The Netherlands: a favourable jurisdiction for intermediate holding companies

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Jos Peters discusses how companies can receive a Dutch tax credit for foreign dividend withholding tax

The Netherlands is under heavy attack, lately, because of its undisputed number one status in the world as treaty shopping jurisdiction. Foreign tax authorities and even the OECD and the European Commission seem to believe that the Dutch government, over the years, has created quite a few tax planning instruments to attract foreign businesses.

Only insiders know that this is not true: most of the attractiveness of the Netherlands in international tax planning stems from its favourable tax treaty network (ie. international tax measures which a foreign tax authority has explicitly agreed to) and another substantial part stems from modern Dutch supreme tax court case law which is never aimed at creating opportunities and just deals with existing cases.

The Dutch supreme tax court has always been miles ahead of most other tax jurisdictions via its modern interpretation of a number of basic tax rules that apply everywhere else too. But contrary to what happened in those other jurisdictions, the Dutch supreme tax court has introduced items such as 'transfer pricing adjustments' and 'non-discrimination', long before these measures got to be explicitly established as such elsewhere.

The few measures the Netherlands has taken explicitly to boost its position as an attractive tax planning location often go unnoticed! What I am about to describe below is an international tax feature which the Netherlands has introduced already many years ago to boost its effectiveness as a favourable jurisdiction for intermediate holding companies which even savvy Dutch tax advisers often forget to mention when doing a presentation on tax planning via the Netherlands, however odd this may seem.

Most readers will know that the Netherlands, in 99% of the cases, will not charge corporate income tax on foreign dividends and capital gains realised on foreign shareholdings. To qualify for this 'participation exemption' only a few easy-to-meet criteria must be fulfilled:

- The Dutch entity must own at least 5% of the economical and legal interest in the foreign entity (both dividend rights and voting rights);
- The foreign entity must have a capital divided into shares;
- The foreign entity does not have to be subject to any foreign profits tax, unless the entity qualifies as a 'passive' entity as defined by law, in which case the foreign underlying profits tax must be 10% or more.

So if a Dutch company receives a dividend from a foreign shareholding which meets these criteria, which will be true in most cases, the Dutch entity will not have to pay corporate income tax on the dividend. The same is true if the Dutch entity should realise a capital gain with the shares in the foreign entity. The Dutch participation exemp-

In many cases the Netherlands will not levy a dividend withholding tax on outgoing dividends tion covers 'benefits of whatever kind and whatever form realized with qualifying foreign shareholdings' so a dividend is treated the same way as a capital gain, when applying the participation exemption in the Netherlands.

In many cases the Netherlands will not levy a dividend withholding tax on outgoing dividends. This is clearly the case in situations where the Dutch entity is owned by a company in another EU jurisdiction, but also some Dutch tax treaties with non-EU countries provide for a zero rate. To mention a few: Singapore, Switzerland, the United States, Malaysia, Norway and Egypt.

However, this implies that the Netherlands does levy a dividend w/h tax on distributions to very many other countries in the world, even if it has a tax treaty with these countries. And vice versa! This, of course, is not an incentive for companies in those other jurisdictions to use the Netherlands as a stepping stone country to establish an intermediate holding company: one might in such a case well be able to benefit from a lower dividend w/h tax rate by using the Dutch tax treaty with a given country, but only at the cost of adding a Dutch dividend withholding tax.

So putting the Netherlands into the dividends or capital gains loop for investments in countries where the Dutch tax treaty would be more beneficial than the home country treaty requires thorough further research on what happens when the dividend received is paid onwards. Dividend w/h tax rates, if they are not zero, are often 5 or 10% in treaty situations and the Netherlands has many treaties.

In many cases the Dutch treaties will likely be at least 5% 'cheaper' than the home country treaty rates. But as long as this potential treaty shopping benefit is undone by the fact that the Netherlands itself charges a dividend tax of its own of at least 5%, the whole exercise may become useless and would only cost money: keeping an intermediate holding company alive attracts hosting and management fees pus other expenses, of course.

Once this became clear to the Dutch Ministry of Finance in 1995 (no doubt based on information it received from international tax advisers), it was decided to introduce a special measure to boost the attractiveness of the Netherlands as a holding company location by introducing a special tax credit which is quite out of the ordinary. Because the foreign dividend is untaxed in the Netherlands, a tax credit against Dutch corporate income tax, the usual way to take foreign underlying taxes into account, is impossible. That's why the tax credit was 'hidden' in the Dutch dividend tax act, as follows:

- If a Dutch intermediate holding company should receive a dividend from a foreign participation which qualifies for the participation exemption, and the foreign country withholds at least 5% dividend tax under its tax treaty with the Netherlands, and:
- If the Netherlands itself has the right under the tax treaty with the home country of the parent of the Dutch entity to withhold at least 5% Dutch dividend tax on the onward payment of this foreign dividend to this foreign parent company:
- The Netherlands will grant a 3% tax credit against the Dutch dividend withholding tax, to avoid 'doubling up' on dividend withholding taxes.

I regularly come across brochures, flyers, seminar slides etc. in which this very easy to use Dutch international tax feature is not addressed at all! This article is intended to make a wider audience aware of its existence. Two real life examples will illustrate how this unknown Dutch tax feature, that everybody can easily benefit from when contemplating to set up a Dutch intermediate holding company, works:

Example 1: a Turkish investment in Russia

Suppose a Turkish enterprise wants to take a 20% participation in a joint venture or consortium in Russia in say the abundant Russian mining industry. In a direct investment, Russia would be allowed to withhold 15% dividend tax on dividend distributions to Turkey. But by routing the investment through a Dutch company, the Russian dividend tax would go down to 10%. So if the expected dividend amounts are big enough, the resulting 5% tax savings would easily outweigh the expenses to set up and maintain the Dutch entity.

However: the Netherlands itself charges a 5% w/h tax on dividend distributions to Turkey. On the face of it, this will undo the benefit of interposing such a Dutch legal entity entirely: the combined dividend withholding taxes in Russia and the Netherlands would still be 14.5% (10% in Russia and 5% in the Netherlands on the remaining 90%) and the 0.5% tax savings would not be worth wile or not enough to cover the expenses of the Dutch entity, even on substantial annual dividends.

However, because of the Dutch tax credit for Russian dividend w/h tax, even though the Netherlands will not charge corporation tax on the Russian dividend, the Dutch dividend tax on distributions to Turkey will – on request, to be filed with the dividend tax return – go down to 1.67% (the Dutch facility of 3% is given on the gross Russian dividend before the payment of Russian dividend tax so 3% of 90% which equals 3.33%. The total combined effective dividend w/h tax burden will now be reduced to 10% Russian dividend w/h tax + 1.67% Dutch dividend w/h tax, ie. in total 11.67%. The tax benefit is now 3.33% and might well have become worth considering.

Example 2: a Canadian investment in Russia

The Canadian/Russian tax treaty provides for a 10% dividend w/h tax in cases where a Canadian company owns more than 10% of the shares in a Russian entity. The Netherlands tax treaty with Russia brings the Russian dividend w/h tax rate down to 5%. The Dutch/Canadian tax treaty also provides for a 5% dividend w/h tax rate, however. So at first sight it makes no sense for a Canadian company to set up a Dutch intermediate holding company for its investment into Russia. Without the special Dutch tax credit, the combined dividend w/h tax burden would be 5% plus 5% on the 95% paid onwards, which equals 9.75%. No-one would enter into tax planning for such a small difference (let alone the question what the Canadian tax credit system is, and how much foreign tax credit the Canadian entity can absorb under the Canadian tax credit limitations which apply it its specific case, two issues which are both out of scope for this article but which will also need to be reviewed in an actual case).

But the special Dutch tax credit of 3% kicks in here as well: because Russia will withhold 5% dividend tax on dividend distributions to the Netherlands, the Dutch dividend w/h tax rate on the onward distribution of the Russian dividend to Canada will be reduced from 5% to 1.85% and the combined effective dividend tax burden will therefore be 6.85% instead of 10%. With an average annual dividend of say €10 million, this special Dutch tax feature therefore saves the Canadian company €315,000 every year. The annual expenses to run such a Dutch intermediate holding company should not exceed €15,000 per year so the net tax benefit to the Canadian investor, before Canadian foreign tax credit which may well be zero, over a 10 year period is a whopping €3million.

In conclusion: when planning foreign investments via an intermediate holding company in one of the European jurisdictions which are well-known for their favourable investment climate (the Netherlands, Luxembourg, Cyprus and Malta, to name the four countries that would immediately come to mind), understanding the special Dutch dividend w/h tax credit for onward paid dividends from foreign shareholdings, held by a Dutch intermediate holding company, may well make the difference. ■

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