Case 10/05383; 10/05385; 10/05386

Country of decision	Netherlands
Other countries involved	Belgium
Case number	10/05383; 10/05385; 10/05386
Date of decision	3 February 2012
Court/Chamber	*Hoge Raad* (Netherlands Supreme Court)
Parties	company, name not disclosed (the taxpayer) State Secretary of Finance (the tax authorities)
Treaty article(s) and paragraph(s)	Netherlands - Belgium income and capital Tax Treaty (1970) Art. 4(4), Art. 3(1(2);1(3)) Taxable year(s): 1997; 1998; 1999
OECD equivalent article(s) and paragraph(s)	4(3) (Resident) 3(1(a); 1(b)) (General definitions)
Keywords	fiscal unity; fiscal unity and residence; person; company; residence of company; dual resident company; effective management; place of effective management

Summary

Summary of facts

The taxpayer was a company created under Netherlands law, and as such was deemed a Netherlands resident under Netherlands corporate income tax law. Its sole owner was an individual, resident in Belgium. The taxpayer, in its turn, owned all the shares of another company resident in the Netherlands. The two companies formed a fiscal unity for Netherlands corporate income tax purposes.

In 1996 the taxpayer's place of effective management was transferred to the home address of its sole shareholder in Belgium, its statutes were amended in order to comply with Belgian law, the currency of its share capital was changed from Dutch guilders into Belgian franks - both currencies at the time had not yet been replaced by the euro -, its sole shareholder was appointed general manager, and, finally, it was listed in the Belgian commercial register. The taxpayer was paying corporate income tax in Belgium as a resident of that country.

For the tax years at issue, the taxpayer had claimed that due to the transfer of its place of effective management it had become a resident of Belgium under Art. 4(4) of then applicable 1970 tax treaty between the Netherlands and Belgium, and as result was no longer liable to Netherlands corporate income taxation. The Netherlands tax authorities, however, denied that a transfer of the taxpayer's place of effective management had actually been achieved, and accordingly had charged tax on the taxpayer's profits as a Netherlands resident.

The Court of Appeals (decision of 5 November 2010, No. 09/00678) had held in favour of the taxpayer, considering, first of all, that the term "effective management" should be understood as related to taking core decisions, directing, and taking initiatives, rather than carrying out, or preparing or determining, policy, or determining the company's activities, and that all of this had been done by the taxpayer's sole shareholder from his home in Belgium.

Whereas the tax authorities had pointed to various circumstances relating to the Netherlands-based management of the subsidiary company owned by the taxpayer, and had argued that those circumstances should be taken into account as well by reason of the taxpayer's fiscal unity with that company, the Court of Appeals had further considered, with reference to an earlier decision by the Netherlands Supreme Court issued under the Tax Arrangement for the Kingdom of the Netherlands (decision of 20 December 2002, No. 37.073), that the treaty residence of companies belonging to the same fiscal unity should as a rule be determined for each of them separately.

The tax authorities had appealed before the Supreme Court against the decision of the Court of Appeals, with the fundamental argument that residence for tax treaty purposes should be determined for a fiscal unity as a whole.

Issues

Whether for purposes of Art. 4(4) of the 1970 tax treaty between the Netherlands and Belgium the effective management of a parent company belonging to a fiscal unity under Netherlands corporate income tax should be determined for that company separately or also having regard to the effective management of its subsidiary sharing in the fiscal unity.

Court decision

The Supreme Court observed that the treaty defines a "person" in Art. 3(1)(2) as either an individual or a company, and a "company" in Art. 3(1)(3) as any body corporate and any unity that is treated as a body corporate in the State in which it is a resident. The Court considered that, whereas in cases of a fiscal unity under the Netherlands corporate income tax law a subsidiary is deemed to have become part of the parent company, this does not imply that parent company and subsidiary would be a unit that is treated as a single body corporate as meant in Art. 3(1)(3).

The Supreme Court furthermore considered that there are no indications that the contracting states would have intended to deem a fiscal unity a person for purposes of the treaty.

The Supreme Court therefore concluded in general terms that in determining the residence of the parent company of a fiscal unity under Art. 4 of the treaty only the place of effective management of the parent company is relevant. In the Court's view, the place of effective management of a subsidiary is relevant for determining the residence of that subsidiary, but not in determining the residence of the parent company of the fiscal unit to which it belongs. *In fine*, residence under Art. 4 of the treaty should be determined separately for each of the companies in the fiscal unity.

As the Supreme Court found the determination by the Court of Appeals of the taxpayer's effective management as being located in Belgium in conformity with the principles that it had set out, it rejected the tax authorities' appeal.

Scope of decision

In this decision the Netherlands Supreme Court delivers clear and definite rules on how a fiscal unity formed under Netherlands corporate income tax law should be treated for tax treaty purposes. These rules apply generally for all Netherlands tax treaties that, like the 1970 treaty with Belgium, employ provisions on the definition of the term "person" and on the residence of companies similar to those of the OECD Model Tax Convention. The zest of the decision is that a fiscal unity does as such not qualify as a person, and the residence of all of its members, the subsidiaries as well as the parent company, should be determined for each separately. A company's civil law status thus prevails over its tax status.

The present decision ends a perceived ambiguity in earlier Supreme Court jurisprudence on the issue. The Supreme Court decision of 13 November 1996, No. 31.008, was commonly read such that for treaty purposes a fiscal unity would qualify as a person in its own right – and by the same token was equally commonly criticized. To ease concerns from practice that tax treaty benefits might be lost where source states refuse to recognize a fiscal unity as beneficiary of income in lieu of an individual subsidiary company, the Netherlands tax authorities had established a practice of issuing residence certificates to subsidiaries in fiscal unities (Decree of 20 December 1996, No. IFZ96/1529). However, in its decision of 20 December 2002, No. 37.073, the Supreme Court had taken an opposite course, recognizing parent company and subsidiaries each as separate persons. Whereas that later decision concerned the Tax Arrangement for the Kingdom of the Netherlands (governing the tax relations between the Netherlands and the Netherlands Antilles and Aruba, respectively), which from a formal law perspective is not a treaty but an internal law, there was doubt left whether it would hold for "real" tax treaties as well. The present decision effectively confirms that the treatment of a fiscal unity under the Tax Arrangement applies under tax treaties in just the same way.

The provision in the Netherlands corporate income tax law that under a fiscal unity a subsidiary is deemed to become one with its parent company – the provision that caused the issue to arise - was amended as of 1 January 2003. Nowadays, the activities and the capital of a subsidiary are merely attributed to the parent company, which is then taxed on the consolidated profits. This change in the law was expressly intended in order to secure separate treatment for tax treaty purposes of each of the companies in a fiscal unity. In hindsight, amending the law appears to have been unnecessary due to the present decision of the Supreme Court.

Another noteworthy element in the case is the Court of Appeals' decision on the proper understanding of the term "effective management", which the Supreme Court apparently shared, or in any case did not comment on. The "core decisions" which the Court of Appeals referred to seem to concur with the "key management" and "decisions that are necessary for the conduct of the entity's business as a whole" mentioned in para. 24 of the current Commentaries to Art. 4 of the OECD Model Tax Convention (version July 2010). The tax authorities had argued, in vain, that the core decisions of the taxpayer would concern, inter alia, the daily management of its subsidiary company. However, as daily management seems in opposition to key management, it is unlikely that it could ever make up part of any core decisions.

As result of the present decision, the taxpayer was taxable in the Netherlands on none of its own income but only on the income of its subsidiary - in so far as attributable to the taxpayer under the terms of the fiscal unity regime. The latter income of the subsidiary was classified under Netherlands domestic tax law as income from a Netherlands permanent establishment of the taxpayer, but under the treaty as the subsidiary's own.

Decision in favour of	the taxpayer
Decision published in	*Vakstudie-Nieuws* 2012/9.15 and 2012/12.19 *NTFR* 2012, 319
Other relevant cases	*Hoge Raad* (Netherlands Supreme Court), 20 December 2002, No. 37.073, *BNB* 2003/286
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