Hamelink & Van den Tooren
Tax Lawyers

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newsletter

In this newsletter we will summarise a recent landmark case rendered by the Dutch Supreme Court. The case concerned the application of the Dutch anti-base erosion rules, which is one of the specific rules provided for in the Dutch corporate income tax Act 1969 ("CITA") on the restriction of interest deduction. Below, we will first summarise the relevant Dutch rules, subsequently we will summarise the facts of the case and the importance of this case for Dutch corporate taxpayers.

Dutch base erosion rules

Article 10a CITA provides that interest on related party debt is not tax deductible if the debt is connected to certain specific transactions. The same treatment applies to costs and currency exchange results connected with the related party debt. The 'tainted' transactions are the acquisition or increase of a share interest in an entity that is or becomes a related party, a capital contribution to a related party and a distribution (including a repayment of capital) to a related party. The background of the anti-base erosion rules is avoiding that corporate taxpayers randomly and without genuine economic reason convert equity into debt within the group, thereby effectively having the choice to make a non-deductible dividend payment or a tax deductible interest payment as remuneration on the funds provided.

If the main rule of article 10a CITA denies the deduction of interest on a related party debt, the taxpayer has two counterproof possibilities to claim deduction irrespective of application of the main rule:

1. The loan and the connected transaction are predominantly based on business reasons; or
2. The interest income is subject to a reasonable taxation in the hands of the lender.

Facts of the case

Two Dutch corporate taxpayers are part of a media group, of which the top holding company is established in South Africa ("TopCo"). TopCo attracted funds in the market by issuing shares. Part of these funds were transferred directly to the relevant Dutch company. Contractually and for accounting purposes, first a loan from TopCo to a South African subsidiary ("SubCo") was recognised, subsequently a capital contribution by SubCo in a Mauritian subsidiary ("MauCo 1") took place, thereafter MauCo 1 granted interest-free loans to another Mauritian group company ("MauCo 2"), which in its turn granted interest-bearing loans to the Dutch companies.

In 2007, the Dutch companies acquired various subsidiaries. These acquisitions were partly funded with above described loans from MauCo 2 and partially with own funds generated by MauCo 1 (dividends and other funds). The own funds of MauCo 1 were transferred to the Dutch companies by first granting interest-free loans to MauCo 2 which in its turn granted interest-bearing loans to the Dutch companies. The acquisitions made by the Dutch companies were based on business reasons.

The case concerned the question whether there were also business reasons for the debts connected to the various acquisitions.

Decision of the Dutch Supreme Court

The Dutch Supreme Court rendered its decision on 5 June 2015. The main conclusions can be summarised as follows:

- The burden of proof to make plausible that there are predominantly business reasons for the related party debt and the connected transaction, are with the taxpayer;
- The business reasons for both the related party debt and the transaction have to be demonstrated. Older case law with respect to abuse of law (where business reasons for the financing were deemed present as long as there were business reasons for the transaction and a real financing need) is not relevant for the interpretation of article 10a CITA;
- In order to qualify for the business reasons exception, the non-tax reasons underlying the chosen transactions must be more important than (foreign and Dutch) tax reasons;
- When arguing that there are business reasons for the related party debt and the transaction, the reasons to enter into the transactions for all group companies involved should be considered, not only of the Dutch company attracting the debt. If funds are re-routed to the Dutch company via group companies, this re-routing must be based on business reasons;
- The taxpayer, in principle, has the freedom to choose the manner in which a transaction is financed. However, it cannot be concluded that business reasons are only absent if the funds have been subtracted from the equity of the Dutch part of the group;
- A related party debt is not by definition based on business reasons if this debt is not attracted in view of a specific transaction.

Importance of the case

The application of article 10a CITA, and in particular the counterproof possibilities, are a continuous topic of discussion between Dutch tax authorities and taxpayers. This case provides for additional clarity on the interpretation of the business reasons counterproof possibility. It is important to note that, although taxpayers have the freedom to choose the manner in which a transaction is financed, any re-routing of funds may give the Dutch tax authorities the argument that the financing of the transaction lacks business reasons. It is therefore crucial to consider the impact of article 10a CITA (and the other interest deduction limitation provisions provided for in the CITA), prior to entering into any financing transaction.

Finally, we note that the case partly has been referred to the Dutch Lower Court. However, the outcome thereof should not have an impact on the above main conclusions.

Should you have any questions on the above, please contact your advisor within Hamelink & Van den Tooren at + 31 70 310 50 70 or + 31 20 333 92 80.