NautaDutilh

Newsletter

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A. Lowering of the corporate tax rate to 27%

Until the end of last year, the corporate tax rate was 34.5%. At the beginning of this year it was lowered to 31.5%, the intention being to continue lowering it until it reaches 30% in 2007. Under the outline, however, it is proposed that the corporate tax rate be lowered even further by 2007, to 26.9%.

The reason for the proposal is that the current tax rate is high relative to other EU Member States. Another way for the Netherlands to regain its position as a favourite country for the setting up of MNEs would be to selectively reduce the taxable base. This strategy is, however, not regarded as feasible because of the constraints imposed by the EC Treaty on state aid and the developments in the area of harmful tax competition. Pending harmonisation of the corporate tax bases and rates throughout the European Union, the principal – if not the only – viable means to compete with other Member States in the area of taxation is by lowering the applicable corporate tax rate.

B. Replacement of the regime for group financing activities

The current group finance regime is in the process of being abolished because the European Commission decided that it clashes with the common market and it appears on the list of harmful tax measures of the Code of Conduct on Business Taxation. The current group finance regime has drawn a substantial volume of group financing to the Netherlands and not replacing it by something else would result in a loss of corporate tax revenues.

In its outline of the proposals to reform the Dutch Corporate Tax Act, the government is considering the introduction of a 'box' for interest from group financing. The balance of interest income and interest expenses regarding group financing would be taxed at a low rate of, for example, 10%. The group financing box would be optional. Not opting for the group financing box means, for example, that a negative balance of interest income and expenses can be set off against profits taxable at the normal rate of 26.9%. A condition is that the whole group of the taxpayer opts for the group financing box. Profits from short term passive investments of funds destined for future acquisitions would fall within the scope of the group financing box.

The government thinks that the group financing box constitutes neither harmful tax competition nor state aid, because it would be available to all corporate taxpayers as an option. The government has also considered the notional interest deduction which Belgium aims to introduce, but has rejected it. Furthermore, the government has considered the idea of introducing a box for R&D, but has decided not to give priority to such a box at this stage.

C. Abolition of the capital tax

Although this measure has nothing to do with corporate tax, it is in line with the reforms that will be introduced for the purpose of making the Netherlands a more popular place of business for MNEs (and funds). Capital tax is levied on contributions of share capital, share premium and disguised capital contributions. Over the years, the capital tax rate has been lowered from 1% to the current 0.55%. The government plans to abolish capital tax from 2006.

D. Extension of loss relief to foreign losses

The Marks & Spencer case has prompted the Dutch government to rethink its current regime for foreign loss relief. At present, foreign loss relief is limited to losses derived from foreign permanent establishments. The fiscal unit regime allows companies that form part of a fiscal unit to pool profits and losses for tax purposes by being treated as a single corporate taxpayer. Normally, however, Dutch companies cannot form a fiscal unit with a non-resident subsidiary. Pursuant to the outline of the reforms, the government is considering extending the fiscal unit regime to non-resident subsidiaries of Dutch companies, so that Dutch members of a fiscal unit can set off losses incurred by foreign members of such a unit against their profits.

The extension of the fiscal unit regime would be limited to companies in EU Member States. Opting for the regime would be limited to a certain period after the acquisition of a qualifying shareholding. The fiscal unit regime would apply for a certain minimum period. Including a subsidiary in a Member State in a fiscal unit would mean including all other qualifying subsidiaries in that Member State as well. The method for setting off losses incurred by foreign subsidiaries against domestic profits would be the same as the method that is currently applied to losses incurred by foreign permanent establishments. The method used for permanent establishments would undergo technical changes making it more restrictive so as to contain the effects of the changes in the fiscal unit regime on corporate tax revenues.

E. Limitation of loss carry-over

The current regime for loss relief is generous. Losses can be carried back three tax years and loss carry-forward is unlimited, save for situations covered by anti-abuse measures. The government is considering limiting loss carry-back to one tax year and loss carry-forward to eight years.

F. Amendment of the participation exemption

Pursuant to the participation exemption, dividends and capital gains from qualifying shareholdings in subsidiaries are exempt from corporate tax. At present, the participation exemption is subject to additional conditions where shareholdings in foreign subsidiaries are concerned: foreign subsidiaries must meet a subject-to-tax test and shareholdings in foreign subsidiaries must not be held for purposes of passive investment. The European Court of Justice's decisions show that the differences between the conditions that apply to resident subsidiaries and those that apply to non-resident subsidiaries are likely to be in conflict with the EC Treaty.

The government is considering replacing the subject-to-tax test and the passive-investment-purposes test by the condition that the subsidiary must not be a passive company. If the subsidiary fails to meet this condition, it would have to meet a stricter subject-to-tax test than before: the profits of the subsidiary would have to be subject to tax at a level which is similar to taxation in the Netherlands. If the subsidiary fails this stricter subject-to-tax test, the exemption would be replaced by an imputation credit. Subsidiaries in EU Member States would normally meet the subject-to-tax test, the government states in the outline. A number of Member States' corporate tax rates are substantially lower than 26.9%.

Subsidiaries would be considered as passive companies if they engage in portfolio investments or in passive group financing. The current published guidelines as to what constitutes passive group financing would continue to apply.

One of the conditions for entitlement to the participation exemption is that the relevant shareholding comprises at least 5% of the nominal issued share capital of the subsidiary. At present, shareholdings that fail to meet this condition may be eligible for the participation exemption subject to additional conditions. In the outline, however, the government proposes to abolish this exception to the 5% condition.

At present, newly acquired shareholdings qualifying for the participation exemption can be depreciated over a five-year period. The depreciations are deductible for corporate tax purposes, but they are eventually added back to taxable profits, so the result is tax deferral only. Losses realised upon the liquidation of a subsidiary that is eligible for the participation exemption are also deductible. The deduction of liquidation losses is permanent, however. The government plans to abolish the depreciation of shareholdings and the deduction of liquidation losses.

G. Reconsideration of the rules denying the deduction of interest expenses

The Corporate Tax Act now contains many complex provisions denying the deduction of interest expenses in specific situations, such as the hybrid loan provisions, the anti-base-erosion provisions, the thin capitalisation rules and rules targeted at leveraged take-over holdings. The government aims to reconsider those rules. It thinks that the thin-cap rules could open the door to abolishing some of the other rules denying the deduction of interest expenses.

H. Changes in the method for the depreciation of buildings

In the outline, the government states that often there are large discrepancies between the depreciation allowable for tax purposes and the actual decrease in the value of assets, such as buildings. The book value of buildings for corporate tax purposes frequently turns out to be considerably lower than the proceeds of the sale. Taxation of the resulting capital gains tends to be deferred using the reinvestment reserve.

The government is considering changing the rules for the depreciation of buildings so that depreciation stops if the book value of a building drops below its annually determined actual value. An increase in the actual value would not result in a claw back of previous depreciation deductions. Buildings that have been depreciated for not more than three years when the new rules for depreciation enter into force, would be eligible for a transitional regime.

Schedule for reforming the Corporate Tax Act

First, the outline will be discussed in Parliament. Afterwards, the Ministry of Finance will prepare a bill for reforming the Corporate Income Tax Act. It aims to submit this bill to Parliament towards the end of this year. The reform bill will be discussed in Parliament in 2006; the Ministry's aim is for Parliament to pass the bill in the course of 2006 so that the reforms can enter into force at the beginning of 2007.