Executive summary

The revised treaty between Zambia and Netherlands, (the 2015 Treaty or the Treaty) which was signed on 15 July 2015, entered into force on 31 March 2018. The provisions of the 2015 Treaty will become effective as from 1 January 2019. The Treaty will supersede the earlier agreement that had been signed by the two countries in 1977 (the 1977 Treaty).

Similar to the 1977 Treaty, the 2015 Treaty borrows heavily from the Organisation for Economic Co-operation and Development (OECD) Guidelines. The Treaty also has some elements from the OECD’s Base Erosion and Profit Shifting (BEPS) plan, as reflected with the inclusion of a main purpose test for the eligibility of the lower rates for dividends, interest and royalties in order to curb treaty abuse. The Treaty notably, also includes elements of the United Nations Model Treaty, such as the service permanent establishment concept which was not present in the 1977 Treaty.

This Alert summarizes key provisions of the 2015 Treaty.
Detailed discussion

Permanent establishment
The definition of a permanent establishment (PE) in the Treaty has been extensively expanded in comparison to the 1977 Treaty to include a service PE, a natural resource as well as a territorial sea PE concept.

A service PE will be deemed to exist when the services are provided in a Contracting State for an aggregate period of 183 days or more within a twelve-month period. This is a notable difference from the provisions of the Zambian Income Tax Act which has the threshold of 90 days. An installation or structure used for the exploration of natural resources for a period not less than 183 days will also create a PE.

Moreover, the Treaty provides that carrying on offshore activities in the territorial waters of the other Contracting State for a period of more than thirty days within any twelve-month period will create a taxable presence. For purposes of the territorial PE, offshore activities do not include the preparatory and auxiliary activities that are specifically not deemed to constitute a PE under the Treaty, such as towing or anchor handling by ships primarily designed for that purpose as well as the transport of supplies or personnel by ships or aircraft in international traffic.

According to the Treaty, an independent agent will not be considered to be independent when its activities are devoted wholly or almost wholly to one foreign enterprise and the transactions between the agent and the foreign enterprise are not at arm’s length.

Business profits
Similar to the 1977 Treaty, the 2015 Treaty provides that business profits of an enterprise in one Contracting State shall be taxable in that Contracting State unless it operates through a PE in the other Contracting State, in which case only business profits attributable to such a PE would be taxed in the second Contracting State.

The profits attributable to such a PE would be the profits that might be expected to accrue to the PE if it were a separate and distinct enterprise from its head office.

The business expenses incurred including the executive and administrative expenses incurred (within or outside the Contracting State in which the PE is situated) by the PE would be allowable in the determination of the PE’s business profits. However, any royalties, fees or other similar payments and interest or similar payments paid by the PE to its head office or any of its other offices shall not be allowed as a deduction in the computation of the PE’s business profits. The limitation on the deductibility of payments to the PE’s head office or any of its other offices was not present in the 1977 Treaty.

Passive Income – Dividends, Interest and Royalties
Dividends, interest and royalties may be taxed in the state of the recipient’s country of residence. However, dividends, interest and royalties may be taxed in the Contracting State of which the payer is a resident. When taxed in the payer’s country of residence; the following withholding tax rates that would be applicable are:

<table>
<thead>
<tr>
<th>Income</th>
<th>Rate (%)</th>
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<tbody>
<tr>
<td>Dividends</td>
<td>15%</td>
</tr>
<tr>
<td>Interest</td>
<td>10%</td>
</tr>
<tr>
<td>Royalties</td>
<td>7.5%</td>
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</tbody>
</table>

As noted, the 2015 Treaty has introduced a main purpose test for the eligibility of the treaty rates with respect to dividends, interest and royalties which was not in the 1977 Treaty. The treaty rates shall not be applicable if the main purpose or one of the main purposes of effecting the transaction giving rising to the dividends, interest or royalties was to take advantage of the reduced treaty rates. The 2015 Treaty has further reduced the rate on royalties to 7.5% from 10% while retaining the 15% and 10% rates for dividends and interest respectively.

Capital gains
Generally capital gains will be taxable in the transferor’s country of residence. However, if the gains relate to immovable property situated in the other Contracting State or if the capital gains relates to movable property attributable to a PE in the other Contracting State; the capital gains may be taxed in that other state.

Currently, Zambia does not have a Capital Gains Tax (CGT). Hence, this article is only relevant for the Netherlands tax jurisdiction. It is possible that possible that a CGT may be introduced in Zambia in the future.

Income from employment
Remuneration received by a resident of a Contracting State in the other Contracting State for employment exercised therein will be taxable in the other Contracting State. In the 1977 Treaty, the taxation of income from employment had been addressed through the dependent personal services article which is not included in the 2015 Treaty.
Other income
Similar to the 1977 Treaty, items of income received by a resident of either State and not expressly addressed in the 2015 Treaty will only be taxable the recipient's country of residence. However, the 2015 Treaty adds an exemption that income from sources in the form of games of chance will be taxable in the state they are derived from.

Some of the items of income that are expressly dealt with in the 2015 Treaty and would therefore not be the subject of the “Other Income” Article include:
- Directors fees
- Entertainment and sportsmen
- Pension, annuities and social security payments
- Government service
- Student and business enterprises
- Professors and teachers

Elimination of double taxation
The Treaty provides for both the credit and exemption methods for eliminating double taxation. Tax paid by a Zambian resident in the Netherlands on income taxable in Zambia will be allowed as a credit in Zambia. In contrast, the Netherlands will exempt from tax certain items of income taxed or taxable only in Zambia. In addition, the Netherlands may also allow as a credit, tax paid in Zambia on items of income taxable in the Netherlands.

Mutual Agreement Procedure
Where a resident of one Contracting State is aggrieved by the actions of the other Contracting State; the resident may submit a case for consideration to the competent authority of his country of residence. Unlike the 1977 Treaty, the 2015 Treaty provides for a three-year limit within which the case must be submitted. The competent authorities will seek to resolve the case through mutual agreement. If mutual agreement cannot be reached within two years; then the case may be referred to arbitration. The arbitration recourse was not available in the 1977 Treaty.

Exchange of information
In the 2015 Treaty, the exchange of information clause has been expanded in comparison to the 1977 Treaty to ensure not only the provisions of the Treaty are correctly applied but also the domestic laws concerning taxes of the Contracting States are correctly applied. The information received will be treated with confidentiality and can only be disclosed in public court proceedings, in judicial decisions or to the arbitrators appointed under the mutual agreement process.

Endnotes
1. OECD Income and Capital Model Convention.
2. 5% if recipient holds 10% or more of the capital in the paying company or is a pension fund.
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