Netherlands

Dutch Supreme Court AG: Test Whether Legal Demerger Does Not Constitute Abuse Too Burdensome for Taxpayer

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Report from Dr René Offermanns, Principal Associate, IBFD

The Advocate General (AG) of the Dutch Supreme Court has recently opined that the test of whether a legal demerger does not constitute abuse is too burdensome for the taxpayer. Details of the opinion are summarized below.

(a) Facts. The taxpayer is an NV that operates a funeral insurance company. The NV was part of a fiscal unity (FE) for corporate income tax purposes.

Due to a precarious capital position and the financial implications of a dispute between the FE and the Dutch tax authorities, the Dutch national bank placed the NV under guardianship. Ultimately, the group was forced to sell the funeral insurance company to a third party through a legal demerger. The NV was transferred to a newly formed acquiring company against the issue of one share, that was sold to the external buyer. The taxpayer argued that this legal division is tax-exempt based on article 15(1)(a) of the Merger Directive (2009/133) (Directive) and the decisions from the ECJ in *Leur-Bloem* (Case C-28/95), *Zwijnenburg* (Case C-352/08) and *Euro Park Service* (Case C-14/16). The taxpayer also contested that it must prove the existence of business motives. The tax inspector disagreed and reasoned that the demerger constitutes abuse for aiming at avoiding or deferring taxation.

(b) Legal background. Based on article 14a(6) of the Corporate Income Tax Act (CITA) a demerger is not exempt from taxation if its purpose is to largely mitigate or defer taxation.

If shares in the separate legal entity or an acquiring legal entity are sold within 3 years of the demerger, to an entity that is not related to the separate legal entity and the acquiring legal entities, business considerations will not be considered present, unless the contrary is justified.

Article 15(1)(a) of the Directive provides that a Member State may refuse or withdraw the benefit, in whole or in part, derived from the application of the Directive's provisions if any of the operations has as (one of) its main objectives tax evasion or tax avoidance.

(c) Issue. The issue was whether the division is exempt from tax or must be taxed because of abuse.

(d) Opinion. The District Court of Gelderland ruled in favour of the taxpayer because there were sufficient non-tax reasons for the demerger. The Court of Arnhem-Leeuwarden overturned that decision because article 14a(6) CITA assumes that there are no business considerations in the sale of shares acquired in a demerger unless the taxpayer proves the existence of business motives.

The AG disagreed with the Court of Appeal.

Regarding the business and shareholder motives, the AG noted that:

- motives of the shareholders are not irrelevant in the present case, since according to the case law of the ECJ, such motives can also be of a business nature if they are not predominantly harmful for tax purposes. This rule also applies to a demerger; and
- in the present case, given the mandatory participation of the Dutch National Bank, non-tax (shareholder) motives are present.

Regarding the burden of proof, the AG held that:

- the division in article 14a(6) CITA is inconsistent with EU law as it establishes an overly general presumption of abuse. The mere sale within 3 years does not justify a presumption of abuse. In addition, it imposes too strict a burden of proof, requiring the taxpayer to demonstrate that (i) an asset/liability transaction and the associated contract takeovers and years of settlement with the buyer of the related tax effects and the resulting goodwill amortization would be highly impractical; and (ii) the benefits of avoiding those complications would not be entirely marginal compared to the tax benefit of tax deferral;
- the abuse rule in the Directive should apply in line with Parent-Subsidiary Directive (2011/96), i.e. that abuse of rights is prohibited; and
- the fact that it is already known before the demerger that the shares acquired in the demerger will be sold to a third party does not constitute an abuse.

The AG is not convinced that an asset-liabilities transaction is the most obvious way to achieve the desired objective in the present case, and notes that there is insufficient evidence that the disadvantages of the above practical objections would be entirely marginal.

Therefore, the AG suggests declaring the taxpayer's appeal well-founded and referring the case to another Court of Appeal for factual investigation. The AG opinion (No. 22/04085 of 12 May 2023), published on 26 May 2023, is available here (in Dutch only).
