



Accountants, Tax & Legal Advisers

TRUST ALERT

“Everything you always wanted to know about ‘tax and audit’, but were afraid to ask.”

(inspired by Woody Allen)

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Dutch qualification of debt instruments

Dutch tax law provides numerous restrictions for the deduction of interest (see issue 2 of HLB Trust Alert 2008). In certain cases, debt will be classified and therefore be treated as equity for fiscal purposes. Interest paid on such “debt” may not be deducted from Dutch taxable profits. On the other hand, if the creditor is a Dutch resident company, the “interest” will be treated as a dividend and can – subject to certain requirements – be received tax exempt by the Dutch creditor.

When is debt classified as equity? According to the Dutch supreme court a key tax principle is that funding which is provided in the form of a debt instrument from a civil law perspective may also be considered as debt from a tax perspective, except in specific exceptional circumstances. The exceptions to the general rule that the civil law classification of a debt instrument is followed for tax purposes are:

- (a) debt from a civil law perspective is classified as equity for corporate income tax purposes if the parties, despite the legal form of the transactions, intended to provide equity instead of debt (sham transaction);
- (b) the circumstances under which the loan was granted are such that it is evident that the funds have permanently left the assets of the creditor – e.g. because the debtor will not be able to repay the loan due to its continued loss position; and
- (c) the loan is granted in such circumstances that the creditor in fact participates in the debtor’s enterprise. This is the case if the following three conditions have been met:
 - The term is perpetual (i.e. over 50 years).
 - The remuneration on the debt is entirely or nearly entirely contingent on profits.
 - The loan is subordinated to all creditors.

A repayment term of 51 years and very small portion of fixed interest (1/8 of the total interest) may in certain jurisdictions mean that a loan will remain a loan for local tax purposes.

The above could result in a deduction of interest in the country of the debtor while the corresponding “interest” income can be received tax exempt in the Netherlands to the extent the participation exemption applies. In that way a Dutch corporate shareholder that has granted “debt” to its subsidiaries can benefit from the classification into equity.

The tax consequences in the country of the debtor, however, should be checked locally. HLB International has member firms in over 110 countries in the world. Obviously we are more than willing to assist both in the country of the debtor as well as in the country of the creditor.

IFRS, a force to be reckoned with

Since fiscal year 2005, publicly listed companies in the European Union must comply with the International Financial Reporting Standards as adopted by the European Union (“IFRS”). Furthermore, in more than a hundred other countries, IFRS is either required or highly recommended. It is clear that this trend to use one uniform accounting standard for financial reporting is unstoppable. It should be noted that IFRS is a standard part of the auditor’s education, in the various Manuals for External Reporting, and for the media, investors, the political arena and financial people.

The Dutch regulatory authorities also allow Dutch private companies to use IFRS for both the consolidated and the standalone financial statements instead of Generally Accepted Accounting Principles in the Netherlands (“Dutch GAAP”). We expect that the shareholders and/or management of private companies will put IFRS on the agenda more often. What is more, the Dutch regulatory authorities have accepted IFRS as a viable alternative in those cases where the (ultimate) parent company prepares consolidated financial statements in accordance with IFRS and where the Dutch intermediate holding company wants to make use of article 2:408 of the Netherlands Civil Code.

What IFRS services can HLB Schippers provide to our clients?

The IFRS desk of HLB Schippers can assist clients in the following areas:

1. Quick scan “Transition to IFRS”
2. Full IFRS implementation (from Dutch GAAP to IFRS)
3. IFRS advice
4. IFRS training
5. IFRS SME advice (both quick scan and full implementation)

1. Quick Scan “Transition to IFRS”

A transition to IFRS not only includes the financial statements but also various other aspects of a company. Management may want to seek advice related to the implications of a transition to IFRS. There are a variety of reasons to change from NL GAAP to IFRS:

- Transparency (compatibility of financial information)
- Harmonisation of external financial reporting standards in an international organisation
- Potential advantages in case the company is to be sold
- International requirements by shareholders and potential investors
- Image

There are also a number of challenges such as:

- Impact/complexity of IFRS standards on the processes and personnel of the company
- Managing the extensive transition process
- Increase and maintain IFRS expertise in the organisation
- Extensive disclosure of financial information
- Cost aspect

To minimize the cost of implementation, we offer our client a quick scan “Transition to IFRS”. This quick scan provides our clients with a high-level analysis of the main implications of the transition to IFRS on the financial statements and the company. Our quick scan focusses on advising our clients on what internal steps to take to ease the transition to IFRS. In 2 to 3 days we discuss all potential relevant IFRS areas with the client which leads to a clear report of factual findings.

2. Full IFRS implementation

HLB Schippers has extensive IFRS knowledge and experience to advise our clients with regard to a full IFRS implementation process. We will analyse (with the client) the effects of the implementation of all applicable IAS and IFRS standards on the financial statements including the application of IFRS 1 “First-Time Adoption of International Financial Reporting Standards”.

3. IFRS advice

HLB Schippers assists clients when questions arise with regard to the application of existing IAS or IFRS standards or the introduction of new IFRS standards.

4. IFRS training

HLB Schippers offers IFRS training either tailored to the needs of the individual client or as basic IFRS training.

5. IFRS SME advice

On 9 July 2009, the final IFRS for Small and Medium-sized Entities (“IFRS SME”) standards were published. IFRS SME allows non-listed companies the opportunity to communicate internationally with their financial statements without the high costs of ‘full IFRS’ as a result of a number of simplifications of ‘full IFRS’. IFRS SME can as such become an interesting option for internationally focused companies and subsidiaries of listed companies.

HLB Schippers can advise clients on the effects of a potential transition from Dutch GAAP to IFRS SME, both at a high level (through a quick scan) as well as in detail (full implementation).

IFRS desk

The IFRS desk at HLB Schippers is led by experienced IFRS experts. For further information, please do not hesitate to contact us.

Tax treaty between the Netherlands and Hong Kong

The Dutch Minister of Finance and the Treasury of the Hong Kong Special Administrative Region signed the first tax treaty between the Netherlands and Hong Kong in March 2010. It is expected that the tax treaty will take effect on January 1, 2011 for the Netherlands and April 1, 2011 for Hong Kong.

The tax treaty enables that profits from Dutch (holding) companies can be repatriated to Hong Kong investors exempt from Dutch dividend withholding tax.

The current situation without tax treaty

At present the Netherlands and Hong Kong do not withhold tax on interest. What is more, Dutch tax law does not withhold tax on royalty payments, while dividends from Hong Kong are not subject to withholding tax. This will not change under the tax treaty.

On the other hand, the Dutch dividend withholding tax rate on dividends paid by a Dutch BV or NV-company to a Hong Kong resident shareholder is 15%. The current withholding tax rate on royalties paid by a Hong Kong company to a Dutch company is effectively 4.95%. Once the new tax treaty comes into force, these rates will be mitigated.

When the tax treaty comes into force

Under the new tax treaty, the Dutch domestic rate of 15% for Dutch BV and NV-companies may be reduced to 0% when certain conditions are met. In addition no minimum withholding period applies.

The 0% dividend withholding tax rate applies to dividends distributed by a Dutch company to a:

- Qualifying headquarters of a multinational group resident in Hong Kong.
- Hong Kong shareholder, whose shares are traded on a recognized stock exchange, owning at least 10% of the share capital in the Dutch company, or
- if the shares of Hong Kong company are at least 50% owned by a company resident in Hong Kong, the Netherlands or another EU country which has concluded a tax treaty with Hong Kong with a 0% withholding tax rate and the shares of the parent of the Hong Kong company are traded on a recognized stock exchange.

- Banks or insurance companies and pension funds resident in Hong Kong
- Hong Kong government, government institutions, political subdivisions or local authorities.

Nevertheless the competent authority of the Netherlands can also allow the 0% rate to apply if these conditions are not met but the Dutch company was not established, acquired or maintained with the main purpose to secure the 0% treaty rate. In all other cases a 10% withholding tax rate applies.

Moreover, the current withholding tax rate on royalties paid by a Hong Kong company to a Dutch company may be reduced to 3% under the tax treaty.

Dutch cooperative

In the case of a Dutch cooperative association paying a dividend to a corporate shareholder abroad, no dividend withholding tax is withheld at all irrespective of whether a tax treaty is in place or not. It is for this reason that nowadays Dutch cooperatives are frequently used as international holding companies instead of Dutch BV-companies in order to avoid the Dutch dividend withholding tax.

Australian tax office attacks inbound investment structure

Contributed by Neil Wickenden, HLB Mann Judd, Australia

In an unexpected move, the Australian Taxation Office (“ATO”) has raised the income tax assessment and also given a substantial penalty on the Australian profits earned by a non-resident private equity fund. Although in this instance a private equity fund is involved, the move potentially has far wider implications for non-resident investors in Australia.

Investment structure

Texas Pacific Group, a US-based private equity fund, had taken an investment position in the Australian company which owns Myer, one of Australia's leading retail department store chains. TPG structured its investment through a Cayman Islands company (TPG Newbridge Myer) which owned a Luxembourg company (NB Queen) which in turn owned a Netherlands holding company. The Netherlands holding company owned the investments in Myer Holdings. This type of structure is common for non-resident equity funds investing into Australia.

Australia-Netherlands double tax agreement

Australia and the Netherlands entered into a double tax agreement in 1976 which was most recently updated in 1986. This treaty does not specifically deal with capital gains, the taxation of which was introduced in Australia only in 1985. But based on recent Australian court decisions, capital gains made by Netherlands' residents on realization of Australian-based assets, other than direct and indirect interests in Australian real estate, would be the subject of the treaty. Such capital gains would not be subject to Australian income tax provided that the Netherlands' residents do not have permanent establishments in Australia.

For this reason, on the sale of the Netherlands company's investment in Myer Holdings it was expected that any profits on the sale would not be subject to Australian income tax. Australia does not have double tax agreements with either Luxembourg or the Cayman Islands.

Income tax assessment

The ATO, however, issued an income tax assessment to the Netherlands company for A\$452 million income tax plus a penalty of A\$226 million. It also sought Court orders to freeze bank accounts containing some of the proceeds on the public float in an effort to secure payment of the income tax assessment. The assessment has apparently been issued under the general anti-tax avoidance provision of Australia's tax laws. Under this

provision, the ATO can set aside or ignore arrangements where one of the participants has a dominant purpose of tax avoidance, and impose substantial penalties.

The basis of the ATO's income tax assessment appears to be, first, that a purpose of the investment structure, and in particular the inclusion of the Netherlands holding company, was tax avoidance. This would explain why the income tax assessment has been issued under the general anti-tax avoidance provision. Secondly, the ATO appear to have taken the view that if the profit had been earned directly by TPG, rather than by the Netherlands holding company, it would have been ordinary trading income rather than a capital gain. This view would be based on the presumption that from the outset it was TPG's intention to sell its investment in Myer Holdings for a profit.

Policy issue

Australian Government policy has been to encourage foreign investment and the flow of capital funds into Australia. Accordingly, in 2006 Australia's tax laws were amended to provide that non-resident investors into Australia would not be subject to Australian income tax on capital gains made on the realization of Australian-based assets, other than direct and indirect interests in Australian real estate.

Although the ATO's move is contrary to Australian Government policy, it would no doubt be defended by the ATO as being the proper administration of the tax law.

Wider implications

The ATO's move has wider implications for other investors into Australia which have structured their investments to take advantage of Australia's DTA's providing relief from Australian capital gains tax. If the ATO take the view that such investors have 'treaty shopped' and also that their intention is to sell their Australian investments for a profit, the ATO could issue the same sort of income tax assessments to them when they sell their Australian investments.

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