Dutch "Most Favoured Nation" Clause: Dutch Supreme Court rules that zero rate applies

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In brief

Regular readers of our Tax Alerts will recall our previous Alert dated 4 September 2017 (*Dividends Tax and Double Taxation Agreements: Dutch Most Favoured Nation Clause*) ("the previous Alert").

In the previous Alert, we drew the attention of readers to the "most favoured nation" clause in the double taxation agreement between the Netherlands and South Africa ("the SA-Netherlands DTA). For some time, many taxpayers have taken the position that this clause ("the Dutch MFN clause") can (when read with at least two other DTAs and provided that the requirements as to beneficial ownership and shareholding in the company declaring the dividends are met) effectively result in an exemption from Dutch or South African dividends tax. This is despite the fact that the SA-Netherlands DTA expressly only provides for a minimum rate of 5 per cent on dividends paid by Dutch resident companies to South African residents (and *vice versa*).

On Friday, 18 January 2019, the Dutch Supreme Court (on appeal by the Dutch tax authorities against a decision of the Dutch High Court (Hertogenbosch) dated 17 August 2017) held that the Dutch MFN clause can indeed apply to effectively exempt from Dutch dividends tax dividends paid by a Dutch resident company to a South African resident.

This decision has important implications for dividends paid by South African resident companies to their Dutch shareholders.

In detail

A recap of the argument in favour of the zero rate

In terms of paragraphs 1 and 2 of the dividends article (article 10) of the SA-Netherlands DTA, the maximum rate of tax that may be imposed by the source state (i.e. the country of residence of the company paying the dividend) is 5 per cent where the recipient of the dividend is the beneficial owner of the dividend and holds at least 10 per cent of the capital of the company paying the dividend.

However, paragraph 10 of article 10 (i.e. the Dutch MFN clause), provides for the automatic application of a lower rate of tax on dividends if South Africa and a "third country" conclude a DTA which provides for a lower rate. If this is the case, the lower rate will apply for the purposes of the SA-Netherlands DTA.

The Dutch MFN clause was introduced into the SA-Netherlands DTA by way of a protocol that was concluded (simultaneously with the SA-Netherlands DTA itself) in 2008 ("the SA-Netherlands protocol"). This fact is important, since one of the other requirements for the MFN clause to apply is that the treaty with the "third country" must have been concluded after the conclusion of the SA-Netherlands DTA and protocol (i.e. 2008).

South Africa currently has one DTA (with Kuwait) that expressly provides for a zero rate in respect of dividends. However, that DTA ("the SA-Kuwait DTA") was concluded in 2006. It is therefore clear that Kuwait cannot be the "third country" contemplated in the Dutch MFN clause.

How then is the Dutch MFN clause triggered? The answer lies in the DTA between SA and Sweden ("the SA-Sweden DTA"), which also contains an MFN clause ("the Swedish MFN clause") in its article dealing with dividends.

As is the case with the Dutch MFN clause, in terms of the Swedish MFN clause, if South Africa has a DTA with any other country ("the other country") in terms of which a lower rate of dividends tax applies, the lower rate will apply for the purposes of the SA-Sweden DTA. The critical difference between the Swedish MFN clause and the Dutch MFN clause is that the Swedish MFN clause applies irrespective of when the treaty with the "other country" was concluded. Consequently, the fact that the Kuwait DTA might have been concluded before the conclusion of the Swedish DTA is irrelevant in determining whether the lower rate applies for purposes of the SA-Sweden DTA.

Although the SA-Sweden DTA was concluded in 1995, the Swedish MFN clause was introduced into that DTA by way of a protocol that was signed in 2010 and that entered into force and became effective in 2012. The protocol ("the Swedish protocol"), which (as a result of the zero rate applicable in terms of the SA-Kuwait DTA) provides for a zero rate of tax on dividends paid by South African companies to Swedish residents, was concluded after the conclusion of the SA-Netherlands DTA.

Consequently, as has been successfully argued by the taxpayer before the Dutch courts and as is the position of many South African companies that pay dividends to Dutch shareholders, (1) South Africa has concluded a DTA (i.e. the Swedish protocol) with a third country (i.e. Sweden); (2) that DTA was concluded after the conclusion of the SA-Netherlands DTA (and the protocol that introduced the Dutch MFN clause into the SA-Netherlands DTA); (3) the Swedish protocol provides for a rate of tax on dividends lower than the rate provided for in article 2 of the SA-Netherlands DTA (i.e. it provides for a zero rate). Accordingly, all of the requirements for the Dutch MFN clause to be triggered are met, and the zero rate applies for the purposes of the SA-Netherlands DTA.

The current position in South Africa

When applying the dividends article in the SA-Netherlands DTA, to dividends paid by South African companies to Dutch residents, the South African Revenue Service ("SARS") has not agreed with the arguments of taxpayers relating to the application of the Dutch MFN clause, nor has it agreed with the approach adopted by the Dutch courts at the District and High Court levels. Accordingly, SARS' view has been that the lowest rate possible in respect of dividends is 5 per cent.

Broadly, the arguments of SARS are generally aligned with the arguments of the Dutch revenue authorities (as presented in the Dutch courts). These arguments may be summed up as follows:

- Even though the Swedish protocol was concluded after the conclusion of the SA-Netherlands DTA, the SA-Kuwait DTA was concluded prior to the SA-Netherlands DTA.
- The SA-Kuwait DTA cannot be directly or indirectly relied upon to reduce the rate of dividend withholding tax to zero per cent.
- The Dutch MFN clause has a "temporal limitation", and is only forward-looking.
- When the SA-Netherlands protocol was concluded, the zero rate applicable in terms of the SA-Kuwait DTA was already in place – it can therefore never have been the intention that this favourable treatment would apply (directly or indirectly) to the SA-Netherlands DTA. Had this been the intention, the South African and Dutch treaty negotiators would have adopted an MFN clause with no temporal limitations.

The above arguments have been rejected by the Dutch courts at the highest level (the Dutch Supreme Court), and the position in the Netherlands is now clear: the Dutch MFN clause can indeed be applied to effectively exempt from Dutch dividends tax dividends paid by Dutch residents to South African residents.

The take-away

A decision of the Dutch Supreme Court, although a final decision and fully binding in respect of all dividends paid by Dutch residents to South African residents is, strictly speaking, not binding on the South African government. This is simply because neither South African taxpayers nor the South African authorities are subject to the jurisdiction of the Dutch courts. Moreover, should the matter come before the South African courts, those courts are not bound by the decisions of Dutch courts. Nevertheless, the decisions of the Dutch courts will undoubtedly be highly persuasive in the South African courts, not only because the arguments that will be presented in the South African courts are likely to mirror those presented in the Dutch courts and because those arguments have already been rejected by the Dutch Courts, but also because it would be impractical for South Africa to apply a different interpretation to the Dutch MFN clause than is applied in the Netherlands.

The impact of the decision of the Dutch Supreme Court on SARS' approach to the interpretation and application of the Dutch MFN clause will become apparent in the very near future.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Johannesburg
(Prof) Osman Mollagee
(011) 797 4153
osman.mollagee@pwc.com

Cape Town
David Lermer
(021) 529 2364
david.lermer@pwc.com

Durban
Frank Mosupa
(011) 797 5294
frank.mosupa@pwc.com

Port Elizabeth
Ian Olls
(041) 391 4474
ian.olls@pwc.com