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News Analysis: Implications of New Transfer Tax Rules for Foreign Companies

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In its 2011 budget,[1] the Dutch government proposed new rules to combat schemes designed to avoid Dutch real estate transfer tax by transferring shares in companies owning real estate rather than transferring real estate itself.

The 2011 budget has already been approved by the second chamber of the Dutch parliament. It is now pending in the first chamber and was expected to enter into force on January 1, 2011. (For prior coverage, see *Tax Notes Int'l*, Oct. 4, 2010, p. 22, *Doc 2010-20785*, or *2010 WTD 185-2*.)

The new rules could also affect the transfer of shares in companies that reside outside the Netherlands but own Dutch real estate.

Dutch Real Estate Transfer Tax

The acquisition of real estate situated in the Netherlands is subject to a real estate transfer tax (RET tax) at a rate of 6 percent based on the fair market value. The definition of real estate includes shares in a real estate company (REC).[2] An acquisition of shares in a REC is subject to the 6 percent RET tax if the purchaser as a result of this acquisition obtains a substantial interest of at least one-third in the REC or further increases such a substantial interest.[3] The 6 percent RET tax is based on the proportionate interest in the fair market value of the underlying real estate assets (that is, not on the value of the shares).

Definition of REC

Under the current law, a company is a REC if:

- it has capital divided into shares, of which the assets at the moment of acquisition of its shares, or at any moment during the year before this acquisition (reference period), consist of at least 70 percent real estate situated in the Netherlands (asset test); and

- at least 70 percent of this Dutch real estate is held for the purpose of trading or exploitation (purpose test).

Also, if a company has a direct or indirect interest of at least one-third in another company, for the application of the asset test, the assets and liabilities of the other company should be proportionally attributed to the first company (attribution rule).

In principle, this definition includes both resident and nonresident companies if the asset test is met. Based on the purpose test, a company that uses the real estate in its own business (other than trading in and exploiting real estate) is generally not qualified as a REC.

Background of Proposed Measures

The definition of REC has led to schemes that aim to avoid the RET tax on the transfer of Dutch real estate by using a real estate company that does not meet the REC definition. For example, it is possible to increase the assets of the company with sufficient other non-qualifying assets (for example, intragroup loans, liquid assets, or foreign real estate) to avoid the 70 percent asset test from being met. It is also possible to circumvent the RET tax by structuring the investment using indirect shareholdings together with group companies or by following a certain timing in the acquisition process.

The law had already been amended to combat some of these schemes, but the government apparently found these changes insufficient.

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[1] Bill No. 32504.

[2] Article 4, para. 1 of the Tax Act Legal Transaction, 1970 (*Wet op belastingen van rechtsverkeer* 1970).

[3] The law includes a provision that provides that shares that are to be acquired in connection with the same or a related agreement should also be taken into account for this purpose. Moreover, even if a substantial interest of one-third does not exist for an individual, the interest in the company held by some other related persons must be taken into account.

Proposed Changes

The RET tax measures contained in the budget mainly deal with the definition of a REC.[4] The bill changes the asset test and the attribution rule.

The amendments consist of four parts:

- A company will be considered a REC if during the reference period its assets consist of more than 50 percent real estate and at the same time consist of at least 30 percent real estate situated in the Netherlands.
- When determining whether the company has an interest of at least one-third in another company and therefore should apply the attribution rule to the assets and liabilities of this other company, the interest held in that other company by some other related persons (including group companies) will be taken into account.
- When applying the asset test, certain receivables (related-party receivables) of related persons, including the transferee of the shares and persons related to this transferee, will be excluded.
- If the company has assets other than real estate and related-party receivables, those other assets will not be taken into account when applying the asset test to the extent the company has debts toward related persons, including the transferee of the shares and persons related to this transferee.

The exclusion of assets under the third and fourth amendment would not apply when it is plausible that the assets concerned originated from appropriate ordinary business activities of the company or a related person (counterproof provision).

Discussion

The new proposed rules make the law even more complex.

The first amendment in the definition of a REC would introduce a two-step test. The first step requires that the real estate owned by the company consist of more than 50 percent real estate. It is important to note that not only is the threshold reduced but also the ownership of foreign real estate should be taken into account. The second step requires that in order to qualify as a REC, at least 30 percent of the overall assets should consist of real estate situated in the Netherlands.

[4]The bill also includes a provision that broadens the scope of "related agreements" (see note 3) that should be considered in order to determine whether an interest of one-third exists. Moreover, the bill also includes a provision that broadens the definition of shares by including "rights to existing shares." These changes are not further discussed in this article.

The purpose test that requires at least 70 percent of the real estate owned to be used for purposes of trading or exploitation would apply to all real estate assets, including any foreign real estate owned. The 6 percent RET tax would continue to be based on the underlying value of the Dutch real estate only.

A nonresident company can already qualify as a REC for Dutch tax purposes under current law. However, the proposed rules would likely increase the chances that a foreign real estate company that owns Dutch real estate as part of its investment portfolio will qualify as a REC. As a consequence, foreign real estate companies may be less inclined to acquire Dutch real estate. Assuming that a foreign company meets the 50 percent threshold, the company (and its shareholders) should be aware that it could become a REC for Dutch RET tax purposes when the Dutch real estate owned (directly, indirectly, and attributed) meets the 30 percent threshold.

If a foreign company meets the two-step test, a Dutch RET tax claim may arise when shares in this foreign real estate company are transferred. From a practical standpoint, it may be difficult — also in view of the other amendments — to determine whether a foreign company is indeed a REC for Dutch RET tax purposes. Moreover, it is questionable whether the Dutch tax authorities will be able to secure their tax claim when a foreign company and nonresident shareholders are involved. It should be noted, however, that RET tax would only be triggered when the transfer of shares in a REC leads to an acquisition of a substantial interest of at least one-third in the REC or when an existing substantial interest is further increased.

The second amendment deals with the attribution rule and would broaden the scope of companies of which the assets and liabilities should be taken into account when applying the asset test. Whether an interest of at least one-third in another company exists would no longer be determined only at the level of the company holding the interest. Under the proposed rules, interests in that other company held by some other related persons would also be considered. For example, when the company has a 25 percent interest in another company and a qualifying person related to the first company holds an interest of 10 percent in that other company, the one-third threshold is met. The company should attribute the assets and liabilities of this other company to its own assets and liabilities, but only to its proportionate interest of 25 percent.

The third and fourth amendments are aimed at combating artificial asset increase schemes. As a result of these amendments, some assets would be ignored when applying the asset test unless the assets can be shown to have resulted from ordinary business activity. ◆

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