# The Netherlands in International Tax Planning
## Second revised edition

### Excerpt – Chapter 8: Outbound investment

#### *8.1.2. Definition of a permanent establishment*

The unilateral decree has its own definition of what a permanent establishment is. This is based on the OECD definition, but not the same. Under the decree a permanent establishment is a lasting place of business of an enterprise through which its business is wholly or partly carried on, including: the seat of the management an enterprise; agricultural pieces of land; and projects of which the execution exceeds twelve months. A dependent agent is defined negatively, i.e. by determining who is not a dependent agent. Persons are not regarded as dependent agents if they are completely independent agents or are agents who are not authorised to conclude contracts, irrespective of whether they maintain a stock of goods for express deliveries. Finally, if only goods are held in consignment, there may be no taxable presence.

Besides defining what a permanent establishment is, the decree also defines what a foreign enterprise is (an exemption is only available for profits from a foreign enterprise run through a foreign permanent establishment). A foreign enterprise includes among others immovable property situated in another State or rights connected to such immovable property; rights to a share in the profit of an enterprise which is managed from another State to the extent that it does not stem from securities (e.g. an interest in a foreign partnership); and activities performed for an uninterrupted period of at least 30 days in, on or above the extraction area of the another State. The extraction area of another State consists of the territorial waters of that State as well as that part of the ocean floor and its subsoil situated outside the territorial waters, to the extent that international law allows the other State to exercise rights of exploration and exploitation of natural resources there.

#### *8.1.3. Exemption method*

Resident taxpayers are exempt from corporate income tax on foreign profits. Foreign profits are the combined amount of the profit from a foreign enterprise in a State, being an enterprise or part of an enterprise that is run through a permanent establishment or dependent agent within the territory of that State. This profit is only taken into account to the extent that it is subject to an income tax levied through that other State.

In terms of determining the profit to be allocated to a foreign permanent establishment, the Netherlands follows the independent enterprises principle. The profit from a foreign enterprise are those that the enterprise can be deemed

to have realised, if it was an independent enterprise which would perform the same activities under the same circumstances and which would conclude transactions with the enterprise of which it is a permanent establishment completely independently.

The exemption is applied separately for each State in which the taxpayer realises profits, by allowing a reduction on the corporate income tax due. This means two things. First, it means that profits and losses from different states do not have to be netted against each other. E.g. if ABV has profitable activities in the US (say 100) and loss generating activities in Portugal (-30), then ABV can still get an exemption for the full 100, whilst deducting the 30 loss from Portugal against its Dutch income. Second, it means that the exemption takes the form of a deduction from taxation rather than of the taxable object (foreign income) being completely ignored for tax purposes, as is generally the case with the participation exemption.

*8.1.3.1. Calculating the exemption*

The exemption for foreign profits equals the amount of tax which would have been due on these profits under Dutch law, had the unilateral decree not been applicable, divided by the total Dutch tax due times the quotient of the foreign profit over the so-called denominator profit. The denominator profit is profit before taking into consideration loss carry forwards from previous years.

E.g. ABV has a profit from its business in the Netherlands of 100 and a profit from its business in the US of 60, bringing its worldwide profit to 160. If the Dutch tax rate is 33.3%, then the total Dutch tax equals (160 * 33.3% =) 53. The exemption equals 60/160 x 53 = 20. This is subtracted from the Dutch tax of 53 whereby 33 Dutch tax remain payable. If ABV had a loss carried forward of 20 from previous years, its “denominator profit” would have equalled 80. This would bring the total Dutch tax to ((100 + 60 – 20) x 33% = ) 47, the exemption to (60/140 x 47 =) 20 and the Dutch tax payable to 27.

The reduction from taxes cannot exceed the total tax that would be due on these profits under Dutch law if this Decree were not applicable. This means that if the Dutch activities of the taxpayer are loss generating there can be no full exemption for the foreign profits. Therefore, to the extent that the total amount of exempt foreign profits exceeds the denominator profit, it is carried forward to the next year. This only takes place if the amount of foreign profits carried forward is confirmed by the tax inspector. One may wonder whether this is EU compliant, since no similar rules exist with regard to the prevention of double taxation for profits from branches inside the Netherlands. The fact that the mechanism for the prevention of double taxation is different for Dutch branches and foreign branches does not seem to be an acceptable justification.

In the year in which the carry forward takes place the foreign profit is increased with the amount of foreign profits carried forward; the denominator profit is not increased.

E.g. In year 1 ABV has a loss from its business in the Netherlands of 20 and a profit from its business in the US of 70, bringing its worldwide profit to 50. If the Dutch tax rate is 33.3%, then the total Dutch tax equals (50 * 33.3% =) 17. The exemption equals 50/50 x 17 = 17. The tax inspector confirms in ABV's tax assessment over year 1, that ABV still has 20 in uncompensated foreign profits to be carried forward indefinitely.

In year 2 ABV has a profit of 100 from its business in the Netherlands and a profit from its business in the US of 60, bringing its worldwide profit to 160. If the Dutch tax rate is 33.3%, then the total Dutch tax equals (160 * 33.3% =) 53. The exemption, including the uncompensated foreign profit carried forward, equals (60 + 20)/160 x 53 = 27, leaving ABV with a Dutch tax payable of 26.

Naturally, the reverse situation is also possible, i.e. domestically profits are made, which are reduced by foreign losses. To avoid a double dip situation where the foreign losses are deducted both in the Netherlands and abroad, Dutch law provides for a recapture of foreign losses before exempting subsequent profits from the same foreign country. The negative foreign profits - determined on a per country basis - is treated as a negative part of the foreign profit from a State of the next year. The negative profit to be carried forward is also confirmed by the tax inspector.

Finally, it must be noted that taxpayers' have an incentive to make the foreign profit as high as possible, since that effectively could increase the size of their exemption. One such a way would be to allocate the interest deduction limitation rules to one's foreign income rather than to one's local income (no deduction = higher foreign profit). However this is prevent in different ways.

First it is determined that when the exemption under measures for the prevention of double taxation is calculated, the total amount of interest which is not deductible under the thin cap rules, can not be taken into account to a higher amount than the amount of interest which is not deducted from the taxable profit under the thin cap rules. This rule is illustrated by the following example from the parliamentary history.

*8.1.3.1.1. Example*

The total intercompany loans of ABV is 1,000, whilst its equity is 200. ABV has a permanent establishment in country X to which 750 of the intercompany loans relate (e.g. acquired realty); the PE has an "equity" of 50. The interest on the loans is 6 percent. ABV has an EBIT of 120 and its PE one of 80. The corporate tax rate used was 34.5% (2003 rate). ABV's maximum debt:equity ratio is 6:2 vs.

its real 10:2. Therefore interest on 400 is non-deductible. This comes to (400 x 6% =) 24 for the determination of ABV's worldwide income.

The thin cap limitation of the PE on a stand alone basis would be 50:150, thereby effectively disqualifying ((700 – 150 =) 600 x 6% =) 36 of its interest deductions. However, due to the legal limitation described above, the maximum add back for calculating the foreign profit can only be 24 instead of 36.

The above example does not take into consideration the thin cap base exemption of Euro 500.000 discussed under **Error! Reference source not found.**, **Error! Reference source not found.**. The unilateral decree however, determines that this should be taken into account on a pro rated basis over all the different PE's of ABV. The effect is a decrease in the non-deductible interest and a related decrease in the exempt foreign profit.

*8.1.3.2. Decree on inspector's confirmation of foreign profit carried forward*

In a Q&A decree published in November 2004, a question was raised on what happens if a tax inspector refuses to confirm the foreign profits carried forward.

The question and answer are represented here after.

3.6 A determination of foreign profit to be carried forward in spite of previous omission
What needs to happen if the tax inspector refused to determine the foreign profit to be carried forward to a later tax year?
Answer
If the tax inspector refused to determine the foreign profit to be carried forward to a later tax year (on time), the taxpayer can appeal to the tax inspector against not taking a decision on time. The filing of such an appeal is generally not subject to any period, provided that the notice of appeal is not filed unreasonably late.
Amplification
The tax inspector determines the amount of foreign profit to be carried forward in a decision against which an appeal can be filed under the Unilateral decree for the prevention of double taxation 2001. The decision is made together with the assessment.