

Real Estate Tax Services News

Keeping you informed

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Foreign real estate investment funds are eligible for Dutch FBI corporate income tax exemption

In brief

On 3 September 2021, the Dutch court of appeal in 's-Hertogenbosch, the Netherlands, (the „Court“) has ruled in a case for a client represented by PwC that under current Dutch tax law (which applies to years commencing on or after 1 August 2007) a German real estate investment fund (a *Publikumsfonds* in the form of a *Sondervermögen*), is in principle entitled to the Dutch FBI regime. The FBI regime is a facility within the Dutch Corporate Income Tax (CIT) Act that can be applied by listed and non-listed (real estate) investment funds providing, amongst others, for a 0% CIT rate. In order to apply the FBI regime, certain conditions (including the portfolio investment test, the distribution test, the shareholder test and the legal form requirement) need to be met. The importance of this case is that the Court confirmed that, contrary to the position taken by the Dutch tax authorities (DTA), the German fund complies with the current legal form requirement even though no (withholding) tax is effectively levied on the Dutch source real estate income at shareholder level. The Court decided differently under former Dutch tax law (which applies to years commencing prior to 1 August 2007). The former law was in breach of EU law, because it restricted the FBI regime to Dutch funds. The Court mandated that as a condition of the application of the FBI regime to foreign funds under the former law, the fund must be prepared to make a “substitute payment” for the (withholding) tax not levied on the shareholders.

CIT liability

In this case the primary question for the Court is whether the German fund qualifies as a foreign taxpayer for Dutch CIT purposes. This because foreign entities that are neither a legal entity, partnership or special purpose fund (*doelvermogen*) do not fall within the scope of Dutch CIT and thus are not subject to Dutch CIT. The Court ruled that the German fund is not a partnership. Referring to the Dutch Supreme Court judgment in ECLI:NL:HR:2020:115, the Court concluded that the German fund qualifies as a special purpose fund and thus falls within the scope of Dutch CIT. According to the Court, the German fund did not issue participations on the basis of which the holder is entitled to the net assets of the fund. It is unclear on the basis of which facts the Court came to this conclusion.

FBI regime prior to August 2007

The subsequent question presented to the Court is whether the German fund is eligible for the FBI regime. For the years commencing prior to 1 August 2007, the Dutch CIT law required that an FBI was incorporated under Dutch law. Therefore, for these years the German fund would not qualify for the FBI regime. According to the Court, such disqualification of foreign funds constitutes a breach of the free movement of capital. The Court accepted, however, the argument that there is a valid justification ground for not applying the FBI regime to the German fund, as no tax was levied in the Netherlands or in Germany on the Dutch source real estate income. Referring to the Dutch Supreme Court judgment in the case Deka (ECLI:NL:HR:2020:1674), the Court mandated that the German fund must be given a less far-reaching opportunity to make a so-called "substitute payment" as a condition for the application of the FBI regime. As the German fund did not make an explicit offer to make the substitute payment, the Court decided it was not entitled to the FBI regime for the years prior to 2007.

FBI regime as from August 2007

However, for the years starting on or after 1 August 2007, the Dutch CIT Act allows entities incorporated under the laws of another EU Member State to elect for the FBI regime. The Court ruled that the German fund can comply with the current legal form requirement and thus can elect for the FBI regime. The DTA argument that no foreign taxation is effectively levied on the Dutch source real estate income was rejected by the Court as Dutch tax law does not require such taxation for a non-resident fund. In this case the German fund was not entitled to the FBI regime for the years 2007 and later, because according to the Court it was not prepared to pay the exit tax in the year preceding the first year of application of the FBI regime. Under Dutch tax law, when entering the FBI regime the deferred capital gains tax is added to the taxable profit of the preceding year.

Portfolio investment test

Under Dutch tax law, the statutory purpose of the FBI, as well as the actual activities it performs, must consist solely of portfolio investment activities. The Court considered that all activities (including those in other territories) of the German fund must fulfil the portfolio investment test for Dutch tax purposes. Subsequently, a distinction was made by the Court between the Dutch activities and the foreign activities of the German fund. According to the Court the required proof that the Dutch real estate investment activities did not go beyond portfolio investment activities was delivered by the German fund. The most important fact supporting this decision was that the real estate developments acquired by the German fund were all acquired through a turnkey agreement under which the principal development risks were for the account of the selling property developer. In relation to the activities of the German fund outside the Netherlands, the Court considered that the DTA do not enforce the investment test in relation to foreign activities of Dutch FBIs. Enforcing the investment test on the non-Dutch activities of foreign funds, would be a breach of the free movement of capital without any valid justification ground. Taking all the above into account, the Court concluded that the portfolio investment test is met by the German fund.

Our view

Following the intensive and lengthy discussions with the DTA, the entitlement of German real estate investment funds to the FBI regime has (finally) been confirmed by a Dutch court of appeal. This is good news for, in particular, German funds that have invested in Dutch real estate on or after 1 August 2007 and made timely objections against CIT assessments in the Netherlands. Based on this decision and provided the normal requirements are met, they can claim the FBI regime in the Netherlands, resulting in an effective exemption of Dutch taxation on the Dutch source real estate income. German and other foreign real estate investment funds which have invested in Dutch real estate directly should also consider filling objections

against CIT assessments in the Netherlands if they can meet the FBI requirements. The case may be brought to the Dutch Supreme Court who will then ultimately decide on the application of the Dutch tax law. In addition, we note that the Dutch Ministry of Finance has announced to reconsider the future of the Dutch FBI regime pending the outcome of this case.

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