Lansigt
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New classification rules for Dutch and foreign entities

Introduction

On Monday, March 29, an internet consultation was started about a new tax law proposal from the Dutch Government, containing new classification rules for Dutch and foreign entities. The current Dutch tax classification rules for Dutch and foreign entities can result in 'hybrid entity mismatches' in an international context. To counter this, the Dutch Government has proposed new rules that should enter into force as per 1 January 2022 (if enacted). The proposals are open for consultation until April 26, 2021.

Current classification rules for (foreign) entities

For Dutch Tax purposes a limited partnership (CV) and a fund for joint account (FGR) are considered transparent or non-transparent. Open CVs and open FGRs are non-transparent and currently liable to corporate income tax (and withholding tax etc.).

The decisive criterion to conclude if a limited partnership (CV) is transparent, is whether accession or substitution of a partner requires unanimous consent of all partners.
If this unanimous consent is required, the limited partnership will be classified as transparent for Dutch tax purposes. Most foreign limited partnership are therefore treated as non-transparent from a Dutch tax perspective. This non-transparency results in a so called 'hybrid' entity, which means that the limited partnership is considered transparent in a foreign country but non-transparent from a Dutch perspective. This difference can result in a tax benefit or disadvantage.

As with the CVs, a fund for joint account (FGR) can be open (non-transparent) or closed (transparent). The decisive criterion to conclude if a fund for joint account (FGR) is transparent, is whether the participations can be sold to other participants or to the fund itself without the consent of the other participants. With a closed fund for joint account, permission is required from the other participants. As with the CVs, the different treatment of countries can lead to a hybrid mismatch.

The proposed rules - CV

It is proposed that open CVs are no longer independently liable for tax. With this the non-transparent CV ceases to exist. From that moment on, all CVs are transparent. The aforementioned change means that non-transparent CVs are deemed to pay tax on hidden reserves and goodwill when becoming transparent. This can result in tax becoming due without cash being generated. To avoid this possible problem several facilities are being proposed:

1. A rollover facility.
2. A share-for-share merger facility.
3. A deferred payment obligation.
4. A rollover facility (in posting situations).

The proposed rules - Open FGR

In contrast to the CVs an FGR can remain either transparent or non-transparent under the proposed rules. The FGR is under the proposed rules qualified as open (independent taxpayer) if the following requirements are met: the FGR collects capital against the issue of certificates of participation in order to invest this capital collectively; and

1. the participations in the FGR are traded on a regulated market as in Section 1: 1 of the Financial Supervision Act or a comparable trading platform; or
2. the FGR has the obligation, at the request of the participants, to regularly repurchase or repay the units of participation at the expense of the assets of the FGR.

Special rules are introduced to avoid that family owned FGR's can remain non-transparent. No transitional law has been proposed for the FGR.

The proposed rules - Foreign Entities

For foreign legal forms that are similar to a Dutch legal form, nothing will change compared to the existing situation, on the understanding that foreign entities that are comparable to a Dutch CV will become transparent for Dutch tax purposes, just like a CV as mentioned above. The similarity approach, that The Netherlands apply to qualify a foreign entity therefore continues to exist. Due to the proposed rules many hybrid mismatches will disappear as the Netherlands will regard a foreign partnership as transparent for tax purposes.

The similarity approach does not provide a solution for certain situations. This concerns situations in which no comparable Dutch legal form exists. For example the British Limited Liability Partnership (LLP), the Irish Unlimited Company (ULC) and the German Kommanditgesellschaft auf Aktien (KGak). In order to adequately overcome these situation, two additional qualification methods are introduced: the symmetry approach and the fixed method:

1. The symmetry approach means that the Netherlands follows the classification of the foreign entity's home state. This method applies to situations in which Dutch law does not provide an equivalent and in which a body incorporated under foreign law and established abroad has an participation in a Dutch corporate tax payer. This also applies in the opposite situation in which a Dutch corporate taxpayer has a participation in an entity incorporated under foreign law that is established abroad.
2. A foreign entity with no clear Dutch equivalent, that is based in the Netherlands, will be considered as a non-transparent entity. This makes the entity a Dutch domestic taxpayer (the fixed method).

Conclusion

The implementation of the ATAD 2 directive, including the proposed implementation of the new rules for reversed hybrid entities, neutralizes the result of many qualification differences. With the addition of the above elaborated rules the qualification methods in The Netherlands will be more in line with what is internationally customary. Would you like to know what this means for you or do you have any other question? Please feel free to contact us!