Improving the Dutch tax regime: changes in the corporate tax system 2007

For years international companies chose for the Netherlands to start a branch in Europe or a holding company which could act as mother company for other branches in Europe. Reason was the open tax climate in the Netherlands looking for example at the many tax treaties with other countries, the so called participation exemption and the ruling practice, but also Schiphol as gateway to Europe, the international minded organization of the country and the available facilities.

But with the international recession profits came under pressure and it became more important for international companies to cut on expenses and to reduce taxation as much as possible. Outsourcing became a good solution to reduce labor costs. Using the internet it became easier for companies to work from a distance. So suddenly the Netherlands became less attractive. This was worsened by the fact that other countries in the EU, especially the last new member states offered a corporate tax rate which was much lower then the Dutch tax rates, in many situations more then 10 percent lower.

With the new policy document "Working on profit" the Dutch government wants to change these developments. The Netherlands must again be more attractive to international companies and also national companies should benefit so that enough jobs and capital will stay available in the Netherlands. Efforts are also made to keep the tax system EU proof.

Most changes will come into force on 1 January 2007. The most important changes will be explained below.

1. Reduction of the corporate income tax rate
2. Changes in the participation exemption
3. Introduction of patent and group interest boxes
4. Limitations on loss carry over
5. Changes in the depreciation of assets
6. Interest deduction streamlined
7. Other minor changes

1. Reduction of the corporate income tax rate

The maximum corporate income tax rate will be reduced from 29.6 to 25.5 %. This rate applies to profits exceeding € 60,000. For profits between € 25,000 and € 60,000 the rate is 23.5 % and for profits below € 25,000 the rate is 20 %.

With the reduction the Dutch corporate income tax rate becomes one of the lowest in Western Europe. Detail is that originally the proposed maximum tax rate was 25 %. This was however against foreign CFC-legislation which would make the Netherlands a tax haven. This would have been a step too far.

In addition to the reduction of the corporate income tax rate also the dividend withholding tax rate will be reduced from 25 % to 15 %. This reduction is proposed to reduce the administrative burden on companies which are based in countries with which the Netherlands have a tax treaty. Based on tax treaties the applicable tax rate was already 15 % (or lower) which means that these companies now in most situations don't have to request a separate refund anymore.

Companies which are not based in countries with which the Netherlands have a tax treaty will now also benefit from the lower tax rate.

2. Changes in the participation exemption

The participation exemption arranges that profit which is paid by a subsidiary to a company shareholder can stay tax free if the company shareholder owns at least 5 % of the shares in the subsidiary. The participation exemption resulted in the establishment of thousands of holding companies in the Netherlands.

The exemption will now apply to all shareholdings of at least 5 % or more of the nominal capital, regardless of the country in which the subsidiary is located. This is only different if the subsidiary is considered to be a low taxed investment company. Low taxed means that the corporate tax is less then 10 % of the profit determined in accordance with Dutch fiscal standards. An investment company is a company whose assets consist for more then 50 % of portfolio investments.

Instead of an exemption the shareholding company will get a tax credit. This credit will be fixed at 5 % of the grossed up (100/95) profit. EU subsidiaries may opt for a credit for the full amount based on the EU Parent-Subsidiary Directive which states that no tax is applicable between parent company and subsidiary in case the EU parent company owns more then 20% (15 % from 2007) of the shares in the EU subsidiary.

3. Introduction of patent and group interest boxes

To support the growth of the knowledge economy the government has created a patent royalty box which will encourage R&D activities.

Companies which develop intellectual property and patents only have to pay tax based on a rate of 10 % over the income generated by these patents, to a maximum of four times the development costs relating to these patents. Any excess of profits is taxed at the normal rate. The taxable income includes all benefits, so not only the royalties. And it doesn't matter from which company the income is received.

The patent royalty box is optional. If the company doesn't opt for this box the income generated by patents will be taxed at the normal rate. In that situation also all development costs can be deducted and don't have to be capitalized anymore.

One restriction is that trademarks, logos and similar assets are explicitly excluded.

The group interest box is created for inter-company financing. In this box the balance of the interest proceeds and interest costs (which could therefore be negative) will effectively be taxed at a reduced corporate income tax rate of 5 %.

Inter-company means:

- a company in which the company in the Netherlands has a more than 50 % interest;
- a company that has a more than 50 % interest in the company in the Netherlands;
- a company in which a company has a more then 50 % interest, whereby that company also has a more than 50 % interest in the company in the Netherlands.

The maximum of tax to be levied at the 5 % rate is limited to a percentage of the average fiscal equity of the company in the relevant tax year. This percentage is equal to the Netherlands statutory interest rate.

All group companies must opt in order to use the group interest box. When granted, the group interest box must be applied by all group companies for at least three years.

The patent royalty box and the group interest box will be applicable once the EU commission has approved them both.

4. Limitations on loss carry over

At the moment a loss in a year can be carried back three years and carried forward indefinite. From 2007 this will be changed to one year back and nine years forward.

Transitional rules indicate that losses incurred up to the year 2002 can still be set off against profits up to the year 2011.

5. Changes in the depreciation of assets

At the moment depreciation of assets is based on the economic value and useful lifetime. This means that depreciation percentages vary for different assets. This will now be more standardized.

Assets must be depreciated to zero over a period of at least five years. For goodwill the minimum depreciation period will be ten years. Depreciation on buildings (which includes the underground) will be restricted to the assessed value, the so called WOZ value which will be determined by the local municipality annually from the year 2008. Only if the building is used for the companies own business depreciation will be restricted to 50 % of the assessed value.

It will still be allowed to take incidental losses to actual values. Originally the government wanted to restrict depreciation of buildings totally to cover the reduction of the corporate tax rate. After objections the changes were adjusted.

6. Interest deduction streamlined

It often happens that related companies lend each other money to do certain transactions. The interest for this loan is only deductible if certain conditions are met. These conditions are now streamlined.

The related company to which the interest is paid must be subject to a reasonable rate of tax of at least 10 %.

The loan must not be seen as equity referring to a so called hybrid loan. This means that the interest for example must not depend on profit made by the company which has to pay the interest, whereby the loan is subordinated and the duration of the loan is more then 50 years. This combination will make the loan capital instead. Interest will then be treated as non deductible dividend.

Other example would be a loan with a duration of more then 10 years which is interest free or has an interest rate that is at least 30 % higher or lower then the market interest rate for similar loans.

7. Other minor changes

There will be some other minor changes in the corporate tax system. Already minor changes were made in 2006.

Selling costs of participations are no longer deductible. Acquisition costs were already not deductible.

If work was in progress a company could decide to take the profit when the work was completed. New rules indicate that from 2007 a proportional part of the total profit must be taken during the work in progress.

Costs related to the issuance of shares by a company or a related entity can't be deducted anymore. The same applies to costs of stock options granted to employees.

We will have to wait and see how international companies will appreciate the changes and especially the lower corporate tax rate. In the mean time the reduced rate already led to objections from national companies which are not subject to corporate income tax. The government has now decided that these companies will get a tax exemption for 10% of the profit they make. Because of this the changes are no longer cost neutral but lead to a tax reduction of more then € 700m.

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