

# Government relaxes proposed tax legislation for leveraged acquisitions

On 11 November 2011, the Dutch Ministry of Finance issued an amendment to the pending legislative proposals that seek to limit the deductibility of interest on acquisition loans that are deemed to cause an acquisition to be "excessively leveraged". Below we set out a short summary and status report.

Current Dutch tax law does not provide for limitations on the deductibility of interest on bank debt. (There are specific limitations on the deductibility of interest on shareholders loans, such as thin cap rules). Accordingly, a Dutch bidco that 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, can effectively fully set off the interest on the bank debt against the profits of the target company.

An earlier proposal (please refer to our update of 19 September 2011 for more details) contemplated a restriction on these deductions that would be based on the debt to equity ratio of the fiscal unity between the Dutch bidco and the relevant target companies after the acquisition (with certain corrections for goodwill embedded in the purchase price and for subsidiaries that would not be part of the fiscal unity). This proposal raised criticism from tax professionals and the business community for the following key reasons:

- The proposal could restrict the deductibility of interest even if the acquisition itself would be modestly leveraged, the reason being that the debt to equity ratio could be adversely affected by eg

existing debts of the target companies.

- Future profits and losses would have an impact on the future debt to equity ratio of the fiscal unity, and therefore would have an effect on the amount of interest on acquisition debt that would be deductible. Accordingly, this would result in uncertainty on the future tax position of the fiscal unity.

The Ministry of Finance has been receptive to these criticisms and now proposes a rule that, in line with an alternative previously suggested by the Dutch Association of Tax Advisors (*Nederlandse Orde van Belastingadviseurs*), allows for a deduction that is to decrease over the time of the investment. Under this new proposal, interest on acquisition loans will be deductible in the year of acquisition up to 60% of the acquisition price (such percentage to be reduced by 5% each subsequent year to 25%). This effectively means for an acquisition of €100 million, interest on €60 million would be deductible in year one, interest on €55 million in year two, interest on €50 million in year three, etc. As from year eight, interest on €25 million would remain deductible.

The €1 million threshold in the original proposal – according to which the first

€1 million of interest on acquisition loans would not be affected by the new rule – will continue to apply. Also, the new proposal states that interest that is non-deductible pursuant to this rule can be carried forward to later years to be offset against bidco's own profits. Finally, the new proposal also seems to allow for additional tax planning that may further mitigate the impact of the restriction, including grandfathering rules and pushing debt down to the target companies.

The proposed new rules are expected to enter into force on 1 January 2012.

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