Summary of the Proposal for a Conditional Exit Tax in the Dutch Dividend Withholding Tax Act 1965

1. Introduction

On 9 October 2020, Mr Bart Snels, member of the Dutch Parliament, submitted a bill to introduce an exit tax into the Dutch Dividend Withholding Tax Act 1965. This proposal follows an earlier proposal submitted on 10 July 2020 and subsequent amendments on 18 September 2020. The purpose of the proposed exit tax is twofold:

1. To safeguard the accrued Dutch dividend withholding tax claim on the profit reserves of a company; and
2. To prevent corporate reorganisations that would result in the disappearance of this dividend withholding tax claim without a foreign dividend tax claim replacing it.

The proposed exit tax applies to situations where a company «leaves» the Netherlands through a cross-border reorganisation and the host country does not take over the profit reserves for the purposes of a withholding tax on dividends, for example because the host country does not have a withholding tax on dividends.

The proposal is based on the long-standing doctrine underlying the Dutch Dividend Withholding Tax Act 1965 according to which all profit reserves of a company from its incorporation until its liquidation must ultimately be taxed as dividend income at the level of the shareholders. According to the initiator of this new bill, the absence of an exit tax in the current Dutch Dividend Tax Act 1965 is a tax gap that urgently needs to be filled.

If adopted, the proposal will apply retroactively as of 18 September 2020, 12 noon. This means that from this date companies and their shareholders will have to take this exit tax into account when considering a cross-border reorganisation in which the accrued Dutch dividend withholding tax claim on the profit reserves is lost and is not taken over by another country.

2. Deemed dividend distribution

According to the proposal, a company «leaving» the Netherlands for a qualifying state through a cross-border reorganisation would be deemed to have distributed all its profit reserves to its shareholders for Dutch dividend withholding tax purposes.

This deemed profit distribution is triggered in the following events:

- The company transfers its seat to a qualifying state;
- In the context of a legal merger, the company transfers all of its assets and liabilities to another company in a qualifying state in exchange for the issuance of shares to its shareholders in that other company;
- In the context of a demerger/spin-off, the company transfers all or part of its assets and liabilities to another company in a qualifying State in exchange for the issuance of shares to its shareholders in that other company; and
- The majority of the shares in the company are acquired by another company in a qualifying state in exchange for shares in that other company.

The proposal defines qualifying states as states which do not have a withholding tax on dividends comparable to the Dutch dividend withholding tax. To be considered a withholding tax comparable to Dutch dividend withholding tax, the tax rate at which the dividends are taxed is, in principle, irrelevant. However, if it is a zero or near-zero rate, there is no comparable withholding tax on dividends. States which grant a «step-up» for the purposes of a withholding tax on dividends in respect of imported profit reserves resulting from a cross-border reorganisation, are also considered qualifying states.

The deemed dividend distribution includes all of the company's profit reserves, including the hidden reserves and goodwill, to the extent that they exceed a threshold of € 50 million. For example, if a company's profit reserves amount to € 250 million, € 200 million (€ 250 million -/- € 50 million) is deemed to have been distributed to shareholders in proportion to their profit entitlement.

An exemption shall apply to the extent that the dividend is deemed to have been paid to a company holding at least 5% of the shares and that company is also a resident of a state with which the Netherlands concluded a tax treaty. In these cases, the Netherlands will normally refrain from taxing outbound dividends at source. As a consequence, the proposed exit tax does not apply to the many regional headquarters of foreign multinationals present in the Netherlands. These regional headquarters are normally set up as a local subsidiary based in the Netherlands.

3. Tax liability

In principle, the tax liability on the deemed dividend distribution is calculated on the basis of the statutory tax rate of the Dutch dividend withholding tax rate of 15%. For example, if the deemed dividend amounts to € 200 million, the tax liability amounts to € 30 million (15% x € 200 million).

The tax liability may be reduced to the extent that the dividend is deemed to have been paid to a foreign shareholder who is entitled to a (partial) reduction of the dividend tax pursuant to a tax treaty concluded with the Netherlands. For example, in a limited number of tax treaties the Netherlands has agreed on a maximum rate of 10% for portfolio shareholders.[1]

As is usually the case with withholding tax on dividend, the company plays an important role as the remitter of the tax on behalf of its shareholders. According to the proposal, the Dutch tax authorities would impose a so-called «protective tax assessment» on the company equal to the amount of tax due. The company would automatically be granted an interest-free deferral of payment of the tax. The tax debt will be recovered in the future to the extent that dividends are actually paid out after the reorganisation.

In order to reflect the fact that the recovered tax liability does not have to borne by the company, the bill provides for a right of recourse by the company against the shareholders

[1] For example, see the Netherlands-United Kingdom Tax Treaty's Article 10(2)(a)(i). If immediately prior to the reorganisation 20% of the company's shareholders are portfolio shareholders resident in the United Kingdom, 20% of tax liability is calculated at the reduced 10% rate.

who actually receive the dividend. Under certain circumstances, the company may be expected to link the Dutch exit tax to a class of shares. As a result, the company can pay out the dividend to its shareholders on a net basis.

It is proposed to waive the remaining tax liability in the event of liquidation of the company. The remaining tax liability will also be waived if the dividends actually distributed become subject to a withholding tax on dividends, for example in the event that a state would introduce a withholding tax on dividends.

4. Step-up on entry into the Netherlands

Dutch dividend withholding tax is levied on distributions from the company's worldwide profits. This is in line with the internationally accepted principle that a state has the right to tax (mainly portfolio) dividends at source regardless of where the distributed profit primarily arose.

When a company «enters» the Netherlands through a cross-border reorganisation, Dutch tax legislation currently provides for a tax exemption. On the basis of this exemption, future distributions from existing profit accumulated in the foreign period are exempt from dividend withholding tax. Technically, these so-called «imported» profit reserves are regarded as paid-up capital for Dutch dividend tax purposes («step-up»). The cross-border reorganisations covered are share-for-share mergers, legal merger and demergers. The bill extends this exemption to cases in which a company transfers its seat to the Netherlands.

According to the initiator of this new bill, the proposed exit tax creates a balanced tax system. As a result the Netherlands:
1. grants an exemption for «imported» profit reserves on entry;
2. imposes a conditional exit tax on «exported» profit reserves on departure.

5. Tax credit relief for Dutch shareholders

Shareholders resident in the Netherlands can normally offset the Dutch dividend withholding tax against the income tax or corporate income tax due. The bill maintains this tax credit. It is proposed to grant a shareholder the right to a tax credit to the extent that the company has reclaimed the Dutch exit tax from that shareholder. As noted above, the bill provides for a right of recourse for the company against the shareholders who actually receive the dividend.

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