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Comparing the participation exemption in the Dutch corporate income tax with the participation exemption in the global minimum tax

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List of abbreviations

Abbreviation	Meaning
ATAD 1	Anti-Tax Avoidance Directive 1
BEPS	Base Erosion and Profit Shifting
CFC	Controlled Foreign Company
CIT	Corporate income tax
CITA	Corporate Income Tax Act
DCC	Dutch Civil Code
ETR	Effective Tax Rate
GAAP	Generally Accepted Accounting Practices
IAS	International Accounting Standard
IFRS	International Financial Reporting Standard(s)
IIR	Income Inclusion Rule
LIFO	Last In, First Out
MNE	Multinational Enterprise
MTC	Model Tax Convention
OECD	Organization for Economic Co-operation and Development
OECD IF	OECD Inclusive Framework
QDMTT	Qualified Domestic Minimum Top-up Tax
STTR	Subject-To-Tax-Rule
UTPR	Under Taxed Payment Rule

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1 Introduction and research question

The participation exemption in the Dutch corporate income tax (CIT) is described by some as one of the crown jewels of the Dutch investment climate (together with the lack of source taxation, the extensive tax treaty network and the ability to obtain certainty in advance from the Dutch tax authorities).[1] The participation exemption has been instrumental in the popularity of the Netherlands as a country where multinationals set up their (EU) headquarter or holding companies. Through the years, many amendments have been made and anti-abuse rules have been incorporated, however, the basic notion has not been changed.

With the introduction of Pillar Two, the Organization for Economic Co-operation and Development (OECD) creates an entirely new corporate income tax with its own tax base, including a participation exemption: the global minimum tax. This tax is to be overlaid over the already existing national corporate income tax systems and the question arose whether this new tax will be the undoing of the success of the Dutch participation exemption. The risk here is that the Dutch participation exemption could be deemed too generous resulting in an effective tax rate that is too low and consequently, additional tax to be levied under the global minimum tax.

The research question of this thesis is:

To what extent does the global minimum tax overrule the participation exemption in the Dutch CIT?

In order to answer this question, I have answered the following sub-questions:

1. How does the participation exemption in the global minimum tax work?
2. How does the participation exemption in the Dutch corporate income tax work? I have prepared an overview of the major items to which this participation exemption applies; and
3. How do these participation exemptions compare? As there is an enormous amount of case law regarding the application of the participation exemption in the Dutch CIT, I have operationalized this question by analysing the legal rules of the landmark cases and then applied the IFRS / global minimum tax framework to the outcomes of these cases.

I have made selection of the cases to compare given the limited amount of space available.

2 A global minimum tax

2.1 Background

Since the financial crisis of 2008, the OECD has worked tirelessly to combat tax avoidance and improve the international framework on taxation. In 2013, it created the Base Erosion and Profit Shifting (BEPS) project which introduced a number of measures ranging from changes to the allocation of taxing rights to new rules to improve the transparency, the so-called BEPS actions 1 through 15. A major milestone was the multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting (Multilateral Instrument) by more than 100 countries in November 2016.[2]

[1] Brief staatssecretaris van Financiën van 19 november 2015, nr. IZV/2015/936 U.

[2] https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm.

Continuing work, the OECD and G20 countries created the so-called Inclusive Framework on BEPS (OECD IF), an ad hoc group of more than 140 members which, amongst others, brought forward the idea of a two-pillar solution.[3]

On 8 October 2021, the IF reached an agreement on the two-pillar solution with the aim to reform the international taxation rules to ensure that multinationals pay their fair share of taxes.[4] Pillar One consists of rules aimed at allocating taxing rights to market jurisdictions more than the current international allocation rights on taxes do and Pillar Two introduces a global minimum tax to address the risks of base erosion and profit shifting that remained following the 15 BEPS actions. On 20 December 2021, the OECD published model rules (the OECD rules) for the global minimum tax[5] and on 14 March 2022, documents providing commentary[6] (the OECD Commentary) and examples[7] (the OECD examples) to the model rules.

The European Commission (EC) published a proposal for a directive to implement Pillar Two[8] with some amendments so that it would meet the requirements of the internal market of the European Union (EU) and the fundamental freedoms in December 2021.[9] The Council of Ministers of the European Union has, since then, debated this directive and made several amendments to the draft directive, with the latest text being published on 21 June 2022.[10]

Since the inception of Pillar Two, the Netherlands has been involved in the process as a member of the Inclusive Framework of the OECD and a firm proponent.[11] In 2022, the Dutch ministry of Finance is preparing implementing legislation for the global minimum tax.

Currently[12], the future of the global minimum tax is still uncertain with support in the United States floundering[13] and the EC being unable to obtain 27 positive votes.[14] In July 2022, tension between the United States and Hungary rose following Hungarian president Orban's statement that he collaborates with the political opposition in the United States to back Hungary's

[3] OECD (2019), Addressing the tax challenges of the digitalization of the economy – policy note, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf.

[4] OECD (2021), Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.

[5] OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm.

[6] OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf.

[7] OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

[8] EC document: Proposal for council directive on ensuring a global minimum level of taxation for multinational groups in the Union. COM(2021) 823 final 2021/0433(CNS).

[9] Staff Working Document to the Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union (SWD(2021) 580 final), p.6.

[10] Council document: Draft Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union- Presidency compromise text and draft Council statement, 2021/0433(CNS), 10497/22 INIT, FISC 143, ECOFIN 647, https://data.consilium.europa.eu/doc/document/ST-10497-2022-INIT/EN/pdf.

[11] Tweede Kamer, vergaderjaar 2019–2020, 32 140, nr. 63, p. 9.

[12] At the date of finalization of this paper.

[13] R. Goulder, 'Did West Virginia just kill global tax reform?', Forbes, 21 July 2022, https://www.forbes.com/sites/taxnotes/2022/07/21/did-west-virginia-just-kill-global-tax-reform/.

[14] M. Kasnyik and W. Horobin, 'EU Clashes With Hungary Over Implementing Global Minimum Tax', Bloomberg, 22 June 2022, https://www.bloomberg.com/news/articles/2022-06-17/hungary-to-oppose-global-minimum-tax-at-eu-meeting-gulyas-says.

resistance to the global minimum tax.[15] The United States retaliated by giving notice of termination of the tax treaty between the two countries.[16]

2.2 Elements of the global minimum tax

2.2.1 General overview

The global minimum tax is a profit tax for large multinational groups (revenue in excess of €750m) set at an effective tax rate (ETR) of 15%.[17] This is achieved by creating a distinct corporate income tax with its own tax base that starts with the net financial income or loss and further draws on common elements of the corporate income tax systems found across the world. Subsequently, it is evaluated whether this income of the companies in question is taxed at the minimum ETR. If the ETR is indeed sufficient, the application of the tax stops (for that year), however, if not then the ETR is 'topped-up' to the minimum ETR.

Topping-up is achieved through a number of mechanisms which apply depending on the situation and according to a specific hierarchy:

1. The Qualified Domestic Minimum Top-up Tax (QDMTT);
2. The Income Inclusion Rule (IIR);
3. The Under Taxed Payment Rule (UTPR); and
4. The Subject-To-Tax-Rule (STTR).

The combination of these mechanism incentivizes adherence of all countries to the global minimum tax. Should a country's corporate income tax insufficiently tax the profit of in scope companies, then it is first up to that country to ensure minimum taxation on the basis of the QDMTT[18] and if that does not work, group companies in other countries are subject to the additional tax on the basis of the IIR. The UPTR and STTR are used for -respectively- a backup in case the IIR is not adequate and to offer developing countries an easy way to levy more tax without having to make the complex calculations of ETR and ETR / UTPR themselves.

In this thesis I will only further address the definition of covered taxes and, of course, the determination of the tax base which contains the participation exemption. I refer to the wide array of available literature and documentation on the other elements. One important note is that the ETR is determined by dividing the covered taxes by the tax base of the global minimum tax.

2.2.2 Covered taxes

Taxes are defined as taxes that relate to income or profits and the starting point is the taxes included in the financial accounts of a company. It also includes taxes that are levied instead of a generally applicable corporate income tax.

2.2.2.1 Exclusions

Any taxes levied in relation to income that is excluded from the computation of the financial income or loss under the tax base do not fall under the definition of taxes.[19] Most relevantly,

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[15] J. Stein, 'GOP officials back Hungary's resistance to global tax deal, bucking Biden', The Washington Post, 1 July 2022, https://www.washingtonpost.com/us-policy/2022/07/01/hungary-gop-tax-deal/

[16] United States Department of the Treasury, 'United States' Notification of Termination of 1979 Tax Convention with Hungary', 15 July 2022, https://home.treasury.gov/news/press-releases/jy0872.

[17] The OECD Rules, op cit., p. 3.

[18] I expect that the introduction of the QDMTT means that all states will enact laws that conform to the global minimum tax that top-up any shortfall in ETR themselves to avoid that the tax revenue slips away to other countries. Therefore, there will be a pressure on each country to implement this QDMTT as accurately as possible.

[19] Article 4.1.3.a of the OECD Rules.

this applies to situations corporate income taxes that apply where a participation exemption would not apply under the applicable corporate income tax, but the dividends or capital gains are excluded from the tax base of the global minimum tax. The OECD Commentary does not provide any supporting reasoning.[20] The result is that in case a certain jurisdiction exempts certain kinds of income that is not exempt in the tax base of the global minimum tax, there is a risk that the ETR in that jurisdiction falls below the minimum percentage, but when the mirror situation occurs, the taxes incurred are disregarded and the consequence may be that the ETR is still too low, while still profit taxes are paid.

This exclusion becomes all the more remarkable when one realizes that any corporate income tax levied on dividends is excluded from the definition of taxes because the dividend is excluded from the tax base, but any source tax on dividends is not. According to the OECD Commentary:

> *"The key distinction between taxes imposed in intra -group dividends, i.e. dividends received from another company and taxes imposed on other excluded dividends and equity method income that the underlying income that funded the intra-group dividend was previously included in the group's financial income and loss when earned. Therefore, taxes paid on such distributed income are included in the taxes of the distributing company and, ultimately, in the numerator of the ETR computation."*[21]

2.2.2.2 Allocation of covered taxes

As a starting point, taxes are allocated to the company that incurs them and includes them in its financial net income. However, in certain situations taxes are allocated from one group company to another: permanent establishments, transparent entities, hybrid entities, application of controlled foreign company (CFC) rules and source taxes. I will highlight CFC rules and source taxes here:

1. Taxes levied from a shareholder as a result of a controlled foreign company regime are allocated to the CFC itself;[22] and
2. Source taxes on dividend distributions are allocated to the company that distributed the dividend.[23]

One would have expected these taxes to be allocated to the shareholder in both cases, as the CFC is levied from the shareholder and the company that distributes dividends is only considered to be withholding agent and the tax is deducted from the income of the shareholder. Under the global minimum tax, these taxes are allocated to CFC / distribution company because this means that these taxes are counted towards the ETR in the jurisdiction where the underlying income was earned (meaning the location where the company that earned income is a tax resident).[24] A CFC regime is defined as a shareholder becoming subject to current taxation on its share of part or all of the income earned by the CFC, irrespective of whether that income is distributed currently to the shareholder.[25]

[20] The OECD Commentary, op cit. p.87.
[21] The OECD Commentary, p. 88.
[22] Article 4.3.2.c of the OECD Rules.
[23] Article 4.3.2.e of the OECD Rules.
[24] The OECD Commentary, p. 95, 96 and 99.
[25] The OECD Rules, p. 54.

2.3 The participation exemption in the global minimum tax

2.3.1 Financial accounting income

The starting point for determining the tax base of the global minimum tax is the financial accounting income or loss of a company:*"[..] the net income or loss determined for a constituent entity (before any consolidation adjustments eliminating intra-group transactions) in preparing the consolidated financial statements of the ultimate parent entity"*.[26] This income or loss must be determined according to the same financial reporting standards as used for the entire multinational group.[27] The accepted financial reporting standards are listed exhaustively and include the standards of major economic countries, for example: IFRS[28], the member countries of the EU and European Economic Area and the United States.[29]

The application of IFRS is mandatory for companies that have issued shares on a regulated market in the EU[30] and therefore, I will refer to IFRS going forward where it is necessary to explain the particular features of the financial income.

2.3.2 Adjustments to the financial accounting income

Article 3.2 of the OECD Rules contains a list of 'exclusions' from the net financial income of an entity, which includes the exclusion for dividends and capital gains, the core elements of a participation exemption. To understand how this participation exemption operates, a number of definitions, which further refer to other definitions, are relevant. For ease of understanding and reference, I have integrally included these below:

Definition[31]	Meaning[32]
Excluded Dividends	Means dividend or other distributions received or accrued in respect of an **Ownership Interest**, except for: (a) A **Short-term Portfolio Shareholding**; and (b) An Ownership Interest in an Investment Entity that is subject to an election under Article 7.6. (OECD Rules)[33]
Excluded Equity Gains or Losses	Means the gain, profit or loss included in the separate accounts of the company arising from: (a) Gains and losses from changes in fair value of an **Ownership Interest**, except for a **Portfolio Shareholding**; (b) Profit or loss in respect of an **Ownership Interest** included under the equity method of accounting; and (c) Gains or losses from disposition of an **Ownership Interest**, except for a disposition of a **Portfolio Shareholding**.

[26] Article 3.1.2. of the OECD Rules.
[27] Unless this is not reasonably practicable compare article 3.1.3. of the OECD Rules.
[28] IFRS stands for International Financial Reporting Standards prepared and issued by the International Accounting Standards Board. IFRS finds it legal basis in the EU by Regulation (EU) 1606/2002 on the application of international accounting standards (IAS Regulation) and Regulation (EU) 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 (IFRS Regulation).
[29] Article 10.1 of the OECD Rules.
[30] Article 4 of the IAS Regulation. A multinational that has a revenue in excess of €750m is likely to have some form of securities issued on a stock exchange, either shares or bonds.
[31] Article 10.1 of the OECD Rules contains all definitions used for the global minimum tax.
[32] I have printed the definitions used within the other definitions in bold to highlight the relationship.
[33] I will not further address the Investment Entities and the rules specifically applicable to them.

Ownership Interest	Means any equity interest that carries rights to the profits, capital or reserves of an Entity, including the profits, capital or reserves of a Main Entity's Permanent Establishment(s).
Portfolio Shareholding	Means **Ownership Interests** in an Entity that are held by the MNE Group and that carry rights to less than 10% of the profits, capital, reserves, or voting rights of that Entity at the date of the distribution or disposition.
Short-term Portfolio Shareholding	Means a **Portfolio Shareholding** that has been economically held by the Constituent Entity that receives or accrues the dividends or other distributions for less than one year at the date of the distribution.

2.3.3 Ownership Interest

The definitions of Excluded Dividends and Excluded Equity Gains or Losses refer to Ownership Interests, Portfolio Shareholding and Short-term Portfolio Shareholding. The definition of Ownership Interest is – in my opinion – the starting point for a good understanding of the participation exemption.

Ownership Interest means: "*any equity interest that carries rights to the profits, capital or reserves of an Entity*"[34], but also: "*[..] the interest in the underlying right is an equity interest, i.e., any shares, interests, participation, or other equivalents [..] which are characterised as equity [..]*"[35]. Ultimately, however, the meaning of the words 'equity interest' in this definition is determined by the applicable financial accounting standard.[36] I will address equity interests under IFRS below.

The words 'equity interest' are used to distinguish from other profit-sharing rights such as profit-sharing agreements with employees or profit participating loans.

It is important that these rights must be held 'economically'; this is the case when the owner is entitled to substantially all the benefits and burdens of ownership and the owner has not renounced or transferred such rights under another arrangement.[37]

Shares that have different rights than others, for example: preference shares versus ordinary shares, are only considered to be the same class of shares insofar they are interchangeable.[38]

A share without voting rights or without profit rights also qualifies as an Ownership Interest; the criterion is not cumulative. Unless specifically required, the rights to profits, capital or voting are deemed equal,[39] which can be illustrated as follows: Suppose company A issues two types of Ownership Interests, one type gives the right to the profit in company A and another in the capital of company A. B holds 50% of first type and 80% of the latter. B's total Ownership Interest in A amounts to: (1/2 x 50%) + (1/2 x 80)% = 65%.

2.3.4 Accounting for ownership interests under IFRS

As noted, the term Ownership Interest is ultimately defined by the applicable accounting standard. Under IFRS, the relevant term is equity instrument: any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.[40] This term is comparable to the examples given by the OECD Commentary (see above). The distinction

[34] The OECD Commentary, p. 206.
[35] Ibid., p. 51.
[36] Ibid.
[37] Ibid. p. 50.
[38] Ibid, p. 52.
[39] The OECD Commentary, p. 207.
[40] IAS 32, paragraph 11.

between equity instrument and liability is therefore an important one and will be discussed in paragraph 4.7 below.

The IFRS rules to account for equity instruments are included in a number of standards. The most relevant standards are IFRS 10 (consolidation), IAS 27 (standalone accounts), IAS 28 (investments in Associates and Joint ventures) IFRS 9 (financial instruments; asset side) and IAS 32 (financial instruments, liability side).[41] Note that IFRS 9 refers to IAS 32 for, amongst others, the definitions of equity instruments. IFRS 9 applies to financial instruments (such as equity instruments, which include shares) unless they must be taken into account under the other standards.

In order to understand the operation and necessity for some of the exclusions that make up the participation exemption, it is important to understand how IFRS accounts for equity instruments in other companies. The following methods must be used, the selection of which depends on the amount of influence the owner has:

1. Equity interest over which the owner has no influence, must be valued at fair value through profit and loss other comprehensive income;[42]
2. Equity interests over which the owner has significant influence, so called associates, or equity interest over which the owner has joint control as part of a joint venture, must be valued using the equity method;[43] or
3. Equity interests over which the owner has control[44], so called subsidiaries, must be fully consolidated in the annual accounts, meaning that the equity interest is lost in consolidation and all assets and liabilities, and profit and loss must be included in the consolidated financial statements on a line-by-line basis.

Because the global minimum tax' starting point is the separate accounts of a group company before the eliminations following from consolidation are applied, this means that only the accounting methods of cost price, fair value through profit and loss or through other comprehensive income and the equity method remain.[45] Depending on the chosen method, the types of income from the equity instruments differ:

1. The owner may irrevocably choose which fair value method: through profit and loss or through other comprehensive income. In case of the former, the changes in value are recognized as profit or loss and dividends are recognized as a reduction in the valuation of the share interest (but not a loss as this is offset by the receipt of the dividend) and in case of the latter the dividends received will be recognized in profit or loss while the changes in value will be booked in other comprehensive income;[46]

[41] Note that IFRS 9 refers to IAS 32 for, amongst others, the definitions of equity instruments. IFRS 9 applies to financial instruments (such as equity instruments, which include shares) unless they must be taken into account under the other standards (FRS 9, paragraph 2.1.a (scope)).

[42] IFRS 9, paragraph 5.7.

[43] Significant influence is the power to participate in the financial and operating policy decision but is not (joint) control of those policies. In practice this is achieved when a company owns between 20% and 50% of the shares and/or voting rights.

[44] Control means: "[..] exposed, or has the rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee." IFRS 10, Appendix A, defined terms.

[45] IFRS 28, paragraph 10.

[46] Ibid., paragraph 5.7.1A and 5.7.6. The primary source of information is the statement of profit and loss. However, the statement of other comprehensive income is sometimes used to allow certain income or expenses to be removed from the profit and loss to allow it to provide more relevant insight. For example, unrealized gains or losses can distort the actual profit of the company if they are booked in the profit and loss account. This can be solved by booking these through the other comprehensive income and recycling them through the profit and loss account upon realization so that only the actual net gain or losses is recognized in the profit and loss account.

2. In case the cost price method is used, intra-group dividends, including distributions that have been received or accrued and also impairments and recovery thereof of the shareholding become visible as income;[47]
3. In case the equity method is used, the result of the shareholding is recognized through increase or decrease in value of the shareholding. Dividends are not recognized as income under this method but decrease the carrying amount of the subsidiary.[48]

The resulting income must therefore be excluded from the profit and loss account to avoid double taxation[49]. This is achieved by adjusting the entities financial accounting net income or loss for Excluded Dividends[50] and Excluded Equity Gains or Losses.[51]

An important note that must be made here is that an equity instrument under IFRS is broader than just shares. It can also pertain to certain kind of options and other instruments as we will see below. However, the OECD Commentary does not limit its definition of an Ownership Interest to just shares, but also included "equivalents".

2.3.5 Excluded Dividends

When dividends are part of the financial income of the company, the exclusion for dividends becomes relevant. Dividends are excluded when they are received from Ownership Interests that are not Short-term Portfolio Shareholdings (see below).

Under IFRS, dividends are defined as "*distributions of profits to holders of equity instruments in proportion to their holdings of a particular class of capital.*"[52] For the global minimum tax, Excluded Dividends means distributions on shares or other equity interests.[53] The terms dividends and other distributions received or accrued are not further elaborated except that, in practice there are many differences in treatment following from the location of tax residency of the distribution entity or the nature of the distribution, for example a share buyback may be treated differently.[54] The OECD aims to create a bright line test that ensures consistency and avoids significant complexity of including all these variations. No examples were included in this respect in the OECD Examples.

This is in stark contrast with the definitions provided in article 10, paragraph 3 of the OECD Model Tax Convention and as explained further in the guidance thereto.[55] Although the lack of this reference can be partially explained by the reference included at the end of that paragraph 3: "*other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company is making the distribution is a resident*". This is exactly the kind of reference that would be detrimental to a good standalone tax base.

It would have been useful to provide more examples for common situations, especially given the wide array of case law present on this question in many jurisdictions, not the least in the Netherlands as we will see later. I expect that there will be a strong call for further guidance in this respect.

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[47] The OECD Commentary, p. 50.
[48] IAS 27, paragraph 12 and IFRS 28, paragraph 3 (definitions).
[49] Ibid.
[50] Article 3.2.1.a of the OECD Rules.
[51] Article 3.2.1.b of the OECD Rules.
[52] IFRS 9, p. A428.
[53] The OECD Commentary, p. 50.
[54] Ibid.
[55] OECD (2017), Model Tax Convention on Income and on Capital: Condensed Version 2017 (MTC), OECD Publishing. https://dx.doi.org/10.1787/mtc_cond-2017-en. It is remarkable how the MTC is referred to off and on in the OECD Commentary. For some items, like the exclusion for international shipping the MTC is followed and used as a guidance. In other places, the definitions or concepts used in the MTC are used the explain what a specific element of the global minimum tax *is completely not*, like for example the definition of covered taxes.

2.3.6 (Short-term) Portfolio Shareholding

Before elaborating on the Excluded Equity Gains or Losses, I will address Portfolio Shareholding and the Short-term Portfolio definitions.

A Portfolio Shareholding is an Ownership Interest that carries the rights to less than 10% of the profit, capital or reserves of an entity or the voting rights therein. As noted, the OECD has modelled the 'participation exemption' according to the common features of participation exemptions found in the corporate income tax systems of IF members. A 10% share ownership or voting right threshold is common and is for example found in the EU's Parent Subsidiary Directive.[56]

The 10% requirement takes into account the percentage of ownership across the entire MNE group and not the single entity[57]: when two group companies each hold 6% of the shares in a third company, this means that the shareholding is not considered to be a Portfolio Shareholding as this adds up to 12%. No guidance is provided for the situation where the ultimate parent entity does not wholly own the intermediary company holding the 6% (from my example). For example, in case one of the group companies holds 6% and the other itself is only owned for 55% [58] by the MNE group. This could result in a group ownership of 6% + (55% x 6%) = 9.33% Alternatively, it could result in a group ownership of 6% + 6%. However, from the other rules and principles used in the global minimum tax especially regarding the application of the IIR when companies are not wholly owned by the ultimate parent entity, I conclude that the proportional ownership calculation would be the likely outcome.[59]

A Short-term Portfolio Shareholding is a Portfolio Shareholding that is not economically held uninterrupted for at least one year at the date of dividend distribution. A holding period is also a common requirement for the application of participation exemptions and applies to exclude the application thereof to trading income. The justification for the holding period is found the desire to avoid creating a discrepancy between the receipt of a dividend and the extent of the rights held during the period as these dividends ordinarily should be the result of holding the shares economically for such a period.[60] This justification applies, in my opinion, to a holding period in general and not just for a holding of less than 10%.

The holding period is tested on a per entity and per Ownership Interest basis. This means that a transfer of a share between group companies of the same multinational resets the holding period[61] and that acquiring the shares over a period of time means that for every single share it must be determined whether the holding period has been met. Furthermore, sales of shares are deemed to be a sale of the most recently acquired shares, a 'last-in-first-out' approach.

The effects of this are illustrated in the examples provided in the OECD Examples.[62] For example, if 100 shares are acquired and a further 100 after 3 months and assuming that these 200 shares represent less than 10% of total shares in the company, then after one year only the 100 shares qualify as a Portfolio Shareholding, the other 100 qualify as a Short-term Portfolio Shareholding meaning that only the dividend from the first 100 shares is excluded. Should 100 shares be sold on the day after the second 100 shares are acquired but before the dividend is

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[56] Article 3, paragraph 1, subparagraph a of the Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

[57] Ibid, p. 51. And 52.

[58] Such a shareholding would still make the company part of the MNE Group assuming the 55% means that the ultimate parent entity has control over the intermediate company and thus requires it to be consolidated in the financial accounts of the ultimate parent entity (see article 1.2.1 of the OECD Rules). The question whether control is present can not be immediately answered with an ownership of 50%, which I want to avoid for these purposes.

[59] The OECD Examples, p. 9: example 2.1.5 -2 where the ultimate ownership of the ultimate parent entity in a given entity is calculated by multiplying the different ownership percentages throughout the ownership chain.

[60] The OECD Commentary, p. 51.

[61] Ibid., p. 52.

[62] The OECD Examples, p. 23 & 24.

distributed, in this example the dividend on the 100 remaining shares would benefit from the exclusion from the tax base because of the LIFO system.

No guidance is available for the situation where the shareholding no longer qualifies as a Portfolio Shareholding followed by a dividend distribution within a year. From the definition and available guidance, it seems that the holding period is no longer relevant once the shareholding becomes so substantial. Apparently, this is sufficient grounds to not include rules that make such a transition less abrupt. This means, in my opinion, increasing a shareholding to 10% or more means that a dividend immediately following such an increase is excluded regardless of holding period and in the inverse situation, one does not to take into account the holding period as usual.

2.3.7 Excluded Equity Gains or Losses

Two categories of gains or losses on Ownership Interests are excluded from the financial income for the global minimum tax: one relating to changes in value resulting from the results of the underlying company and one relating to the gains or losses realized from the disposition of the Ownership Interest.

2.3.7.1 Equity gains during ownership

Gains and losses from changes in fair value of an Ownership Interest, except for Portfolio Shareholding are exempt. This excludes the changes in value of an Ownership Interest that is valued using a fair value through profit and loss method. In case the shares are valued at fair value through other comprehensive income, this means they may have already been excluded from the financial net income and therefore, no exclusion is necessary.[63]

Gains and losses on an Ownership Interest resulting from the equity accounting method are also excluded. Under IFRS (as noted above) Ownership Interests are accounted under equity account method when the investment is an associate and in the separate accounts when it is a subsidiary.

This exclusion does not exclude Portfolio Shareholdings. Although not explicitly stated, this seems to be because it is assumed that this method will not be applied to Portfolio Shareholdings as the equity accounting method only applies to interests that represent at least an interest of 20%.[64] Although the aforementioned is likely to hold true in almost all cases, I note that the equity method is prescribed when the owner has significant influence. Significant influence is assumed when the interest is 20% or more.[65] However, significant influence can also result from having a board member in the board of the company, having significant transactions with the company or having a say in the policy making process. Therefore, it would have been more prudent to include the exclusion for Portfolio Shareholdings. Ultimately, it would be best if the reason is explicitly covered in further guidance.

2.3.7.2 Equity gains or losses upon disposal

Equity gains or losses realized upon disposal of the Ownership Interest, except if it is a Portfolio Shareholding, are also excluded.

Differing from the application of Excluded Dividends, gains or losses upon disposal are not excluded insofar they relate to Portfolio Shareholdings, regardless of a holding period. So, Portfolio Shareholdings that have been owned for more than a year, also do not qualify.

A reference is made to results incurred on a hedging instrument that has been entered into to hedge currency results on Ownership Interests denominated in a different currency. The IF

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[63] See above, paragraph 2.3.4.
[64] The OECD Commentary, p. 53.
[65] IAS 28, paragraphs 5 – 9.

members: "*will consider providing [guidance] on the extent to which such gains and losses may be treated as Excluded Equity Gains and Losses*".[66]

2.4 The participation exemption in the global minimum tax: conclusion

The global minimum tax rightfully includes a participation exemption by excluded dividend income and gains or losses resulting from share interests and seems to successfully account for the peculiarities of financial accounting income to make sure that the aim: avoiding double taxation of profits already taxed in the hands of the subsidiary or associate is met.

The OECD is forced to look for the common denominator in designing the participation exemption due to the sheer variation in designs of participation exemptions in the corporate income tax systems of the IF-member states and therefore they seem to have chosen a good middle ground approach in determining the scope of the participation exemption: a minimum shareholding of 10% and a holding period of 1 year, but fully exempting income and gains if these conditions are met.

The reasoning for the holding period is that trading income from shares must not be exempt, this could have been achieved more accurately with addressing exactly that. But that would likely not have resulted in a bright line test.

Due to the nature of the global minimum tax, the participation exemption does not need to be accompanied with significant anti-abuse rules like a CFC or a subject to tax test applicable to the subsidiary, as the global minimum tax itself effectively functions as a CFC.

The global minimum tax uses the financial accounting income as a starting point. The OECD Rules and OECD Commentary define the participation exemption and guidance thereto, but references are also made to the accounting standards applied by the multinational group. This means that the accounting standards will become relevant for the levy of tax and furthermore, and that the choice of accounting standard can possibly have influence over the calculation of top-up tax. This may result in other interests influencing the accounting income than those that were originally intended and the other way around: accounting standards now have an even bigger and more direct influence on the amount of profit tax levied.

One major point of attention is the way covered taxes are calculated, which may result in difficulties with differing participation exemptions: any profit taxes levied in relation to income that is excluded from the global minimum tax' base, is not taken into account for the calculation of the ETR. This may result in an asymmetry.

3 Dutch CIT participation exemption: a short overview and basic elements

In this section, I will address certain types of income and how they relate to the Dutch participation exemption. I will first start with an introduction and a background to the Dutch CIT and its participation exemption and subsequently address the most important definitions: income derived from a participation and participation.

3.1 Overview

3.1.1 General

Dutch CIT applies to all companies and entities tax resident in the Netherlands or carrying on a business in the Netherlands through a permanent establishment (and certain additional

[66] The OECD Commentary, p. 53.

situations relating to anti-abuse rules).[67] It is a direct tax that is levied over the total profit realized over the lifetime of the company on an annual basis. Profit is determined on the principles of *totaalwinst* and *goed koopmansgebruik* (roughly summarized as Dutch tax GAAP and distinct from Dutch GAAP and IFRS, but it draws on these principles heavily).[68] Subsequently, exemptions – such as the participation exemption[69] are applied to the pertinent items of income.

Below, I will refer to the company applying the participation exemption as the parent (company) and the company the shares of which are subject to the application of the participation exemption as the participation or a subsidiary.

The purpose of the participation exemption is to prevent double taxation of profits that were already taxed in the hands of the subsidiary.[70] The participation exemption exempts income (positive income but also losses) derived from a participation, including costs related to the acquisition or disposition.[71] In short, a participation is a shareholding of at least 5% in a company (I will elaborate below).

3.1.2 Anti-abuse

Furthermore, certain anti-abuse rules apply – imposing additional requirements on the participation. The participation may not be held as a portfolio investment, unless an additional test is met.[72] The participation exemption still applies to participations that are either subject to a reasonable profit tax (10%) levied over a tax base comparable with the Dutch CIT or the assets of the participation usually (in) directly consist of less than half of portfolio investments that are not subject to a reasonable profit tax levied over a tax base comparable to the Dutch CIT.[73] A notable exception from the definition of portfolio investments is real estate, because real estate is not mobile and is generally subject to taxation in the country of its location and therefore not prone to be subject to tax avoidance by moving it around.[74] Net losses incurred on a participation that is dissolved and liquidated, are – in principle – not subject to the participation exemption.[75]

The Dutch CIT also has CFC legislation relation to the abovementioned low taxed portfolio investments and has implemented the CFC rule of ATAD 1,[76] which applies to CFC's with passive income in tax resident in countries that are either included on the EU list of non-cooperative jurisdictions for tax purposes,[77] or that are included on the Dutch blacklist of low tax countries, *i.e.,* countries that have no profit tax or a profit tax with a statutory rate of less than 9%.[78]

[67] Articles 1 – 3 of the Dutch CIT Act 1969 (hereafter: CITA).

[68] Articles 8 and by reference article 3.8 of the Dutch Personal Income Tax Act 2001 (hereafter: PITA).

[69] Section 2.5 of the CITA contains the main articles regarding the participation exemption, but through out the act further rules are included to deal with the concurrence of the participation exemption with other rules such as the fiscal unity or mergers.

[70] Dutch Supreme Court, 22 November 2002, ECLI:NL:HR:2002:AD8488, BNB 2003/34.

[71] Article 13, paragraph 1, CITA.

[72] Article 13, paragraph 9, CITA.

[73] Article 13, paragraph 11, CITA.

[74] Article 13, paragraph 12, a, CITA.

[75] Article 13d and 13e, CITA.

[76] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD 1).

[77] Council document 6437/22 FISC 50 ECOFIN 156 of 24 February 2022 (Council conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes).

[78] Decree of the Ministry of Finance, *Regeling laagbelastende staten en niet-coöperatieve rechtsgebieden voor belastingdoeleinden*, Stcrt. 2021, 48636.

Furthermore, the participation exemption does not apply to dividends received that are (effectively) deductible from the taxable basis of the distributing entity. In this case, there would not be double taxation that needs to be avoided.[79]

3.1.3 History

The participation exemption in the Dutch CIT dates to the earliest precursors of this tax and is a fundamental part thereof.[80] The requirements varied over time because of international influences, anti-abuse rules and as a result of fundamental changes to the character of taxes on companies[81]. For example, at one time, the participation exemption already applied when one single share was owned[82] and at another time only when 90%[83] of the capital was owned and at times, the participation exemption only provided an excepted for half or two thirds of the dividends received or not to capital gains.[84]

3.2 Participation

A participation is defined as: owning a shareholding of at least 5% of the nominal paid up capital in a company of which the capital is partially or fully divided into shares.[85] Nominal paid up capital is the capital that has actually been contributed (and paid) on the shares but excludes share premium.

Under Dutch company law, shareholders of limited liability companies (*Naamloze en besloten vennootschappen*) are in principle equally entitled to the residual profit of a company and to the liquidation proceeds.[86] Deviations from this are allowed but must be included in the articles of association. The profit must be determined in according with generally accepted accounting standards in the Netherlands, which include Dutch GAAP according to title 9 of book 2 of the DCC and IFRS.

The CITA provides for several extensions to the definition of participation. In case a regular participation is owned, the following is also considered to be part of the participation:[87]

1. profit certificates in the participation (that is an entity); and
2. So called profit participation loans provided to the participation. Profit participation loans are loans that can effectively be considered equity and therefore, remuneration under this instrument should be exempt under the participation exemption.[88]

[79] Article 13, paragraph 17, CITA.
[80] J.A.G. van der Geld & A.W. Hofman, *De deelnemingsvrijstelling en deelnemingsverrekening* (Fiscale Monografieën nr. 149), Deventer: Wolters Kluwer 2017, p 23.
[81] Ibid., p. 23. The precursor of the CIT was a tax on distributions and the participation exemption there served to reduce the tax on a distribution of the parent following a distribution of the participation.
[82] Ibid., p. 24.
[83] Ibid., p. 27.
[84] Ibid., p. 26.
[85] Also: at least 5% ownership of certificates in a mutual fund, entitlement to at least 5% of the profits in a (Dutch) limited partnership, a membership in a cooperative association (without 5% requirement) and also in case of the application of anti-hybrid rules implemented on the basis of the ATAD 2 directive. I will only discuss shares and companies.
[86] Articles 2:105/216 of the DCC and Article 2:23b, paragraph 1 of the DCC.
[87] Article 13, paragraph 4 of the CITA.
[88] I will further elaborate on the conditions of this type of loan below.

In a case a shareholding does not represent 5% or more, this interest can still qualify as a participation if the entity in which the shareholding is held, is a connected entity or when a connected entity owns a regular participation.[89,90]

A shareholding remains qualified as a participation for 3 years if it no longer represents 5% or more of the shareholding of the participation after an uninterrupted ownership of 5% of at least one year before the date the ownership fell below 5%, the so-called expiring participation.[91]

Standard case law exists as to the question whether option contracts can also constitute a participation, which I will address in more detail below.

3.3 Income derived from

The phrase: "income derived from" (*uit hoofde van*) requires that there is a direct causal relationship between the participation (see below for more detail) and the income. Income is defined broadly and also includes losses. Because it also includes losses, the application of the participation exemption is mandatory once the requirements have been met.

The most obvious types of income are dividend distributions and capital gains realized upon disposal of the participation. Other examples are: hidden dividends (resulting for example from not dealing at arm's length with a subsidiary), acquisition costs and costs relating to the disposal, earn outs, income from options, etc..[92]

Under Dutch tax GAAP, dividends received from the participation do not change the carrying value of the participation. Dividends received are booked through the profit and loss account and subsequently exempt under the participation exemption, if applicable. Furthermore, participations to which the participation exemption applies must be valued at cost price plus acquisition costs. Capital repayments and capital contributions respectively decrease and increase the carrying value of the participation. The parent company is not obliged to impair the shareholding as this would not have an impact on the tax profit because of the participation exemption.[93] The parent is allowed, however, to impair the participation to lower market value.[94]

4 Comparison between elements of the Dutch participation exemption and the global minimum tax participation exemption

4.1 Introduction

In this section, I will address the main research questions of this paper: comparison of the Dutch participation exemption with the participation exemption of the global minimum tax. I

[89] Article 13, paragraph 5, CITA. This does not only apply to a shareholding, but also when the parent owns profit certificates or a profit participating loan.

[90] An entity is connected with another entity when there is a shareholding interests of at least 1/3 between the two or via other companies that are also connected (Article 10a, paragraph 4, CITA.) The primary meaning of a shareholding in this context is the same as with the participation exemption: the paid up capital. However the voting rights and different classes of shares can also influence this (Decree of the Ministry of Finance, *Vennootschapsbelasting, toepassing van artikel 10a van de Wet op de vennootschapsbelasting 1969*, Stcrt 2013, 8768, paragraph 5 and Decree of the Ministry of Finance, *Vennootschapsbelasting, verliesverrekening, toepassing artikel 20a van de Wet op de vennootschapsbelasting 1969*, Stcrt. 2020, 23674, paragraph 2).

[91] Article 13, paragraph 16, CITA.

[92] W.C.M. Martens, *De deelnemingsvrijstelling in de Wet op de Vennootschapsbelasting 1969* (FED fiscale brochure), Deventer: Wolters Kluwer 2017, p. 65.

[93] Dutch Supreme Court, 28 March 2014, ECLI:NL:HR:2014:684, BNB 2014/119.

[94] A.W. Hofman, *Vpb.2.4.6.D.c Fiscale waardering van een deelneming op kostprijs of lagere bedrijfswaarde of lagere fiscaal intrinsieke waarde* in: A.W. Hofman, M.L.M. van Kempen & A.C. Rijkers (red.), Cursus Belastingrecht, Deventer: Wolters Kluwer.

will compare this on a per income / item basis. I have limited the comparison to the most common items: minimum thresholds, voting rights, economic ownership, conditional right to obtain shares and compensation for damages, costs, the distinction between equity and liabilities: preference shares and profit participation loans, option contracts, convertibles and anti-abuse rules.

4.2 Minimum thresholds & holding period

The Dutch participation exemption requires a shareholding of 5%. This 5% is a minimum percentage which needs to be owned by one single group entity. Once this threshold has been met by a connected entity, the participation exemption applies to even one share. The Dutch participation exemption does not include a holding period. Furthermore, the 5% threshold does not apply in the case of an expiring participation (see paragraph 3.2 above)

The global minimum tax participation exemption requires that at least 10% is owned for capital gains and dividends to be excluded or, alternatively that the share interest is held for at least a year in order for dividends to be excluded. This 10% may be spread out over the entire MNE group (see paragraph 2.3.6). The global minimum tax is surprisingly flexible regarding the fragmentation across a multinational group of the share ownership, where the Dutch participation exemption requires in any event at least an interest of 5% by one company in a multinational group.[95]

This area contains the most fundamental differences and this may especially require adaptation from companies that invest in small share interests, such as insurance companies to cover their obligations under their policies.

This would effectively mean that they would have to double the sizes of share interests they invest in to obtain the capital gains exemption. This may also drive them invest more and longer in share interests for only the dividends.

From the consultation dated April 2022 on the OECD Rules, it stands out that the holding period is criticized by insurance companies and others. For example, the Global Federation of Insurance Companies notes that they would deem a change of how the holding period operates, more equitable: the exact date of the dividend distribution does not need to be one year in the past, but just that the holding period is at least one year.

4.3 Voting rights

The Dutch participation exemption only qualifies voting rights in case the participation is resident in an EU country and the tax treaty provides for a reduction of source tax on dividends on the basis of a percentage of the voting rights. Only the tax treaty between the Netherlands and Ireland has such a provision.[96] Therefore, the relevance of this provision is negligible.

The participation exemption in the global minimum tax gives equal weight to voting rights and to other rights. This will likely result in unforeseen consequences where a minority shareholder is given less voting rights or shares without voting rights. The other rights must then become larger to make sure that the 10% threshold is met.

4.4 Shares & economic ownership

Under the Dutch participation exemption, legal ownership (*eigendom*) of the shareholding qualifies. However, if another person has a legal relationship with the owner of the shares that

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[95] If one group company owns at least 5%, then another group company can also apply the participation exemption to any shares in that company it owns without the 5% minimum applying. This is called the drag along rule (article 13, paragraph 5, subparagraph a of the CITA.

[96] Vakstudie Vennootschapsbelasting, artikel 13, aantekening 5.2.7, Fiscale Encyclopedie De Vakstudie *Vennootschapsbelasting*, Deventer: Wolters Kluwer

means that this person has the full economic ownership (economic ownership is benefiting from the increases in value and decreases and the risk of loss of the asset)[97], that other person also has a participation that can qualify under the participation exemption.[98] For example, a holder of dematerialized shares does not possess the legal ownership in the shares but is the economic owner of the shares and can therefore apply the participation exemption.

IFRS also utilizes a substance over form approach: assets are recognized when a company has a right that can produce an economic resource.[99] Furthermore, IFRS does not specifically require that a right is based on company law or that the concept of ownership underpins a right. Indeed, as discussed, above an equity instrument is any 'right' that entitles its holder to the residual interest (see paragraph 2.3.4 above) and further noted in the OECD Commentary (see paragraph 2.3.3 above).

It is important to note that under Dutch CIT, the legal shareholder can also apply the participation exemption without the economic ownership. The question then arises, what exactly the income should be to apply this to as the legal owner will likely not have any income because of the existence of the relationship with the economic owner. The OECD Commentary notes that the shareholder must not have transferred or relinquished the economic rights under another arrangement in order the be considered to own the Ownership Interest. Therefore, under the global minimum tax, the legal owner cannot apply the exclusions. As noted, the practical relevance thereof may be negligible.

Although there is a theoretical difference in the approach of the Dutch CIT on the one hand and the global minimum tax on the other, I see no practical difference in the approaches.

4.5 (Conditional) right to obtain shares / compensation for damages

Acquisitions are generally intense, time-consuming processes that can take up to a year. Generally, between conclusion of the share purchase agreement and closing (delivery of the shares) generally some time elapses to and certain conditions need to be fulfilled. In case the everything goes well, and all conditions are met, the shares are delivered and the deal is concluded. Both for Dutch tax purposes and IFRS, the shares are capitalized including costs (see below) on the balance sheet for the prices paid. In the intermediate period, the seller is often prohibited from extracting profit from the target. However, what happens when the deal is cancelled and the ex-buyer must be compensated for damages?

A participation exists and must be capitalized on the balance sheet for Dutch CIT when an unconditional right to obtain the shares is present. In case a suspensive condition still needs to be fulfilled, the right is not unconditional.[100] This means that any compensation for damages following a cancellation in an earlier stage does not fall under the participation exemption.[101]

Moreover, should an unconditional right to obtain a participation become ineffective or illegal, then no participation is created after all and any compensation suffers the same fate as above.[102]

Under IFRS, an acquisition is only recognized the moment the acquirer obtains control in the target.[103] However, according to the OECD Rules one needs to look at whether the company has the economic ownership of substantially all the burdens of share ownership, meaning that the shares should be capitalized and any dividend (unlikely during such an acquisition process) and

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[97] Dutch Supreme Court, 24 December 1957, ECLI:NL:HR:1957:AY1099, BNB 1957/123.
[98] Dutch Supreme Court, 16 October 1985, ECLI:NL:HR:1985:BH4845, BNB 1986/118.
[99] International Accounting Standard 32, paragraph 11 and International Financial Reporting Standards Foundation, Conceptual Framework for Financial Reporting, 2018, paragraph 4.4.
[100] Dutch Supreme Court, 10 July 2020, ECLI:NL:HR:2020:127, BNB 2020/160, paragraph 3.2.4.
[101] Dutch Supreme Court, 23 September 2016, ECLI:NL:HR:2016:2124, BNB 2017/11, paragraph 2.4.3.
[102] Dutch Supreme Court, 10 July 2020, ECLI:NL:HR:2020:127, BNB 2020/160, paragraph 3.2.4.
[103] IFRS 3, paragraph 8.

changes in value should be excluded only once this has occurred. Although the timing differs from the timing of the Dutch participation exemption, in case of a cancelled acquisition any compensation for damages cannot be considered a distribution of profits in my opinion.

Therefore, I see no deviation.

4.6 Acquisition and disposal costs

Acquisition and disposal costs also fall under the Dutch participation exemption, meaning that they must be capitalized together with the participation and are not deductible.[104] To determine what costs qualify one must ask the question whether these costs would have been made without the acquisition or disposal.[105] This also includes internal costs, such as salary costs and other indirect costs.

Under IFRS, acquisition related costs are costs the acquirer incurs to effect a business combination. These are generally not capitalized but directly expensed as costs in the period they are incurred.[106] The OECD Commentary makes no note of acquisition or disposal costs except for mentioning that costs related to Excluded Dividends are not disallowed.[107]

The Dutch participation exemption is therefore more stringent than the global minimum tax participation exemption and therefore this has an increasing effect on the ETR.

4.7 Distinction between equity and debt financing

In the Dutch CIT, the question between equity and debt financing case resulted in much debate, case law and legislative changes. As the Dutch Supreme Court phrases it aptly: "*For the answer to the question whether the participation exemption applies it is decisive whether distributions under the [shares] can be considered as a remuneration for the capital contributed on the shares or otherwise as a capital contribution by the shareholder in this capacity*".[108] The starting point of this determination is civil and company law form.[109]

In order to be considered equity, the instrument must result in risk bearing capital (the contributions of the shareholders may be used to settle the debts of the company) under the applicable laws and on the basis of the agreements between the parties.[110] As noted, under Dutch company law, this follows from the principles that the shareholders share in the profit and are entitled to the liquidation proceeds after all debts have been settled. Choosing a substance over form approach depending on the likelihood that the capital would be used to settle the debts of the company or following the GAAP qualification of an instrument, would result in too much legal uncertainty. This formal approach prevails even when the risks are negligible.

For debt instruments, the starting point is the civil law form, with a certain number of exceptions that have the result that a loan is considered equity for tax purposes. Although the Dutch Supreme Court does not explicitly describe what element of the civil law form is decisive, the court creates a limitative system capital provided to a subsidiary is either risk bearing capital (see above) or a loan (*geldlening*).[111] Therefore, if the capital is not risk bearing equity, it is debt. This can also be inferred from the Dutch law rules on loans: the core element of a loan agreement is the obligation to repay a sum of money.[112]

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[104] In case the acquisition or disposal is cancelled, the costs be deducted at once.
[105] Dutch Supreme Court, 7 December 2018, ECLI:NL:HR:2018:2264, BNB 2019/26.
[106] IAS 3, paragraph 53.
[107] The OECD Commentary, p. 52.
[108] Dutch Supreme Court, 7 February 2014, ECLI:NL:HR:2014:181, BNB 2014/80, paragraph 3.4.1.
[109] Ibid., paragraph 3.4.2.
[110] Ibid., paragraph 3.4.3.
[111] Dutch Supreme Court, 25 November 2005, ECLI:NL:HR:2005:AT5958, paragraph 4.4.
[112] Article 7:129, DCC.

Following this starting point, a loan can be requalified to equity for Dutch CIT in certain cases:

1. A sham loan. In case parties actually intended to provide equity instead of a loan;
2. In case of loss financing. If the loan has been provided under such facts and circumstances that it must have been clear from the outset to the provider of the capital that the loan would not be (fully) repaid; or
3. Profit participating loan (*deelnemerschapslening*). In case the loan has conditions that mean that the creditor is actually participating in the subsidiary.

As noted above, the profit participating loan also falls under the participation exemption on the basis of article 13, paragraph 4, subparagraph b. Income from the other two categories can also fall under the participation exemption depending on the facts and circumstances. I will discuss the details of the profit participation loan in more detail in paragraph 4.7.2 below.

Under IFRS, an equity instrument means any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.[113]

It is however important to note that the distinction between equity and liabilities is at times difficult to make and requires a careful analysis of the features of an instrument. Due to the nature of the definition of equity instruments as the residual category, the conceptual approach is that equity instruments are instruments that are not liabilities. Furthermore, IFRS uses a substance over form approach, meaning that the features of an instrument need to be examined to determine whether they meet the criteria of an equity instrument or liability.[114]

The existence of a liability requires:

1. An obligation,
2. To transfer an economic resource, and
3. That exists because of past events.

The most fundamental characteristic and the primary distinction between a liability and equity is the first: the obligation. The aspect of the obligation can relate to the principal amount (*e.g.* repay the loan) and the periodic remuneration (*e.g.* pay interest) and both must be evaluated and can lead to different conclusions for the principal and the remuneration; a split instrument. An equity instruments lacks the obligatory part and there is always a discretionary element to such an instrument: the discretion to make a cash payment under the instrument.[115] IAS 32 describes preference shares as follows:

> *When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example, the history of making distributions, intention, amount of the reserves, etc.*[116]

The degree of subordination is also irrelevant.[117] It seems that it is not relevant who has the discretion: with shares it is the shareholder who can resolve to distribute dividends,[118] meaning that the shareholder itself can decide when it wants to be paid.

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[113] International Accounting Standard 32, paragraph 11 and International Financial Reporting Standards Foundation, *Conceptual Framework for Financial Reporting,* 2018, paragraph 4.63.

[114] J. Ramirez, Accounting for derivates. Advanced Hedging under IFRS 9, (The wiley finance series), West Sussex: John Wiley & Sons, Ltd. 2015, p. 565.

[115] Ibid., 566.

[116] IAS 32, p. A1369.

[117] J. Ramirez, Accounting for derivates. Advanced Hedging under IFRS 9, (The wiley finance series), West Sussex: John Wiley & Sons, Ltd. 2015, p. 568.

[118] Article 2:105 of the Dutch Civil Code (hereafter: DCC).

One example is a perpetual instrument with discretionary interest: "*Suppose that an entity issues a perpetual debt instrument with annual interest, and that the entity has discretion over whether to pay the instrument's interest. Payment of interest is mandatory when the entity distributes dividends to its common shareholders. Unpaid interest does not accrue additional interest. Because the entity has no contractual obligation to deliver cash (or another financial asset), the instrument as a whole is classified as an equity instrument.*"[119]

In short, decisive is the obligation versus the discretion whether (re)payments need to be made under the instrument. The logical result of the above is that only a limited number of instruments qualify as equity.

One exception exists where a liability contains an obligation of the entity to issue another equity instrument under certain conditions.[120]

4.7.1 Preference shares

The above means that the qualification of an instrument as equity or debt, depends on the legal conditions for Dutch CIT purposes and on the basis of the questions whether an obligation exists to repay the principal or pay a periodic remuneration for IFRS. See an overview of common preference shares below:

Instrument features[121]	**Qualification Dutch CIT**	**Qualification IFRS**
Ordinary shares	Equity	Equity (no obligations)
Redeemable preference shares with non-discretionary dividends	Equity	Liability (obligation to repay principal; obligation to pay dividends)
Redeemable preference shares with discretionary dividends	Equity	Liability for principal and equity for dividends (obligation to repay principal; no obligation to pay dividends)
Non-redeemable preference shares with discretionary dividends	Equity	Equity (no obligations)
Non-redeemable preference shares with non-discretionary dividends (the object of the Dutch Supreme Court case BNB 2014/80)	Equity	Liability (no obligation to repay principal, obligation to pay dividends)

The above means that the Dutch participation exemption applies to a wider array of shares than the exclusions under the global minimum tax and as a result, the ETR can fall below the minimum.

Interesting to note that a redeemable preference share with a discretionary dividend has a split qualification under IFRS. Note that splitting up of the tax qualification of instruments under Dutch CIT is not allowed.[122] On the basis of the OECD Commentary, it is not clear what the consequences would be under the global minimum tax, as it requires equity ownership and a dividend or other form of distribution. One the one hand, one needs to be remunerated as a holder of equity (quod non) but on the other hand, the ultimate determination is made under

[119] Ibid., 567.
[120] International Financial Reporting Standards Foundation, Conceptual Framework for Financial Reporting, 2018, paragraph 4.64.
[121] Table from J. Ramirez, Accounting for derivates. Advanced Hedging under IFRS 9, (The wiley finance series), West Sussex: John Wiley & Sons, Ltd. 2015, p. 566.
[122] Dutch Supreme Court, 25 November 2011, ECLI:NL:HR:2011:BN3442, BNB 2012/37.

the applicable GAAP, IFRS in this case. It would be recommendable to have further guidance prepared by the OECD in this regard.

4.7.2 Profit participating loan (*deelnemerschapslening)*

As discussed above, a profit participating loan is a loan for civil law purposes but reclassified to equity under Dutch CIT. The requirements for reclassification are: [123]

1. The remuneration on the loan is almost completely dependent on the profit of the company or a specific asset, if this asset is significant for the determination of the profit.[124] The fact that payment can be deferred depending on the profit does not mean that an otherwise fixed remuneration is dependent on the profit;
2. The term of the loan is longer than 50 years or there is no term (for example it only becomes due and payable upon dissolution or bankruptcy); and
3. The loan is junior to the non-secured creditors (*concurrente schuldeisers*) in the company.

The above criteria must be assessed formally, meaning that a profit participation loan is present when the above conditions are met and it is not relevant how realistic these conditions are. However, the aforementioned does not preclude that the entire loan agreement can still be disregarded (see the sham loan).[125]

Under IFRS, we use the same framework as described above: is there a (re)payment obligation or is it discretionary? This question must be asked for both the principal and the remuneration.

The requirement that the principal only needs to be repaid after 50 years or only upon bankruptcy, raises the question whether this obligation (and thus a right for the holder) has any practical meaning. However, an instrument qualifies only as an equity instrument, in case the obligation to pay is completely absent.[126] It is important to see that under IFRS, the factual possibility to meet the payment obligation plays no role.[127] Therefore, the obligation remains in my opinion.

The fact that the remuneration is (almost completely) dependent on the profit is not relevant for the determination of the status thereof. However, the fact that the starting point is a loan (see above, civil law qualification) suggests that there is an obligation, the size thereof and possibly the timing, determined by the profit. This means that in my opinion this obligation also remains.

In conclusion, the qualification frameworks diverge. Whereas IFRS has no specific framework for profit participating loans and no reference to whether the payment obligation must be profit dependent or not, the Dutch CIT choses a substance over form approach, which means that the Dutch participation exemption can apply more often and therefore the ETR can drop below the minimum.

4.8 Option contracts relating to shares

The purpose of the participation exemption in the Dutch CIT is to avoid double taxation as a result of owning a participation. In case the interest in a share is split up between two parties, for example by writing a put option on these shares, allowing both parties to benefit from the

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[123] Dutch Supreme Court, 11 March 1998, ECLI:NL:HR:1998:AA2453, BNB 1998/208, paragraph 3.3 and 25 November 2005, ECLI:NL:HR:2005:AT5958, BNB 2006/82, paragraph 3.2.

[124] H. Vermeulen, *Vpb.2.2.2.D.e1 Wat wordt verstaan onder winstafhankelijkheid?* In: A.W. Hofman, M.L.M. van Kempen & A.C. Rijkers (red.), Cursus Belastingrecht, Deventer: Wolters Kluwer.

[125] Dutch Supreme Court, 5 January 2018, ECLI:NL:HR:2018:2, BNB 2018/60, paragraph 2.4.2.

[126] IAS 32, p. A1343, paragraph 16.a.i.

[127] IAS 32, p. A1368.

participation exemption falls within this purpose, which makes sure that the participation exemption applies to all income derived from such a shareholding.[128] This starting point – which was already partially addressed in paragraph 4.3 above regarding economic ownership – works out as follows for option contracts.

4.8.1 Options on shares that already exist

In case a parent owning a participation sells a put or call option for this participation, the income from these options qualifies as derived from and the resulting sale price if the option is exercised, also falls under the participation exemption for both the parent and the counter party of the option. It is important to note that the shares underlying the option must represent at participation (5% or more).[129]

The shares must actually be owned by the party which must deliver the shares under the option contract.[130] This means that the income derived from options that relate to shares to acquire on the market should an obligation to deliver arise under the contract is not exempt under the participation exemption.

Under IFRS, an option is considered a derivative that is deemed to be distinct from the underlying asset. The derivative is itself an economic resource, namely, to obtain another economic resource in the future. An option contract as above can become a financial liability if the parent must deliver the shares in the participation to the counterparty of the option. However, it can only become an equity instrument if it would have related to the delivery of equity instruments in the parent itself, not in a third party.[131] Furthermore, dividends are qualified as distributions of profits to holders of equity instruments[132] On this basis it seems that the premiums received or paid on an option contract in relationship to a participation owned do not fall under the exclusions.

4.8.2 Options on shares that still have to be issued (warrants)

Income derived under a contract on the basis of which one party has the right to receive shares that still need to be issued but that after issue will constitute a participation in the other party, is also exempt under the Dutch participation exemption.[133] This income can either be the premium or changes in value of or gains on the disposal of the options.

Under IFRS, the same framework as above applies. Option contracts that relate to the shares in the company itself are qualified as equity instruments.[133] However, note that the OECD Rules limit the exclusion for dividends to dividends or other distributions of profits. The same applies to the changes in value of the option contract as, in my opinion, this cannot be considered to represent: "*substantial all the benefits and burdens of ownership*"[134]

When looking at the changes in fair value of an option, things become less clear. Whereas the OECD Rules specifically limit income from equity interests to dividends and other distributions, the changes in fair value must result from the proportionate share in the entity's income.[134]

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[128] Dutch Supreme Court, 22 November 2002, ECLI:NL:HR:2002:AD8488, BNB 2003/34.

[129] Ibid., paragraphs 3.3.1. – 3.3.4.

[130] Dutch Supreme Court, 6 November 2020, ECLI:NL:HR:2020:1738, BNB 2021/12, paragraph 3.1.3. It was long thought that the only relevant criteria was that the option contract must result only in the acquisition of a shareholding that represents a participation, however, it turned out that this was not the case.

[131] IAS 32, p. A1341.

[132] IFRS 9, p. A428.

[133] Dutch Supreme Court, 22 April 2005, ECLI:NL:HR:2005:AT4491, BNB 2005/254.

[133] J. Ramirez, Accounting for derivates. Advanced Hedging under IFRS 9, (The wiley finance series), West Sussex: John Wiley & Sons, Ltd. 2015, p. 573.

[134] The OECD Commentary, p. 51.

[134] The OECD Commentary, p. 54.

However, an option is regarded as an equity instrument under IFRS and it can also change in value if the underlying company's performance changes.

It is therefore not entirely clear what the consequences would be under the participation exemption of the global minimum tax. Therefore, additional guidance is welcome. Given that the Dutch participation exemption seems broader than other participation exemptions,[135] I expect that any potential guidance will limit the participation exemption of the global minimum tax to exclude warrants.

In conclusion, it seems that the Dutch participation exemption is too broad although to a different extent depending on whether the options relate to shares in a third party or the issuer and therefore the ETR can drop below the minimum.

4.9 Convertibles

A convertible is a hybrid instrument: it contains an element of a liability, the nominal debt and corresponding obligation to pay interest and an equity component consisting of the conversion right.[136] Upon conversion, shares are issued and the contribution obligation is fulfilled by settling the debt.

The Dutch participation exemption applies to the increases and decreases in valuation of the conversion right, but not to any income realized upon receipt of the conversion right.[137] This requires that the conversion right gives right to shares that would result in the participation exemption being applicable after conversion.

Under IFRS, a convertible must be split up into its components and accounted for in accordance with their qualification as either a financial liability or asset or as an equity instrument.[138] The result is that issuing a convertible loan is economically essentially the same as entering into a loan and an option on shares to be issued (warrant).[139]

As noted above, the OECD Rules limit the applicability to distributions of profit and changes in fair value of the equity instrument insofar they arise from the financial performance of the underlying company. Again, it is unclear whether the OECD meant to include the results on the convertible right in the exclusions or not.

In my opinion the above means that there is a good chance that the Dutch participation, again, is too broad.

4.10 Anti-abuse / CFC

As noted in paragraph 3.1.2 above, the Dutch participation exemption does not apply to income derived from a participation that qualifies as a portfolio investment and is not adequately taxed or owns low taxed assets. In that case, dividend received from such a participation are not exempt.

The participation exemption of the global minimum tax does not take this into account. There are no additional requirements beyond that the Ownership Interest must not be a (Short-term) Portfolio Interest.

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[135] I have only found that the Irish participation exemption also applies to options, warrants and convertibles. Loyens & Loeff, *Holding Regimes in a New Era*, 2021.

[136] W.C.M. Martens, De deelnemingsvrijstelling in de Wet op de Vennootschapsbelasting 1969 (FED fiscale brochure), Deventer: Wolters Kluwer 2017, p. 134.

[137] Dutch Supreme Court, 12 October 2007, ECLI:NL:HR:2007:BB5353, BNB 2008/6, paragraph 3.2 and 3.1. I will not further discuss the – complicated – Dutch tax treatment of the conversion right for the issuer.

[138] IAS 32, p. A1351.

[139] Ibid., p. A1352.

Furthermore, any Dutch CIT levied as a result from the above, does nót increase the ETR because that CIT is excluded from the ETR calculation.[136] This outcome may be avoided if the exclusion of the participation exemption could fall under the definition of a CFC regime thus allocation this tax to the participation in question. However, this definition requires that the shareholder is taxed on the income of the participation itself; the CFC. The anti-abuse rule in the Dutch participation exemption however does not include the participation's income in the shareholder's tax base, but it merely disallows application of the participation exemption to the income derived by the shareholder.

This is a signification deviation, although in practice one wants to avoid not having the participation exemption apply.

Dutch CIT also has a CFC rule based on ATAD 1,[137] which applies to "*income derived by that entity*" that consist of certain passive types of income (dividends, interests, etc.).[138] In my opinion, this tax qualifies as a CFC tax and therefore taken into account for determining the ETR of the CFC in question.

5 Conclusion

In this thesis, I have compared the participation exemptions of the Dutch corporate income tax and the new global minimum tax by comparing their application in a set stylized cases based on the tremendous amount of case law in relation to the Dutch participation exemption. My goal was to answer the following question:

To what extent does the global minimum tax overrule the participation exemption in the Dutch CIT?

In a significant number of situations, the global minimum tax overrules the Dutch participation exemption. Notable deviations are the shareholding percentages (5 versus 10) and the equal weighting of profit and voting rights. The existence of a holding period in the global minimum tax is also a significant deviation. Furthermore, the Dutch participation exemption applies to certain types of preference shares and certain types of loans, whereas the global minimum tax does not. Uncertainty arises with option contracts and guidance thereto would be preferable. Surprisingly, costs are deductible under the global minimum tax.

Overall, I do not expect problems with the above in straightforward group situations. Problems arise with smaller interests and when anything more complicated than just ordinary shares is attempted.

One unexpected point is what happens when the Dutch participation exemption does not apply by virtue of its anti-abuse clauses that are not modelled as a CFC: for example, the portfolio investment participation that is not sufficiently subject to tax. The global minimum tax does not deem the features of the subsidiary and in particular the level of tax to which it is subject relevant meaning that this participation applies. The resulting tax is furthermore excluded from the calculation of the ETR in the hands of the parent company that cannot apply the participation exemption, creating the risk of a significant corporate income tax burden and still a top-up tax under the global minimum tax.

Although the above is already an adequate answer to the research question, the answer can only be *fully* given by taking into account the applicable financial accounting standards that apply. I have examined IFRS for this purpose as IFRS is, effectively, the only relevant standard for companies in Europe that meet the €750m revenue requirement.

[136] See paragraph 2.2.2.1 and article 4.1.3.a. of the OECD Rules.
[137] Article 13ab CITA. There is another CFC rule, which I will not address further.
[138] See paragraph 3.1.2.

The OECD Rules on determining the tax base are overlaid over the financial net accounting income determined on the basis of the IFRS. It is precisely this interplay that raised significant questions and uncertainty requiring further administrative guidance by the OECD in order to be effective. For example, IFRS deems certain option contracts to be equity instruments; instruments that give rise to the residual profit in a company. However, the OECD participation exemption seems not to include income and changes in value of such an option contract, while it *does* defer to the applicable rules under IFRS. What takes precedent? Nevertheless, I have been able to come to conclusions on these stylized cases as noted above.

This immediately shows a significant weakness of the global minimum tax: it is overlaid over financial accounting income which was never intended or designed to be used in the levy of a profit tax. It was meant to provide a true and fair view of the financial position of a company. Now, not only the accounting standards bodies, but also tax authorities and tax advisers and politicians will start to take interest in the financial accounting standards. Conversely, the opinions of accounting standards bodies can have a significant influence on the revenue under the global minimum tax, while these bodies are not democratically elected.

The OECD has performed a significant feat with creation the global minimum tax and the guidance thereto, although the end is not yet in sight. If the global minimum tax is adopted it would be wise to aim for limitation of the applicable financial accounting standards to avoid the risk of arbitration between them or provide more guidance on how to take into account the adjustments posed in chapter 3 of the OECD Rules. Unfortunately, looking at BEPS Action 13, where after 6 years of operation, no significant headway has been made in harmonizing the information to be included, I expect not much additional guidance. At first. Because if and when the global minimum tax will start making a difference, the interest of states will be on the interpretation of the rules and so will the litigation.

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