LEGAL AND TAX ALERT

Tax Alert: Tax Plan 2021

Oct. 15, 2020

Introduction

On September 15, 2020, the Dutch government published its Tax Plan 2021 package. The Tax Plan 2021 package introduces various amendments to the Dutch tax laws and includes the following bills:

- Tax Plan 2021;
- Other tax measures 2021;
- Changes to Box 3 Adjustment Act;
- Real Estate Transfer Tax Differentiation Act;
- Implementation of Allowances Improvement Act;
- Industrial CO_2 Tax Act;
- 2020 and 2021 rates Surcharge for Sustainable Energy;
- One-off rent reduction for low-income tenants.

In addition, a bill has been submitted to the House of Representatives which provides for a limitation of the cessation/liquidation loss rules in corporate income tax (**"CIT"**).

Currently, the Tax Plan 2021 package is subject to discussion in the Dutch House of Representatives and for most of its measures it is aimed to enter into force on January 1, 2021.

This letter will focus on the following aspects of the Tax Package 2021:

1. Corporate Income Tax:

- Change in corporate income tax rates;
- Change in effective tax rate for the innovation box;
- Coronavirus tax reserve;
- Announced adjustments to the arm's length principle;
- Additional substance requirements for intercompany financing / licensing;
- Amendments to loss set-off regime;
- Change in anti-base erosion rules;
- Clarification of overlap hybrid mismatch measures and interest deduction limitations;
- Maximum annual loss set-off, however unlimited carry-forward (2022);
  - New group tax scheme (replacing the Dutch fiscal unity regime corporate income tax;
  - Payment discount abolished.

1. Conditional withholding tax on interest and royalties;
2. Real estate transfer tax;
3. Bill on a CO_2 levy for certain industries.

1. **1. Corporate Income Tax ("CIT")**

- *Change in corporate income tax rates*

The previously announced tax rate reduction in the high rate of CIT from 25 to 21.7 per cent will not be implemented. However, the CIT rate applicable to the first bracket is still going to be decreased from 16.5 to 15 per cent. This lower rate will apply in 2021 for profits up to EUR 245,000 and in 2022 this threshold is expected to increase to EUR 395,000.

Taxable profits	**2019**	**2020**	**2021**	**2022**
Lower rate	19.0%	16.5%	15.0%	15.0%
Higher rate	25.0%	25.0%	25.0%	25.0%

For taxpayers with a financial year that is the same as the calendar year, the new rates will apply to the 2021 financial year and subsequent years. For taxpayers with a split financial year, a mixed effective rate will apply in proportion to the days of the financial year before and after January 1, 2021 and January 1, 2022 respectively. The withholding tax rate on interest and royalties that will apply as of 2021 is linked to the high CIT rate. That rate will – without an amendment of the law – also be 25%.

- *Change in effective tax rate for the innovation box*

The effective tax rate of the innovation box will be increased from 7 per cent to 9 per cent as per 2021. This was already announced on the Budget Day of last year.

- *Coronavirus tax reserve*

Companies that expect a loss during 2020 as a consequence of the coronavirus crisis are allowed to create a coronavirus reserve in the corporate income tax return for 2019. This may lead to a liquidity benefit. This is in line with a decision that has already been taken earlier this year.

- *Conditional withholding tax on interest and royalties*

The Dutch government has proposed a conditional withholding tax on interest and royalties paid to affiliated entities located in 'tax havens' and in situations where tax evasion is present. This new withholding tax on interest and royalties paid by Dutch domiciled entities to affiliated entities located in 'tax havens' and in situations where tax evasion is present shall be implemented on January 1, 2021. In this respect, entities are affiliated if the interest or royalty-receiving entity can exercise influence to the point that the activities of the paying entity can be determined (e.g. >50% of the voting rights). Furthermore, a 'tax haven' is defined as a jurisdiction with a statutory corporate income tax rate of less than 9% or as a jurisdiction included on the EU-list of non-cooperative jurisdictions.

- *Announced adjustments to arm's length principle*

The Dutch government aims to tackle informal capital structures and will present in the spring of 2021 a new legislative proposal to adjust the arm's length principle. The arm's length principle ensures that transactions between group companies take place under ordinary trade conditions. The legislative proposal will limit the downward adjustment of the Dutch taxable amount when the amount of this downward adjustment is not taxed by the recipient or is taxed at a lower rate.

- *Additional substance requirements for intercompany financing / licensing*

Some time ago a decree was published that determines that as of 1 January 2021, additional substance requirements will apply to Financial Service Companies (**"FSC"**). A FSC is a Dutch taxpayer whose activities, for more than 70 per cent, consist of directly or indirectly receiving and paying interest/royalties/rent/leasing instalments to foreign group companies. The additional requirements are: 1) EUR 100,000 of payroll expenses and 2) existence of an office space at the disposal of the company for at least 24 months. Failure to meet these requirements will result in the exchange of information with the country from which the payments were made (source state). As a consequence, e.g. the source state could deny treaty benefits.

- *Amendments to liquidation loss rule*

The Netherlands is one of the few countries where a liquidation loss on participations with a shareholding of 5% or more (for which the participation exemption applies) can be taken into account, regardless of the participation's country of residence. However, an initiative legislative proposal has been submitted in October 2019 that aims to tighten the conditions of the liquidation loss facility as per January 2021.

The legislative proposal entails the following changes to the liquidation loss facility as per January 2021:

- A quantitative limitation: this implies that a liquidation loss, insofar as it amounts to more than EUR 5 million per participation, can only be taken into account if the Dutch entity holds a qualifying interest (in general: holds more than 50% of the statutory voting rights).

- A territorial limitation: The liquidation loss facility will only apply to participations located in an EU/EEA state (or a state with which the EU has concluded a specific association agreement, such as Turkey).

- The temporal limitation: A Dutch entity can take into account a liquidation loss within three years from the date of ceasing the activities of the participation, unless the Dutch entity substantiates that there are sound business reasons for later liquidation of its participation. Transitional law applies for the temporal limitation until December 31, 2023.

The bill also contains several additional changes to ensure that the new conditions cannot be avoided. For example, there is a look-through approach which prevents the rule being circumvented via a (intermediate) holding company. An assessment has to be made as to whether the liquidation loss could also have been taken into account if the taxpayer had directly retained the participation.

- *Change in anti-base erosion rules*

Under the anti-base erosion rules (art. 10a CITA 1969) interest costs (including expenses and currency exchange results) are non-deductible under certain conditions. This currently applies to both positive and negative items, as a result of which e.g. positive currency exchange results are tax exempt. This can, in effect, impact the non-deductibility of the interest costs of all loans that are in scope of art. 10a CITA 1969. Therefore, it is currently possible that the anti-base erosion rules on balance provide for an exemption. It is proposed to limit the exemption of a positive currency exchange result to the amount of non-deductible costs on that specific loan.

- *Clarification of overlap hybrid mismatch measures and interest deduction limitations*

The possible overlap between the hybrid mismatch measures and certain interest deduction limitations will be clarified. The general rule is that where deduction limitations overlap, the order of the legislation will be adhered to. This means that first the hybrid mismatch measures will be applied and that, insofar as deductible interest still remains, the earnings stripping measure and the thin cap rule will be applied in respect of that interest.

- *Maximum annual loss set-off, however unlimited carry-forward (2022)*

By way of a Memorandum of Amendment to the 2021 Tax Plan, the government will propose an in time unlimited carry-forward loss set-off as of January 1, 2022 (currently a carry-forward period of six years applies; the carry-back period is and will remain one year). However, losses will only be fully available for carry-forward and carry-back set off up to an amount of EUR 1 million of taxable profit. In the case of a higher profit, the losses will only be able to be set off up to 50% of that higher taxable profit. We are currently preparing a Tax Alert regarding this proposal for amending the maximum annual loss set-off and we shall provide you with this Tax Alert shortly.

- *New group tax scheme (replacing the Dutch fiscal unity regime corporate income tax*

The current fiscal unity regime has become vulnerable under EU law. In connection with this, some elements of the legislation have already been amended, see the Fiscal Unity Emergency Repair Act (with, in principle, retroactive effect through to January 1, 2018). However, with regard to other elements, the risks under European law have not (or may not have) entirely disappeared. On Budget Day, the Deputy Minister of Finance, Mr. Vijlbrief, sent a letter to the Lower House of Parliament in which he outlined, among other things, the main features of a potential new group scheme and the follow-up process. The decision to present a bill to the Lower House will be left to a following government.

- *Payment discount abolished*

The government had intended to abolish, as of 2021, the payment discount that is currently granted for the payment, in full, of any corporate income tax payable that is paid before the first instalment deadline (instead of in instalments). The percentage at which the payment discount is calculated is linked to the rate for the late payment interest to be charged. We now know that the latter percentage will be 0.01 through to December 31, 2021. Despite the fact that the payment discount will not be abolished as of 2021, it will be extremely small in 2021 due to the calculation percentage of 0.01.

1. **2. Conditional source tax on interest and royalties**

By the 2021 Bill on conditional withholding tax (**"WHT"**) - part of the 2020 Tax Plan - a conditional WHT was introduced for outbound interest and royalty payments to related parties that are resident in countries without tax on profits or countries that levy such tax at a nominal rate of lower than 9 per cent, countries included in the EU list of non-cooperative jurisdictions and in tax abusive situations. The tax rate for the source tax will be equal to the highest rate of the corporate income tax, i.e. 25% (2021). The bill will enter into force on 1 January 2021.

- *Expansion of withholding tax on dividends to low tax countries (2024)*

By letter dated May 29, 2020 to the Lower House of Parliament, the Deputy Minister of Finance announced that as of January 1, 2024 dividend flows to low tax jurisdictions will be taxed. Measures to realize this will be worked out in detail before the government's term of office ends. With a view to this, as of 2024 the withholding tax on interest and royalties will be supplemented by a withholding tax on dividends.

- *Dividend exit tax proposed*

On July 10, 2020, a private member's bill was sent to the Lower House of Parliament in which it was proposed to introduce a final settlement obligation for dividend withholding tax purposes for certain types of cross-border relocations of the registered office, cross-border mergers, cross-border divisions and cross-border share mergers. It is proposed to introduce the measures with retroactive effect to 12:00 noon on 18 September, 2020.

1. **3. Real estate transfer tax**

- *Real Estate Transfer Tax exemption for first-time buyers*

Young first-time buyers on the housing market are eligible for a Real Estate Transfer Tax (**"RETT"**) exemption during the coming five years (up to and including 31 December 2025). Someone will qualify as a first-time buyer if they are 18 years old or older but under the age of 35 when they purchase the property. Another condition is that the first-time buyer can only use the exemption once. Buyers aged 35 and over, and buyers younger than 35 who are no longer eligible for the exemption, will pay the RETT at the reduced rate of 2 per cent. One condition for both first-time buyers and buyers aged 35 and over is that they will actually live in the property on a long-term basis. Otherwise, the general increased RETT rate will be applicable (8%).

- *Increase in the general transfer tax rate*

The general RETT rate is to be increased from 6 to 8 per cent (an increase to 7 per cent had been previously announced). This applies to commercial and factory premises as well as to homes which the buyer does not use for long-term accommodation, for example holiday homes or buy-to-let properties.

1. **4. Bill on a CO■ levy for industry**

The Dutch government has announced that a national CO■ levy is to be introduced in 2021 for industrial production and waste incineration. This levy is to be introduced alongside the existing system for the pricing of CO■ at EU level (EU-ETS). The ETS indirect emission costs subsidy scheme ends this year. Companies will be eligible for an exemption (which will decrease over time) on part of their emissions (dispensation rights), so that they can change their operations in order to reduce their CO■ emissions. There are possibilities for using a surplus of dispensation rights for set-off and transfer purposes.

Next steps

Please note that the proposals as set forward in the tax Plan are still subject to possible amendments.

If you have questions on how the 2021 Tax Plan will affect your business, please do not hesitate to contact us.

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September 25, 2020