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Budget Day 2023: Real Estate Update

20 September 2023

On 19 September 2023, the Dutch government published the 2024 Budget Plan, as well as changes to tax legislation. In this update, we will summarize the latest proposals and legislative changes that will come into effect in the near future and which are relevant for the Dutch real estate market.

The Dutch government has fallen during the summer and is now functioning as a caretaker government. Even though a caretaker government usually submits fewer legislative proposals because proposals on controversial topics cannot be submitted by a caretaker government. Nearly all tax measures concerning real estate were considered non-controversial.

Budget Day Proposals

Cancellation of the RETT concurrence exemption for certain share deals

4% RETT will be due on share deals for newly built real estate that is used for VAT exempt purposes such as residential real estate. The measure should enter into force as from 1 January 2025. A transitional regime will apply for certain ongoing development projects. This measure was already announced earlier and has now been included in the 2024 Budget Plan.

Currently, newly built real estate can be acquired without VAT or real estate transfer tax (**RETT**), by acquiring all the shares in the relevant real estate company (**REC**), as the transfer of such shares is out of scope of VAT and exempt from RETT. This RETT exemption follows from the so-called Transparency-rulings, in which the Supreme Court ruled that the RETT concurrence exemption also applies to a share deal if the concurrence exemption would have applied to a direct transferof real estate (asset deal). A direct transfer of newly built real estate is taxed with VAT and benefits from the RETT concurrence exemption. The share deal strategy is used often by developers of properties with VAT exempt lease, such as residential or healthcare.

The Dutch government considers the difference in taxation between asset deals and share deals a disturbance of the level playing field and intends to resolve it by levying RETT on certain share deals.

To this end, the government proposes to abolish the RETT exemption for share deals of RECs owning building land and newly built real estate that is (partly) used for VAT exempt purposes.

RETT exemption remains for real estate used for VAT taxed purposes

The RETT exemption will not be abolished for acquisitions of shares in companies owning new real estate that is used for activities allowing at least 90% VAT recovery in the two years following the acquisition. Reasoning behind this exception is that the RETT proposal is aimed at countering VAT saving structures, and such VAT savings are not considered a motive for a share deal in case of at least 90% VAT recovery for the real estate asset. Consequently, share deals with newly built logistical, office and retail real estate should in most cases still qualify for the RETT exemption, as these types of assets are often rented out VAT taxed for at least 90%.

New RETT rate of 4%

To prevent overkill with this proposal, a new RETT rate of 4% will be introduced which will apply to acquisitions of shares in companies with building land and new real estate for which the VAT recovery right is less than 90%. During the construction of this new real estate at least part of the VAT on construction costs is not recoverable, justifying a lower RETT rate than the general rate of 10.4%.

Transitional law

Lastly, there will be transitional law for ongoing development projects. Acquisitions of shares in companies owning building land or newly built real estate will qualify for the RETT exemption if a letter of intent was agreed in writing with the intended buyer before 19 September 2023, 15:15 hours, provided that the acquisition of the shares takes place ultimately on 1 January 2030. In order to apply for the transitional law acquirers should file a notification with the Dutch tax authorities within 3 months from 1 January 2024. Further, it should be plausible that the conclusion of the letter of intent is not mainly aimed at making use of the transitional law.

Abolishment of direct real estate as qualified investment for fiscal investment institutions

A company can, under conditions, qualify for the fiscal investment institution regime (*FBI-regime*) resulting in a 0% corporate income tax rate and a mandatory annual distribution of profits subject to generally 15% Dutch dividend withholding tax. As of 1 January 2025, a fiscal investment institution may no longer hold *direct* investments in Dutch real estate. Consequently a *direct* investment in **Dutch** real estate would result in the loss of the fiscal investment institution status. A fiscal investment institution can still hold *direct* investments in non-Dutch real estate and *indirect* investments in (Dutch) real estate owned by a regular taxpayer. Under the proposed rules, an FBI is allowed to hold and manage a regularly taxed subsidiary company engaged in real estate development of non-Dutch real estate or Dutch real estate held by an affiliated entity that is a regular taxpayer (i.e. an *indirect* investment in Dutch real estate). A similar provision is proposed for ancillary services. The current 60% financing limit for (non-Dutch or indirect) real estate investments will remain in place. In order to enable FBIs to restructure in anticipation of the new rules, the proposed measures include a temporary real estate transfer tax exemption applicable in the year 2024 that can be applied to restructurings carried out in anticipation of the entry into force of the above measure.

Entity classification rules for Dutch and foreign entities

The current Dutch tax classification rules for Dutch and foreign entities (such as partnerships) are quite unique and deviate from international standards. In particular, this has caused ‘hybrid entity mismatches’ in an international context. It is now proposed to overhaul the Dutch tax classification rules for Dutch and foreign entities to bring them more in line with international standards.

Current entity classification rules
Currently, the Netherlands applies very specific entity classification rules to determine whether a limited partnership (either Dutch or foreign) is considered transparent or non-transparent for Dutch tax purposes. The decisive criterion is whether accession or substitution of a limited partner requires unanimous consent of all (general and limited) partners (the 'consent requirement'). Only if such unanimous consent is required (and in practice obtained), a limited partnership is classified as transparent for Dutch tax purposes. In practice, this means that foreign limited partnerships are often treated as non-transparent from a Dutch tax perspective. Since foreign limited partnerships are considered transparent in many countries, but non-transparent from a Dutch tax perspective, this results in 'hybrid' entities.

New rules for Dutch partnerships
As of 1 January 2025, it will be codified in Dutch tax law that all Dutch partnership are transparent for Dutch tax purposes. Non-transparent Dutch limited partnerships (CV) and other types of non-transparent Dutch partnerships cease to exist.

Foreign entities
The Netherlands currently applies the 'similarity approach' to classify foreign entities. In short, this approach means that one looks at the most similar Dutch equivalent of the foreign entity ('corporate resemblance') to determine the Dutch tax position thereof.

Under the proposal, the similarity approach would remain in force as primary classification rule and would be codified in Dutch tax law. However, due to the revised rules for the Dutch partnership, which would become per se transparent (without consent requirement), many hybrid mismatches will disappear as the Netherlands (in line with most other jurisdictions) would then also regard a foreign partnership as transparent for tax purposes.

For certain situations where the similarity approach does not provide a solution, there would be two new rules:

- For entities with no clear Dutch equivalent, the 'symmetry approach' would apply. This means that the foreign entity would for Dutch tax purposes be classified as non-transparent if in the jurisdiction that treats the foreign entity as tax resident, the assets and liabilities as well as income and expenses are attributed to the foreign entity.
- For foreign entities with no clear Dutch equivalent and which are based in the Netherlands, the 'fixed approach' would apply. This means that the foreign entity based in the Netherlands would always be classified as non-transparent entity for Dutch tax purposes, thus becoming a Dutch domestic taxpayer.

Entity classification rules for funds for joint account
In addition, it is proposed to change the tax classification rules applicable to Dutch funds for joint account (FGR) as of 1 January 2025.

To date, an FGR can be classified as tax transparent or tax non-transparent. There are currently three types of FGRs, in short: (i) an FGR in which participations are only transferable to other participants with unanimous consent (transparent), (ii) an FGR in which the participations can only be repurchased by the FGR or transferred to certain close-related family members (transparent) and (iii) an FGR with transferable participations (non-transparent).

It is now proposed that as of 1 January 2025, an FGR may only be non-transparent, if it is (i) regulated following the Dutch Financial Supervision Act (Wet op het financieel toezicht) and (ii) the participations in the FGR are tradeable. In case the participations in an FGR can solely be repurchased by the FGR, the participations would be deemed to be non-tradeable and thus such FGR will be classified tax transparent, even when it is regulated.

Transitional rules

The aforementioned changes mean that non-transparent partnerships and FGRs would be deemed to realise any capital gains in their assets (i.e., a tax triggering moment) when becoming transparent. Similarly, the partners/members in non-transparant partnerships and FGRs are deemed to realise their investment. In practice, this could result in tax becoming due without cash being generated. Therefore, several facilities are proposed to apply as from 1 January 2024: (i) rollover facilities, (ii) a share-for-share merger facility (including a real estate transfer tax (RETT) exemption), or (iii) a deferred payment obligation (spread out over ten years). Any restructurings using those facilities can be carried out during the year 2024 to avoid the tax triggering moment on 1 January 2025. The RETT exemption however only applies in the case of CVs and FGRs that were already in existence on 19 September 2023 at 15:15.

Changes to VBI-regime

Subject to certain strict conditions, certain investment entities can apply the VBI-regime which results in a tax-exempt position for corporation tax and dividend tax. In line with the proposed changes to the FGR classification rules, the VBI-regime will be amended in such a way that only entities regulated pursuant to the Dutch Financial Supervision Act can apply for the VBI-status. Generally, this means that the VBI-regime will no longer be available to family-owned investment vehicles as of 1 January 2025.

Extension of certain investment allowances

The Energy Investment Deduction (EIA), the Environmental Investment Deduction (MIA) and the Arbitrary depreciation of environmental investments (Vamil) are currently available until 31 December 2023. Following generally positive evaluations of these investment allowances, it is proposed to extend these measures to at least 31 December 2028. With respect to the EIA, the deduction percentage will be reduced from 45.5% to 40.5% as of 1 January 2024 due to budget overruns.

Leased real estate to qualify as investment for business succession scheme

The government proposes to consider real estate that is rented to third parties, or parts thereof, as investment asset for the application of the business succession scheme and the income tax deferral scheme, which will mean that these schemes can no longer apply to such real estate. This applies not only in case of actual renting out at the time of acquisition, but also when the property is intended to be rented out or made available to a third party. To the extent the property is financed by debt, these debts are also classified as investment assets.

Real estate used within the ‘own company’ remains part of the company assets and may qualify for the scheme. The same applies (in short) to real estate leased to another company in which the testator or donor has a direct or indirect substantial interest (at least 5%).

If the real estate, or parts thereof, is made available to another person on a time-proportional basis for 10% or less, the measure does not apply.

Temporary rental of real estate in the service sector, such as hotels, pubs, restaurants, tennis courts, bowling alleys and squash courts, are not covered by the measure. Such real estate is therefore not considered as investment asset by default.

Legislation to come into effect per 2024

In addition to the proposals noted above, a number of legislative proposals were already fully adopted and will come into effect automatically as per 2024.

Conditional withholding tax on dividends

As per 1 January 2024, legislation to introduce a conditional withholding tax on dividend payments (and other types of profit distributions) enters into force. The conditional withholding tax will apply to dividends made to low-taxed jurisdictions and/or jurisdictions included on the EU-blacklist, to certain hybrid entities and in certain situations that are considered abuse.

The conditional withholding tax on dividends will be integrated in the Withholding Tax Act 2021, which currently covers intra-group interest and royalty payments only. The rate is set at the headline corporate income tax rate, which will be 25.8% in 2024, which may result in an increase of Dutch withholding tax exposure on dividends to 25.8%.

As far as Dutch cooperatives are concerned, contrary to the existing Dutch dividend withholding tax, intra-group dividend payments made by all Dutch cooperatives (including by so-called non-holding cooperatives / property cooperatives) are in scope of the conditional withholding tax on dividends.

Changes to substantial shareholding regime

The tax rate for the substantial shareholding regime (box 2) will be divided in two brackets. A rate of 24.5% will apply to the first EUR 67,000 of income and 31% for the exceeding amount, per 1 January 2024. Currently, a flat rate of 26.9% applies. This is relevant for all individuals that derive income from entities (e.g. real estate entities) in which they hold a substantial interest (in principle more than 5%).

Other changes announced as per 1 January 2024 and later years

Residential real estate

On 27 February 2023, the Minister of Housing published the draft ‘Affordable Rent Act’ (*Wet betaalbare huur*). This Act regulates mid-market rents and amends the current rent regulation. At the time the Act was published, it was the intention that the Act would enter into force on 1 January 2024. With the collapse of the Dutch government on 6 July 2023, it became unclear what implications the collapse would have on the (enforcement of the) Act. On 12 September 2023, Parliament has determined that this Act is not a controversial legislative proposal, meaning that Parliament will continue to process the Act. However, it is yet unclear whether a majority in Parliament will vote for the Act, since the coalition agreement between the governmental parties is no longer in place and after the elections of 22 November 2023, a new House of Representatives will be installed.

If you are interested in more information on the Afforable Rent Act, please be referred to our earlier blog via this link.

Limitation interest deduction (earnings stripping rule)

The deductibility of interest under the earnings stripping rule is proposed to be tightened by eliminating the EUR 1,000,000 threshold for companies owning real estate that is leased to third parties.

Under the earnings stripping rule as currently applicable, the deductibility of net interest expenses (i.e. the balance of interest costs and interest income including foreign exchange results on the loans) is limited for corporate income tax purposes to the highest of: (i) 20% of the fiscal EBITDA (formerly 30%), and (ii) a threshold of EUR 1,000,000. The ratio is applied at taxpayer level (in case of a fiscal unity at fiscal unity level). No distinction is made between intra-group and third-party interest and costs.

Upon introduction of the earnings stripping rule, the Dutch Ministry of Finance acknowledged that related entities could apply the EUR 1,000,000 threshold multiple times. However, the Dutch legislator had already announced that, should the splitting up of assets across multiple entities occur often in practice, anti-fragmentation rules may be introduced.

In April 2023, the Dutch Ministry of Finance announced an amendment of the earnings stripping rule, with a view to the EUR 1,000,000 threshold being disapplied to companies owning real estate leased to third parties. This means that such taxpayers can only rely on the 20% EBITDA threshold for deduction of interest expenses. This is a (further) tightening of the interest deductibility rules for taxpayers engaged in the leasing of real estate.

This measure is intended to apply as of 1 January 2025. A legislative proposal is expected to be published on Budget Day in September 2024.

Limitation of the RETT demerger exemption

Earlier it was announced that the Ministry of Finance considers to make the conditions for the RETT demerger exemption stricter, making it more difficult to restructure real estate without the levy of RETT (we refer to our earlier blog via this link). This measure is not included in the 2024 Budget Day Proposals and it remains uncertain if and when a legislative proposal will follow. However, in a separate letter of the state secretary of Finance to the House of Representatives sent on Budget Day it is reiterated that this proposal is still on the table and that a legislative proposal may be drafted for consultation on short notice.

Revision of VAT on renovation services

Earlier this year, it was announced that a VAT revision period for services such as renovations and construction is considered, similar to the VAT taxed transfer of real estate (we refer to our earlier blog via this link). This measure is not included in the 2024 Budget Day Proposals and it remains uncertain if and when a legislative proposal will follow. However, in a separate letter of the state secretary of Finance to the House of Representatives sent on Budget Day it is reiterated that this proposal is still on the table and that a legislative proposal may be drafted for consultation on short notice.

RETT exemption for land swaps

The RETT exemption for land swaps (*kavelruil, formerly land consolidation, ruilverkaveling*) can be applied to acquisitions that take place under the Rural Area Development Act (*WILG*) and from 1 January 2024 onwards under the Environment Act (*Omgevingswet*). This includes land consolidation by agreement (voluntary parcel exchange). The objective of the exemption is that RETT does not hinder the realisation of a structural improvement of rural areas. In a separate letter of the state secretary of Finance to the House of Representatives sent on Budget Day it is stated that the Ministry of Finance considers making the conditions for this RETT exemption stricter, as signals from the tax authorities show that parties outside the intended target group are using this exemption purely to gain a tax advantage.

Contacts

For more information, please contact your trusted Loyens & Loeff adviser.

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