



# **New Japan-Netherlands tax treaty coming into effect**

On 25 August last year, the governments of Japan and the Netherlands signed a new tax treaty (the “Convention between Japan and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income”, hereinafter the “New Treaty”), and exchanged diplomatic notes on 29 November 2011 notifying each other that the necessary domestic procedures to approve the New Treaty had been completed. As such, the New Treaty will come into effect by the end of 2011 and will be applicable from 1 January 2012.

\* The previous treaty signed by Japan and the Netherlands in 1970 (“Convention between the government of Japan and the government of the Kingdom of the Netherlands for the avoidance of double taxation with respect to taxes on income”) will be referred to as the “Old Treaty”.

The New Treaty lowers or eliminates withholding tax on investment income, i.e. dividends, interest and royalties, and also introduces measures against treaty abuse which we explain below. On the other hand, the New Treaty allows taxation in the source country on capital gains derived from a disposition of shares in a real property holding company (RHPC), i.e. a company of which total assets are at least 50% real properties located in the source country (restricted to cases where more than 5% of the shares are owned if listed), etc.

## 1. Comparison of tax rates on investment income and capital gains under the Old Treaty and the New Treaty

	Old Treaty		New Treaty			
	Beneficiary/income details	Tax rate	Beneficiary/income details	Tax rate	LOB	Anti-conduit provision
Dividends	Owning at least 25% of voting shares for 6 months	5%	Owning at least 50% of voting shares for 6 months, certain pension funds	0%	Yes	Yes
	Other	15%	Owning at least 10% of voting shares for 6 months	5%	No	
			Other	10%	No	
Interest	Government agency, etc.	0%	Government agencies, banks, certain pension funds, etc., interest paid with respect to indebtedness arising as a consequence of the sale on credit of equipment, merchandise or service	0%	Yes	Yes
	Other	10%	Other	10%	No	
Royalties	All	10%	All	0%	Yes	Yes
Capital gains on stock sales	All	0%	Shares of RPHCs	Japan corporate tax rate	Yes	No
			Other	0%		

## 2. Introduction of measures to prevent treaty abuse

The new treaty introduces measures against treaty abuse including; (1) a limitation on benefits (LOB) provision, which applies to income that is sought to be fully exempt from tax in the source country as well as, (2) anti-conduit provisions on investment income and "other income".

### (1) LOB provision

Articles 10-3 (fully tax-exempt dividends), 11-3 (fully tax-exempt interest), 12 (fully tax-exempt royalties), 13 (capital gains) and 20 (other income) of the New Treaty are subject to the LOB provision which limits the availability of treaty benefits to qualified persons only (individuals, qualifying government agencies, listed companies and their subsidiaries, pension funds, etc.). However, even if a resident is not a qualified person, the benefits may still be available if either the equivalent beneficiary test, the active trade/business test, or the headquarters test is passed or; approval is obtained from the competent authority.

### (2) Anti-conduit provisions

Benefits provided under Articles 10 (dividends), 11 (interest), 12 (royalties) and 20 (other income) of the New Treaty will not be available for the recipient if it is construed as a conduit transaction (e.g., the recipient remits a similar type of income to a third-party country resident after receiving such income).

### 3. Commencement of application of the New Treaty on investment income

According to Article 30-2, with respect to taxes withheld at source, the New Treaty shall be applicable for amounts taxable on or after 1 January 2012. A clear definition of “amounts taxable on or after 1 January 2012” has not been provided.

When the current Japan-US tax treaty was introduced in 2004, the same expression was used for the commencement of application of the treaty and the National Tax Agency of Japan published the following notice regarding investment income received in the US. It stated that the treaty was applicable to the amount of investment income “due to be received” on or after the date of commencement of application and it further explains the meaning of “due to be received” as below.

*Excerpt from notice*

#### **National Tax Agency**

##### **Commencement of Application of the New Japan-U.S. Income Tax Convention in Japan (With respect to Taxes Withheld at Source regarding Investment Income)**

The Convention shall be applicable with respect to taxes withheld at source for amounts taxable on or after July 1, 2004. Therefore, the Convention is applicable to the amount of investment income (dividends, interest, and royalties) “due to be received” on or after that date.

Specifically, the date on which an amount is due to be received for purposes of the Convention is as follows:

##### **Dividends**

- ▶ The date of the shareholders’ meeting where dividends are declared
- ▶ As for interim dividends, the date of the resolution by the board of directors

##### **Interest and Royalties**

- ▶ If the date of payment is stipulated in a contract, that date; if not, the date on which the interest or royalties are actually paid

### 4. Election of application of Old Treaty

Article 30-4 of the New Treaty provides an elective grandfathering period of 12 months from the effective date of the New Treaty in the case where a tax payer is entitled to greater benefits under the Old Treaty than the New Treaty. The option to elect to apply the Old Treaty is available until 31 December 2012. It is therefore recommended to compare benefits under the Old Treaty and the New Treaty and study tax planning ideas considering future disposition of shares etc. at an early point.

Comments or general inquiries regarding this tax alert may be directed to our Corporate Communications team at [tax.marketing@jp.ey.com](mailto:tax.marketing@jp.ey.com).

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