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Global Tax Alert

Dutch Government publishes list of low-taxed jurisdictions: Impact to the Middle East

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Executive summary

On 28 December 2018, the Dutch Government published a list with low-taxed and non-cooperative jurisdictions relevant in the application of certain new Dutch measures against tax avoidance. The list will be used in applying the new supplementary controlled foreign company rules (as of 1 January 2019), the new ruling policy (effective as of 1 July 2019) and the expected conditional withholding tax on interest and royalty payments (effective as of 1 January 2021). The list comprises 21 jurisdictions. Specific discussions have been held during the consultation phase on the Middle Eastern jurisdictions included on the list, Bahrain, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates (UAE). Inclusion on the list could impact multinationals with entities or permanent establishments in one of the 21 jurisdictions and controlled by or engaged in transactions with a Dutch taxpayer.

Detailed discussion

On 28 December 2018, the Dutch Government published its list of low-taxed and non-cooperative jurisdictions to be used for purposes of three new measures to combat tax avoidance and tax evasion. The list will be updated each year to include those jurisdictions that the Dutch Government has identified as having no profit tax regime or a profit tax regime with a statutory rate of less than 9%

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(low-taxed jurisdictions) as well as those jurisdictions that are included in the EU blacklist for non-cooperative jurisdictions in tax matters,[1] as published in the calendar year prior to the calendar year in which the relevant fiscal year commences.

The list published includes five jurisdictions that are currently included in the EU blacklist for non-cooperative jurisdictions in tax matters: American Samoa, Trinidad and Tobago, United States Virgin Islands, Guam and Samoa. The Dutch Government further identified 16 additional low-taxed jurisdictions that are added to this list: Anguilla, Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Guernsey, Isle of Man, Jersey, Cayman Islands, Kuwait, Qatar, Saudi Arabia, Turks and Caicos Islands, Vanuatu and the UAE.

The list will be reassessed annually by 1 October and is in particular relevant for the following three measures.

Controlled foreign company (CFC) rules

As of 1 January 2019, new supplementary CFC rules are effective in the Netherlands. These supplementary CFC rules seek to subject certain undistributed "tainted" (passive) income of a CFC to current taxation at the level of the Dutch taxpayer. Under these rules, direct or lower-tier subsidiaries of a Dutch taxpayer are considered a CFC if the Dutch taxpayer holds a direct or indirect interest of more than 50%[2] in the subsidiary's nominal share capital, profits or voting rights **and** the subsidiary is established in a jurisdiction included in the list for low-taxed or non-cooperative jurisdictions. Also, permanent establishments located in these jurisdictions are in scope of the supplementary CFC rules. The subsidiary's or permanent establishment's income further needs to generally consist for more than 30% of certain defined "tainted" (passive) income to be classified as a CFC.

The CFC rules do not apply if the CFC carries on a genuine economic activity, i.e., if it has sufficient relevant substance in the foreign jurisdiction as demonstrated by satisfying a certain set of relevant substance requirements (safe-harbor, further detailed below). In addition, a taxpayer is also able to demonstrate otherwise the existence of a genuine economic activity, e.g., by means of organizational, economic or other relevant characteristics of the group as well as the structure and strategy of the group.

Revised ruling practice

On 22 November 2018, the Dutch Government issued a letter that sets out a proposal for a new policy in relation to the issuance of rulings with an international character.[3] The Dutch Government is expected to apply the amended policy as of 1 July 2019. One of the elements contained in the new ruling policy is that the Dutch tax authorities will no longer be issuing rulings such as advance tax rulings (ATRs) and advance pricing agreements (APAs) if entities established in a low-taxed or non-cooperative jurisdiction are involved.

Conditional withholding tax on interest and royalties

On 1 January 2021, a conditional withholding tax on intercompany interest and royalty payments to low-taxed jurisdictions is expected to be implemented. These rules were proposed to subject companies established in a low-taxed or non-cooperative jurisdiction to a 20.5% (withholding) tax on interest and royalty payments received from an *affiliated* company in the Netherlands. Furthermore, artificial structures implemented to avoid the levy of this withholding tax are expected to be targeted through an anti-avoidance rule.

On 15 October 2018, the Dutch Government also announced its plans to revisit and defer the previously announced introduction of a conditional *dividend* withholding tax that would be accompanied with the elimination of the current dividend withholding tax.[4]

Impact to the Middle Eastern region

General

The current list established includes among others Bahrain, Kuwait, Qatar, Saudi Arabia and the UAE. Oman is the only Gulf Cooperation Council (GCC) state that is not included on the list.

Despite the critical notes provided in response to the draft list in the consultation phase, the State Secretary of Finance has maintained Kuwait, Qatar and Saudi Arabia on the list since the profit tax regime in those jurisdictions is limited to entities with non-domestic shareholders. Following the State Secretary, the levy of Zakat is not considered to be sufficiently similar to the levy of a profit tax with a statutory rate of at least 9%.

CFC

In the event a Dutch corporate taxpayer would have a CFC in Bahrain, Kuwait, Qatar, Saudi Arabia or the UAE, the CFC rules should not apply if that CFC would perform a genuine economic activity. For CFCs engaged in operational business activities, the impact of the supplementary CFC rules is thus expected to be limited. Under a safe-harbor rule, genuine economic activity is in any case considered present when the below relevant substance requirements are met:

(a) At least half of the board of directors of the CFC reside or are effectively resident in the state in which the CFC is resident.

(b) The directors resident in the state referred to in (a) have the required professional knowledge to perform their duties satisfactorily. The duties of the (aggregated) directors include at least the decision making on any transactions to be entered into by the respective entity and the proper fulfilment of such transactions.

(c) The CFC has qualified personnel at its disposal to fulfil and administer the transaction entered into.

(d) Decisions by the board of directors of the taxpayer are made in the state referred to in (a).

(e) The main bank account(s) of the CFC is/are maintained in the state referred to in (a).

(f) The bookkeeping activities of the CFC take place in the state referred to in (a).

(g) The remuneration paid by the CFC for the personnel performing the activities is equal to €100,000 multiplied by the so-called residency state factor (in Dutch: *woonlandfactor*) applicable for the specific state.

(h) The CFC has, during a period of at least 24 months, an office space at its disposal in the state referred to in (a) and such office space provides for the equipment necessary for the personnel referred to in (g) to perform their activities.

Rulings

Currently, multinationals with business activities in these (Middle Eastern) jurisdictions have typically been able to obtain advance certainty by means of an ATR or APA. Following the announced ruling policy, multinationals may however be limited going forward in obtaining a tax ruling with the Dutch tax authorities when engaged in transactions with entities established in either one of the listed jurisdictions. It is expected that the new ruling policy first be applied to rulings issued on or after 1 July 2019. Therefore, companies seeking advance certainty from the Dutch tax authorities might consider initiating the ruling process as soon as possible, before the new ruling policy will apply.

Currently no withholding tax

The Netherlands in principle levies 15% Dutch dividend withholding tax on distributions of profits. However, dividends paid by a Dutch entity to a parent company in Bahrain, Kuwait, Qatar, Saudi Arabia and the UAE Emirates are generally exempt from Dutch dividend withholding tax in corporate structures qualifying for a Dutch domestic exemption. Furthermore, the Netherlands currently does not impose a withholding tax on interest and royalty payments.

Withholding tax as of 2021?

The inclusion of the jurisdictions in the low-tax jurisdiction list in combination with the announced introduction as of 2021 of a withholding tax on interest and royalty payments and the potential change in dividend withholding tax might impact multinationals paying dividends, interest and royalties to the listed jurisdictions.

If the Netherlands levies withholding tax on interest, royalties or dividends to investors in the listed countries, such levy may potentially be reduced or exempt under a tax treaty, if applicable. The Netherlands has existing tax treaties with all listed GCC countries but these treaties do not restrict the Netherlands' right to levy withholding tax in all situations.

In general, multinationals should review how the above changes could impact their structures.

Endnotes

1. See EY Global Tax Alert, *Council of the European Union publishes list of uncooperative jurisdictions for tax purposes*, dated 6 December 2017.
2. Constructive ownership rules apply.
3. See EY Global Tax Alert, *The Netherlands announces new tax ruling policy*, dated 26 November 2018.
4. See EY Global Tax Alert, *Dutch Government maintains dividend withholding tax, funds used to reinforce attractiveness of Dutch business climate*, dated 15 October 2018.

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