

Netherlands: Conditional withholding tax on interest and royalties to low-tax jurisdictions 2021

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Introduction

The Netherlands is about to depart from its tradition that no withholding tax is levied on royalties and interest payments. The background of this change in policy is that the government does no longer wish to facilitate such payments to (permanent establishments of) group entities established in low-tax jurisdictions (statutory rate of less than 9%) or jurisdictions that are mentioned on the EU list of non-cooperative jurisdictions. The government envisages to introduce a conditional interest and royalty withholding tax ("IRWHT") as of January 1, 2021.

Main characteristics

The proposed IRWHT concerns a withholding tax on interest and royalty payments by a Dutch entity (or a Dutch permanent establishment of a foreign entity) to a foreign entity or a permanent establishment in a low-tax jurisdiction, whereby the payer and recipient belong to the same group. The proposed rate is 21.7%, which is the same as the corporate income tax rate proposed for 2021.

1. Interest and royalty payments

The IRWHT is levied on gross interest and royalty payments. The definition of interest includes any consideration in relation to a loan agreement. Royalties are defined in line with the OECD Model Tax Convention. If the interest or royalty payment is less than an arm's length remuneration, the IRWHT will be levied on the arm's length remuneration. The IRWHT must be reported by the end of the relevant tax year.

IRWHT is due even if the payment is non-deductible for Dutch corporate income tax purposes. Furthermore, IRWHT cannot be credited against the Dutch corporate income on interest income levied from a so-called substantial shareholder (in brief, an entity that owns 5% or more of the shares in a Dutch entity). Consequently, the IRWHT can easily result in double or triple taxation.

2. Group

Entities are considered belonging to the same group if there is a decisive influence ("qualified interest") in a parent-subsidiary situation or in a sister-companies common parent situation. The relationship can be direct or indirect. A qualified interest is defined as an interest that gives such an influence on the decision making process that it can determine the entity's activities. This is a rather broad criterion, but in any case it covers interests that represent more than 50% of the statutory voting rights in an entity. Furthermore, entities are considered as a group if they are closely working together and jointly have a qualifying interest.

3. Low-tax jurisdictions

The interest or royalty payment must be made to a low-tax jurisdiction, being a jurisdiction with a statutory profit tax

rate of less than 9% or a jurisdiction that is included on the EU list of non-cooperative jurisdictions. At present, the Dutch list includes American Samoa, Anguilla, the Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Cayman Islands, Guam, Guernsey, Isle of Man, Jersey, Kuwait, Qatar, Samoa, Saudi Arabia, Trinidad & Tobago, the Turks and Caicos Islands, United Arab Emirates, the US Virgin Islands and Vanuatu. The EU list includes American Samoa, Belize, Dominica, Fiji, Guam, Marshall Islands, Oman, Samoa, Trinidad & Tobago, United Arab Emirates, US Virgin Islands and Vanuatu. The draft bill only looks at the statutory rate in the relevant jurisdiction.

The draft bill does not provide for a “valid commercial reasons that reflect economic reality”-escape.

4. Anti-abuse rules

The draft bill includes various anti-abuse provisions aiming to prevent that taxpayers can circumvent the rules by using a permanent establishment in low-tax jurisdictions or by interposing an entity in a high-tax jurisdiction. Payments to an entity in a high-tax jurisdiction may still be subject to IRWHT if the entity is interposed with (one of) the main reason(s) to avoid the IRWHT and in addition thereto was not established for valid commercial reasons that reflect economic reality. The Netherlands may be limited in levying the IRWHT in case of a full tax treaty concluded with one of the above mentioned jurisdictions that does not provide for an anti-abuse clause.

Our observations

Although the proposed IRWHT seems straightforward at first sight, in certain situations it can also affect interest and royalty payments made to entities in high-tax jurisdictions. Further, the proposal introduces a liability provision for the board of directors of the interest or royalty paying entity. Directors can be held jointly and severally liable for unpaid IRWHT. We will keep you posted on further developments.

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