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Our reference
2021-0000110580

**Your letter / Your
reference**

Date 7 juni 2021
Subject Unilateral termination of double tax treaty between the
Netherlands and the Russian Federation

The Russian Federation has notified me that it is terminating the double tax treaty between the Netherlands and Russia unilaterally. In this letter I will inform the House about the background to this decision and what its consequences will be.¹

Background

The Netherlands has been holding negotiations with the Russian Federation on a standard, partial revision of the double tax treaty since 2014. Although officials reached agreement on the partial revision of the tax treaty in January 2020, including arrangements for preventing tax avoidance, the Russian Federation contacted the Netherlands in August 2020 with a view to revising certain aspects of the negotiated amendments. The Russian Federation proposed that the treaty should allow higher withholding taxes to be levied in order to generate more tax revenue. Russia made the same request to several countries, which it appears to have selected on the basis of the volume of outbound dividend and interest payments from the Russian Federation to those countries. Besides the Netherlands, it approached Cyprus, Malta and Luxembourg. These three countries eventually agreed to Russia's proposal. As far as I know, Russia is also approaching Switzerland, Singapore and Hong Kong or has already done so.

Dutch assessment of Russia's proposal

The Netherlands has always been willing to make further agreements to combat tax avoidance, but the proposal basically means that the Russian Federation would only be prepared to grant treaty benefits to listed companies under strict conditions, even when there is no question of treaty abuse. One of these conditions is that a listed company in the Netherlands must have a direct shareholding in a subsidiary in Russia, or vice versa. It seems likely that not all listed companies will automatically meet (or be able to meet) all the conditions. Businesses with no stock exchange listing, such as family businesses, would no longer be eligible for any treaty benefits at all. Only a very limited number of taxpayers would still qualify for treaty benefits. This does not take sufficient account of the interests of real Dutch businesses. In addition, companies in other EU countries that are also active in Russia will not face such (unusual) higher

¹ The House was previously informed about the negotiations that were being conducted. See Parliamentary Papers, House of Representatives 2020-21, no. 1447.

withholding taxes, which would put real Dutch companies at a disadvantage compared with companies from those countries.

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The Netherlands has put forward various constructive counterproposals aimed at combating tax avoidance, including conduit activities, while sparing genuine economic activities. For example, in addition to a principal purposes test (generic anti-abuse provision), the Netherlands has proposed a strict limitation on benefits provision (specific anti-abuse provision). Such a provision would make it possible to limit access to the treaty to businesses with genuine economic activities. The Russian Federation has informed the Netherlands that it is only possible to make the same arrangements as previously made with Cyprus, Malta and Luxembourg, and that there is no room for negotiation. The Netherlands has emphasised several times that these countries cannot be compared to the Netherlands. This is because a significant proportion of Dutch investments involve (real) Dutch companies that operate and invest in Russia on a large scale. Taking all the above reasons into consideration, the Netherlands finds the Russian Federation's proposal unacceptable.

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During the negotiations, the Minister of Finance and myself, together with the Dutch embassy in Moscow and representatives of the Dutch and Russian business communities, informed the Russian Federation several times and at various levels that the proposed amendments to the double tax treaty would be harmful to both countries and that termination would undermine our bilateral investment relationship. None of these actions ultimately persuaded the Russian Federation to alter its stance.

Consequences of Russia's decision to terminate the double tax treaty

The treaty can be terminated unilaterally subject to a notice period of at least six months before the end of a calendar year. The treaty has been terminated by Russian Federation within this period, and will therefore cease to apply on 1 January 2022.

From that date, the Double Tax (Avoidance) Decree 2001 (BVDB 2001) can be invoked in certain circumstances. This is unilateral Dutch legislation that prevents resident taxpayers (i.e. those residing or established in the Netherlands) from being taxed twice (i.e. in the Netherlands and in another country) on the same income, in certain situations and under certain conditions. For example, a Dutch businessperson (natural person) who makes a profit with the help of a permanent establishment in another country is entitled to a tax exemption for this profit, and a Dutch employee who receives a salary for work performed abroad is also entitled to an exemption. In addition, to prevent double (economic) taxation, businesses will still be entitled to an exemption for foreign corporate profits ('participation exemption' and 'object exemption').

The most important consequence of the treaty's termination is that Russia will be able to levy higher withholding taxes on outbound dividend, interest and royalty payments. In addition, these higher withholding taxes will no longer be eligible for offset once the treaty is terminated. This is because, in the absence of a double tax treaty, the payments in question cannot be offset and will in principle be taxed twice, in both the Netherlands and Russia.²

² An exception applies to intercompany dividends, which are exempt from corporation tax in the Netherlands. This means that withholding tax levied on these dividends by Russia cannot be offset in the Netherlands.

Next steps

Although the Russian Federation's termination of the treaty is a step in the wrong direction, it is not irreversible. Both the Netherlands and the Russian Federation stand to benefit from a well-functioning double tax treaty. The Netherlands will therefore continue its efforts to engage in dialogue and to resolve the issue by the end of the year.

I will keep the House informed of any relevant developments.

Yours sincerely,

State Secretary for Finance - Tax Affairs and the Tax Administration,

J.A. Vijlbrief

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