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Tax Treaty Classification of Netherlands-Source Income from Lucrative Interests (Carried Interest)

This article discusses the tax treaty classification of Netherlands-source carried interest (income from lucrative interests) earned by non-resident taxpayers. The Netherlands legislator has created a specific regime to tax this type of remuneration in order to discourage the granting of such benefits. However, the article establishes that the effectiveness of this regime may be restricted by Netherlands tax treaties and the Netherlands tax liability of non-residents.

1. Introduction

The Law on Taxation of Excessive Remuneration (*Belastingheffing excessieve beloningsbestanddelen*) entered into force on 1 January 2009. This law consists of a number of tax amendments to the Wages Tax Act 1964 (*Wet op de loonbelasting 1964*, WTA) and Income Tax Act 2001 (*Wet inkomstenbelasting 2001*, ITA 2001) that are aimed at taxing the top salaries of, amongst others, directors and private equity fund managers. The two measures discussed in this article are as follows:

- (1) a quasi-final tax (quasi-payroll tax) that is levied in the form of an employers' tax of 30% on severance payments ("golden handshakes") to the extent such severance payments are higher than the annual salary; this tax is levied on salaries of EUR 522,000 or greater (2011 amount);¹
- (2) the taxation of income from capital (such as shares and debt claims) in Box I, subject to progressive tax rates, as income from other activities, provided these items represent remuneration for work of the recipient that is subject to special conditions that give the item the character of a lucrative interest (carried interest), for example, if a "leveraging" effect exists with respect to the shares.²

This provision has been described as a "greed tax" (*graaitax*)³ and has also been referred to as "symbolic legislation" and "botched legislation".⁴ The regulation on lucrative interest (carried interest) represents a fundamental revision of the income tax system. The measure regarding excessive severance payments is, essentially, an extension of the quasi-final tax regime under the WTA.⁵

The legislator, by taxing income from lucrative interests (carried interest) under the category of "income from other activities" (Art. 3.92b ITA 2001) is targeting, in particular, what it considers to be excessive income earned, for example, by private equity fund managers or manag-

ing partners. Such persons are given the opportunity to invest their remuneration for their work in shares, debt claims and certain other property subject to special conditions that result in potential returns that are out of proportion with the capital invested and thereby can be considered excessive.

Many questions arise in regard to the tax treaty classification of lucrative interests derived in a cross-border situation (where the assumption is that the income will be taxed under domestic law as income from other activities and any possible taxation as wages has been settled):

- Under which article of the OECD Model Tax Convention (OECD Model) should the income from a lucrative interest be classified?
- To what extent is the meaning given to "income from lucrative interests" under domestic law decisive in regard to a tax treaty under Art. 3(2) of the OECD Model or does the context here require a different meaning?

These aspects are, amongst others, elaborated on in this article. The discussion in the article is limited to non-resident taxpayers (Section 3.). Section 2. gives a short overview of the system of ITA 2001 in relation to income from lucrative interests. Section 4. contains some conclusions that can be drawn from the parliamentary debate regarding the tax treaty aspects of income from lucrative interests. Section 5. provides an analysis of the tax treaty classification of income from lucrative interests. Section 6. outlines the tax treaty classification of these types of income that the author prefers. Section 7. provides some conclusions.

* Professor of International and European Tax Law, VU University Amsterdam and tax lawyer, De Brauw Blackstone Westbroek, Amsterdam. The author can be contacted at f.p.g.potgens@vu.nl or frank.potgens@debrauw.com.

1. Art. 32bb WTA.
2. Art. 3.92b ITA 2001.
3. A.J. van Soelen and A.C. Hendriks, "Graaitax verdient betere codificatie", *Fiscaal Tijdschrift Vermogen* 10 (2008), p. 5 et seq.
4. During the discussion of the draft law in the First Chamber, Senator Biermans used these terms. See Eerste Kamer, Handelingen, 9 December 2008, pp. 13-595, right column.
5. Until 1 January 2009 this kind of quasi-final taxation was only applied with respect to early retirement (Art. 32aa WTA), and only in fairly exceptional situations. For situations in which pension rights in excess of EUR 522,000 (on the basis of a final pay system) have accumulated, Art. 32bc of the WTA contains a quasi-final tax at a rate of 15% on a notionally calculated back service (this measure, however, entered into force on 1 January 2010).

2. The System of ITA 2001 in Relation to Income from Lucrative Interests

It should be kept in mind that the regime covering income from other activities only comes into play when the income has left the sphere of wages (Sec. 3.3 ITA 2001 and Art. 3.80-3.87 ITA 2001).⁶ This follows from the order of sources under Art. 2.14(1) of the ITA 2001. The tax base on which the wage tax is levied forms a part of the opening value of the lucrative interest:⁷ on the opening balance sheet for the determination of income from other activities the relevant property titles are booked at the historic cost price plus the amount that was paid as wages.⁸ The quasi-profits regime of Art. 3.94 and Art. 3.95 of the ITA 2001 is then applicable to the income from the lucrative interests.⁹

3. Non-Resident Tax Liability

For a non-resident taxpayer, the benefit from a lucrative interest forms part of his Netherlands income if that income is partially intended as remuneration for activities carried out in the Netherlands (Art. 21(1)(b) and (2) in conjunction with Art. 7.2(2)(c) and (3) ITA 2001). For a resident taxpayer, a benefit from a lucrative interest that is related to work that took place outside the Netherlands forms part of his worldwide income (Art. 2(1)(a) in conjunction with Art. 3.92b ITA 2001). One problem with this is that the Double Taxation Avoidance Decree 2001 does not mention the category “taxable income from other activities” and, therefore, in certain circumstances, no relief from double taxation will be available.¹⁰ These differences between the Decree and non-resident tax liability are out of kilter.¹¹

In Art. 7.2(3) of the ITA 2001 the term “work activities in the Netherlands” is so broad that it includes, “the holding of shares, debt claims or rights within the meaning of Art. 3.92b or having debts within the meaning of Art. 3.92b if the benefits arising therefrom may be considered to be aimed partially at remunerating work activities carried out in the Netherlands”. As a result of the wording of the phrase “to be aimed partially at remunerating”, if at least one of the reasons for granting a lucrative interest is to remunerate the taxpayer for employment in the Netherlands, all the benefits from this interest in the Netherlands are taxable under national legislation.¹² The Netherlands has, in this respect, excessively extended its taxing jurisdiction. It would have been more logical to restrict the benefits subject to non-resident tax liability to those benefits that can be allocated to work activities in the Netherlands on the basis of proportionality, in other words, in proportion to the work activities that were actually carried out in the Netherlands.¹³

A requirement for non-resident tax liability in regard to income from a lucrative interest is that the work activities connected to the lucrative interest have to be carried out in the Netherlands. The seat of the company in which the lucrative interest is held or that has granted the lucrative interest is not a relevant criterion in applying Art. 7.2(3), in conjunction with Art. 7.2(2)(c), of the ITA

2001.¹⁴ Under the right of option in Art. 3.95b(5) of the ITA 2001, where the lucrative interest is indirectly held through a holding company, the taxpayer is granted the option to be taxed only once in Box II (taxable income from a substantial shareholding taxed at a rate of 25%). The condition for this is that, in the relevant calendar year, at least 95% of the income derived from the lucrative interest is redistributed by the holding company to the individual taxpayer. During the parliamentary debates it was pointed out that the option available in Art. 3.95b(5) of the ITA 2001 is also available for a non-resident taxpayer who holds an indirect lucrative interest via a personal holding company resident abroad if at least 95% of the benefits from the lucrative interest is immediately paid out by the personal holding company to the shareholder.¹⁵ This remark probably stems from EU law considerations,¹⁶ but it does mean that, through such a structure, it is possible to avoid non-resident tax liability.

4. Some Conclusions as Regards the Parliamentary Debate

The application of tax treaties to lucrative interests, as described in the parliamentary debate, can be summarized as follows. It should be noted that these conclusions are largely based on deduction, that there are inconsistencies and that it is not entirely clear what method of treaty interpretation was being followed:

- The starting point is that income from lucrative interests should be classified under Arts. 15 (income from employment) or 16 (directors’ fees) of the

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6. Explanatory Memorandum (MvT), Kamerstukken II, 2007/08, 31 459, No. 3, pp. 8 and 17, as well as Explanatory Memorandum (MvA), Kamerstukken I, 2007/08, 31 459, No. C, p. 10.
 7. Explanatory Memorandum (MvT), Kamerstukken II, 2007/08, 31 459, No. 3, p. 8 and MvA, Kamerstukken I, 2007/08, 31 459, No. C, p. 10.
 8. Further Additional Report (NNV), Kamerstukken II, 2007/08, 31 459, No. 9, p. 19.
 9. Explanatory Memorandum (MvA), Kamerstukken I, 2007/08, 31 459, No. C, p. 11.
 10. Tax treaties concluded after 1980 refer to the method of calculating double taxation relief contained in the Double Taxation Avoidance Decree 2001.
 11. J.A. Booij, “De Wet Inkomstenbelasting 2001 en de toepassing van belastingverdragen”, in A.C. Rijkers and H. Vording (eds.), *Vijf jaar Wet IB 2001* (Deventer: Kluwer, 2006), p. 239. For more details on this situation reference is made to E. Nijkeuter, “Of een koe een haas vangt: over lucratieve belangen in grensoverschrijdende situaties”, *Weekblad fiscaal recht* 6809 (2009), p. 490 et seq., section 7.
 12. The fact that the entire benefit is taken into account under the non-resident tax liability was confirmed by the State Secretary in Explanatory Memorandum (MvA), Kamerstukken I, 2008/09, 31 459, No. C, p. 18.
 13. See also J. Doornebal, “Zeven redenen waarom het lucratief belangregime het Staatsblad niet had mogen bereiken”, *Nederlands Tijdschrift voor Fiscaal Recht* 402 (2009), p. 3.
 14. Nijkeuter, note 11, p. 490 and Nijkeuter, *Belastingheffing van dividend en de interne markt* (Amersfoort: SDU Uitgevers, 2010), p. 167.
 15. Explanatory Memorandum (MvA), Kamerstukken I, 2007/08, 31 459, No. C, p. 19.
 16. Compare ECJ, 18 November 1999, Case C-200/98, *X AB and Y AB v. Riksskatteverket*; 13 April 2000, Case C-251/98, *C. Baars v. Inspecteur der Belastingen Particulieren/ondernemingen Gorinchem*; 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen*; and 3 October 2006, Case C-290/04, *FKP Scorpio Konzertproduktionen GmbH v Finanzamt Hamburg-Eimsbüttel*.

OECD Model because of the presumed link with employment;¹⁷

- The classification under Arts. 15 or 16 of the OECD Model holds as long as appreciation or capital gains are at issue. Therefore, from the Netherlands perspective, there does not appear to be room for Art. 13 of the OECD Model (capital gains);¹⁸ it is less clear what the treaty classification will be if a dividend is paid on the lucrative interest. On the one hand, the State Secretary argues that such a payment falls under Art. 10 of the OECD Model (dividends)¹⁹ and, on the other hand, he is of the opinion that a payment by a non-transparent (in the Netherlands view) US limited partnership to a Netherlands resident falls under Art. 16 (income from employment) or Art. 17 (directors' fees) of the Netherlands-US tax treaty (1992) (in his answer, however, the State Secretary makes generalizations on the basis of the specific case and puts the discussion in a more general framework).²⁰

5. A Further Analysis of the Tax Treaty Classification of Benefits from a Lucrative Interest

5.1. Art. 3(2) OECD Model

The question arises whether the benefits from a lucrative interest have to be classified primarily under Art. 15 of the OECD Model as income from employment or under Art. 16 of the OECD Model as directors' fees (see also 4.). Whether Art. 15 (income from employment) or Art. 16 of the OECD Model (directors' fees) is applicable depends on the interpretation of the concepts of "salaries, wages and other similar remuneration" and "directors' fees and other similar payments". These concepts are not defined in the treaty and, thus, must be interpreted in accordance with Art. 3(2) of the OECD Model, which refers to the applicability of the domestic law of the contracting states to the treaty in question unless the context otherwise requires. The reference to domestic law was upheld by the Netherlands Supreme Court (*Hoge Raad*) in its decisions of 5 September 2003 (fictitious wages).²¹ Art. 3(2) of the OECD Model does not require that reference be made to domestic law only when the concepts are identical. What is decisive is whether or not the domestic law uses a similar concept that, at least according to the Netherlands Supreme Court, is also used in a similar context as that under the applicable tax treaty.²² Hence, the concept "salaries, wages and other similar remuneration", as a matter of principle, must be given the meaning that is given to the concept of "wages" under Art. 10(1) of the WTA and Art. 3.81 of the ITA 2001. This was also upheld by the Netherlands Supreme Court in its decision of 10 February 1999 (with regard to a severance payment).²³ The same is, *mutatis mutandis*, applicable in regard to directors' fees. The context will only require a meaning that deviates in exceptional circumstances; examples of this include, at least from a Netherlands tax law perspective, the classification of public disability allowances²⁴ under tax treaties that do not contain a specific provi-

sion on social security allowances²⁵ and the classification of wages as fictitious (Art. 12a WTA) under tax treaties

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17. Further Additional Report (NNV), Kamerstukken II, 2007/08, 31 459, No. 9, p. 23 and plenary session of 3 September 2008, *Belastingheffing excessieve belongingsbestanddelen*, 31 459, TK 107, 7875. The State Secretary based his conclusion, i.e. that Arts. 15 or Art. 16 of the OECD Model are applicable to benefits from a lucrative interest, on the fact that the remuneration is connected to [work] activities (the State Secretary repeated this view in answer to the question raised by the Netherlands Order of Tax Consultants/*Nederlandse Orde van Belastingadviseurs* as a result of the Memorandum on the Netherlands Tax Treaty Policy that was published by the Ministry of Finance on 11 February 2011; compare annex 1 of the letter of the State Secretary of Finance of 24 June 2011 to the Chairman of the Second Chamber of the States-General, p. 16). This also represents, at least if the author understands him correctly, a sufficient connection with the employment. In this way, the benefits come within the scope of Art. 15 of the OECD Model, which, in this scenario, refers to "benefits" from an employment and not "wages" (plenary session of 3 September 2008). Thus, Art. 15 allocates the taxation right over this income to the work state. The fact that in effectuating this taxation right the Netherlands subsequently taxes the income as income from other activities does not, according to the position of the State Secretary taken during the plenary session of 3 September 2008, make any difference. It seems that this extract of the plenary session of 3 September 2008 explicitly concerns the distinction between income from employment (Art. 15 OECD Model) and capital gains (Art. 13 OECD Model). However, the parliamentary question only refers to "capital gains". The answer to this question employs the more neutral expression "capital benefits". Annex 1 to the letter of the State Secretary of Finance of 24 June 2011 to the Chairman of the Second Chamber of the States-General, p. 16 indicated that the carried interest is also intended to remunerate activities. If these activities are carried on in the course of employment or as a director, the carried interest has to be classified under Arts. 15 or 16 of the OECD Model. Again, this statement does not devote attention to the question of whether the connection with the employment suffices in order to regard the carried interest as wages or directors' fees at the moment it is treated as income from lucrative interest under the ITA 2001.
 18. Explanatory Memorandum (MvA), Kamerstukken I, 2008/09, 31 359, No. C, pp. 17 and 18.
 19. Explanatory Memorandum (MvA), Kamerstukken I, 2008/09, 31 359, No. C, p. 18. According to the State Secretary, a dividend that is paid by a company resident in the Netherlands to a non-resident taxpayer who holds a lucrative interest has to be classified under Art. 10 of the tax treaty if the treaty follows the OECD Model.
 20. Report on consultation in writing, Kamerstukken I, 2008/09, 31 459, No. E (Letter from the State Secretary of Finance to the Chairman of the First Chamber of the States-General of 5 December 2008), pp. 8 and 9. It is useful to note that Art. 10 of the OECD Model is only applicable when the limited partnership is an entity residing in the United States; see, in regard to these aspects of the dividend article, J.F. Avery Jones et al., "The Definitions of Dividends and Interest: Something Lost in Translation", *World Tax Journal* 1 (2009), p. 5 et seq.
 21. Supreme Court, 5 September 2003, BNB 2003/379 and 381. See, for a short discussion of these decisions, F.P.G. Pötgens, "The Relationship between Preservative Tax Assessments and Netherlands Tax Treaties: Not Always *Pacta Sunt Servanda?*", *European Taxation* 5 (2010), p. 186.
 22. Supreme Court, 21 February 2003, BNB 2003/177 and 178.
 23. Supreme Court, 10 February 1999, BNB 1999/153.
 24. Occupational Disability Insurance Act (*Wet op de Arbeidsongeschiktheidsverzekeringen*, WAO) and General Disability Insurance Act (*Algemene Arbeidsongeschiktheidswet*, AAW). The AAW has been abolished as of 1 January 1998 and the WAO has been replaced by The Law on Work and Income according to Working Ability (*Wet Werk en Inkomen naar Arbeidsvermogen*, WIA) as of 1 January 2006.
 25. In its decision of 27 September 2000, BNB 2001/29, the Supreme Court held that a WAO allowance under the Tax Regulation for the Kingdom (*Belastingregeling voor het Koninkrijk*, BRK) – which does not contain a specific social security provision – fell under the other income article despite the fact that, under domestic law, a WAO allowance has to be considered wages from former employment (Art. 11(1)(e) WTA). Apparently, the Supreme Court considers, although it did not make this entirely clear, that, in this case, the context requires a meaning that deviates from the meaning under domestic law. As a consequence, the public disability allowance did not fall within the income from employment article (Art. 15(1) and (2) BRK).

concluded before the WTA containing such fictions was enacted (before 1 January 1997).²⁶

An explicit choice has been made in the national legislation to tax benefits from a lucrative interest as income from other activities. The regime for income from employment (Art. 3.80 of the ITA 2001, in conjunction with Art. 10(1) WTA) is then either no longer applicable or was never applicable at all, for example, because there was no employment relationship. In any event, the specific rules of Art. 3.92b of the ITA 2001 that provide for the taxation of income from a lucrative interest only come into play when the situation falls outside the sphere of wages taxation.²⁷ What is certain, however, is that, under domestic law, there cannot be said to be wages so that it is difficult to see how, by means of Art. 3(2) of the OECD Model, the position can be taken that the income falls under Art. 15 of the OECD Model (or Art. 16, which in this event has to be viewed as *lex specialis* with respect to Art. 15). The context does not play a role here at all. After all, under domestic law, there cannot be said to be wages.²⁸

The State Secretary does not exactly clarify how he arrived at the opinion that Art. 15 (or Art. 16) of the OECD Model can be applied to benefits from a lucrative interest based on the hypothesis that they will be considered income from other activities under domestic law and thus will not be taxed (and will no longer be taxed) as income from employment. In the plenary session of 2 September 2008 – in support of his position – he pointed to the fact that Art. 15 of the OECD Model refers to “benefits” and not “wages” and, as such, income from a lucrative interest would also fall under Art. 15 of the OECD Model. This is where the crux of the analysis lies. Art. 15 of the OECD Model uses the concept “salaries, wages and other similar remuneration” and not the more neutral concept of “benefits”. “Salaries, wages and other similar remuneration” is a concept with a legal connotation, which is not defined in the treaty and which, hence, must be interpreted with the help of Art. 3(2) of the OECD Model. In this event, the meaning that the concept has under domestic law must be examined. The consequence is, thus, that the benefits from a lucrative interest cannot be classified under Art. 15 of the OECD Model. No further problems of delimitation occur because it is clear that other distributive provisions of the OECD Model apply depending on the civil law form of the relevant benefits (see 6.).

5.2. Decisions with regard to fictitious income

Even if one accepts the State Secretary’s view that benefits from a lucrative interest may fall under Arts. 15 or Art. 16 of the OECD Model and that, for purposes of the tax treaty, they may be considered to be salary, it has not yet been established that this classification holds for all tax treaties concluded by the Netherlands. On the basis of the Supreme Court case law this only holds true for tax treaties that were concluded after 1 January 2009.²⁹ After all, the fiction in Art. 3.92b of the ITA 2001 results in a potential displacement of the allocation of taxation rights. This is because, as a result of a post-treaty change

in the domestic law, income that normally flows to the taxpayer as dividends, interest or capital gains (and falls under Arts. 10, 11 or 13 of the OECD Model – see also 6.) will be classified under a different allocation provision (Arts. 15 and 16 of the OECD Model) with the result that the Netherlands potentially will have broader taxation rights than under the first-mentioned provisions. Application of such a domestic law fiction to a tax treaty concluded earlier is prevented by the context of Art. 3(2) of the OECD Model,³⁰ i.e. the requirement of the Netherlands to exercise good faith in the interpretation and application of a tax treaty (compare Arts. 26 and 31(1) of the Vienna Convention).³¹ This entails that the classification

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26. In its decisions of 5 September 2003, BNB 2003/379 and 381, the Supreme Court held that Art. 15 (dependent personal services) and Art. 16 (directors’ fees) of the former Netherlands–Belgium tax treaty (1970) were not applicable to fictitious wages (Art. 12a WTA) because the context within the meaning of Art. 3(2) of the OECD Model prevented application of Art. 12a of the WTA under that treaty. The Supreme Court seemed to accept that the fictitious wages were considered to be “salaries, wages and other similar remuneration derived by” within the meaning of Art. 15(1) of that treaty.
 27. Explanatory Memorandum (MvT), Kamerstukken II, 2007/08, 31 459, No. 3, pp. 8 and 17, as well as Explanatory Memorandum (MvA), Kamerstukken I, 2007/08, 31 459, No. C, p. 10. See also S.A. Stevens, “Belastingheffing van lucratieve belangen: een excessieve en onduidelijke heffing”, *Maandblad Belastingbeschouwingen* 1 (2009), p. 24 and M.F.D. Schul, “De excessieve aanpak van beloningsbestanddelen”, *Weekblad fiscaal recht* 6801 (2009), p. 264 et seq., section 7.
 28. A different approach is followed by P. Kavelaars, “Arbeidsinkomsten en verdragsbeleid”, *Maandblad Belastingbeschouwingen* 4 (2011), p. 170. According to this author, income from a lucrative interest continues to be wages for wage tax purposes although it is characterized as income from other activities for income tax purposes. This difference is, according to Kavelaars, due to the rule on the order of sources that is included in the ITA 2001. However, as mentioned above, taxation as income from a lucrative interest presupposes that the sphere of wages has been left behind with the result that the connection with employment is too remote for the interest to be treated as wages. Moreover, for the tax treaty classification of the income the characterization for income tax purposes prevails over that under wage tax, i.e. a withholding tax that is ultimately credited against the income tax due. Compare the decision of the Supreme Court of 12 December 2003, BNB 2004/123. The classification of a repurchase of a company’s own shares for income tax purposes (alienation) was decisive at the tax treaty level and prevailed over the different characterization thereof under the dividend withholding tax (dividend), inter alia, because the dividend withholding tax was ultimately credited against the income tax.
 29. Supreme Court, 5 September 2003, BNB 2003/379 and 381 (fictitious wages) and 18 June 2004, BNB 2004/134 (fictitious interest).
 30. On the basis of the Netherlands Supreme Court’s decisions in BNB 2003/379 and 381 one can assume that if the other contracting state has a measure in its national legislation comparable to the Netherlands taxation of benefits from lucrative interests (the principle of reciprocity or reciprocity of legislation) the classification preferred by the State Secretary of Finance, i.e. classification under Arts. 15 or 16 of the OECD Model, can be followed. In its decision of 19 June 2009, BNB 2009/264 (a lump-sum payment of an annuity received after the annuity holder’s emigration from the Netherlands to Belgium) the Netherlands Supreme Courts nuances the principle of reciprocity. A tax treaty-frustrating deeming provision (which effect is also recognized by the Belgian case law), included in the domestic legislation of a contracting state (Belgium; Art. 364bis of the Belgium Income Taxes Code) after the conclusion of a relevant tax treaty (the former Netherlands–Belgium tax treaty (1970)) cannot justify a comparable fiction having effect at the tax treaty level if it was included in the Netherlands legislation after the conclusion of the tax treaty in question. See also Pötgens, note 21, p. 189 and E.C.C.M. Kemmeren, “Exitheffing bij pensioenen: Financiën is hardleers”, *Weekblad fiscaal recht* 6820 (2009), p. 881 et seq., section 7.
 31. The Netherlands Supreme Court mentioned Art. 31(1) of the Vienna Convention in its decision of 5 September 2003, BNB 2003/380, which dealt with surrender of a pension by a resident of Singapore. The pension was built up in a Netherlands pension fund and on the basis of employment with a Netherlands BV that had partly been carried out

of benefits from a lucrative interest must not apply to tax treaties concluded before 1 January 2009.³²

5.3. Conditions for the applicability of Art. 15 OECD Model

For tax treaties concluded after 1 January 2009, if the hypothesis of the State Secretary is correct, i.e. that Arts. 15 and Art. 16 of the OECD Model can be applied to benefits from a lucrative interest, it has to be determined first whether or not one of the conditions in Art. 15(2) of the OECD Model has not been fulfilled before allocating the taxation right to the state of employment, as well as whether the conditions of Art. 16 of the OECD Model have been fulfilled. In particular, the condition in Art. 15(2)(b) of the OECD Model may be of relevance in this respect.

Assuming that the benefits from a lucrative interest are allocated by a non-resident private equity firm to a fund manager who is not resident in the Netherlands (both the private equity firm and the fund manager are resident in state X with which the Netherlands has concluded a tax treaty that follows the OECD Model). The benefits from the lucrative interest also cover activities that the fund manager carried out for a Netherlands resident target company. The fund manager is subject to non-resident tax liability for the entire benefit that he receives from the lucrative interest under Art. 7.2(2)(c) in conjunction with Art. 7.2(3) of the ITA 2001 (see also 3.). Assuming that the viewpoint of the State Secretary can be followed, i.e. that this benefit does fall under Art. 15 of the applicable tax treaty, the Netherlands, as the employment state has, in principle, taxation rights over that part of the benefit that can be allocated to the employment carried out in the Netherlands. The allocation of remuneration to employment carried out in the Netherlands is generally made on the basis of a days-based fraction as per a decision of the Supreme Court.³³ The days-based fraction and the time-proportionate allocation set out in the decision is not applied if the benefit specifically involves activities that were carried out for the Netherlands target company and are not, at the same time, aimed at remunerating the activities that were carried out, for example, for the private equity firm in State X.³⁴ This will, presumably, often occur in situations that are comparable to the one in the example.³⁵

Moreover, assuming that the conditions of Art. 15(2)(a) and (c) of the OECD Model are fulfilled, it has to be examined whether or not the Netherlands target company can be considered an employer who pays remuneration or on whose behalf remuneration is paid. The Netherlands target company may be considered to be an employer within the meaning of Art. 15 of Netherlands tax treaties that follow the OECD Model if it is a formal employer, i.e. if the fund manager entered into a formal employment contract with the Netherlands resident target company. If the target company is not a formal employer, it may be considered an employer within the meaning of Art. 15(2)(b) of the relevant tax treaty. In this instance, it must satisfy the conditions that the Supreme Court laid

down in its decisions of 1 December 2006,³⁶ in which the Court advocates a material or substantive interpretation of the concept of “employer” for purposes of Art. 15 of Netherlands tax treaties that are patterned on the OECD Model, which lead to the determination of a “de facto” employer.³⁷ The target company is regarded as a ‘de facto’ employer if the following conditions are met:

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in the Netherlands. Art. 19b(1)(b) of the WTA, which was introduced after the conclusion of the Netherlands–Singapore tax treaty, provided that a surrender of a pension leads to a reclassification of the fair market value of the pension entitlement as wages from previous employment deemed to have been enjoyed at a time immediately preceding the surrender. The good faith to be observed in the interpretation of Art. 18(1) of the Netherlands–Singapore tax treaty (1971) (which allocated the taxation rights over the amount of the surrender of a pension exclusively to Singapore) entailed that the fiction of Art. 19b(1)(b) of the WTA is in conflict with the interpretation of Art. 18(1) of that treaty since application of the fiction in Art. 19b(1)(b) of the WTA to that treaty would mean that the amount of the surrender would be classified under Art. 15, with the result that the Netherlands would gain taxation rights at the expense of Singapore. See also Supreme Court, 19 June 2009, BNB 2009/263, 265 and 266 (preservative tax assessment imposed pursuant to Art. 2.8(2) in conjunction with Art. 3.83(1) of the ITA 2001 on the emigration of a pensioner to France, Korea and the Philippines, respectively) and Supreme Court, 19 June 2009, BNB 2009/264 (surrender of a tax-privileged annuity by the party entitled to the annuity who had emigrated earlier to Belgium in connection with which the value of the entitlement was taxed as a negative expense for income provision under Art. 3.133 in conjunction with Art. 3.137 of the ITA 2001, i.e. the market value of the previously paid and deducted premiums was taxed at that time); the Supreme Court was of the opinion that this was not in conformity with the good faith to be observed in the interpretation of Art. 18 of the treaty with France, Art. 19 of the treaty with Korea and Art. 18 of the treaty with the Philippines (pensions), or Art. 22 (other income article) of the former tax treaty with Belgium. See, for a discussion of these decisions of the Netherlands Supreme Court, Pötgens, note 21, p. 183 et seq. In its decision of 15 April 2011, BNB 2011/160, the Supreme Court held that a preservative assessment imposed on the emigration of a pensioner to Belgium did not contravene the good faith that had to be observed when interpreting and applying Art. 18 of the Netherlands–Belgium tax treaty (2001) because this provision assigns the taxation right to the source state (the Netherlands) in many cases. This may only be different if the Netherlands does not have the authority under Art. 18 of that treaty to tax an irregular transaction as regards a pension arising after the emigration, for example, a lump sum that would normally lead to collection of a preservative assessment. It is striking that the Supreme Court found it irrelevant in this respect that the Belgium–Netherlands tax treaty entered into force on 1 January 2003 (after the inclusion of the preservative assessments into the Netherlands ITA 2001) and that Belgium was aware of the system of preservative assessments imposed on pensioners emigrating to Belgium (which followed from the joint explanatory memorandum). According to the Supreme Court, these elements may not prejudice the taxpayer’s interests.

32. On the same lines see Stevens, note 27, p. 24; Schul, note 27, section 7 and R. M. Freudenthal and E.P.H.G. Raaijmakers, “Belastingheffing over lucratieve belangen: veel hagel en weinig mug...”, *Weekblad fiscaal recht* 6791 (2008), p. 1373. See, however, the decision of the Netherlands Supreme Court of 15 April 2011, note 31.

33. Supreme Court, 23 September 2005, BNB 2006/52.

34. See F.P.G. Pötgens, *Income from International Private Employment, Doctoral Series No. 12* (Amsterdam: IBFD, 2006), pp. 370 and 371 for further examples of income components that are specifically allocable to an employment exercised in the work state.

35. In examining the parliamentary history, it is apparent that the description of the allocation is ambiguous. The Report on written consultations, Kamerstukken I, 2008/09, 31 459, No. E (letter of the State Secretary of Finance to the Chairman of the First Chamber of the States-General of 5 December 2008), pp. 8 and 9, allocates the benefits from a lucrative interest entirely to the activities that are carried out abroad prior to emigration to the Netherlands, but it should be noted that, in the example, no activities were carried out in the Netherlands. Stevens, note 27, p. 23 infers somewhat cautiously, on the basis of the Explanatory Memorandum (MvA), Kamerstukken I, 2008/09, 31 459, No. C, p. 17, that an allocation proportional to time must be made.

36. Supreme Court, 1 December 2006, BNB 2006/75 through 79.

37. The Decree of the State Secretary of Finance of 12 January 2010, BNB 2010/110 elaborates on the meaning of employer for purposes of

- (1) Subordinate relationship: did the target company have the authority to give instructions, meaning that the fund manager was obliged to follow its concrete directions during his work activities in the work state (the Netherlands)?
- (2) Are the costs of the work activities of the fund manager borne by the target company and are the advantages of that work for the account of the fund manager and the risks and disadvantages resulting from that work for the account of the target company?
- (3) Is the target company responsible for the results of the work of the fund manager?
- (4) Is the salary of the fund manager recharged, on an individually identifiable basis, by the private equity firm in State X to the target company?

In particular, the elements under (1) and (4) will often be crucial. After all, with regard to (1) it is conceivable that the private equity fund manager will not work under the authority of the target company and that it would also not have the authority to give him instructions. The authority over the work the fund manager performs for the target company is exercised by the private equity firm resident in State X and, therefore, the condition of Art. 15(2)(b) of the tax treaty with State X (which follows the OECD Model) has been fulfilled and the treaty thus restricts the Netherlands in exercising its national taxation rights.

With regard to (4) duplication can be seen with the requirement that the wages must be “paid by or on behalf of”. Hence, it is unclear why, in its decisions of 1 December 2006, the Supreme Court looked at whether the tax was recharged on an individually identifiable basis in answering the question whether or not there was an employer and why the Court did not take into account the recharge under the “paid by or on behalf of” requirement.³⁸ It should be noted here that, in its decision of 19 June 1996,³⁹ the Supreme Court held that remuneration is paid on behalf of the target company (in the case at hand), if the private equity firm specifically passes on the relevant remuneration (in other words, on an individually identifiable basis) to the target company. In its decision of 23 June 2006,⁴⁰ the Supreme Court again emphasized the importance of an individually identifiable recharge in connection with which it considered an allocation of the costs of a severance payment under the arm’s length principle of Art. 9 of the OECD Model to be insufficient. Generally, when granting shares and similar benefits constituting lucrative interests there is no party involved that bears the costs in connection with the grant (the grant of a lucrative interest will lead, at most, to dilution of the interests of other shareholders, a circumstance that is not suitable for a cost recharge). Given the nature of granting these types of benefits, there will not, generally, be an individually identifiable recharge. Therefore, for this reason as well, the requirement of Art. 15(2)(b) of the relevant tax treaty will be met. As a consequence, under that treaty, the Netherlands does not have any taxation rights.

5.4. Conditions for application of Art. 16 OECD Model

The above example can be adapted somewhat to circumstances where the fund manager is the director of the Netherlands resident target company. In interpreting “director” under Art. 16 of the tax treaty, the Supreme Court takes a formal approach; there is a director in the above sense when the person in question is a member of the board of directors.⁴¹ It is important to emphasize that, according to the Supreme Court, there is a director’s fee within the meaning of Art. 16 of the treaty only if the remuneration at issue is recharged, on an individually identifiable basis, or is borne on such a basis by the company for whom the directorship is carried out (See the 15 July 1997 Supreme Court decision, which dealt with a Netherlands resident target company. Here, the Supreme Court mentions the “paid by or on behalf of” requirement in order to determine whether or not there was a sufficient relationship between the remuneration and the work that the relevant taxpayer carried out as director for it to be considered a director’s fee).⁴² See also the Supreme Court decision of 11 June 2004, wherein the Court determined that a severance payment may, according to the Supreme Court, only be seen as a director’s fee within the meaning of Art. 16(2) of the former Netherlands-Belgium tax treaty if, and to the extent that, it is borne on an individually identifiable basis by the company of which the relevant person was the director.⁴³ The Supreme Court repeated and confirmed this position in its 1 December 2006 decision.⁴⁴ In ground 3.3. it held that, with regard to the applicability of Art. 16 of the former Netherlands-Belgium tax treaty:

Article 16 § 2 of the Treaty is – to the extent relevant – applicable to the fee received by a resident of the Netherlands who is a member of the board of directors of an NV/SA resident in Belgium. ‘Fee’ in this respect means: fee that is paid to the director for the work done in the capacity as director that as such is paid by or on behalf of the NV/SA (compare HR 15 July 1997, No. 32 016, BNB 1997/298). The claim, which is based on a different view, can thus not be upheld. (author’s translation)

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Netherlands tax treaties patterned on Art. 15(2)(b) of the OECD Model. The Decree provides, inter alia, a practical rule for assignments within a group of companies. For example, the recipient Netherlands resident group company is not regarded as an employer for tax treaty purposes provided that the employee is not employed in the Netherlands for a period exceeding 60 work days during a 12-month period. This 60-days regulation is also included in Ministry of Finance, Memorandum on Netherlands Tax Treaty Policy 2011/*Ministerie van Financiën, Notitie Fiscaal Verdragsbeleid* 2011, Para. 2.10; see also Kavelaars, note 28, pp. 168 and 169. See, for a discussion of BNB 2010/110, J.P. van ‘t Hof and M.R.M. Deden, “Het begrip ‘werkgever’ volgens art. 15 OESO-Modelverdrag nader toegelicht”, *Weekblad fiscaal recht* 6868 (2010), p. 971 et seq. and R. Oldenhuis, “De 60-dagenregeling nagenoeg geheel nutteloos. De wet biedt een alternatief!”, *Weekblad fiscaal recht* 6863 (2010), p. 819 et seq.

38. F.P.G. Pötgens, “De Hoge Raad bevestigt en verduidelijkt het materiële werkgeverschap onder de belastingverdragen”, *Weekblad fiscaal recht* 6714 (2007), p. 375, section 3.3.
39. Supreme Court, 19 June 1996, BNB 1996/369.
40. Supreme Court, 23 June 2006, BNB 2006/295.
41. Supreme Court, 22 December 1999, BNB 2000/94 and 10 December 2004, BNB 2005/195.
42. Supreme Court, 15 July 1997, BNB 1997/298.
43. Supreme Court, 11 June 2004, BNB 2004/344.
44. Supreme Court, 1 December 2006, BNB 2007/77.

This means that the remarks made with respect to Art. 15(2)(b) of the tax treaty in 5.4. are, *mutatis mutandis*, applicable to Art. 16 of the OECD Model. As a result, if the remuneration cannot be recharged on an individually identifiable basis by the private equity firm to the target company, there cannot be said to be a director's fee within the meaning of Art. 16 of the applicable tax treaty; hence the Netherlands does not have the right to tax.

6. Classification of Benefits from a Lucrative Interest under Art. 10 (Dividends), Art. 11 (Interest) and Art. 13 (Capital Gains) of the OECD Model

Since the benefits from a lucrative interest do not fall under Arts. 15 or 16 of the OECD Model the question arises how they *should* be classified. In the author's opinion, the civil law form under which the benefits are enjoyed ultimately determines which treaty article is applicable, in other words Art. 10 (dividends), Art. 11 (interest) or Art. 13 (capital gains) of the OECD Model. This can be explained in more detail as follows.

Classification as business profits under Art. 7 of the OECD Model. In this regard, Art. 3(1)(h) of the OECD Model provides that the concept of "business" includes, "the performance of professional services and other activities of an independent character" and Art. 3(1)(c) establishes that the concept of "enterprise" entails "the carrying on of any business". Any income from other activities can also be subsumed under this article,⁴⁵ including benefits from a lucrative interest. Assuming the benefits are classified as falling under Art. 7 of the OECD Model, Art. 7(7) will also have to be taken into account. Art. 7(7) of the OECD Model provides that where profits include items of income that are dealt with separately in other articles of the tax treaty, the other provision takes priority. Depending on the nature of the income received or realized, Art. 10 (dividends), Art. 11 (interest) or Art. 13 (capital gains) of the OECD Model are applicable and these, as a matter of principle, prevail over Art. 7 of the OECD Model. Art. 10(4) (dividends), Art. 11(4) (interest) and Art. 13(2) (capital gains) of the OECD Model have to be taken into account. However, these provisions assume that there is a permanent establishment (PE) and, as such, the underlying shareholding in respect of which the dividends are paid, the debt claim in respect of which the interest is paid or the movable property that is alienated is effectively connected to the business assets of the PE. The conclusion is thus that, given the assumption that, in the sphere of a lucrative interest, it is not likely that a PE has been constituted, the benefits from a lucrative interest (depending on the form in which these benefits are enjoyed or realized) have to be classified under Arts.

10, 11 or 13 of the OECD Model. This is also in line with the nature of the income and thereby with the structure of the OECD Model.

7. Conclusion

With respect to the tax treaty classification of benefits from a lucrative interest, the author's view differs from that of the State Secretary of Finance. Contrary to the State Secretary's view, the author established that benefits from a lucrative interest do not fall under Arts. 15 and 16 of Netherlands tax treaties that follow the OECD Model. According to the author, this follows from a consistent application of Art. 3(2) of the OECD Model, which refers, for the meaning of undefined terms, to the domestic law of the states applying the tax treaty. By virtue of the Netherlands domestic law, benefits from a lucrative interest are only taxed as income from other activities if they do not fall under the tax regime for income from employment. If this is the case, they no longer constitute income from employment. Because of the reference to the domestic law in Art. 3(2) of the OECD Model, these benefits are also not wages within the meaning of Arts. 15 and 16 of the OECD Model and, as such, these provisions are not applicable. Instead, the benefits from a lucrative interest, depending on the nature of the underlying capital components, as a rule, have to be classified under Arts. 10, 11 or 13 of the OECD Model.

Even if the State Secretary's viewpoint as regards the applicability of Arts. 15 and 16 of the OECD Model were to be endorsed, the conditions imposed on the allocation of the taxation rights to the Netherlands would often not be satisfied in regard to non-resident taxpayers of the Netherlands. This is, in particular, the situation with respect to the individually identifiable recharge criterion.

In addition, regarding tax treaties concluded before 1 January 2009, in examining the context, as required by Art. 3(2) of the OECD Model, including the Supreme Court decisions regarding fictitious wages and fictitious interest, it is evident that the Netherlands would be restricted in taxing benefits from lucrative interests enjoyed by non-resident taxpayers.

45. See A.C.G.A.C. de Graaf, P. Kavelaars and A.J.A. Stevens, *Internationale Belastingrecht* (Deventer: Kluwer, 2010), pp. 149 and 150, as well as Pötgens, note 34, p. 287.