Government Relaxes Thin Capitalization Rules

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CapitalizationRules

OnDecember4thethedutchgovernmentpublishedapolicystatement1thaterelaxesthestoon-to-be-abolished
thin capitalization rules. The policy changes, which relate to the election to apply the group ratio test, took
effect on December 4.

The thin cap rules, which were added to the Dutch
Corporate Income Tax Act with effect from January 1,
2004, will be abolished as of January 1, 2013, or if a
taxpayer’s tax year is not the calendar year, the first
day of the first financial year starting after January 1,
2013. (For prior coverage, see Tax Notes Int’l, Oct. 1,
2012, p. 34, Doc 2012-19630, or 2012 WTD 184-2.)

The thin cap rules limit the deductibility of interest
costs if a borrowing company is considered excessively
debt financed. The limitation only applies to the extent
that the interest costs relating to the excessive debt fi-
nancing can be considered to be because of affiliated
parties. Whether a taxpayer qualifies as excessively
debt financed is determined, in principle, on the basis
of the fixed ratio of 3 to 1.

A taxpayer may elect to apply a group ratio test in-
stead of the fixed ratio test. Under this alternative test,
a company does not qualify as excessively debt fi-
nanced if the taxpayer is not more highly leveraged
than the overall group to which it belongs. In principle,
the group ratio test is to be applied using data derived
from the taxpayer’s financial statements and the
overall consolidated financial statements.

Group Ratio Test

The Dutch Supreme Court has ruled that in some
circumstances the thin cap rules also apply if no con-
solidated group financial statements are prepared. In
the relevant case (No. 10/01719, Nov. 18, 2011), the
Dutch taxpayer argued that one of the conditions for
applicability of the thin cap rules is that the Dutch tax-
payer is part of a group for Dutch corporate law pur-
poses and that in the absence of consolidated financial
statements, no such group should be deemed to exist.
The Supreme Court ruled that the existence of a group
(for Dutch corporate law purposes) needs to be deter-
mimed based on the criteria laid down in the relevant
provision. The Court deemed it irrelevant that the
Dutch accounting rules — which refer to the same cri-
teria to be applied for Dutch corporate law purposes —
provide an exemption from the obligation to prepare
consolidated financial statements.

Obviously, non-Dutch accounting rules that a non-
resident member of a Dutch group may be subject to
to apply totally different criteria to determine
whether consolidation needs to occur at the level of
that (higher-tier) entity. That will not affect the out-
come of the analysis of whether the foreign entity
should be considered a member of the same group for
Dutch corporate law purposes.

Without consolidated financial statements at the
level of the head of the group, there seems to be no
basis for a Dutch taxpayer to elect for the group ratio
test. After all, the group ratio is to be derived from
data included in the group’s consolidated financial
statements.

The Dutch state secretary for finance has deter-
mimed that this is unreasonable and that in such a case
the purpose and scope of the group ratio test justifies
the determination of the group ratio as if consolidated
financial statements had been prepared.

Election to Apply Group Ratio Test

The thin cap rules state that the election for the
group ratio test, which can be made for each separate
year, should be made in the tax return for the relevant
year. In principle, no election can be made after the
assessment for the relevant tax year has become final.
In a deviation from previous policy, taxpayers may
now submit a request for an ex post facto reduction of
the Dutch corporate income tax assessment for a given
year if it appears (after the assessment has become fi-
nal) that erroneously no election was made.

It should be noted that the state secretary for fi-
nance believes that it is always advantageous to elect
the group ratio test if the group ratio exceeds the fixed

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ratio of 3 to 1. This is not necessarily true since different principles will be applied to determine the level of debt financing obtained by a Dutch taxpayer. For example, when determining the relevant debt amount, netting is allowed when applying the fixed ratio test, which is not the case with the group ratio test.

The state secretary for finance considers it important that the election for the group ratio test is made solely for the relevant year. If in a subsequent year the group ratio is lower than the fixed ratio, the group ratio does not need to be selected again. Also, there are no potentially adverse tax consequences from electing for the higher group ratio. In the view of the state secretary for finance, this means that not opting for the higher group ratio must be explained by a mistake made by, or on behalf of, the taxpayer. Therefore, taxpayers now have the option to request an ex post facto reduction in these cases. Such requests must to be submitted to a centralized department within the Dutch tax authorities.

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