Dutch Supreme Court favours South African companies under the ‘Most-favoured Nation’ clause


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South African multinationals achieved a victory recently when the Dutch Supreme Court held that South African parent companies could, effectively, be exempt from Dutch withholding tax on dividends.

The case involved a South African company receiving dividends from its Dutch subsidiary company. Ordinarily, the double tax agreement between SA and the Netherlands ("NL-SA DTA") would only have limited the Dutch withholding tax (on the SA company) to 5%. However, the critical question was whether the SA company qualified for the so-called MFN (most-favoured nation) treatment that would grant full exemption from the Dutch tax—essentially allowing the SA company to repatriate 100% of the Dutch dividends back to SA.

The MFN concept in the NL-SA DTA essentially means that, if either country gives any other country a more beneficial dividend treatment, then that (more beneficial) treatment automatically applies in the NL-SA DTA.

Although the main question before the Dutch Supreme Court was simple, the underlying interpretational issues were complex. The NL-SA MFN, concluded in 2008, is forward-looking, meaning that only agreements concluded after the NL-SA DTA could have an impact. In 2008, the only SA DTAs that offered full exemption for dividends all pre-dated the NL-SA DTA, and so far no full-exemption DTAs were concluded after 2008. In 2012, however, SA concluded another MFN agreement with Sweden (the Sweden MFN), which was both forward-and-backward-looking. The Sweden MFN—which was concluded after the NL-SA DTA—would benefit from exemptions that pre-date the NL-SA DTA. As a result, the Sweden MFN also allows the NL-SA
DTA to be indirectly backward-looking, so dividend exemptions granted before the NL-SA DTA could (from 2012) also be claimed under the MFN.

A critical aspect of the court’s deliberations was the question of the actual intention of the SA and Dutch governments at the time of concluding the DTA. There is nothing in the wording of the SA-NL MFN to suggest that it should not be indirectly backward-looking, but the Dutch revenue authorities argued that, in fact, it was not the intention of the contracting States to grant the dividend exemption. The dispute went through three levels of the Dutch judiciary (culminating at the Supreme Court), and all three levels found no evidence to support the position of the Dutch tax authority. The courts considered that the ordinary meaning of the text, applied in good faith, meant that the exemption should apply to the NL-SA DTA. Another aspect before the court was whether the Sweden MFN (which was simply in a Protocol to the much older original SA-Sweden DTA) was in fact a qualifying “agreement” —but the court seemed to have no hesitation in holding that it was indeed an acceptable post-2008 agreement. Thus, in conclusion, as long as there are other SA DTAs that grant an exemption for dividends, SA companies will be able to claim the exemption from the Netherlands.

An important consequential implication is that this exemption should also apply in the opposite direction. That is, Dutch parent companies investing into SA should also qualify (under the MFN) for the exemption on dividends paid from SA. Although we understand that the South African Revenue Service (SARS) has historically opposed this view, it is hard to see how we (in SA) would come to a different conclusion than that of the Dutch Supreme Court. That said, this exemption is in any event unlikely to remain in the long term, since SA has worked hard to ensure that all of its remaining “full-exemption” DTAs are amended as quickly as possible —with only one still surviving (at the time of this article). In other words, as soon as the single remaining full-exemption DTA is amended, the MFN will automatically cease to trigger the exemption.

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