Policy decree on Dutch tax exemption for pension institutions raises questions

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In Brief

Subject to certain conditions, Dutch and foreign pension institutions are exempt from Dutch corporate income tax and entitled to a refund of Dutch dividend withholding tax levied on income from Dutch equities (the 'Exemptions'). On 12 January 2018 the Dutch Ministry of Finance issued a policy decree on the conditions to be met in order to be eligible for the Exemptions. Aside from specific situations, Dutch pension institutions should typically be able to meet these conditions. The conditions to be met by foreign pension institutions to enjoy the Exemptions however appear to be rather strict and potentially even contrary to EU law.

Introduction

Under certain conditions, pension institutions are exempt from Dutch corporate income tax. As a result, a foreign pension institution receiving Dutch source income may be exempt from Dutch corporate income tax. Dutch source income of pension institutions may consist of income derived from Dutch immovable property or business income generated by a Dutch permanent establishment of the pension institution.

Pension institutions meeting the conditions for the exemption from Dutch corporate income tax may also be entitled to a refund of Dutch dividend withholding tax levied on income from Dutch equities.

In the decree, the Ministry of Finance provides further clarification on the conditions for the exemption from Dutch corporate income tax and the refund of Dutch dividend withholding tax on income from Dutch equities (the 'Exemptions').

Summary of the decree

General conditions to be eligible for the Exemptions

Dutch and foreign pension institutions, which provide employment related pension arrangements, are entitled to the Exemptions provided certain conditions are met. In the decree, the Ministry of Finance provides further clarification of the conditions to be met in order to be eligible for the Exemptions. One of those conditions is that the pension institution provides "qualifying pension arrangements". In this respect, the following general requirements are noted:

- The pension arrangement is only available to a specific group of participants but there is in principle an obligation to participate for the individuals forming part of such group.
- The pension arrangement should meet the conditions for protecting and securing the accumulated pension rights with the aim of providing a lifelong pension upon retirement.
- The pension arrangement should be based on collectively organised solidarity.

Dutch employment related pension arrangements generally meet these conditions.

Specific criteria to be met by foreign pension institutions

Under the decree, foreign pension institutions (like Dutch pension institutions) are eligible for the Exemptions provided their activities consist 90% or more of providing employment related pension arrangements to (former) employees, their spouses, their partners and children. The profits of the pension institutions should be for the benefit of the participants of the pension arrangement and may not be distributed to shareholders or equity providers with the exception of a return up to 5% calculated over the contributed equity. The pension arrangements carried out by a foreign pension institution must be similar in nature and scope to a Dutch "qualifying pension arrangement" as defined above. The decree includes a list of specific criteria which should cumulatively be met by a foreign pension arrangement in order to be considered a "qualifying pension arrangement". The criteria include the following:

- The pension arrangement may not provide the option to opt-out from the arrangement or to obtain a (partial) lump sum payment upon retirement (except in the event that the lump sum can only be used to purchase the right to multiple pension payments).
- The pension rights should be based on the length of the employment contract and the compensation for providing labour.
- The pension arrangement may not include the possibility of redeeming the pension rights (except for certain minor pension rights in order to reduce the administrative costs).
- The pension arrangements consist of old-age, survivors, or disability pensions.
- The pension arrangements should provide for a life-long pension (certain pre-pension arrangements are allowed).
- The pension arrangements are based on a pension agreement between the employer and employee; pension arrangements for the self-employed do in principle not qualify.
- The pension arrangement does not form part of the social security system.

Transitional measure

Foreign pension institutions that have received a tax ruling in the past confirming their entitlement to the Exemptions may rely on such ruling until 1 January 2020. From that date, existing tax rulings are considered to be terminated.

Entry into force

Although, the decree was published on 12 January 2018 the decree is effective from 14 December 2017 (the date on which it was signed).

Impact of the decree

Dutch pension institutions

Typical Dutch pension institutions providing Dutch employment related pension arrangements should generally be able to meet the conditions to be eligible for the exemption. This may however be different if they provide employment related pension arrangements which are governed by foreign law. Foreign pension arrangements may include elements that conflict with the above-mentioned requirements. In this case, the Dutch tax authorities may deny the application of the Exemptions.

Foreign pension institutions

It is expected that many foreign pension institutions do not fulfill the requirements set in the decree as they will often carry out pension arrangements that do not meet the strict criteria of a Dutch qualifying pension arrangement.

Impact for pension institutions not meeting the conditions of the decree

If the pension arrangement does not meet the conditions of the decree, the Dutch tax authorities are expected to deny the application of the Exemptions.

The position is different if the pension institution has obtained a tax ruling from the Dutch tax authorities confirming their entitlement to the Exemptions. Although, such a ruling will be no longer valid from 2020, this may not have a negative impact for these institutions on their dividend withholding tax position, given the proposed abolishment of Dutch dividend withholding tax from 2020 (except for abusive arrangements and dividends paid to low tax jurisdictions). We do not expect dividends paid to pension institutions to be considered part of abusive structures.

For types of Dutch source income that fall within the scope of Dutch corporate income tax, such as income derived from Dutch immovable property, the termination of a tax ruling from 2020 would result in the levy of Dutch corporate income tax from 2020 unless the pension institution would fulfill the requirements of the new decree. The dividend withholding tax positions of pension institutions that enjoy an exemption from or a reduction of Dutch dividend withholding tax under a double tax treaty are not expected to be adversely affected by this decree.

Our view

The decree is inter alia a result of questions raised in practice about the circumstances under which a foreign employment related pension arrangement is in nature and scope similar to a Dutch employment related pension arrangement. Although, we appreciate that the Ministry of Finance is trying to address these questions, we have doubts as to the criteria applied in the comparison of foreign pension institutions with Dutch exempt pension institutions. Given the purpose of the Exemptions, the comparison should arguably be made on the basis that the foreign pension institution provides employment related pension arrangements that are qualifying and typical under the pension and employment legislation of the country of residence of the pension institution and its participants. Under this argument, foreign pension regimes need to be respected, which is also consistent with the criteria applied for Dutch wage tax purposes.

The decree is the interpretation of the Ministry of Finance of article 5 of the Dutch Corporate Income Tax Act. This provision has not changed. Further, the (interpretation of) Dutch tax legislation needs to be compliant with the fundamental freedoms defined in the TFEU. Given that one or more of the conditions set by the decree may be considered an impediment of the fundamental freedoms, we expect that EU pension institutions whose Exemptions are rejected will seek to challenge such rejection by taking the matter to court in order to obtain a decision from the Court of Justice of the European Union in this matter. It is noted that non-EU pension institutions that hold Dutch equities as a portfolio investment may also invoke the protection of EU law regarding their dividend withholding tax position.

The transitional measure seems to be arbitrary given the fact that the relevant provision in the Dutch Corporate Income Tax Act has not changed. This measure may be seen as unfair by pension institutions that did not obtain a tax ruling but relied on the application of the law itself. Furthermore, the transitional measure does not take into account that an investment in Dutch immovable property typically has an investment horizon laying well beyond 2020.

Next steps

Dutch tax exempt pension institutions which provide foreign employment related pension arrangements and foreign pension institutions with Dutch sources of income are recommended to assess whether they meet the conditions of the decree and also to enter into a dialogue with the Dutch tax authorities to obtain their view. Should the Dutch tax authorities decide that the pension institution does not qualify for the Exemptions, the pension institution could consider taking further action such as filing a complaint with the European Commission or starting a litigation against a tax assessment or decision to deny the Exemptions.

Should you wish to discuss the potential impact of this decree on your specific situation, please reach out to your regular PwC contact or to one of the contacts listed below.

Contact

Uwe Stoschek
Global Real Estate Tax Leader
Phone: +49 30 2636-5286
uwe.stoschek@de.pwc.com

Jeroen Elink Schuurman
EMEA Real Estate Tax Leader
Phone: +31 88 792-6428
jeroen.elink.schuurman@nl.pwc.com

The Netherlands

Jeroen Elink Schuurman
National Real Estate Tax Leader
Phone: +31 88 792-6428
jeroen.elink.schuurman@nl.pwc.com

Tijmen Cabollet
Senior Real Estate Tax Consultant
Phone: +31 88 792-4311
tijmen.cabollet@nl.pwc.com

Germany

Sven Behrends
Partner, München
Phone: +49 89 5790-5887
sven.behrends@de.pwc.com

Helge Dammann
Partner, Berlin
Phone: +49 30 2636-5222
helge.dammann@de.pwc.com

Marcel Mies
Partner, Düsseldorf
Phone: +49 211 981-2294
marcel.mies@de.pwc.com

Dr. Michael A. Müller
Partner, Berlin
Phone: +49 30 2636-5572
mueller.michael@de.pwc.com

Josip Oreskovic-Rips
Partner, Frankfurt am Main
Phone: +49 69 9585-6255
josip.oreskovic-rips@de.pwc.com

Uwe Stoschek
Partner, Berlin
Phone: +49 30 2636-5286
uwe.stoschek@de.pwc.com