

Netherlands introduces new withholding tax on interest & royalty payments and increased substance requirements as of 2021: A detailed review

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Executive summary

The Dutch Government enacted, on 27 December 2019, a withholding tax on interest payments and royalties to low tax jurisdictions and in abusive situations, effective as of 1 January 2021. This new withholding tax will have a rate of 21.7%. If a treaty jurisdiction would fall under the low-tax jurisdiction definition, there is a three-year grandfathering period applicable for such jurisdiction.¹

Also on 27 December, the Dutch Government enacted additional substance requirements for Dutch intra-group financing and/or licensing companies related to the exchange of information, again effective as of 1 January 2021. If the additional substance requirements are not met, additional information related to the intra-group financing and/or licensing activities may be exchanged with tax authorities of the relevant jurisdictions.

Detailed discussion

WHT on interest and royalty payments

A withholding tax (WHT) of 21.7% is introduced as of 1 January 2021 on intra-group interest and royalties (deemed) paid or accrued by a Dutch corporate taxpayer (entity or permanent establishment) to a related entity resident in:

- ▶ A jurisdiction with a statutory tax rate lower than 9%
- ▶ A jurisdiction that is included on the European Union (EU) list of non-cooperative jurisdictions
- ▶ Other jurisdictions if the entity allocates the interest or royalties to a permanent establishment in a jurisdiction with a statutory tax rate lower than 9% or in a jurisdiction that is included on the EU list of non-cooperative jurisdictions
- ▶ Certain abusive situations, which includes (deemed) payments/accruals to hybrid entities

Low-tax jurisdiction or EU list of non-cooperative jurisdictions

Payments to affiliated entities resident in a jurisdiction with a statutory tax rate lower than 9% (a low-tax jurisdiction) or a jurisdiction on the EU list of non-cooperative jurisdictions (the EU List) are in scope of the conditional WHT. The Dutch Government publishes a list at the end of each year of jurisdictions that qualify as low-tax jurisdictions or are included on the EU List at that time. Only jurisdictions that are included on that list for the preceding calendar year are in scope of the conditional WHT. As of 1 January 2020, the following jurisdictions are included on the list: American Samoa, Anguilla, Bahamas, Bahrain, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Fiji, Guam, Guernsey, Isle of Man, Jersey, Oman, Samoa, Trinidad and Tobago, Turkmenistan, Turks and Caicos Islands, United Arab Emirates, Vanuatu, and the US Virgin Islands. Having substance in an entity that is resident in a low-tax jurisdiction or a jurisdiction on the EU List does not provide for an exemption from the conditional WHT.

Grandfathering for tax treaty jurisdictions

With respect to low-tax jurisdictions or jurisdictions that are on the EU List with which the Netherlands has concluded a tax treaty, a three-year grandfathering period applies during which the WHT will not apply. The Dutch Government will approach the relevant treaty partner to renegotiate and amend the respective treaty.

Abusive situations

The WHT may also apply on interest and royalty payments in certain abusive situations. These include the following:

- ▶ Interposing conduit companies in non-low tax jurisdictions or jurisdictions that are not on the EU List, if these intermediate conduit companies do not meet certain substance requirements or in the absence of actual

economic activities. Having relevant substance in such a conduit company provides a presumption of proof that the arrangement is not abusive.

- ▶ (Deemed) payments/accruals to a hybrid entity, as a result of which the corresponding income is not taxed by any jurisdiction.

Affiliated entities

The WHT is due on payments to affiliated entities. Entities will be considered affiliated in the following cases:

- ▶ One entity directly or indirectly holds a qualifying interest in the other.
- ▶ A third entity directly or indirectly holds a qualifying interest in both entities.
- ▶ One entity, together with a cooperating group of shareholders, holds a qualifying interest in the other.
- ▶ A cooperating group of shareholders hold a qualifying interest in both entities.

An interest is a "qualifying interest" when a holder of such interest can exercise control over decisions of the entity. This should be determined based on the relevant facts and circumstances. An interest representing 50% or more of the statutory voting rights will in any case qualify as a qualifying interest. Whether a group of shareholders qualify as such cooperating group of shareholders depends on the facts and circumstances, such as coordinated group decisions.

Definition of interest and royalties

The WHT is due on (deemed) payments/accruals of interest and royalties. Interest is defined as consideration of any kind – including costs – for debt. The definition of royalties follows the OECD model treaty definition and includes consideration for the right to use any patents, trademarks, designs or models.

Definition of (deemed) payments/accruals

The WHT is due on accrued, imputed or paid considerations. Upward corrections if the interest or royalty payment is not at arm's length (e.g., imputed expenses), are also in scope of the WHT.

Moment of enjoyment

The WHT is due at the moment of enjoyment of the interest or royalty payment by the recipient. The moment of enjoyment is defined as:

- ▶ The time the interest or royalty has been paid or settled, made available to the beneficiary or becomes interest-bearing.
- ▶ The time the interest or royalty has become claimable and collectible.
- ▶ If interest or royalties have accrued and remained outstanding during a calendar year: on 31 December of that year.

Tax rate

The rate of the WHT equals the headline corporate income tax rate, which will be 21.7% in 2021. Note that the WHT applies regardless of whether an interest or royalty payment is deductible for corporate income tax purposes.

Permanent establishments

WHT is due if the interest or royalty income is allocated to a permanent establishment in a low-tax jurisdiction or a jurisdiction that is on the EU List, even if the head office is not a resident of such jurisdiction. The conditional WHT may also be due if the head office is resident in a low-tax jurisdiction or jurisdiction that is on the EU List, even if the interest or royalty income is allocated to a permanent establishment not situated in such jurisdiction.

A payment made by an entity not resident in the Netherlands but allocated to a permanent establishment situated in the Netherlands may also be in scope of the WHT.

Administration and liability

Both the payor and recipient of the interest or royalty are liable for the WHT. The payor must report and withhold the WHT within thirty days after the moment of enjoyment. Non-compliance with these obligations may result in administrative penalties.

Additional substance requirements for intra-group financing and licensing companies

As of 1 January 2021, additional substance requirements are introduced for Dutch intra-group financing and licensing companies related to the exchange of information with other jurisdictions.

Currently, Dutch companies predominantly (at least 70%) engaged in financing and/or licensing activities that can claim the benefits of a tax treaty or EU Directive must declare in their annual Dutch corporate income tax return whether a defined set of substance requirements is met. If one or more of these substance requirements are not met, detailed information on the intra-group financing and/or licensing activities must be provided to the Dutch tax authorities. The Dutch tax authorities may then spontaneously exchange this information with the relevant foreign tax authorities. As of 1 January 2021, the following substance requirements will be added:

- ▶ The annual salary cost relating to the financing and/or licensing activities of the Dutch company should be at least €100K.
- ▶ The Dutch company should have an office space available (leasing or holding in property) for a period of at least 24 months. This office space should not only be rented (or held) but also be used in the Dutch company's operations and should be appropriate for its business activities.

Next steps

To prepare for the WHT, all intercompany interest and royalty (deemed) payments from the Netherlands to any entities in EU listed jurisdictions or to any hybrid entities should be reviewed. It should also be considered whether any situations may be seen as abusive situations for WHT purposes resulting in any (deemed) payments to be subject to WHT.

The substance of Dutch entities predominantly engaged in financing and/or licensing activities claiming benefits from a tax treaty or EU directive should be reviewed to avoid triggering the exchange of information as of 1 January 2021.

Endnote

1. See also: EY Global Tax Alert, [The Netherlands publishes 2020 budget proposals](#), 18 September 2019.

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