Ministerie van Financiën

Memorandum on Dutch Tax Treaty Policy 2011

Summary

1. Introduction

The purpose of tax treaties is to prevent both double taxation and double non-taxation on a reciprocal basis. Previous policy notes on the Dutch position taken in the (re)negotiation of tax treaties were published in 1987[1], 1996[2] en 1998[3] (no English text available). Important developments have taken place in the time elapsed since the publication of the latter of these policy notes. For one thing, the issue of transparency and the exchange of information has received a great deal of attention in the international arena. Another development to be discerned is the tendency to include provisions in tax treaties to combat abuse. On a national level domestic tax legislation has been subject to significant change, partly due to international developments. All these combined developments have necessitated the publication of a new policy memorandum on Dutch tax treaty policy. This memorandum covers the major policy positions in regard of future tax treaty negotiations. To a great extent, the prior policy notes, having a more technical approach, remain of value except for the new positions in this memorandum.

Taking the OECD Model Convention as a basis, the Netherlands strives to contend with specific characteristics of potential tax treaty partners (consisting of countries often widely varying in their approach) with tailor-made solutions. This approach precludes the use of a standard Dutch model tax treaty.

[1] *Kamerstukken II* 1987/88, 20 365, nr. 2.

[2] *Kamerstukken II* 1996/97, 25 087, nr. 1.

[3] *Kamerstukken II* 1997/98, 25 087, nr. 4.

2. Major issues in the tax treaty policy

Considerations on entering into tax treaty relations

In the decision whether or not to enter into negotiations on a new tax treaty , the Netherlands will take several factors in consideration.

Interaction between tax systems

The tax system of a potential tax treaty partner and the interaction thereof with the Dutch tax system from a legal and an economic point of view is relevant in deciding whether or not a tax treaty is necessary.

Economic relations

The possible effects of a tax treaty on the economic relations with the potential treaty partner is a factor which will be taken into consideration.

Competitive position of employees, entrepreneurs and investors

Dutch based individuals and enterprises conducting economic activities in another State may find themselves in a disadvantageous competitive position compared to individuals or enterprises from a third State operating in that other State. By concluding a tax treaty with that other State, this comparative disadvantage can be removed.

Other economic or political factors

On a more general level, varying factors of an economic, political or diplomatic nature can lead to the desirability of concluding a tax treaty with another State.

Tax treaty relations with low-tax jurisdictions

The aforementioned factors will also be applied in deciding whether or not to conclude a tax treaty with a State which imposes low taxes. Maintaining or improving the competitive position of Dutch individuals and enterprises can be an important factor to conclude a tax treaty with a low-tax jurisdiction. If however such a treaty would entail a risk of abusive tax-schemes, effective anti-abuse measures[4] will be proposed. If such risk would be considered too high, an alternative could be to enter into a non-comprehensive tax-treaty with the treaty partner.

Relations to developing countries

The importance of developing countries in the investments of Dutch enterprises continues to grow. Tax treaties provide for legal certainty for entrepreneurs and individuals considering economic activities in such countries. The Netherlands endeavours to expand its treat network to (more) developing countries.

Against the background of the conclusions of the G-20 in Seoul and their attention for the future of cooperation on development[5] as well as the strive of the administration towards

[4] The issue of anti-abuse measures will be dealt with in a broader sense in "Instruments for the prevention of treaty-abuse".

[5] Vide the outcome of the G-20 summit of November 20th, 2010, *The Seoul Summit document*, item 50, sub h.

a result-oriented policy of cooperation with developing countries[6], the Netherlands will support initiatives for the improvement of tax systems and tax administrations in developing countries on both a bilateral and a multinational level. This will eventually reduce developing countries' dependency on development aid.

3. Specific elements

A selection of current specific elements of Dutch tax treaty policy will be elaborated on in this section. The focus therein will be on issues where the positions vary from the 1998 memorandum.

Residency and liability to tax
A tax treaty applies to persons who are residents of one the contracting States (article 1 OECD Model Convention treaty). To be considered a resident of one of the contracting States liability to tax is required (article 4 OECD Model Convention treaty).

With a view to enhancing legal certainty the Netherlands seeks to include a provision in tax treaties which specifies the criterion of liability to tax. This provision clarifies that tax exempt corporate entities in both contracting States will be considered a resident for tax treaty purposes. Entities which are transparent for tax purposes (where the income is taxed in the hands of the participants rather than on the level of the entity) however will be expressly excluded as a resident for tax treaty purposes.

With regard to its own entities, the Netherlands aims to consider the following entities as tax treaty residents:

(i) Pension funds and not for profit organizations;

(ii) Associations (Verenigingen) and foundations (stichtingen) irrespective of whether or not they engage in entrepreneurial activities;

(iii) Tax Investment Institution (fiscale beleggingsinstelling);

(iv) Tax exempt investment institutions (vrijgestelde beleggingsinstelling).

In the course of negotiations the Netherlands is willing to exclude certain tax treaty benefits to the Tax exempt investment institution.
As for the recognition of residency for tax treaty purposes of entities in the other contracting State subject to a special tax regime, the Netherlands will take a position depending on the characteristics of the tax regime.

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[6] With reference to the report of the Wetenschappelijke Raad voor het Regeringsbeleid (Scientific Board on Government Policy) of January 18th, 2010: *Ontwikkelingssamenwerking: minder pretentie, meer ambitie*.

The Netherlands strives for legal certainty vis-à-vis the possible entitlement to tax treaty benefits of Sovereign Wealth Funds[7].

Attribution of profits to permanent establishments and the arms' length principle
In cases where a permanent establishment exists, it has to be determined how much profit has to be attributed to the permanent establishment. The Netherlands fully adheres to the Authorized OECD Approach of the 2008 OECD report[8]. The Netherlands is of the opinion that the new article 7 of the OECD Model Convention is a correct interpretation of the principles which have been at the basis of article 7 OECD-Model Convention from the outset[9]. For the sake of clarity and legal certainty, the Netherlands seeks to include the new text of article 7 OECD-Model Convention in tax treaties.

Dividends, interest and royalties
The Netherlands consistently seeks to agree on exclusive resident state taxation for participations (of in general 10% or more). To counter possible dividend conduit arrangements[10], the Netherlands can propose to include an anti-abuse provision in the treaty.
As regards portfolio-dividends the Netherlands seeks to maintain the domestic rate of taxation (dividend withholding tax; currently at 15%).
The Netherlands seek to agree on exclusive resident state taxation for interest and royalties. On request of the treaty partner, the Netherlands is willing to consider reasonable anti-abuse provisions.

Pensions and annuities
In deviation of the position expressed in the 1998 Policy Memorandum[11], the Netherlands will seek to agree on taxation in the source state for pensions and annuities which were granted tax relief in the build-up phase. The right of taxation in respect of such pension or annuity is attributed to the State that has granted such tax relief. In view of the practical constraints related to this attribution or as part of a final compromise, the Netherlands can agree with specific treaty partners on the attribution of limited taxation rights to the source State.

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7 Described broadly as: Investment Funds controlled decisively by the government. See OECD discussion paper "Application of tax treaties to state-owned entities, including sovereign wealth funds".

8 Report on the attribution of profits to permanent establishments, OECD Paris 2008.

9 See decree *Winstallocatie vaste Inrichtingen* (Attribution of profits to permanent establishments) of January 15th, Nr. IFZ2010/457M, Stcrt 2011 nr. 1375.

10 For instance if the treaty partner either levies an (corporate) income tax on dividends received (from the Netherlands), nor taxes the dividends paid (for instance a dividend withholding tax).

11 The position in the 1998 Memorandum was the attribution of taxing rights in respect of pensions to the State of residence (with some exceptions depending on the taxation of pensions or annuities in the State of residence).

Sportspersons and artistes; teachers

The Netherlands no longer seeks to agree on a specific provision on the attribution of taxing rights in respect of income of sportspersons and artistes (attribution of taxing rights to the state of performance). The Netherlands intends to apply to the generic rules in respect of profits or dependent services. This would generally imply that the taxing rights in respect of activities of an occasional nature will be attributed to the State of residence.

Further, the Netherlands will no longer seek to agree on a specific provision in respect of the income of teacher and professors. In these cases as well the generic rules on the attribution of taxing rights will apply.

Tax Sparing Credits

The so-called tax sparing credit-method provides for a credit for taxation at source at the level of the tax rate of the source State disregarding whether or not this tax is (fully) levied in the source State. Tax sparing provisions are known to be prone to abuse. Furthermore, studies have shown that the intended economic virtue of tax sparing provisions is doubtful[12]. The Netherlands will no longer agree on including tax-sparing credits in tax treaties. The Netherlands will continue to seek to end tax-credit provisions in its existing treaties.

Exchange of information

The Netherlands regards the current international standard on exchange of information as a minimum. The Netherlands will continue to seek for enhancing the instruments for exchange of information both on a multi-lateral[13] and a bi-lateral[14] level, for instance by spontaneous and automatic exchanges.

Instruments to prevent treaty-abuse

Prevention of abuse of tax treaties is important to the Netherlands. Therefore the Netherlands is prepared to include provisions which enable to deny all or some benefits of a tax treaty in cases where the Netherlands or a treaty partner identify – in view of the interaction between the tax systems of the treaty partners – possible abuse of the treaty. Broadly two categories of such provisions can be distinguished. Firstly, the provision can be based on the nature or the activities of the person entitled to the element of income (a

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[12] *Is there a need to re-evaluate tax sparing?*, Paris: OECD 1998.

[13] Example. The Convention on Mutual Administrative Assistence in tax matters, as changed most recently by the Protocol of May 27th, 2010, Trb. 2010, 221.

[14] Both by means of bilateral TIEA's aimed specifically at the exchange of information as by means of including a provision in accordance with the current article 26 of the OECD Model Convention in comprehensive tax treaties.

person or entity-based approach). A well known example of such a provision is a so-called "limitation on benefits"-provision, often made up of detailed criteria. Secondly, provisions can be included which are transaction-based, often applying a more broadly defined criterion of abusive intent. The Netherlands aims at safeguarding legal certainty in the drafting of such provisions.