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SWEET & MAXWELL

International Matters

The Netherlands as Seen by a UK Resident

Dr Ineke A. Koele*

Discretionary trusts; Double taxation; High net worth individuals; Investments; Netherlands; Residence; Tax

This article forms part of our series in which overseas professionals share their experience and knowledge of local property and tax law and practice to describe the opportunities and pitfalls in their own jurisdictions for the benefit of their opposite numbers in the UK who find themselves advising clients minded to invest or reside in another country. Here the subject is the Netherlands. When it comes to capital taxation the operative word is pitfalls.

Introduction

Based in the heart of continental Europe, with a North European culture and a long tradition of tradesmanship, increasingly the Netherlands attracts families of high net worth and charities from the UK and other Anglo-Saxon jurisdictions. The Netherlands have a strong position in the World's Happiness Index (5th),[1] the World's Innovation Index (6th),[2] the Elite Quality Index (5th)[3] and the World Competitiveness Index (6th).[4] The culture of the Dutch populace is very open-minded, sometimes noisy, liberal in a practical sense and, foremost, truthful. They say what they mean. Refreshing but annoying indeed!

A liberal legal culture

A liberal legal culture means in effect that the Netherlands do *not* have, for example:

- Restrictions for UK people to buy real estate or any other asset in the Netherlands;
- Gift or inheritance tax in the hands of non-residents with respect to Dutch situs assets such as, e.g. real property;
- A Charity Commission that provides detailed supervisory authority on what a charity may or may not do.

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[1] World Happiness Report, "Ranking of Happiness 2019–2021" (18 March 2022), *worldhappiness.report*, *https://worldhappiness.report/ed/2022/happiness-benevolence-and-trust-during-covid-19-and-beyond/#ranking-of-happiness-2019-2021*.

[2] WIPO, Global Innovation Index 2019 Rankings (2020), *wipo.int*, *https://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2021.pdf*.

[3] T. Casas and Guido Cozzi, "Elite Quality Report 2022, country scores and global rankings, executive summary" (28 April 2022), *ssrn.com*, *https://deliverypdf.ssrn.com/delivery.php?ID=133113085074071121106121066106602411200606405605806902910400702011911000711203112506709803301910102212201012109306408007710111705905201400108110112101607006512211610001804901009702609612109200310307701110108011407401712106701512712102600502807109802810 3&EXT=pdf&INDEX=TRUE*.

[4] "World Competitiveness Center Rankings, 2022 results" (15 June 2022), *imd.org*, *https://www.content.imd.org/centers/world-competitiveness-center/rankings/world-competitiveness/*.

This last does not fit in the Dutch vision of charities being part of the private domain.

It also means that we do prefer "substance over form". This means, for example, that the residence of individuals is not determined by an exact number of days that one is physically present in the Netherlands but by all *relevant circumstances*. The same counts for charities; they are not resident in the country of their formation or registration, but in the country where they are *effectively managed*, like any other corporation.

Residence is a very important topic as we do not recognise the concept of *domicile*. Once a resident of the Netherlands, one is subjected to worldwide income tax to the same extent as gift and inheritance taxes apply to donors and deceased persons resident in the Netherlands. Albeit the Netherlands has concluded bilateral treaties on income tax and gift and inheritance tax with the UK,[5] this does not always prevent situations of effective double taxation due to qualification and timing differences.

Finally, an important element of our culture is that we may enter into pre-consultation with the tax authorities and request a position on, e.g. domicile, qualification of foreign trusts and other uncertainties and, if necessary, consequences may be negotiated and settled in advance and even on an ongoing basis. Tax legislation relating to foreign trusts is so indefinite that it is also necessary to engage proactively with the tax authorities on this.

Investments in the Netherlands

An investment by a *UK resident individual* in a Dutch company or real property will lead to effective Dutch taxation.

A privately owned real property is subject to income tax in the hands of the UK resident. Currently, we have an income tax that is based on a fictitious yield calculated on the current value of the property valued as per 1 January of each calendar year. The yield is contingent on the market circumstances of the past year and currently amounts to 5.5%. The income tax rate is 31%. In effect, the income tax therefore functions as a wealth tax of approximately 1.7% per annum irrespective of whether there is in fact any (rental) income. The income tax on privately held assets is currently subject to amendments following a Supreme Court decision that urges the legislator to make a more nuanced treatment of properties so that a savings account with a negative interest will not trigger this income tax that in fact is functioning as a wealth tax.

Upon acquisition of a private real property that is not the principal dwelling for the owner, a high transfer tax of 8% of the value is due, and this rate will be increased to 10.4% as of 1 January 2023. This high rate is introduced in order to discourage investors to buy dwellings.

An investment in a company established in the Netherlands is subject to income tax on dividends and eventually capital gains with respect to these shares at a current rate of 26.9%. Albeit the bilateral income tax treaty concluded between the Netherlands and the UK will prevent the Netherlands in general from levying a higher income tax than 15% on dividends, it is important to note that this suffers exception if the dividends are not remitted to the UK and for that reason not subject to effective UK income tax due to the remittance basis. Pursuant to art.22 of the bilateral income tax treaty between the Netherlands and the UK, the Netherlands will not provide avoidance of double taxation to the extent the income is received by an individual who is resident but not domiciled in the UK and which is or will not be remitted to the UK.

Capital gains with respect to substantial shareholdings in the Netherlands are only subject to income tax effectively if the shareholder has been a resident of the Netherlands in the past five years; again, this

[5] See the schedules to the Double Taxation Relief and International Tax Enforcement (Taxes on Income and Capital) (Netherlands) Order 2009 (SI 227/2009) and the Double Taxation Relief (Netherlands) Order 2013 (SI 3143/2013): *https://www.legislation.gov.uk/uksi/2009/227/pdfs/uksi 20090227 en.pdf*; *https://www.legislation.gov.uk/uksi/2013/3143/pdfs/uksi 20133143 en.pdf*. For the Double Taxation Relief (Taxes on Estates of Deceased Persons and Inheritances and on Gifts) (Netherlands) Order 1980 (SI 706/1980): see *https://www.legislation.gov.uk/uksi/1980/706/made*.

suffers exception if the capital gains belong to an individual resident but not domiciled in the UK and are not being remitted to the UK under the UK remittance basis.

Where an investment in private real property is considered, careful planning is required in the context of residence (see under "Relocation"). Unless a private real property is rented out to third parties, it is the most objective criterion for "residence" for tax purposes. Please note that the tax consequences do not correlate whatsoever to immigration or visa rules; one may not have any permit to live in the Netherlands, but simultaneously be considered a resident for tax purposes.

Investment by a UK trust

Where a UK resident trust would invest in Dutch assets, whether residential properties or otherwise, it is important to note already that Dutch legislation is likely to disregard the trust for tax purposes entirely and will treat the transferor of the assets, or the last surviving generation of the same, as the owner of the Dutch assets for tax purposes. This kind of fiction may effectively lead to double taxation, as undoubtedly this fiction creates a mismatch with the UK reality for tax purposes. I will refer to the Dutch treatment of trusts later.

Investment by a UK company

Where a UK company would invest in Dutch real property or an enterprise, it would become subject to Dutch corporate income tax on the real income and capital gains on these assets. Where hybrid entities are used, such as partnerships, the qualification of the entity is dependent on the (transparent or opaque) treatment for tax purposes in the Netherlands.

Where a UK non-domiciled resident would invest in Dutch assets through an entity in a low-tax jurisdiction that holds a substantial interest in a Dutch entity, the non-Dutch entity may be fully subjected to corporate income tax on all income and capital gains with respect to the shares in the Dutch entity if the structure is considered to be "abusive".[6]

Relocation to the Netherlands

Any pre-immigration planning should be finalised before becoming a Dutch resident, as of that date the immigrant is subject to unlimited tax liability in the Netherlands for all taxes, including gift and inheritance tax upon a gift provided by the immigrant or upon his or her decease. Typically, therefore, planned donations and other transfers are executed before taking up residence in the Netherlands. Where a newly-bought Dutch residential property is intended to function as the main residence of someone, only 2% transfer tax will be due.

The centre of vital interest—focus on avoidance of double taxation

Very distinct from many other jurisdictions, residence of individuals according to Dutch tax law is, according to art.4 of the Dutch General Tax Code, determined "according to the circumstances". The relevant circumstances include both objective and subjective circumstances, and there is no decisive order in weighing those relevant circumstances. In the relevant case law, the frequency of staying, the disposal of a home, and the place where close family (wife, children) live, are strong connecting factors, like nationality, memberships, and insurances. No particular significance is attached to certain (categories of) circumstances, such as the social or economic ties between the person concerned and a country. This implies that there is no ranking on the basis of which, for example, social ties would take precedence over

[6] Corporate Income Tax Act art.17 para.3.

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economic ties when answering the question of whether a lasting personal tie is present. Furthermore, the Supreme Court rejects a classification of circumstances that involve a legal, economic or social bond with the Netherlands.

Following standing case law of the Dutch Supreme Court issued on 12 April 2013,[7] an individual already has a Dutch residence if there is *a sustainable relationship with a personal character* with the Netherlands. In order to determine Dutch residence, it is *not* required that the centre of vital interests of an individual should be in the Netherlands; this implies that there is no ranking on various connecting factors with other jurisdictions and accordingly, it is acknowledged that it is possible for an individual to have multiple residences according to Dutch tax law.

In order to avoid double income taxation where a person maintains a nexus with both the UK and the Netherlands, the bilateral income tax treaty between the UK and the Netherlands provides, that *for the purpose of the treaty* (which overrides national laws), an individual is deemed to be a resident only of a State in accordance with the following so-called tie breaker, allocating the residence of an individual who has a permanent home available in both states to the jurisdiction with which his or her personal and economic relations are closer (centre of vital interests). Only in case this can not be determined, he or she shall be deemed to be a resident only of the State in which there is an habitual abode and, if that does not render a clear result, the last resort for residence is the state of which he or she is a national.

In practice, therefore, the concept of *centre of vital interest* is of great importance and normally would lead to a decision. From practical experience, it has appeared that the notion of centre of vital interest is interpreted differently in the UK and in the Netherlands. In the Dutch interpretation, we tend to look more at the emotional factors like relationships, place where children reside, and social club memberships, whereas in the English tradition the traditional place of the family's wealth, brokers and manor, but also the official registration as a resident are at least of equal importance to determine the centre of vital interest. In such a situation, a negotiation with the tax authorities is essential to avoid effective double taxation, lacking which one may have to provide proof of the precise factual circumstances in a later stage.

The application of the 30% regulation

Dutch tax law has an incentive to attract foreign qualifying workers to the Dutch labour market. This is specifically relevant to UHNW individuals, as it provides for a five-year tax holiday of assets held abroad. Technically, the criterion for the 30% regulation is that somebody is scarce on the Dutch labour market. However, in practice there are no precise requirements, and the scope for application is extremely broad. Whether a large corporation is hiring a foreign expat, or a newly created Dutch company is hiring one of its shareholders, is not relevant either. There is however one crystal clear requirement: in order to benefit from this incentive one should be clearly a non-resident at the moment of application.

The five-year tax holiday on assets held abroad is very functional for income tax purposes. However, it has no application to Dutch gift and inheritance tax. As of the date of immigration the full risk of Dutch inheritance tax with respect to worldwide-held assets bears upon the immigrant. The rates are varying from 20% where the partner and direct descendants are concerned up to 40% for all other persons; only very moderate exemptions apply. For spouses, there is an exemption of €680.645, that includes however the value of any pension rights. There is no general marital exemption between spouses. Where generations are skipped, the applicable inheritance tax rates are increased to 80%.

This only bears exception where UK citizens are concerned who have also a house available in the UK and who do not have the intention to remain a resident of the Netherlands indefinitely. The bilateral treaty

[7] HR 12 April 2013, BNB 2013/123.

on inheritance tax between the Netherlands and the UK provides in that case that the Netherlands is only allowed to levy inheritance tax with respect to Dutch real property and some other situs assets.[8]

For immigrants who do not wish to fall foul of forced heirship rules, it is key to draft a will with a choice of law for English, Scots or Northern Irish law as appropriate if they have UK citizenship. Dutch estate law, however, has also practical advantages such as, e.g. the absence of probate.

Be mindful when trust structures are involved

The Netherlands have adopted a rigorous tax system to "combat abuse" of foreign discretionary trusts, which is based on the notion that "hovering of assets" between a settlor and beneficiaries is unacceptable for Dutch tax purposes. In essence, the assets of a trust with discretionary elements are attributed for Dutch tax purposes to the transferor of assets into trust during his or her life and, upon the decease, the same is fictitiously attributed to the heirs of the transferor(s)—whether or not those persons are also beneficiaries of the trust.

Where the idea of a discretionary trust is that nobody can tell whoever will receive what, the fiction in the Netherlands is that upon the decease of the transferor(s), the respective heirs are deemed to own the assets in proportion to the share of the total estate that each heir is entitled to under the applicable estate law. In annex, there are several further anti-abuse provisions, e.g. if heirs are disinherited by the transferor into trust. Only if the attributed heir is apparently unable to benefit from any trust, he or she may escape the Dutch taxation on the deemed apportionment of the assets in the trust; this may however have consequences for the other heirs involved as their portion is deemed to be enlarged.

An individual that is a resident of the Netherlands therefore may become fully subject to income tax with respect to assets held in a discretionary trust upon the decease of a parent who has been a transferor of assets into trust. Whereas Dutch income tax functions as a wealth tax (a fictitious yield that is amended from year to year is subject to 31% income tax) the resident is subject to income tax irrespective as to whether any distributions are being received. In practice, it is rather difficult to obtain avoidance of double taxation for any tax that may be imposed on the discretionary trust. The deemed attribution of ownership also counts for gift and inheritance tax, which entails that any distribution by the trust to a third party may be treated (partially) as a taxable gift by the Dutch resident beneficiary.

On the opposite side, Dutch resident beneficiaries may receive distributions from a foreign discretionary trust without being subject to income tax based on the fictitious attribution of the trust assets to a non-Dutch-resident transferor of assets. During the life of the transferor of the assets, the beneficiaries therefore escape any income taxation in the Netherlands upon distributions. In that case, however, the Dutch resident has still full reporting obligations to the tax authorities on the trust situation, qualification and its assets.

It is therefore very important to seek proper guidance and advice with respect to the structuring of trusts to avoid unintended situations of taxation that are not in line with the trust distributions. In practice, a proactive approach towards the tax authorities may avoid or iron out the most salient irregularities of this transparency legislation.

Where according to Dutch views a trust is not discretionary, which implies that beneficiaries have enforceable claims towards a trustee, they are—depending on the precise circumstances—taxable on a claim on the trust or alternatively, are deemed to own the underlying assets of the trust. It is important to acknowledge that a trust may have both discretionary elements and non-discretionary elements with different tax consequences.

[8] Double Taxation Relief (Taxes on Estates of Deceased Persons and Inheritances and on Gifts) (Netherlands) Order 1980 (SI 706/1980) art.4(3).

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Outlook

Public spending has increased but so has public revenue as a result of the extremely high-energy prices. There is a recent trend to increase tax on wealthy persons. However, there is a very strong lobby by the HNWIs especially the family business owners. As a result, until now higher taxes have been announced predominantly for the small entrepreneurs and professionals.