KPMG Meijburg & Co Tax & Legal

Farewell bonuses for personnel of a participation are not participation selling costs

On December 22, 2023 the Dutch Supreme Court clarified the term 'participation costs'. This means, on the one hand, that in practice costs will more often be deductible, such as the farewell bonuses that were paid to personnel of the sold participation in the case before the Supreme Court. On the other hand, the Supreme Court seems to regard more costs as participation costs than was perhaps thought. This judgment is relevant for every company that is planning to buy or sell participations.

The Supreme Court judgment and its potential implications are addressed in more detail below.

The case

BV X (the taxpayer) holds all the shares in Dutch, German and US subsidiaries. BV X constitutes a fiscal unity for corporate income tax purposes with the Dutch subsidiary. On April 9, 2015 the subsidiaries was sold. After the sale, BV X awarded bonuses to the entire personnel of the former subsidiaries. The bonuses were dependent on length of service, salary and the performance of the relevant employees. Farewell bonuses totaling more than EUR 1.5 million were awarded. The bonuses were for the account of BV X. The payment and remuneration of the farewell bonuses actually took place via holding companies that directly/indirectly held the interest in BV X. BV X wanted to deduct the farewell bonuses in the 2015/2016 split financial year. The tax inspector refused this, primarily because he believed that this involved non-deductible participation selling costs.

The District Court

In the proceedings before the District Court, BV X argued that the farewell bonuses of more than EUR 1.5 million could be deducted because these costs were normal wage costs that belonged at the subsidiary, that these costs had arisen before the subsidiary was sold and thus could be deducted within the fiscal unity by means of creating a provision immediately prior to the termination of the fiscal unity, which was terminated by selling the shares in the Dutch subsidiary. This line of reasoning is entirely consistent with past Supreme Court case law. However, the District Court found that the facts were different than in the cases on which the Supreme Court had ruled, for example in 2021, and that consequently it was not possible to create a provision before the fiscal unity was terminated. The District Court inferred from the facts that the awarding of the farewell bonus had only occurred after the shares were sold and that at the time the fiscal unity was terminated the employees were not aware of a potential farewell bonus related to the sale of the shares. Moreover this did not involve normal wage costs, i.e. remuneration for work performed resulting from the employment contract. The employees had already been paid for this via their usual salary and bonuses. The farewell bonus was remuneration that fell outside the normal employment contract. According to the District Court, it was therefore not possible to create a provision at the level of the Dutch subsidiary. Parties agreed that in that case it had to be assessed whether the costs could be deducted at the level of BV X (the parent company).

The District Court then dealt with the question whether BV X could still deduct the costs. According to the District Court, this was however not possible because these were non-deductible participation costs, giving as reason that without the sale the bonuses would not have been awarded.

The Supreme Court judgment

The Supreme Court began by summarizing the facts. What stands out is that the Supreme Court mentions a fact that is not discernible from the District Court judgment, but apparently is from the file, i.e. that of the total amount in bonuses of more than EUR 1.5 million, EUR 1,371,534 relates to employees of the Dutch subsidiary. Why this is relevant is explained below.

The Supreme Court then stated the most important considerations regarding the participation costs. In 2018 the Supreme Court had ruled that participation costs are only those costs that, assessed according to objective standards, have a direct causal connection with the acquisition or sale of a subsidiary. This is the case if the costs are incurred due to the acquisition or sale of a participation, in the sense that without the acquisition or sale the costs would not have been incurred.

Our highest court has now clarified that the required direct causal connection includes a condition that those costs are causally connected to the sale or acquisition in such a way that these were incurred because they – from an objective perspective – are useful or necessary to realize that sale or acquisition. There is no such connection in the case of costs which, although they would not have been incurred if the sale or acquisition had not taken place, cannot otherwise contribute in any way to realizing the sale or the acquisition. These costs are not useful or necessary for realizing the sale or acquisition. The farewell bonuses in these proceedings are not participation selling costs, because they were not paid out with the intention of realizing the sale of the participation. The farewell bonuses were only the result of the sale.

The Supreme Court settled the case itself and ruled that the EUR 1,371,534 is deductible. This is the amount that was paid to the employees of the Dutch participation. It is not entirely clear why the amounts that were paid to the employees of the foreign participations are non-deductible.

KPMG Meijburg & Co comments

The judgment provides more clarity on what should and should not be understood under participation costs. Costs that in no way contribute to realizing an acquisition or a sale are not participation costs. These are in any case all costs arising from decisions taken after the acquisition or sale of a participation (‘the non-essential costs’). However, many costs will be necessary (‘the essential costs’) or will in some way contribute to realizing the sale or acquisition of a participation (‘the useful costs’). These costs do qualify as participation costs. But in our view, these costs – if they also contribute to another goal (for example financing the acquisition of a participation) – will also partly have to be attributed to that other goal.

The judgment also makes clear that the costs for bonuses that are paid to employees of a participation as part of the acquisition or sale of that participation do not automatically belong at the company that is the employer (the participation). This seems to be the case if the bonus arises from the employment contract. In other cases, the costs may belong at the shareholder level and it then has to be assessed whether they are participation costs. Ensuring that a farewell bonus for personnel is deductible is thus an exacting process.

Feel free to contact us if you would like to know more about participation costs.

KPMG Meijburg & Co
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