

Eligibility for Treaty Benefits Under The Netherlands-U.S. Income Tax Treaty

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The information in this article is general in nature and based on authorities that are subject to change. Applicability to specific situations is to be determined through consultation with your tax adviser. This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG.

To be entitled to benefits under income tax treaties, companies must satisfy eligibility requirements. This article includes flowcharts to help practitioners navigate the eligibility requirements of the Netherlands-U.S. income tax treaty applicable to Dutch companies.¹

Income tax treaties may exempt business income from source country income taxes and eliminate or reduce domestic withholding taxes on payments between residents of countries that are parties to an income tax treaty. To be entitled to benefits under U.S. income tax treaties, a company must not only be a resident of the tax treaty partner's country, but generally must also satisfy at least one of the tests in the treaty's limitation on benefits provision, if applicable.

The flowcharts in this article focus on the eligibility of Dutch companies claiming benefits on income that would otherwise be subject to U.S. taxation. This article does not address the eligibility for treaty benefits of entities that are partnerships or are otherwise transparent for U.S. or Dutch tax purposes. Also, the flowcharts do not address "triangular cases" under article

12 (interest) or article 13 (royalties) of the treaty. This article is based on the treaty, the 2004 protocol to the treaty, the U.S. Treasury technical explanation to the 2004 protocol, and the memorandum of understanding (MOU) to the 2004 protocol.

This article is the sixth in a series of articles² that provide flowcharts to assist practitioners in determining a company's eligibility for tax treaty benefits under the LOB provisions of specific U.S. income tax treaties, and, when applicable, in determining eligibility for a 0 percent withholding tax rate on cross-border intercompany dividend payments to the company.

²See John Venuti, Jason Connery, Douglas Poms, and Alexey Manasuev, "Eligibility for Treaty Benefits Under the Canada-U.S. Income Tax Treaty," *Tax Notes Int'l*, June 15, 2009, p. 967, *Doc 2009-11815*, or *2009 WTD 113-15*; Venuti, Ron Dabrowski, Poms, and Manasuev, "Eligibility for Treaty Benefits Under U.K.-U.S. Income Tax Treaty," *Tax Notes Int'l*, Mar. 23, 2009, p. 1095, *Doc 2009-4590*, or *2009 WTD 56-9*; Venuti, Connery, Poms, and Manasuev, "Eligibility for Treaty Benefits Under the Luxembourg-U.S. Income Tax Treaty," *Tax Notes Int'l*, July 21, 2008, p. 285, *Doc 2008-14359*, or *2008 WTD 142-8*; Venuti, Dabrowski, Poms, and Manasuev, "Eligibility for Treaty Benefits Under the France-U.S. Income Tax Treaty," *Tax Notes Int'l*, Feb. 11, 2008, p. 523, *Doc 2008-773*, or *2008 WTD 33-10*; and Venuti and Manasuev, "Eligibility for Zero Withholding on Dividends in the New Germany-U.S. Protocol," *Tax Notes Int'l*, Jan. 14, 2008, p. 181, *Doc 2007-27516*, or *2008 WTD 12-10*.

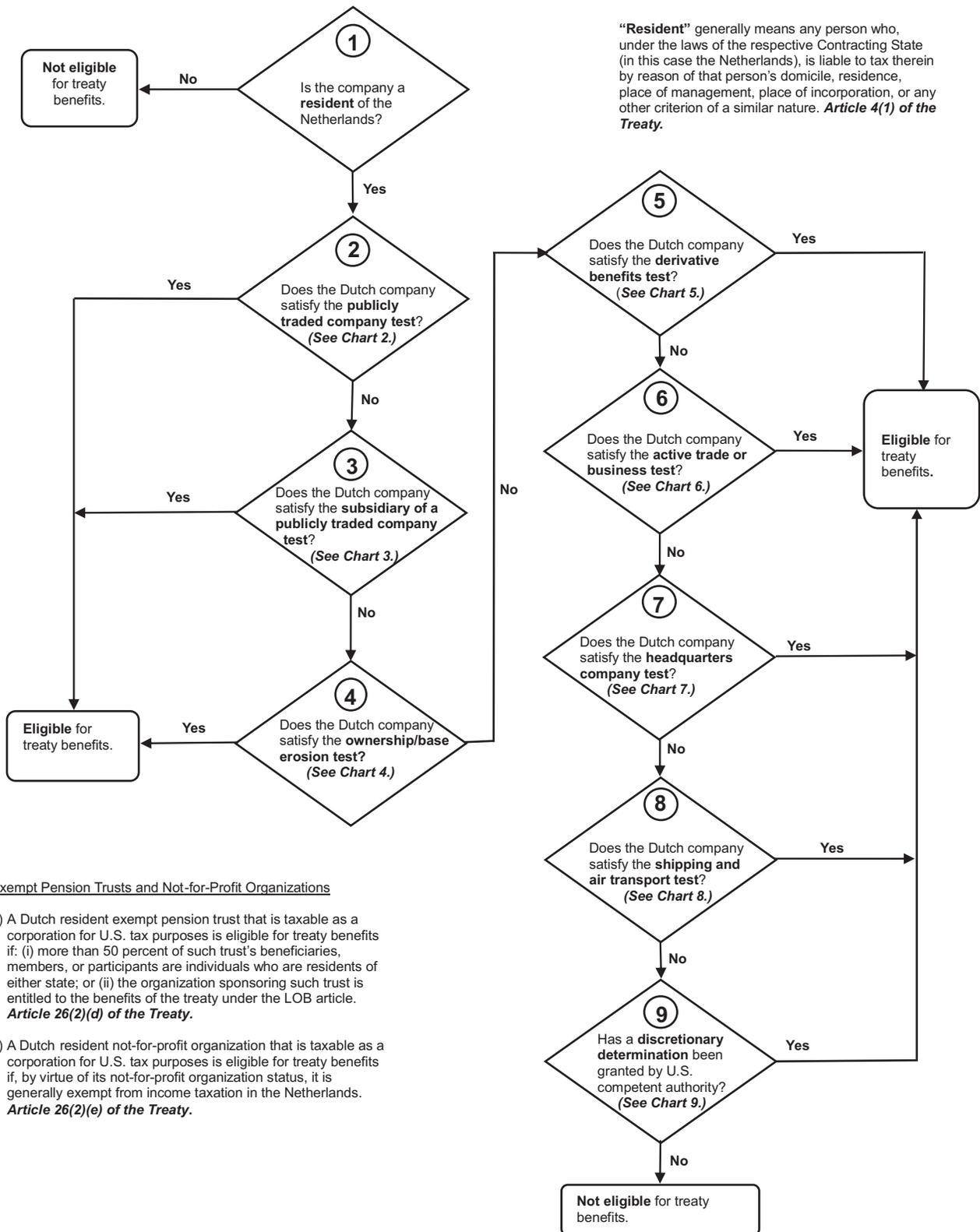
¹Convention Between the Kingdom of the Netherlands and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, signed on December 18, 1992 (as amended by protocols signed on October 13, 1993, and March 8, 2004).

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This article contains 10 flowcharts. The first nine flowcharts analyze the LOB provision of the treaty as applied to Dutch companies. The tenth flowchart analyzes the requirements a Dutch company must satisfy to qualify for a 0 percent withholding tax rate on cross-border intercompany dividend payments to the com-

pany under article 10(3) of the treaty. Although the flowcharts provide a comprehensive review of applicable provisions under the treaty, taxpayers and their tax advisers should carefully evaluate each case and determine whether the requirements of the treaty are met based on all facts and circumstances. ◆

Chart 1. Eligibility for Treaty Benefits Under Article 26 (LOB) of the Netherlands-U.S. Tax Treaty



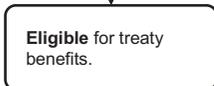
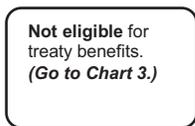
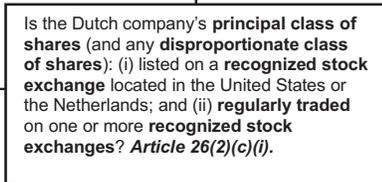
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Chart 2. Publicly Traded Company Test Under Article 26(2)(c)(I) (LOB) of the Netherlands-U.S. Tax Treaty

“Principal class of shares” means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the **principal class of shares** is that class or those classes that in the aggregate represent a majority of the aggregate voting power and value of the company. *Article 26(8)(b)(i) of the Treaty.*

“Shares” include depository receipts thereof or trust certificates thereof. *Article 26(8)(b)(ii) of the Treaty.*

“Disproportionate class of shares” means any class of shares of a company that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments, or otherwise, in the earnings generated in the other state by particular assets or activities of the company. *Article 26(8)(c) of the Treaty.*



“Recognized stock exchange” means:

- (i) the NASDAQ system and any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934;
- (ii) the Amsterdam Stock Exchange and any other stock exchange subject to regulation by the Authority for the Financial Markets (or its successor) in the Netherlands (e.g., Euronext);
- (iii) the Irish Stock Exchange, the Swiss Stock Exchange, and the stock exchanges of Brussels, Frankfurt, Hamburg, Johannesburg, London, Madrid, Milan, Paris, Stockholm, Sydney, Tokyo, Toronto, and Vienna; and
- (iv) any other stock exchange agreed upon by the competent authorities. *Article 26(8)(a) of the Treaty; MOU, Paragraph XXV.*

Shares in a class of shares are considered to be **regularly traded** on one or more **recognized stock exchanges** in a tax year if the aggregate number of shares of that class traded on such stock exchange(s) during the 12 months ending on the day before the beginning of that tax year is at least 6 percent of the average number of shares outstanding in that class during the 12-month period. *Article 26(8)(h).* If a class of **shares** was not listed on a **recognized stock exchange** during this 12-month period, the class of **shares** will be treated as **regularly traded** only if the class meets the aggregate trading requirements for the taxable period in which the income arises. *MOU, Paragraph XXVII.*

Trading on one or more **recognized stock exchanges** may be aggregated for purposes of meeting the **regularly traded** standard. Authorized but unissued shares are not considered for purposes of the publicly traded company test. *U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.*

A Dutch company has **substantial presence** in the Netherlands if either:

- 1) (i) the aggregate volume of trading in such company's stock on **recognized stock exchanges** in its **primary economic zone** is greater than the aggregate volume of trading in its stock on **recognized stock exchanges** located in the United States; or (ii) trading in the company's stock on **recognized stock exchanges** in its **primary economic zone** constitutes at least 10 percent of total worldwide trading in such company's stock; or
- 2) the company's primary place of management and control is in the Netherlands. *Article 26(8)(d) of the Treaty.*

For purposes of 1) (i) and (ii), the Dutch company may make this determination using the average trading volumes for the three preceding tax years. *Article 26(8)(e)(i) of the Treaty.*

The “**primary economic zone**” of the Netherlands includes the member states of the European Union or the European Economic Area. *Article 26(8)(e)(ii) of the Treaty.*

A Dutch company's **primary place of management and control** is in the Netherlands only if executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial, and operational policy decisionmaking for the company (including its direct and indirect subsidiaries) in the Netherlands than in any other state, and the staffs conduct more of the day-to-day activities necessary for preparing and making those decisions in the Netherlands than in any other state. *Article 26(8)(e)(iii) of the Treaty.*

For guidance regarding the persons who are considered “executive officers and senior management employees,” see *MOU, Paragraph XXVI; U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty*

Chart 3. Subsidiary of a Publicly Traded Company Test Under Article 26(2)(c)(ii) (LOB) of the Netherlands-U.S. Tax Treaty

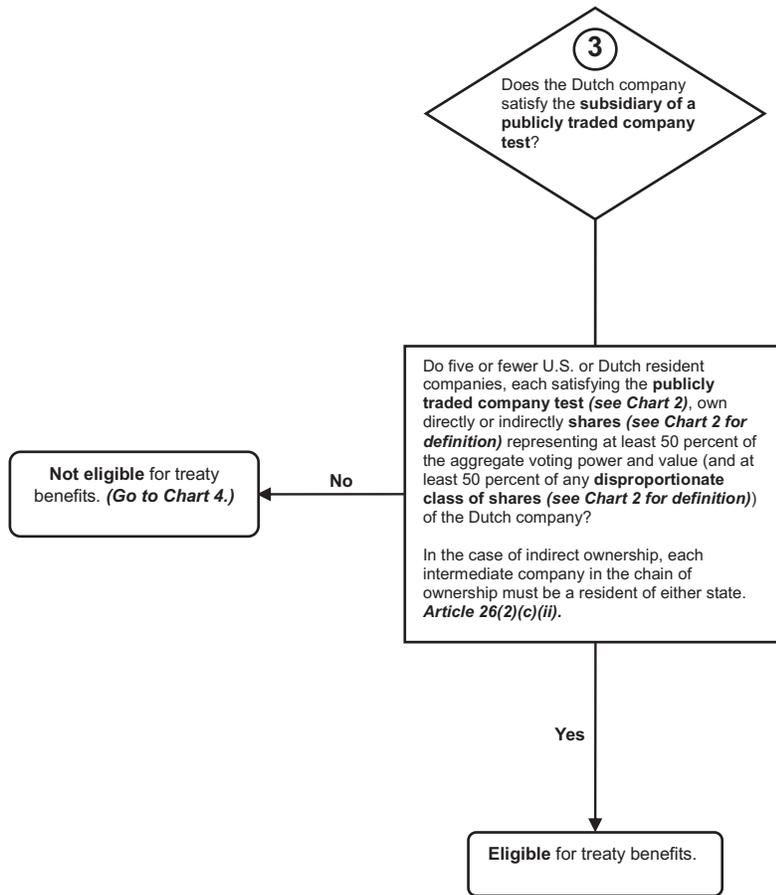
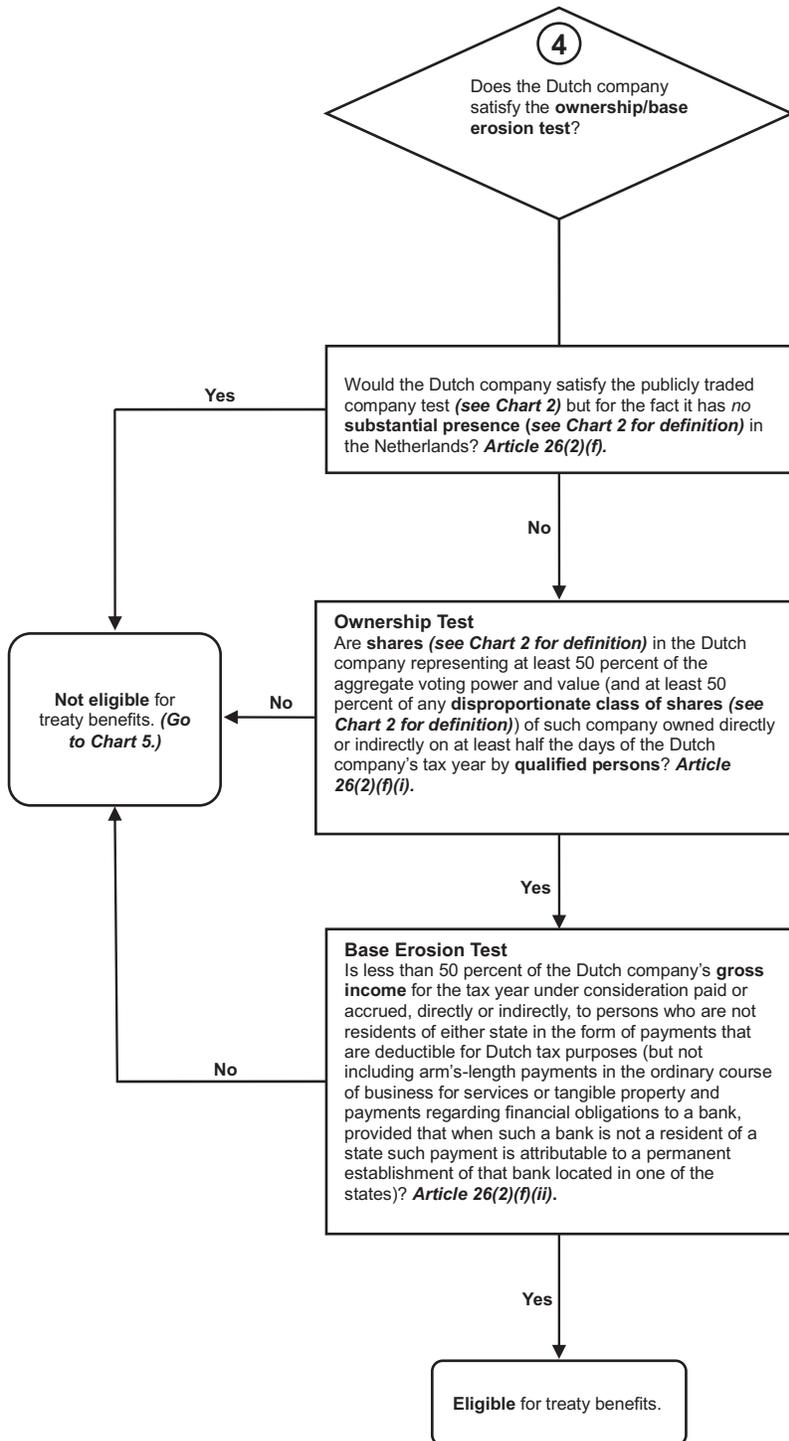


Chart 4. Ownership and Base Erosion Test Under Article 26(2)(f) (LOB) of the Netherlands-U.S. Tax Treaty



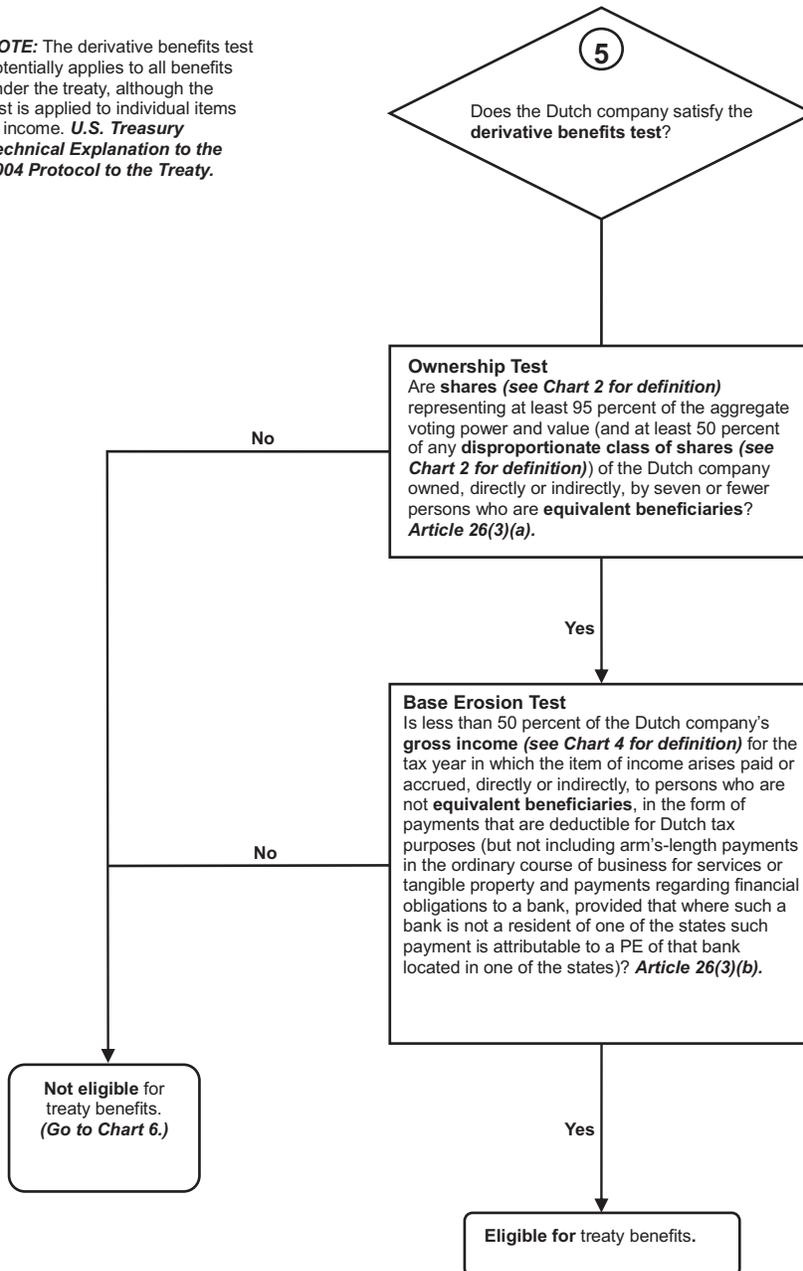
Qualified persons for purposes of this test are limited to residents of the Netherlands or the United States that are:

- A. individuals resident in the United States or the Netherlands (*article 26(2)(a) of the Treaty*);
- B. the Netherlands or the United States, political subdivisions, or local authorities thereof (*article 26(2)(b) of the Treaty*);
- C. companies that satisfy the publicly traded company test (*see Chart 2 (article 26(2)(c)(I) of the Treaty)*);
- D. certain exempt pension trusts (*article 26(2)(d) of the Treaty*); and
- E. certain not-for-profit organizations (*article 26(2)(e) of the Treaty*).

“Gross income” means total revenues derived from a Dutch company’s principal operations, less the direct costs of obtaining such revenues. *MOU, Paragraph XV*. In the case of the United States, **gross income** has the meaning as such term in section 61 of the Internal Revenue Code of 1986, as amended, and the regulations thereunder. *U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty*.

Chart 5. Derivative Benefits Test Under Article 26(3) (LOB) of the Netherlands-U.S. Tax Treaty

NOTE: The derivative benefits test potentially applies to all benefits under the treaty, although the test is applied to individual items of income. *U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.*



“Equivalent beneficiary” means :

A resident of a member state of the EU or of a EEA state or of a party to the North American Free Trade Agreement but only if that resident:

(i)(A) would be entitled to **all** the benefits of a comprehensive income tax treaty between any EU member state or EEA state or any party to NAFTA and the United States under provisions analogous to the rules for **qualified persons (see Chart 4 for the definition)**, provided that if such treaty does not contain a comprehensive LOB article, the person would be a **qualified person (see Chart 4 for definition)** if such person were a resident of one of the states under article 4 (resident) of the treaty; **and**

(B) for income referred to in article 10 (dividends), 11 (branch tax), 12 (interest), or 13 (royalties) of the treaty, would be entitled under such treaty to a rate of tax regarding the particular class of income from which benefits are being claimed under the treaty that is at least as low as the rate applicable under the treaty; **or**

(ii) is a resident of either the United States or the Netherlands that is a **qualified person (see Chart 4 for definition)**. *Article 26(8)(f) of the Treaty; MOU, Paragraph XVIII.*

NOTE: For purposes of applying paragraph 3 of article 10 (dividends) of the treaty to determine whether a person owning shares, directly or indirectly, in the company claiming the benefits of the treaty is an **equivalent beneficiary**, such person shall be deemed to hold the same voting power in the company paying the dividends as the company claiming the benefits holds in such company. *Article 26(8)(f) of the Treaty.*

NOTE: Under article 26(8)(f)(I), a company that satisfies the **subsidiary of a publicly traded company test (see Chart 3)** or the **ownership/base erosion test (see Chart 4)** is **not** an equivalent beneficiary.

Chart 6. Active Trade or Business Test Under Article 26(4) (LOB) of the Netherlands-U.S. Tax Treaty

(Only applies if an item of income is derived in connection with or incidental to an active trade or business in the Netherlands)

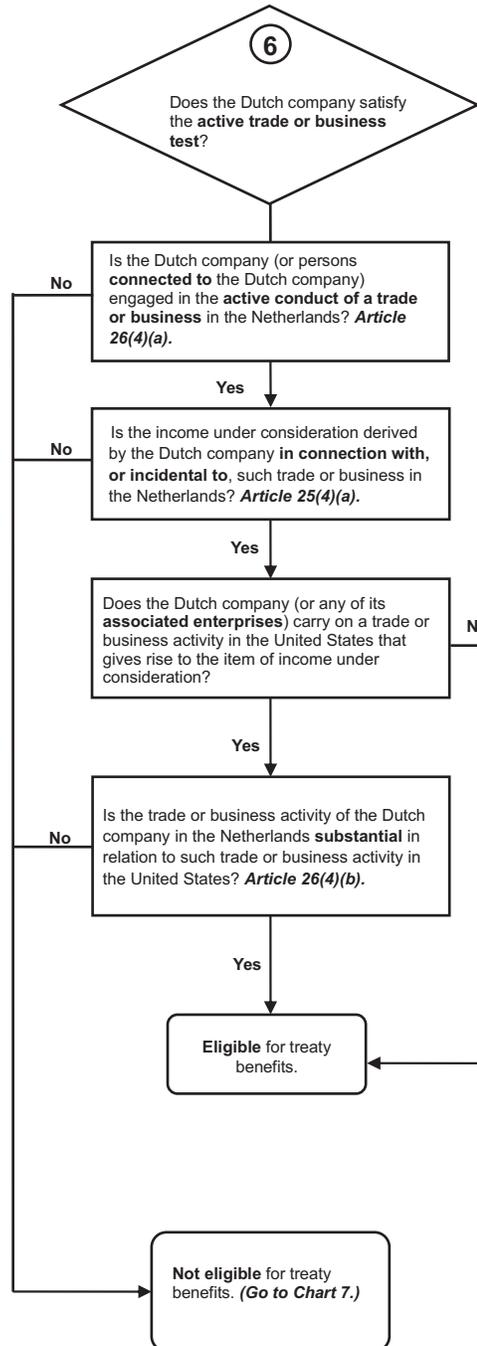
The phrase “**active conduct of a trade or business**” is not defined in the treaty. The U.S. Treasury explanation to the 2004 protocol to the treaty explains that the United States will refer to the regulations promulgated under section 367(a) to define this phrase.

The **active conduct of a trade or business** does not include the activities of making or managing investments for one’s own account, unless these activities are banking, insurance, or securities dealing carried on by a bank, insurance company, or registered securities dealer. **Article 26(4)(a) of the Treaty; MOU, Paragraph XX.**

Income is considered derived in **connection with** a trade or business if the income-generating activity in the source state (e.g., the United States) is a line of business that “forms a part of” or is “complementary” to the trade or business conducted in the Netherlands by the income recipient. **MOU, Paragraph XIX.** A business activity generally is considered to “form a part of” a business activity conducted in the source state if the two activities involve the design, manufacture, or sale of the same products or type of products, or the provision of similar services. The line of business in the state of residence may be upstream, downstream, or parallel to the activity conducted in the source state. Thus, the line of business may provide inputs for a manufacturing process that occurs in the source state, may sell the output of that manufacturing process, or may sell the same sorts of products that are being sold by the trade or business carried on in the source state. **MOU, Paragraph XIX; U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.**

For two activities to be considered to be “complementary,” the activities need not relate to the same types of products or services. They should be part of the same overall industry and be related in the sense that the success or failure of one activity will tend to result in the success or failure for the other. **U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.**

An item of income derived from the source state (e.g., the United States) is “incidental to” the trade or business carried on in the Netherlands if production of the item facilitates the conduct of the trade or business in the Netherlands. **MOU, Paragraph XIX.**



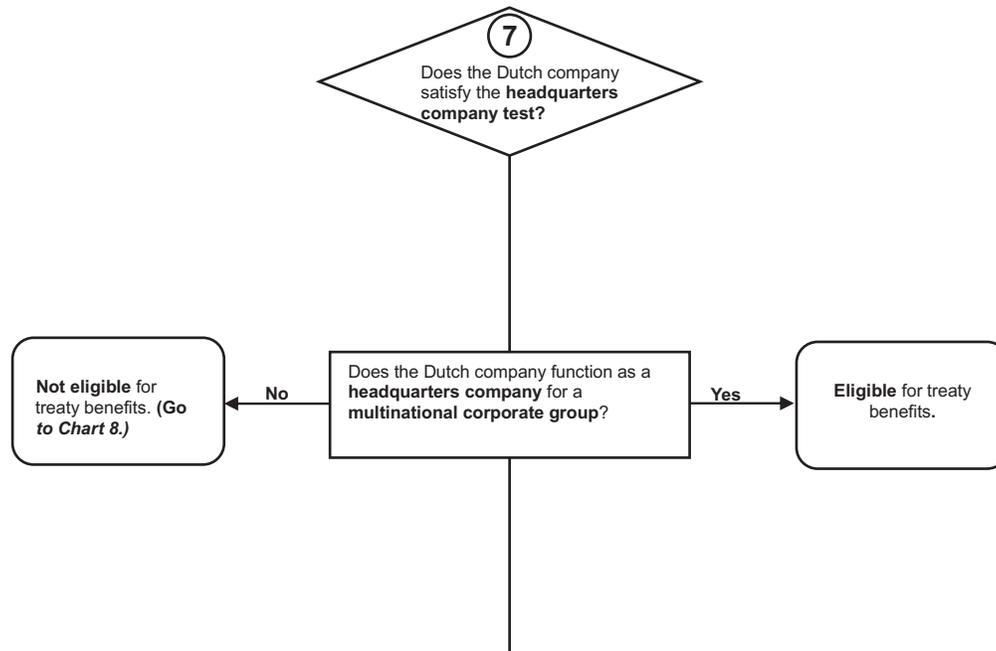
A Dutch company is deemed to conduct activities conducted by: (i) a partnership in which it is a partner; and (ii) persons **connected to** it. A person is **connected to** the Dutch company if, for example, one possesses shares representing at least 50 percent of the aggregate voting power and value of the other company or another person possesses, directly or indirectly, shares representing at least 50 percent of the aggregate voting power and value in each company. In any case, a Dutch company is considered to be **connected to** another if, on the basis of all the facts and circumstances, one has control of the other or both are under the control of the same person(s). **Article 26(4)(c) of the Treaty.**

The Dutch company is **associated** with an **enterprise** of the United States if it participates directly or indirectly in the management, control, or capital of the U.S. enterprise or if any third person or persons participate directly or indirectly in the management, control, or capital of the Dutch company and the U.S. enterprise. **Article 9(1) of the Treaty.**

Whether the trade or business activity of the Dutch company is **substantial** in relation to trade or business activity in the United States is based on a facts and circumstances test. Factors to be taken into account include: (i) the comparative sizes of the trades or businesses in each state (measured by reference to asset values, income, and payroll expenses); (ii) the nature of the activities performed in each state; and (iii) the relative contributions made to that trade or business in each state. In making each determination or comparison, one must give due regard to the relative sizes of the U.S. and Dutch economies. **U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.**

A trade or business activity of the Dutch company in the Netherlands is deemed **substantial** if for the preceding tax year, or for the average of the three preceding tax years, the asset value, the gross income, and the payroll expense that are related to the trade or business in the Netherlands equal at least 7.5 percent of the Dutch company’s (and any related parties’) proportionate share of the asset value, gross income, and payroll expense, respectively, that generated the income in the United States, and the average of the three ratios exceeds 10 percent. If the Dutch company owns, directly or indirectly, less than 100 percent of an activity conducted in either state, only the Dutch company’s proportionate interest in such activity is taken into account. **MOU, Paragraph XXII.**

Chart 7. Headquarters Company Test Under Article 26(5) (LOB) of the Netherlands-U.S. Tax Treaty



A **multinational corporate group** includes all corporations that the **headquarters company** supervises and excludes affiliated corporations that the **headquarters company** does not supervise. The **headquarters company** does not have to own shares in the companies that it supervises. See *U.S. Treasury Technical Explanation to the 2004 Protocol of the Treaty*.

A Dutch company will be considered a **headquarters company** only if:

- 1) it provides a substantial portion of the overall supervision and administration of the group (e.g., pricing, marketing, internal auditing, internal communications, and management), which may include, but cannot be principally, group financing;
- 2) the **corporate group** consists of corporations resident in, and engaged in an active business in, at least five countries, and the business activities carried on in each of the five countries (or five groupings of countries) generate at least 10 percent of the gross income of the group;
- 3) the business activities carried on in any one country other than in the Netherlands generate less than 50 percent of the gross income of the group;
- 4) no more than 25 percent of its gross income is derived from the United States;
- 5) it has, and exercises, independent discretionary authority to carry out the functions referred to in subparagraph 1) above;
- 6) it is subject to the same income taxation rules in the Netherlands that apply to a company engaged in an active trade or business in the Netherlands; and
- 7) the income derived in the United States either is **derived in connection with, or is incidental to** (see *Chart 6 for definition*), the active business referred to in subparagraph 2) above.

If the gross income requirements of subparagraphs 2), 3), or 4) above are not fulfilled, they will be deemed to be fulfilled if the required ratios are met when averaging the gross income of the preceding four years. **Article 26(5); U.S. Treasury Technical Explanation to the 2004 Protocol of the Treaty.**

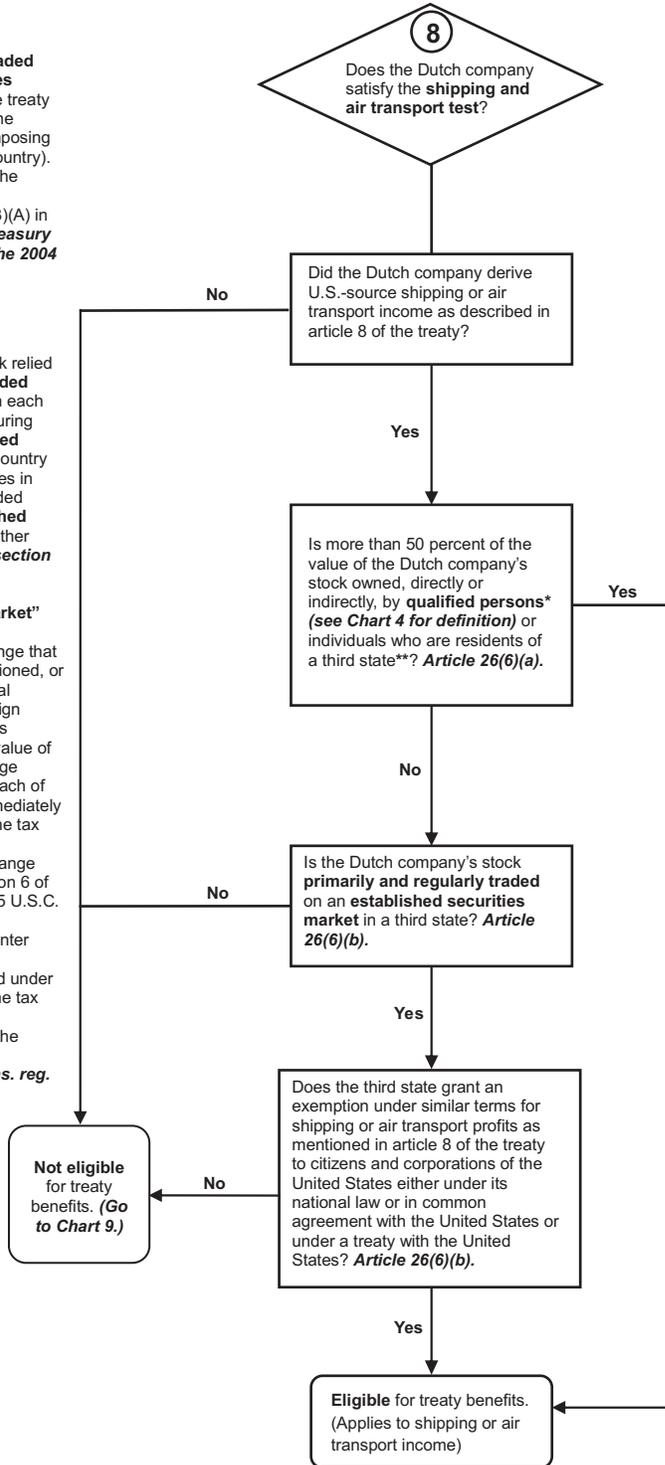
Chart 8. Shipping and Air Transport Test Under Article 26(6) (LOB) of the Netherlands-U.S. Tax Treaty

(Only applies to shipping or air transport income)

“Primarily and regularly traded on an established securities market” is not defined in the treaty and, thus, is defined under the internal law of the country imposing the tax (that is, the source country). **Article 3(2) of the Treaty.** The United States will apply the principles of section 883(c)(3)(A) in defining this phrase. *U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.*

“Primarily traded” means, regarding each class of stock relied on to meet the **regularly traded** test, the number of shares in each such class that are traded during the tax year on all **established securities markets** in that country exceeds the number of shares in each such class that are traded during that year on **established securities markets** in any other single country. *Treas. reg. section 1.883-2(c).*

“Established securities market” generally means:
 (i) a foreign securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority of the qualified foreign country in which the market is located, and has an annual value of shares traded on the exchange exceeding \$1 billion during each of the three calendar years immediately preceding the beginning of the tax year;
 (ii) a national securities exchange that is registered under section 6 of the Securities Act of 1934 (15 U.S.C. 78(f));
 (iii) certain U.S. over-the-counter markets;
 (iv) any exchange designated under a LOB article in a U.S. income tax treaty; and
 (v) any other exchange that the Secretary may designate by regulation or otherwise. *Treas. reg. section 1.883-2(b).*



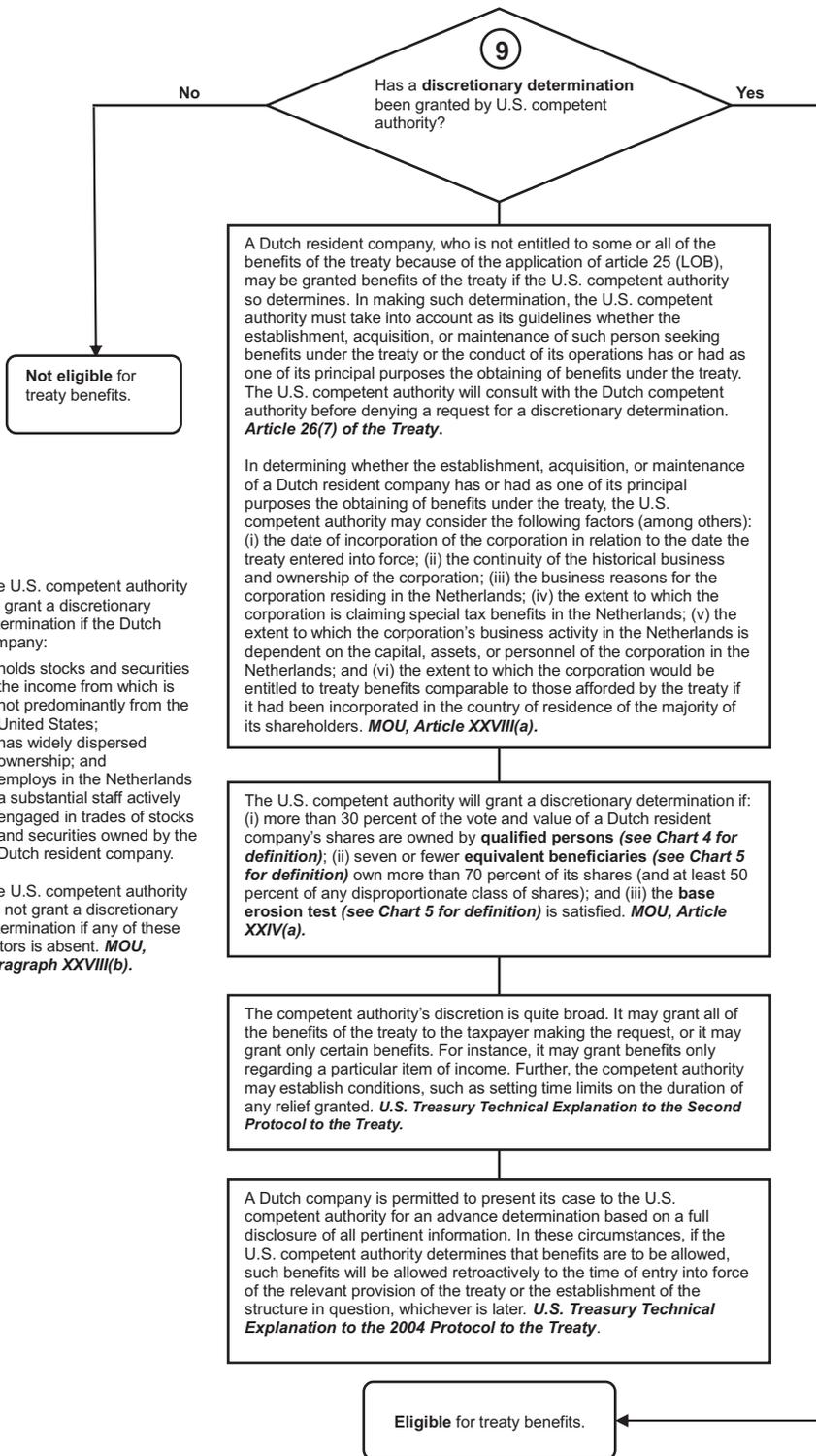
* **Qualified persons** for this purpose also include persons that satisfy the **subsidiary of a publicly traded company test (see Chart 3)** or the **ownership/base erosion test (see Chart 4)**.

** The third state must grant by law, common agreement, or treaty an exemption under similar terms for profits mentioned in article 8 of the treaty to citizens and corporations of the United States. *U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.*

Stock of a corporation is **“regularly traded”** on one or more **established securities markets** if:
 (i) one or more classes of stock of the corporation that, in the aggregate, represent more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote and of the total value of the stock of such corporation are listed on such market(s) during the tax year; and
 (ii) regarding each class relied on to meet the more than 50 percent requirement of (i) above —
 (A) trades in each such class are effected, other than in de minimis quantities, on such market or markets on at least 60 days during the tax year (or 1/6 of the number of days in a short tax year); and
 (B) the aggregate number of shares in each such class are traded on such market(s) during the tax year and are at least 10 percent of the average number of shares outstanding in that class during the tax year (or, in the case of a short tax year, a percentage that equals at least 10 percent of the average number of shares outstanding in that class during the tax year multiplied by the number of days in the short tax year, divided by 365). *Treas. reg. section 1.883-2(d).*

NOTE: Special rules apply for classes of stock traded on domestic **established securities markets (see Treas. reg. section 1.883-2(d)(2))** and for closely held classes of stock (see *Treas. reg. section 1.883-2(d)(3)*).

Chart 9. Discretionary Determination by U.S. Competent Authority Under Article 26(7) (LOB) of the Netherlands-U.S. Tax Treaty



The U.S. competent authority will grant a discretionary determination if the Dutch company:

- holds stocks and securities the income from which is not predominantly from the United States;
- has widely dispersed ownership; and
- employs in the Netherlands a substantial staff actively engaged in trades of stocks and securities owned by the Dutch resident company.

The U.S. competent authority will not grant a discretionary determination if any of these factors is absent. **MOU, Paragraph XXVIII(b).**

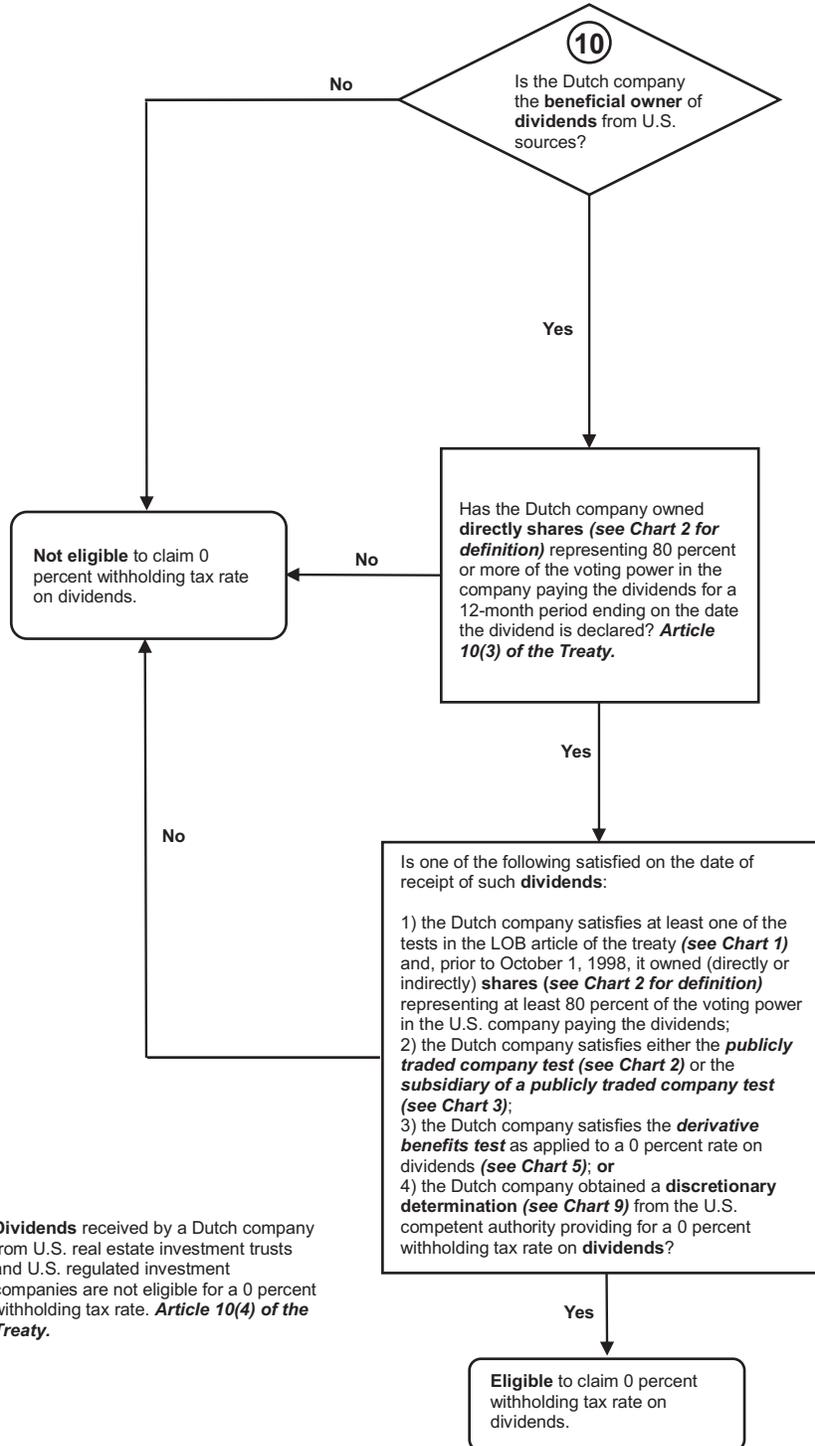
Requesting competent authority assistance – A taxpayer may request the assistance of the U.S. competent authority under Rev. Proc. 2006-54. The U.S. competent authority may determine in its own discretion that the taxpayer qualifies for certain benefits under the LOB article of the treaty.

There is a US \$15,000 user fee for requesting a **discretionary determination** under the LOB provision. If a request is submitted for more than one entity, a separate user fee is charged for each entity. **Rev. Proc. 2006-54, section 14.2.**

The U.S. competent authority must consider the obligations of the Netherlands by virtue of its membership in the European Communities (EC). In particular, the U.S. competent authority will consider any legal requirements for the facilitation of the free movement of capital and persons, together with the differing internal tax systems, tax incentive regimes, and existing tax treaty policies among member states of the EC. As a result, when certain changes in circumstances otherwise might cause a person to cease to be entitled to be a qualified person, such changes need not result in the denial of benefits. The changes in circumstances contemplated include, all under ordinary business conditions:

- a change in the state of residence of a major shareholder of a company;
- the sale of part of the stock of a company to a resident in another member state of the EC; or
- an expansion of a company's activities in other member states of the EC. **MOU, Paragraph XXVIII(c).**

Chart 10. Eligibility for 0 Percent Withholding Tax Rate on Dividends Under Article 10(3) of the Netherlands-U.S. Tax Treaty



Dividends received by a Dutch company from U.S. real estate investment trusts and U.S. regulated investment companies are not eligible for a 0 percent withholding tax rate. *Article 10(4) of the Treaty.*

“Beneficial owner” is not defined in the treaty and, thus, is defined under the internal law of the country imposing the tax (here, the United States). *Article 3(2) of the Treaty.* The beneficial owner of a dividend is the person to which the dividend income is attributable for tax purposes under the laws of the United States. Thus, if the Dutch company receives dividends as a nominee or agent on behalf of another person, the Dutch company is not the beneficial owner of the dividend. *U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.*

“Dividends” means income from shares (see *Chart 2 for definition*) or other rights participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares (see *Chart 2 for definition*) by the laws of the state of which the company making a distribution is a resident (see *Chart 1 for definition*). Dividends also include, in the case of the United States, income from debt obligations carrying the right to participate in profits. *Article 10(6) of the Treaty.* Dividends are defined “broadly and flexibly” by the United States and include:

- (i) a payment to a Dutch company denominated as interest that is made by a thinly capitalized corporation to the extent that the debt is recharacterized as equity under the laws of the United States;
- (ii) amounts treated as a dividend upon the sale or redemption of shares or upon a transfer of shares in a reorganization (see, e.g., *Rev. Rul. 92-85, 1992-2 C.B. 69*); and
- (iii) a distribution from a U.S. publicly traded limited partnership, which is taxed as a corporation under U.S. law. *U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.*

However, a distribution by a U.S. limited liability company is not characterized by the United States as a dividend, provided the U.S. limited liability company is not treated as an association taxable as a corporation under U.S. law. *U.S. Treasury Technical Explanation to the 2004 Protocol to the Treaty.*