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C H A N C E

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New Dutch tax legislation affects leveraged acquisitions

Last week the Dutch government issued the long expected tax proposals which will affect leveraged acquisitions in the Netherlands. The proposals are expected to enter into force per 1 January 2012.

Restriction of interest deductions on acquisition debt

Under current law, no limitations apply to the deductibility of interest on bank debt (while for interest on shareholders loans various limitations apply, such as thin cap rules). Accordingly, if a Dutch bidco, leveraged with bank debt, acquires a Dutch target company and subsequently (i) forms a fiscal unity (tax consolidation) with the target company, or (ii) merges into the target company, effectively the interest on the bank debt can be fully offset against the profits of the target company.

It is now proposed to introduce a limitation on the deductibility of interest in these situations, ie such interest on the acquisition loans can only offset profits of the target company if and to the extent the debts of the fiscal unity are not considered "excessive." A €1 million threshold would apply, ie interest up to €1 million per annum would always be deductible. Interest that is non-deductible pursuant to this rule may be carried forward to later years to be offset against bidco's own profits.

In principle there would not be such "excessive" debt financing if the bidco would be financed with one third of equity and two thirds of debt, ie a 1:2 ratio (note that for purposes of this test, the goodwill embedded in the purchase price for the target shares will have to be amortised over a ten year period, effectively reducing the equity for purposes of this test in later years). This means that if a bidco would (solely) acquire a Dutch target company for €100 million, and bidco would be financed with €25 million equity and €75 million debt, €25 million of the debt would be "excessive", resulting in a restriction of the deductibility of interest on €25 million of the acquisition debt (and possibly more in later years due to aforementioned depreciation of the goodwill embedded in the target shares).

It must be noted however that the amount of "equity" for purposes of this test will be reduced by the book value of participations. If in the aforementioned example the Dutch target company would for instance hold foreign participations with a book value of €10 million, the amount of excess debt would be €45 million.

The proposals contain a grandfathering for acquisitions in which both the Dutch target companies and the acquisition debt are included in a fiscal unity with the bidco prior to 1 January 2012. This is an important improvement in comparison to the grandfathering previously reported in the financial press (ie a grandfathering solely for structures set up prior to 1 January 2007). Also the 1:2 ratio is slightly better than the 2:3 ratio previously reported in the financial press.

For future leveraged acquisitions it would be prudent to analyse the impact of these rules and to determine the level of equity that would optimise the deductibility of interest on acquisition debt. In this respect, "real" debt push downs, ie where the debt push down is achieved through a dividend or refinancing as opposed to a legal merger or fiscal unity between bidco and the target company, will in our view not be affected by these proposals.

Interest relating to participations

Recently, there were strong indications that an additional restriction of interest deductions on acquisition debt would be introduced relating to shareholdings to which the participation exemption applies (thus excluding subsidiaries that form part of the fiscal unity). The reason for such additional restriction would be that there is currently a tax "mismatch" between the income (tax exempt pursuant to the participation exemption) and the expenses (tax deductible subject to the various interest restrictions). It is somewhat surprising that the proposed legislation does not contain such additional restriction. This is positive for structuring cross-border transactions through the Netherlands, albeit that it cannot be ruled out that such restriction is still on the agenda to be introduced effectively per 2012. Please note that as mentioned above - in case of a Dutch fiscal unity - the book value of the participations held by, and the acquisition debt in relation to such participations taken up by, the fiscal unity members would adversely affect the debt-to-equity ratio for purpose of the proposed restriction as described in the previous

Dividend withholding tax anti-abuse rule affecting certain coop structures

Dutch coops (*coöperaties*) are regularly used when setting up cross-border structures. The reason is that profit distributions by a Dutch coop to its members are, unlike profit distributions by a BV or NV, not subject to Dutch dividend withholding tax. The proposed legislation introduces an anti-abuse rule, according to which profit distributions by a coop may become subject to Dutch dividend withholding tax.

A foreign investor will continue to benefit from a dividend withholding tax exemption if it has structured its foreign shareholdings through a coop provided that it holds its membership interest as part of its business assets (this should also be met in most current structures to avoid Dutch (corporate) taxation at the level of the foreign investors). Typically, for cross-border private equity structures this has been confirmed by advance tax rulings.

If a foreign investor sets up a coop in order to acquire (directly or indirectly) Dutch subsidiaries, a dividend withholding tax exposure may arise up to the amount of the profit reserves of the Dutch subsidiaries existing at the time of the acquisition (on which there is an already existing Dutch dividend withholding tax claim), unless it can be demonstrated that the use of the coop is not predominantly motivated by the avoidance of (Dutch dividend tax or foreign) tax. For these situations one may consider extracting all profit reserves prior to the acquisition (if possible at all) or using an intermediate EU holding company.

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