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Uncollected Dividend Tax Liability Is Part of Taxable Profits, Court Rules

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COUNTRY DIGEST

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In a recently released decision, the Dutch Supreme Court ruled in favor of the Dutch tax authorities and held that a company that was released from its dividend tax liability must add the amount of the liability to its taxable profits for the relevant year for corporate income tax purposes.

Case History

The case (No. 12/01957, LJN: BX9148, Mar. 8, 2013) concerned a Dutch limited liability company (BV). As of December 31, 2006, BV's tax balance sheet showed a dividend tax liability amounting to €45,378. In an earlier year, BV had paid a dividend to its sole shareholder (an individual) from which, in its capacity as withholding agent, it had withheld the correct amount of Dutch dividend tax. The statute of limitation for the collection of the dividend withholding tax, which is levied on the dividend recipient, expired, so the Dutch tax authorities could not collect the amount of withholding tax from BV. Consequently, when issuing the 2006 Dutch corporate income tax assessment, the Dutch tax authorities held that BV should be considered released from its dividend tax liability and that the amount of the liability should be added to BV's taxable profits.

BV disagreed that the release of liability constituted a taxable event and objected to the assessment. The main ground for its objection was that a profit distribution paid to a shareholder, which includes any amount of withholding tax due from the shareholder but withheld by the distributor, constitutes a nondeductible expense. BV argued that it was therefore logical that a subsequent release of liability — for which no tax deduction had thus been claimed — regarding such a dividend payment would not contribute to BV's taxable profits. In an old decision, the Supreme Court had, in fact, decided along these lines regarding declared dividends that could no longer be claimed by the shareholders.

Supreme Court's Decision

The tax authorities rejected BV's objection. After the District Court of Haarlem found in favor of BV, both the High Court of Amsterdam and the Supreme Court agreed with the tax authorities' position.

The Supreme Court held that based on article 10, paragraph 1, opening sentence and subparagraph (a) of the Corporate Income Tax Act 1969 (CITA), distributions of profit are not deductible in determining the taxable profit. This is based on the principle that a distribution of a dividend by a company to its shareholder is a matter that takes place between the company and its shareholder — that is, within the capital sphere rather than the profit sphere. In other words, it is a matter of determining the use of a company's (after-tax) profits rather than determining the company's profits itself. In the Court's view, the principles underlying this provision of the CITA also apply if a shareholder does not retrieve a declared dividend payment made; this uncollected dividend does not increase the taxable profit once the payment of the dividend can no longer be demanded by the shareholder.

However, the Supreme Court held that a dividend tax liability does not fall within the capital sphere and the scope of the relevant provision, but instead should be treated as an (autonomous) debt stemming directly from Dutch law — in this case, the Dividend Tax Act. Consequently, the release of the relevant liability should receive the same treatment as all other ''ordinary'' debts: The release of dividend tax liability increases BV's taxable income.

Comments

As a consequence of this decision, it might seem that BV is subjected to partial double taxation on the same profits. After all, corporate income tax was due on the profits out of which the dividend was paid. The dividend withholding tax liability is part of that after-tax profit distribution. Following the release of this liability, corporate income tax becomes due a second time because the amount of the liability is included in the taxable profits in the year in which the release takes place. On this ground, the release of a dividend

debt has previously been considered nontaxable. However, one important difference can be recognized between a dividend debt and a dividend withholding tax debt: If dividend tax was withheld by BV on the account of a Dutch shareholder, that shareholder may have claimed a credit for the tax against its own personal or corporate income tax liability regardless of whether the withholding tax was actually paid to the Dutch tax authorities.

It is not clear from the facts of the case whether BV's shareholder actually claimed and obtained a credit for the dividend tax withheld by BV. If so, the outcome of this case seems only fair. This would be different if no credit was enjoyed. This decision means that now the amount of the release of liability will be subject to corporate income tax in the year of release and to dividend withholding tax upon distribution in the future. ◆

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