

Scheme for participations falling below the 5% threshold also applies to covered call options

On Friday, October 25, 2024 the Dutch Supreme Court ruled in [a judgment](#) that the 'Falcons doctrine' means that the scheme for participations falling below the 5% threshold also applies to covered call options whereby the interest has fallen below 5% (and the participation exemption thus applies). Below we take a more in-depth look at this judgment.

The case

Facts

In 2014 shares and covered call options in the Japanese company A were issued to the taxpayer. The shares represented a shareholding of 8.5%. The covered call options gave a right to acquire a shareholding of 5%. In November 2015 the taxpayer waived some of the options. The remaining options only gave a right to acquire a shareholding of 2.34%. In March 2017 the Japanese company A was listed on the Tokyo Stock Exchange, diluting the taxpayer's shareholding to 2.28%. After the listing on the stock exchange, the option only gave a right to acquire a shareholding of 1.58%. After the IPO, the taxpayer exercised the call options, realizing a profit on them. The taxpayer applied the participation exemption to this profit pursuant to the scheme for participations falling below the 5% threshold as contained in Section 13(16) Corporate Income Tax Act 1969.

The question before the Court

In dispute before the Supreme Court was whether the scheme for participations falling below the 5% threshold applies to the result realized on exercising the call options. The dispute revolved around the question whether the Falcons doctrine has an effect on the scheme for participations falling below the 5% threshold. The taxpayer believes it does. The Deputy Minister of Finance believes it does not because, according to him, a participation falling below the 5% threshold requires that the interest qualified as a participation before it fell below 5%, and he believes that call options as such are never a participation (see also [Policy Statement on the Participation Exemption](#), section 2.16.3).

The Dutch Supreme Court judgment

The Supreme Court reiterated that the aim of the participation exemption is to prevent the same profit being taxed twice in participation relationships. The Supreme Court had previously ruled on this in the Falcons judgment. This aim means that if the interest in a share belonging to a participation is split up, as is the case when an option is written, the participation exemption should be applied at both the option writer and the option holder, so that the participation exemption applies to all the benefits and drawbacks of that share (the Falcons doctrine).

The Supreme Court then addressed the question whether the Falcons doctrine also has an effect on the scheme for participations falling below the 5% threshold. The Supreme Court found that if both the option writer and the option holder are (via the Falcons

doctrine) eligible for the participation exemption, it is then consistent with the intent of the participation exemption expressed in the Falcons judgment that both parties may apply the scheme for participations falling below the 5% threshold (provided that the other conditions of the scheme are also met). The Supreme Court noted that this is also in line with the rationale of the scheme. The Supreme Court thus ruled in favor of the taxpayer.

KPMG Meijburg & Co comments

This judgment makes clear that, via the Falcons doctrine, the scheme for participations falling below the 5% threshold may also apply to covered call options whereby the interest has fallen below 5%. The scope of the participation exemption has thus been defined more precisely.

It is noteworthy but unfortunate that the Supreme Court skillfully avoided answering the principal question of whether a split interest in itself constitutes a participation. This, despite the fact that both parties had expressly asked that question. It is therefore still unclear whether a shareholding and a split interest can be added together. For example, a shareholding of 3% and an interest via options of 3%. And what is also not yet clear is whether a split interest has affiliation or equivalence effect. Does a participating loan fall under the participation exemption if the holder of such a participating loan also has a covered option of 5% of the shares in the debtor?

If you would like to know more about this matter, feel free to contact us or your usual Meijburg tax advisor.

KPMG Meijburg & Co
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