United States — Kingdom of the Netherlands Income Tax Convention

This ruling confirms that the Netherlands investment yield tax is a tax for which a credit may be allowed under Article 25(4) of the U.S.-Netherlands income tax convention because, under Article 2(2), it is substantially similar to a prior Dutch tax that was a covered tax under the convention.

Rev. Rul. 2002–16

ISSUE

Whether the newly enacted Dutch tax on an individual's imputed income from savings and investment in the Netherlands, Box 3 of the Netherlands Individual Income Tax Act of 2001, is a tax for which a credit may be allowed against U.S. income tax liability under the Convention Between the United States of America and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, effective December 31, 1993 (the "Treaty").

FACTS

Prior to January 1, 2001, the Netherlands individual income tax (*de inkomstenbelasting*) was imposed on a single taxable income base, which comprised all the income that a taxpayer received in a year. Various deductions were allowed against this income. Additionally, a dividend and interest allowance could be used against income from savings and investments.

Effective January 1, 2001, the Netherlands introduced a schedular system of individual taxation that applies to both residents and nonresidents. Under the new system, instead of a single taxable income base there are three separate bases. These are referred to as "Boxes," and are organized as follows:

> Box 1 includes taxable income from work (including profits and losses from business and professions and sales of business property, wages, pensions, and income from partnerships), dividends received by security dealers, and imputed income from an owner-occupied home. Expenses related to business profits are deductible. Nonresidents are subject to tax on the income in this box from Dutch sources, including imputed income from a home within the Netherlands.
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> Box 2 includes taxable income derived from a substantial business interest in corporations. Substantial is defined as a 5% or more interest. Two types of income are taxed: dividends and capital gain realized on selling assets that form a substantial holding. Acquisition (margin) interest is deductible. Nonresidents are subject to tax on the income in this box with regard to substantial interests in Dutch companies.
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> Box 3 includes taxable income from savings and investments. Taxable income is the fixed yield (imputed income) set at 4% of the value of the investment assets reduced by certain liabilities. Taxpayers cannot reduce their tax burden by proving that their actual rate of return on investments was in fact less than 4%. If income imputed from investment assets is subject to tax under Box 3, any actual interest, dividend, and rental income will not be taxed. The investment yield tax applies to assets such as real estate (other than the taxpayer's personal residence), stocks and shares, savings deposits, and non-exempt endowment insurance. If income from an asset is subject to tax under Box 1 or 2, income will not be imputed with respect to that asset for purposes of Box 3. Also, income is not imputed with respect to assets without yield capacity (such as personal use property). Interest paid and other expenses relating to imputed income taxed under Box 3 are not deductible. However, debt that exceeds 2,500 EUR and that is not related to the assets included within Box 1 and Box 2 can be deducted from the tax base on which the imputed income of 4% is computed; in addition, all taxpayers are entitled to a tax-free asset allowance of 17,600 EUR. Nonresidents are subject to tax on the income in this box from assets within the Netherlands minus related debt. Assets within the Netherlands include only immovable property, rights in immovable property, and rights in the profits of a company with a registered office within the Netherlands provided that the rights are not in the form of stock.

Under the new system, each form of income may be included in only one box. If there is a loss in one box, it may not offset positive income in the other two boxes. The loss may, however, be carried over and deducted against income in that box in a later year. In addition, if a taxpayer incurs a loss on the complete termination of his or her substantial interest that is subject to tax in Box 2, as much as 25% of that loss may be applied against the Box 1 tax.

Box 1 taxable income comprises approximately 95% of the total income tax base. Boxes 2 and 3 comprise approximately 1.5% and 3.5% respectively of the total income tax base.

Taxable income within the three boxes is reduced by personal deductions, such as medical expenses, educational expenses, donations, and alimony. Personal deductions are used to offset first income in Box 1, then income in Box 3, and finally income in Box 2. Any excess personal deductions may be carried forward.

After reduction by personal deductions, taxable income is subject to the following income tax rates in the three boxes as follows:

Box 1	Progressive rates of up to 52%
Box 2	25%
Box 3	30%

Various credits are allowed against the taxes of the three boxes combined. Some of these credits, such as the general tax credit, child credit, old-age credit, and the handicapped credit, are nonrefundable. Two additional credits, a wage credit and a credit for the dividend tax, also are allowed, and may, in some cases, lead to a refund.

LAW AND ANALYSIS

Under Article 25(4) of the Treaty, a credit may be allowed against U.S. tax liability for the Box 3 tax if, under Article 2(2), the Box 3 tax is a substantially similar tax imposed in place of a tax that was in force at the time the Treaty was signed. Under the general rule of Article 25(4) of the Treaty, Methods of Elimination of Double Taxation, the United States treats as an income tax, for which a credit may be allowed under Article 25, the appropriate amount of income tax paid or accrued to the Netherlands by or on behalf of a resident or national of the United States. For purposes of Article 25(4), the taxes referred to in paragraphs 1(a) and 2 of Article 2, Taxes Covered, are considered income taxes.

Article 2(1)(a) lists the Netherlands taxes that were in force at the time the Treaty was signed and that were covered under the Treaty. These included the Dutch individual income tax, *de inkomstenbelasting*.

Under Article 2(2), Netherlands taxes that were not in force at the time the Treaty was signed are nonetheless covered taxes, and thus taxes for which a credit may be allowed under Article 25(4), if they are identical or substantially similar taxes imposed after the date of signature of the Treaty in addition to, or in place of, the existing taxes.

In general, the purpose of a Taxes Covered Article is to ensure that tax treaties do not become obsolete due to changes in the tax systems of the parties to a treaty. Thus, if identical or substantially similar taxes are imposed in addition to, or in place of, the taxes that were in force and covered at the time a treaty was signed, it is appropriate to give effect to the intent of the Contracting States, and allow the treaty to continue to apply to the basic income tax structures of Contracting States. There is no definitive test for whether a tax is substantially similar to a covered tax; rather, the outcome rests on the facts and circumstances of each particular case. If it is concluded that a newly enacted tax is substantially similar to a covered tax, it also becomes a covered tax, but remains so only until such time as it is amended. When that occurs, a separate analysis must be made in order to determine whether the amended tax is substantially similar to the taxes in force at the time the treaty was signed.

HOLDINGS

Considered in its entirety, the Netherlands Individual Income Tax Act of 2001 imposes taxes that are substantially similar to the income tax referred to in Article 2(1)(a) of the Treaty. Because the taxes imposed pursuant to the Netherlands Individual Income Tax Act of 2001 are substantially similar to the income tax referred to in Article 2(1)(a) of the Treaty, those taxes are covered under Article 2(2), and therefore treated as income taxes for which a credit may be allowed under Article 25(4). Accordingly, the tax imposed under Box 3, which forms a part of the Netherlands Individual Income Tax Act of 2001, is treated as an income tax for which a credit may be allowed under Article 25(4).

Taxpayers generally may rely upon Revenue Rulings to determine the tax treatment of their own transactions, and need not request a ruling that would apply the principles of a published Revenue Ruling to their own particular cases. However, because each Revenue Ruling represents the conclusion of the Service as to the application of the law to the specific facts involved, taxpayers, Service personnel, and others concerned are cautioned against reaching the same conclusions in other cases unless those cases present facts and circumstances that are substantially the same as those in the Revenue Ruling. Treas. Reg. § 601.601(d)(2)(v)(*e*). Accordingly, because the provisions of the Netherlands Individual Income Tax Act of 2001 described in this Revenue Ruling are facts on which this Ruling bases its holding, a taxpayer must verify that the description is still accurate before relying on the Ruling. A taxpayer may not rely on the Ruling if the Netherlands Individual Income Tax Act of 2001 has been altered or changed in any material respect by subsequent Dutch law.

EFFECTIVE DATE

This Revenue Ruling is effective with respect to taxable years beginning on or after January 1, 2001. This Revenue Ruling will cease to be effective if the Netherlands Individual Income Tax Act of 2001 is modified in any material respect for tax years that are affected by such change. Taxpayers are responsible for determining whether any such modifications have occurred.

DRAFTING INFORMATION

The principal author of this Revenue Ruling is Nina Chowdhry of the Office of the Associate Chief Counsel (International) (CC:INTL:Br1). For further information regarding this Revenue Ruling, contact Ms. Chowdhry at (202) 622–3880 (not a toll-free call).