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News alert:
Change in preferential Dutch income tax treatment directors' fees!

According to the new published 2020 Dutch tax treaty policy, the 26 year old approving policy for allowing to claim a double tax relief per the exemption method instead of the credit method will be withdrawn. That can have a significant impact for Dutch tax residents who earn remuneration received in the capacity as (statutory) director or as supervisory board members. It is unclear when the policy change will effectively be implemented.

Introduction

Since 1994, the Netherlands adopted a policy where it was approved to apply the exemption method on directors' and supervisory board members' renumeration received from a foreign company if the applicable tax treaty prescribed the credit method. The same policy was lastly part of a resolution of 18 July 2008. This 26-year old policy will be discontinued in the (nearby) future.

Based on the 2008 resolution, in brief, the beneficial exemption (with progression) method may be applied for deduction of double taxation provided that (i) the income is subject to taxation in the other country and (ii) the remuneration is are fiscally not treated more favourable than (regular) employment salary. In other words, under the terms and conditions mentioned above the director was treated, as concerns the method for deduction of double taxation, as if he was an employee who could rightfully claim the exemption method.

Initial comments

A few years ago the so-called Gulf states resolution (in Dutch: Golfstatenbesluit) suddenly came up which – in derogation of the applicable treaties – approved of applying the exemption method for employees whist the income was not at all subject to taxation in those states. This has been a debatable resolution and was not understood by everyone. The Netherlands has chosen to give employees who reside in the Netherlands and work in the Gulf states the same treatment as non-residents of the Netherlands who work over there. In other words, the policy to align with the tax liability in the work state was also decisive in this Gulf states resolution. It can be seen as a confirmation of the path of the Dutch authorities it starting taking 26 years ago.

However, the notification is clearly making and end of this and this is therefore a very unexpected decision. For Dutch resident directors and supervisory board members of foreign companies, the general tax treaty policy now is that equality in the residence state is decisive. This has been somehow motivated that directors are very well able to perform (large parts of their) activities in the home country or at least not necessarily in the country where the foreign company is located.

The reason for continuing to allow the exemptiom method to be applied by resolution of July 18, 2008 is in the first place to pursue equality with (normal) employees in the same country. Due to the high tax rates in the Netherlands, this decision may well result in inequality when comparing the tax treatment of remuneration that is taxable under the regular employment income article.

The foregoing does not mean the exemption method will never be applicable to directors' or supervisory board members' remuneration again, but it will rather be the exception. Only a few treaties apply the exempt method for such remunerations, for example Spain, Singapore and Luxembourg.

Our view & recommencations

A salary split may be in place with countries that apply the credit method in order to avoid double taxation. This means that the Netherlands in the first place takes the foreign income into consideration for progressive (Box I) taxation and subsequently grants a proportional relief of double taxation at the average Dutch rate. Under the current policy you may well apply the exempt method which could results in a salary split advantage. This advantage will however be gone when this 26 year old policy is withdrawn (except for those few countries of which the tax treaties foresee directly in the exemption method).

The effective date of this change is yet unknown. It is also uncertain under what conditions the current policy expires. Furthermore, it does not require any formal change of law but "only" the withdrawal of the approval. This means that taxpayers should not expect too much from the legislator. The legislator will presumably be less inclined to introduce transitional arrangements. It can therefore not to excluded that the change of policy means the exemption method may already not be claimed anymore on fiscally earned income within 2020. Technically it may even be argued that the changed rules will even apply on income earned before the current policy/resolution is withdrawn. The new policy may even go that far in the sense it would influence the years for which no tax return has been done yet or for which no (definitive) assessment has been imposed. Of course this would be very unjust and we do expect some fair policy when changing the rules (for instance that it will only apply for the 2021 and onwards), but one can never know. From the past we have learned that on various occasions, the authorities have not always been very mindful for taxpayer’s position. We advise to file tax returns in the Netherlands for earlier years as soon as possible if this has not been done yet.

It may also be considered what the best timing is to exercise share options. One can think of exercising still in 2020 based on the hope that the policy withdrawal only applies as per 2021, but this is uncertain. Or, one can decided to wait until a potential emigration from the Netherlands.

To conclude this news letter, don’t be mistaken, this is a very important change and it is really the question when and under what conditions the policy will be withdrawn. For any taxpayer’s impact by the change to come, the consequences are potentially very substantial and any (potential) advantage of the salary split will disappear. We recommend to discuss this with the employer. If the interests are really high, a fiscal emigration from the Netherlands to a country that has a better tax treatment on such income, may even be considered. For instance, those executive employees who can expect a substantial income from equity, bonus or LTIP, may be much better off leaving the Netherlands.

Contact

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