LOYENS & LOEFF

Law & Tax

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March 2023

Newsletter
Real Estate

Contents

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.
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- **News from the EU**
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    - CJEU confirms potential application TOGC-scheme in real estate transactions
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        - Swiss supreme court confirms wealth tax in Switzerland on SCI equity interests.

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

Imme Kam
Partner, Paris office

1. Investment structures for French real estate funds

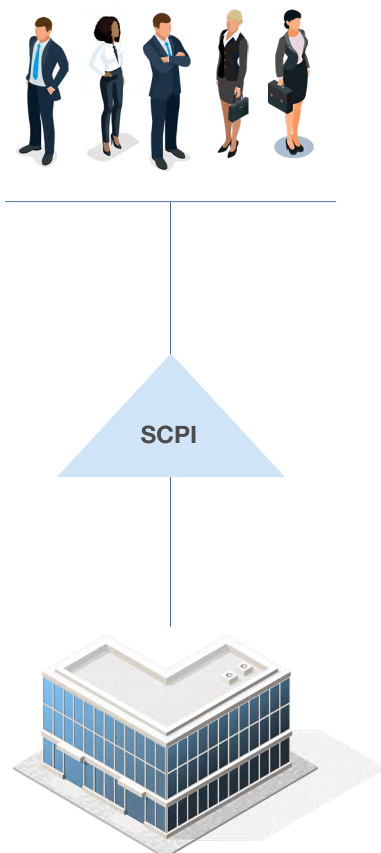
French real estate funds have been quite active in our home markets recently. In this contribution, we comment the investment structures we have seen the most, highlighting possible pitfalls and attention points. Note that this contribution does not comment on French regulatory and tax aspects, and only focuses on SCPI and SIIC (or corporation benefitting from a SIIC regime).

1.1 Investment structures for French SCPI

We start from the assumption that French SCPI are translucid from a French tax standpoint, meaning that they have legal personality and title to the asset, but the taxation is established in the hands of the unit holders, and not of the SCPI. In addition, we understand that SCPIs are subject to regulatory constraints with respect to the assets they can invest in and therefore we have assumed that the SCPI shall either invest directly in the real estate asset or via an AIF (or another translucid entity).

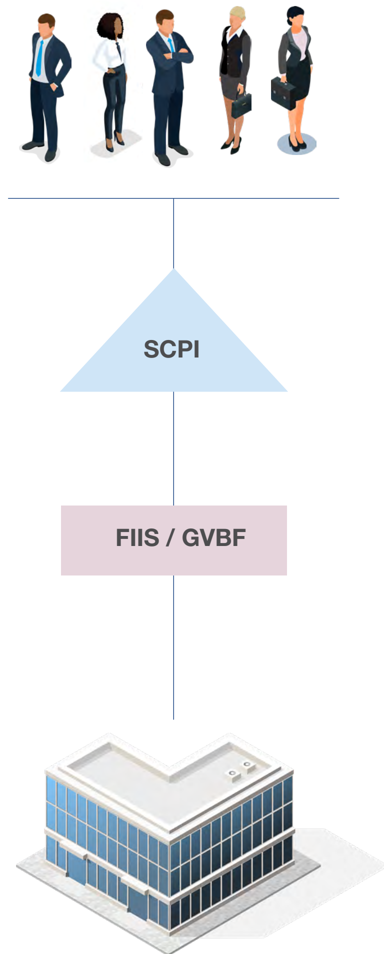
1.1.1 Investment in Belgian real estate

Direct investment in Belgian real estate



- Based on the (current and future) tax treaty, Belgium is granted exclusive power to levy taxes on real estate income (rental income, capital gain upon exit). The applicable rate is currently 25%. Note that the taxation of capital gain upon exit is applied through a withholding tax, and then corrected (e.g., to consider the carried-forward tax losses) via the yearly non-resident corporate income tax return. The non-resident corporate income tax return is filed by the SCPI.
- There is no (branch) tax on the repatriation or allocation of revenues from Belgium to France.
- In case the SCPI would attract financing that would be directly allocable to the Belgian real estate, the financing costs should be tax deductible provided that (i) the standard deductibility rules are complied with, (ii) the interest is at arm's length and (iii) the exceeding borrowing costs amount to maximum 30% of the SCPI Belgian EBITDA or 3M EUR on a group basis (i.e., considering all Belgian investments of the SCPI).
- The tax burden of such a structure lies in the RETT. Acquisition of ownership of real estate is indeed subject to 12% (Flanders) or 12.50% (Brussels and Wallonia) RETT. An alternative could be to structure the acquisition as a split deal: (i) the SCPI would acquire a (99-y) long-term lease right (*droit d'emphytéose / erfpachtrecht*) subject to 2% RETT, (ii) a third-party would acquire the residual property rights (*tréfonds*) subject to 12 or 12.50% RETT and (iii) the transferee of the long-term lease right would be granted an option to acquire the residual property rights (and therefore to reunify the full ownership), to be exercised at the soonest 15y after the granting of the long-term lease right to the SCPI.
- The acquisition of a newly built or heavily refurbished real estate within two years of the first use is or can be subject to 21% VAT instead of RETT.

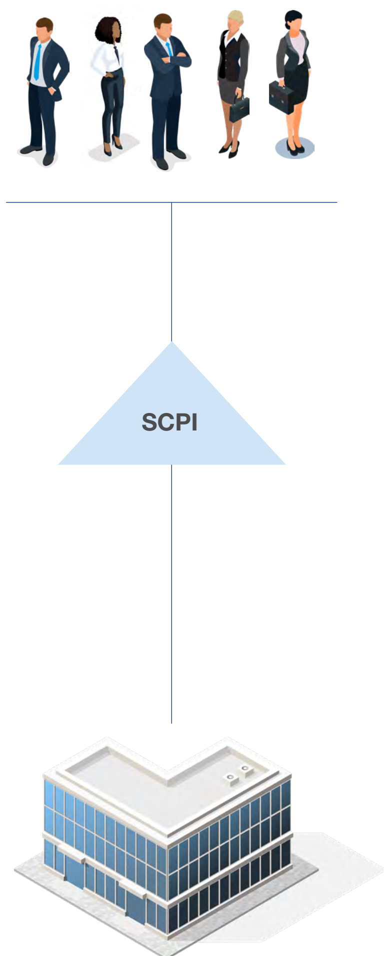
Indirect investment in Belgian real estate



- In such a structure, the Belgian real estate is owned by a FIIS (*fonds d'investissement immobilier spécialisé*) / GVBF (*gespecialiseerde vastgoedbeleggingsfonds*). The (real estate) income of the FIIS / GVBF is excluded from its taxable base but the FIIS / GVBF is subject to an annual dividend distribution, therefore shifting the taxation from the vehicle to its investors.
- Based on the current tax treaty, and considering the absence of condition of taxation, Belgian source dividends distributed to the SCPI should be subject to 10% or 15% withholding tax in Belgium. The future tax treaty may lead to a drastic increase of the tax leakage, since dividends distributed by a FIIS / GVBF would be subject to 30% withholding tax (unless distributed to a shareholder owning less than 10% of the FIIS / GVBF).
  It remains untested but one could envisage to consider the SCPI fully transparent and to determine this shareholding condition in the hands of the unit holders. For retail SCPI, this would lead to a reduction of the Belgian withholding tax to 12.8%.
  Considering this increase of the tax burden, and subject to French tax credit, one could consider liquidating the FIIS / GVBF therefore putting in place a direct holding structure (see above). The tax treatment of existing reserves at the level of the FIIS / GVBF must however be carefully reviewed.
- In case the FIIS / GVBF is leveraged, only the standard deductibility rules and the at arm's length principle apply.
- Upon disposal of the FIIS / GVBF shares, France is exclusively competent to tax, both under the current tax treaty (residual article according to which the power to tax is entrusted to the state of the seller) and the future tax treaty (power to tax allocated to the seller's state in absence of real estate rich clause in Belgium).

1.1.2 Investment in Dutch real estate

Direct investment in Dutch real estate

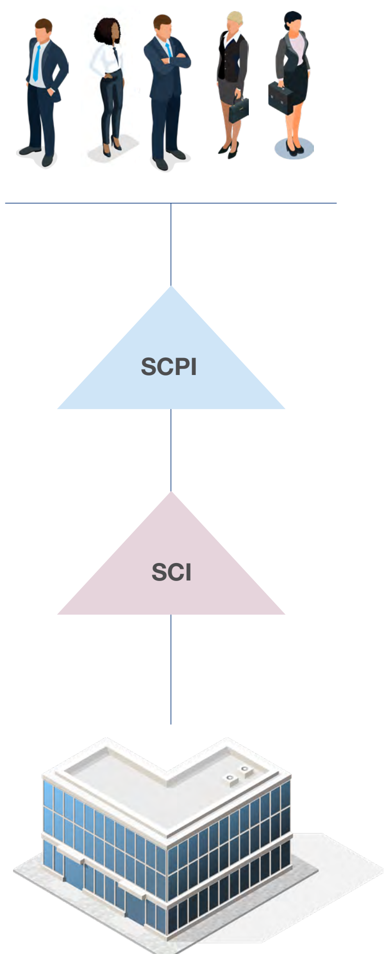


- Under current Dutch rules, an SCPI can be considered either transparent or opaque for Dutch tax purposes, depending on its articles of association. In short, the decisive criterion is whether accession or substitution of an investor requires unanimous consent of all other investors (i.e., including the general partner). Only if such unanimous consent is required (and in practice obtained), an entity is classified as tax transparent for Dutch tax purposes. In practice where in our experience SCPIs habitually do not provide for such a restricted transferability, it generally means that foreign entities such as SCPIs are quite often treated as opaque from a Dutch tax perspective. However, this is about to change, as new Dutch entity tax classification rules are expected to be introduced in 2024 (see under 'New Dutch tax entity classification rules' for more information).
- In case an SCPI is considered opaque from a Dutch tax perspective, the SCPI is subject to Dutch CIT as a non-resident on all income (such as rental income) and capital gains attributable to its direct investments in Dutch real estate against the headline rate of 25.8% (19% on the first EUR 200,000 of profits, 2023 rates).
- If an SCPI is treated as transparent for Dutch tax purposes, each corporate investor in the SCPI is subject to Dutch corporate income tax (**CIT**) on real estate income and capital gains. However, certain investors (such as pension funds) may be eligible for an exemption from CIT. Private individual investors are subject to Dutch personal income tax based on the value of the investors' interest in the Dutch real estate.
- The foreign investors are subject to registration and tax compliance obligations in the Netherlands which need to be spontaneously complied with. In case an SCPI has numerous investors, a tax transparent classification from a Dutch tax perspective would likely lead to the conclusion that direct investment in Dutch real estate by the SCPI is unfeasible. Considering the proposed changes to the Dutch entity tax classification rules, direct investment in Dutch real estate by SCPIs will require special attention.
- There is no dividend withholding tax or branch tax on the repatriation or allocation of revenues from the Netherlands to France.
- In case the SCPI would use extra financing, allocated to the Dutch real estate, the financing costs should be tax deductible

provided that (i) the standard deductibility rules are complied with, (ii) the interest is at arm's length and (iii) the net borrowing costs amount to maximum 20% of the SCPI Dutch EBITDA or 1M EUR on an aggregate basis (i.e., considering all the SCPI's direct investments in Dutch real estate).

- A conditional withholding tax on related party interest expenses, allocated to the Dutch real estate, may apply in relation to a low-taxed or EU blacklisted jurisdictions, hybrid entities or abusive situations.
- The acquisition of Dutch real estate by an SCPI is in principle subject to Dutch RETT at a rate of 10.4% on the purchase price (or the fair market value, if higher). The transfer of newly constructed real estate is in principle subject to 21% VAT by operation of law before, on the date, or two years after the real estate was first put into use. The transfer of leased property is generally considered a transfer of going concern which is not subject to VAT.

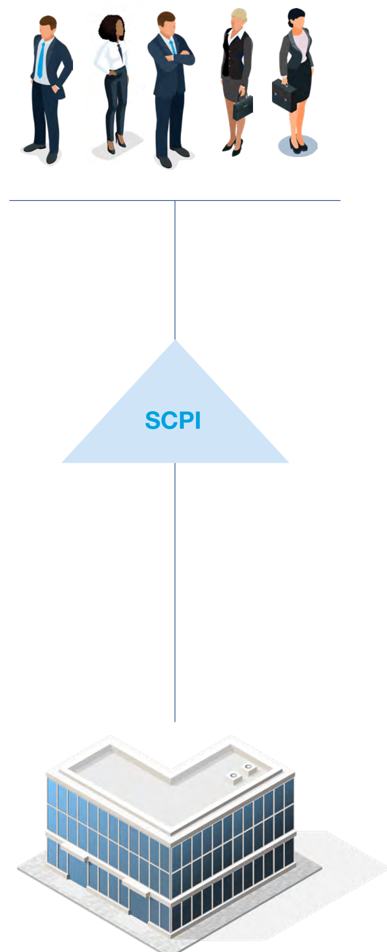
Indirect investment in Dutch real estate



- The Dutch real estate is owned by a French SCI (**PropCo**). Under current Dutch rules, an SCI can be considered either transparent or opaque for Dutch tax purposes, depending on its articles of association (although this may change under the new classification rules expected to enter into force in 2024). In case the SCI is considered opaque from a Dutch tax perspective, it is subject to Dutch CIT as a a non-resident on all income (such as rental income) and capital gains attributable to its direct investments in Dutch real estate against the headline rate of 25.8% (19% on the first EUR 200,000 of profits, 2023 rates).
- There is no dividend withholding tax or branch tax on the repatriation or allocation of revenues from the Netherlands to France.
- The financing costs should be tax deductible provided that (i) the standard deductibility rules are complied with, (ii) the interest is at arm's length and (iii) the net borrowing costs amount to maximum 20% of the SCI Dutch EBITDA or 1M EUR on an entity basis (i.e., 1M EUR per PropCo). Note that the potential application of the Dutch anti-hybrid rules (ATAD2) and the Dutch conditional withholding tax on related party interest may limit such advantages and should be analyzed.
- Indirect investment via a Dutch fiscal investment institution (*fiscale beleggingsinstelling*, FBI) is not considered a viable option as the Dutch government has proposed legislation that such entities will not be allowed to invest directly in real estate from 2025 onwards (see 'Abolishment of direct real estate investment by Dutch FBIs' for more information). This option is therefore not discussed in this contribution.

1.1.3 Investment in Luxembourg real estate

Direct investment in Luxembourg real estate



- Based on the 2018 double tax treaty in place with France, Luxembourg may tax real estate income (rental income and capital gains) from Luxembourg based real estate derived by the SCPI. The applicable corporate income tax rate is currently 18.19% (including a 7% surcharge for the unemployment fund). In case the SCPI would be considered to conduct a business activity in Luxembourg, municipal business tax will be levied in addition. The rate thereof depends on the municipality in which the business activity is carried out (6.75% for Luxembourg-City, as an example). Passively owning a building to rent it out to third parties should generally not give rise to a business activity in Luxembourg. Moreover, the unitary value of the real estate is subject to Luxembourg net wealth tax at an incremental rate of 0.5%. Given that unitary values are based on rental values dating back to 1941, the unitary value of Luxembourg real estate is significantly lower than its fair market value.
- There is no (branch) tax on the repatriation or allocation of real estate revenues from Luxembourg to France.
- In case the SCPI would attract financing that would be directly allocable to the Luxembourg real estate, the financing costs should be tax deductible provided that (i) the standard deductibility rules are complied with and (ii) the interest is at arm's length. In case the Luxembourg activities of the SCPI would give rise to a business activity, additional deduction limitation rules, such as the interest deduction limitation rule (which caps the deduction of exceeding borrowing costs at the higher of 30% EBITDA or EUR 3 million), will need to be complied with.
- The tax burden of this structure lies in the Luxembourg RETT. Acquisition of ownership of (commercial) real estate is indeed subject to 10% RETT, if located in Luxembourg-City and 7% RETT if located outside of Luxembourg-City. Moreover, Luxembourg subjects the sale of interests in partnerships to Luxembourg RETT if that partnership owns real estate located in Luxembourg. Whether or not the SCPI should be viewed as a partnership within the meaning of the Luxembourg RETT law depends on whether it can be assimilated to a Luxembourg *société de personnes*, for which a case-by-case analysis is required.

1.1.4 Investment in Swiss real estate

- Switzerland applies two different sets of taxation for real estate investments.
- For federal income tax purposes, income from real estate for private tax resident individuals is fully taxable but capital gains are tax-free (only taxed at cantonal level). Corporate investors are taxed both on income and capital gains.
- For cantonal income tax purposes, capital gains realized by a private tax-resident individual are subject to real estate capital gains tax. The tax rate varies between cantons and takes into account the holding period of the investment (short term capital gains are taxed at a higher rate, e.g., 40-50%). Some cantons also levy real estate capital gains tax for corporate investors (monistic system; levied only on the difference between acquisition costs and the sale price; difference between book value and acquisition costs are subject to regular corporate income tax) whereas the majority of cantons levy capital gains from real estate with regular corporate income tax (dualistic system; tax rates vary from approx. 12% to 20%).
- Foreign real estate investors would be subject to tax in Switzerland under domestic law pursuant to the above system.
- Based on the Swiss-French double tax treaty, both income and capital gains resulting from immovable property can be taxed in the state of the property. The same applies for wealth taxation. Accordingly, Switzerland would be free to levy real estate taxation in accordance with the above rules (depending on the location of the respective investment).

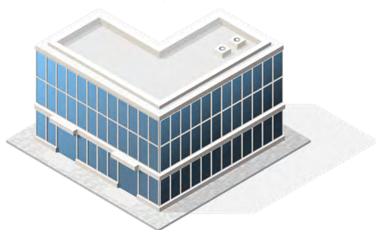
1.2 Investment structures for French SIIC

We start from the assumption that French SIIC are corporations with separate legal personality and subject to corporate tax, although benefitting from a deviating regime for (certain) real estate investments. This regime provides from an exemption from corporate income tax subject to a distribution obligation.

1.2.1 Investment in Belgian real estate

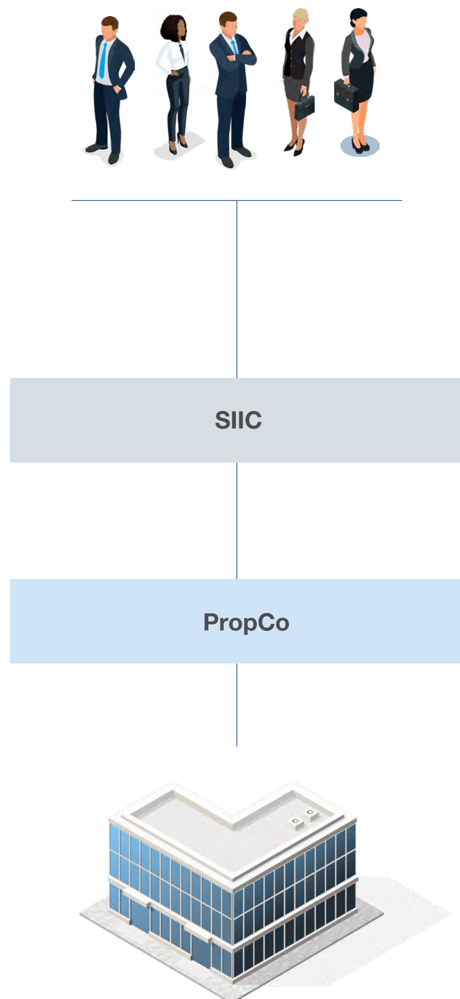
Direct investment in Belgian real estate

SIIC

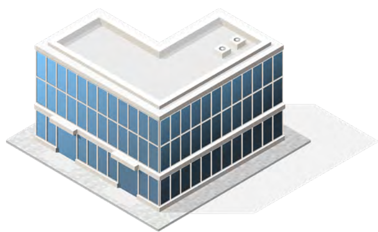


- The structuring and tax aspects of a direct investment in Belgian real estate are the same as for an SCPI (see above). Considering the double level of taxation (i.e., once at the level of the Belgian branch of the SIIC and once upon distribution by the SIIC), this investment structure is not often seen.

Indirect investment in Belgian real estate (PropCo)

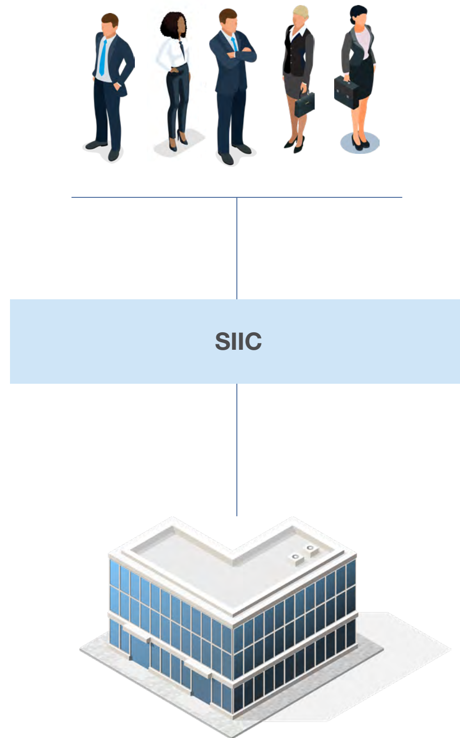


- In such a structure, the Belgian real estate is owned by a property company subject to regular corporate income tax (**PropCo**). The (real estate) income of the PropCo is subject to 25% corporate income tax, on a net basis (after deduction of yearly depreciation and costs).
- The financing costs should be tax deductible provided that (i) the standard deductibility rules are complied with, (ii) the interest is at arm's length and (iii) the exceeding borrowing costs amount to maximum 30% of the PropCo's EBITDA or 3M EUR on a group basis (i.e., considering all Belgian investments of the SIIC).
- Based on the current tax treaty, Belgian source dividends distributed to the SIIC should be subject to 10% or 15% withholding tax in Belgium. Under the future tax treaty and provided that a minimum 365 days holding period is complied with, these dividends should be exempted from withholding tax.
- Upon disposal of the PropCo shares, France is exclusively competent to tax, both under the current tax treaty (residual article according to which the power to tax is entrusted to the state of the seller) and the future tax treaty (power to tax allocated to the seller's state in absence of real estate rich clause in Belgium).

Indirect investment in Belgian real estate (FIIS / GVBF)	
 SIIC FIIS / GVBF 	• The structuring and tax aspects of an indirect investment in Belgian real estate via a FIIS / GVBF are the same as for an SCPI (see above). Contrary to the SCPI, the SIIC is opaque and therefore it should not be possible to look-through to assess the shareholding condition.

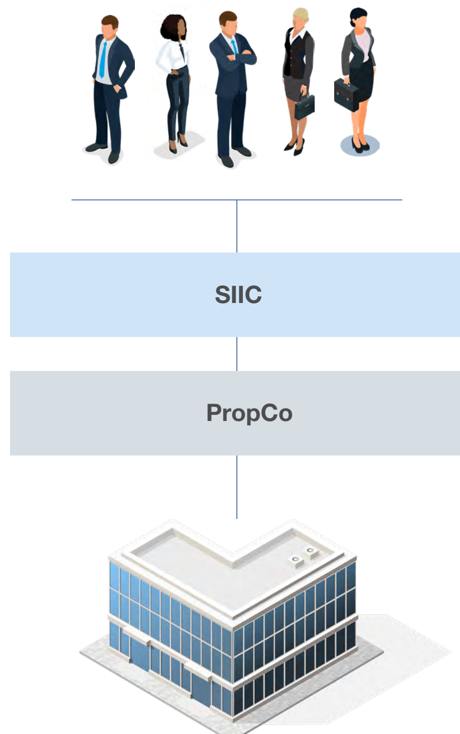
1.2.2 Investment in Dutch real estate

Direct investment in Dutch real estate



- The structuring and tax aspects of a direct investment in Dutch real estate are the same as for an SCPI (see above). Considering the double level of taxation (i.e., once at the level of the Dutch branch of the SIIC and once upon distribution by the SIIC), this investment structure is not often seen

Indirect investment in Dutch real estate

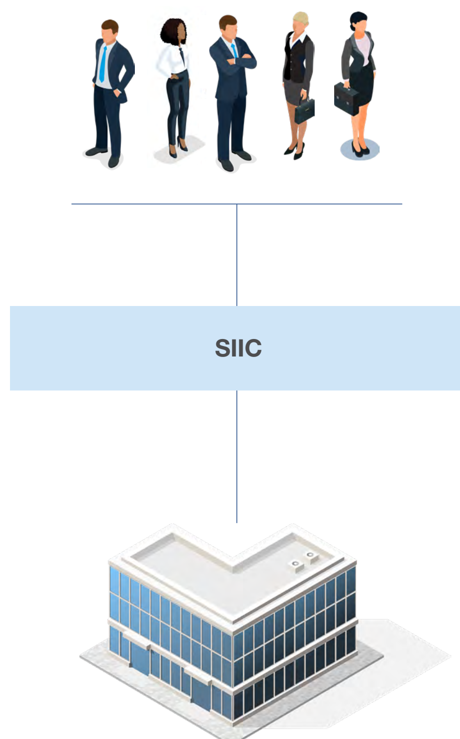


- The Dutch real estate is owned by a Dutch property company established as a BV or cooperative (**PropCo**). PropCo is subject to Dutch CIT as a resident taxpayer on all income (such as rental income and capital gains on Dutch real estate) against the headline rate of 25.8% (19% on the first EUR 200,000 of profits, 2023 rates).
- The financing costs should be tax deductible provided that (i) the standard deductibility rules are complied with, (ii) the interest is at arm's length and (iii) the net borrowing costs amount to maximum 20% of the PropCo EBITDA or 1M EUR on an entity basis (i.e., 1M EUR per PropCo). Note that the potential application of the Dutch anti-hybrid rules (ATAD2) and the Dutch conditional withholding tax on related party interest may limit such advantages and should be analyzed.

- Dutch source dividends distributed by a PropCo to the SIIC should in principle be subject to 15% dividend withholding tax in the Netherlands, although a full exemption may under circumstances apply based on the Dutch domestic exemption or the dividend withholding tax may be reduced under the tax treaty. Dividends distributed by a cooperative owning only direct Dutch real estate investments should not be subject to dividend withholding tax. This may change, however, upon the entry into force of new Dutch conditional withholding tax rules on dividends in 2024.
- Upon disposal of shares in a PropCo or membership rights in a cooperative, the Netherlands is exclusively competent to tax under the Netherlands – France tax treaty (based on the MLI real estate rich clause).
- Indirect investment via a Dutch fiscal investment institution (*fiscale beleggingsinstelling*, FBI) is not considered a viable option as the Dutch government has proposed legislation that such entities will not be allowed to invest directly in real estate from 2025 onwards (see 'Abolishment of direct real estate investment by Dutch FBIs' for more information). This option is therefore not discussed in this contribution.

1.2.3 Investment in Luxembourg real estate

Direct investment in Luxembourg real estate

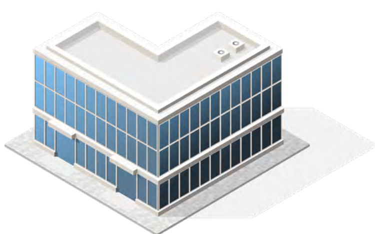


- The structuring and tax aspects of a direct investment in Dutch real estate are the same as for an SCPI (see above). Considering the double level of taxation (i.e., once at the level of the Dutch branch of the SIIC and once upon distribution by the SIIC), this investment structure is not often seen

Indirect investment in Luxembourg real estate (PropCo)

SIIC

PropCo



- In this structure, the Luxembourg real estate is owned by a Luxembourg resident capital company (typically a *société à responsabilité limitée*) (**PropCo**). The income (rental income and capital gains) of the PropCo is fully subject to corporate income and municipal business tax in the hands of the PropCo at a rate of 24.94% if the registered office of the company is located in Luxembourg City. Moreover, the unitary value of the real estate is subject to Luxembourg net wealth tax at an incremental rate of 0.5%. Given that unitary values are based on rental values dating back to 1941, the unitary value of Luxembourg real estate is significantly lower than its fair market value.
- Distributions by the PropCo give rise to 15% withholding tax, which may be reduced (even to 0%) based on the tax qualification of the SIIC for Luxembourg tax purposes as transparent or opaque and the application of the Luxembourg withholding tax exemption. For this, a case-by-case analysis based on the articles of associated of the SIIC is required as there are no default qualification rules applicable in Luxembourg.
- Luxembourg capital companies are typically leveraged with a view to repatriating recurrent real estate income by way of a repayment of loan principal and at arm's length interest payments, which are both not subject to Luxembourg withholding tax.
- In case the PropCo is leveraged, the deduction of interest payments from the taxable basis in Luxembourg is subject to the standard deductibility rules, the at arm's length principle, the interest deduction limitation rules and the anti-hybrid mismatch rules.
- Upon disposal of the shares in the PropCo, Luxembourg is competent to tax under the current tax treaty in place with France. Under its domestic tax law, Luxembourg does not tax share deals, other than in situations where a foreign investor has owned a significant participation in a Luxembourg company (more than 10%) and has disposed of shares within a period of 6 months after having acquired those shares (i.e., short-term capital gains) or cases of abuse of law.
- A sale of the real estate via a share deal is not subject to Luxembourg RETT.

1.2.4 Investment in Swiss real estate

- We refer to the above developments.
- In cantons with a monistic system, the sale of shares in a legal entity which predominantly holds Swiss real estate (50%) is deemed to be an alienation of the property itself triggering real estate capital gains tax. Some cantons will allow for a tax neutral step-up in basis if the investment vehicle is a Swiss legal entity.
- Cantons with a dualistic system generally do not levy tax on the sale of a real estate investment company, i.e., share deals pertaining to a Swiss or foreign vehicle should be more favorable in these cantons. Note that some cantons (e.g., Geneva) may apply a different tax treatment if the Swiss real estate is directly held by a non-Swiss legal entity.

1.3 Conclusions

The appetite of French funds for non-French real estate remains high but such investments sometimes lead to a higher burden in terms of structuring. The past modifications to the French-Luxembourg tax treaty and the announced modifications to the Belgian-French tax treaty, as well as new classification rules under Dutch tax law, may lead to a review of the classic investment structures, for the past and for the future.

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News from the EU

1. The EU Taxonomy update

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. It imposes additional disclosures obligations that apply since 1 January 2022. The EU Taxonomy 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.

Under the economic activities already classified under the EU Taxonomy, one can find the following real estate activities that are subject to technical screening criteria (**TSC**) established by the Commission:

- 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

1.1 The rules of the game: recap

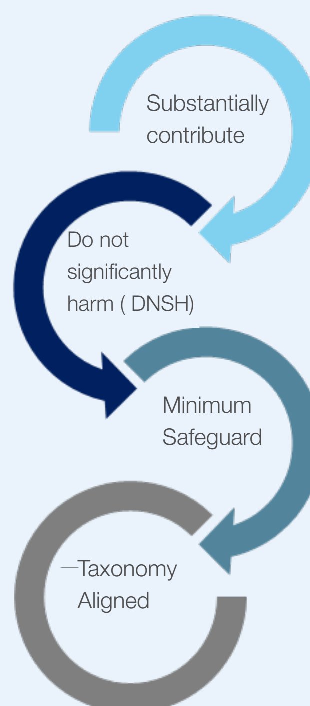
- The EU Taxonomy defines six environmental objectives:
- climate change mitigation
- climate change adaptation
- sustainable use and protection of water and marine resources
- transition to a circular economy
- pollution prevention and control
- protection and restoration of biodiversity and ecosystem

The focus is currently on the **climate objectives** (climate change mitigation and climate change adaptation) for which detailed TSC have been established by the Commission that can be found in the EU Taxonomy Compass.

To be considered **taxonomy aligned** and therefore qualified as **sustainable**, an activity:

- must contribute substantially to at least one of the six environmental objectives;
- may not significantly harm any other environmental objective (DNSH); and
- must meet minimum social standards.

These cumulative three tests determine whether an activity is taxonomy aligned, and hence whether it can be reported as sustainable.



1.2 Let's take an example

The activity concerned is the acquisition and ownership of an existing (before 31 December 2020) building and its assessment towards the goal of "**climate change mitigation**".

This activity substantially contributes to this goal when that building has at least an Energy Performance Certificate (EPC) class A; or the building is within the top 15% of the national or regional building stock expressed as operational Primary Energy Demand (PED). This activity does not significantly harm this goal when the building has at least an Energy Performance Certificate (EPC) class C. As an alternative, the building is within the top 30% of the national or regional building stock expressed as operational Primary Energy Demand (PED) and demonstrated by adequate evidence, which at least compares the performance of the relevant asset to the performance of the national or regional stock built before 31 December 2020 and at least distinguishes between residential and non-residential buildings.

1.3 Challenges and answers of the Commission in relation to EPC

The EU Taxonomy raises many challenges for the real estate sector, especially on how to apply when not all data is available. One of these challenges relates to the reference made to EPC as measurement tool.

In its draft notice published on 19 December 2022, on the interpretation and implementation of certain TSC, the Commission has proposed technical clarifications in response to FAQs on the TSC. Some of these clarifications concern the EPC, the main important ones being mentioned below.

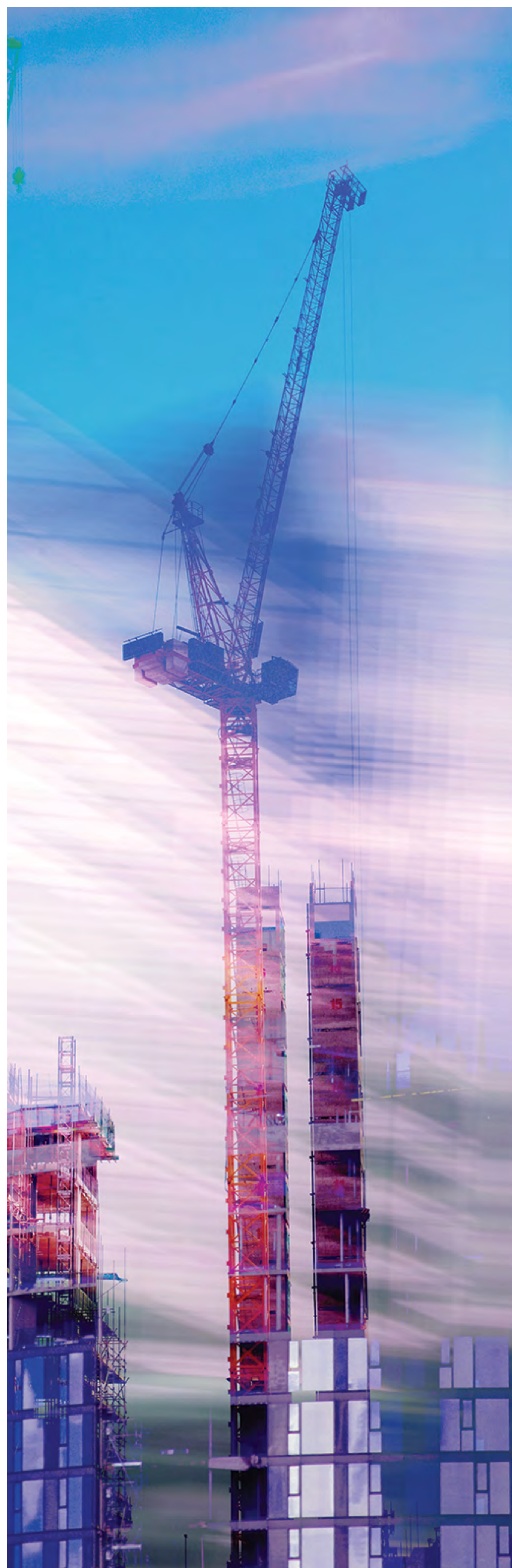
- EPC derives from a European legal framework, which raises the question of the classification of non-EU real estate assets. How can those assets be classified as Taxonomy-aligned and, more essential, how are buildings standards like BREEAM and LEED treated in the EU Taxonomy? For the Commission, these standards are not considered but "*where they can help demonstrating compliance with the TSC, they can be accepted for the purpose of compliance with the TSC.*"
- In relation to the economic activity "acquisition and ownership of buildings", the question raised whether equivalent to EPC can be used for assessing alignment with the TSC. The Commission acknowledges that "*some Member States may exclude specific types of buildings from EPC schemes*". As a consequence, and within the EU, "*whenever an EPC is available for the relevant building considered, it should be used. When this is not possible, equivalents can be used instead*."
- In relation to the economic activity "construction of new buildings", the TSC refers to an "as built Energy Performance Certificate (EPC)". However, such certificate shall only be obtained at, or even after, completion of the works while the financing is needed as from the start of the works. The Commission acknowledges that "*it is not possible to obtain an EPC as-built until the very end of the project*", and therefore "*it should be possible as a provisional measure to obtain and use an EPC as-designed. This would allow the building process to start. However, upon completion of the works, there needs to be an EPC as-built to certify that indeed the building complied with the criterion 10% better than NZEB*."
- In relation to the economic activity "renovation of existing buildings", a 30% reduction in Primary Energy Demand (PED) will be / is achieved, validated through an EPC. For the Commission, it means that the "*calculation of reduction should be based on the values in an EPC before and after the renovation, based on the numeric indicators in kWh/m2 indicated in the EPC*", so both an EPC before renovation and an EPC after renovation are required. However, when an EPC is not available and cannot be generated, "*the initial primary energy demand and the estimated improvement can be based on a detailed building survey, an energy audit conducted by an accredited independent expert or any other transparent and proportionate method. The 30 % improvement should result 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 of three years.*"

It should also be mentioned that the Commission has proposed a revision of the EU Directive on Energy Performance of Building. The main measures proposed are as follows:

- the gradual introduction of minimum energy performance standards to trigger renovation of the worst performing buildings;
- a new standard for new buildings and a more ambitious vision for buildings to be zero-emission;
- enhanced long-term renovation strategies, to be renamed national Building Renovation Plans;
- increased reliability, quality and digitalisation of Energy Performance Certificates; with energy performance classes to be based on common criteria;
- a definition of deep renovation and the introduction of building renovation passports; and
- modernisation of buildings and their systems, and better energy system integration (for heating, cooling, ventilation, charging of electric vehicles, renewable energy).

1.4 Conclusion: a willingness to keep EPC as standard but with some flexibility

The Commission clearly (and repeatedly) confirms its willingness to keep the EPC as the standard assessment tool within Europe. Responding to the industry demand to introduce a list of proxies to EPC, the Commission also shows a certain flexibility when EPC is not available, which is also the case for non-EU real estate assets and often the case for industrial or logistics assets. However, its draft notice also mentions the “compliance with the TSC” and “equivalents to EPC”. It seems therefore not enough to have a BREEAM certificate (and moreover: which one and with which rating) to conclude to a Taxonomy alignment; a technical screening is still required.



2. Pillar 2 – what to expect for the real estate sector?

On 15 December 2022, the Council of the EU formally adopted the directive implementing minimum taxation rules for large multinational groups (the so-called "GloBE rules" of Pillar Two) at EU level. Member States will now have to transpose the directive into their national laws before 31 December 2023.

The GloBE rules seek enforcing a **global minimum corporate income tax at an effective rate of 15%**, calculated on a jurisdiction-per-jurisdiction basis. Top-up tax would be due on the income of entities in each jurisdiction where the effective rate – computed based on these GloBE rules rather than domestic tax rules – is below 15%. The mix of measures gives top-up taxing rights to the (ultimate) parent entity's jurisdiction, the jurisdiction of the low-taxed entities (if in the EU) or as a backstop even to other group jurisdictions based on a formulary apportionment.

The GloBE rules will apply to **MNEs with a consolidated turnover of at least EUR 750 million**, but a lower threshold may be applied at the discretion of implementing countries.

However, certain entities are excluded based on their particular purpose and status. In particular, "*investment funds and real estate investment vehicles should also be excluded from the scope of this Directive when they are at the top of the ownership chain, since the income earned by those entities is taxed at the level of their owners.*" More specifically:

- **Investment funds** that are an ultimate parent entity are excluded from the scope of Pillar Two. To qualify as "investment fund" an entity or arrangement must meet a series of seven cumulative conditions. Some of them require a specific attention. The fund must be designed to pool assets from a number of investors, some of which are non-connected. Captive funds should therefore not be able to benefit from this exclusion; that being said, captive funds should also not qualify as "ultimate parent entity". The fund, or its management, should be subject to a regulatory regime which includes appropriate anti-money laundering and investor protection regulation. It remains to be seen what "appropriate" will mean; in any case it should be concluded that funds subject to the AIFMD and/or UCITs Directive should comply with this requirement. Other conditions relate to (i) the investment in compliance with a defined investment policy, (ii) the cost reduction or risk spreading achieved collectively by the investors, (iii) the goal of generating investment income or capital gain, or to protect investors against an event or outcome, (iv) the right to return for the investors based on the contribution made and (v) the management by professionals on behalf of the investors.
- **Real estate investment vehicles** that are an ultimate parent entity are excluded from the scope of Pillar Two. This exclusion benefits to REITs, defined as "*a widely held entity that holds predominantly immovable property and that is subject to a single level of taxation, either in its hands or in the hands of its interest holders, with at most one year of deferral*". This definition however raises certain questions for which clarification will be needed. What does "widely held" means, is there a minimum level of floating (which is usually the case in the local regulations of REITs)? Is the condition of single level of taxation still complied with if certain activities of the REIT are taxable? In certain REIT regimes, the single level of taxation is achieved in the hands of the shareholders via a compulsory dividend distribution, but what could be the consequences if the REIT chooses to reduce its indebtedness instead of distributing or decide to reinvest instead of distributing (knowing that in certain REIT regime the reinvestment period might exceed one year)?
- To benefit from this exclusion, the investment fund or the REIT must be the **ultimate parent entity** (UPE). An UPE is an entity that owns, directly or indirectly, a controlling interest in any other entity (or the main entity of a permanent establishment in scope) and that is not owned, directly or indirectly, by another entity with a controlling interest in it. Based on the directive, "controlling interest" refers to an ownership interest whereby the owner is required (or would have been required) to consolidate all assets, liabilities, income,

expenses and cash flows on a line-by-line basis in accordance with an acceptable financial accounting standard. In a European context, this refers to IFRS 10 (*Consolidated Financial Statements*) – which immediately raises the question of the exception to consolidation for investment entities who shall measure an investment in a subsidiary at fair value.

This condition might lead to quite disturbing consequences, for example in case of a European REIT (entity A) controlled by another (European or not) REIT or by a governmental entity (entity B), or in case of an investment fund (entity A) controlled by a pension fund (entity B). The entity A should be excluded from the scope of Pillar Two, provided that entity B itself benefits from an exclusion and either entity B owns (directly or through excluded entities) at least 95% of the value of entity A (which essentially invests funds for entity B) or entity B owns (directly or through excluded entities) at least 85% of the value of entity A and the latter derives substantially all of its income from dividends or equity gains (which shall not be the case in case of direct holding of real estate assets).

- Let's take a captive investment fund controlled by a pension fund or by a REIT (being itself the ultimate parent entity). The investment fund shall be excluded from Pillar Two because the controlling entity is an excluded entity as well.
- Let's take REIT A controlled by REIT B. REIT B might be excluded if it is the ultimate parent company. But REIT A shall not benefit from an exclusion since REIT A is not the ultimate parent company and, considering minimum floating requirements, REIT B is not owning 95% of the value of REIT A (and REIT A does not meet the income requirement).

- **Platform companies** and **SPVs** held nearly fully by an exempt UPE and serving the investment purpose of that UPE should also qualify as excluded entities. Importantly, where the fund is excluded from consolidation obligations, it might be that in certain jurisdictions the consolidation obligation shifts to a holding entity below the fund. In such a situation, the group would not have an investment fund as UPE but that holding entity, and the rules may still apply.

Other usual suspects are pension funds and insurance companies.

- **Pension funds** also benefit from an exclusion for Pillar Two. This concept covers both regulated entities operating to the benefit of the public as pension funds of MNE group provided that the retirement benefits are secured or otherwise protected by national regulations and funded by a pool of assets held through a fiduciary arrangement or trustor.
- **Insurance companies** are large real estate investors. As a matter of principles, they are in scope of Pillar Two.

These new rules of the (tax) game are complex and, as mentioned above, the provisions concerning excluded entities might not be that straight-forward. The groups concerned are now under time pressure – to determine their own qualification for each group entity separately, recommended restructuring and potential tax consequences – since the new set of rules provided for by Pillar Two should apply as from **1 January 2024.**

3. CJEU confirms potential application TOGC-scheme in real estate transactions

In a recent decision (C-729/21), the CJEU confirmed that the transfer of rented out real estate could constitute a transfer of a going concern (TOGC), provided that (i) the (tangible and intangible) assets together can be used to operate an independent economic activity and (ii) the purchaser intends to operate an activity with the assets hence acquired. Although the possible applicability of the TOGC-scheme to real estate transactions is acknowledged in several jurisdictions, such as the Netherlands and Belgium, this is not the case for all EU member states. In Luxembourg, the TOGC-scheme is rarely applied to the transfer of rented out real estate, even if the purchaser continues the leasing activities.

3.1 Facts

In the case at hand, the seller, a project developer, sold a fully built-up shopping mall that was rented out to various tenants. The transferred assets included the land and the constructions with all their accessories, the lease agreements and all the intellectual property rights and websites linked to the shopping mall. Although the buyer continued the renting out of the mall to the tenants, it had to conclude a new insurance agreement and contract a property manager. The seller and purchaser opted for a VAT taxed transfer and therefore VAT was charged to the buyer. The Polish tax authorities, however, claimed that this VAT was erroneously charged by the seller, on the basis that the transaction qualified as a TOGC and thus could not be reclaimed by the buyer. Under the TOGC-scheme no supplies of goods and services would be recognized for VAT purposes.

The Polish Supreme Court asked the CJEU (i) whether it is necessary, as a condition for the application of the TOGC scheme, that the buyer should be treated as the successor of the seller and (ii) whether a TOGC can be recognized even though not all the assets pertaining to a business were transferred.

3.2 Decision

The CJEU concludes that the treatment of the buyer as a “*successor to the transferor*” is a consequence of the transfer of assets qualifying as a TOGC, and not a condition.

With regard to the second question, the CJEU recalls that a TOGC requires that all of the elements transferred must, together, constitute a (part of an) undertaking with which an independent economic activity can be carried on. In addition, the buyer must have the intention to operate a business, or the part of the undertaking transferred, and not intend to immediately liquidate the activity concerned and sell the stock, if any.

In the case at hand the tangible and intangible assets transferred have allowed the buyer to continue the operation of the undertaking (i.e., the renting out of the shopping mall), even though some contracts, notably the insurance and property management contracts, were not transferred. Hence, the CJEU considers it possible for the transaction to constitute a TOGC, which is subject to verification by the referring court.

3.3 Why is this decision important

This ruling is of specific interest for the real estate sector, where input VAT often represents significant amounts and therefore important risks. The decision notably highlights the risks associated with the application of VAT (or the possibility to opt for VAT) when a transaction should instead qualify as a TOGC; in this case, VAT could be considered as having been incorrectly applied, leading to its non-deductibility.

For the Luxembourg market, this decision sheds a specific light on the local practice, where the TOGC scheme is rarely applied on real estate asset deals. In practice, parties prefer to opt for the application of VAT whenever possible, as the local tax authorities generally consider that asset deals do not qualify as TOGCs and tax rulings are not available to confirm the applicability of the TOGC scheme. The VAT option, in such cases, provides certainty to the parties as it requires a prior approval from the tax authorities; where the conditions for the VAT option are not fulfilled, the parties should enquire about the possibility to rely on the TOGC scheme to avoid potentially heavy regularization of input VAT that has been deducted in the past.

For the Belgian market, the decision ruled by the Court is in line with the practice where Belgian VAT Authorities consider that the TOGC scheme may nevertheless be applicable even if the transferor keeps certain assets that are not part of the branch of activity transferred, provided that this does not prevent the transferee from carrying on an autonomous economic activity by means of all the elements transferred. In the light thereof, the VAT Authorities consider that the fact that the building in which the branch of activity is operated, or the rights relating to this building are not transferred is not necessarily such as to call into question the application of the TOGC scheme. Nonetheless, the Belgian VAT Authorities can be reluctant to accept the TOGC scheme, especially in a context where the transfer implies a building leased with VAT. However, some recent rulings and decisions from the local VAT Authorities also confirmed that the transfer of building and its related lease activity (either subject to VAT or not) can be considered as a TOGC.

For the Dutch market, this decision confirms the practice, where the TOGC scheme can be applied on certain transfers of rented out real estate. Though the fact that the seller in the case at hand is a project developer transferring a newly built real estate asset that was 'developed' by entering into lease agreements is not given much attention by the CJEU, this is an important element for the Dutch practice. According to case law from the Dutch Supreme Court a project developer selling a newly built real estate that was rented out prior to the sale, could not apply the TOGC scheme as the developer was considered to sell stock, rather than (a part of) a totality of assets. This is generally also the position of the local tax authorities. As the CJEU ignores the fact that the seller is a project developer in this decision, it seems that the CJEU does not consider this as an impediment to the application of the TOGC scheme. Currently two new cases on this matter are pending with the Dutch Supreme Court. The Dutch practice is looking forward to the Dutch Supreme Court rulings and this CJEU decision may impact the outcome.

3.4 On practical aspects

Aside from the general outcome of the decision, the ruling from the CJEU also sheds light on very practical aspects that cannot be overlooked when discussing TOGCs in the framework of real estate transactions. We have listed some of them hereunder:

3.4.1 In case of TOGC, can the seller recover its input VAT?

The TOGC has no impact on the VAT recovery position of the seller, as the buyer is deemed to be the successor to the transferor. As a result, the VAT position of the seller remains similar to the one that directly existed prior to the transfer and no regularization is triggered by the TOGC itself.

For instance, if the seller benefited from a full input VAT deduction right on construction costs as the building was fully let out with VAT, the TOGC will not be considered as a VAT exempt transfer of real estate and will not, on the seller's side, trigger an obligation to regularize the deducted input VAT.

3.4.2 What must be transferred? Does the seller need to transfer employees?

The CJEU has defined the TOGC as the '*transfer of a business or of an independent part of an undertaking, including tangible elements and, as the case may be, intangible elements, which, together, constitute an undertaking or a part of an undertaking which is capable of carrying on an independent economic activity, but that it does not cover the simple transfer of assets, such as the sale of a stock of goods*'.

As a result, whether an operation qualifies as a TOGC heavily depends on the nature of the undertaking (or part thereof) that is transferred and on the nature of the undertaking that the buyer intends to pursue. In essence, the assets transferred must allow the buyer to pursue the foreseen undertaking. In that framework, it could be imagined that no employees would be transferred – depending on the undertaking pursued by the buyer –, or that only part of the assets that were used by the seller to perform its activities be transferred under the TOGC provided that the assets transferred are sufficient to enable the buyer to continue an autonomous economic activity.

3.4.3 The parties have applied a TOGC scheme. What are the risks?

Where the parties have opted for a TOGC, the risk is, in general, the requalification of the transaction by the tax authorities as an operation falling within the scope of VAT. Such a requalification could lead to significant tax exposures.

Firstly, in case the operation is requalified as a VAT exempt sale of real estate, the seller would be required to regularize the input VAT it may have deducted in the past on acquisition and construction costs.

Secondly, a requalification as a VAT taxable sale of real estate (*e.g. for a building considered as "new" for VAT purposes in Belgium and the Netherlands*) would mean that VAT must be remitted to the tax authorities (including, in some cases, with interests and penalty). While the seller would generally be the primary debtor of that VAT, country specific rules (such as the extended reverse charge) could apply, whereby the buyer is the primary debtor of the relevant VAT. In addition, countries such as Luxembourg and Belgium provide for a co-liability that applies under specific circumstances. As VAT is not always fully deductible, this leads to a significant potential exposure for both the seller and the buyer.

These risks call for specific attention, not only in the decision to apply the TOGC, but also in the framework of negotiating the transaction.

3.4.4 The parties have not applied a TOGC scheme. What are the risks?

Where the parties have not applied a TOGC scheme, the tax authorities can also – depending on the specificities of the transaction – requalify the transaction as a TOGC, as exemplified by the CJEU decision detailed above.

In such a case, the main risk lies with the deductibility of input VAT at the level of the buyer, as VAT was incorrectly charged on the transfer – and any incorrectly applied VAT is due, but not deductible. In this respect, the Belgian VAT authorities have shown some flexibility in such context in the past, where the VAT deduction performed by the buyer is only rejected if the seller has not paid the VAT to the Treasury. However, the Belgian VAT authorities also take a stricter standpoint in relation to other VAT treatment as the reverse charge mechanism wrongly applied (confirmed by recent case law) and could influence the administrative position on TOGC scheme.

3.4.5 Is there an obligation to obtain prior approval from the tax authorities?

No – a TOGC applies by virtue of the law when the conditions are met. Whether a TOGC exists or not is however not always a clear-cut case. Considering the risks outlined above, the possibility to file a ruling on the application – or not – of a TOGC is a precious asset.

In Belgium the application of the TOGC scheme must be assessed based on a case-by-case analysis. Since concrete guidelines from the authorities are still lacking it is often recommended to ask for a ruling beforehand. In the Netherlands the application of the TOGC scheme can be ruled with the Dutch tax authorities in order to obtain certainty. Luxembourg is an exception here, where the ruling practice does not exist for VAT; in this jurisdiction, the application of the TOGC scheme calls for increased caution.

3.4.6 What is the impact of a TOGC on the obligation to regularize input VAT deducted?

In case of transfer of a real estate to which the TOGC scheme applies, any obligation to regularize the input VAT that was deducted in the past by the seller in respect of acquisition and construction costs of that real estate passes to the buyer.

The outcome is however different where the transfer of a real estate is not subject to VAT and does not trigger the obligation to regularize input VAT – based on specific local provisions implementing Article 188, §2 of the VAT Directive – without however qualifying as a TOGC. In such cases, the seller may be required to regularize the input VAT it may have deducted in the past on acquisition and construction costs to the extent that the claw-back period has not yet lapsed, even when this regularization is triggered by the activities performed by the buyer.

3.4.7 What is the impact of a TOGC on transfer taxes?

In Belgium, the transfer of a building subject to VAT (i.e., considered as “new” for VAT purposes) is exempt from transfer taxes. Such exemption also applies when a “new” building is transferred as part of the TOGC scheme. In the Netherlands the application of the TOGC scheme does not impact whether real estate transfer tax is due, meaning that a transaction that qualifies as a TOGC may be subject to real estate transfer tax or may qualify for a specific exemption. In Luxembourg, the transfer of a real estate asset in the framework of a TOGC remains subject to transfer taxes at the usual rate.

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1. Belgium: A new contract law since 1 January 2023

The new contract law (Book 5 of the Civil Code) entered into force on 1 January 2023. Subject to specific legislations (e.g., property rights, commercial leases), it applies to all agreements concluded as from this date and will have a significant impact on contractual relationships and obligations.

The "old" contract law shall continue to apply to any agreements entered into before such time, unless parties prefer to submit them to the new provisions. The "old" and "new" contract law will as such co-exist for some time and seemingly identical contractual relationships may have different effects as a result.

Book 5 reflects the legislator's aim to increase legal certainty by codifying important principles of Belgian contract law developed over the years by case law and legal doctrine. At the same time, Belgian contract law is modernized by the legislative recognition of certain legal principles aiming at protecting weaker parties.

While contractual freedom and the rule that agreements must be kept (*pacta sunt servanda*) remain cornerstones of Belgian contract law, Book 5 includes some limitations to such freedom or its negative effects, if deemed excessive, and introduces certain novelties.

1.1 Pre-contractual phase

One of the most striking novelties introduced by the new Book 5 is the fact that the dynamic formation of a contract, through the game of offer and acceptance, is now regulated in the Belgian Civil Code. While confirming the principle of the parties' freedom of contract and to negotiate, the new Book 5 at the same time emphasizes the need for the parties to sufficiently inform each other and their possible pre-contractual liability during contract negotiations.

- Freedom of contract. Article 5.14 anchors the principle of freedom of contract. According to article 5.14, outside the cases provided for by law, everyone is free to decide whether he/she is willing to enter into a contract or not and to choose his/her counterparty, without having to justify the reasons for this choice. Moreover, the parties are free to determine the content of their contract, as long as it meets the validity requirements established by law. Consequently, freedom of contract is situated at three levels. Firstly, parties are free to decide whether, they wish to contract. Secondly, parties are free to decide with whom they wish to contract. Unlike public entities, they do not have to justify their choice in doing so. Thirdly, parties are free to determine the content of their contract. All this, of course, subject to legal restrictions, e.g., restrictions arising from anti-discrimination laws, competition law, B2B or B2C laws, etc. Regarding the content of the contract, article 5.14 explicitly provides that the contract must meet "*the validity requirements provided by law*", which means, among other things, that it must have a lawful object and cause.
- Freedom to negotiate. Article 5.15 enshrines the principle of freedom to negotiate. According to that principle, parties are free to initiate, conduct and terminate pre-contractual negotiations. However, in doing so, they must act "*in accordance with the requirements of good faith*." What exactly this means and whether the parties are effectively acting in accordance with "*good faith*" must be assessed on a case-by-case basis, taking into account all the concrete circumstances of the case.
- Pre-contractual information duty. Article 5.16 imposes an obligation on the parties to adequately inform each other during the pre-contractual phase: they must give each other, during the pre-contractual negotiations, the information that the law, good faith and custom, in light of their capacity, their reasonable expectations and the subject matter of the contract, require them to give. However, the Explanatory Memorandum confirms that there is no general obligation to inform: parties must also inform themselves and are not obliged to communicate all information to each other. They must only communicate the information required by law, i.e., the information which the law, good faith or custom require them to communicate to the other party. For example, a soil certificate or town planning information when selling a real estate property, or the information required to be disclosed to consumers under the provisions of the Belgian Economic Law Code.

Moreover, the Explanatory Memorandum confirms that article 5.16 does not exclude that parties agree on the information to be disclosed during the negotiations, e.g. in the letter of intent, the heads of terms, etc.

- Pre-contractual liability. Article 5.17 anchors the principle of pre-contractual liability. According to article 5.17, parties "*may incur extra-contractual liability towards each other during pre-contractual negotiations. When negotiations are erroneously terminated, this liability implies that the injured party is placed back in the situation in which he would have been had no negotiations taken place. Where there was a legitimate expectation that the contract would be concluded without any doubt, this liability may include repair of the loss of the expected net benefits from the contract not concluded. The breach of an information obligation may lead not only to pre-contractual liability but also to the nullity of the contract if the requirements stipulated in article 5.33 are met.*" Consequently, article 5.17 describes two cases of pre-contractual liability: the erroneous termination of negotiations and the breach of an information obligation.

Regarding the erroneous termination of negotiations, the Explanatory Memorandum confirms that the freedom to terminate negotiations remains the starting point and exceptions should be applied with great restraint. However, if there is an erroneous termination of negotiations, the one who erroneously terminates the negotiations is liable and is obliged to compensate the damage suffered by the injured party.

When determining the compensation, in principle, only the **negative contract interest** ("*negatief contractbelang" / "intérêt négatif*") is taken into account: the injured party must be placed in the situation as if he had never negotiated. In this sense, for example, costs incurred with a view to the contract negotiation and conclusion that have become useless are eligible for compensation. The loss of an opportunity to win a contract with a third party is also eligible for compensation. By contrast, expenses that are not causally related to the erroneous termination of the negotiations, for example expenses that would have been incurred anyway, are not eligible for compensation.

Exceptionally, the **positive contract interest** ("*positief contractbelang" / "intérêt positif*") also qualifies as compensable damages, especially if the legitimate expectation was created that the contract would be concluded "without any doubt". In that case, the injured party is placed in the situation as if the contract had indeed been concluded, so that the damages then consist of the loss of the expected net benefits from the contract not concluded. Whether or not the contract would have been concluded "without any doubt" must be assessed on a case-by-case basis, taking into account all the concrete circumstances of the case.

Regarding the breach of an information obligation, article 5.17 emphasizes that this may not only give rise to extra-contractual liability of the one who breaches the information obligation, but also to (a claim for) the annulment of the concluded contract if the contract is afflicted with a defect in consent.

1.2 Other noteworthy changes in a nutshell

- Introduction of a "hardship" principle. Under Book 5, a party shall be entitled to request the revision of a contract if its execution becomes excessively burdensome due to **unforeseeable circumstances** beyond the control of that party. Protection against hardship becomes as such the rule unless it has been excluded by law or contract. This contrasts with the past Belgian legislation and case-law where obligors must provide for explicit contractual protection to deal with any adverse consequences of unforeseeable circumstances.
- Imposing contract terms on counterparties becomes more as ever a balancing act. The existing legislation prohibiting certain clauses in B2B and B2C agreements, is complemented by a general legal provision providing that unfair clauses can have no legal effect. Unfair clauses are clauses that cannot be negotiated and create a clear imbalance between the rights and obligations of parties. In addition, under Book 5, an "**abuse of circumstances**" can lead to the nullity or to the alteration of a contract.

- Unilateral rights in case of breach of contract. The right for a party to take unilateral (and sometimes even pre-emptive) action, **without prior court intervention**, when suffering from a breach of contract, is explicitly recognised. Book 5 provides that, upon a party's default, the counterparty has the right to unilaterally terminate the contract and have the works performed by a third party at the cost of the defaulting party.
- Statutory regime on transfer of debts and transfer of contracts. The new Book 5 provides, for the first time in Belgian Civil Law, in statutory mechanisms for a transfer of contract.
- Battle of Forms. Book 5 introduces the so-called "**knock-out**"-**rule** to deal with conflicting general conditions and contract terms.

1.3 Impact for the real estate sector

We analysed the provisions of the new contract law from the real estate sector point of view and in pragmatic manner. You can access our dedicated booklet here .

2. Belgium: Indexation of rent prices

In Belgium, the Regions are competent for residential and commercial leases, incl. with respect to the fixing of prices. Unless parties agree on fixed rent price or an adjustment based on another metric than the cost of living, rent prices are indexed based the so-called "health index". The health index is derived from the CPI excluding alcohol, fuel, and tobacco.

Considering the impact of the current crisis on rental prices, as well as the society's concern for sustainability and climate change, the three Regions have decided to freeze or limit the indexation of the residential rent prices depending on the energy performance level of the asset.

2.1 Brussels

In the Brussels Capital Region, indexation of residential rent is prohibited if the energy level of the dwelling carries an F or G-label. If the label mentions 'E' the indexation is limited to 50% of what is legally allowed. If the level is A, B, C or D, the indexation can be applied as foreseen by law or by contract. This regime is applicable **since 14 October 2022** and lasts for **12 months**.

For commercial rent (retail industry) and **since 22 December 2022**, landlords can apply the indexation of the rent but the health index must be retreated to exclude its energy component. The (new) indexation formula for commercial rent in Brussels is thus as follows:

- For leases concluded before 1 August 2021: Base rent * 0.99 * (new index 0 energy / base index)
- For leases concluded as from 1 August 2021: Base rent * (new index 0 energy / base index)

In January 2023, the health index was 128 and the index 0 energy was 124.98.

This measure applies for **one year** following the entry-into-force of the Ordonnance, i.e., until **22 December 2023**.

2.2 Flanders

In the Flanders Region, indexation of residential rent is prohibited when the residence's energy label is E or F. If the level is 'D' only half of the normal indexation is allowed. Full indexation is allowed for residences with energy levels A+, A, B or C. The entry-into-force was **1 October 2022**. The measure is applicable during **12 months** but after this period, a correction mechanism becomes applicable preventing a normal indexation (or recapture) for the D, E and F labels afterwards.

2.3 Wallonia

In the Walloon region and for residential rent, an index-freeze regime similar to the two other regions is put in place. Since **1 November 2022**, there will be a complete index freeze in case the energy level is F or G. If the energy label is E, the indexation is limited to 75%. For D energy labels the indexation is limited to 50%. Finally, there is no cap on the indexation of residential rent for premises with an energy level label A, B or C. The index freeze will last for **1 year** after which a correction mechanism will become applicable for the contracts that fell under the index freeze preventing a normal indexation (or recapture).

3. Belgium: Property sale by public authority null and void due to insufficient competition

In a highly mediatized judgment of 8 November 2022, the Ghent Court of Appeal clarifies which rules public authorities have to observe when selling real estate. In order to avoid unpleasant and far-reaching consequences, such as the annulment of the sale-purchase agreement, both the selling public authorities and the interested buyers must take into account the rules on state aid and competitive bidding.

3.1 Facts

In September 2016, OCMW/CPAS Ghent (the City's social centre) proceeded with the sale of 79 agricultural plots. All plots were sold through a single transaction to an investor after it emerged as the best bidder from a public procedure.

The sale was criticized by farmers from the wider region, some of whom had ongoing leases. An organic farmer from Lokeren also opposed the sale, as he felt he was deprived of the opportunity to expand his farm in the region. Because this method excludes certain categories of interested parties, the plots would have been sold for a price below their real market value. Consequently, the court was asked to pronounce the nullity of the sale-purchase agreement. The Ghent Court of Appeal now rules in favor of the farmer in question.

3.2 State aid measures

Article 107(1) TFEU defines 'State aid' as 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market'.

Important in this context is the court's consideration that the buyer of the agricultural land enjoyed an advantage that it could not enjoy under normal market conditions, i.e. without state intervention. It is noted that a sale of immovable property is market-conform if it is conducted through a competitive, transparent, non-discriminatory and unconditional bidding procedure.

According to the court, the sale in one lot of 79 different plots, can hardly be considered a competitive, non-discriminatory procedure. Indeed, the size of the transaction is such that it has made it impossible for small players in the agricultural sector to compete effectively for the sale. This argument is reinforced by the fact that the purchase of one or more separate plots was not made possible under the procedure, and this despite the fact that several individual farmers had expressed their interest beforehand.

The arguments put forward by OCMW/CPAS Ghent to justify the sale of all the plots together are dismissed one by one. The court denounces that alternatives, such as dividing the transaction into smaller lots, were not or not sufficiently examined. It also concludes that the OCMW/CPAS Ghent seems to have acted mainly out of convenience rather than with a view to selling at market conditions. For the sake of completeness, it should be noted that taxation reports show that the plots were actually sold below the market price.

The court ultimately stated unequivocally that all the conditions for state aid were met. The aid measure follows from the grouping of 79 agricultural plots in one transaction, which ultimately resulted in the plots being sold at a lower price than the market price.

3.3 Nullity as a useful remedy

As the formalities for the granting of a state aid measure were not properly complied with, the OCMW/CPAS Ghent is held responsible. The self-employed farmer, a rather small player in the agricultural sector, had no chance to compete because of the way the sale was structured, which caused him damage. Moreover, this damage would not have occurred if the OCMW/CPAS Ghent had not made this mistake. All elements are thus combined to open the right to compensation for the farmer. The court awards compensation in kind by annulling the sale agreement of the 79 parcels of agricultural land. This way, all parties involved are put back in the situation that existed before the wrongful act of the OCMW/CPAS Ghent and the independent farmer regains the opportunity to acquire one or more parcels.

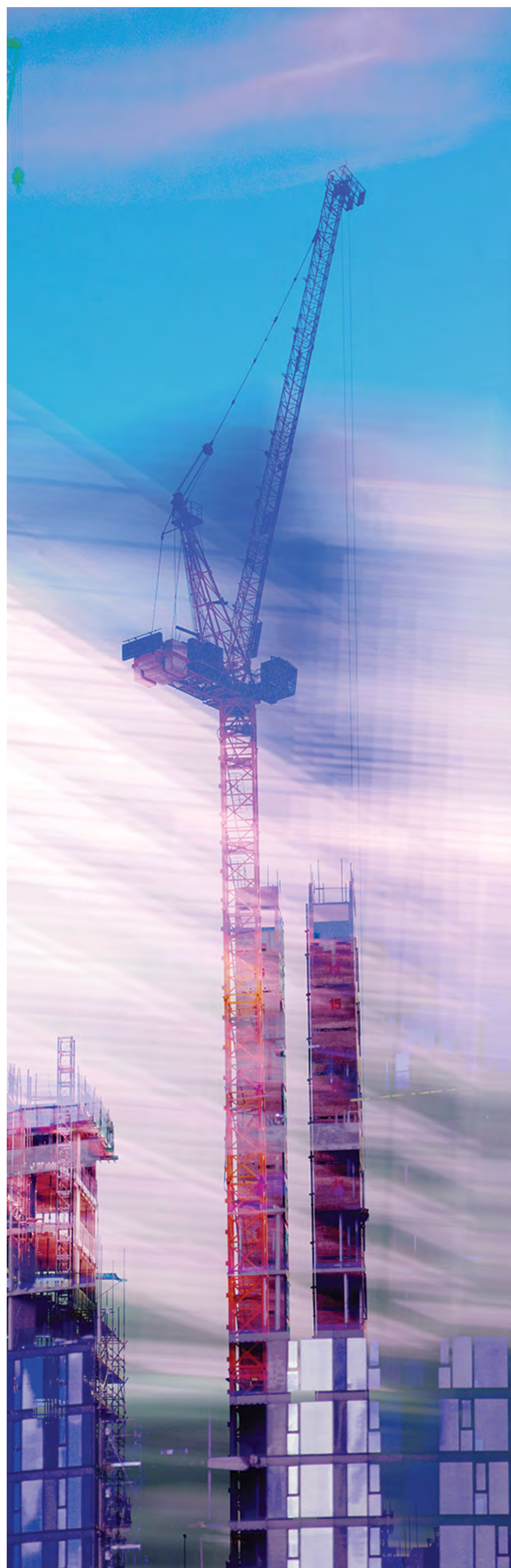
3.4 Parallels with the Dutch Didam judgment

The recent Belgian judgment is reminiscent of the Didam judgment handed down by the Dutch Supreme Court in late 2021. This judgment too stipulated - albeit with reference to the principle of equality - that public entities must offer equal opportunities to potential buyers when disposing of real estate.

In essence, this judgment states that public authorities must give sufficient publicity to their intention to sell real estate. Indeed, the aim is to inform as many interested parties as possible about the intended sale, as well as the procedure and any criteria that will be used in the context of choosing a buyer.

3.5 Conclusion

The practice whereby a public entity itself freely selects a buyer and then sells one-on-one to this selected buyer without too much consideration for other interested parties seems to be a thing of the past for good. It is clear from the aforementioned case-law that public entities must, to the extent reasonably acceptable, achieve equal access for all interested buyers when selling real estate. This implies, on the one hand, that the interested buyers must be able to know about the public authority's intention to proceed with the sale, which implies publicity obligations. On the other hand, unless justified, the subject of the sale may not be structured in a way that artificially limits the circle of potential buyers to e.g., only very large and wealthy property developers. Indeed, in such a case, access to competition from smaller players is made difficult or impossible.



4. The Netherlands: The Didam ruling from the lender's point of view

The Didam ruling has caused a stir within the real estate (financing) market. The Dutch Supreme Court has ruled that, in principle, a government agency may not simply proceed with a one-on-one sale of real estate in the Netherlands without first conducting a public selection procedure.

A government agency is only allowed to deviate from this rule in cases only one candidate qualifies for the transaction in question. This must be established in advance or reasonably assumed by the government agency based on objective, verifiable and reasonable criteria. If real estate has been sold without considering the Didam-criteria, the validity of the transaction concerned (and therefore the sale and purchase agreement, hereinafter the 'SPA') between the government agency and the buyer might be successfully affected by a third party, in the form of nullity (*nietigheid*). The possible invalidity of the SPA could have negative consequences for the government agency, the buyer and the lender of the relevant real estate.

4.1 Financing of real estate

For example: after the Didam ruling (i.e., after 26 November, 2021), a government agency comes to an agreement with party A on the sale and transfer of a real property in the Netherlands. Party A obtains financing for the purchase by means of a loan from a lender. To secure repayment of such loan, a mortgage on the real property concerned is established. The sale takes place by execution of the SPA, and the real estate transfers to A (i.e., closing). After closing, a third party (party B) takes the position that the Didam-criteria have not been taken into consideration by the government agency (and therefore have not been met). As a result, party B claims the SPA to be null and void (*nietig*).

In the event the SPA and closing are successfully declared null and void, this will entail that A never became the owner of the real property as a consequence of which the mortgage was never established. In such a case, ownership will in principle have remained with the government agency. However, the lender is not left empty-handed if it can successfully invoke the doctrine of good faith under Dutch law. In a successful plea of good faith, (i) the real property will still be encumbered with a mortgage serving as security for the repayment of the loan by party A to the lender, (ii) while the government agency is (still) the owner of the respective real property. It is likely that in such a case, A will breach the lender's credit terms, the lender would demand repayment of A's loan and A would forfeit a contractual penalty towards the lender.

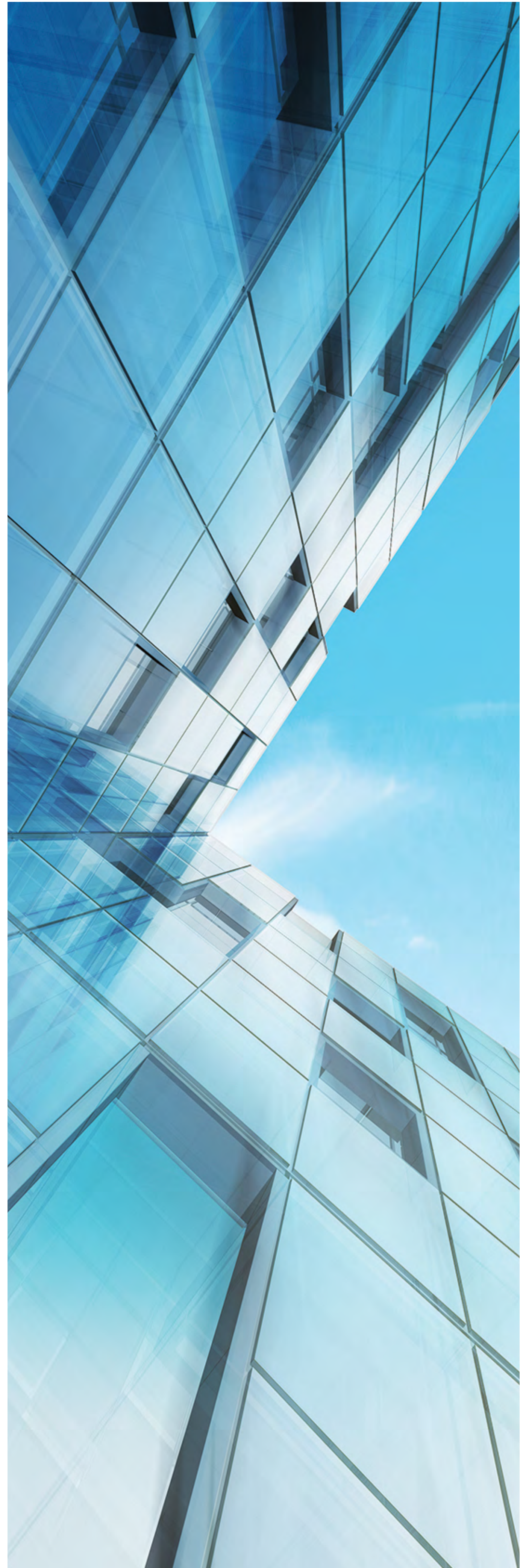
4.2 Takeaways following the Didam ruling

It is important to ensure that new real estate transactions are not affected by the Didam ruling. The duty of government agencies to publish real estate sales in advance is now common knowledge. However, a government agency still has the discretionary authority to decide that a sale does not need to be preceded by a public selection procedure if it believes only one candidate qualifies for the transaction. However, the government agency must publish its reasoning for this decision. As the lender will not be able to determine with complete certainty whether the correct procedures have been followed by the government agency, it will always have to consider the risk that the real estate transaction could be invalid retrospectively in case the seller is a government agency.

With a view to preserving the mortgage, it is important for the lender to request from the purchaser (in its capacity as borrower) whether the Didam-criteria were considered and met in the transaction process before concluding the credit agreement. In our opinion, the lender will generally be bona fide if that question is answered in the affirmative, which will give it consequently third-party protection on the Dutch principle of good faith. In the worst-case scenario, the lender will then be able to enforce the mortgage via public auction.

4.3 Conclusion

The Didam ruling has complicated the dynamics and fundability of real estate transactions in the Netherlands. The Didam ruling may have major (practical) implications for real estate financing. In this blog, we have included a classification of the possible situations that may arise as a result of the Didam ruling for illustrative purposes. In doing so, we have only briefly addressed the issues that may arise in real estate transactions on lenders end, and the possible remedies available in this regard.



5. The Netherlands: New Dutch entity tax classification rules

In Spring 2021, the Dutch government proposed to overhaul the Dutch tax classification rules for Dutch and foreign entities, such as partnerships, with the aim to align these rules with international standards. Following public debate and input from stakeholders around this topic, it has recently been announced that two separate bills of law to change the Dutch tax classification rules will be submitted on Dutch Budget Day in Autumn 2023

On the one hand, a bill to change the general tax classification rules and on the other hand this separate bill to change the Dutch tax classification rules for Dutch funds for joint account (*fonds for gemene rekening* or **FGR**) as these rules are closely connected to the tax investment regimes that are dealt with in this proposal.

Based on the public consultation version of the bills of law, the following changes are anticipated.

5.1 Dutch entities

Under the current rules, a Dutch limited partnership (*commanditaire vennootschap* or **CV**) is classified as transparent in case accession or substitution of a limited partner is subject to the unanimous consent of all limited and general partners. This ‘consent requirement’ will be abolished under the new classification rules, making all Dutch CVs per se transparent for Dutch tax purposes.

5.2 FGR

An FGR can be tax transparent or tax non-transparent. There are currently three types of FGRs, in short being: (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) other FGRs with transferable participations (non-transparent).

Under the newly proposed rule, an FGR will only be non-transparent, provided that it is regulated following the Dutch financial supervision legislation and the participations in the FGR are tradeable. In case the participations in the FGR can solely be repurchased by the FGR, the participations are deemed to be not tradeable and thus such an FGR remains tax transparent even when it is regulated. In all other situations, the FGR will be qualified tax transparent. These changes may affect the current qualification of many FGRs, including typical family-owned FGRs which currently qualify as non-transparent and often make use of the exempt investment institution regime (*vrijgestelde beleggingsinstelling* or **VBI**).

The sudden change in entity classification caused by these new rules will in principle result in a tax recognition event for the FGR concerned and/or its participants, and thus can result in tax becoming due without cash having actually been generated. Therefore, several facilities are being proposed to alleviate this immediate tax charge: (i) a rollover facility, (ii) a share-for-share merger facility (including a RETT exemption), and/or (iii) a deferred payment obligation (spread out over ten years).

As this newly proposed rule – which is envisaged to enter into force as of 1 January 2024 – could result in non-transparent FGRs becoming transparent or vice versa, one should carefully check the (potential) tax consequences for existing structures. For more information, see our newsletter of 10 March 2023.

5.3 Foreign-law entities

The Netherlands are expected to maintain the use of the 'similarity approach' to classify foreign entities. In short, this approach means that one looks at the most comparable Dutch equivalent of the foreign entity ('corporate resemblance') to determine the Dutch tax position thereof. As a result, foreign partnerships that are comparable to a Dutch CV (such as limited partnerships) will be classified as per se transparent, reducing the possibility of certain hybrid mismatches.

For entities with no clear Dutch equivalent, the 'symmetry' approach will apply. This means that the Netherlands will follow the tax classification of the foreign entity's state of residence. In case such entity is a resident of the Netherlands, the entity will be classified as non-transparent.

No clear guidance is currently available on how to determine whether a foreign entity is equivalent to a Dutch entity. For example, depending on the relevant criteria, a French SCPI may be considered equivalent to a Dutch CV or FGR, or not equivalent to any Dutch legal entity at all. If equivalent to a Dutch CV, an SCPI would be classified as per se transparent from 2024 onwards.

In case an SCPI were to be considered equivalent to a Dutch FGR, it could be either treated as transparent or opaque in the Netherlands, depending on its articles of association and the final version of the new classification rules. Another possible outcome is that no Dutch equivalent legal entity exist, which would mean that the tax treatment of the SCPI's jurisdiction of residence should be followed for Dutch tax purposes. However, given the SCPI's unique translucid tax status in France – which is unknown in the Netherlands – it is uncertain how this classification would be implemented in practice.

A lot of uncertainty still surrounds the expected new classification rules. However, the probability that a foreign entity is classified as tax transparent for Dutch tax purposes increases from 2024 onwards. This may have major undesired consequences for fund entities holding Dutch real estate, as their investors may become subject to Dutch taxation, registration and compliance obligations in relation to the fund's Dutch real estate income. Hence, real estate investment funds, such as French SCPIs or SCIs, investing in Dutch real estate will require special attention in the coming years.

6. The Netherlands: Key take-aways of the 2023 budget for the real estate sector

On 20 September 2022, the Dutch government published the 2023 Budget, as well as a number of (announced) 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.

6.1 Abolishment of direct real estate investment by FBIs

On 20 September 2022, the Dutch government announced its intention to disallow the FBI to directly invest in real estate (i.e., the Dutch REIT regime). The initial date of entry into force,1 January 2024, was later postponed to 1 January 2025. On 8 March 2023, the public consultation of the draft bill of law was published, providing more details on the proposed measures, including the alleviating measures in relation to RETT. See our newsletter of 10 March 2023 .

Under the current rules, an FBI is subject to Dutch CIT at a rate of 0%, but the mandatory annual distribution is subject to 15% Dutch dividend withholding tax. As it is feared that not in all situations Dutch taxation on real estate can effectively be secured, the Dutch government proposes to introduce the rule that the FBI regime can no longer be applied by entities that invest directly in real estate, as of 1 January 2025. No distinction will be made between Dutch real estate and non-Dutch real estate. As a result of the announced measures, once promulgated into law a Dutch FBI having invested in real estate will lose its tax regime and become subject to the regular headline rate of 25.8% on its Dutch results.

Indirect investment through a company that owns real estate will still be allowed as long as it concerns portfolio investment in real estate. An FBI can therefore (continue to) invest in real estate by owning shares in a regularly taxed subsidiary. However, an FBI is not allowed to engage in the management of a related real estate entity.

In addition, the current 60% debt financing limit for real estate investments will be abolished. This means that the general financing limit will apply, i.e., a maximum of 20% debt financing.

The Dutch government acknowledges that, in anticipation of these new rules, FBIs may need to restructure. In this respect, the Dutch government proposes alleviating measures in relation to RETT as of 1 January 2024. This will take the form of a conditional RETT exemption during the year 2024 for restructurings directly related to the proposed measure.

6.2 Change in RETT rate

The RETT rate has changed as of 1 January 2023. The default RETT rate increased from 8% to 10.4%. The lower RETT rate of 2% will continue to apply to natural persons who acquire residential real estate and use the house or apartment as a main residence to live there themselves. However, investors acquiring residential real estate fall in the higher default RETT rate.

6.3 Change in the lower CIT tax rate and bracket

As of 1 January 2023, the lower CIT rate for the first bracket was increased from the 15% rate to 19%. Furthermore, this lower CIT rate will no longer apply to the first EUR 395,000 of profits (as applicable in 2022), but to the first EUR 200,000 of annual profits per taxpayer as of 1 January 2023. The headline CIT rate remains at 25.8%.

6.4 Abolition landlord levy

The landlord levy was abolished as of 1 January 2023. The abolition was already agreed in the coalition agreement of the government coalition parties and is intended to allow landlords to invest in the building, renovation and making sustainable of residential housing.

The amendment is not part of the Tax Plan 2023 but is arranged in a separate bill.

6.5 VAT zero rate for solar panels on residential property

As of 1 January 2023, a zero VAT rate applies to the purchase and installation of solar panels on a residential property. In most cases, this allows solar panels to be installed on homes without any VAT liabilities and related obligations, regardless whether the homes are owned by owner-occupiers of by investors. The zero rate only applies if the solar panels are installed on dwellings and outbuildings belonging to dwellings.

6.6 Increase of the budget for the energy and environmental investment deductions

It is proposed to increase the annual budget of the energy investment deduction with EUR 100 million and the annual budget of the environmental investment deduction with EUR 50 million.

7. The Netherlands: New RETT proposal for share deals - further setback for Dutch housing marketsector

The Dutch Ministry of Finance has started public consultation on a law proposal that will further complicate the realization of and investment in buy-to-let residential real estate.

The proposal concerns the cancellation of the real estate transfer tax (**RETT**) exemption for the acquisition of shares in a company owning newly built real estate. Such transactions have become more common in the past years. Cancellation of this RETT exemption will significantly impact all transactions with newly built real estate in the form of share deals, especially investments in newly built residential real estate by (institutional) investors.

The proposal is intended to enter into force as of 1 January 2024 and does not contain transitional rules for pending transactions. Interested parties can provide a response in the public consultation until 27 March 2023. If this proposal is enacted, it would be a new setback for the Dutch residential market and the attempt to alleviate the housing shortage.

8. The Netherlands: New legislative proposal for regulation of mid-market residential

On 27 February 2023, the Dutch government has published a draft legislative proposal, based on which the rents of residential rental properties in the so-called "mid-market rental sector" will become regulated. The proposal is intended to enter into force as from 1 January 2024 and may be amended by Parliament in the meantime.

The residential rental market in the Netherlands has been regulated by the government for more than half a century through tenancy law. In the Netherlands, rental properties are currently classified either as a "liberalized unit" (*geliberaliseerde huurwoning*) or a "regulated unit" (*sociale huurwoning*). Regulated units are subject to rent control, limiting the amount of rent that can be charged and the amount of annual rent increases. Liberalized units are not subject to rent control (but annual rent increases are currently temporarily limited as well). Self-contained units are considered regulated if the initial rent does not exceed the rent control ceiling (*liberalisatiegrens*) of currently EUR 808.06. For each regulated unit, the maximum rent is assessed based on the number of points assigned to such units, which are attributed based on the facilities of the unit, for example: the size of the unit, number of bathrooms, appliances in the kitchen, the energy efficiency, renovations and the value of the unit. As at 1 January 2023, if a unit is allocated 149 points or more (corresponding with a maximum starting rent of EUR 809.83 or more), it would be considered a liberalized unit.

The proposed legislation will amend the residential rental market as currently in place in the Netherlands. Through the legislation, the residential rental market will be divided into three segments (as opposed to the current two segments):

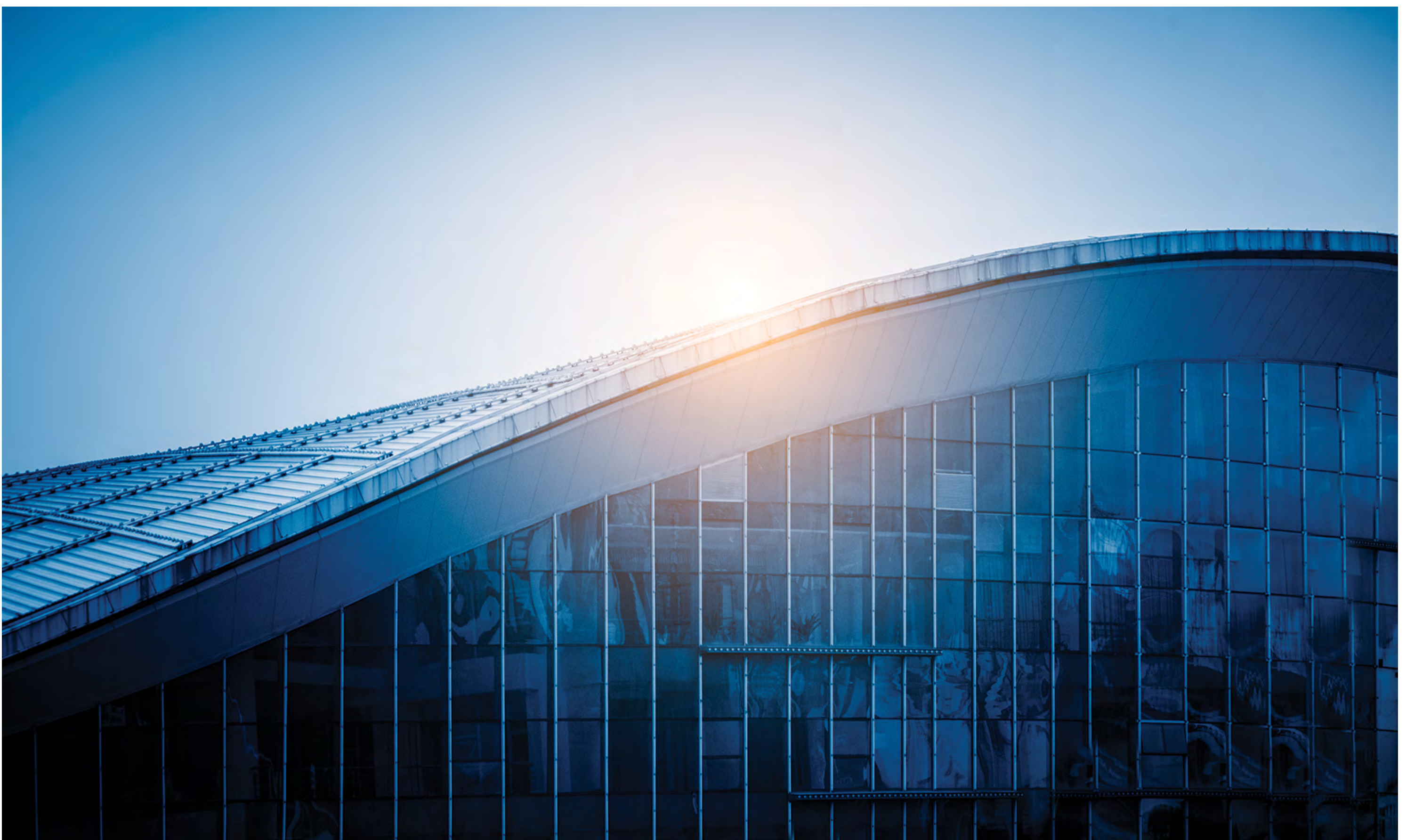
- the "low rent segment" (*laagsegment*) (currently named: the regulated segment), which applies to units of up to and including 148 points (the so-called "low rent ceiling" (*maximale lagehuurgrens*));
- the "mid rent segment" (*middensegment*), which applies to units between 149 and 186 points (the "mid rent ceiling" (*maximale middenhuurgrens*), which will correspond to a rent of approx. €1,123.13, in accordance with the points system that will be in effect on 1 January 2024); and
- the "high rent segment" (*hoogsegment*), which applies to units with 187 points or more and is comparable to the currently liberalized segment.

Whereas the mid-market rental sector is currently unregulated, it will become a regulated segment. This means that, where currently approximately 80% of the rental properties are regulated, an estimated 95% of all rental properties will become subject to rent control. The maximum starting rent that can be charged for a newly regulated unit will be determined by the number of points allocated to such unit. Furthermore, the draft legislation provides for several amendments in the calculation of points. Laatly, the point-system will become mandatory law, meaning that (i) the tenant may demand a correction of its rent in accordance with the applicable maximum rent and (ii) a public law penalty may be imposed.

9. The Netherlands: New template for retail leases

The Dutch Council for Real Estate (*Raad voor Onroerende Zaken* or **ROZ**) regularly publishes standard templates for retail, office and residential leases together with a set of general terms and conditions, which templates are market practice in the Netherlands. Recently, the ROZ has published a new standard template for retail lease agreements, together with a new set of general terms and conditions.

The latest retail ROZ model dated from 2012. In the new template, more arrangements between landlord and tenant with regard to sustainability, including energy saving measures and energy labels, are included, as a result of which we expect these topics to become more and more relevant when concluding retail leases in the Netherlands.



10. Luxembourg: Share class redemption – long-awaited tribunal decision

On 27 January 2023, the Luxembourg Administrative Tribunal (the Tribunal) issued its long-awaited judgment on the tax treatment of the repurchase of a class of shares (case 42432). It notably deals with the question whether the repurchase (and cancellation) of a class of shares should trigger Luxembourg dividend withholding tax on (part of) the repurchase price.

The Tribunal ruled that the redemption of shares is in principle not a profit distribution but triggers a capital gain not subject to withholding tax. However, if the repurchase price exceeds the fair market value of the repurchased shares (i.e., what a third party would have paid for these shares) and that excess is motivated by the shareholder relationship, the surplus of the repurchase price constitutes a hidden distribution of profits, subject to withholding tax.

The case is relevant for many Luxembourg companies that have issued so-called alphabet shares with the aim of offering to investors the flexibility to repatriate profits by redeeming a class of shares. In such a case, it is reasoned that no withholding tax is due: either based on so-called partial liquidation treatment, or on the basis of capital gain treatment following the ruling of the Luxembourg Administrative Court of 23 November 2017 (case 39193C) on a repurchase of shares in a different setting.

10.1 Facts of the case

A Luxembourg limited liability company had organised its share capital in 10 different classes of shares (named A to J) next to a class of ordinary shares, all held by the same shareholder. The lettered classes each made up about 5% of the nominal share capital. In a subsequent year, the company repurchased and cancelled all class J shares at a price significantly higher than 5% of the liquid assets of the company. As regards the economic rights of each class of shares, the articles of association did generally not attach different shareholder rights to the various classes. They just specified that any repurchase of an entire class of shares needed to happen in reverse alphabetical order (from J to A), at a redemption price amounting to (up to) virtually all of the distributable reserves.

The company considered the repurchase (and cancellation) of class J as a partial liquidation not subject to withholding tax. The tax authorities challenged this treatment on the grounds of abuse of law and upheld their levying of 15% withholding tax on the excess of the repurchase price over the nominal value of the repurchased shares.

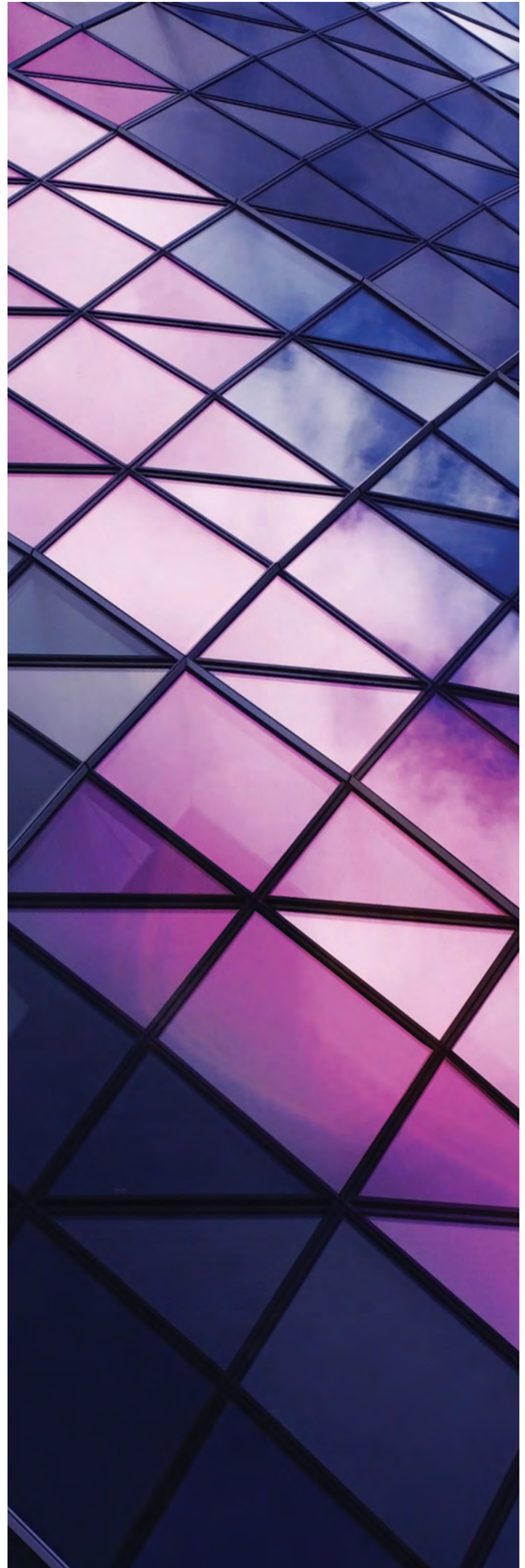
10.2 Analysis of the Tribunal

In line with the case law of the Luxembourg Administrative Court of 23 November 2017 (39193C), the Tribunal ruled that the redemption of a class of shares followed by a cancellation of the shares is not, in principle, a dividend distribution. The Tribunal included the caveat that a hidden distribution of profits may still arise in case the redemption price exceeds the fair market value of the redeemed shares, and such excess has no valid economic reasons but is solely explained by the shareholder relationship. The Tribunal then recalled a few elements in the case at hand that seem more relevant in the context of an abuse of law analysis rather than an analysis of the fair market value of the shares, such as the facts that (i) there was only one shareholder, (ii) all classes were created at the same time and (iii) the share classes did not have separate economic rights (other than allocating distributable reserves upon the redemption of a share class). The latter feature in particular is a difference with other fact patterns more often seen on the market. On that basis, the Tribunal concluded that the repurchase price of the shares should be treated as a hidden distribution of profits, but only insofar it exceeds the fair market value of the shares.

Absent any differences between the various classes of shares, the large asymmetry between the actual repurchase price and the proportional share in the net assets of the company of the repurchased shares led the tribunal to find that the company failed to establish that the repurchase price was not above the fair market value of the repurchased shares. The Tribunal referred the case back to the tax authorities for such determination. Because of its conclusion, the Tribunal has deemed it unnecessary to address whether in the case at hand there was abuse of law.

10.3 Takeways

Subject to appeal, if any, the Tribunal's judgment gives welcome clarity to the tax treatment of a repurchase of (a class of) shares, followed by their cancellation. The Tribunal confirms that the redemption of shares should, as a matter of principle, not be characterized as a profit distribution that is subject to withholding tax but as a capital gain which is not subject to withholding tax. The Tribunal, however, focused on the fair market value of such class of shares and not surprisingly confirmed that the redemption price exceeding the fair market value would characterize as a (hidden) dividend distribution. Taxpayers should therefore carefully consider how the redemption price is determined and whether it reflects the fair market value. Also, even if the tribunal did not examine the redemption from an abuse of law perspective, this aspect cannot be set aside.



11. Luxembourg - VAT & real estate: changes since 1 January 2023

In this context of strong inflation, VAT constitutes a lever of action that governments can activate to maintain buying power amongst the population. It is also a strong element of any tax policies – including those aimed at reducing the use of fossil energy. It comes therefore as no surprise that the Luxembourg Government recently announced two significant VAT measures: a general reduction in VAT rates, and a special reduction of the VAT rate applicable to solar panels. Players in the Luxembourg real estate sector should pay specific attention to these new rules, as their practical implementation can in many instances raise questions.

11.1 Temporary reduction in VAT rates

In order to fight the effects of inflation, the Luxembourg Government has announced a temporary reduction of VAT rates in Luxembourg as from 1 January 2023. The reduction is planned to be maintained for a full year. In effect, most current rates will be reduced by 1%. However, the super-reduced rate of 3%, sometimes applicable to residential real estate, will remain unchanged.

	Standard rates	Temporary reduced rates	Most relevant products
Standard rate	17%	16%	All transactions that do not benefit from a reduced rate
Intermediate rate	14%	13%	Custodian services, management of credits and credit guarantees some alcohol products
Reduced rate	8%	7%	Electricity, gas

- VAT taxable leases. Where the parties have opted for the application of VAT on their lease agreement, the applicable VAT rate will have to be reduced from 17% to 16%. While this seems to be a fairly easy change to adopt, the practical implementation may prove more complicated than expected. Under Luxembourg VAT Law, business-to-business transactions generally generate an obligation to raise an invoice. In such cases, VAT is due at the earliest of (i) the time of issuance of the invoice or (ii) the fifteenth day of the month following that during which the supply took place. However, the Grand-Ducal Regulation dated 7 March 1980 allows landlord not to raise invoices each month under specific conditions. Instead, the landlord can simply provide the tenant with a one-off written information, to be updated in case of modification of the rent. Yet, this exception simply constitutes an attenuation of the obligation to raise an invoice, as opposed to a derogation, as the written information is deemed to replace the invoice. Ultimately, the applicable VAT rate will therefore depend on whether the landlord issues, or not, a monthly invoice. In such a case, the VAT rate applicable should be that of the earliest of (i) the date of the invoice or (ii) the fifteenth of the following month. Where, on the contrary, the landlord does not raise an invoice, then VAT should be due at the rate applicable on the fifteenth of the following month. Based on the above, the rent for December 2022 may, under certain circumstances, be subject to a 16% VAT rate, while the rate for December 2023 may, in turn, attract a 17% VAT rate.

- VAT exempt leases. It is very common for lease agreements in Luxembourg to provide that, where VAT cannot be opted for (generally because the tenant does not fulfil the relevant conditions), the agreed rent is automatically increased by an amount equal to the VAT rate, or 17%. With the reduction of applicable VAT rates in 2023, the rent effectively due may have to be adapted. This is particularly true where the VAT clause provides that the agreed rent is automatically increased by an "amount equal to the applicable VAT rate". In this specific case, the increase no longer amounts to 17%, but should instead be capped at 16%. As always, a careful review of the relevant contract is warranted to ensure that these VAT changes are implemented in a way that also follows the documented agreement of the parties.
- Charges. Where the charges are re-invoiced by the landlord to the tenant as a separate VAT taxable supply, specific attention will also have to be given to the applicable VAT rate, as both the supply of electricity and of gas will benefit from a rate of 7%. Here also, timing of the invoice may have a significant influence on the applicable VAT rate.

11.2 Reduced rate on solar panels

Finally, the Luxembourg Government has also announced – in the framework of discussing the 2023 budget law – that the supply and installation of solar panels on a range of building should benefit from the super-reduced rate of 3%.

12. Luxembourg: Noteworthy (upcoming) changes in real estate law

12.1 Land taxation

On 10 October 2022, a bill of law aiming to reform the current land tax (*impôt foncier*) and to introduce two new national taxes was lodged with the Luxembourg Parliament: a land mobilisation tax (*impôt à la mobilisation des terrains*) and a tax on the non-occupation of housing (*impôt sur la non-occupation de logements*). The main aim of the bill of law is to adapt the unitary values applied for purposes of determining the land tax to be paid by a landowner to today's fair market values. The bill of law is still under review. As 2023 is an election year in Luxembourg, it is expected that this reform will only progress slowly and not be voted into law before a new parliament will have been formed.

12.2 Housing lease

- **Modification of the legal regime**. On 31 July 2020, a bill of law was deposited, aiming to modify the Act of 21 September 2006 on the housing lease. The goals are to improve the situation of tenants and promote access to housing by controlling the brokers fees, decreasing the rental guarantee from three to two months, providing a legal framework to cohousing and the abrogation the rent indexation in case of luxury dwellings. The bill of law is still under review.
- **Eviction of the tenant**. As per an Act of 23 December 2022, a tenant who has been sentenced to leave leased premises can request before a judge the suspension of its eviction from the leased premises until 31 March 2023 if it was not able to find another dwelling within three months as from the eviction judgement (to be extended two times with 3 months).

12.3 Co-ownership

The Act of 30 June 2022, aiming to modify the law of 16 May 1975 on the co-ownership, obliges co-owners of buildings to establish a works fund to anticipate the renovation of buildings, in particular in relation to the realisation of energy-saving works. The works fund is built-up with mandatory annual contributions, the amount of which are decided at the co-owners' general assembly. The annual contributions cannot be lower than the minimum amounts set by the law based on the thermal insulation class of the buildings. This obligation will enter into force on 1 August 2023.

12.4 Commercial lease

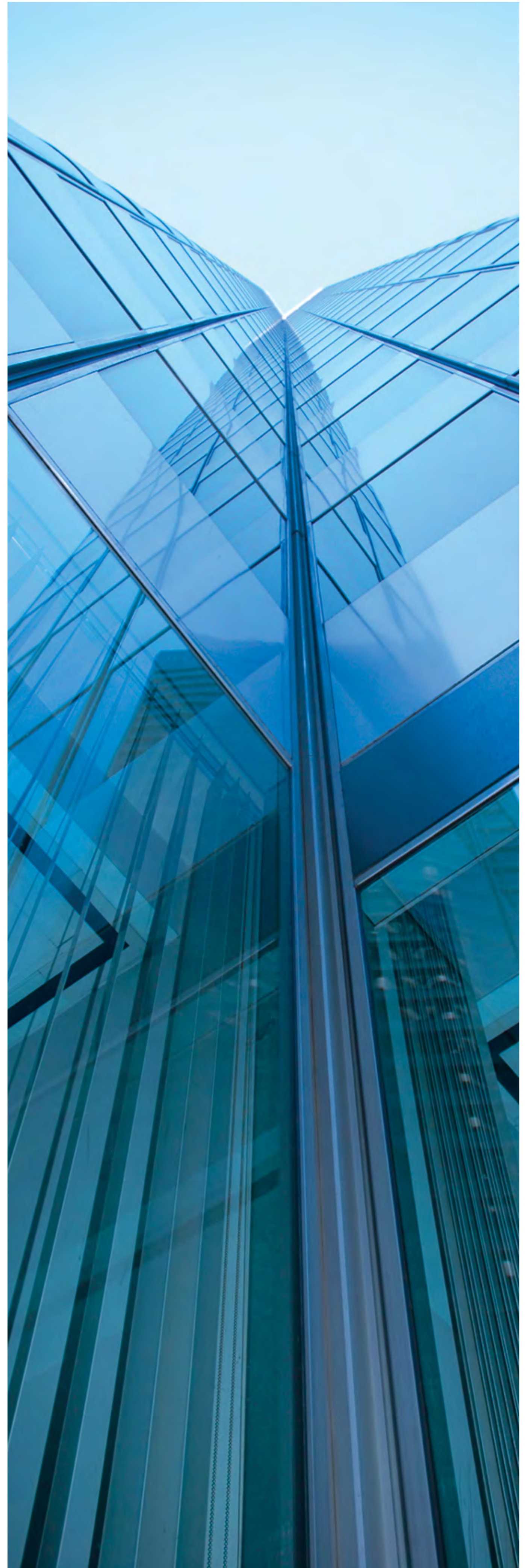
In a judgment of 23 December 2022, the Constitutional Court declares article 1762-6 (4) of the Civil Code - that prevents a tenant to sub-let its premises with a top-up rent - contrary to the Constitution. The Constitutional Court considers that whilst the fight against speculation aims at protecting the general interest, such prohibition triggers a disproportionate restriction. Pending remedial action from the legislator, the balance between the legitimate purpose of Article 1762-6 (4) and the trade and industry freedom is achieved if the rent under the sub-lease agreement does not exceed the rent paid by the tenant to the landlord increased with tenant's operating expenses relating to the sub-lease and a reasonable profit.

12.5 Revitalisation of the real estate market

On 8 February 2023, a bill of law was deposited, aiming to revitalize the Luxembourg real estate market. The goals are to support the housing sector by creating a favourable tax climate to re-encourage private investment. The bill of law contemplates to:

- extend the super-reduced rate of VAT of 3% from the construction of housing for private use to the construction of rental housing;
- increase the tax credit for registration duty purposes available upon the purchase of a residential building for private use from EUR 20,000 to EUR 50,000; and
- put an accelerated depreciation scheme at a rate of 6% in place for owners that rent out residential buildings.

The bill of law is currently still under review by the Luxembourg parliament.

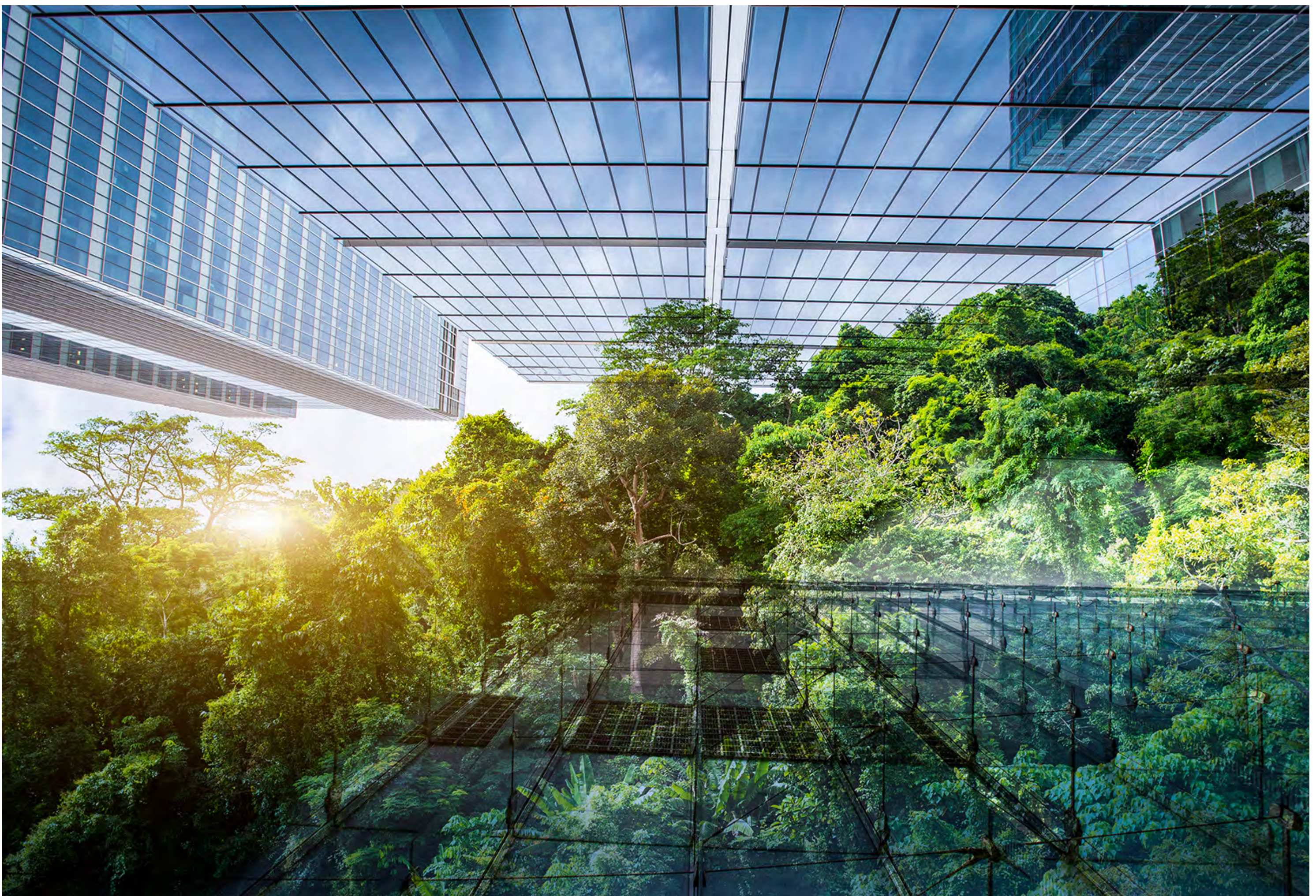


13. Switzerland: Swiss supreme court confirms wealth tax in Switzerland on SCI equity interests

In a recent decision, the Swiss supreme court clarified the income tax treatment of French SCI for Swiss tax resident investors.

In the case at hand, a Swiss tax-resident individual living in the canton of Vaud held 99% of the equity interests in a French SCI. The SCI held two properties. The cantonal tax administration of Vaud argued that the SCI should be treated as legal entity under Swiss domestic law and that the individual would therefore owe wealth tax on the fair value of the interests held in the SCI regardless of the tax treatment in France.

The supreme court upheld this decision re-confirming that the taxation right for equity interests held in a French SCI held by a Swiss individual can be subject to tax in Switzerland. As France did not exercise its taxation right in the case at hand, the canton of Vaud was free to levy wealth tax on the SCI shares and concurrently also no double taxation would arise. We wish you a pleasant reading and hope to see you soon.



Contacts

Imme Kam
Partner - Tax

T +33 1 49 53 91 25
E imme.kam@loyensloeff.com

Real Estate

Ariane Brohez
Partner - Real Estate & Real Estate Taxation

T +32 2 743 43 21
E ariane.brohez@loyensloeff.com

Pauline Leegwater
Partner - Real Estate

T +31 20 578 59 73
E pauline.leegwater@loyensloeff.com

Steven Lucas
Partner - Real Estate

T +31 20 578 52 46
E steven.lucas@loyensloeff.com

Jochem van der Wal
Partner - Investment Management

T +31 20 578 52 34
E jochem.van.der.wal@loyensloeff.com

Julien Lecler
Counsel - Real Estate

T +32 2 773 23 59
E julien.lecler@loyensloeff.com

Have contributed to this issue

Agathe van Amerongen
Senior Associate
T +31 10 224 63 29
E agathe.van.amerongen@loyensloeff.com

Jérôme Aries
Tax Adviser
T +31 10 224 65 19
E jerome.aries@loyensloeff.com

Mane Bajadjan
Senior Associate
T +31 20 578 51 34
E mane.bajadjan@loyensloeff.com

Christine Beernaerts
Counsel
T +352 4 66 23 05 36
E christine.beernaerts@loyensloeff.com

Lien Bellinck
Counsel
T +32 2 773 23 36
E lien.bellinck@loyensloeff.com

Damian van Boxtel
Tax Adviser
T +31 20 578 53 52
E damian.van.boxtel@loyensloeff.com

Olivier Coulon
Tax Adviser
T +352 466 230 303
E olivier.coulon@loyensloeff.com

Valentijn De Boe
Partner
T +32 2 773 23 33
E valentijn.de.boe@loyensloeff.com

Michaël Eeckhout
Associate
T +32 2 743 43 66
E michael.eeckhout@loyensloeff.com

Kévin Emeraux
Tax Adviser
T +352 466 230 570
E kevin.emeraux@loyensloeff.com

Tom Hamen
Tax Adviser
T +352 466 230 283
E tom.hamen@loyensloeff.com

Pierre-Antoine Klethi
Senior Associate
T +352 466 230 429
E pierre-antoine.klethi@loyensloeff.com

Yves Landheer
Senior Tax (Compliance) Adviser
T +31 20 578 55 26
E yves.landheer@loyensloeff.com

Nicolas Lippens
Partner
T +32 2 773 23 21
E nicolas.lippens@loyensloeff.com

Jet de Mol van Otterloo
Associate
T +31 20 578 58 33
E jet.de.mol.van.otterloo@loyensloeff.com

Olivia Oosterlynck
Associate
T +32 2 700 10 45
E olivia.oosterlynck@loyensloeff.com

Caroline Orban
Associate
T +32 2 773 23 28
E caroline.orban@loyensloeff.com

Sjoerd Pennink
Associate
T +31 20 578 50 18
E sjoerd.pennink@loyensloeff.com

Fabian Sutter
Partner
T +41 434 34 67 00
E fabian.sutter@loyensloeff.com

Aude Van den Bussche
Associate
T +32 2 773 23 91
E aude.van.den.bussche@loyensloeff.com

Marloes Voorrips
Senior Associate
T +31 20 578 50 80
E marloes.voorrips@loyensloeff.com

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