EU member state were previously denied interest deductions. Those companies, like the taxpayers at the center of the cases, will be able to deduct certain interest expenses from their taxable profits after all.

The government said it “regrets” that the court ruled the Dutch scheme regarding the interest deduction conflicts with EU law.

But in the court's view, even though the provision may be formulated neutrally, cross-border companies are at a disadvantage compared to resident companies that can form tax consolidation groups, said Jasper Korving, senior tax manager at Deloitte Netherlands.

“You cannot say that 10a always applies to both cross-border and domestic situations, but because resident companies can form a fiscal unity they aren't confronted with this interest deduction limitation,” he said, adding that the court viewed this as an additional advantage stemming from the fiscal unity that didn't have anything to do with the “essence of the regime.”

About 11,000 companies will be able to invoke the decision to deduct interest paid in the past and reclaim overpaid taxes in the financial years between 2012 and 2017. If all those companies do so, the country's tax coffers could be depleted by 400 million euros ($493 million), the government said in a letter sent to lawmakers in 2017.

Tax Battles to Come?

“In principle, you might have to go back tens of years to examine whether certain loans or transactions fall under the scope of” the 10a interest deduction limitation, Bosman said Feb. 22, adding that this would be an “enormously laborious” task.

Noting that the 10a interest limitation deduction also included exceptions as well as “room for interpretation,” he warned that the decision might result in more disputes with the Dutch tax administration and potential double taxation for corporate taxpayers.

“And it could naturally lead to higher tax debts for companies than under the current rules because the consolidation aspect is being let go of for certain money flows,” he said.

Concessions Coming

“The cabinet regrets that the unique element of the Dutch fiscal unity, the consolidation notion is coming to an end with” Snel said in the Feb. 22 letter following the decision. Any future intragroup arrangement, he added, likely wouldn't include “this unique consolidation element.”

Korving noted that the letter seemed to signal the government's plan to “kill off” the tax consolidation regime, but he also saw some positives. The letter “seems to say that if really good arguments are brought forward, there will still be the possibility to maintain the tax consolidation regime in one way or another,” he said.

The Dutch cabinet is expected to replace the tax consolidation regime with a new group contribution system, but both lawmakers and practitioners said that this new system just wouldn't be the same.

A group relief or group contribution system similar to those existing in other EU countries will be markedly different from the current tax consolidation regime, Bosman said.

“The Dutch fiscal unity is a true tax consolidation system,” Bosman said, pointing out that it makes the Netherlands unique in the EU. A tax consolidation system makes it possible for tax-neutral reorganizations in which activities can be transferred from one group entity to another, or assets and liabilities can be merged without triggering a

tax, he said.

While a tax consolidation regime allows companies to only file one tax return, a group contribution system would require each standalone entity to file its own return. The "group approach" that allows the profits of one entity to be offset from the losses of another is only applied later, Bosman said.

"What we now have is a very broad arrangement, while a group contribution system would represent a much more limited concession," he said.

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For More Information

The CEUJ ruling is at http://curia.europa.eu/juris/document/document.jsf?text=&docid=199570&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=830413

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