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BRIEFING

SUMMARY

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Taxpayers in financial distress and insolvencies: Netherlands tax aspects

This briefing discusses the Netherlands tax aspects affecting financially distressed and insolvent corporate taxpayers, (secondary) tax liabilities and preferential rights in relation to tax claims, including how third parties can be affected by seizure of assets located at the premises of the distressed taxpayer. It also notes the tax consequences for Netherlands creditors of a debtor that is unable to pay and for Netherlands shareholders holding shares in a subsidiary that is liquidated.

Introduction

This briefing is of a general nature and does not purport to present a complete picture of all Netherlands tax aspects that could be relevant in the case of a business's (threatened) insolvency. It sets out some key tax aspects affecting a taxpayer in financial distress and during its subsequent insolvency and highlights the potential tax issues for creditors and other parties that have dealt with the insolvent business. The briefing focuses on corporate taxpayers.

Taxpayer in financial distress

A key issue for executive directors (members of the board) to consider is that there are specific tax rules that relate to their personal liability for the payment of (principally) wage withholding tax, social security contributions, value added tax (VAT), environmental taxes and excise duties. This personal liability applies if the company has not promptly filed a notice with the tax authorities of its inability to pay these taxes (the notice needs to be given within two weeks of the due date of the tax that the company is unable to pay). These rules are strictly enforced and apply in addition to the general (non-tax) rules of directors' liability in the case of mismanagement. Personal liability also extends to directors who have no internal responsibility for the taxpayer's financial and tax affairs and even to de facto directors and 'indirect directors' (directors of another legal entity that acts as managing director). Exoneration is granted only in very limited circumstances. Each director can give this notice, thereby preventing personal liability.

The purpose of the reporting obligation is to allow the tax authorities to take the necessary measures to secure payment of any outstanding taxes. It can therefore be expected that after such a notice has been made, the tax authorities will accelerate collection measures in respect of any tax that is due.

In Netherlands' focused loan documentation, filing this notice is sometimes considered an event of default, requiring the early and full repayment of the loan outstanding.

Generally, tax claims have the highest preference by law; only claims secured by mortgage and pledge (with the exception of pledge on certain assets used on the taxpayer's premises) are treated with higher preference. As soon as the tax authorities become aware that a taxpayer is in financial distress, they will attempt to collect any tax that is already due. They can also issue tax assessments when necessary and declare them immediately payable. They can seize the taxpayer's assets on the basis of a payment order (*dwangbevel*), which the collector of taxes can issue without the courts' involvement. The receipt of such a payment order requires the taxpayer's immediate attention, because failing to respond to it may lead to immediate seizure of assets and a subsequent public sale.

If certain taxes have remained unpaid (generally certain withholding taxes, VAT and excise duties), the authorities can even seize assets owned by third parties, provided

they are used by the taxpayer on its premises for the purposes of its business (*bodemrecht*). They can then organise a sale of those assets, the proceeds of which are used towards the payment of the outstanding tax liabilities. This is to ensure that the collector's right of priority takes preference over the right of a third party that essentially has retained ownership merely as security for payment. This may apply, for instance, to assets that have been made available on a financial lease basis; it should not apply to assets that are leased on an operational lease basis. It should also not apply to stock or assets not physically used on the taxpayer's premises. A third party whose assets are seized on this basis should take immediate action to defend its rights, because the period during which it is possible to appeal against the seizure is very short (seven days).

Insolvency of a taxpayer

An insolvent taxpayer's tax obligations continue regardless of its insolvency, but certain issues become more prominent. The court-appointed administrator is responsible for handling the insolvent company's tax affairs.

Typically, when it has become clear that the insolvency proceedings are unlikely to lead to full payment of outstanding tax liabilities, the tax authorities will consider whether they can hold third parties liable for payment of the unpaid tax on the basis of specific provisions in the tax legislation. Such liability (secondary tax liability) may apply, inter alia, to:

- other members of the same fiscal unity (for corporate income tax or for VAT purposes) for taxes relating to the tax year in which they were members of the same fiscal unity as the insolvent taxpayer;
- customers of the insolvent taxpayer in certain industries (eg customers of contractors, in the textile industry, customers of employment agencies and, in some cases, in outsourcing arrangements; traders in certain type of goods that are sensitive to VAT carousel fraud schemes);
- selling shareholders in certain cases (eg cash companies with tax obligations);
- the de facto leader of a branch (permanent establishment) of a foreign-resident taxpayer; and
- the person(s) responsible for the factual relocation abroad of a Netherlands-resident corporate taxpayer (this may be deemed to be the case if Netherlands-resident directors resign from a company that still has tax liabilities outstanding and transfer responsibility for the company's affairs to non-resident directors).

Within an insolvency procedure, the administrator can decide to sell assets to third parties. If this happens, the correct application of VAT is important, especially if VAT is charged by the administrator when it is not required. In those cases, the purchaser may be unable to deduct VAT charged and may not have effective recourse against the administrator for the incorrect charging of VAT. In the case of a sale of real estate under an enforcement action from a creditor, the VAT may be levied from the purchaser and not from the seller.

Whether an insolvency procedure ends as a result of an agreement reached with the creditors or because the insolvency has become final when there are no assets any more for the payment of outstanding obligations, the non-payment of the residual obligations will normally not lead to any additional tax (effectively) payable.

Tax aspects for the creditor of an insolvent party

Generally, Netherlands taxpayers may take a devaluation loss when it has become plausible that the full amount of a receivable will not be received. The receivable should be valued on the lower fair market value. There are no formal rules in this respect and devaluation for tax purposes does not depend on the outcome of the GAAP/IFRS tests for the devaluation of receivables; all relevant facts and circumstances may be used to make the lower valuation plausible. Insolvency of the debtor and/or non-payment is therefore not a requirement for taking this devaluation loss. If the receivable's market value increases again, the loss will have to be reversed, up to the receivable's original carrying costs. There are anti-abuse rules that aim to prevent the avoidance of any subsequent revaluation of the receivable. If the debtor's insolvency has become final and no further repayments can be expected, the receivable's residual carrying value can be taken as a loss.

If and to the extent that the receivable on an insolvent debtor includes VAT charged on the provision of services or the sale of goods, and the total amount of the receivable is not fully paid, the VAT component can

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be reclaimed (on a pro rata basis in the case of partial payment) from the tax authorities. The test is again that it should be plausible that the relevant amount of the receivable will not be received. Again, insolvency is not a condition, but is usually considered sufficient evidence that full payment on the receivable will not occur.

Tax aspects for the shareholder of an insolvent party

The Netherlands shareholder of a party whose insolvency has become final can generally take a tax-deductible loss on the cost price for tax purposes of the shares held in that insolvent party. Normally, a loss on a shareholding in a qualifying subsidiary is not deductible under the participation exemption. A loss that has become final as a result of the liquidation of the subsidiary is, however, in principle deductible. An important condition is that the subsidiary's business is not continued by the shareholder or any other related party. This may be an issue if the group to which the insolvent party belongs attempts to continue the relevant business in some form. A further timing point is that the liquidation loss can technically be taken only when the subsidiary's liquidation procedure has been finalised; in complex insolvency matters this may take many years. It may be that the tax authorities, in these difficult times, take a more practical approach on a case-by-case basis.

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