



VMW TAXAND

New Dutch – Japanese tax treaty signed

For more than 400 years Japan and the Netherlands have had a very good trade relation. The tax treaty between Japan and the Netherlands is of great importance due to significant inward and outward investment to and from Japan through Dutch companies.

Today (August 25th 2010) representatives of Japan and The Netherlands signed a new treaty for the avoidance of double taxation in Tokyo. The new treaty replaces the one concluded between Japan and the Netherlands in 1970.

The most important changes of the new tax treaty are that it will significantly reduce the withholding tax rates applicable to dividends and royalties. This will ensure that the Netherlands will remain one of the most important trading partners of Japan. The treaty will also introduce new provisions aimed at preventing tax evasion and abuse of the treaty.

The main changes of the new treaty compared to the current treaty can be summarized as follows:

Reductions or exemptions of withholding tax

The most important reduction considers a full dividend withholding tax exemption for beneficial owners of shareholdings representing at least 50% of the voting rights in a subsidiary (subject to other specific requirements such as a 6 month holding period and the limitation of benefits requirements). Under the current treaty a minimum 5% dividend withholding tax rate applies. A Dutch Coop structure can be considered in structures where the requirements for the 0% rate can not be met.

Due to the introduction of the participation regime in the Japanese tax regime the 5% dividend withholding tax can not be credited against Japanese taxable income and therefore results in a significant tax cost upon repatriation of profits. The new treaty will eliminate this cost (provided that the requirements for the 0% rate are met) and will therefore make the Netherlands an even more attractive location for holding companies for Japanese multinationals.

The withholding tax on royalties will also be reduced to 0% (from 10%). This is only relevant for royalty payments by Japanese companies to a Dutch company as the Netherlands does not levy royalty withholding tax. The interest withholding tax rate will also be reduced to 0% for qualifying financial institutions such as banks (please note that the Netherlands does not levy withholding tax on interest).



The withholding tax rates are in line with recent tax treaties concluded by Japan with Australia, France, the UK and the US. These withholding tax rates are however significantly lower compared to other typical holding/finance locations.

Please find an overview below:

		Current treaty	New treaty
Dividends	Qualifying shareholders	5%	0%
	Other	15%	10%
Interest	Financial institutions	10%	0%
	Other	10%	10%
Royalties		10%	0%

Limitation on benefits

The 0% withholding tax rates are only applicable if so-called “limitation of benefits” requirements are met. These requirements are also included in the recent tax treaties that Japan has concluded with the United States, Australia and the United Kingdom. These rules are based on limitation of benefit rules included in most of the US tax treaties. The limitation on benefits rules provide that a resident of either country is only entitled to all treaty benefits if such a resident qualifies under one of the limitation of benefits tests. Examples of such tests in this treaty are the stock-exchange test, the equivalent beneficiary test and the headquarter test. The Japanese tax authorities in general require foreign companies wishing to apply the benefits of the treaty to complete a form in order to determine whether the limitation on benefits rules are met.

In normal investment structures of Japanese companies into or through Dutch companies these requirements should easily be met. Current structures should however be reviewed. VMW Taxand has developed flowcharts to easily determine whether the limitation of benefits requirements can be met.

Mutual agreement procedure

The mutual agreement procedure to resolve double taxation is now included in more detail. A case should be presented to the competent authorities within three years. The treaty also includes an arbitration procedure if the authorities have not been able reach an agreement within two years of the presentation to the competent authority. The arbitration panel will consist of three independent arbitrators.



Transfer pricing adjustments

A transfer pricing adjustment made by one of the contracting States will be followed by an appropriate adjustment of the other contracting State provided both contracting States agree to the adjustment. The competent authorities shall, if necessary, consult each other in this regard.

Tokumei Kumiai structures

Multinationals have frequently structured investments into Japan through Japanese silent partnerships (Tokumei Kumiai or TK) structures with a Dutch silent partner because under the current treaty distributions of the TK can be made free of Japanese corporate income tax and withholding tax.

The protocol to the new Netherlands-Japan tax treaty gives Japan explicitly the right to tax any income and capital gains from sleeping partners in a TK. This effectively means that distributions from a TK to a Dutch resident partner will incur Japanese withholding tax of 20%. The attractiveness of Dutch TK structures will therefore be reduced by the new treaty but may still be beneficial under circumstances.

Other changes

The capital gains article now contains a specific provision under which the source state is allowed to levy tax on the alienation of shares in companies which value consists of at least 50% of immovable property.

The Protocol to the treaty explicitly allows the Netherlands to qualify income from liquidation proceeds and purchase of own shares as dividends rather than capital gains.

It was expected that a new tie-breaker rule based on a mutual agreement procedure would be introduced for determining the residency of dual-resident corporate entities. The final text of the treaty however mentions that the residency shall be determined based on the place of head or main office and does not include a specific mutual agreement procedure.

The treaty includes an article which ensures the application of the participation exemption on dividends received by Japanese companies provided that the Japanese company owns 10% of the (voting) shares and the company owned those shares for more than six months prior to the dividend.

Entry into force

The treaty still needs to be ratified by both countries. Due to the delay in the formation of a new coalition government in the Netherlands the ratification procedure may also be delayed and therefore the new treaty may enter into force as of 1 January 2012 instead of 2011. A



grandfathering period of twelve months applies where any person elects to continue to apply the current treaty because the person has greater benefits under the current treaty.

Conclusion

The current Dutch – Japanese tax treaty stems from 1970. Given the many Japanese investments in the Netherlands, there is a clear need to update the treaty to ensure that the Netherlands continues to be one of the most attractive investment and holding locations for Japanese multinationals. The proposed new treaty introduces welcome changes to sustain current investment and attract future trading by Japanese companies. Current structures should be reviewed in order to determine whether the new lower withholding tax rates apply and whether the limitation of benefits requirements are met. Current TK structures for investments in Japan may need to be changed once the treaty enters into force.

The delay in the ratification procedure in the Netherlands is unfortunate. VMW Taxand will work with various industry groups to try to speed up this process in order to have the new treaty effective as of 2011.

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