LOYENS & LOEFF

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Newsletter
Focus Real Estate

In this edition

→ The EU Taxonomy: what about real estate activities?

→ ATAD 3- what to expect for the real estate sector?

→ VAT Titanium case: a building alone cannot constitute a permanent establishment for VAT purposes

→ News from our home markets

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Introduction

Dear Friends,

This newsletter is aimed at informing you about the legal, tax and regulatory developments, relevant for your business, in the Benelux and in Switzerland.

In this newsletter with a focus on real estate, you will learn more on:

1. The EU Taxonomy: what about real estate activities?
2. ATAD 3- what to expect for the real estate sector?
3. VAT Titanium case: a building alone cannot constitute a permanent establishment for VAT purposes
4. News from our home markets

   - **Belgium**
     - Renovation obligations in the Flemish Region: the governmental agenda for the period 2020-2050
   - **Luxembourg**
     - Luxembourg real estate levy: New Circular from the Director of the Luxembourg Tax Authorities
   - **The Netherlands**
     - Expansion of the conditional withholding tax to Dutch real estate held by foreign entity
     - Amendments to the classification of (foreign) partnerships
     - Increase of the real estate transfer tax rate
     - Budget increases for certain investment allowances
     - Dutch Supreme Court denies interest deduction in acquisition structure
     - Tightening of the earnings stripping rules
     - Increased headline corporate income tax rate and conditional withholding tax rate
   - **Switzerland**
     - Regulatory restrictions for acquisition of real estate
     - Leading case on transfer pricing for real estate development projects
     - Leading case on requirements for tax neutral restructuring of real property

We wish you a pleasant reading and hope to see you soon.

Imme Kam
Partner, Paris office

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The EU Taxonomy: what about real estate activities?

ESG is no longer merely a buzz word but has become a driving force behind many developments in the market. The real estate sector will not escape that trend. To support genuinely sustainable investments, the EU has developed a classification system of multiple economic activities to enable the identification of activities that are environmentally sustainable. Such classification is embedded in the EU Taxonomy Regulation (Regulation (EU) 2020/852 (Taxonomy) on the establishment of a framework to facilitate sustainable investment) which also imposes additional disclosures obligations that apply since 1 January 2022. Only 102 economic activities are yet classified under the Taxonomy Regulation including some real estate activities.

The role and position of the European Taxonomy in the ESG regulatory framework

The EU taxonomy is a classification system, establishing a list of environmentally sustainable economic activities. The EU's goal is that this classification system will be the corner stone for the development of sustainable investments and implementation of the European Green Deal. The aim is to fight greenwashing and make sure that significant investments oriented towards sustainable investment serve activities that are genuinely environmentally sustainable.

In addition to the classification, the Taxonomy Regulation extends the existing disclosure obligations under the Non Financial Reporting Directive ('NFRD') and the Sustainable Finance Disclosure Regulation ('SFDR'). As a result, companies and asset managers will have to report the percentage of their turnover, capital expenditures and operational expenditures aligned with the EU taxonomy. Asset managers will also have to report the percentage of their portfolio invested in activities aligned with the EU taxonomy.

The Taxonomy Regulation does not impose any obligation on companies or investors to invest (even partially) in sustainable taxonomy aligned activities. It adopts a comply or explain principle based on disclosure regarding the taxonomy alignment of a company's activities or of financial products. However, it is expected that the EU definition of sustainable investment will become an increasingly important benchmark for future investments. As a matter of example, the existing voluntary standards for Green Loans or Green Bonds, such as LMA or ICMA-standards are not linked to the EU Taxonomy definition of sustainable investment. The EU Commission is currently working on a voluntary EU Green Bond Standard which would require the raised funds to be allocated only to taxonomy aligned projects.

Taxonomy aligned sustainable activities

The Taxonomy Regulation establishes four conditions for an activity to be considered sustainable. The activity:

1. must contribute substantially to at least one of the six environmental objectives defined in Article 9 of the Taxonomy Regulation
   Currently, the following six environmental objectives are included in the EU Taxonomy Regulation:
   (i) climate change mitigation; (ii) climate change adaptation, (iii) sustainable use and protection of water and marine resources, (iv) transition to a circular economy, (v) pollution prevention and control, (vi) protection and restoration of biodiversity and ecosystem.
2. may not significantly harm any other environmental objective listed in 1

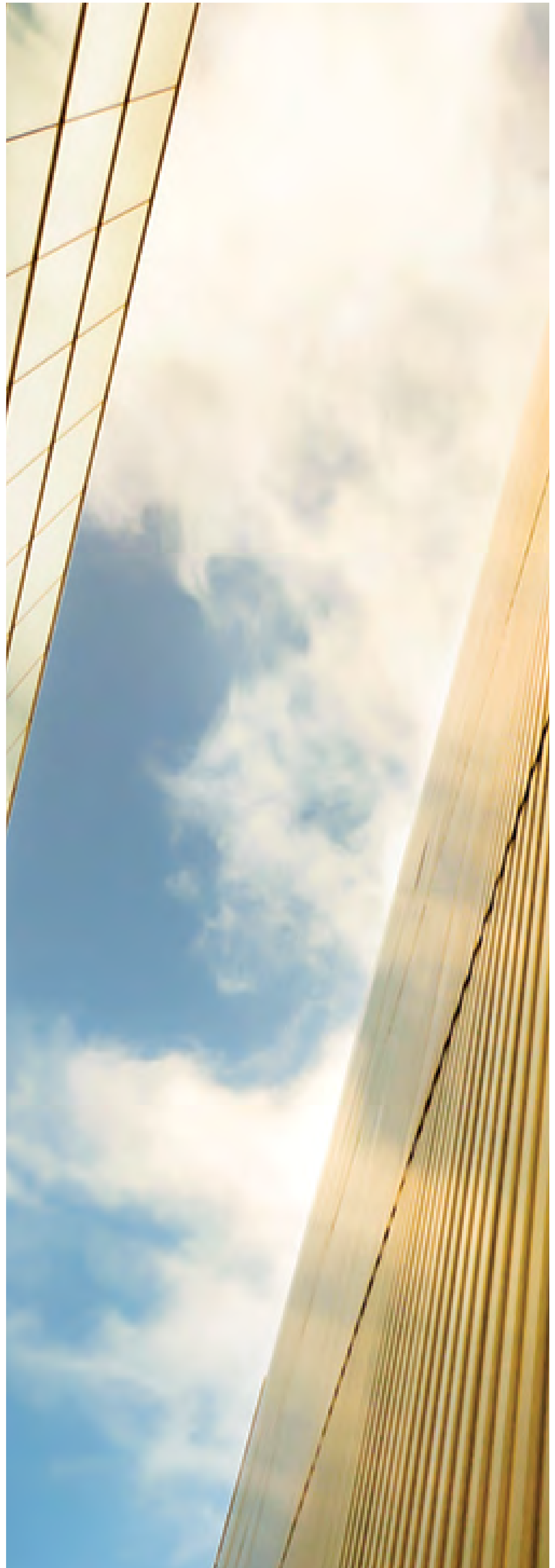
3. must meet minimum social standards

For an economic activity to be considered taxonomy-aligned the activity must be caried out in compliance with the minimum safeguards (social standards) laid down in the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work, the eight fundamental conventions of the ILO and the International Bill of Human Rights.

4. must comply with the technical screening criteria established by the Commission (the "TSCs").

The EU Taxonomy Climate Delegated Act implementing the TSC for the first two environmental objectives has been published in the EU Official Journal in December 2021. This long-awaited publication was the last requirement preventing the additional disclosure obligations imposed by the Taxonomy Regulation from being applied in practice.

Currently only for the first two objectives there are technical screening criteria available, enabling market participant to in concreto assess for approximately 102 activities whether they meet the required technical standards to substantially contribute to one of the first two environmental objective and / or not significantly harm any of the other objectives. **Several real estate activities are already included in this first list with TSCs.**



What are the Construction and real estate activities that are taxonomy aligned?

TSC are available for the following real estate activities for which it is therefore possible to assess under which conditions these activities are EU taxonomy aligned:

- construction of new buildings;
- renovation of existing buildings;
- acquisition and ownership of buildings; and
- installation, maintenance and repair of some specific energy related infrastructure such as (i) energy efficiency equipment, (ii) charging stations for electric vehicles in buildings (and parking spaces attached to buildings), (iii) instrument and devices for measuring, regulation and controlling energy performance of buildings, and (iv) renewable energy technologies.

Below we explore some of the conditions put forward for the above real estate activities to be taxonomy-aligned, with a specific focus on the requirements regarding climate mitigation.

Construction of new buildings

Construction of new buildings contributes to climate change mitigation if the new building benefits from a very low energy performance (10% lower than the threshold set for the nearly zero-energy building requirements in national measures) confirmed in an Energy Performance Certificate, testing for airtightness and thermal integrity (and to be disclosed to investors and clients).

Moreover, the new buildings must meet so-called “do no significant harm” criteria in the field of climate adaptation, water, circular economy, pollution prevention and biodiversity.

To substantially contribute to the climate change adaptation objective, new buildings should amongst others implement physical and non-physical solutions (‘adaptation solutions’) that substantially reduce the most important physical climate risks that are material to that activity. For the physical climate risks that are material a robust climate risk and vulnerability assessment should be performed.

Renovation of existing buildings

To substantially contribute to climate change mitigation, a building renovation should comply with the applicable requirements for major renovations as set in the applicable national and regional building regulations for ‘major renovation’ implementing Directive 2010/31/EU. Alternatively, the renovation must lead to a reduction of primary energy demand (PED) of at least 30%. The 30% improvement results from an actual reduction in primary energy demand (where the reductions in net primary energy demand through renewable energy sources are not taken into account) and can be achieved through a succession of measures within a maximum period of three years.

As far as climate change adaptation is concerned, the renovation of a building must meet the same requirements as the construction of a new building.

Acquisition and ownership of buildings

When buying real estate and exercising ownership of real estate, the EU taxonomy requires that buildings built before 31 December 2020 have at least an Energy Performance Certificate (EPC) class A to substantially contribute to climate change mitigation. Properties that belong to the top 15% of the national or regional building stock expressed as operational Primary Energy Demand will also be considered as sustainable. For buildings built after 31 December 2020, the building must meet the criteria as specified for new buildings at the time of the acquisition.

A large non-residential building (with an effective rated output for heating systems, systems for combined space heating and ventilation, air-conditioning systems or systems for combined air-conditioning and ventilation of over 290 kW) is considered as being efficiently operated through energy performance monitoring and assessment.

Installation, maintenance and repair of energy efficiency equipment

Installation, maintenance and repair of energy efficiency equipment contribute to climate change mitigation when (i) they comply with minimum requirements set for individual components and systems in the applicable national measures implementing Directive 2010/31/EU and (ii) the installation consists of addition of insulation to existing envelope components, such as external walls (including green walls), roofs (including green roofs), lofts, basements; replacement of existing windows or doors with new energy efficient windows or doors; installation and replacement of energy efficient light sources; installation, replacement, maintenance and repair of HVAC and water heating systems, highly efficient technologies; …

Installation, maintenance and repair of charging stations for electric vehicles in buildings (and parking spaces attached to buildings)

As an "enabling activity" the installation and maintenance of charging stations for electric vehicles in buildings and parking spaces can substantially contribute to climate change mitigation if the activity:

- does not lead to a lock-in of assets that undermine long-term environmental goals, considering the economic lifetime of those assets; and
- has a substantial positive environmental impact, on the basis of life-cycle considerations.

While not required to substantially contribute to climate change mitigation, for this activity to substantially contribute to climate change adaptation the charging stations cannot be installed in buildings dedicated to extraction, storage, transport or manufacture of fossil fuels.

Installation, maintenance and repair of instruments and devices for measuring, regulation and controlling energy performance of buildings

This activity includes individual measures such as installation, maintenance and repair of:

- zoned thermostats, smart thermostat systems and sensing equipment, including motion and day light control;
- building automation and control systems, building energy management systems (BEMS), lighting control systems and energy management systems (EMS);
- smart meters for gas, heat, cool and electricity; and
- façade and roofing elements with a solar shading or solar control function, including those that support the growing of vegetation.

For the applicable technical requirements, see more information in the EU Taxonomy Compass (see below).

Installation, maintenance and repair of renewable energy technologies

This concerns individual measures such as the installation, maintenance and repair of:

- solar photovoltaic systems and the ancillary technical equipment;
- solar hot water panels and the ancillary technical equipment;
- wind turbines and the ancillary technical equipment;
- heat exchanger/recovery systems; …

For the applicable technical requirements, see more information in the EU Taxonomy Compass (see below).

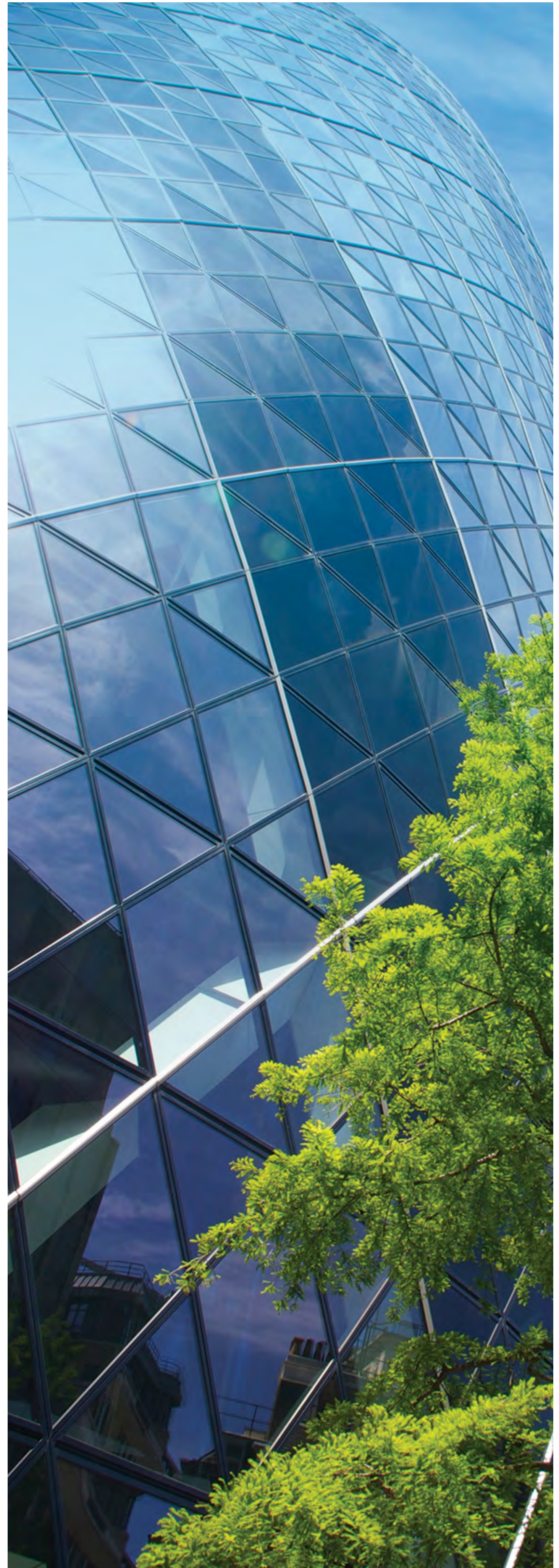
What is the EU Taxonomy Compass?

To make the contents of the EU Taxonomy legislation more accessible, the EU Commission launched the EU Taxonomy Compass. This practical tool provides a visual representation of the contents of the EU Taxonomy.

For the activities already included in the first EU Taxonomy Climate Delegated Act it enables users to check which activities are taxonomy-eligible activities, to which objectives they substantially contribute and what criteria they have to meet, as well as under which conditions the activity at hand does not significantly harm any of the other environmental objectives.

The EU Taxonomy Compass will be updated to include future delegated acts specifying technical screening criteria for additional economic activities substantially contributing to the climate objectives and the other environmental objectives of the Taxonomy Regulation as soon as the required TSCs are officially agreed upon.

You can access the EU Taxonomy Compass to check the sustainability conditions applicable to all the real estate activities listed above at the following weblink.



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ATAD 3: what to expect for the real estate sector?

The European Commission has deposited a proposal for a Council Directive laying down rules to prevent the misuse of European shell entities for tax purposes (ATAD 3). This proposal is one of the initiatives to improve the current tax system with a focus on ensuring fair and effective taxation. If adopted, ATAD 3 might have immediate consequences as it proposes applying a 'reference period' of the two preceding years to assess substance. Since the proposal foresees 1 January 2024 as the date of entry into force, this reference period may already have started as of 1 January 2022.

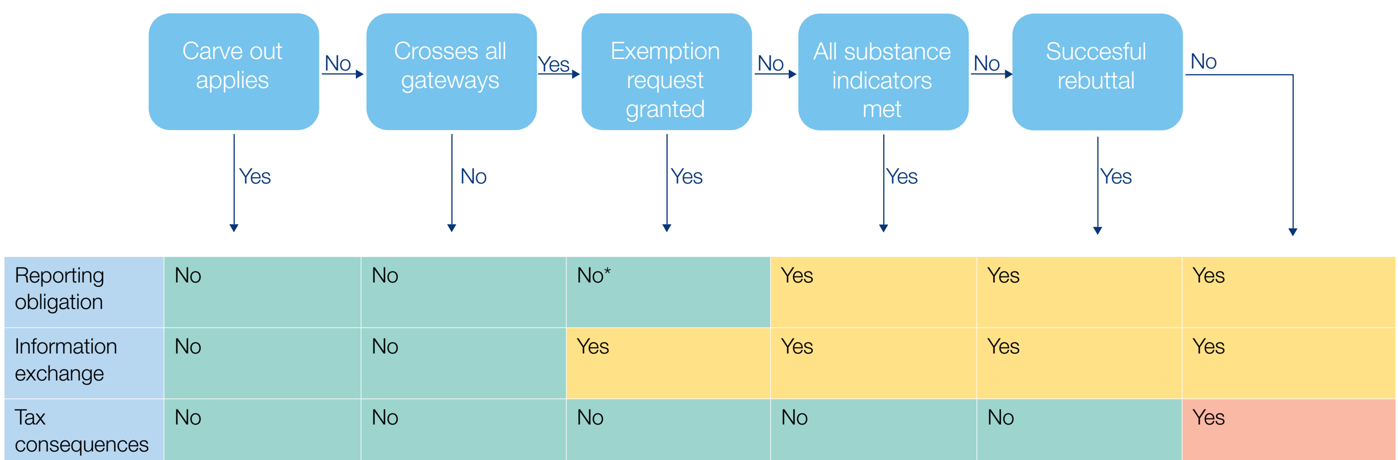
Below we describe this proposal in more details and from a real estate sector perspective.

ATAD 3 in a nutshell

What is the general purpose?

The purpose of ATAD 3 is preventing tax avoidance and evasion using shell entities. To this end, common rules are introduced to identify EU undertakings that are at risk, to impose a reporting obligation to low substance entities, and in case the entity is deemed to be a shell and cannot rebut this presumption, to attach tax consequences to this qualification.

From the Explanatory Memorandum, it appears quickly that a common definition of "shell entity" is not an attainable goal. One can indeed read that "shell entities" are "undertakings which are presumably engaged with an economic activity but that, in reality, do not conduct any economic activities" or "undertakings that are engaged in an economic activity, but which do not have minimal substance and are misused for the purposes of obtaining tax advantages". Instead of proposing a general definition, ATAD 3 lays down indicators of minimum substance and introduces a "substance test" through a series of steps. These steps determine whether (i) a reporting obligation, (ii) an information exchange and (iii) tax consequences apply.



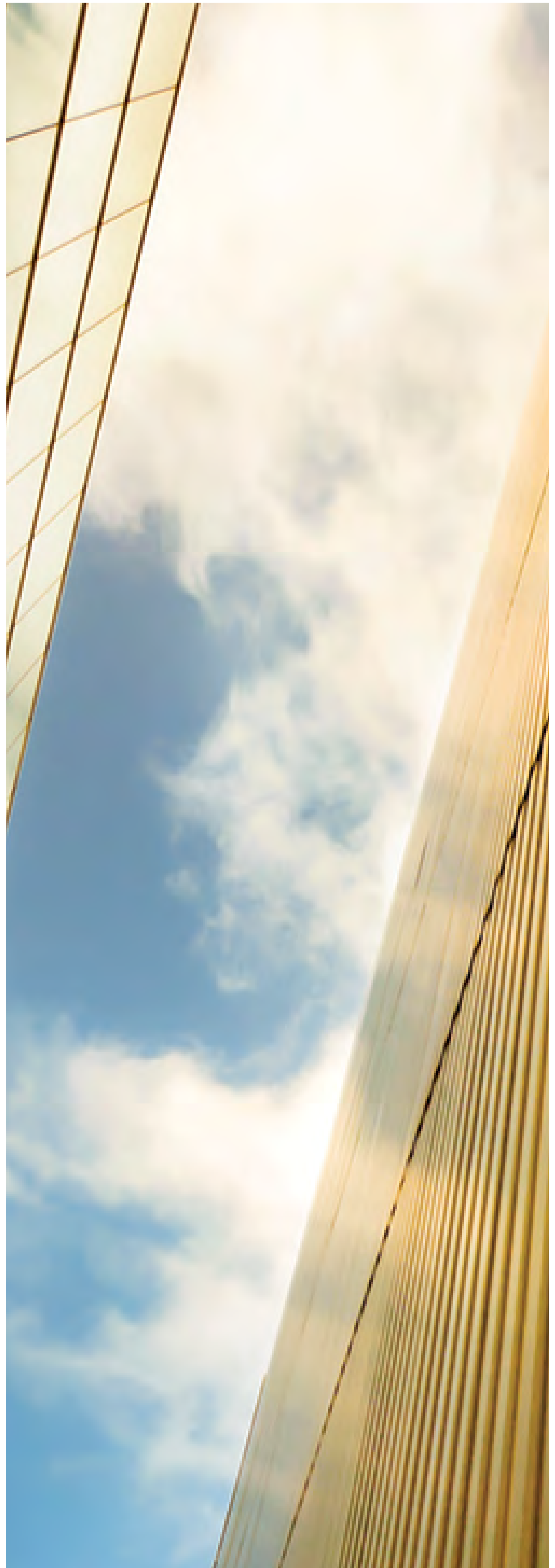
Reporting obligation	No	No	No*	Yes	Yes	Yes
Information exchange	No	No	Yes	Yes	Yes	Yes
Tax consequences	No	No	No	No	No	Yes

*In case an exemption is requested, the undertaking shall have to provide evidence thereof.

Is being outside ATAD 3 a safe haven?

ATAD 3 is about **substance** and, in case the **minimum substance requirements** are not met, the possibility of a **successful rebuttal** to avoid the tax consequences of a lack of substance. The proposal is clear on that aspect: *"where an undertaking has been found to have sufficient substance under this Directive, this should not prevent the Member States from continuing to operate anti-tax avoidance and evasion rules, provided that they are consistent with Union law."*

Based on this general statement, it remains to be seen how ATAD 3 will influence current case law and administrative positions on the concept of **beneficial ownership**. Indeed, falling outside the scope of ATAD 3 should not automatically mean that the undertaking is the beneficial owner of dividends and interest. As far as tax consequences are concerned, the proposal only provides for the (negative) consequences of a qualification as shell but does not contain any provision confirming a tax treatment in case of non-shell. Consequently, in addition to the attention to be paid to the substance criteria, one should also continue to comply with the (minimum) beneficial ownership criteria: (i) the undertaking freely determines use and enjoyment of the up-streamed income (no contractual obligation nor practice passing on (all) income received) and (ii) it uses up-streamed income to fund its operational expenses and/or new investments.



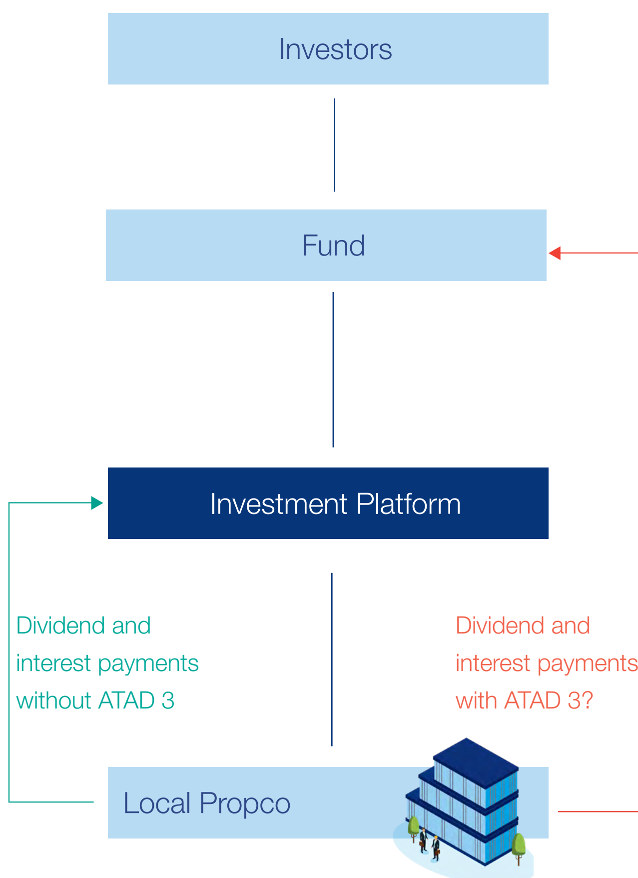
Why is ATAD 3 relevant for the real estate sector?

Many cross-border real estate investments are structured through investment platforms. Looking at these investments solely from a tax perspective, they usually allow the investors to repatriate their investment proceeds with a minimum tax leakage, **while the real estate income remains subject to taxation in the Member State where the asset is located**.

ATAD 3 might increase the tax leakage on the repatriation of investment proceeds.

Let's take three basic examples, assuming that the investment platform is a shell for which the presumption cannot be rebutted.

1st example



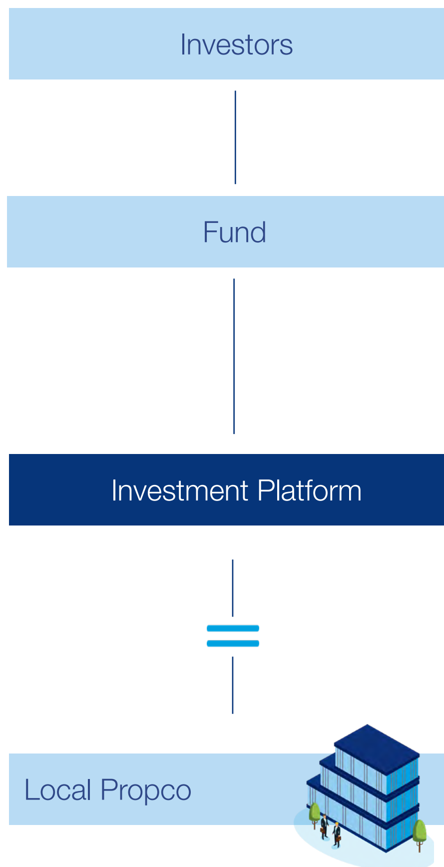
Several investors are pooled in an investment fund. This investment fund has incorporated an EU investment platform with a view to invest in European real estate via local property companies.

The acquisition, as well as the financing needs of these local property companies, are financed by a mix of equity and shareholder's debt, resulting in dividend and interest payments during the investment lifetime.

As a result of ATAD 3, the Member State of the investment platform will deny the delivery of a tax residence certificate (or will deliver a qualified certificate). Consequently, the investment platform shall lose the benefits of the EU Directives and/or tax treaties that allow an exemption or reduction of withholding taxes.

The source state, being the Member State where the property company is located, will subject these dividends and interest to withholding tax. The question remains whether this Member State will consider the shareholder when determining the applicable withholding tax (provided this shareholder is not itself a shell in an EU context).

2nd example

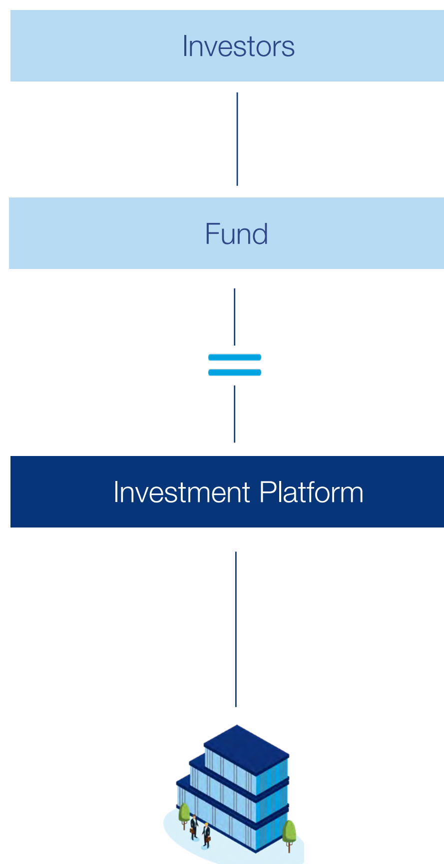


For the same structure, the exit is designed as the sale of the shares in the property company. The tax treaty entered into by the Member State of the investment platform and the Member State of the property company does not contain a real estate asset rich clause, with as a consequence that the power to tax the realised capital gain should be allocated to the Member State of the investment platform.

If the latter is a shell and is denied a tax residence certificate, it is unclear whether:

- the Member State of the property company shall only apply its own non-resident taxation rules; or
- the Member State of the property company shall first determine whether it is granted taxation rights on the basis of the tax treaty entered into with the shareholder of the investment platform (assuming the latter is not itself a shell).

3rd example



In our last example, the European real estate is directly owned by the investment platform.

During the investment lifetime, the real estate income is subject to tax in the Member State where the real estate is located. ATAD 3 should therefore not have (adverse) tax consequences, except as the case maybe for withholding tax purposes in case interest is allocated to this real estate.

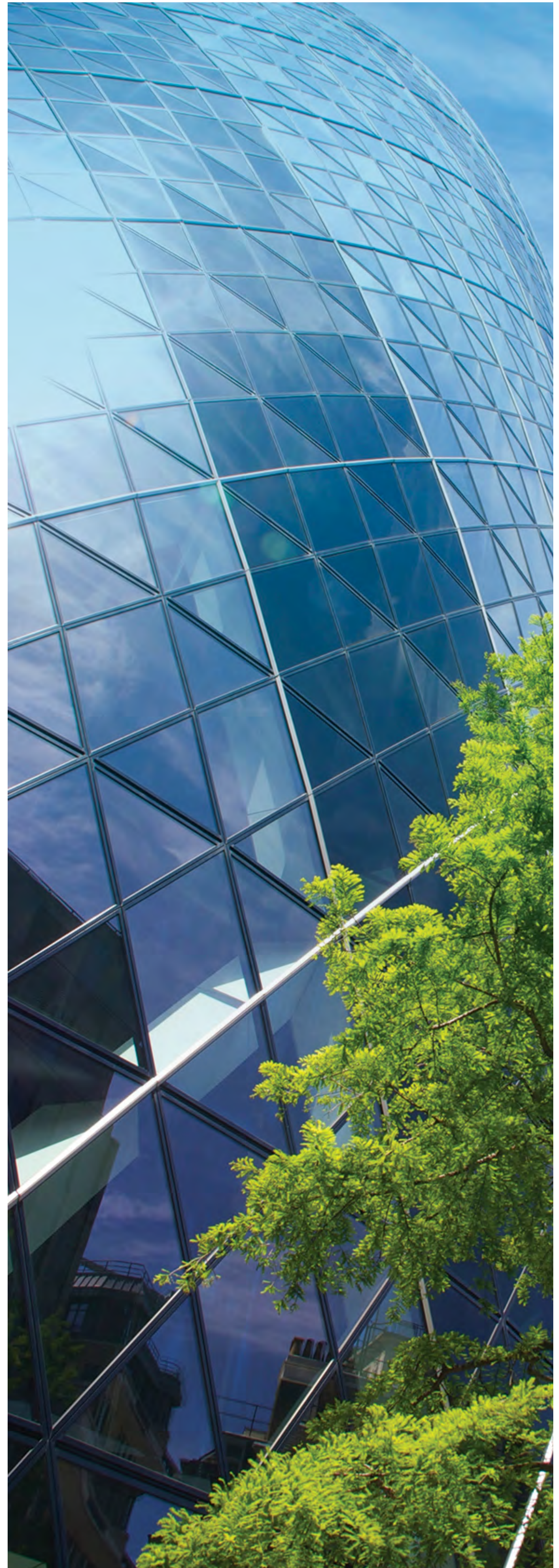
The situation on exit is more complicated in case this exit is structured by the sale of the shares of the investment platform since ATAD 3 provides that (i) the Member State where the property is located shall tax this property in accordance with its national law and (ii) the Member State of the shareholder shall tax such property as if it is owned directly by the shareholder, without prejudice to any tax treaty for the elimination of double taxation.

In case the shell is totally disregarded, it should mean that the share deal is requalified in an asset deal for direct taxation purposes.

How does ATAD 3 work?

In practice, investors and managers of real estate investment structures should answer three questions:

- Do I have a reporting undertaking? The key concept in ATAD 3 is the "**gateways**". When an undertaking does not benefit from a carve-out, it must be verified whether it crosses all gateways, which means that the undertaking is "at risk".
- If so, does it pass the minimum substance requirements? An undertaking "at risk" can demonstrate, through reporting and adequate documentation in its annual tax return, that it complies with the **minimum substance requirements** laid down in ATAD 3. In such a case, only the reporting requirement shall apply but not the tax consequences provided for in ATAD 3. As mentioned above, this is however no "safe haven". If the minimum substance requirements are not met, the undertaking is presumed to be a shell.
- Can the undertaking rebut the presumption of being a shell? Tax consequences laid down in ATAD 3 can still be avoided through the **rebuttal of the presumption**. Here as well, the undertaking will have to report and demonstrate that it is used for "valid reasons". If the presumption is successfully rebutted, the undertaking shall be obliged to report but the tax consequences will not apply. In absence of successful rebuttal, tax consequences are attached to the qualification as shell.



The gateways

ATAD 3 in principle applies to all undertakings, irrespective their legal form, that are considered tax resident in a Member State. Since the goal is however to only target "entities at risk" and to subject them to a reporting obligation, "gateways" are introduced to narrow the scope of ATAD 3. Only those non-carved-out undertakings that cross all gateways are considered at risk.

The undertakings must meet the following cumulative criteria to determine whether it goes to the next step:

- more than 75% of the revenues of the undertaking in the preceding two tax years consists of passive income including interest, royalties, dividends and capital gains, income from financial lease or real estate (defined as "Relevant Income"). When the undertaking has holding activities or owns real estate, this condition is deemed met if the book value of the assets that can generate dividends and capital gains represents more than 75% of the total book value of its assets;
- the undertaking is engaged in cross-border activities when:
    - at least 60% of the Relevant Income is earned or paid out via cross-border transactions or
    - more than 60% of the book value of the undertaking's real estate or other private property of high value are located outside the jurisdiction of the undertaking in the preceding two tax years;
- the undertaking outsourced the administration of day-to-day operations and the decision making on significant functions in the preceding two tax years.

Platforms engaged in cross-border real estate investments will most likely cross the quantitative gateways. For them, the most relevant gateway concerns **the outsourcing of the administration of day-to-day operations and the decision making on significant functions.**

The proposal insists that this criterion should point out "undertakings which have no or inadequate own resources to perform core management activities" and therefore engage third party services providers or associated enterprises. Outsourcing of certain ancillary services only, such as bookkeeping services, while the core activities remain with the undertaking, would not in itself suffice to pass this gateway.

Considering this proposal and the reference period, managers should immediately reorganise their operations – if not yet already done – to ensure the insourcing of day-to-day operations and significant functions, bearing in mind that, as the moment from all gateways are crossed, a reporting obligation kicks in.

The minimum substance requirements

When it crosses all gateways and cannot benefit from an exemption, the undertaking is subject to a reporting obligation, and it must first declare in its annual tax return whether it meets the substance indicators and provide satisfactory supporting evidence:

- the undertaking has own premises or premises available for the exclusive use of the undertaking;
- the undertaking has at least one own and active bank account in the EU; and
- at least one qualified director of the undertaking that is authorized to take decisions in relation to the activities generating the Relevant Income, is: (i) a tax resident in the Member State of the undertaking (or resides sufficiently close to the Member State to perform the duties); and (ii) is not employed by a non-associated enterprise and does not perform the function of director in another non-associated enterprise, or alternatively, the majority of the qualified full-time employees of the undertaking is tax resident in the Member State of the undertaking (or reside sufficiently close to the Member State to perform their duties).

The first minimum substance requirement, i.e., **having own premises or premises available for exclusive use**, will probably be the most debated topic in the coming weeks in the framework of the public consultation, especially in a scenario where several undertakings of the same group share the same premises. At this stage, it is advised to lease (or own) dedicated premises and, in a group scenario, to have (sub-)leases in place at market conditions.

If the undertaking provides satisfactory supporting documents, it is presumed to have minimum substance for that tax year. If the undertaking declares not to meet the minimum substance requirements, or does not provide sufficient supporting evidence, it is presumed to be a shell.

The rebuttal of the presumption

If the undertaking cannot evidence it meets the minimum substance requirements, it can still rebut the presumption of being a shell. The Explanatory Memorandum acknowledges that “there can be valid reasons for the use of such entities”. Stakeholder consultations also reveal that undertakings that could be considered to be shell companies, are not put in place to obtain tax advantages but rather for valid commercial reasons: ensuring the limitation of liability, protecting investors and maintaining the value of the portfolio, meeting the requirements of third-party lenders to ring-fence assets and liabilities, facilitating joint ventures, streamlining decision making, and providing a convenient vehicle for sale or partial sale. Most of these reasons are often seen in cross-border real estate investment structures.

ATAD 3 therefore includes a rebuttal mechanism whereby the undertaking can challenge the outcome of the previous steps, by evidencing the commercial, non-tax motives, underlying a certain structure. The presumption of being a shell may indeed be rebutted, in the Member State of the undertaking, with additional evidence on

- information on the commercial rationale behind the establishment of the undertaking;
- information on the employee profiles; and
- concrete evidence that decision-making concerning the Relevant Income generating activity takes place in the Member State of the undertaking. This evidence should demonstrate that the undertaking has performed and continuously had control over, and borne the risks of, the business activities that generate the Relevant Income or, in absence of such income, the assets of the undertaking.

The Member State of the undertaking confirms the rebuttal of the presumption for the tax year concerned and the validity of the rebuttal can be extended for another five years if the legal and factual circumstances do not change.

Carve-out and exemption

As detailed above, ATAD 3 only targets undertakings “at risk”. Consequently, a series of undertakings are explicitly carved out (and do not have to determine whether they cross the gateways) and some non-carved out undertakings that cross the gateways can request for an exemption without having to demonstrate they meet the minimum substance requirements.

The carve-out

A series of undertakings are explicitly carved-out from further obligations as they are considered being low-risk and irrelevant for the purposes of ATAD 3. These carve-outs include inter alia companies that have securities admitted to trading or listed on a regulated market or MTF and certain regulated financial undertakings like AIFs managed by an AIFMD.

Two specific carve-outs are of particular importance:

- undertakings with at least five own full-time equivalent employees or members of staff exclusively carrying out the activities generating the relevant income;
- undertakings with holding activities that are resident for tax purposes in the same Member State as the undertaking’s shareholder(s) or the ultimate parent entity (this term is defined in annex III to the Directive 2011/16/EU on administrative cooperation in the field of taxation) (the so-called **Shareholder’s carve-out**). The Shareholder’s carve-out requires a direct participation or a participation through EU entities that do not meet the minimum substance requirements. It should be assumed that the shareholder itself is not a shell. For the purposes of the Shareholder’s carve-out, it remains unclear whether this holding company must limit its activities to the holding of shares in subsidiaries to benefit from the carve-out or can also grant loans to these subsidiaries.

The exemption

Undertakings that can demonstrate that their existence does not reduce the tax liability of its beneficial owners (in the sense of the AML Directive) or of the group, as a whole, can request an exemption. The undertaking must then provide sufficient and objective evidence that its existence does not lead to tax benefits by including information about the group and its activities. A comparison must be made between the amount of overall tax due by the beneficial owner(s) or the group as a whole, with and without the undertaking.

The availability of such an exemption might be interesting for the real estate sector but may also appear challenging depending on the factual circumstances.

Take these two examples:

- A pension fund that is totally tax exempt in its country of residence has incorporated an EU investment platform with a view to invest in real estate, these investments being equity-funded. This pension fund (or its pseudo-UBO) should qualify as beneficial owner under the AML Directive. Via this investment platform, the pension fund receives a flow of dividends. When Member State where the real estate assets are located, would allow a distribution of dividends exempt from withholding tax in case of direct investment and the investment platform crosses all gateways, then this investment platform can request an exemption in its Member State.
- A limited number of investors have set-up a fund that invests, via an investment platform, in real estate debt. The flow of interest is repatriated to these investors under a withholding tax exemption. In case the investors would have granted loans directly to the local property companies, they would have either benefitted from a withholding tax exemption or from a tax credit. The existence of the investment platform therefore does not lead to a decrease of the tax burden and this investment platform can request an exemption in its Member State.

It appears from these two examples that the tax position of the investor(s) should be considered in case of a captive fund, or a fund dedicated to a limited number of investors, since these investors should qualify as beneficial owners (under the AML Directive). On the contrary, the same investors might suffer a tax burden in case they invest through real estate funds with a large investor-base and via intermediary shell(s), as they should not qualify as beneficial owners in the sense of the AML Directive and therefore their tax position should not be considered when assessing whether an exemption can be obtained.

This exemption is granted by the Member State of the undertaking concerned for the tax year under review. Provided that the factual and legal circumstance remain unchanged, this exemption can be extended for another five years. Note that if the exemption is granted, an information exchange with the other Member States applies.

Tax consequences of being a shell

Once an undertaking is considered to be a shell for purposes of ATAD 3 it will not be able to access the benefits of the EU Directives and/or of the tax treaties of its Member State concluded with other Member States.

The Member State where the shell is resident will either deny the shell company a tax residency certificate or the certificate will specify that the company is a shell. This will serve as an administrative check, informing the relevant source country that it should not grant tax treaty benefits or apply EU Directives towards the shell. Nevertheless, the Member State of the shell would remain free to continue considering the shell as resident for local tax purposes and levy tax on the relevant income flows and/or assets.

At the same time:

- EU source jurisdictions shall ignore the shell for tax purposes and will tax or exempt the outbound payment according to the tax treaty or EU Directive in effect with the country of the shareholder(s) of the shell, or in absence of such treaty in accordance with its national law.
- Third country source jurisdictions may apply domestic tax on the outbound payment or may decide to tax according to the tax treaty in effect with the jurisdiction of the shareholder(s) of the shell.
- EU shareholder jurisdictions shall include the payment received in the shareholder's taxable income and may allow relief for any tax paid at source but will also deduct any tax paid by the shell in its Member State.
- Third country shareholder jurisdictions are not compelled to apply any consequences but may consider applying a tax treaty in force with the source jurisdiction to provide relief.

With regard to real estate assets directly owned by a shell, ATAD 3 contains a specific provision stating that (i) the Member State where the property is located shall tax this property in accordance with its national law and (ii) the Member State of the shareholder shall tax this property in accordance with its national law as if the property was owned directly by the shareholder, without prejudice to the provisions of applicable tax treaty.

Procedural aspects

Exchange of information

Information will be exchanged among Member States through a central directory – by way of an update of the DAC – when undertakings fall within the gateways. Information exchange will also apply where the tax administration of the Member State decides to certify that an undertaking has rebutted the presumption of being a shell or should be exempt from the obligation under ATAD 3.

In other words, no exchange of information shall take place (i) when an undertaking is carved-out from the scope of ATAD 3 or (ii) when an undertaking does not cross all gateways.

Administrative penalties

ATAD 3 leaves it to the Members States to lay down penalties applicable against a violation of the national provisions implementing the directive. Those penalties should include an administrative pecuniary sanction of at least 5% of the undertaking's turnover in the relevant tax year in case of breach of reporting obligations or false declaration in relation to the minimum substance requirements.

Request for tax audits

Member States will be able to request the Member State of the undertaking to perform tax audits when it has reason to believe that an undertaking has not met its obligations under ATAD 3.

Practical questions

Assessment of gateways in the two preceding years

Whether an undertaking crosses all gateways is determined considering the situation in the two preceding years. How will (or can) this rule be applied to newly incorporated undertakings? The proposal including working documents does not contain any provision or guidance in this respect.

Collection of withholding taxes

Withholding taxes are usually applied at the time of the payment or attribution of the relevant revenues. From a procedural standpoint, what will happen during the tax year under review? Does the payor have to withhold at source taking the prudent approach that the undertaking shall be considered a shell and if it appears not to be the case, request a reimbursement? Or can the withholding tax exemption be applied, and then the corresponding amount be transferred (if the qualification of shell is confirmed) to the Member State after the assessment has been made? In such a case, will penalties or late payment interest apply?

DAC 6

If an undertaking is a shell under ATAD 3, then the question of whether it is the beneficial owner of interest in the sense of hallmarks C under DAC 6 arises. The timing of the reporting obligation under DAC 6, basically in advance of the implementation of a structure, does not match the timing of the assessment under ATAD 3 which is based, firstly on factual and legal circumstances in the two preceding years. How are DAC 6 and ATAD 3 to be combined?

Next steps

This proposal is open for consultation until 6 April 2022, with the EU Commission expecting an entry-into-force on **1 January 2024**. Note that since this proposal uses a reference period of two preceding years this reference period, if the proposal is adopted without modification, may already have started on **1 January 2022**.

In addition, on 25 January 2022, Members of the European Parliament recommended, in the Committee on Economic and Monetary Affairs (ECON Committee), the reforming of withholding tax regimes in the European Union to prevent tax avoidance, while reducing barriers for companies and investors that operate cross-border.

The Members of the European Parliament have approved a draft resolution prepared by the ECON Committee, which includes e.g., the support of the Commission's intention to put forward a proposal by the end of 2022 establishing a European withholding tax framework. This draft resolution should be put on a vote on 7 March 2022 but remains non-binding.

A new legal framework on this field is near and all parties concerned should assess the consequences and prepare without delay.

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VAT Titanium case

No VAT fixed establishment without staff (Titanium case)

In its decision of 3 June 2021, the Court of Justice of the EU (CJEU) concluded that a building let in a Member State, in circumstances where the owner of that building does not have his own staff to perform services relating to the letting, does not constitute a permanent establishment within the meaning of the VAT Directive.

A decision of principle on the concept of permanent establishment

Titanium is a Jersey-based company whose corporate purpose is property management, asset management and the management of housing and accommodation. In 2009 and 2010, Titanium leased a building in Austria, subject to VAT, using an Austrian property management company. The latter acted as an intermediary with service providers and suppliers, invoiced the rents and operating costs, kept the commercial records and prepared the VAT return data. These services were performed by the agent in premises other than those of the building owned by Titanium.

Titanium retained the decision-making power to enter into and terminate leases, to determine the economic and legal terms of the leases, to carry out investments and repairs as well as to organise their financing, to select third parties to provide other upstream services and, finally, to select, appoint and monitor the property management company itself.

In the view of the Austrian tax authorities, a rented property constitutes a permanent establishment for VAT purposes and Titanium was therefore liable for VAT on the rental payments. On the other hand, Titanium considered that, as it had no staff in Austria, it did not have a permanent establishment. The VAT debtors were therefore the tenants under an extended reverse charge mechanism, and not the owner.

A constant jurisprudence...

The CJEU's decision is not a priori a surprise, as the concept of permanent establishment has long referred to “any establishment, other than the seat of the economic activity [...], i”.

...which leaves some questions unanswered

However, the judgment does not eliminate all questions relating to the concept of permanent establishment. For example, the CJEU is careful to point out that although Titanium did not have its own staff in Austria, it had also reserved to itself “all important decisions concerning the letting of the building in question”. Does this mean that, had the service provider retained greater powers over the management of the building, a permanent establishment of Titanium could have been recognised through the manager itself?

Practical impact: glass half full...or half empty

The decision of the CJEU may be of interest since it simplifies the question of the location of general services (i.e., services which are not intrinsically linked to immovable property, which are always located at the place of the immovable property) in certain cases. Indeed, such services are in principle located at the place where the taxable person has established the seat of his economic activity but may also have to be located at the place of the taxable person's foreign permanent establishment.

By ruling out the recognition of a permanent establishment embodied in the building alone, the CJEU has reduced the cases in which such a localisation exercise will be required.

However, the ruling could also be disadvantageous for taxable persons letting a property (with VAT) in another Member State, where the latter has implemented an extended reverse charge mechanism. In such a case, the taxable owner may no longer be able to register for VAT in the country where the property is located, as he will not have a permanent establishment there and will not be liable for the VAT on the rental payments.

The input VAT incurred at the place of the property would then only become deductible under Directive 2008/9/EC (formerly the 8th Directive). In addition to the administrative complexity, Directive 2008/9/EC has an impact on the pre-financing of VAT, as the refund periods are longer than the "local" periods. Moreover, VAT becomes deductible only to the extent that the taxable person carries out transactions which give rise to the right to deduct in his Member State of establishment. If the Member State of establishment imposes more restrictive conditions on the right to deduct input VAT, the taxable person may be worse off...

This aspect will not have escaped the attention of taxable owners established in Luxembourg and holding real estate in Germany. The administrative practice there is that a foreign taxable person is treated as a German resident when it exploits real estate in Germany - and some question the compatibility of such a practice with the CJEU decision. If this administrative practice is challenged - a circumstance which is still uncertain at this time - Luxembourg taxable owners could face significantly longer VAT refund periods.

In Belgium, it seems that this new decision has delayed the publication of an administrative circular clarifying the concept of permanent establishment, which was already long overdue. The practical impact of this ruling can therefore be expected to be detailed in the circular.

Finally, in the Netherlands, the Titanium case law does not seem likely to have a material impact on the market, as it is ultimately in line with a 2019 decision of the Dutch Supreme Court, under which the recognition of a permanent establishment requires the presence of own staff. Moreover, foreign taxable persons can register as such for VAT purposes, so that the deduction of local VAT seems to remain acquired, without the taxable person having to make an application under Directive 2008/9/EC.

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News from our home markets: **Belgium**

The renovation obligations in the Flemish Region: the governmental agenda for the period 2020-2050

The Flemish government has been striving for years to optimise the use of energy in buildings. Initially, this was done with all kinds of premiums and incentives. But at the end of 2020, the government changed tack: renovation becomes an obligation. By 2050, houses must have an average energy label A, and non-residential buildings must even be carbon neutral. To this end, the government developed a long-term renovation strategy, a large part of which can be found in a Flemish Government Decree of 9 July 2021.

2020

When selling or renting houses, flats, studios, etc., an energy performance certificate (EPC) must be presented since more than 10 years. An EPC informs the buyer/ tenant about the energy performance of the building. This is done using a score or label ranging from A+ (very good) to F (very poor). It also contains specific recommendations to make the building more energy efficient. The EPC must be drawn up by a recognised energy expert and is valid for 10 years.

Since 1 January 2020, an EPC is also mandatory for the sale of full ownership or the granting of a property right as well (usufruct, long-term lease and rental of small non-residential buildings. These are buildings or parts of buildings with a surface area of no more than 500 m^2. If they are part of a larger building, that building may have a usable floor area of no more than 1000 m^2. The validity of the certificate is reduced to 5 years.

The energy score must be published when the building (or part of it) is offered for sale or rent.

2022

First modification: when selling, only EPCs that were drawn up from 1 January 2019 onwards will be taken into consideration. Older EPCs will no longer be valid. Certificates that were drawn up when building a house will remain valid.

Second modification: an EPC will also become mandatory for the common parts of an apartment building. However, this will happen in phases:

- For large apartment buildings (at least 15 units), the obligation enters into force on 1 January 2022. As mentioned above, for the individual units, this obligation already exists for some time. The notion “units” include both flats and small non-residential units (shops, medical practices, offices, etc.).
- For medium-sized apartment buildings (5 to 14 units), the obligation will enter into force on 1 January 2023.
- For small apartment buildings (2 to 4 units), the obligation will enter into force on 1 January 2024.

Third modification: the renovation obligation of all non-residential building.

In the event of a transfer or granting of a property right (ownership, usufruct, long-term lease right, right to build), the following measures must be complied with within 5 years from the notarial transfer deed (for both small and large non-residential buildings):

- If the minimum R-value of 0.75 m^2K/W for roof insulation is not achieved, roof insulation with maximum U-value of 0.24 W/m^2K must be installed.
- If there is single glazing, it must be replaced with glazing with a maximum U-value of 1 W/m^2K.
- All central generators for space heating that are older than 15 years must be replaced, unless you can demonstrate that the installation meets the minimum installation requirements for renovation. If there is a natural gas network in the street, a fuel oil boiler may not be replaced by a new fuel oil boiler.

- All cooling systems older than 15 years that use cooling agents based on ozone-depleting substances or cooling agents with a GWP value of 2500 or higher must be replaced by cooling systems that do not use these harmful cooling agents.

The renovation obligation does not have to be met if the unit is part of a building that will be demolished within 5 years from the transfer deed. The obligation also does not apply if the transfer is the result of a merger or (partial) demerger of a company.

In addition to the renovation obligation, a small nonresidential building must achieve Energy Label C or better. This only applies if the transfer concerns the building in its entirety. If it appears that this energy label has not been obtained after 5 years from the notarial deed, an administrative penalty of EUR 500 to EUR 200,000 may be imposed. This penalty is not exonerating: the competent authority sets a new deadline by which the obligation must be met.

2023

As mentioned above, for medium-sized apartment buildings (5 to 14 units), the obligation to have an EPC for the common parts will enter into force on 1 January 2023. Large non-residential buildings must, from 1 January 2023 onwards, achieve a minimum renewable energy share of 5% within 5 years from its transfer.

From 1 January 2023, an EPC for sale and rental of large non-residential buildings will be mandatory.

2024

In 2024, the EPC requirement for the common parts of an apartment building is extended to the small apartment buildings (2 to 4 units).

2025

The decree of 9 July 2021 also introduces an EPC for non-residential buildings (EPC-NR). This EPC can be drawn up for a non-residential unit regardless of its size.

From 2025 onwards, all large non-residential buildings with heating or cooling capacity must permanently have a valid energy performance certificate. For small non-residential buildings, owners can decide which EPC they prefer (the new one or the small non-residential EPC). This will be the standard EPC for non-residential buildings.

2028

The Flemish government also intends to set a good example and foresees that its buildings will achieve the minimum label by 2028. What “level” the buildings must meet is still to be determined.

2030

From 2030 onwards, large non-residential buildings too must reach a minimum label (to be determined).

2050

The existing residential buildings must achieve a level of energy performance in 2050 that is comparable to that of new homes for which planning permission was obtained in 2015. To achieve this, the average energy performance level of the entire housing stock must be reduced by 75%. As part of the greenhouse gas reduction for residential buildings, there must be a shift towards making the remaining electricity and heat demand more sustainable, combined with managing energy consumption through digitalisation.

For non-residential buildings, the government also aims to achieve a carbon-neutral building stock for heating, sanitary hot water, cooling and lighting by 2050.

News from our home markets: **Luxembourg**

The Luxembourg real estate levy: New Circular from the Director of the Luxembourg Tax Authorities

On 20 January 2022, the Director of the Luxembourg Tax Authorities published a Circular PRE_IMM n°1 (the Circular), relating to the annual levy on income from real estate located in the Grand Duchy of Luxembourg (Real Estate Levy), introduced by Article 4 of the Law of 19 December 2020 (the Law). The Circular clarifies the scope of application of the Real Estate Levy, the modalities of its declaration and payment, as well as the contours of the implementation of two compliance obligations.

Scope of the Real Estate Levy

The Real Estate Levy is a direct tax levied annually at a rate of 20% on income from real estate located in the Grand Duchy of Luxembourg, made or received by an investment vehicle.

The Real Estate Levy only applies to investment vehicles taking the form of Part II collective investment undertakings, specialised investment funds or alternative investment funds under Luxembourg law and considered opaque from a Luxembourg tax point of view. This mainly concerns investment vehicles that have adopted the form of a S.à r.l., a S.A. or a S.C.A.

Three types of income are covered by the Real Estate Levy, namely (i) income from the rental of real estate located in the Grand Duchy of Luxembourg, (ii) capital gains resulting from the alienation of such real estate, or (iii) income from the alienation of shares in companies holding such real estate.

This income may be received directly by the investment vehicle or indirectly through a tax-transparent entity, such as a mutual fund or a general partnership (SNC), a limited partnership (SCS), a special limited partnership (SCSp), an economic interest grouping (EIG), a European economic interest grouping (EEIG), a temporary commercial company, a joint venture company or a civil company.

The basis of assessment of the Real Estate Levy is limited to the aforementioned income derived exclusively from real estate located in the Grand Duchy of Luxembourg. Any real estate income realised by a Luxembourg investment vehicle from real estate located abroad is therefore excluded from the basis of assessment of the Real Estate Levy.

Declaration and payment of the Real Estate Levy

The investment vehicle is required to declare all of its income subject to the Real Estate Levy by (i) 31 May following the year of receipt of such income if it closes its financial year on 31 December, or (ii) 31 December of the year of receipt of such income if it closes its financial year on a different date.

The declaration is made by means of the Model “ACD (Prélèvement immobilier) : Déclaration pour le prélèvement immobilier” at the Bureau de la Retenue d’Impôt sur les Intérêts (BRII), on the MyGuichet.lu website and must contain certain mandatory information (i.e., the amount of income subject to the Real Estate Levy and its breakdown by property, the amount of the Real Estate Levy applied, a certified report of an approved auditor on the determination of the income from the property, by type of income, by property and containing the details of the calculations made and the Tax Identification Number (TIN) of the investment vehicle).

The payment of the Real Estate Levy must be made by 10 June of the year following the year in which the income was received or derived. Any delay gives rise to the payment of late interest. In the event of an overpayment, it is possible to request a reimbursement of this amount until 31 December of the year following the year in which the Real Estate Levy was paid.

Establishment of two compliance obligations

The Circular also specifies the content of two compliance obligations introduced by the Law, for the tax years 2020 and 2021.

Under the first obligation, all predefined investment vehicles - even those not making real estate investments - are required to inform the BRII whether or not they held, directly or indirectly through a tax transparent entity, any real estate in Luxembourg during those financial years. This information obligation, which is therefore unique, extends to a public which is wider than the real estate world alone and thus concerns a large part of Luxembourg investment funds sector.

Under the second obligation, investment vehicles that held at least one real property located in Luxembourg, directly or indirectly through a tax transparent entity, are required to inform the BRII if they have changed their form to a tax transparent entity.

The transmission of these two compliance obligations is done by means of the model "ACD (Prélèvement immobilier) : Déclaration informative sur la détention ou l'absence de détention d'un bien immobilier sis au Grand-Duché de Luxembourg et sur le changement de forme juridique", and must be filed on MyGuichet.lu by 31 May 2022 at the latest.

Any omission or delay in filing the form may be subject to a fixed fine of EUR 10,000. The latter may however be contested by means of a complaint to the Director of the Luxembourg Tax Authorities.

Conclusion and contributions of the Circular

The Circular was published in January 2022, i.e., more than one year after the entry into force of the Law. The Director of the Luxembourg Tax Authorities has mainly limited herself to reiterating the letter of the Law, without bringing any major additional clarifications. However, the Circular serves as a valuable reminder of the compliance obligations that the investment vehicles concerned must fulfil.

News from our home markets: **The Netherlands**

Foreign real estate investor-specific tax developments

Expansion conditional withholding tax to Dutch real estate held by foreign entity

Since 1 January 2021, the Netherlands levies a 25% withholding tax on intra-group interest and royalty payments to entities in certain low taxed or blacklisted jurisdictions, to certain hybrid entities or in cases of abuse. Payments by Dutch resident entities can be subject to such withholding tax, but also payments by non-resident entities in case such payment can be allocated to a Dutch permanent establishment. On 1 January 2022, the scope of the withholding tax was expanded to also include payments allocable to Dutch real estate investments that do not necessarily qualify as a permanent establishment.

Amendments to the classification of (foreign) partnerships

A legislative proposal was first announced to be published this winter (2021/2022). However, the Dutch Ministry of Finance recently announced it is postponed until the third quarter of 2023. Currently, unlike international standards, limited partnerships in the Netherlands may qualify as opaque or transparent based on certain consent requirements for admissions and transfers (see our Tax Flash for more background information). This system creates unintended hybrid mismatches in international (fund) structures (i.e., ATAD2 and withholding tax issues). The proposal will introduce new classification rules in line with international standards, most likely resulting in the abolishment of the unanimous consent requirement for closed (transparent) limited partnerships, meaning that (Dutch and foreign) limited partnerships will likely become tax transparent from a Dutch perspective by default.

Real estate-specific tax developments

Increase of real estate transfer tax rate

The newly installed Dutch government plans to increase the rate of transfer tax for the acquisition of (i) non-residential property and (ii) residential buy-to-let property, from 8% to 9%, effective 2023. With this measure, the government parties want to create room on the housing market for non-investors.

Budget increases for certain investment allowances

Companies that invest in energy-saving assets or sustainable energy can make use of the so-called Energy Investment Deduction (**EIA**). By applying the EIA, companies can deduct 45.5% of the investment costs from their taxable profit, under certain conditions. In addition to the EIA, the Environmental Investment Deduction (**MIA**) offers companies an additional deduction possibility to reduce the taxable profit for investments in certain innovative and environmentally friendly business assets. On Budget Day 2021, the caretaker government announced that the percentages of the MIA will be increased as of 1 January 2022 from 13.5%, 27% and 36% to 27%, 36% and 45%, respectively. The government intends intend to structurally increase the budgets for the EIA and MIA as of 1 January 2023 by EUR 50 million and EUR 30 million, respectively.

Other relevant tax developments

Dutch Supreme Court denies interest deduction in acquisition structure

On 16 July 2021, the Dutch Supreme Court published its long-awaited ruling in the Hunkemöller-case. The Supreme Court ruled in favour of denying the fiscal deduction of interest payments made by a Dutch group to its private equity investors based on the abuse of law doctrine (*fraus legis*) (see our Tax Flash for more background information). This landmark decision will have an impact on many pending cases and discussions regarding interest deduction in acquisition structures. We recommend reviewing existing financing structures in light of these new developments.

Tightening of the earnings stripping rules

As of 1 January 2022, the earnings stripping rules are tightened by decreasing the maximum percentage of deductible interest from 30% to 20%. As a result, the deduction of net interest expenses (on both third party and related party debt) is limited to the highest of (i) 20% of the earnings before interest, taxes, depreciation and amortization (EBITDA) and (ii) a threshold of EUR 1 million.

Increased headline corporate income tax rate and conditional withholding tax rate

On 1 January 2022, the headline corporate income tax rate was increased from 25% to 25.8%. The SME bracket was increased from EUR 245,000 to EUR 395,000. Consequently, the applicable tax rates will be 15% for profits up to Euro 395,000 (SME-rate) and 25.8% on the higher amount. It should be noted that the headline corporate income tax rate is also decisive for the tax rate to be applied for the conditional withholding tax on interest and royalties. As a result, the applicable 2022 rate for the conditional withholding tax will also change to 25.8%.

News from our home markets: **Switzerland**

Regulatory restrictions for acquisition of real estate

The acquisition of real estate property in Switzerland through foreign nationals is restricted (so called **Lex Koller**). For an acquisition of real estate property in Switzerland (i.e., residential property for individuals), a permit is required for foreign nationals residing abroad or in Switzerland, except for (i) nationals of a member state of the European Community (EC) or of the European Free Trade Association (EFTA) or (ii) individuals holding a valid Swiss residence permit C.

Companies domiciled abroad are also deemed to be persons abroad (irrelevant whether they have a legal personality). For vacation apartments, on the other hand, the provisions are even stricter since the purchase of vacation apartments is subject to local quota and an authorization by the competent authorities (**Lex Weber**).

However, commercial property can typically be acquired by a foreign investor without such permit (e.g., hotel investments).

This is also why the inbound investment market for Swiss real estate is focused on commercial property and residential property investments are de facto reserved for domestic players. Although there are certain exceptions, e.g., real estate investment vehicles which are listed on a stock exchange, real estate investments still entail a significant regulatory burden for non-Swiss investors.

During 2021 the Swiss parliament held several votes on potentially increasing the restrictions in certain areas. For instance, after a public consultation on a specific provision restricting foreign investments in critical infrastructure in the beginning of 2022, the Swiss Government is expected issue a draft bill to parliament for some form of restrictions for foreign investments in critical infrastructure similar to other European countries. Separately, although stricter regulations were rejected at the beginning of 2021 by the Swiss parliament, the committee on economic affairs of the national council approved to look into restricting acquisitions of residential property father. This may entail new discussions on the acquisition of real property of citizens of a third state (i.e., non-EU/EFTA) or the conversion of commercial property into residential property. In any event, for foreign investors the Swiss market will continue to require careful review in order to find suitable investments.

Leading case on transfer pricing for real estate development projects

Decision of the Swiss Federal Supreme Court 2C_913/2020 dated 14 April 2021.

For real estate development projects which are executed by a developer group, it is common that the property up for development is held by a different group entity compared to the entity which provides the development work (so-called two-contract model).

This split entails an important tax implication: certain Swiss cantons levy a real estate capital gains tax (**RECGT**) on capital gains from real property held by corporate investors. The tax rates for RECGT are significantly higher than regular corporate income tax rates, e.g., 30-45% compared to 12-16%. Developers therefore are incentivized to allocate relatively low amounts to the company holding the real property subject to RECGT and to allocate a majority of profits to the developing entity, as the latter will be subject at a much lower tax rate. As the RECGT is a special tax on income market participants often argued that general transfer pricing rules would not apply in this context.

The Swiss supreme court however now ruled that for tax purposes, the return on the real property as well as the remuneration for developing work both are subject to the arm's length principle. The court held that in the absence of actual identity between the seller and the contractor (developer), both taxpayers are to be considered as separate taxable persons and taxed separately for the profit made by each, so that the profit of one taxable person cannot be allocated to the other. As such, the

arm's length remuneration can be determined for both functions performed in the development project, i.e., the maintenance and sale of the property as well as the development services. In the context of a controlled group, the court held that there is no reason not to apply standard transfer pricing rules even for the purposes of a specific capital gains tax which be considered to be outside of the common rules applicable to ordinary income taxes.

The court ruled that the situation may be different if the seller of the property and the developer are act as an economic unit within the scope of the construction project. Due to the economic relationship and the specific circumstances, it could be possible that profit shifts were made between the related persons. Indications exist, for example, where the seller of the property and construction company cooperate from the beginning to the end of the realization of the construction project, the timing and the form of the contracts with the buyers.

The court ruled that if one company holds participation rights of the other company to a considerable extent (e.g., real estate company is held by the developer or by a joint holding entity), in particular if the shareholders, the management and the board of directors of the seller and the construction company are identical or similar, so that they are affiliated companies under uniform management, both entities would qualify as related parties for tax purposes. If, due to the external circumstances, the tax authority cannot exclude the possibility that profits are allocated differently among the companies involved than it would be the case under at arms' length conditions, the tax authority must be able to investigate the cooperation between the companies – notably requiring for instance the property entity to disclose agreements with the developer or vice versa.

In the case at hand, the tax authority could not exclude a possible profit shifting due to the contractual arrangement with third parties, the participation of the general contractor in the real estate company of one third as well as the same main shareholder as sole managing director and chairman of the board of directors in both companies. The construction accounts required by the tax authority and the partnership agreement with the general contractor were not submitted. Due to the breach of the duty to cooperate, the tax authority made a discretionary assessment of the real estate company, which was upheld by the supreme court.

Leading case on requirements for tax neutral restructuring of real property

Decision Tax Appeals Court of Zurich dated 15 July 2021
For investment or development projects real property is typically transferred to specific SPV vehicles before attracting external investors. However, Swiss tax law limits the possibility to conduct a tax neutral reorganization for real property. In a recent court ruling, a taxpayer held real estate as an individual and transferred the property to a legal entity as part of a tax neutral restructuring and to benefit from a tax deferral.

However, the published practice statements of the Federal Tax Administration (Circular no. 5) require that such transfer is only tax neutral if the real estate company is deemed to maintain a business or part of a business. This is the case if the following cumulative conditions are met:

- The company operates on the market (market presence) or the relevant real property is rented to group companies;
- The company employs or contracts at least one person for the management of the real estate (one full-time position for purely administrative work);
- The rental income is 20 times the normal market personnel expenses for real estate management.

Since the taxpayer had the management of the real estate carried out by an external professional real estate management company, the tax authority and the Tax Appeals Court denied the second requirement. According to the second condition, the person commissioned must also be involved in the company "as if employed by the company". The management, which the taxpayer has done himself, does not exceed what is usually associated with the mere investment of capital. For the taxpayer's own professional real estate management, it is necessary to cover all needs related to the planning, management and leasing of the buildings. The transfer of the real estate was qualified as not tax neutral and thus subject to tax.

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