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INSIGHTS

G.A.A.R. OR S.A.A.R.? EFFECT OF THE NORDCURRENT DECISION IN BELGIUM, THE NETHERLANDS, AND LUXEMBOURG

DRAMATIC CHANGES PROPOSED IN THE DEFINITION OF THE TAX TERM "ISRAELI RESIDENT"

CAN THE SHARES OF COMPANIES OWNING FRENCH REAL ESTATE BE CATEGORIZED AS REAL ESTATE? SOME KEYS TO SOLVE THE RIDDLE

AND MORE

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EDITORS' NOTE

In this month's edition of *Insights*, our articles address the following:

- **G.A.A.R. OR S.A.A.R.? Effect of the Nordcurrent Decision in Belgium, the Netherlands, and Luxembourg.** Earlier this year, the C.J.E.U. issued its anticipated judgment in the Nordcurrent case (C-228/24). The judgment concerns the extension of the anti-abuse rule in the E.U. Parent-Subsidiary Directive ("'P.S.D.") to national participation exemption mechanisms. The ruling has significant implications and resonance in Belgium and the Netherlands, less so in Luxembourg, In their article (1) Werner Heyvaert, a Partner, and Yannick Vandenplas, an Associate, in the Brussels office of AKD Benelux Lawyers, (2), Jan-Willem Beijk and Anton Akimov, Partners in the Netherlands practice of AKD Benelux Lawyers, and (3) Maria-Clara Vassil, a Senior Associate, and Sanja Vasic, an Associate in the Luxembourg office of AKD Benelux Lawyers provide a clear summary and analysis of the case, explore its practical implications in their respective countries, and offer a perspective on its broader impact.
- **Dramatic Changes Proposed in the Definition of "Israeli Resident" and "Foreign Resident."** Under current Israeli tax law, an individual's tax residency status is determined primarily by the "Center of Life" test, which examines personal, economic, and social ties to Israel and another country. The test is supplemented by numerical presumptions that look to the number of days an individual is present in Israel over a period of time looking to one year or three years. A determination based on day count can be challenged by either the taxpayer or the Tax Authority. In 2023, a draft bill was published that provided an irrebuttable determination of tax residence or nonresidence in certain fact patterns. The draft bill was never enacted. In July, the Israeli Ministry of Finance announced draft legislation designed to modify existing rules. In his article, Boaz Feinberg, a Tax Partner of Arnon, Tadmor-Levy, Tel Aviv, explains the proposal in detail, including the new five-year rolling testing period and the weight given to days in each year of the testing period. He points out that days of presence in later years can affect the residence status in earlier years.
- **Can the Shares of Companies Owning French Real Estate be Categorized as Real Estate? Some Keys to Solve the Riddle.** An immovable asset is a plot of land or a structure built on the land. Neither can be moved without being damaged or without damaging the land to which it is attached. Certain rights are also immovable due to their intrinsic link to immovable assets. An example would be real estate property rights, such as those embedded in a *usufruct* arrangement. In comparison, a movable asset can be transported from one place to another or is intangible by its nature. The French Civil Code expressly includes shares of companies in the concept of movable assets, even where such companies own real estate. The historical distinction between immovable and movable property is why French tax law created an autonomous concept of a "predominantly real estate company." The definition of a predominantly real estate company varies depending on the tax being imposed. In their article, Xenia Lordkipanidze, a Partner in Overshield Avocats, Paris, and Clement Pere, an Associate in the Tax Department of Overshield

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Avocats, Paris, explain the inconsistency of French law and cases. The *Cour de Cassation*, the French Supreme Court for non-administrative matters, has jurisdiction over disputes relating to gift and inheritance duties and wealth tax has reached one conclusion – shares comprise movable property. The *Conseil d'Etat*, the French Supreme Court for administrative matters has jurisdiction over disputes relating to personal and corporate income tax, including capital gains tax, has reached a contradictory conclusion – shares of a predominantly real estate company comprise immovable property. The question posed by the authors is which Supreme Court reached the correct answer. Not surprisingly, the answer given is that it depends on relevant factors.

- **Tax Issues Faced by Foreign Persons Investing In Greek Commercial Real Estate.** Greece's diverse real estate market has become an increasingly attractive destination for foreign investment. The Mediterranean climate, rich cultural history, and growing economy make the country particularly appealing to investors looking for residential and commercial properties. Greece's investment landscape is further enhanced by favorable tax incentives, such as the Non-Dom tax regime, the tax regime for pensioners, the tax regime for employees and freelancers, the family office regime, and the Golden Visa program. In their article, Natalia Skoulidou, a Partner of Iason Skouzos Tax Law, Athens, and Aikaterini D. Besini, a Senior Associate at Iason Skouzos Tax Law, Athens, provide a comprehensive overview of the tax landscape for foreign investors investing in Greek commercial real estate. Their article outlines the key tax considerations at each stage of the investment process to help investors navigate the complexities of Greece's tax system in order to make well-informed strategic decisions. The outcome can be quite favorable to investors from abroad.

- **U.S. Investment In U.K. Real Estate – Separated By a Common Language.** It is common for U.S. individuals investing in commercial real estate in the U.K. to adopt a two-tier structure through which U.K. real estate is owned. It is also common to hold each property through a separate special purpose vehicle ("S.P.V.") formed in the U.K. In their article, George Mitchel, a Partner in Forsters L.L.P., London, Heather Corben, a Partner in Forsters L.L.P., Lon-don, and Amy Barton, a Senior Associate in Forsters L.L.P., London, explain how this relatively simple structure (i) enables a U.S. resident investor to eliminate two levels of tax on distributed profits, (ii) creates foreign tax credit limitation in the U.S. allowing a U.S. resident investor to obtain an immediate foreign tax credit for U.K. taxes as gains are harvested at the time shares of a U.K. limited company are sold, and (iii) allows the estate of a U.S.-resi-dent investor to obtain benefits under the U.K.-U.S. Estate Tax Treaty limiting death duties to taxes imposed in the U.S. They also caution about a particular risk if a structure is headed by a U.S. grantor trust having one or more U.K. residents as beneficiaries.

- **Tax Issues Faced by Foreign Persons Investing in Italian Commercial Real Property.** For nonresident investors, Italy contains many little known provisions to reduce or eliminate tax on income and gains arising from real property. A careful reading of domestic tax law, combined with the proper application of bilateral income tax treaties, reveals several planning opportunities that can significantly enhance the efficiency of cross-border real estate investment. In their article, Federico Di Cesare, a Partner of Lipani Legal & Tax (formerly Macchi di Cellere Gangemi), Rome, and Dimitra Michalopoulos,

an Associate in the tax practice of Lipani Legal & Tax (formerly Macchi di Cellere Gangemi), Rome, explain that, *inter alia*, capital gains arising from the sale of the Italian real property are not subject to Italian income tax if the real property is held for more than five years. Similarly, capital gains arising from the sale of shares in an Italian corporation or its liquidation are not subject to tax for a nonresident investor even when the assets of the corporation consist mostly of real property. Other opportunities are available to reduce or eliminate capital gains taxation for a nonresident who qualifies as a minority shareholder or benefits from an income tax treaty. Nonetheless, it is Italy, and numerous regulatory pitfalls must be managed, including legal requirements, factual conditions, and holding period.

- **Strategic Considerations for International Investors in Dutch Real Estate.** From an economic viewpoint, the Netherlands is a highly attractive destination for international real estate investors, thanks to its robust legal framework, transparent property market, and strategic location within Europe. From a tax policy viewpoint, however, the Dutch tax environment can be challenging, as it is subject to frequent legislative changes. Recent updates – including the partial discontinuation of the Dutch equivalent of a R.E.I.T., known as the F.B.I. regime, revised entity classification standards, and stricter interest deduction rules – have significantly impacted the landscape for cross-border investors. In his article, Anton Louwinger, a partner in CMS Netherlands, Amsterdam, explains the important issues at various points in the ownership period, including (1) R.E.T.T. or V.A.T. on purchases, (2) C.I.T. during ownership, (3) caps on deductions for interest expense and application of anti-abuse rules for payments to a foreign related party, (4) withholding tax on interest and dividend payments, (5) caps on the use of N.O.L.'s, and (6) taxation of capital gains upon sales.

- **F.I.R.P.T.A. Revisited -- Things To Remember When Nonresidents Invest in U.S. Real Property.** The year 2025 marks the 45th anniversary of the enactment of the Foreign Investors Real Property Tax Act. It is a good time to revisit issues that are faced by nonresident investors considering an acquisition of real property in the U.S. For the private investor, many decision points must be addressed. Here are a few that come readily to mind: (1) Will the investment generate passive or active income? (2) Now and possibly in the future, will the investment be limited to one property or will there be multiple properties? (3) Is it better to own the property directly or through a holding company? (4) Should the holding company be formed in the U.S. or abroad there, or should there be holding companies in both places? (5) Should the holding company be tax-transparent or tax-opaque? (6) Will the structure prevent death duties from being imposed in the U.S.? (7) If the initial holding structure produces suboptimal results, can the structure be revised, and if so, at what cost? (8) Is it better to hold all U.S. properties through one U.S. holding company or is it better to hold each U.S. property through its own separate U.S. holding company? Stanley C. Ruchelman and Wooyoung Lee provide guidance to foreign investors and their home country advisers so that well-reasoned investment structures can be formulated at the front end that take into account U.S. tax rules, foreign tax rules, and preferences of the particular client.

- **Still Fourth Down And Goal For Medtronic Transfer Pricing Case.** In an article published in Insights in 2022, Michael Peggs commented that the Tax Court knew where it wanted to end up and simply looked for a method that was consistent with its destination. He predicted that the approach of the Tax Court was not likely to be upheld on appeal. In early September, the Tax Court's decision was vacated and remanded for further proceedings. In the "boxing matches" taking place between (1) Medtronic and the I.R.S. and (2) the Tax Court and the Court of Appeals, it seems the boxers are in the fourth round of a ten-round bout. Stay tuned.

- **Bigger Benefits for (Bigger) Small Businesses: Q.S.B.S. Changes in O.B.B.B.** The Qualified Small Business Stock" ("Q.S.B.S.") rules broadly allow for tax-free sales of Q.S.B.S., up to a certain limit. The benefit is subject to meeting several requirements, among which is a requirement for a five-year holding period by the seller. In their article, Galia Antebi, Nina Krauthamer and Wooyoung Lee explain that the One Big Beautiful Bill ("O.B.B.B.") causes the Q.S.B.S. benefit to be significantly more investor friendly. It allows for more gain exclusion, bigger businesses to qualify, and partial exclusions for holding periods shorter than five years.

We hope you enjoy this issue.

- The Editors

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G.A.A.R. OR S.A.A.R.? EFFECT OF THE *NORDCURRENT* DECISION IN BELGIUM, THE NETHERLANDS, AND LUXEMBOURG

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INTRODUCTION

On April 3, 2025, the Court of Justice of the European Union (C.J.E.U.) issued its anticipated judgment in the *Nordcurrent* case (C-228/24). The judgment concerns the application of the anti-abuse rule in the E.U. Parent-Subsidiary Directive ("P.S.D.") to national participation exemption mechanisms.

The ruling has significant implications and resonance in Belgium, the Netherlands, and Luxembourg, where similar issues have been the subject of ongoing debate. This article provides a clear summary and analysis of the case, explores its practical implications in each of these countries, and offers a perspective on its broader impact.

FACTS AND C.J.E.U.'S ASSESSMENT

Background

In 2009, Nordcurrent Group UAB, a Lithuanian video game developer, established a U.K. subsidiary to distribute games internationally. In 2017 and 2018, the functions and risks of the U.K. subsidiary were transferred back to the parent corporation in Lithuania. After this relocation, Nordcurrent received dividends from its U.K. subsidiary and claimed exemption from Lithuanian corporate tax under the national participation exemption rules in Lithuania, implemented when the P.S.D. was transposed into national law. The U.K. subsidiary was then liquidated.

The Lithuanian Revenue Service denied the exemption for the U.K.-source dividends, arguing that the U.K. subsidiary was a non-genuine arrangement lacking sufficient substance. It employed one person who served as the sole director, owned no tangible assets, and shared an address with 97,110 other corporations. The Lithuanian Revenue Service claimed that the arrangement was set up to obtain a tax advantage, thereby constituting abuse under the P.S.D.'s General Anti-Avoidance Rule ("G.A.A.R.").

Nordcurrent argued that its U.K. subsidiary provided a real commercial advantage as an intermediary between Nordcurrent and various advertising and game distribution platforms until direct agreements could be concluded with such platforms. Following an agreement with Google in 2017, distribution functions and associated risks were gradually transferred from the U.K. subsidiary to Nordcurrent, leaving the U.K. subsidiary responsible only for distribution until its winding-up at the end of 2019. Nordcurrent emphasized that the U.K. subsidiary was formed and operated for valid commercial reasons since establishment in 2009 and was not merely a conduit entity. This was further evidenced by the fact that the Lithuanian Revenue Service never questioned the U.K. subsidiary's activities nor the reasons for its formation

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prior to the years 2018 and 2019. Nordcurrent also claimed there was no actual tax advantage. The U.K. subsidiary was profitable and subject to a 24% tax rate.

Legal Issues and C.J.E.U. Response

In the course of the litigation, the Lithuanian Tax Dispute Commission (*Mokestinių ginčų komisija prie Lietuvos Respublikos Vyriausybės*) adjourned the hearing of the case in order to refer the following preliminary questions to the C.J.E.U.:

- Can Lithuania deny the participation exemption if the subsidiary is not a conduit corporation but is still deemed a non-genuine arrangement?
- Should the abuse assessment focus only on the circumstances at the time of dividend distribution, or must all relevant facts and circumstances be considered?
- Is the mere categorization of a subsidiary as a non-genuine arrangement sufficient to deny the exemption, or must there also be a tax advantage that defeats the P.S.D.'s purpose?

In its April decision, the C.J.E.U. responded as follows:

- The anti-abuse rule of the P.S.D. is not limited to conduit corporations. It applies to any non-genuine arrangement, even if the subsidiary generated its own profit.
- A holistic assessment is required when evaluating whether an arrangement is non-genuine. Accordingly, all relevant facts and circumstances must be considered, including the reasons for the subsidiary's creation and its activities over time.
- To deny the exemption, a non-genuine arrangement must exist, and its main purpose must be the allowance of a tax advantage that is inconsistent with the object of the P.S.D. These factors may exist at the creation of a corporation or at a later date, as facts may change over time.

IN-DEPTH ANALYSIS

Holistic and Dynamic Assessments

The P.S.D. aims to eliminate double taxation of profits distributed between E.U. corporations. However, the P.S.D. includes a G.A.A.R. to prevent abuse. Article 1, paragraphs 2 and 3 of the P.S.D. deny benefits to arrangements that are not implemented for valid commercial reasons reflecting economic reality, especially if the main purpose is to achieve a tax advantage. The C.J.E.U. clarified that the anti-abuse rule is not restricted to classic "conduit" or "letterbox" corporations. Even subsidiaries with real activities are in the scope of the G.A.A.R. if, in the broader context, their existence or continued operation is primarily tax driven. This builds on earlier case law such as the Danish cases[1] and the Cadbury Schweppes case[2] by extending the principle to a wide range of corporate arrangements.

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[1] C-116/16 and C-117/16.

[2] C-196/04.

When applying the P.S.D. G.A.A.R. it is imperative to have a holistic and dynamic approach. Consequently, Revenue Services are now required to consider (i) the full history of the arrangement, from its creation to the dividend payment (ii) changes in business purpose or substance over time, and (iii) the overall tax effect, including whether the subsidiary's profits were taxed at a higher rate abroad than they would have been if such activities were not conducted by that subsidiary.

"Holding and finance corporations require less physical presence than operational entities conducting manufacturing or sales activities."

This C.J.E.U.'s holistic approach was foreshadowed by Attorney-General Kokott in the Danish case C-115/16.

> Since companies that focus on asset management, by definition, may carry out little activity, this criteria should not require high demands. When there is a valid incorporation, the company is actually reachable at its registered address and has the necessary material and personnel resources to achieve its objective – in this case, the management of a loan agreement – the structure in question cannot be considered disconnected from the economic reality.[3]

Holding and finance corporations require less physical presence than operational entities conducting manufacturing or sales activities. Instead, the focus is on economic substance. Does the corporation genuinely manage assets, assume risks, and generates income locally, even if some functions are outsourced or physical presence is limited? This means that limited physical substance does not automatically indicate a lack of genuine economic activity, especially for asset management, holding or finance corporations.

Whether the substance is adequate, is determined by the corporation's business purpose and ongoing activities. A contextual and dynamic assessment is required rather than a one-size-fits-all approach. This approach prevents both an overly formalistic denial and an automatic approval in favor of a nuanced, fact-driven analysis.

Objective and Subjective Elements

In order to determine whether abuse of the P.S.D. exists, both an objective element, and a subjective element must be examined. The objective element is met if the arrangement lacks valid commercial reasons or economic reality, and for that reason, is not genuine. The subjective element is met if the main purpose of the arrangement, or one of its main purposes, is to obtain a tax advantage that undermines the P.S.D.'s intent. Both elements must be present.

For example, a subsidiary with little substance is not automatically considered abusive if there is a genuine business rationale or no undue tax benefit. The C.J.E.U. noted that the tax rate in the subsidiary's country is relevant. Consequently, if income is taxed at a higher rate abroad, the unfavorable rate differential may indicate the arrangement was not primarily motivated by tax considerations. Ultimately, it is the overall tax impact, rather than merely the formal structure, that determines whether abuse exists.

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[3] Paragraph 67.

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PRACTICAL IMPLICATIONS

Belgium

Belgium has long struggled with the application of anti-abuse rules to the participation exemption and different withholding tax exemptions in complex international structures. Belgium has implemented both a national G.A.A.R. and a specific anti-abuse rule derived from the P.S.D. ("S.A.A.R.") in its tax legislation.

Particularly notable is S.A.A.R. for the dividend withholding tax ("W.H.T.") exemption under the P.S.D., as set out in Section 266, 4th limb of the Belgian Income Tax Code ("B.I.T.C."). This provision transposes the P.S.D. anti-abuse provision into Belgian law. The W.H.T. exemption does not apply to dividends linked to legal acts, or a series of acts, that are artificial and primarily aimed at obtaining a tax benefit. In principle, the formal burden of proof of tax abuse lies with the Belgian Revenue Service. In practice, taxpayers often need to prove the absence of tax abuse.

Meanwhile, Section 344 B.I.T.C. adopts a G.A.A.R., which impacts the application of the participation exemption. Taxpayers are prevented from achieving tax benefits through artificial arrangements that lack valid commercial reasons or do not reflect economic reality. When applying the participation exemption, Section 344 B.I.T.C. permits the Belgian Revenue Service to disregard transactions or structures that are primarily tax-motivated and circumvent the intent of the B.I.T.C. or implementing decrees. As a result, even if the formal requirements for the participation exemption are met, the exemption may be denied if the arrangement is deemed abusive under Section 344 B.I.T.C.

Court Cases

The criteria for tax abuse or for establishing the existence of genuine business reasons developed by the Belgian courts are the same in relation to the P.S.D. and various withholding tax exemptions.

On December 1, 2020, the Ghent Court of Appeals applied the G.A.A.R. in line with the E.U. anti-abuse principle, emphasizing the need to assess all relevant facts and circumstances. This approach was confirmed by the Court of Cassation on November 30, 2023, in which the court observed that the artificial nature of a structure and the intentions of the ultimate beneficiaries become apparent when all the relevant transactions carried out by related corporations are taken into account.

The Court clearly outlined the criteria to establish tax abuse (*fraus legis*). The Belgian Revenue Service must demonstrate that (i) the acts are primarily or substantially tax-driven, which is the subjective condition and (ii) the tax advantage frustrates the purpose of the P.S.D., which is the objective condition. The ruling also implied that a taxpayer could counter allegations of tax abuse by applying a look through approach, under which the subjective condition cannot be met if the taxpayer demonstrates that the tax benefit would have been granted without the interposition of the challenged structure.

The *Nordcurrent* ruling confirms this two-pronged test but makes it more difficult for a taxpayer to demonstrate the subjective test has not been met by the tax authorities. While the look-through defense remains available, it is no longer sufficient to show that the ultimate shareholder would have been entitled to the tax benefit if

the transaction were carried out in a simplified manner. Rather, the taxpayer must demonstrate that the entire structure, in its context and over its lifetime, was not aimed primarily at obtaining an improper tax advantage.

Belgian courts have occasionally ruled in favor of taxpayers. On October 30, 2023, the Constitutional Court issued a landmark ruling stating that the Belgian G.A.A.R. complies with the constitutional principle of legal certainty in tax matters, if interpreted as follows:

- The Belgian Revenue Service bears the burden of proof. It must demonstrate the existence of tax avoidance that frustrates the objectives of a precisely identified tax provision. Merely demonstrating that a taxpayer's activity is not aligned with a specified provision of tax law does not meet that burden.
- In order to prove that the objectives of a tax provision have been frustrated by a particular transaction, the Belgian Revenue Service must demonstrate that the objectives of the tax provision are clear and understandable from a plain reading of the text of the law or from the legislative history.
- Also, the Belgian Revenue Service must consider provisions already in place to combat the asserted abuse of law in question.

On October 26, 2023, the Court of Cassation ruled that tax abuse can be established only if the objectives of the tax provision are clear from the statute or, where applicable, from the legislative history. In an earlier decision of November 25, 2021, the Court of Cassation confirmed that although artificial arrangements designed to avoid dividend withholding tax by characterizing a transaction as a tax-exempt return of paid-up capital can be reclassified as a dividend distribution under the anti-abuse rules, any return of paid-up capital made pursuant to a valid capital reduction decision adopted in accordance with the Code on Corporations and Associations remains tax exempt.

In one case regarding holding company structures, a shareholder sold all of the shares of Corporation A to Corporation B, which was jointly owned by the seller's son and a private equity fund. Unless the sale of shares is deemed not to be normal management of private assets or takes place after December 31, 2025, Belgium does not tax capital gains on shares realized by private individuals.[4] To finance the purchase of the shares, Corporation B obtained a bank loan, which was quickly refinanced through a loan granted by Corporation A and one of its subsidiaries.

On September 6, 2022, the Antwerp Court of Appeals clarified that a taxpayer's involvement in a series of transactions and its decision to engage in the structure is sufficient to establish tax abuse even if the taxpayer did not formally participate in every legal act that comprised the overall transaction. On January 11, 2024, the Court of Cassation confirmed the judgment of the Court of Appeals that unity of intent does not require formal participation in any and all legal acts. The Antwerp Court of Appeals further emphasized that, to successfully rebut allegations of tax abuse, non-tax motives behind the transactions must be more than negligible and cannot be purely artificial – a position the Court of Cassation endorsed.

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[4] From January 1, 2026, capital gains on shares and other financial assets will be subject to a capital gains tax of up to 10%. The basis in appreciated assets subject to the tax will be revalued to ensure that existing unrealized gains as of that date are not taxed.

Rulings

The Office for Advance Tax Rulings ("O.A.T.R.") has issued several rulings[5] clarifying the application of Section 266, 4th limb B.I.T.C. (the S.A.A.R. that is derived from the P.S.D., restricting the exemption from D.W.T. on outbound dividend distributions). These rulings consistently emphasize the need for (i) genuine economic activity, (ii) sufficient substance in the form of personnel, premises, and assets, and (iii) valid business reasons for the structure. The absence of these elements is considered a strong indication of abuse.

Conclusion

The *Nordcurrent* decision reinforces the foregoing approach of Belgian courts. Only structures supported by genuine substance and valid business reasons will withstand scrutiny. A broad and holistic approach must be taken, initially at the time of creation and then at various points during the lifetime of an arrangement as changes in the level of operations occur. Taxpayers should maintain full documentation and must be prepared for a comprehensive, fact-based review by the Belgian Revenue Service and the courts.

The Netherlands

In Dutch tax law, the two-pronged test was already implemented. Therefore, the *Nordcurrent* decision has limited impact on the dividend W.H.T. and the Conditional W.H.T. on interest and royalties.

Participation Exemption

In *Nordcurrent*, the targeted G.A.A.R. of the P.S.D. addresses artificial arrangements at the subsidiary level, which also affects the application of the participation exemption at the parent company level. This applies as long as both the subjective elements (intent and artificiality) and the objective elements (purpose and scope) of the G.A.A.R. are satisfied. An artificial arrangement at the parent level may also affect a participation exemption, just as it may impact a withholding exemption.[6]

The Netherlands has deliberately not implemented the G.A.A.R. as referred to in Article 1(2) and (3) of the P.S.D. into the Corporate Income Tax Act 1969 ("C.I.T.A."), as *fraus legis* – the general G.A.A.R. – is considered sufficient to address artificial arrangements. This year, the G.A.A.R. as referred to in the first European Anti-Tax Avoidance Directive ("A.T.A.D.1") has been implemented in Article 29i of C.I.T.A. This A.T.A.D. G.A.A.R. is interpreted in line with the Dutch doctrine of *fraus legis*.

Consequently, the question is whether Nordcurrent, with guidance on the P.S.D G.A.A.R., would impact the Dutch participation exemption, given that the Dutch G.A.A.R. is applicable and the P.S.D. G.A.A.R. was not implemented in Dutch tax law. This could be debated because of a statement by the European Commission,

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[5] For example: Ruling No. 2018.1201 (26 February 2019); Ruling No. 2021.0099 (March 16, 2021); Ruling No. 2021.0767 (October 19, 2021); Ruling No. 2021.1116 (January 18, 2022); Ruling Nos. 2021.1223 and 2021.1224 (January 25, 2022); Ruling No. 2022.0329 (June 14, 2022); Ruling No. 2023.0095 (March 14, 2023); Ruling No. 2023.0321 (June 13, 2023).

[6] See C.J.E.U. judgment of February 26, 2019, ECLI:EU:C:2019:135 (T&Y Danmark), V-N 2019/14.11).

which confirmed that the amendments are not intended to affect national participation exemption systems in so far as these are compatible with the Treaty provisions.[7] This has been interpreted by many experts to mean that the Dutch G.A.A.R. was sufficient to prevent abuse and, therefore, the P.S.D. G.A.A.R. is not applicable.

If this were the case, *Nordcurrent* would have had no effect prior to implementation of Article 29i C.I.T.A. Other experts, however, argue that the P.S.D. G.A.A.R. remained applicable, and that the fact that the legislature's failure to explicitly implement Article 1(2) P.S.D. in this context is irrelevant.[8] Finally, given the implementation of the A.T.A.D. G.A.A.R., we believe it is likely that *Nordcurrent* could still have an impact on the Dutch participation exemption – particularly for years prior to 2025. For 2025 and onwards *Nordcurrent* can serve as guidance in interpreting Article 29i C.I.T.A.

Temporal Aspects of Determination

Another question that was addressed by *Nordcurrent* concerns the point at which it is proper to determine whether an artificial arrangement is present. Is it at incorporation, at dividend distribution, or in light of the overall structure? The answer is that an assessment of all relevant facts and circumstances is required. This means that the facts and circumstances at the establishment of the subsidiary corporation must be considered as well as the facts and circumstances at the time of the dividend distribution. However, it remains unclear how the assessment should be made when a situation changes from economically real to artificial, or vice versa. Nonetheless, the C.J.E.U. emphasized that it cannot be ruled out that a structure initially set up for business reasons reflecting economic reality may, at a certain point, be deemed artificial due to the maintenance of the structure despite a change in circumstances. This implies an ongoing assessment. The C.J.E.U. does not elaborate on this statement, possibly because only the European Commission has the right of initiative.

"Another question that was addressed by Nordcurrent concerns the point at which it is proper to determine whether an artificial arrangement is present."

Finally, the case seems to create some tension with the Dutch Supreme Court's judgment of January 10, 2020.[9] That judgment, concerned the substantial interest scheme referred to in Article 17(3)(b) C.I.T.A. The Dutch Supreme Court considered the time of distribution decisive. However, in line with *Nordcurrent*, we believe that both the time of incorporation and the time of distribution are relevant to determine whether an arrangement is artificial, meaning that the test is applied on a continuous basis.

Potential Impact on D.A.C.6, Pillar 2 and Unshell

The interpretation given by the C.J.E.U. to the concept of a tax advantage may be instrumental for interpreting the similar concept in the main benefit test of the mandatory disclosure rules for cross-border arrangements under D.A.C.6 and the anticipated integration of Unshell[10] into D.A.C.6.

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7 See here.

8 (see C.J.E.U. judgment of November 13, 1990, C-106/89 (Marleasing), Jurispr. p. I-4135).

9 ECLI:NL:HR:2020:21, BNB 2020/80, V-N 2020/4.8).

10 Proposal for a COUNCIL DIRECTIVE laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, COM/2021/565.

It may also preemptively address preliminary questions regarding the E.U. Pillar 2 Directive[11] and the significance of E.C. statements and F.A.Q.s. An example is the relationship between O.E.C.D. Safe Harbours and Article 32 of the E.U. Pillar 2 Directive. With this judgment, these statements may eventually prove to be irrelevant as well.

Luxembourg

For Luxembourg, the decision aligns closely with existing domestic practice and legislation.

Anti-Abuse Framework

Luxembourg's tax framework provides for both general and specific anti-abuse provisions. The P.S.D.'s specific anti-abuse rule ("S.A.A.R.") is transposed into the Luxembourg Income Tax Law ("L.I.T.L.") under (i) Article 147(2) for withholding tax exemptions and (ii) Article 166(2bis) for dividend income exemptions from corporate income tax. It ensures thew following

- The S.A.A.R. applies to corporations established in a Member State.
- The exemption is denied if the dividends are deducted in the Member State of source.
- The exemption is further denied if the dividends result from legal acts or a series of acts that are artificial and primarily aimed at obtaining a tax advantage.
- The tax advantage is inconsistent with the purpose of the P.S.D.

The two last points mirror the P.S.D.'s two-pronged test for abuse.

In parallel, Luxembourg applies a General Anti-Abuse Rule ("G.A.A.R.") under Section 6 of the Tax Adaptation Law (*Steueranpassungsgesetz*). This provision is broader in scope than the E.U. G.A.A.R. and applies to all cases of abuse of law, based on four criteria:

- Use of private law instruments
- Tax reduction due to avoidance of tax law
- Use of an inadequate legal path
- Absence of economic or commercial justification for the chosen path

Luxembourg Case Law

Until mid-2024, it remained unclear which provision – S.A.A.R. or G.A.A.R. – should prevail in cases involving the participation exemption. This ambiguity was resolved by the Luxembourg Administrative Court's landmark decision of July 31, 2024, which ruled on the application of the S.A.A.R. in a participation exemption case. The Court upheld the tax authorities' denial of the exemption, which was challenged under both

[11] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, ST/8778/2022/INIT, OJ L 328, 22.12.2022, pp. 1–58.

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the G.A.A.R. and the S.A.A.R. However, the Court clarified that, under the principle of *lex specialis derogat legi generali*,[12] the S.A.A.R. must be applied first, with the G.A.A.R. serving as a supplementary tool only where the S.A.A.R. lacks precision.

Conclusion

The *Nordcurrent* ruling confirms that Member States can deny the participation exemption under the P.S.D.'s G.A.A.R. However, Luxembourg's legal framework already incorporates a similar two-pronged test under Article 166(2bis) and 147(2) L.I.T.L. Moreover, the substance-over-form approach is well-established in Luxembourg practice. As such, the ruling does not materially alter Luxembourg's tax landscape. Rather, the decision validates the approach currently followed in Luxembourg.

[12] A specific statutory rule prevails over a general statutory rule.

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DRAMATIC CHANGES PROPOSED IN THE DEFINITION OF THE TAX TERM "ISRAELI RESIDENT"

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Tags
Center of Life
Irrebuttable Presumption
Israeli Tax Resident

INTRODUCTION

In July, the Israeli Ministry of Finance published draft legislation aimed at reshaping the rules that determine when an individual is classified as an Israeli tax resident. The proposal introduces new numerical thresholds and a fresh framework for assessing residency. This article explains how the draft compares with existing law and what it may mean in practice.

BACKGROUND

Current Rules

Under current Israeli tax law, an individual's residency status is determined primarily by the "Center of Life" test, which examines personal, economic, and social ties to Israel and compares those ties to ties that exist with another country. In this regard, it is similar to the "Center Of Vital Interests" test that appears in Paragraph 2.a) of Article 4 (Resident) of the O.E.C.D. Model Tax Convention on Income and on Capital.

The test is supplemented by numerical presumptions. If an individual spends at least 183 days in Israel in a single tax year, or 425 days across three years (with a minimum of 30 days in the most recent year), the law presumes residency. This presumption is not absolute and may be challenged by either the taxpayer or the Tax Authority.

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2023 Proposed Rules

In 2021, the Committee for International Tax Reform – a technical committee composed of representatives from both the Tax Authority and the private sector – recommended the adoption of a single-factor test based on the number of days an individual spends in Israel. That recommendation formed the basis for a 2023 draft bill which established an irrebuttable determination of tax residence or nonresidence in any of the following fact patterns.

Residence

- The individual is present in Israel for 183 days or more during any two-year period.
- The individual is present in Israel (i) for 100 days or more during the relevant tax year and (ii) for a total of 450 days over the tax year and the two preceding tax years. However, an individual who meets this test will not be considered an Israeli resident if he or she is present in a tax treaty partner

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jurisdiction for 183 days or more and a tax residency certificate from that country has been issued.

- The individual is present in Israel for 100 days or more during the tax year and has a spouse or common law partner who is an Israeli resident during that year.

Nonresidence

- The individual is present in Israel for not more than 29 days in each tested tax year, except where the individual stays in Israel for 15 days or more within (i) the first 30 days of the first tested tax year described below or (ii) the last 30 days of the last tested tax year.
- The individual and that individual's spouse or common law partner are present in Israel for not more than 59 days in each tested tax year, except where at least one of the individuals is present in Israel for more than 29 days within (i) the first 60 days of the first tested tax year or (ii) the last 60 days of the last tested tax year.
- The individual and that individual's spouse or common law partner are present in Israel for not more than 99 days in each tested tax year and are resident in a tax treaty partner jurisdiction where each is present for at least 183 days each year. However, both will be treated as Israeli residents if either is present in Israel for 50 days or more within the first 100 days of the first tested tax year or the last 100 days of the last tested tax year.

A tested year is any year described below:

- The relevant tax year and the two subsequent tax years.
- The relevant tax year and the immediately preceding and subsequent tax years.
- The relevant tax year and the two preceding tax years.

2025 Proposal

In response to public criticism that the rules proposed in 2023 did little to reduce ambiguity, the Justice Ministry proposed a new set of rules that largely disregards the committee's findings and introduces a new framework.

The new framework relies on the calculation of weighted days of stay over a rolling five-year period consisting of (i) the tax year in issue, (ii) the two preceding years, and (iii) the two subsequent years. Within this framework, three testing periods are evaluated to determine whether an individual is an Israeli tax resident for a particular year. The testing periods are as follows:

- The current tax year and the two preceding years.
- The current tax year and the two subsequent years.
- The current tax year and the immediately preceding and subsequent years.

Tests for Residence and Nonresidence

Depending on the total number of weighted days of presence in Israel during the tested periods, an individual is determined to be either a resident or a nonresident of Israel. An individual is conclusively determined to be an Israeli tax resident in either of the following circumstances:

- The individual is present in Israel for 75 days or more during the current tax year, and cumulatively for at least 183 weighted days in any of the three-year testing periods.
- The individual is present in Israel for 30 days or more during the current tax year, and cumulatively for at least 140 weighted days of stay, and the individual's spouse or common-law partner meets the 75-day and 183-day thresholds mentioned in the preceding bulleted paragraph.

Conversely, an individual is conclusively determined to be a foreign resident for Israeli tax purposes in either of the two following circumstances:

- The individual is present in Israel for 74 days or less during the current tax year, and for a maximum of 110 weighted days in each of the three alternative calculation periods.
- The individual and his or her spouse are present in Israel for 90 days or less during the tax year, and for a maximum of 125 weighted days in each of the three alternative calculation periods.

Note that any part of an actual day of presence in Israel is treated as a full day for purposes of applying the weight given to that day. Thus, a person who arrives in Isael on a flight landing at 11:59 p.m. is treated as being present in Israel for a full day. The same rule applies to a departing flight leaving Israel that takes off at 12:01 a.m. That one minute constitutes a full day of presence.

The draft also addresses partial-year residency. If an individual becomes an Israeli resident after previously being a foreign resident, or severs Israeli residency and becomes a resident abroad, he or she will only be considered an Israeli resident for part of the tax year of arrival or departure, provided that no more than 21 cumulative days are spent in Israel outside the period of Israeli residence.

Weighting Factors

In computing days of presence, not all days in a three-year period are given the same weight. The calculation applies the following weights to the days in each year as follows:

- The current year in issue is given 100% weight.
- The immediately preceding year and succeeding year are given 33.33% weight.
- The second preceding year and the second succeeding are given 16.67% weight.

To illustrate, 150 physical days spent in an immediately preceding year or an immediately succeeding year would be counted as 50 days, while 150 days spent in

a second preceding year or a second succeeding year in issue would be counted as 25 days. All 150 days of presence in Israel during the current tax year would be given full weight.

IMPLICATIONS OF THE NEW DRAFT

One major consequence of the draft bill is that any individual who spends fewer than 183 days in Israel in a given year, but accumulates 183 weighted days over three years, will be deemed an Israeli resident, with no option to contest this determination. The same result applies to an individual who spends 75 days or more in Israel but less than 183 days in one year, combined with 183 weighted days across three years. Even a person who limits presence in Israel to 30 days in one calendar year could be deemed an Israeli resident if that person's spouse or common law partner is an Israeli resident and is present in Israel for 140 weighted days or more in any of the 3-year measuring periods.

Conversely, an individual will be classified as a foreign resident if presence in Israel during the tax year is limited to not more than 74 days and presence in Israel over three years is limited to nor more than 110 weighted days. Alternatively, a couple who each spent 90 days or fewer in a given tax year and not more than 125 weighted days each over three years would be considered foreign residents.

EXAMPLES

The Goldman Couple from New York

Arty and Beth Goldman, long-time New York residents, own an apartment in Israel and visit annually to spend time with their grandchildren, ensuring they stay no more than 150 days in any tax year. They reside in New York for the remainder of the year and are actively involved in their local community. Under the new draft, the Goldmans would be conclusively classified as Israeli residents, with no recourse unless relief is granted under the Israel-U.S. Income Tax Treaty ("the Treaty"), as discussed below.

This scenario highlights the risk to frequent vacationers or retirees who maintain a home in Israel but clearly reside abroad. To clearly remain nonresident, people in this category must cap their stays to an average of 120 days per year (a gray zone). To be conclusively treated as foreign residents, these individuals should cap their stays at not more than 73 days or fewer per year or not more than 110 weighted days across three years (about 95 days annually).

Ravit, High-Tech Entrepreneur

Ravit, a high-tech entrepreneur is married to Ram, an Israeli resident. She spends around 100 days in Israel per year, with her residence and primary business operations centered in Silicon Valley. Under the proposed rules, Ravit would be classified an Israeli resident, solely because of her spouse's residency, despite her strong economic and social ties abroad. Absent recourse to relief under the Treaty, Ravit would need to cap her annual stays in Israel to not more than 96 days. To be considered a foreign resident definitively, she must cap her stays in Israel to not more than 75 days on average each year.

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This example illustrates how the spousal presumption can override clear indicators of foreign residency, making the framework particularly harsh for global couples.

Yoni and Keren, Postdoctoral Studies and High-Tech Relocation

In August 2025, Yoni and Keren and their children relocate to Boston, where Keren will pursue postdoctoral studies and Yoni will transfer to the U.S. branch of his Israeli employer. In 2024, the family spent 50 days in Israel. In 2025, they plan to spend 210 days in Israel. To avoid being classified as Israeli Residents for the 2026 tax year and thereby also for 2025, the couple must cap their time in Israel to less than 21 days in 2025 from August to December, and less than 67 days in 2026.

Note, the Treaty will not provide a benefit for Keren if she is present in the U.S. under a student visa. However, it is likely that the family is present in the U.S. under Yoni's L-1 visa status as an intercompany transferee. That visa allows Yoni to work in the U.S.

"Note, the Treaty will not provide a benefit for Keren if she is present in the U.S. under a student visa."

This scenario illustrates the complexity of "tail-end" residency determinations when individuals enter or exit Israel. Similar rules would apply to first-time Israeli residents and senior returning residents having lived abroad for ten or more consecutive years. If adopted, the draft law could shift the calculation of the ten-year period, potentially accelerating tax exposure for returnees.

TREATY PROTECTION

Residence Tiebreaker

Israel has entered income tax treaties with most O.E.C.D. countries. These treaties establish rules for resolving dual residency through tiebreaker provisions that look to the location of an individual's permanent home, habitual abode, center of vital Interests, and citizenship. If none of the tiebreaker tests resolve the issue, the tax authorities of the respective countries are empowered to reach an agreement through a mutual resolution process. Note that they are not obligated to resolve the matter.

Splitting the Right to Tax

Even when the issue of sole residence for treaty purposes is resolved, another issue pops up. The jurisdiction that has the primary right to tax the individual – and in some cases, the exclusive taxing right – must be identified.

A person who exits from the Israeli tax net is subject to exit tax in Israel, which, under current rules, may be deferred to the date of the actual sale of the property. Israel will determine when the individual ceases to be an Israeli resident under its internal rule. This means that the Tax Authority will assert the right to tax the gain attributable through the date on which residence is relinquished. No foreign tax credit is available to offset the Israeli tax on that portion of the gain.

While treaty provisions may take precedence over domestic Israeli law, the right of a taxpayer to invoke a treaty benefit is subject to interpretation by the relevant tax authorities. Moreover, Israel has no tax treaties in effect with certain countries having low thresholds to tax residence and low tax rates. Individuals moving to such countries are exposed to unfavorable surprises if ties remain to Israel.

SUMMARY

It is worth questioning why the Israeli Tax Authority set aside the original committee's recommendations without broader consultation. While the stated aim was to increase certainty and reduce disputes, it is far from clear whether this goal will be achieved in the absence of treaty relief. If the proposal is enacted as drafted, many individuals who consider themselves to be nonresident may encounter unexpected challenges to claimed nonresident status.

While the effort to reduce uncertainty and enable individuals to plan their days in Israel is a positive objective, the thresholds established in the law are likely to be troubling to many.

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CAN THE SHARES OF COMPANIES OWNING FRENCH REAL ESTATE BE CATEGORIZED AS REAL ESTATE? SOME KEYS TO SOLVE THE RIDDLE

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Tags
Capital Gains
France
Inheritance Tax
Immovable Property
Movable Property
Predominantly Real Estate
Wealth Tax

INTRODUCTION

"Why is a raven like a writing-desk?" the Mad Hatter asks Alice in a famous Lewis Carroll story.[1] "Why are shares of a company like a house?" is a question that French tax authorities (the "F.T.A.") and French administrative and civil judges have been attempting to answer for several years. It seems that no common solution has been reached thus far.

This article addresses case law in which various courts have attempted to characterize shares of stock in companies owning real estate as movable assets or as the equivalent of immovable assets for purposes of applying income tax and inheritance tax treaties between France and a treaty partner state.

BACKGROUND

French law is based on a common distinction between (i) natural or legal persons having legal rights and (ii) the subject matter to which those rights apply. In turn, the subject matter is divided between movable and immovable assets (sometimes referred to as "real estate" in this article), with no intermediate category.[2]

An immovable asset is a plot of land or a structure built on the land. Neither can be moved without being damaged or without damaging the land to which it is attached. Certain rights are also immovable due to their intrinsic link to immovable assets. An example would be real estate property rights, such as those embedded in a *usufruct* arrangement.

In comparison, a movable asset can be transported from one place to another or is intangible by its nature. The French Civil Code expressly includes shares of companies in the concept of movable assets, even where such companies own real estate.[3] Authors agree on the fact that such characterization covers shares of entities carrying on commercial activities and shares of entities that are merely civil (non-trading) companies. It is therefore clearly established under French civil law that company shares are categorized as intangible, movable assets that are separate and apart from the underlying assets that are owned.

This classification as movable or immovable property has significant tax implications. To illustrate, (i) the taxation of capital gains arising from the disposition of movable and immovable is different, (ii) the registration fees that may be due upon

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1 Lewis Carroll, "Alice's Adventures in Wonderland," (1865).

2 Articles 516 et seq. of the French Civil Code.

3 Article 529 of the French Civil Code.

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the purchase of real estate rather than shares is different, and (iii) the character of the asset as movable or immovable impacts on the imposition of French taxes of nonresidents, as capital gains realized by nonresidents generally are not taxed in France (subject to some exceptions), while real estate capital gains of nonresidents are taxed.

TAX CONCEPT OF A PREDOMINANTLY REAL ESTATE COMPANY

The historical distinction between immovable and movable property is why French tax law created an autonomous concept of a "predominantly real estate company." The definition of a predominantly real estate company varies depending on the tax being imposed. While it differs slightly for capital gains tax, gift/inheritance duties, or 3% real estate tax on real estate, the concept of a predominantly real estate company can be summarized as follows: A predominantly real estate company is a company or organization, regardless of form, in which more than 50% of the value of its assets consists directly or indirectly of

- real estate or rights relating to real estate, and
- shares or other rights in other companies that are predominantly real estate companies,

provided that the real estate is not used for the company's own industrial, commercial, agricultural or non-commercial professional activities.[4]

This concept allows the F.T.A. to treat the shares of companies owning real estate as real estate for tax purposes, where such assimilation is provided by the tax legislation. Thus, the transfer of shares of a predominantly real estate company is subject to real estate capital gain taxation in France, as if the transferor transferred real estate directly.[5]

LIMITATIONS TO THE CONCEPT

Nonetheless, the tax concept of a predominantly real estate company does not mean that the real estate companies shares are considered as real estate, *per se*. It only allows the F.T.A. to assimilate certain shares to real estate for domestic tax purposes.

The impact of classifying shares as real estate or movable assets extends beyond domestic rules. While the current version of Paragraph 4 Article 13 (Capital Gains) of the O.E.C.D. Model Tax Treaty expressly deals with capital gains of predominantly real estate companies, attributing the right to tax capital gains to the State in which the underlying real estate is located, many bilateral tax treaties concluded by France contain provisions that do not distinguish between ordinary company shares

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4 *E.g.* French Tax Administration guidelines applicable to capital gains realized by non-residents: BOI-RFPI-PVINR-10-20 No. 120 (19/04/2019).

5 Note however, that in most cases, the registration duties imposed on the purchaser remain at 5% for real estate companies shares instead of 6.2% for real estate. An exception applies when members of the company are entitled to an allocation of the underlying real estate.

and shares in predominantly real estate companies. Based on earlier versions of the O.E.C.D. Model Tax Treaty, the capital gains article in those tax treaties typically provides that real estate capital gains derived from the alienation of immovable property are taxed by the State in which the real estate is located. Treaties may also provide that real estate assets are subject to wealth tax in the State where the real estate is located. For these treaties, a question arises as to what is real estate and what is not. To answer this question, tax treaties refer to domestic law and, in the specific case of real estate, to the law of the State where the real estate is situated.

As simple as the solution may seem in theory, French practice is not consistent. The F.T.A. usually tends to claim that such shares should be considered as real estate for tax treaty purposes in order to allow French tax to be imposed on gains from the sale of those shares. However, the answer may vary depending on the wording of the tax treaty at issue.

In the absence of clear rules, it has been left to judges to decide how those shares are categorized for tax purposes. Depending on the court's classification, the answer will differ. The French judicial system is divided between civil courts and administrative courts. The former apply the civil law concepts with tax treatment based on the civil classification, while the latter apply taxation rules, even where the result contradicts the civil law principles.

APPROACH OF THE COUR DE CASSATION: CHARACTERIZE FIRST, TAX SECOND

In tax matters, the judicial system (consisting of judicial courts of original jurisdiction, courts of appeal, and the *Cour de Cassation*, which is the French Supreme Court for non-administrative matters)) has jurisdiction over disputes relating to (i) gift and inheritance duties and (ii) wealth tax. The scope of its jurisdiction has enabled the *Cour de Cassation* to clearly state its position on the characterization of shares in companies holding real estate.

Shares are Movable Assets

A judicial saga related to the France-Monaco inheritance tax treaty dated 1st April 1950 (the "France-Monaco Inheritance Tax Treaty") ultimately ended with a clear decision from the Plenary Chamber of the *Cour de Cassation*.[6] The case concerned the inheritance of a Moroccan national with heirs residing in France. As the deceased was domiciled in Monaco, the question arose as to which of the two states had the right to apply the inheritance duties on the shares of a Monegasque civil company owning French real estate.[7] The heirs considered that the shares should not be subject to inheritance tax in France as they were movable assets subject to Article 6 of the France-Monaco Inheritance Tax Treaty, which addresses shares,

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6 *Cour De Cassation*, Plenary Chamber, 2nd October 2015, No. 14-14.256, P+B+R+I

7 The France-Monaco tax treaty applies in principle exclusively to French or Monegasque nationals but was applied to this case by virtue of the nondiscrimination clause in the France-Morocco tax treaty dated 29th May 1970.

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bonds, claims, and similar items.[8] For the F.T.A., Article 6 was irrelevant. It argued that Article 2 regarding real estate applied even though Article 2 contained no specific provisions for real estate company shares.[9] This approach allowed for the imposition of inheritance tax in France, where the real estate was located.[10]

The court of original jurisdiction[11] and the Court of Appeal[12] both ruled that a real estate company's shares were movable assets and therefore fell under Article 6 of the France-Monaco Inheritance Tax Treaty, which precluded taxation in France.

The F.T.A. challenged this decision before the *Cour de Cassation* and their challenge initially succeeded. The *Cour de Cassation* decided in 2012 to reject the application of Article 6 of the tax treaty and to apply Article 2 related to real estate. It referred the case back to the Court of Appeal. This decision was a major upheaval in well-established civil case law based on Civil Code rules. For that reason, it was criticized as creating legal uncertainty. In a decision dated 9th January 2014, the Court of Appeal confirmed its original position that shares are shares, no matter what assets are owned by a company. In 2015, the *Cour de Cassation* confirmed the decision of the Court of Appeal in Plenary Chamber. It ruled that a civil judge should rely on civil law before inferring tax consequences.

Before looking at the Court's reasoning, Article 1 of the France-Monaco Inheritance Tax Treaty addresses the meaning of terms not otherwise defined in the treaty in a fairly standard way. Paragraph (e) of Article 1 provides as follows:

> As regards the application of the provisions of this Convention by either of the Contracting Parties, any term not otherwise defined shall,

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8 Article 6 provides as follows in relevant part:

> Stocks or shares, Government bonds, debentures, unsecured or secured debt-claims and all other property left by a national of one of the two States, to which Articles 2 to 5 do not apply, shall be subject to the following provisions:
>
> (a) If the deceased at the time of his death was domiciled in one of the two States, the property shall be liable to succession duties only in that State.
>
> (b) If the deceased was not domiciled in either State, the property shall be liable to succession duties only in the State of which the deceased was a national at the time of his death; if at the time of his death he was a national of both States, the French and Monaco authorities shall reach a special agreement in regard to each particular case.

All translations of French case law, statutory law, and tax treaties into the English language are unofficial.

9 Article 2 provides as follows in relevant part:

> 1. Immovable property and rights to immovable property forming part of the estate of a national of one of the two Contracting States shall be subject to succession duties only in the State in which it is situated.

10 Article 750 *ter* of the French Tax Code.

11 Nice judicial court, 25th March 2010, No. 08/2969.

12 Aix-en-Provence Court of Appeal, 1st Chamber, 3rd May 2011, No. 10/06591

> unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of this Agreement.[13]

Paragraph 2 of Article 2 then looks at the definition of immovable property:

> The question whether a given property or right is immovable property or a right in respect of immovable property shall be determined in conformity with the law of the State in which the property or the object of the right is situated.

Based on the reference to French domestic law, the F.T.A. argued that French tax law applied and under that law, the Monegasque company is considered as a predominantly real estate company within the meaning of French tax law, because its assets were of a real estate nature. That reasoning was rejected by the *Cour de Cassation*:

> After rightly finding that the shares in the Monegasque company constituted intangible movable properties and that, under the [France-Monaco Inheritance Tax Treaty], the company Cogest was subject to Article 6 * * * and not to Article 2, which concerns real estate and real estate property rights, the Court of Appeal correctly concluded * * * that the taxation of the shares transferred by the demise of their owner residing in Monaco fell within the jurisdiction of that State and not that of France.[14]

The *Cour de Cassation* did not impose any conditions to its decision. The principle is simple and applicable to all tax treaties with similar wording. Shares in a company owning real estate in France constitute "intangible movable assets" subject in principle, exclusively to inheritance tax in the State of residence of the deceased, unless the tax treaty provides otherwise.

In cases that come before the *Cour de Cassation*, the *Parquet General* provides legal advice to the court on the scope of the decision to be made. Here, the *Avocat General* made the following points to the court:

> It should first be noted that at no point did the French legislation use the term "real estate" or "real estate rights" in relation to SCI[15] shares; it merely characterized as French those foreign SCI shares that meet the criteria it sets out. However, what is sufficient under domestic law is not sufficient under the tax treaty. * * * I therefore consider that SCI shares, even those that are "predominantly real estate," do not have a "real estate nature" within the meaning of Article 2 of the [France-Monaco Inheritance Tax Treaty] dated 1st April 1950. And that the Court of Appeal was right to say so in its confirmatory judgment * * *.[16]

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[13] All translations into the English language are unofficial. Unless otherwise indicated, all translations of tax treaty provisions reflect text appearing on the I.B.F.D. website.

[14] Unofficial translation by authors.

[15] Private real estate company.

[16] Unofficial translation by authors.

In the absence of a tax definition classifying shares of predominantly real estate companies as real estate, the holding in the case should be viewed as good authority to the issue addressed. In the 2015 annual report of the *Cour de Cassation*, the following comment was made regarding the case:

> [T]here cannot be a different definition in civil law and tax law for company shares which, according to the former, would be movable property and, according to the latter, would be immovable property. As several *Commissaires du Gouvernement*[17] have pointed out * * *, the tax judge must necessarily appropriate civil law concepts * * * since it is defined by the Civil Code.[18]

"In addition to gift and inheritance duties, judicial courts have jurisdiction to hear disputes relating to wealth taxation"

Decision in 2025 Case: Adopts Opposing View (In Appearance)

In addition to gift and inheritance duties, judicial courts have jurisdiction to hear disputes relating to wealth taxation.[19] It was in this context that the *Cour de Cassation* ruled at the beginning of 2025[20] on the question of the taxation of shares in predominantly real estate companies under the France-Luxembourg Income and Capital Tax Treaty dated 1st April 1958, as amended ("France-Luxembourg 1958 Income Tax treaty"), which is no longer in force and was rather unusual in its wording. On this occasion, the court ruled that shares of French companies predominantly owning real estate in France that were held by a Luxembourg resident were subject to French wealth tax under the France-Luxembourg 1958 Income Tax Treaty because the shares should be regarded as real estate assets for tax treaty purposes.

To reach its decision, the Court looked at the following provisions of the treaty:

- Paragraph 1 of Article 20 (Capital) provides as follows in respect to taxes on capital:

  > If the capital consists of immovable property and its accessory * * * the tax may be levied only in the Contracting State which, by virtue of the preceding Articles, is authorized to tax income derived from such property.

- Paragraph 1 of Article 3 (Income from Immovable Property/Capital Gains) identifies the treaty partner state that is empowered to impose tax on immovable property:

  > Income from immovable property and its accessories, including income from agriculture and forestry exploitation, shall only be taxable in the State where the property is situated.

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17 In a case that is argued before the *Conseil d'Etat*, the *Commissaire du Gouvernement* sets out the circumstances of the dispute, the arguments put forward by the parties and the questions raised before analyzing the case and giving his or her own opinion to the court without taking part directly in the court's final decision. In recent years, the *Commissaire du Gouvernement* is referred to as the *Rapporteur Public*.

18 *Cour de cassation*, Annual Report 2015, p. 110. Unofficial translation by authors.

19 Formerly the *Impôt de Solidarité sur la Fortune* ("ISF") and, since 1st January 2018, the Impôt sur la Fortune Immobilière ("IFI").

20 *Cour de Cassation*, Commercial Chamber, 2nd April 2025, No. 23-14.568.

> This provision shall also apply to profits derived from the alienation of the property concerned.

- Paragraph 4 of Article 3 identifies the treaty partner state that is empowered to impose tax on gains from the sale of shares in company that essentially is a predominantly real estate company:

> Gains from the alienation of shares or other rights in a company * * * or other similar body or entity, the assets or property of which consist for more than 50% of their value of, or derive more than 50% of their value - directly or indirectly through the interposition of one or more other companies * * * or similar bodies or entities – from immovable property situated in a Contracting State or rights connected with such immovable property shall be taxable only in that State. For the purposes of this provision, immovable property pertaining to the business activities of such company shall not be taken into account.

There is no definition of real estate assets, either directly in the France-Luxembourg 1958 Income Tax treaty or by reference to the domestic laws of the States, but rather cross-reference between various provisions of the above-mentioned articles, resulting in the right to apply wealth taxation on assets being granted to the State entitled to tax the income originating from those assets and the capital gains originating from their disposition.

Based on the above, the *Cour de Cassation* concluded that shares in real estate private companies having their registered office in France, and owning real estate located in France must be regarded as real estate properties within the meaning of the tax treaty. The Court could have taken a more cautious approach. For example, it could have stated that shares in predominantly real estate companies should be assimilated to real estate assets for tax treaty purposes, rather than implying an actual characterization as real estate.

Following the decision, tax advisers wondered whether the intention of the *Cour de Cassation* was to abandon the civil law approach in favor of the purely tax law approach of the Administrative Supreme Court, which is discussed below. Also subject to conjecture was whether the new approach could be extended to other tax treaties. The consensus is that the impact of the 2025 decision likely will be limited. The current France-Luxembourg tax treaty dated 20th March 2018 ("the France-Luxembourg 2018 Income Tax Treaty") is drafted based on the O.E.C.D. model, which differs from its predecessor in that it includes interpretation guidelines that refer to the domestic law of the States, as follows:

- Paragraph 2 Article 6 (Immovable Property) provides as follows:

  > The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. * * *

- Paragraph 2 of Article 3 (General Definitions) provides as follows:

  > As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State

for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

- However, Paragraphs 1 and 4 of Article 21 (Capital) provide limitations to the foregoing rules as follows:

    1. Capital represented by immovable property referred to in Article 6, owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State.

    * * *

    2. All other elements of capital of a resident of a Contracting State shall be taxable only in that State.

While the transposition of the 2025 decision to the France-Luxembourg 2018 Income Tax Treaty might seem understandable because tax law definitions are given prevalence over other laws, a somewhat comparable provision in the France-Monaco Inheritance Tax Treaty did not prevent the *Cour de Cassation* from applying civil law concepts in its 2015 decision. Moreover, nothing in the 2025 decision of the Commercial Chamber of the *Cour de Cassation*, based exclusively on an atypical wording, indicates that it intended to overturn the principle adopted by the same Court in 2015 in plenary session regarding a Monegasque company owning immovable property in France.

In the view of the authors, there is no reason to believe that the position of the *Cour de Cassation* in 2015 that was based on civil law principles has been undermined. Companies' shares are movable assets, even in presence of underlying real estate assets, for all the taxes entering the scope of the judicial courts' jurisdiction. However, as far as taxes subject to the jurisdiction of the administrative courts are concerned, the solution would be quite different.

APPROACH OF THE CONSEIL D'ETAT: TAX FIRST, CHARACTERIZE LATER

In tax matters, the administrative courts (administrative court, administrative court of appeal, and the *Conseil d'Etat* which is the French Supreme Court for administrative matters) have jurisdiction over disputes relating to personal and corporate income tax, including capital gains tax. Thus, the *Conseil d'Etat* has jurisdiction to rule on tax treaty issues related to the characterization of shares of holding predominantly real estate companies.

It would have been logical for the *Conseil d'Etat* to follow the analysis of the *Cour de Cassation*, as there is no tax definition of immovable property in the tax law. Only the civil definition exists. Nonetheless, the *Conseil d'Etat* followed its own path.

France-Belgium Treaty – First Case

Likely due to the lack of a specific definition of real estate in the tax law, the *Conseil d'Etat* has taken a fairly broad view of real estate for the application of international tax treaties. In two cases concerning the France-Belgium tax treaty dated 10th

March 1964 ("the France-Belgium Income Tax Treaty"), the *Conseil d'Etat* ruled that anything taxed as immovable property should be considered immovable property.[21]

In what is now a standard practice, the France-Belgium Income Tax Treaty contains provisions that address the definition of certain terms.

Paragraph 1 of Article 3 provides the taxing rule for income from immovable property:

> Income from immovable property including property accessory thereto and livestock and equipment used in agriculture and forestry shall only be taxed in the Contracting State in which such property is situated.

Paragraph 2 of Article 3 defines the term "immovable property" as follows:

> The term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated.

Paragraph 4 of Article 3 states that properties are taxable in the State where they are located (be it for income or capital gains) as follows:

> The provisions of paragraphs 1 to 3 shall apply to income derived from the direct use, letting or leasing, or use in any other form of immovable property, including income from agriculture and forestry enterprises. They shall also apply to gains from the alienation of immovable property.

Article 18 adopts a rule for income not otherwise mentioned in the treaty, as follows:

> In so far as the preceding Articles of this Convention do not provide otherwise, the income of residents of one of the Contracting States shall only be taxable in that State.

Article 22 adopts a rule for undefined terms, as follows:

Any term not specifically defined in this Convention shall, in so far as the context does not require otherwise, have the meaning ascribed to it under the law in each Contracting State which governs the taxes which are dealt with in the Convention.

For a Belgian resident holding shares in a French predominantly real estate company, the consequences of the classification of the shares were critical because

- capital gains on real estate properties are taxable in the State where the property is located, *i.e.* France (Article 3.4.) but
- capital gains on movable property are taxable in the State of residence of the transferor, *i.e.* Belgium (Article 18).

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[21] Conseil d'Etat, 8th and 3rd sub-sections, 24th February 2020, No. 436392.

The F.T.A. guidelines to the France-Belgium Income Tax Treaty treat shares of predominantly real estate companies as immovable property,[22] and that was the basic argument of the F.T.A. in the case. On the other hand, the taxpayer argued that such guidelines went beyond the provisions of the tax treaty. The *Conseil d'Etat* adopted the position of the F.T.A.

> Article 244 *bis* A of the [French Tax Code], applicable to capital gains on real estate realized by individuals who are not tax residents in France * * * subjects to this regime capital gains realized by such individuals on the sale of shares they hold in companies or organizations, whatever their form, whose assets consist mainly, directly or indirectly, of real estate or real estate rights. The tax law thus treats shares in predominantly real estate companies as real estate properties when they are sold by a person who is not resident in France for tax purposes.[23]

"Two years later, the Conseil d'Etat had the opportunity to consider a second case with similar facts."

The *Rapporteur Public* advising the *Conseil d'Etat* justified this reasoning in the following way:

> Let us state at the outset that the criteria of civil law seem to us to be irrelevant, since the tax treaty expressly stipulates that, in order to define, in particular, the concept of "immovable properties," reference should be made to the tax legislation of the States.
>
> If we follow this approach, real estate within the meaning of the tax treaty will therefore be what French tax law characterizes and taxes as such.[24]

This reasoning might appear justified by the plain language of Article 22, and once the appropriate classification has been determined, the appropriate taxation can be applied. But this line of reasoning did not prevent the *Cour de Cassation* from characterizing real estate company shares as movable assets.

France-Belgium Treaty – Second Case

Two years later, the *Conseil d'Etat* had the opportunity to consider a second case with similar facts.[25] Again, a Belgian resident sold shares in a French predominantly real estate company. In its decision, the *Conseil d'Etat* confirmed its earlier analysis. The main argument underlying the taxpayer's appeal was that shares in predominantly real estate companies are never classified as real estate but are only taxed as such. The *Rapporteur Public* advising the *Conseil d'Etat* was the same individual who advised in the first case. In the following language, she explained there was no reason to reconsider the principal laid down in the first case

> [W]e see no reason to reconsider the position taken recently by the joint sub-sections. The purpose of tax legislation is not, in first instance, to define legal concepts, but to lay down rules for taxation.

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22 French Tax Administration guidelines applicable to the France-Belgium tax treaty: BOI-INT-CVB-BEL-10-10 No. 130 (12/09/2012)

23 Unofficial translation by authors.

24 Unofficial translation by authors.

25 *Conseil d'Etat*, 8th section, 27th December 2021, No. 451625

> It therefore does not seem illogical to us, unless the reference in the tax treaty to the legislation governing the taxes covered by the tax treaty is given a very limited scope, to rely on the tax treatment reserved for a type of income in order to determine its classification within the meaning and for the purposes of the tax treaty.[26]

The Court adopted the views of the *Rapporteur Public*. It upheld the principle that, for tax treaty purposes, shares in predominantly real estate companies must be treated as real estate for the sole reason that French tax law taxes them as such.

This reasoning raises logical and practical issues. First, it creates confusion between "assimilation" for applying a tax regime and "characterization" of assets as immovable property. In fact, the *Conseil d'Etat* did not use the term "characterization" in its reasoning, but rather "assimilation" because there is no tax definition of immovable property, as previously noted. In order to avoid resorting to the definition of civil law as followed by the *Cour de Cassation*, the *Conseil d'Etat* preferred to rely exclusively on the applicable tax regime.

The approach of the *Conseil d'Etat* contravenes the classic legal syllogism dear to French legal practitioners, under which (i) the court determines the applicable rule of law based on a specific factual situation (ii) in order to deduce the appropriate ruling, as illustrated by the following logic path:

Characterization → Tax regime → Practical application

Instead, the *Conseil d'Etat* applied a pre-chosen approach to "hardwire" a specific conclusion:

Domestic Tax Regime → Assimilation → Practical application

The approach of the *Conseil d'Etat* may well lead to double taxation situations. In comparison to France, the Belgian Supreme Court concluded that shares of a predominantly real estate company are not real estate assets and should therefore be taxed only in the country of residence of the transferor.[27] The decision did not involve the taxation of capital gains, but rather the nature of the income received by a Belgian resident who held shares in a French look-through company receiving real estate income. The Belgian Supreme Court analyzed the French tax law and ruled that the shares were not real estate assets because no French tax provision defined the shares as such. This also corresponds to the Belgian approach in which the shares of real estate companies are considered as movable assets. In its decision, the court upheld the grounds raised by the applicant, in particular:

> Income distributed by a real estate private company to its Belgian resident shareholder, a natural person, cannot be classified as income from real estate as referred to in Article 3 of the France-Belgium Income Tax Treaty, even if a taxation on the profits made by that [company] was paid in France by that shareholder as rental income tax pursuant to [its look-through nature].[28]

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[26] Unofficial translation by authors.

[27] Belgian Supreme Court, 29th September 2016, F.14.0006.F.

[28] Unofficial translation by authors.

This divergent interpretation by the French and Belgian courts is likely to give rise to situations of double taxation in the event of a sale of shares in a predominantly real estate company. Each State would consider that it has jurisdiction to ultimately tax the same gain. The authors are not aware of any cases where the tax authorities of both States had the opportunity to confront the analysis in order to find a common solution.

As a final anecdotal point, some advisers point to the weakness of the F.T.A.'s position by referring to a signed, but not yet in force, replacement income tax treaty between France and Belgium. It contains an express provision that is like Paragraph 4 of Article 13 (Capital Gains) of the O.E.C.D. Model Treaty discussed above, despite Belgium's reservation to the provision, due to the insistence of the F.T.A.

RECENT CASE IN LOWER COURT – A MORE SENSIBLE APPROACH

A recent decision by the Montreuil Administrative Court suggests resistance on the part of a court of original jurisdiction to the assimilation approach of the *Conseil d'Etat*.[29]

In the case, shares in a French predominantly real estate company were sold by a Dutch company. The assets of the French company consisted mainly of shares in two French private companies predominantly owning real estate.

The France-Netherlands tax treaty dated 16th March 1973 ("France-Netherlands 1973 Income Tax Treaty") contained articles similar to those mentioned above. Immovable property was defined in accordance with the law of the State in which the property is located. In addition, an undefined term has the meaning assigned to it by the laws of that State governing the taxes covered by the tax treaty, unless the context requires a different interpretation.

Despite the recommendation of the *Rapporteur Public* that was in line with the two decisions of the *Conseil d'Etat*,[30] the Montreuil Administrative Court applied a two-step approach to reaching its decision.

- Under the first step, it looked to the domestic law of France that addresses the taxation of capital gains realized on the sale of immovable property. It determined that while French domestic law assimilates the sale of predominantly real estate company shares to a sale of real estate, mere assimilation is not, by itself, sufficient when analyzing the terms of a tax treaty.
- Under the second step, the court looked to the terms of the provisions of the France-Netherlands 1973 Income Tax Treaty applicable to the sale of

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29 Montreuil Administrative Court, 7th May 2025, No. 2301787.

30 The Rapporteur Public recommended the following:

> If you fall within the scope of the Baartmans decision, you can only interpret Article 13(1) of the [France-Netherlands 1973 Income Tax Treaty] as bringing the capital gain in dispute within the scope of real estate income, with the consequence that it is taxable in France. You will therefore reject the conclusions seeking exemption from tax.

> immovable property, Paragraph 1 of Article 13 (Capital Gains). That provision allocates to France the right to tax gains from the alienation of immovable property located in France as well as the right to tax gains from the alienation of shares or comparable interests in a company whose assets consist mainly and directly of immovable property located in France.

The Court determined that the Dutch company did not directly own immovable property in France. In addition, the Court determined that the target company which issued the shares that were sold by the Dutch company was not a company whose assets consist mainly of immovable property since it directly owned no immovable property in France. Rather, it owned shares of lower-tier companies which, in turn, owned immovable property. Such indirect ownership of immovable property was not sufficient to trigger tax in France under Paragraph 1 of Article 13 (Capital Gains). According to the Court:

> [Paragraph 1 of Article 13] must be interpreted as limiting taxation in * * * [France] to cases where the assets are directly constituted by immovable properties, in the absence of any clarification as to the indirect nature of the company's holding of immovable properties.[31]

Accordingly, neither of the fact patterns set out in Paragraph 1 of Article 13 were present. The shares transferred by the Dutch company were neither real estate properties nor shares of a company directly holding real estate properties.

In sum, the Montreuil Administrative Court made an effort at every stage to characterize the facts. It did not infer the characterization of shares as real estate for tax treaty purposes based on the sole fact that the transfer of these shares was subject to the real estate capital gains regime under domestic law. Such resistance from the court of original jurisdiction of the case provides some degree of hope that the evolution of the administrative case law on the topic will be more aligned with the classic legal characterization method.

CONCLUSION

The question of a tax treaties' classification of shares in predominantly real estate companies is particularly relevant as many tax treaties do not yet contain express provisions on this subject. As we have seen, the analysis may vary in light of the nature of the tax at stake and of the drafting of the relevant provision in each applicable treaty.

So, considering the French tax cases discussed above, do not be surprised if, when asked whether the shares of a company are properly characterized as movable property or immovable property, a well-informed tax advisor will answer "Well, it depends."

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[31] Unofficial translation by authors.

TAX ISSUES FACED BY FOREIGN PERSONS INVESTING IN GREEK COMMERCIAL REAL ESTATE

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Tags
Commercial Real Estate
Digital Transaction Duty
Due Diligence
E.N.F.I.A.
Greece
Non-Dom
R.E.T.T.
S.R.E.T.
V.A.T.

INTRODUCTION

Greece's diverse real estate market has become an increasingly attractive destination for foreign investment. The Mediterranean climate, rich cultural history, and growing economy make the country particularly appealing to investors looking for residential and commercial properties. Greece's investment landscape is further enhanced by favorable tax incentives, such as the non-dom tax regime, the tax regime for pensioners, the tax regime for employees and, freelancers, the family office regime, and the Golden Visa program.

This article provides a comprehensive overview of the tax landscape for foreign investors, investing in Greek commercial real estate. Outlining the key tax considerations at each stage of the investment process – from acquisition and ownership to income generation and withdrawal plans – to help investors navigate the complexities of Greece's tax system in order to make well-informed strategic decisions.

ACQUISITION OF REAL ESTATE (DIRECT INVESTMENT)

Under Greek law, the relevant purchase process of a property located in Greece includes the following required legal steps:

Legal Due Diligence

As an initial step, a deed check must be made in the competent Land Registry to ensure that there is an uninterrupted chain of ownership for the property and to check whether active liens, encumbrances, and charges (foreclosures, mortgages, etc.) exist on the property.

Once free and clear title exists, an examination of potential restrictions on transactions involving properties located in border areas[1] is needed. Greek law prohibits any *inter vivos* transaction that establishes contractual rights over real estate situated in those areas in favor of individuals or legal entities with citizenship or registered seat outside the Member States of the E.U. and the European Free Trade Association. The same restriction applies to the transfer of shares or company interests, or

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[1] The term "border areas" refers to (i) the regional units of Dodecanese, Evros, Thesprotia, Kastoria, Kilkis, Lesvos, Xanthi, Preveza, Rodopi, Samos, Florina, and Chios, (ii) the islands of Thira (Santorini) and Skyros,(iii) the former provinces of Nevrokopi (formerly in the regional unit of Drama), Pogoni and Konitsa (formerly in the regional unit of Ioannina), Almopia and Edessa (formerly in the regional unit of Pella), and Sintiki (formerly in the regional unit of Serres) and (iv) the former communities of Othonoi, Mathraki, and Ereikoussa.

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any change in the identity of shareholders or partners in companies of any form that own real estate in these regions.

Furthermore, an examination of other potentially applicable restrictions, such as those related to forest area or archaeological sites, may be required, where relevant.

Technical Due Diligence

A thorough technical due diligence is typically required to determine the physical condition of the property. This is mostly undertaken by an engineer and may be followed up by a filing with an Urban Planning Authority where construction or demolition is contemplated.

Issuance of a Greek Tax Registration Number

A Greek tax registration number ("T.I.N.") for the buyer must be applied for.

Notary Deed

Any deed concerning the establishment, transfer, alteration, modification, or abolition of in rem rights over immovable property in return for valid consideration must be executed in the form of a notarial deed. The submission of a transfer tax return and the payment of the tax due must be completed as of the time of execution of the notarial deed.

Registration of the Notary Deed at the Land Registry

After the signing of the contract, the registration of the title before the Land Registry is required, which is the last step taken in the transfer of the title.

Costs

The costs associated with the purchase typically include the following:

- The notary fee, usually estimated at up to 1% on the contractual value of the property transferred. It is payable by the purchaser
- The real estate agent's fee, which is not specified by law and is freely negotiated. Typically, the fee amounts to 2% of the sale price and is paid by each party to its respective agent
- Attorney's fee, which is not mandatory under Greek law. However, it is common practice to engage an attorney for reasons of legal certainty and to ensure the lawful transferability of the property
- Registration expenses at the Land Registry are usually fixed fees that vary by location and the value of the transaction

ACQUISITION OF SHARES IN REAL ESTATE ENTITIES

The acquisition of shares in Greek real estate entities is a much simpler process, as no formal requirements exist for the share purchase agreement and no obligation exists to register the agreement with the Land Registry.

In certain types of Greek companies, foreign shareholders must first obtain a Greek T.I.N. to participate in the Greek company. Possession of a Greek T.I.N. does not necessarily require the filing of a Greek tax return. Rather, the filing requirement depends on the type of taxpayer (individual or legal entity) and whether any Greek-source income is earned.

As with the direct acquisition of land, comprehensive legal and tax due diligence is recommended. However, the scope of the due diligence is somewhat broader as it relates to hidden liabilities of the company and the underlying real estate.

TAXES ON ACQUISITION OF REAL ESTATE

Real Estate Transfer Tax

Real estate transfer tax ("R.E.T.T.") is imposed on the purchase of real estate property not qualifying as a new building. Tax is imposed at the national level (3%) and a surcharge is imposed at the municipal level (3% of the R.E.T.T. (0.09%), making the combined effective tax rate 3.09%. R.E.T.T. is payable by the buyer, and imposed on the taxable value of real estate, typically the sale price, but not less than the objective value of the real estate.

To determine the objective value of real estate, the starting values are taken into consideration based on the Objective Real Estate Valuation System. These values are established on geographical zones or building blocks, and by property type, such as urban, rural, or other classifications. The starting values are increased or decreased proportionally, depending on factors that positively or negatively affect the value of the property. Such factors include construction quality, age of the building, location within the building block or floor level for apartments, commerciality of the street, and cultivation value, or touristic/holiday significance in the case of rural land.

For the determination of the market value of real estate properties that are transferred or acquired for any reason and for which the Objective Real Estate Valuation System does not apply, other data are considered, such as

- data from comparable or similar nearby properties,
- data derived from transfers for consideration,
- data reflecting values for inheritance tax purposes arising from the death of an owner,
- data reflecting values for gift tax purposes,
- data derived from expropriations,
- data derived from judicial partitions, and
- data derived from other valuation assessments.

An exemption from R.E.T.T. applies under conditions to individuals purchasing real estate to cover their primary residence needs.[2]

Value Added Tax ("V.A.T.")

V.A.T. is imposed at the standard rate of 24% on real estate that qualifies as a "new building." A building is "new" if its building permit is issued or renewed on, or after January 1, 2006. V.A.T. applies when both of the following conditions exist:

- The property is transferred by a person subject to V.A.T., such as (i) a construction/building or other type of company or (ii) anyone who carries out construction activity on an occasional basis, provided that person opts for the standard V.A.T. regime).
- The transfer takes place prior to its first occupation.

The taxable value subject to V.A.T. is the highest of the following three values: (a) the sale price, (b) the objective value of the real estate, and (c) the construction cost. The seller collects the V.A.T. from the buyer.

For the purchaser, V.A.T. is recoverable only if it is subject to V.A.T. and intends to use the property for an activity subject to V.A.T. Where those two facts exist, the input V.A.T. imposed on the purchase cost is offset by output V.A.T. on its sales.

It should be noted that an optional V.A.T. suspension regime for newly built properties applies as of 2020, and has been extended until December 31, 2025.[3]

An exemption from V.A.T. applies to individuals purchasing real estate for their primary residence needs, subject to certain conditions.

TAXES ON ACQUISITION OF SHARES

No direct or indirect tax is due upon the purchase of shares in real estate companies, apart from a transaction duty of 0.1% imposed on the sale of shares listed on an exchange.

TAXES ON OWNERSHIP

Real estate ownership in Greece is subject to a number of taxes, which vary depending on the type of property, the legal status of the owner (individual or legal entity), and the property's use and location.

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[2] A primary residence is the property used as the permanent home of the owner and the house where is declared as the official address. In Greece, the primary residence is legally protected and may give rise to tax benefits, such as exemption from real estate transfer tax or V.A.T., provided that certain value and size criteria are met.

[3] The provisions of article 39 of law 4646/2019 introduced an optional V.A.T. suspension regime for real estate under article 6 of the Value Added Tax Code (law 2859/2000), with the obligation of the professional who chooses to be subject to this regime to remain in it until December 31, 2025.

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Unified Real Estate Ownership Tax ("E.N.F.I.A.")

E.N.F.I.A. is a nationwide annual property tax, that applies to all owners of real estate in Greece, including foreign investors. It is imposed on the rights *in rem* of

- full ownership,
- bare ownership,
- *usufruct*,
- dwelling,
- surface of the real estate property, or
- sights of exclusive use of parking space, auxiliary room, swimming pool.

The tax is imposed on the owner as of the 1st of January of each calendar year. The tax consists of (i) a main tax, imposed on legal entities and individuals, (ii) an additional increase in the main tax for individuals if a threshold is exceeded, and (iii) a supplementary tax imposed on legal entities.

The main tax, for both individuals, and legal entities on buildings is calculated separately for each property based on several factors, including (a) the surface area of the building measured in square meters, (b) the basic tax rate and the zone value, (c) the use of the building (main or auxiliary use), (d) the building's age, (e) the floor-level, and (f) the number of facades.

Specifically, the main tax on buildings is calculated by multiplying the square meters of the building by the main tax, ranging from €2 per square meter to €16.20 per square meter, and other coefficients affecting the value of the property, such as location and use. The main tax on land is calculated by multiplying the square meters of the land by the main tax, ranging from €0.0037 to €9.25 per square meter, and other coefficients affecting the value of the property, again such as location and use.

For individuals, there is an additional gradual increase in the main tax by 5% to 20%, provided that the total value of the real estate property exceeds €500,000.

The supplementary tax for legal entities is calculated on the total value of the rights on the real estate of the legal entity at a rate of 0.55%. For properties that are self-used for the production or exercise of any kind of business activity, the supplementary tax is calculated at a rate of 0.1%.

Municipal Taxes

Additional taxes apply both to individuals and legal entities, depending on the municipality where the property is located. These can include local property taxes (such as T.A.P.), tax on electrified spaces, and garbage collection fees. Most of these charges are typically collected together with electricity bills by the electricity supplier.

Special Real Estate Tax ("S.R.E.T.")

S.R.E.T. is effectively a Specific Anti-Avoidance Rule ("S.A.A.R.") imposed on legal entities that own real estate in Greece on January 1st of each year and do not meet specific transparency requirements on their ultimate beneficial owners or other exemption criteria. The primary purpose of S.R.E.T. is to prevent the use of offshore

companies and structures for holding real estate in Greece, particularly high-value properties, to avoid paying property-related taxes.

It is imposed on real rights of full ownership, bare ownership, or *usufruct* rights in real estate located in Greece. S.R.E.T. is imposed at a tax rate of 15% of the value of the particular right. The value of the real estate and the rights attached thereto as of January 1st of the tax year are taken into account for the calculation of the tax.

The law provides several exemptions from S.R.E.T.

- **The business income exemption.** Companies, regardless of the country of establishment, which engage in commercial, manufacturing, industrial, craft, or service activities in Greece, are exempt from S.R.E.T., provided that during the relevant financial year, the gross income from these activities exceeds the gross income from real estate. Gross income from real estate does not include income from real estate used exclusively by companies for the purpose of conducting their business activities.
- **The disclosure exemption.** Companies established in Greece or another E.U. Member State that which have registered shares held by individuals or which declare the individuals who hold them, provided that the individuals have a tax identification number in Greece as foreign tax residents.
- **Regulated entity exemption.** Investment vehicles regulated by competent authorities, such as mutual funds, alternative investment funds, and other structures managed by regulated investment managers.

"The value of the real estate and the rights attached thereto as of January 1st of the tax year are taken into account for the calculation of the tax."

Asset Reporting Obligations

Any individual or legal entity, regardless of nationality, residence, or registered seat, must submit a property declaration on Form E9 if any of the following events occurs during a calendar year:

- Real property rights were acquired through a purchase, donation, or parental gift.
- Real property rights were inherited.
- Real property rights were transferred through a sale, donation, or parental gift.
- Modifications were made to a real property, such as legalizing unauthorized constructions, completing an unfinished building, or adding a new floor.

For purposes of Form E9, the following rights are considered real property rights:

- Full ownership
- Bare ownership
- *Usufruct*
- Habitation
- Surface right

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For this purpose, real property includes a real or contractual right of exclusive use of a parking space, auxiliary space, or swimming pool located in a jointly owned part of the property and constituting an accessory to the above real rights.

The property declaration is submitted for the year in which an event listed above arises. For the completion of the property declaration, the actual condition of the property is taken into account as determined based on the final registration in the cadastral office. If no final registration exists, the details of the property as stated in the title of acquisition are taken into account.

In cases of changes in the ownership of real estate, the notary, within 30 days from the execution of a deed of conveyance by which rights over a property are established, modified, altered, or transferred for any reason, is obliged to submit a property data declaration reflecting the contracting parties. This obligation is waived if it is expressly stated by the party or parties involved that the relevant property declaration will be submitted by them.

TAXES ON INCOME FROM REAL ESTATE

Income derived from real estate in Greece is defined as income, whether in cash or in kind, arising from the leasing, owner-occupation, or free use of land and property. It is subject to taxation, regardless of whether the property is owned by a resident or nonresident individual or legal entity. Real estate income includes rental income from residential or commercial leases. The Greek tax system distinguishes between individuals and legal persons, applying different tax rates, deductions, and reporting obligations.

Individual Income Tax

Real estate income must be reported annually via the annual income return of the individual on Forms E1 and E2). Real estate income is subject to the following progressive tax rates:

Income from Real Estate (EUR)	Tax Rate (%)
0 - 12,000	15
12,001 – 35,000	35
35,001 and up	45

For property owned and occupied by an individual, the income from free use of the property is presumed to be 3% of the property's objective value.

The following expenses are deductible from the real estate income under the conditions set out below:

- Expenses incurred for the purchase of goods and the provision of services related to the energy, functional, and aesthetic upgrade of buildings, which have not been or are not included in any building upgrade program are amortized over five years, up to the amount of tax payable for each tax year. The total amount that is deductible over the 5-year period is capped at €16,000.

The deduction claimed for the purchase of goods cannot exceed one-third of the expenses attributable to the provision of services.

- 5% of all costs related to repair, maintenance, renovation, or other fixed and operating costs of the property.
- The rent paid in cases of subleasing.
- 10% of all costs related to flood protection systems and drainage works.
- The amount of compensation paid by the lessor to the lessee for the termination of the lease of the property.

CORPORATE INCOME TAX (C.I.T.)

Domestic C.I.T.

All resident legal entities and permanent establishments of foreign legal entities must maintain accounting books and records and are taxed based on the same rules. C.I.T. generally is imposed at the rate of 22%. Credit institutions subject to specific rules on deferred taxation are subject to C.I.T. at the rate of 29%.

Income from real estate is treated as business income and is subject to C.I.T. Subject to certain limitations, deductions are allowed for business expenses, depreciation, and bad debt provisions.

To be deductible, business expenses must (i) relate to real transactions at market value, (ii) be recorded in accounting books & records, (iii) be supported by relevant tax records, and (iv) must not be of a kind that are included in the list of explicitly non-deductible expenses. Nondeductible expenses include interest expenses on loans granted by third parties (excluding bank loans, related-party loans,[4] and bond issued by S.A.'s), to the extent they exceed the interest rate of loans on open deposit/withdrawal accounts granted to non-financial enterprises, as published in the Statistical Bulletin of the Central Bank of Greece for the period closest to the date of the loan. Note that thin capitalization rules cap net interest expense deductions, exceeding €3.0 million at 30% of E.B.I.T.D.A. for nonfinancial enterprises.

In addition to standard business expense deductions, tax depreciation of fixed assets may also be deducted in computing taxable income. Land is not depreciable. For buildings, constructions, installations, industrial and special installations, non-building installations, warehouses and stations, including their annexes, an annual depreciation rate of 4% is applied.

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[4] Loans between related parties are subject to transfer pricing rules and restrictions.

Special deductibility restrictions apply for transactions with noncooperative states[5] and states with preferential tax regimes. Moreover, tax losses are carried forward for five years, while carrybacks are not allowed. Under an anti-abuse provision, the carry-forward of tax losses may be forfeited in cases where there is a change in ownership or voting rights of a company of more than 33% and, within the same or the following tax year, there is also a change in the company's business activity which represents more than 50% of the annual turnover compared to the tax year before the change in ownership/voting rights took place.

It is noted that the definition of income from real estate includes not only the actual income deriving from the lease of real estate, but also the deemed income deriving from the free use or self-use of real estate, and which is calculated at 3% of the objective value of real estate. However, where a legal entity uses the real estate for its own business activities, the deemed expense is deducted from the legal entity's gross income to the extent it doesn't exceed 3%, resulting in a tax-neutral treatment.

Dividend Tax

A flat tax rate of 5% is imposed on dividend distributions to individual shareholders, which exhausts their tax liability. If the recipient of the dividend is a tax resident in a country with which an income tax treaty is in force and effect, its provisions overcome Greek domestic tax law.

Dividends paid to non-resident companies are subject to a withholding tax rate of 5%. However, intra-group payments of dividends to a parent company that is resident in another E.U. Member State or Switzerland are exempted from withholding taxes, provided that the conditions of the E.U. Parent-Subsidiary Directive are met.

"A flat tax rate of 5% is imposed on dividend distributions to individual shareholders, which exhausts their tax liability."

In the case of a non-E.U. parent company or an E.U. parent company that does not qualify for the benefits of the E.U. Parent-Subsidiary Directive, an applicable income tax treaty may provide for a lower rate of withholding or an exemption not otherwise allowed under Greek tax law.

Remittances of profits from a Greek permanent establishment to its head office are not subject to a withholding tax.

Permanent Establishment Issues

Foreign legal entities that have directly acquired real estate property in Greece and derive real estate income are taxed at the C.I.T. of 22%, even if they do not have a permanent establishment in Greece. In the case of a foreign legal entity that is tax resident in a country with which Greece has signed an income tax treaty, the right to impose Greek income tax is based on the immovable property article, usually Article 6 of an income tax treaty entered into by Greece. There is no need to examine

[5] Noncooperative states are those that are not member states of the EU, whose situation regarding transparency and exchange of information in tax matters has been examined by the Organization for Economic Co-operation and Development (O.E.C.D.) and has not been found to be largely compliant, and which: a) have not concluded and do not apply with Greece a convention on administrative assistance in tax matters or have not signed the Joint Convention of the Council of Europe – O.E.C.D. on mutual administrative assistance in tax matters, and b) have not committed to the automatic exchange of financial information starting in 2018 at the latest.

whether a permanent establishment exists as required in a business profits article, which is usually Article 7 of an income tax treaty entered into by Greece.

In the case of a foreign legal entity that is a tax resident in a country with which no income tax treaty is in effect, the Circular states that the entity is deemed to have a permanent establishment in Greece due to the exploitation of immovable property generating Greek-source income.

Digital Transaction Duty or V.A.T.

Where property is leased to a lessee who is a taxable person for V.A.T. purposes and the property is used by the lessee for a business activity that is subject to V.A.T. – including offices, retail spaces, or industrial premises – the lessor may, with the agreement of the lessee, elect to apply V.A.T. to the rental income. If the lessor has not opted for the V.A.T. regime, the rental income is subject to the Digital Transaction Duty – a successor to the previously applicable stamp duty. The same tax rate applies to the Digital Transaction Duty and follows the same collection procedure. It is not imposed on residential rentals.

TAXES ON EXIT

Transfer of Real Estate

For nonresident individuals, the Greek Income Tax Code includes a provision stating that capital gains arising from the transfer of real estate or the transfer of shares in real estate-rich companies are subject to a 15% capital gains tax. Although the provision was adopted in 2014, it has never been applied due to suspensions of its application. Currently, the suspension is effective for gains recognized through December 31,2026.

For foreign corporations, capital gains derived from the transfer of real estate property are classified as business income for income tax purposes and are taxed at the corporate income tax rate of 22%. The capital gain is calculated as the sale value of the real estate property minus its tax book value, comprised of the acquisition cost), plus capital improvements, and reduced by tax depreciation claimed. The absence of a permanent establishment is not relevant based on the same rationale discussed above with regard to rental income.

Transfer of Shares in Real Estate Companies

For nonresident individuals, capital gains arising from the transfer of shares are subject to a 15% capital gains tax. However, different tax treatment is available to individuals who are tax resident in countries with which an income tax treaty is in force that exempts capital gains arising from the sale of shares with no carveout for shares of real estate-rich companies. Those individuals are exempt from Greek tax with regard to such capital gains, provided they substantiate their tax residence to the Greek tax authorities.

For foreign corporations, capital gains derived from the transfer of shares in real estate-rich Greek companies are classified as business income for income tax purposes. The gain is not subject to C.I.T. in Greece if a permanent establishment is not maintained in Greece.

PATH FORWARD

Attractive Tax Rules

While the above discussion is by no means exhaustive, it illustrates why foreign investors increasingly opt to acquire and hold Greek commercial real estate through corporate structures involving Greek companies types such as a Société Anonyme ("AE" in Greek), a Private Company ("IKE" in Greek), or a Limited Liability Company ("EPE" in Greek). All provide the following benefits:

- **Limited Liability Protection.** In general, the liability of the shareholders is limited to the amount of their contributions, investors shield themselves from personal liability, securing their broader asset portfolio.
- **Attractive Flat Tax Rate.** Corporate income from real estate is taxed at a flat C.I.T. rate of 22%, which is significantly lower than the 45% upper tax rate of the personal income tax scale imposed on high-value rental income.
- **Dividend Withholding Tax Exemption.** Withholding tax on dividends may be alleviated, subject to meeting the Parent-Subsidiary requirements or by virtue of beneficial income tax treaty provisions.
- **Tax Depreciation Benefits.** Greek tax law allows for an annual 4% tax depreciation on commercial property, reducing taxable income and generating significant long-term savings.
- **Flexibility on Exit.** As a major incentive for corporate ownership over direct property holding, a transfer of shares in Greek real estate companies by foreign tax resident companies that do not have a permanent establishment in Greece is not subject to capital gains tax. Additionally, capital gains deriving from the transfer of Greek shares for individuals who are resident in countries having beneficial income tax treaty provisions as to gains from share sales are also exempt from tax.

Based on the above, a very commonly used structure for inbound real estate investments that achieves most of the benefits discussed in this article consists of (i) the establishment of a Greek company, (ii) having the legal form of an S.A., a P.C. or an L.L.C., (iii) that directly acquires and holds the Greek real estate asset, and (iv) that is held in its turn by an interposed E.U. parent holding company, qualifying under the Parent-Subsidiary Directive and the Interest-Royalty Directive.

That structure ensures limited liability, taxable profits reduced to a considerable extent by operating expenses and tax depreciation, and corporate income taxation at an effective tax rate of 22%, with no additional tax on dividend distributions. Moreover, asset acquisitions by the Greek company can be financed in tax-efficient ways as interest expense incurred on loans to acquire real estate assets is, in principle, deductible, subject to transfer pricing rules where applicable and thin capitalization rules. Withholding tax on interest payments may be eliminated, subject to the fulfillment of the Interest-Royalty Directive conditions. Bond loans issued by Greek S.A. companies are very commonly used as they are also exempt from the Digital Transaction Duty and a special bank duty.

Upon exit, foreign resident corporate sellers tend to prefer share deals that are beneficial not only on the seller's side, due to ensuring no income taxation on the capital

gains realized on the sale and no indirect or transfer taxes, but also on the buyer's side, who is not burdened with liability for R.E.T.T., the real estate transfer tax. On the other hand, asset deals may also have their merits, including a reasonable 22% C.I.T. liability on real estate capital gains realized, and avoiding the restrictions of a share deal, such as (a) restrictions on allocating the purchase price to the underlying asset, (b) restrictions on depreciating the acquisition value of the shares, and (c) restrictions on deducting financing costs associated with the share acquisition.

The availability of tax optimization structures for inbound real estate commercial investments adds to the investment opportunities currently presented in the booming Greek real estate market, making Greece a highly attractive market for international investors.

Real Estate-Associated Immigration and Tax Incentives

Additional incentive regimes, like the Golden Visa, which grants residency to non-E.U. investors meeting certain investment thresholds, and the non-dom preferential tax regime, provides favorable tax treatment to nonresident High Net Worth Individuals relocating to Greece, are associated with the acquisition of real estate in Greece. The table below shows the basic points of both the Golden Visa residency and the non-dom preferential tax regime:

Golden Visa Residency	Non-Dom Preferential Tax Regime
• 5-year residence permit for non-E.U. citizens & family members • Access to the Schengen Zone, similar to a Schengen C-type Visa • Investment in real estate (one single property) ranges from €250.000 to €800,000, depending on the region of the property	• Flat tax of €100,000/year • Exhaustion of Greek tax liability for total foreign-source income and capital gains. • Investment of min € 500,000 in Greece • No reporting obligation • Applicable for a maximum of 15 tax years. • Extension to relatives with a flat tax of €20,000 per year/relative. • Exemption from Greek inheritance and gift tax for property located abroad

These initiatives aim to attract high-net-worth individuals by offering benefits such as residency rights without immediate citizenship requirements, reduced tax liabilities on foreign income, and access to the European Union's mobility and business opportunities. Together, they contribute to boosting Greece's economy through increased foreign investment, real estate development, and the introduction of new talent and entrepreneurship. These programs often come with streamlined application processes and additional incentives like family inclusion and eventual citizenship pathways, making Greece an appealing destination for global investors seeking both lifestyle and financial advantages.

Real Estate Investment Companies ("R.E.I.C.'s")

Greek R.E.I.C.'s, which are S.A. companies that operate under Law 2778/1999 and are regulated by the Hellenic Capital Market Commission, also consist of a preferential tax regime containing substantial exemptions and reduced effective taxation. Their exclusive purpose is to acquire and manage real estate property, and their minimum share capital is €25.0 million. Tax beneficial treatment includes the following:

- Annual tax equal to 0.375% of the average semi-annual value of their assets, calculated based on the reference rate of the European Central Bank.
- Exemptions from corporate income tax for rental income, capital gains, dividends, and interest income.
- Capital gains tax does not apply to property sales.

It is noted that R.E.I.C.'s are an alternative holding structure for real estate which have their own types of regulatory obligations, including the requirement for the R.E.I.C. to be listed on the Athens Stock Exchange within a two-year timeframe of operation.

FINAL REMARKS

Investing in Greek real estate presents substantial opportunities for foreign investors. However, successfully capitalizing on these opportunities requires a thorough understanding of the complex tax obligations involved at every stage, beginning with acquisition, moving to ownership, and addressing eventual exit. Navigating this tax landscape effectively is crucial to optimizing risks. By strategically structuring investments, leveraging available tax incentives, and benefitting from sound tax advice, foreign investors can confidently and efficiently maximize the return on their commercial real estate investments in Greece.

"Investing in Greek real estate presents substantial opportunities for foreign investors."

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U.S. INVESTMENT IN U.K. REAL ESTATE INVESTMENT – SEPARATED BY A COMMON LANGUAGE

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Tags
C.G.T.
Corporation Tax
I.H.T.
L.T.R.
Nil Rate Band
Opting to Tax
Real Estate
S.D.L.T.
U.K.

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INTRODUCTION

The focus of this article is the U.K. tax treatment of direct or indirect investments in U.K. commercial real estate made by wealthy individuals, particularly U.S. residents. It begins with an overview of the principal U.K. tax issues for non-U.K. residents, focusing on capital gains tax ("C.G.T."), corporation tax, and inheritance tax ("I.H.T."). It then provides illustrations on how those tax rules apply in practice, focusing on two common fact patterns used by U.S. persons.

It is common for investors to own commercial real estate through a company rather than owning real estate directly, and to hold each property through a separate special purpose vehicle ("S.P.V."). What follows is based on this commercial practice.

OVERVIEW – U.K. TAXATION OF DOMESTIC COMMERCIAL REAL ESTATE

C.G.T. and Corporation Tax

Since April 2019, non-U.K. resident individuals are subject to C.G.T. on gains realized on disposals of directly held U.K. commercial real estate. The gain is calculated by deducting the base cost and allowable expenses from the consideration that is received in the transaction. The tax rate for individuals is progressive and is capped at 24%.

The scope of C.G.T. was extended in April 2019 to cover gains realized on the disposal of indirect interests in U.K. land, in particular the disposal of shares in a property-rich company. Any gain realized on the disposal of shares in a property-rich company can be taxed at up to 24%. Broadly speaking, a company is considered to be property-rich once 75% of its value is derived from U.K. land, which includes interests in both U.K. commercial property and U.K. residential property.

Where a company owns U.K. real estate, it is liable to corporation tax at 25% on profits realized on the sale of the underlying property. While holding real property, a company is taxed on rental income at the same rate. As with trading income, the profits of a property business are calculated in accordance with generally accepted accounting practice. Expenses such as repairs and maintenance as well as management and agent fees are generally deductible. But there are restrictions. For example, expenses of a capital nature such as capital improvements or those not incurred exclusively for the purposes of the property business are excluded. Certain categories of plant and machinery, such as heating and ventilation systems, may attract tax relief as capital allowances.

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In the cases above, if the U.K. real estate or interest in a property-rich company that is being sold was acquired before April 5, 2019, the base cost is increased to the value as at April 5, 2019.

I.H.T.

The U.K.'s non-dom regime was abolished on April 6, 2025, so domicile no longer determines an individual's liability to I.H.T. Instead, tax exposure depends on three factors:

- The first is whether the individual is a long-term UK resident. ("L.T.R.").
- The second is the situs of the property.
- The third, which is only relevant to non-U.K. situs property, is whether the property derives its value directly or indirectly from UK residential property.

Broadly, an individual is an L.T.R. if he or she were a U.K. resident in ten out of the preceding 20 tax years. Note that the U.K. tax year runs from April 6th to the following April 5th. Since 2013, a statutory test that is largely formulaic determines the residence of individuals.[1]

An L.T.R. is liable to I.H.T. on worldwide assets. But an individual who is not an L.T.R. is chargeable to I.H.T. in regard only to U.K. situs assets and non-U.K. situs assets to the extent that they derive their value from U.K. residential property. From April 2017, U.K. domestic rules prevent the estate of an L.T.R. from shielding the value of U.K. residential property from I.H.T. by holding it through a non-U.K. company. These rules do not extend to U.K. commercial property held through a non-U.K. company.

Whether or not the decedent is an L.T.R., the estate of the decedent is entitled to a tax-free allowance of £325,000, known as the "nil-rate band." On death, an individual's estate is subject to I.H.T. imposed at a flat rate of 40% on the value of any directly owned U.K. commercial real estate that exceeds the nil-rate band. In contrast, commercial real estate held indirectly through a non-U.K. company is not subject to U.K. I.H.T. provided the decedent was not an L.T.R. as of the date of death.

Stamp Duty Land Tax ("S.D.L.T.")

The S.P.V. as the buyer would be liable to S.D.L.T. on the purchase of commercial real estate. S.D.L.T. is calculated using the "slice system," a form of graduated tax. Commercial real estate is subject to S.D.L.T. at a 0% rate on the value up to £150,000. Thereafter, the rate is 2% on the value up to £250,000, and 5% on the value exceeding £250,000. To illustrate, S.D.L.T. for a commercial property with a purchase price of £10,000,000 is £489,500.

Payment of S.D.L.T. is due within 14 days of the earlier of (i) the date of completion

[1] The detail of the test is beyond the scope of this article. In short, there are tests that can result in an individual being automatically nonresident or resident. For example, an individual is automatically U.K. resident if 183 days are spent in the U.K. If none of the automatic tests apply, whether an individual is U.K. resident is determined by reference to the number of specific ties that exist to the U.K., such as whether (i) at least one night is spent in an accommodation that is available to the individual for a minimum of 91 days during the tax year and (ii) the number of days spent in the U.K. by the individual.

or (ii) the date on which the contract is "substantially performed" (*e.g.* if the buyer takes occupation to do works on the property prior to completion).

Value Added Tax ("V.A.T.")

"Opting to tax" is an election that the owner of commercial or rental property can make to charge V.A.T. on the lease or sale of commercial property, which would otherwise be exempt from V.A.T. This allows the business to recover the V.A.T. it incurs on costs related to the acquisition, improvement, and operation of the property. Once made, the option to tax remains in effect for 20 years and can be revoked in limited circumstances, only.

Before purchasing a property, the buyer should confirm whether the seller has opted to tax with regard to a commercial property. If the property were opted, the buyer would pay V.A.T. on the purchase price. As a result, the buyer would pay S.D.L.T. on the total amount paid, which would include the purchase price and V.A.T. on that purchase. Therefore, this can result in an increased cost across two taxes. However, if the buyer provides goods or services that are V.A.T. chargeable, the V.A.T. incurred on purchase may be recoverable, but the S.D.L.T paid on that V.A.T. is not recoverable.

The buyer will also need to consider whether it wishes to opt to tax the property when renting it out. While this can enable it to recover V.A.T. costs associated with operating a property rental business, some tenants cannot recover V.A.T., including tenants in the financial sector, charities, and healthcare providers. They would find V.A.T. charges on rent unattractive.

Ordinarily, no V.A.T. charges apply if either (i) the seller has not opted the property or (ii) "transfer of a going concern" treatment applies. For the latter to apply, the buyer would need to purchase a property rental business and continue the rental business thereafter.

"Before purchasing a property, the buyer should confirm whether the seller has opted to tax with regard to a commercial property."

OVERVIEW – U.K.-U.S. INCOME AND ESTATE TAX TREATIES

Determining the most appropriate investment structure may be influenced by whether an individual is able to benefit from relief under the U.S.-U.K. Estate and Gift Tax Treaty ("the Estate Tax Treaty") for transfer tax purposes (including I.H.T.) and the U.S.-U.K. Income Tax Treaty ("the Income Tax Treaty") in respect of income tax, corporation tax and C.G.T.

The Estate Tax Treaty

The Estate Tax Treaty can limit an individual's exposure to I.H.T. In general, the Estate Tax Treaty grants the country of domicile the right to tax the worldwide assets of an individual, and credit is given for estate tax paid in the other country where real estate and business property of a permanent establishment are located. However, there is a saving provision which allows the country of an individual's nationality to continue taxing the individual. This provision can significantly restrict the treaty relief that is available to dual nationals.

Note that following the abolition of the non-dom regime, an individual's exposure to I.H.T. depends on whether he or she is an L.T.R. The U.K. legislation enacting the

changes confirms that references to domicile in the U.K.'s I.H.T. treaties should be read as referring to an individual who is an L.T.R.

For example, an individual domiciled in the U.S. who is not a U.K. citizen would not be exposed to I.H.T. on shares in a U.K. company, but would be liable to I.H.T. on U.K. commercial real estate that is owned directly. In comparison to the Income Tax Treaty, the Estate Tax Treaty does not extend the definition of immovable property to include shares in a property-owning company.

As will be explored below, it is also possible for a U.S. domiciled individual who is not a U.K. citizen to form a trust that shields its assets other than U.K. real property and business property of a permanent establishment from I.H.T.

The Income Tax Treaty

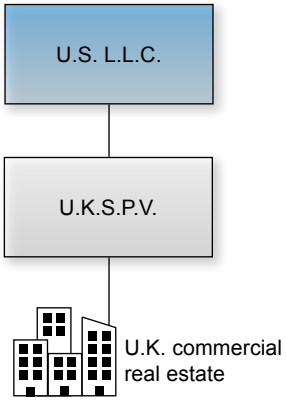
Under the Income Tax Treaty, the U.K. is entitled to tax gains realized by a U.S. resident on the disposal of real property located in the U.K. Further, in contrast to the Estate Tax Treaty, the U.K.'s taxing rights extend to shares in a company that derives its value directly or indirectly from U.K. real property.

The Income Tax Treaty provides that gains from disposals of U.K. real estate subject to tax in the U.K. are treated as income from a U.K. source. Foreign tax credits will therefore be allowed by the U.S., although this will be limited to the amount of U.S. tax imposed on the foreign source income.

The U.K. is allocated primary taxing rights under the Income Tax Treaty on rental income from U.K. commercial real estate. A credit for the U.K. tax may be available in the U.S.

EXAMPLES

Two-Tier Ownership – U.S. L.L.C./U.K. S.P.V.



In the above example, U.S. residents own U.K. commercial real estate through a two-tier structure. In particular, the U.S. residents hold interests in a U.S. limited liability company ("U.S. L.L.C."), which in turn owns all the shares in a U.K. private limited company ("U.K. S.P.V.") that holds the U.K. commercial real estate. We have assumed that the U.S. residents are U.S. citizens that are neither U.K. citizens nor L.T.R.'s.

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It is likely that the U.S. resident individual will follow the default treatment of U.S. L.L.C.'s and file an income tax return treating the L.L.C. as tax transparent. This would enable the investor to be taxed only at the individual level.

Similarly, the U.S. resident individual would probably elect for U.K. S.P.V. to be treated as a partnership for U.S. income tax purposes. A U.K. incorporated company is preferred because one incorporated in the U.S. would not be able to elect for pass-through treatment under the check-the-box rules. If the election were not made, the U.S. may regard the U.K. S.P.V. as being a corporation that is a C.F.C. or P.F.I.C., and therefore subject to less favorable tax treatment under U.S. tax rules. Electing for the U.K. S.P.V. to be treated as a pass-through entity enables U.S. investors to claim a credit for a proportionate share of U.K. income taxes. This election does not impact the U.K. tax treatment. If an actual partnership were desired to hold the shares in U.K. S.P.V., a U.S. partnership might be preferred because U.S. partnerships are not subject to the U.K. regulatory rules on entities that constitute collective investment vehicles.

Companies incorporated in the U.K. are automatically U.K. resident. U.K. S.P.V. is treated as opaque by the U.K.'s H.M. Revenue & Customs ("H.M.R.C.") and the U.K. does not have a check-the-box regime. Therefore, income and gains are taxed at the level of U.K. S.P.V. It will be subject to U.K. corporation tax at a rate of 25% on profits relating to (i) gains realized on a disposal of the commercial real estate, and (ii) rental income. There is no withholding tax on the payment of dividends from U.K. companies.

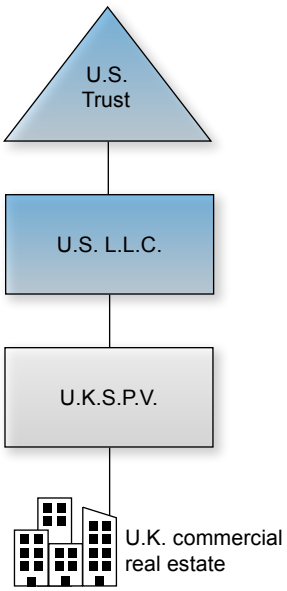
It is generally considered optimal to have a separate S.P.V. for each property – on an onward sale, a purchaser of the shares in U.K. S.P.V. will pay stamp duty (at 0.5%) rather than S.D.L.T. on the transaction.

On a disposal by the L.L.C. of shares in the U.K. S.P.V., the L.L.C. will likely be subject to corporation tax at 25% on any gain because H.M.R.C. treats U.S. L.L.C.s as opaque entities. The investors in the U.S. L.L.C. would claim a tax credit for a share of the U.K. tax paid under the Income Tax Treaty.

If the investor in U.S. LLC were not an L.T.R. there should be no I.H.T. exposure because the interest in U.S. L.L.C. should have a non-U.K. situs. We do not need to rely on the Estate Tax Treaty because, unlike U.K. residential property, the situs of U.K. commercial real estate can be blocked by holding the property through a non-U.K. entity. In the alternative, if the investor held shares in U.K. S.P.V. directly, the Estate Tax Treaty would assist, assuming the U.S. investor were U.S. domiciled and not a U.K. national. Under the Estate Tax Treaty shares in U.K. S.P.V. should not constitute immovable property or business property of a permanent establishment.

As to the financing of U.K. S.P.V.'s purchase, interest payable on a commercial loan secured on the property should, normally, be deductible for the purpose of calculating U.K. corporation tax, subject to the U.K.'s rules that can restrict deductibility where a company or a group of companies has net interest and financing costs of over £2 million in a 12-month period. Advice should be obtained if this is likely to be an issue.

Three-Tier Ownership – U.S. Trust/U.S. L.L.C./U.K. S.P.V.



In this example we have varied the ownership structure to include a U.S. trust as the owner of the interests in U.S. LLC. We have assumed that the trust is irrevocable and is U.S. resident. We also assume the settlor is a citizen and domiciliary of the U.S. and is neither a U.K. national nor an L.T.R.

The trustee of a non-U.K. tax resident trust should not be subject to U.K. tax on the trust's non-U.K. income and gains. Any U.K. resident beneficiaries would be subject to tax on a benefit received from the trust, including rent-free use of real estate. If the trust were settlor-interested and the settlor were U.K. resident, the trust's worldwide income and gains would be treated as arising to the settlor and subject to tax in the U.K.

Here, there is the potential for double taxation where both the grantor or trustees are liable to U.S. tax on the trust's income and gains and there are U.K. resident beneficiaries who receive a benefit from the trust. For example, if the trust were grantor for U.S. income tax purposes, the U.S. grantor might be chargeable to U.S. tax on the trust's income and gains as they arise, but the beneficiaries would only be liable to U.K. tax on receipt of a benefit such as a distribution. Advice should be obtained on the options for managing this exposure to double tax.

Below the level of the trustee, the U.K. tax implications are the same as in the first example. If the trustee disposed of its interests in U.S. L.L.C. it would be subject to C.G.T. at up to 24% on any gain, and a credit may be available in the U.S. for such U.K. tax.

As for I.H.T., an individual who is U.S. domiciled and not a U.K. national may be able to rely on the Estate Tax Treaty to form a trust that shields assets other than U.K. immovable property and business property of a U.K. permanent establishment from I.H.T. Based on the assumptions made above about the settlor, the Estate Tax Treaty should ensure that the trust's interests in U.S. LLC in this second example are not exposed to I.H.T.

There are of course many permutations to the above examples and advice should be taken in both jurisdictions when setting up the investment structure.

CONCLUSION

George Bernard Shaw is attributed the saying that England and America are two countries divided by a common language. While he may have been referring to cultural and linguistic differences, the saying is equally true with regard to income and estate tax consequences that apply when U.S. investors plan for the acquisition of commercial real estate in London. But with guidance on both sides of the Atlantic, the differences can be managed.

"There are of course many permutations to the above examples and advice should be taken in both jurisdictions when setting up the investment structure."

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TAX ISSUES FACED BY FOREIGN PERSONS INVESTING IN ITALIAN COMMERCIAL REAL PROPERTY

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Tags
Cadastral Value
I.M.U.
I.R.E.S.
I.R.P.E.F.
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Real Estate
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Redditi Fondiari

INTRODUCTION

This article examines the case of a foreign investor who directly or indirectly invests in commercial real estate properties located in Italy. Generally, foreign investors invest in the real estate sector indirectly, through Italian real estate companies or through real estate investment funds established in Italy.[1] This structure generally eliminates the risk of having a permanent establishment.

In comparison, the professional conduct of real estate investment activities in Italy by a nonresident investor involving the direct management of local multiple properties could give rise to a permanent establishment for tax purposes. In those facts, the income attributable to that permanent establishment would be taxable in Italy under the rules applicable to business income ("*redditi d'impresa*").

The analysis in the balance of this article focuses specifically on income derived by a nonresident investor from the ownership, rental, and subsequent transfer of commercial real estate assets located in Italy to an unrelated purchaser. It begins with direct investment in real estate and then addresses indirect investment through Italian entities.

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DIRECT CROSS-BORDER REAL ESTATE INVESTMENT

Rental Fees

According to Italian tax law, rental income received by nonresidents qualifies as income from immovable property ("*redditi fondiari*") and is subject to taxation in Italy. The applicable regime varies, depending on whether the recipient is an individual or a legal entity. In either event, the nonresident investor is required to file a tax return in Italy.

Nonresident individual investors are subject to individual income tax ("*I.R.P.E.F.*") at progressive rates varying from 23% to 43%, plus local surcharges.[2] In comparison,

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1 For more detail, see G.A. Giannantonio, G. Paladini, "*Investimento immobiliare e convenzioni internazionali contro le doppie imposizioni: la prospettiva italiana" Gli strumenti di investimento nel settore immobiliare italiano – Terza Edizione* (February 2017), page 222.

2 Reference is made to Article 23, paragraph 1, lett. a) of Presidential Decree no. 917 of December 22, 1986.

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nonresident companies are subject to corporate income tax ("*I.R.E.S.*") at 24%.[3] No regional tax ("*I.R.A.P.*") applies.

Tax is imposed when income is recognized under the accrual method of accounting. In principle, the amount subject to tax is the higher of the following two amounts:[4]

- The rental fees, subject to a forfait (lump-sum) reduction under the tax regime provided by law[5]
- The *cadastral* (*i.e.*, State) value, recorded in the Land Register, revalued for tax purposes

In practice, the rental fees are higher in most cases.

Because this fact pattern involves the direct ownership of Italian real estate by nonresidents, the domestic tax rules generally are not overridden by the real estate provision of income tax treaties entered into by Italy, such as Article 6 (Income from Immovable Property) of the Italy-U.S. Income Tax Treaty. It allocates the right to tax real estate to the State in which the property is situated. Relief from double taxation may be requested in the country of residence of the nonresident investor.

Lease payments on commercial properties located in Italy are subject to (i) V.A.T.,[6] imposed at a nil rate or at a 22% rate or (ii) registration tax,[7] generally imposed at a 1% or 2% rate. As an exception, the supply of hotel accommodations generally are subject to V.A.T. at 10%, and a similar rate of V.A.T. is imposed on the rental of housing having similar functions, such as B&B accommodations, tourist apartments and room rentals with services. If the landlord is a nonresident, registration for V.A.T. purposes in Italy generally is required.[8]

Ownership

The ownership of real estate properties in Italy, either as full ownership or under certain other real property rights – including *usufruct*,[9] use, habitation, *emphyteusis*,[10]

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3 Reference is made to Article 73, paragraph 1, lett. d) and Article 77 of Presidential Decree no. 917 of December 22, 1986.

4 Reference is made to Article 37, paragraph 4-bis of Presidential Decree no. 917 of December 22, 1986.

5 Flat reduction currently set at 5%.

6 Reference is made to Article 10, paragraph 1, no. 8 of Presidential Decree no. 633 of October 26, 1972.

7 Reference is made to Article 40 of Presidential Decree no. 131 of April 26, 1986.

8 See Resolutions of the Italian tax authorities no. 117/E/2004, no. 18/E/2021, no. 8/E/2014; Circular Letter no. 12/E/2007.

9 According to the Merriam-Webster Dictionary, usufruct is the legal right of using and enjoying the fruits or profits of something belonging to another, who holds bare legal title while the usufruct arrangement is in effect.

10 According to the Merriam-Webster Dictionary, *emphyteusis* is a Roman and civil law contract by which a grant is made of a right either perpetual or for a long period to the possession and enjoyment of originally agricultural land subject to the keeping of the land in cultivation or from depreciation, the payment of a fixed annual rent, and some other conditions.

or surface rights – gives rise to the application of the unified municipal tax ("I.M.U.")[11] and other minor local charges, such as garbage tax. The standard I.M.U. rate is 0.76%; however, municipalities may, by specific resolution of the municipal council, decrease the rate or increase it up to 1.06%, which is the tax rate in most cases).

An exemption from I.M.U. is provided for inventory properties owned by companies. Examples are buildings constructed and intended for sale by the construction company, as long as they remain designated for that purpose and are not rented out. Filing obligations are mandatory.[12]

Capital Gains

In general, capital gains realized by nonresident individuals are subject to (i) *I.R.P.E.F.*, individual income tax, imposed at progressive rates varying from 23% to 43%, plus (ii) local surcharges.[13] The filing of a tax return is mandatory. Alternatively, a nonresident individual seller may elect to be subject to a 26% substitute tax, in which case the notary overseeing the transaction becomes responsible for collection and payment of the tax and filing the required tax return.[14]

The taxable income ("*redditi diversi*") will be calculated as the difference between the sale price and the purchase price or the construction, whichever is applicable.[15]Again, *I.R.A.P.*, the regional tax, is not applicable.

Capital gains realized by nonresident companies are subject to *I.R.E.S.*, the corporate income tax, imposed at a 24% rate, and the filing of an Italian corporate income tax is mandatory.[16] As with nonresident individuals, *I.R.A.P.* is not applicable.

The taxation rules change once real estate is held for more than five years from the completion of construction or from the date of purchase by a nonresident individual or a nonresident corporation. At that point, capital gains arising from the sale of the real estate are no longer subject to Italian income tax. Such favorable domestic tax treatment of real estate gains realized by nonresidents is not overridden by contrary terms of a capital gains article of an income tax treaty, such as Paragraph 1 of Article 13 of the Italy-U.S. Income Tax Treaty. Although the provision allocates the right to tax gain from the alienation of immovable property to the Contracting State in which such property is situated, Italy will not impose tax once the five-year threshold is reached.

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11 Reference is made to Article 11, paragraphs from 739 to 783 of Law no. 160 of 2019.

12 Reference is made to Article 1, paragraph 751 of Law no. 160 of December 27, 2019.

13 Reference is made to Article 23, paragraph 1, lett. f) and Article 67, paragraph 1, lett. b) of Presidential Decree no. 917 of December 22, 1986.

14 Reference is made to Article 1, paragraph 496 of Law no. 266 of 2005.

15 Reference is made to Article 68, paragraph 1 of Presidential Decree no. 917 of December 22, 1986.

16 Reference is made to Article 73, paragraph 1, lett. d) and Article 77 of Presidential Decree no. 917 of December 22, 1986.

INDIRECT CROSS-BORDER REAL ESTATE INVESTMENT THROUGH ITALIAN COMPANIES

Rental Fees and Ownership

According to Italian tax law, rental income received by Italian tax resident companies qualifies as *redditi d'impresa*, or business income, and is subject to taxation in Italy. Both (i) *I.R.E.S.,* the corporate income tax, imposed at the rate of 24%[17] and (ii) *I.R.A.P.* the regional tax, generally imposed at the rate of 3.9% apply.[18]

Income is recognized as it accrues. Taxation applies on the rental fees if the immovable property is recorded as business asset. The tax base is the greater of the following two items: (i) the rental fees charged and (ii) the *cadastral* (*i.e.*, State) value[19] computed for tax purposes as recorded in the Land Register.

The V.A.T., registration tax rules, I.M.U., and related local charges are the same as those discussed above for a nonresident owner

Distribution of Profits to the Nonresident Investor

According to Italian tax law, a 26% withholding tax generally is applied to dividends paid by Italian resident companies to shareholders that are not Italian residents.[20]

If the recipient can provide documentary evidence issued by the competent tax authorities that it has paid a final tax in its country of residence on the gross amount of the dividends paid, the recipient generally is entitled to a partial refund up to 11/26ths of the withholding tax collected. This equates to a net 15% tax rate.

A different set of withholding taxes is imposed on dividends that are paid to companies and entities resident and liable to tax in (i) E.U. Member States or (ii) E.E.A. States that allow an adequate exchange of information with Italy. For these nonresident shareholders, a reduced 1.20% final withholding tax is levied on dividends.[21]

Under certain conditions, dividends paid to an E.U. resident parent company may be exempt in Italy.[22] To obtain the benefit, the parent company must meet the following conditions:

- It must be resident for tax purposes in an E.U. Member State without being considered as resident in a non-E.U. country according to a Double Tax Treaty in force.

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17 Reference is made to Article 73, paragraph 1, lett. a) and Article 77 of Presidential Decree no. 917 of December 22, 1986

18 Reference is made to Article 2, paragraph 1 and Article 16 of Legislative Decree no. 446 of December 15, 1997.

19 Reference is made to Article 90, paragraph 1, of Presidential Decree no. 917 of December 22, 1986.

20 Reference is made to Article 27, paragraph 3 of Presidential Decree no. 600 of September 29, 1973.

21 Reference is made to Article 27, paragraph 3-ter of Presidential Decree no. 600 of September 29, 1973.

22 Reference is made to Directive no. 2011/96/EU, "*Parent-Subsidiary Directive*" and to Article 27-*bis* of Presidential Decree no. 600 of September 29, 1973.

- It must have one of the legal forms listed in the Annex of the Parent-Subsidiary Directive.
- It must be subject to one of the taxes listed in the Annex of the Parent-Subsidiary Directive, without the possibility of benefiting from an exception or an exemption, unless temporarily or territoriality limited.
- It must directly hold the capital of the subsidiary for a period of at least one uninterrupted year.

The Italian Tax Authorities require specific items of documentation to obtain the benefit of the exemption.[23] The first is a form issued by the tax authorities in the country of residence of the shareholder certifying that the shareholder meets the first two conditions relating to tax residence and legal form. The second is a self-declaration by the shareholder certifying that all conditions are met.

In addition to the requirements of Italian law, anti-abuse provisions of the E.U. Parent-Subsidiary Directive provide that the benefit of the Directive is denied where the structure implemented by the parent corporation and the subsidiary is not genuine and does not reflect economic reality.[24]

Where the E.U. Parent-Subsidiary Directive is not relevant for one reason or another, a foreign parent corporation may be entitled to the benefits available by income tax treaty, such as those provided in Article 10 (Dividends) of the Italy-U.S. Income tax Treaty. Paragraph 2 of the Article 10 reduces the rate of withholding tax on dividends to 15%, in general, and to 5% where foreign shareholder holds at least 25% of the voting stock of the company paying the dividend for a 12-month period ending on the date the dividend is declared. Note that the recipient of the dividend must meet the anti-treaty shopping provision, if any, of the relevant treaty, which in the case of the of the Italy-U.S. Income tax Treaty appears in Article 2 of the accompanying Protocol.

"The Italian Tax Authorities require specific items of documentation to obtain the benefit of the exemption."

Capital Gains Taxation

Taxable capital gains realized by Italian companies from the sale of commercial real estate properties qualify as *redditi d'impresa*, business income, and are subject to *I.R.E.S.,* corporate income tax, imposed at a 24% rate.[25] Those gains also are subject to *I.R.A.P.*, regional tax, generally imposed at a 3.9% rate.[26]

In comparison, capital gains realized by nonresident investors from the sale of participations in, or the liquidation of, Italian companies generally are subject to taxation in Italy.[27] However, two provisions may reduce or eliminate Italian tax on the gain.

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23 Reference is made to Article 27-*bis*, paragraph 3 of Presidential Decree no. 600 of September 29, 1973.

24 Reference is made to Article 27-*bis*, paragraph 5 of Presidential Decree no. 600 of September 29, 1973, as amended by Article 26, paragraph 2, lett. b) of Law no. 122 of July 7, 2016.

25 Reference is made to Article 86 of Presidential Decree no. 917 of December 22, 1986.

26 Reference is made to Article 5 of Legislative Decree no. 446 of December 15, 1997.

27 Reference is made to Article 23, paragraph 1, letters b) and f), of Presidential Decree no. 917 of December 22, 1986.

- **Minority holdings**. The first provision applies to nonresident investors that hold minority interests in Italian companies. For this purpose, a minority interest is defined to mean less than 2% of a listed company and less than 20% for an unlisted company.

  In either circumstance, a nonresident investor may benefit from a domestic exemption with regard to the capital gain, provided the investor is tax resident in a white-listed jurisdiction that has in effect an adequate exchange of information agreement with Italy.[28]

- **Tax Treaty Exemption**. The second provision applies to nonresident investors that benefit from an income tax treaty with a favorable capital gains provision. Article 13 in Italy's income tax treaties generally allocates the right to tax gains to the country of residence of the taxpayer, subject to taxation in the country of situs where gains relate to immovable property and permanent establishment property.

  Paragraph 12(b)(ii) of Article 1 of the Protocol to the Italy-U.S. Income Tax Treaty provides that the term (immovable property) in the case of Italy includes "shares or comparable interests in a company or other body of persons, the assets of which consist wholly or principally of real property situated in Italy * * * ."

  Nonetheless, Paragraph 1(a) of Article 3 of the Protocol provides that favorable treatment under Italian domestic law cannot be overridden by the Treaty. It provides as follows:

  > 1. The Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded: (a) by the laws of either Contracting State * * *.

Foreign Tax Credit

The Italian tax law[29] and Article 23 of the Double Tax Treaties signed by Italy provide for resident taxpayers (including Italian companies) a credit for income taxes paid abroad to avoid double taxation.

CONCLUSION

For nonresident investors, Italy contains many little known provisions to reduce or eliminate tax on income and gains arising from real property. A careful reading of domestic tax laws, combined with the proper application of bilateral income tax treaties, reveals numerous planning opportunities that can significantly enhance the efficiency of cross-border real estate investment, be it direct or indirect.

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[28] Reference is made to Article 5, paragraph 5 of Presidential Decree no. 461 of November 21, 1997.

[29] Reference is made to Article 165 of Presidential Decree no. 917 of December 22, 1986.

While the *Dolce Vita* is still available, numerous regulatory pitfalls must be managed, including requirements, conditions, and holding period. This article should assist foreign investors and their legal and tax advisors in navigating the complex regulatory framework governing the Italian real estate sector.

"While the Dolce Vita is still available, numerous regulatory pitfalls must be managed, including requirements, conditions, and holding period."

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STRATEGIC CONSIDERATIONS FOR INTERNATIONAL INVESTORS IN DUTCH REAL ESTATE

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R.E.T.T.
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Vastogoedlichaam
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W.O.Z. Value

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INTRODUCTION

From an economic viewpoint, the Netherlands is a highly attractive destination for international real estate investors, thanks to its robust legal framework, transparent property market, and strategic location within Europe. From a tax policy viewpoint, however, the Dutch tax environment can be challenging, as it is subject to frequent legislative changes. Recent updates – including the partial discontinuation of the Dutch equivalent of a R.E.I.T., known as the F.B.I. regime, revised entity classification standards, and stricter interest deduction rules – have significantly impacted the landscape for cross-border investors. This article provides an overview of recent developments and key considerations.

ACQUISITION OF DUTCH REAL ESTATE: TRANSFER TAX, V.A.T., AND STRUCTURING

Purchasing Dutch real estate, whether through a direct asset transaction or by acquiring shares in a real estate holding company, triggers Dutch Real Estate Transfer Tax ("R.E.T.T.") for the buyer. As of 2024, the standard rate for R.E.T.T. is 10.4%, with a reduced 2% rate for owner-occupied residential property. For residential property acquired by investors, a new 8% rate will apply from January 1, 2026. R.E.T.T. is calculated based on the higher of the purchase price or the fair market value.

R.E.T.T. is not limited to direct asset acquisitions. Acquiring shares in a company classified as a real estate entity (*vastgoedlichaam*) can also trigger R.E.T.T. A company is considered a real estate entity if the following two tests are met during a specific reference period:

- More than half of its assets are real estate, with at least 30% of such assets being Dutch real estate.
- At least 70% of the real estate is held mainly for passive investment or active trading in real estate. To illustrate, a self-storage business can qualify as a real estate entity because the services it provides – leasing storage space –mainly relate to the exploitation of real property. In comparison, real estate used in an active hotel business operated by the owner of the real estate or by an affiliated entity would not be considered as either passive investment or active trading in real estate.

R.E.T.T. becomes due if an acquirer, individually or together with affiliates, obtains a significant interest in the real estate entity. Generally, the acquisition of a one-third interest or more in a real estate entity is viewed to be significant.

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Generally, the transfer of Dutch real estate is exempt from Value Added Tax ("V.A.T."), as is the transfer of shares in a real estate holding company. Exceptions exist in cases involving (i) the transfer of land held for development or (ii) the transfer of newly constructed property when made within two years of its first use. If applicable, V.A.T. is imposed at the rate of 21%.

If V.A.T. is due by operation of law, R.E.T.T. may not be payable when the concurrence exemption applies. This exemption is available if the acquisition is already subject to V.A.T., provided that (a) the property has not been put into use as of the moment of transfer or (b) the so-called project developer scheme can be applied. provided that the real estate has not been used at the moment of transfer. It is also available if the transaction would have been subject to V.A.T. but for the T.O.G.C. facility regarding sales of going concerns The T.O.G.C. facility is discussed later in this article.

Under the developer scheme, the concurrence exemption from R.E.T.T. applies if the acquisition takes place within six months after the first use of the property provided that (1) the developer has no intention of operating the real estate for its own account other than during the six-month period leading up to a sale and (2) the purchaser can fully or partially deduct the V.A.T. For this concurrence exemption to apply, in principle the real estate must be transferred at its market value.

For acquisitions of real estate in use for more than two years, the transaction is exempt from V.A.T. by law. In some cases, a seller of real estate may opt for V.A.T. taxation on the sale and delivery of the property, which is only possible if the buyer intends to use and actually uses the property during a specific reference period for activities that entitle it to a V.A.T. deduction of at least 90%. This allows the buyer to reclaim the V.A.T. charged in full or nearly in full, but the buyer's use of the property for V.A.T.-taxable or V.A.T.-exempt purposes will be monitored during a ten-year adjustment period.

The T.O.G.C. facility applies where an asset transaction qualifies as a transfer of a going concern, hence "T.O.G.C." It applies if the property is used for business activities for V.A.T. purposes, including leasing activities. When the facility applies, no V.A.T. is due, but R.E.T.T. may still apply.

TAXATION DURING OWNERSHIP: CORPORATE INCOME TAX, INTEREST DEDUCTION, AND DEPRECIATION

Dutch resident companies and nonresident companies with Dutch real estate are subject to Dutch corporate income tax ("C.I.T.") on rental income and capital gains. The C.I.T. rates for 2025, and expected for 2026) are 19% on the first €200,000 of taxable profit and 25.8% on profits above €200,000.

Transaction costs related to the acquisition of real estate are capitalized and depreciated over time. In comparison, costs related to share acquisitions generally are not deductible. Interest expense on loans used to finance real estate acquisitions is generally deductible, but several limitations apply. The earnings stripping rule of A.T.A.D. I limits net interest deduction to the greater of €1.0 million or 24.5% of E.B.I.T.D.A.

The Dutch fiscal unity regime allows companies to form a tax group, enabling the consolidation of profits and losses and the tax-neutral transfer of assets within the group. This regime is available only to companies with at least 95% ownership links, which is why foreign investors often acquire shares in a Dutch real estate entity through a Dutch holding company which subsequently forms a fiscal unity, effectively pushing down the interest costs to the level of the real estate entity.

The deductibility of interest expenses can also be denied where any of the following circumstances:

- Mismatches exist in the cross border treatment of (i) entities, (ii) loans, and (iii) transfer pricing.
- The anti-base erosion rule applies because, (a) interest on related-party debt used to finance share acquisitions is taxed at an effective rate of less than 10% in the hands of the lender or (b) the transaction or the loan are not based on sound business reasons.
- The arrangement is considered abusive under the general anti-abuse rule.

"The Dutch fiscal unity regime allows companies to form a tax group, enabling the consolidation of profits and losses and the tax-neutral transfer of assets within the group.

Buildings can be depreciated for tax purposes, but only down to the W.O.Z. value, the official property value determined by the municipality. Land is not depreciable. However, If the market value of a building falls significantly and durably below the book value, the difference can be deducted in one go, even if this brings the book value below the W.O.Z. value.

Maintenance costs are immediately deductible in the year incurred, while improvement costs must be capitalized and depreciated over the useful life of the improvement, with a minimum period of five years.

V.A.T. ON LEASING AND ONGOING COMPLIANCE

Revenue derived from leasing of real estate generally is exempt from V.A.T. However, the landlord and tenant may jointly opt for V.A.T.-taxable leasing if the tenant uses at least 90% of the property for V.A.T.-taxable activities. This allows the landlord to recover input V.A.T. on costs related to the property. Both Dutch and foreign landlords leasing out Dutch property are subject to these rules and may need to register for V.A.T. in the Netherlands.

From 2026, a five-year adjustment period will apply to services related to immovable property with a value of at least €30,000. This means that any V.A.T. previously deducted must be reviewed annually based on the actual use of the property, and a claw-back of V.A.T. may be required if the use changes.

WITHHOLDING TAXES: DIVIDENDS AND INTEREST

Dividends paid by Dutch companies are subject to 15% Dutch dividend withholding tax, unless reduced or exempted by a tax treaty or the EU Parent-Subsidiary Directive. The application of the dividend withholding tax exemption is subject to strict anti-abuse conditions, including the requirement for sufficient economic substance at the level of the shareholder.

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Distributions by Dutch cooperatives owning real estate are generally not subject to dividend withholding tax, which explains the use of cooperatives for the acquisition of Dutch real estate. Another option is to use a foreign entity, not incorporated under Dutch law, to acquire Dutch real estate. The Netherlands does not levy withholding tax on arm's length interest payments. However, as of 2021 for interest and royalties and 2024 for dividends, a conditional withholding tax of 25.8% applies to payments that are made to (i) related entities in listed low-tax or noncooperative jurisdictions or (ii) in cases of abuse. The use of a cooperative instead of a regular private limited company does not prevent the application of conditional withholding tax. The same applies to foreign entities holding Dutch real estate. Consequently, it is important to assess the extent to which an applicable income tax treaty limits Dutch taxing rights.

Foreign investment funds holding shares in Dutch companies may face challenges in reclaiming Dutch dividend withholding tax. Each situation requires careful analysis.

DISPOSALS: ASSET VS. SHARE DEALS AND TAX IMPLICATIONS

When Dutch real estate is sold by a Dutch or foreign company or fund, Dutch corporate income tax is imposed on the capital gain. The buyer is responsible for R.E.T.T. on the acquisition of Dutch real estate, subject to the concurrence exemption in the case of unused real estate.

Gains on the sale of shares by a Dutch investor in a Dutch real estate entity are generally exempt from C.I.T. under the participation exemption, provided the seller holds at least 5% and the subsidiary is not a passive investment company. If a foreign investor sells shares in a Dutch real estate entity, Dutch tax may apply if the shares represent a substantial interest and the structure is considered abusive or lacks sufficient substance. Ownership of 5% or more of the target constitutes a substantial interest. The buyer is liable for R.E.T.T. if the target qualifies as a real estate entity and the substantial interest threshold is met.

LOSS UTILIZATION RULES FOR REAL ESTATE COMPANIES

Tax losses incurred for Dutch corporate income tax purposes can be carried back one year and carried forward indefinitely, provided the loss is confirmed in a tax assessment. For profits up to €1.0 million, losses can be fully offset. For profits above €1.0 million, only 50% of the excess can be offset. If the ultimate ownership of a real estate company changes by more than 30%, unused losses are forfeited. This means that buyers of real estate entities should not attribute value to such tax assets.

RECENT LEGISLATIVE DEVELOPMENTS AND PRACTICAL CONSIDERATIONS

From January 1, 2025, Dutch fiscal investment institutions, including F.B.I.'s which are the Dutch equivalent of R.E.I.T.'s, will no longer be permitted to invest directly in Dutch real estate and benefit from the 0% C.I.T. rate. F.B.I.'s may still invest

indirectly via a regularly taxed subsidiary. This change ensures that income from Dutch real estate is always subject to Dutch C.I.T.

From 2025, Dutch and comparable foreign partnerships will generally be treated as tax transparent for Dutch tax purposes, unless they qualify as regulated mutual funds. In the latter case, specific criteria apply to determine whether a mutual fund is considered transparent or opaque for Dutch tax purposes. To mitigate negative transitional effects, a transitional regime allows funds that adjust their fund terms to the so-called redemption variant before January 1, 2026, to maintain transparent status retroactively from January 1, 2025. On September 16, 2025, an alternative transitional regime was published that will exist alongside the first. Further details regarding the exact conditions of the alternative regime are expected in the coming months, in anticipation of an amendment to the new fund classification rules that are anticipated to come into effect as of January 1, 2027.

CONCLUSION

As illustrated above, the Dutch real estate tax regime is characterized by complexity, frequent legislative changes, and a high level of scrutiny in general, and especially for international and cross-border structures. Key issues for U.S.-based investors include

- the distinction between direct and indirect acquisitions,
- the definition and treatment of real estate entities,
- the application of anti-abuse rules, and
- the impact of recent legislative reforms such as the abolition of the F.B.I. regime for direct real estate investments and the reclassification of partnerships.

With the tightening of rules for interest expense deductions, new V.A.T. adjustment requirements, and strict R.E.T.T. exemptions, it is more important than ever for international investors and their advisors to plan proactively and stay informed during the period of ownership. The classification of the investment vehicle, the presence of sufficient economic substance, and timely restructuring in response to legislative changes are all critical to optimizing investment returns and ensuring compliance.

F.I.R.P.T.A. REVISITED – THINGS TO REMEMBER WHEN NONRESIDENTS INVEST IN U.S. REAL PROPERTY

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Tags
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Branch Profits Tax
D.R.E.
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U.S.R.P.H.C.
Withholding

INTRODUCTION

The year 2025 marks the 45th anniversary of the enactment of the Foreign Investors Real Property Tax Act. It is a good time to revisit issues that are faced by nonresident investors considering an acquisition of real property in the U.S.

For the private investor, many decision points must be addressed. Here are a few that come readily to mind:

- Will the investment generate passive or active income?
- Now and possibly in the future, will the investment be limited to one property or will there be multiple properties?
- Is it better to own the property directly or through a holding company?
- Should the holding company be formed in the U.S. or abroad there, or should there be holding companies in both places?
- Should the holding company be tax-transparent or tax-opaque?
- Will the structure prevent death duties from being imposed in the U.S.?
- If the initial holding structure produces suboptimal results, can the structure be revised, and if so, at what costs?
- Is it better to hold all U.S. properties through one U.S. holding company or is it better to hold each U.S. property through its own separate U.S. holding company?

The goal of this the article is to provide guidance to foreign investors and their home country advisers so that well-reasoned investment structures can be formulated at the front end that take into account U.S. tax rules , foreign tax rules, and preferences of the particular client.

F.I.R.P.T.A. BACKGROUND

Basic F.I.R.P.T.A. Rules

Non-U.S. persons are generally subject to U.S. income tax on two types of income: (i) income that is "effectively connected" with the conduct of a U.S. trade or business,

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known as “effectively connected income” or “E.C.I.,” and (ii) U.S.-source income that is fixed, determinable, annual, or periodic (“F.D.A.P.” income), which mostly refers to investment income, such as dividends and interest, but not capital gains.[1]

Gains derived by foreign persons from the disposition of U.S. real property are governed by a special set of rules enacted under the Foreign Investment in Real Property Tax Act (“F.I.R.P.T.A.”), which treats such gains as E.C.I.[2] This means that foreign sellers of U.S. real estate must pay tax on a net basis and file U.S. tax returns reporting the sale.

Specifically, F.I.R.P.T.A. applies to dispositions of “U.S. Real Property Interests” (“U.S.R.P.I.’s). U.S.R.P.I.’s include[3]

- direct interests in U.S. real property, and
- shares in U.S. corporations that are viewed as “U.S. real property holding corporations” (“U.S.R.P.H.C.’s”).

A U.S. corporation is a U.S.R.P.H.C. if the value of its U.S.R.P.I.’s is at least 50% of the aggregate value of all of its real property and all other assets used or held for use in a trade or business.[4]

Tax under F.I.R.P.T.A. is collected partly through the F.I.R.P.T.A. withholding tax. Under F.I.R.P.T.A. withholding rules, a buyer of a U.S.R.P.I. generally is required to withhold and remit to the I.R.S. an amount equal to 15% of the amount realized.[5] A limited set of exceptions exist to the obligation of the purchaser to withhold tax.[6]

Because F.I.R.P.T.A. tax liability and withholding differ with respect to both rate and tax base (gain for the former vs. amount realized for the latter), the tax withheld often does not match the seller’s final tax liability. If the tax withheld exceeds the final tax liability, the seller is refunded the excess when it files a U.S. tax return. The tax previously withheld is claimed as a credit against the seller’s U.S. tax liability.[7]

Nonrecognition

By default, F.I.R.P.T.A. overrides the nonrecognition provisions of the Code.[8] Therefore, unless a specific provision in the F.I.R.P.T.A. regulations allows for a taxpayer to make use of a nonrecognition provision, tax is due on would-be tax-free transactions. Among other requirements, a transaction must generally involve an exchange of one or more U.S.R.P.I.’s for one or more other U.S.R.P.I.’s to qualify for nonrecognition.

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1 Code §§881(a) for F.D.A.P. and 882(a)(1) for E.C.I.

2 Code §897(a).

3 Code §§897(c)(1)(A), (c)(4).

4 Code §§897(c)(1)(A), (c)(4).

5 Code §1445(a). A different withholding regime applies to distributions of U.S.R.P.I.’s by foreign corporations, under which the distributing corporation must withhold 21% of the gain. See Code §1445(e)(2).

6 Code §1445(b).

7 Treas. Reg. §1.1445-1(f)(1).

8 Code §897(e)(1).

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However, for certain types of nonrecognition transactions, the requirements are relaxed. For example, a corporation's contribution of property to its wholly owned subsidiary is typically nontaxable under Code §351. But a foreign corporation's contribution of its U.S.R.P.I. to its foreign subsidiary would fail the U.S.R.P.I.-for-U.S.R.P.I. requirement, as the parent would receive the subsidiary's stock, and foreign stock cannot be a U.S.R.P.I. However, the regulations allow certain foreign-to-foreign Code §351 contributions to qualify for nonrecognition if certain other requirements are met in lieu of the U.S.R.P.I.-for-U.S.R.P.I. requirement, namely that the transferred U.S.R.P.I. be stock in a U.S.R.P.H.C. (as opposed to a direct interest in U.S. real estate) and that the transferee corporation have the same owners as the U.S.R.P.I. did shortly before its transfer.[9]

Exceptions to Withholding

There are several situations in which a taxpayer is not subject to withholding. One situation is if the property transferred is determined to not be a U.S.R.P.I. This is particularly important for U.S.R.P.I.'s that are shares in U.S.R.P.H.C.'s. Formally, U.S. law presumes that any interest in a U.S. corporation is an interest in a U.S.R.P.H.C., unless either the corporation or the I.R.S. determines that it is not a U.S.R.P.H.C.[10] If the corporation makes the determination, it must also provide notice to the I.R.S. [11]Additionally, a U.S. corporation that is a U.S.R.P.H.C. at any time during the shorter of (i) the foreign shareholder's holding period or (ii) the five-year period preceding the date that the foreign shareholder disposes of the interest retains its U.S.R.P.H.C. status unless the corporation or I.R.S. establishes that this taint is cleansed.[12] The taint is generally cleansed if all U.S.R.P.I.'s are disposed of in taxable transactions.[13] If the corporation can establish that it is not a U.S.R.P.I., and the withholding agent receives a copy of the notice from either the foreign shareholder or the corporation, withholding is excused.[14]

"There are several situations in which a taxpayer is not subject to withholding."

If the transaction qualifies for nonrecognition under the rules described earlier, withholding is excused provided the seller furnishes a notice of nonrecognition to the buyer explaining the reason why the transaction is properly treated as a nonrecognition transaction.[15] Additionally, the buyer must send a copy of the notice to the I.R.S. within 20 days of the transaction.[16]

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9 Treas. Reg. §1.897-6T(b)(1)(iii). In Notice 2006-46, the I.R.S. announced its intention to revise the regulation in the context of to foreign-to-foreign Code §351 transactions and B-reorganizations, loosening some of the requirements for tax-free treatment. While the changes in the notice had immediate effect, the regulation has not been amended.

10 Treas. Reg. §1.897-2(g)(1)(i).

11 Treas. Reg. §1.897-2(h)(2). The corporation can also make the determination voluntarily, in the absence of a request from the shareholder, and provide notice to the I.R.S. (Treas. Reg. §1.897-2(h)(4)).

12 Code §897(c)(1)(A)(ii).

13 Code §897(c)(1)(B).

14 Code §1445(b)(3).

15 Treas. Reg. §1.1445-2(d)(2)(i)(A).

16 Treas. Reg. §1.1445-2(d)(2)(i)(B).

Alternatively, the buyer or seller can apply to the I.R.S. for a F.I.R.P.T.A. withholding certificate. A withholding certificate allows the buyer to reduce or eliminate the amount it must withhold.[17] Applications must fall into one of the following categories:[18]

- **Category 1:** Foreign person subject to withholding is entitled to nonrecognition or exemption from tax
- **Category 2:** Amount that would be withheld exceeds the maximum tax liability
- **Category 3:** Deferred payment or installment sales
- **Category 4:** Agreement to pay tax at a later date
- **Category 5:** Blanket withholding certificate for multiple dispositions of U.S.R.P.I.'s
- **Category 6:** Applications on any other basis

Applications under Categories 1, 2, or 3 are submitted using Form 8288-B (Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests).[19]

However, in recent practice, F.I.R.P.T.A. withholding certificates may not be a viable option due to extended processing times. Although the statute requires the I.R.S. to act on an application within 90 days after it is received,[20] I.R.S. agents have advised that withholding certificates currently take about 18 months to two years to be issued. In one recent matter, a taxpayer received a withholding certificate 14 months after submitting an application. As such, claiming a refund through filing a tax return may be a faster way for the seller to receive all the funds to which it is entitled.

INVESTMENT STRUCTURES

There are several different options for a foreign person to invest in U.S. real estate, depending on the number of properties involved and the foreign person's tax goals.

Investment in a Single Property Structure

Direct Investment by a Foreign Person

A foreign person can invest directly in U.S. real estate. The foreign person would be required to file a nonresident tax return on Form 1040-NR (U.S. Nonresident Alien Income Tax Return) for an individual or on Form 1120-F (U.S. Income Tax Return of a Foreign Corporation) for a corporation. Taxation of rental income would depend on whether the foreign investor is considered to be engaged in the conduct of a U.S. trade or business. If the investor is considered to be engaged in a U.S. trade

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17 Treas. Reg. §1.1445-3(a).

18 Rev. Proc. 2000-35 §4.05-4.10.

19 Rev. Proc. §4.04(5). Form 8288-B is not strictly required, but the I.R.S. advises that use of the form will expedite the application process.

20 Code §1445(c)(3)(B) (the I.R.S. "shall take action…within 90 days"). But note that Rev. Proc. 2000-35 §4.01 softens this requirement and states that the I.R.S. "ordinarily will act" on an application within 90 days.

or business (or elects to be treated as such), the rental income is subject to net taxation at individual or corporate tax rates that apply to U.S. persons. If the investor is not considered so engaged, the rental income is subject to gross-basis 30% withholding, or lower if a treaty applies. The investor may also make an election to treat the income as E.C.I.[21]

If the investor is a corporation, an additional tax known as branch profits tax may apply. Branch profits tax mimics the dividend tax that would have resulted if the foreign corporation set up a U.S. subsidiary to purchase the real estate instead of directly investing.[22] By default, branch profits tax is levied at 30%, although tax treaties may lower this rate.

Branch profits tax applies to after-tax earnings & profits that are connected with the conduct of a U.S. trade or business. The base against which after-tax profits are measured is referred to as the dividend equivalent amount ("D.E.A."). Note that for a branch that operates real estate in the U.S., depreciation for earnings & profits purposes typically is computed using a useful life that is longer than the useful life that is used for purposes of computing taxable income. As a result, the amount of D.E.A. may exceed the taxable income reported on the U.S. tax return filed by a foreign corporation.

The D.E.A. for a particular taxable year is reduced by an increase in the net equity of the U.S. branch as of the close of the preceding year.[23] On the other hand, the D.E.A. for a particular taxable year is increased by a decrease in the net equity as of the close of the preceding year.[24] For that reason, a reduction in the D.E.A. of a U.S. branch of a foreign corporation may turn out to be a deferral of branch profits tax rather than a permanent reduction of the tax.

In principal, there is no branch profits tax due in the year that a foreign corporation disposes of its U.S. assets.[25] This treatment equates to the treatment of a complete liquidation of a U.S. subsidiary by a foreign corporation. In that set of circumstances, a foreign corporation is not subject to dividend withholding tax when a liquidating dividend is received. Similarly, the non-previously taxed, accumulated effectively connected earnings and profits, as of the close of the taxable year of complete termination, are extinguished for purposes of the branch profits tax.

However, this favorable treatment applies only when a complete termination of the business exists. If a complete termination does not exist, the branch profits tax may be imposed on the non-previously taxed, accumulated effectively connected earnings and profits at such time as the net equity of the U.S. branch is reduced.

For there to be a complete termination, several tests must be met.

- First, the foreign corporation must have no U.S. assets, or its shareholders must adopt an irrevocable resolution to completely liquidate and dissolve the corporation, and before the close of the immediately succeeding taxable

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21 Code §871(d) for a foreign individual and Code §882(d) for a foreign corporation.

22 Code §884(a).

23 Code §884(b)(1); Treas. Reg. 1.884-1(b)(2).

24 Code §884(b)(2); Treas. Reg. §1.884-1(b)(3).

25 Treas. Reg. §1.884-2T(a).

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year, all assets in the U.S. must be distributed, used to pay creditors, or removed from the country.

- Second, for three years following the close of the year of complete termination, none of the U.S. assets of the terminated business, or property attributable to the sale of the business or to the U.S. earnings in the year of complete termination, can be used by the foreign corporation or by an affiliate in the conduct of a trade or business in the U.S.
- Third, the foreign corporation must not have any income that is, or is treated as, effectively connected with the conduct of a trade or business in the U.S. during the three-year period.
- Finally, the foreign corporation must extend the period of limitations on the assessment of the branch profits tax for the year of complete termination for not less than six taxable years.

As is generally the case under F.I.R.P.T.A., the sale of the property subjects the investor to U.S. tax as though the investor were engaged in a U.S. trade or business. Thus, if the seller is an individual, the gain on the sale would be taxed at the long-term capital gains rate of 20%, assuming the property was held for more than one year. To the extent the gain is attributable to a basis reduction based on the use of straight line depreciation, the tax rate is 25%. If the seller is a corporation, the gain would be taxed at the corporate rate of 21%. And in either case, the sale is also subject to withholding at 15% of the amount realized even if there is no gain.

Finally, if the investor is an individual, he or she also has potential estate tax exposure. With limited exception, nonresident, noncitizen ("N.R.N.C.") individuals are generally subject to estate tax only on property considered to be situated in the U.S. at the time of the decedent's passing, commonly referred to as "U.S.-situs property," which includes real estate located in the U.S.[26] As applied to foreign individuals, the estate tax is $345,800 on the first $1 million and 40% on the balance of the value of the taxable property. The amount subject to tax can be reduced if there is nonrecourse debt attached to the property. Additional deductions are available for administrative expenses of the estate and claims against the estate, but only if worldwide assets are reported on a true and accurate U.S. estate tax return, allowing only an apportioned amount of global (i) administrative expenses of the estate and (ii) claims against the estate to reduce the taxable value of the U.S. property.

Investment Through a Disregarded Entity ("D.R.E.")

As an alternative, the investor could form a single-member L.L.C. which would hold the U.S. real estate. By default, a single-member U.S. L.L.C. is treated as a disregarded entity ("D.R.E.") for U.S. tax purposes. A D.R.E. is not viewed as a separate entity for most U.S. tax purposes. Instead, a D.R.E.'s assets are considered held directly by its owner, and its income is considered realized directly by its owner.

This means that the same income tax consequences associated with the direct investment described above apply here. However, there is an argument that for purposes of estate and gift tax, the property subject to taxation is not the underlying

[26] Code §2103; Treas. Reg. §20.2104-1(a)(1).

property but rather the D.R.E. interest itself.[27] In principle, this means that a gift of the D.R.E. by a foreign individual is not subject to gift tax, as gifts of intangible property (such as equity interests in an entity) are not taxable when made by foreign persons. Additionally, this could open the door for a position that the D.R.E. interest is a foreign-situs asset and therefore also exempt from estate tax. But this is not a settled position, and those who rely on it should be prepared to take on a challenge by the I.R.S.

Investment Through a U.S. Partnership

Multiple investors can join together in a partnership that holds the property. For example, if the L.L.C. in the previous example has at least one other investor, the L.L.C.'s U.S. tax treatment defaults to that of a partnership.

The partnership is required to withhold on its foreign partners' share of the rental income.[28] The rate of withholding depends on whether the partnership is viewed to be engaged in a trade or business. If yes, the rent is considered E.C.I., and withholding applies at the highest possible tax rate applicable to the partner (20% for corporations and 37% for individuals).[29] If not, the rent is considered F.D.A.P. [30]which is subject to 30% withholding.[31] Additionally, the foreign partner is required to file a U.S. Federal income tax return and likely a state tax return if the rent is E.C.I. [32]

On a sale of a partnership interest, the foreign investor is subject to 15% withholding on the proceeds if two conditions are met.

- First, 50% of the partnership's gross assets are U.S.R.P.I.'s.
- Second, 90% of the partnership's gross assets consist of U.S.R.P.I.'s and cash.[33]

"There is a difference in certainty between the application of gift tax and estate tax when the property being transferred is a partnership interest."

A sale of the U.S.R.P.I. by the partnership subjects the investor to the withholding tax on E.C.I. described in the previous paragraph. In either scenario, the investor must file a U.S. tax return to report gain and pay tax or claim a refund, as the case may be.

There is a difference in certainty between the application of gift tax and estate tax when the property being transferred is a partnership interest. A gift of a partnership interest by a foreign individual is likely not subject to gift tax because gift tax does not apply to gifts of intangible property by foreign persons,[34] and a partnership interest is

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27 See *Pierre v. Commr*. (T.C. Memo. 2010-106), where the Tax Court held that for gift-tax purposes relating to a gift of a single-member L.L.C. that was taxed as a D.R.E., valuation was determined at the L.L.C. level rather than that of the underlying L.L.C. assets. Practitioners disagree on whether this applies only to the question of valuation or whether this more broadly means that a D.R.E. interest is "regarded" for transfer-tax purposes.

28 Treas. Reg. §1.1441-5(b)(2)(i)(A); Code §1446(a).

29 Code §1446(a).

30 Code §§871(a)(1)(A), 881(a)(1).

31 Code §§1441(a), 1442(a).

32 Code §875(1); Treas. Reg. §§1.6012-1(b)(1)(i), -2(g)(1)(i).

33 Code §1445(e)(5).

34 Code §2501(a)(2).

most likely to viewed as intangible property, notwithstanding the partnership's ownership of the underlying property.[35] In comparison, a transfer of a U.S. partnership interest at the death of an N.R.N.C. individual is subject to U.S. estate tax when the intangible is considered to be a U.S.-situs asset. The situs of a partnership interest has long been unsettled law. But in this scenario, where the partnership is formed in the U.S. and holds U.S.-situs assets, the partnership interest likely will be considered a U.S.-situs asset.[36]

Investment Through a Foreign Partnership

The foreign investor could be a member of a foreign partnership.[37] The results are similar. However, if the rent is F.D.A.P. and not E.C.I., the tenant and not the partnership is considered to be the withholding agent.[38] Provided the foreign partnership provides sufficient documentation (*i.e.*, its own Form W-8IMY, its foreign partners' Forms W-8BEN or W-8BEN-E, its domestic partners' Forms W-9, and a spread sheet showing the percentage interest of each partner), the withholding agent will withhold under F.D.A.P. only on the income allocated to foreign partners.

As with the U.S. partnership, the estate tax exposure related to a partnership interest is unclear. However, the use of a foreign partnership provides a stronger argument that the interest is not a U.S.-situs asset, based on inconsistent case law.[39]

Investment Through a Foreign Trust

A foreign investor could create a foreign trust and contribute cash, after which the trustee can purchase U.S. real estate. While the income tax consequences are largely similar, this option can provide better protection against estate tax. However, this requires the investor to relinquish control over and beneficial interests in the property.

Investment Through a Foreign Corporation

The tax treatment of a foreign corporation holding U.S. real estate is discussed in detail above and will not be repeated. As to the ultimate investor, dividends from the foreign corporation are not subject to withholding tax as long as branch profits tax

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35 See, *e.g.*, *Lehman v. Commr.*, 7 T.C. 1088 (1946).

36 But not all theories lead to U.S.-situs classification. For example, one theory would determine the situs of a partnership interest by reference to the domicile of the partner.

37 Note that a foreign equivalent of an L.L.C. may be treated as corporation for U.S. purposes under the default classification rules. In that situation the foreign L.L.C. would need to file an election to be treated as a partnership.

38 Treas. Reg. §1.1441-5(c).

39 Under Code §7701(a)(5), a partnership that is not a domestic partnership is considered to be a foreign partnership. The estate tax situs rule with regard to partnerships is based on case law and an old I.R.S. ruling that are not consistent. Moreover, Code §864(c)(8), which reversed the holding in Grecian Magnesite Mining, Industrial, & Shipping Co. v. Commr., 926 F.3d 819 (C.C. Cir. 2019), appears to apply specifically to income taxes covered by Subtitle A of the Internal Revenue Code. The estate tax appears in Subtitle B of the Internal Revenue Code.

applies.[40] If branch profits tax does not apply by reason of the provision of an income tax treaty, a treaty benefit will be available to the shareholder only if the foreign corporation and its shareholder are qualified residents of the treaty jurisdiction.[41]

No U.S. tax is due on the sale the foreign corporation's stock. Additionally, because shares in a foreign corporation are considered foreign-situs assets,[42] the investor should not be subject to estate tax with respect to shares held in the foreign corporation.

Investment Through a Foreign Corporation With a U.S. Subsidiary

Another option is to insert a U.S. subsidiary between the foreign parent corporation and the U.S. real estate. The U.S. corporation is subject to 21% corporate tax on both rental income and gain on the sale of real estate.

With respect to dividends paid to the foreign parent from its U.S. subsidiary, a 30% withholding tax will be imposed to the extent of the U.S. subsidiary's earnings & profits. The rate may be lower if a tax treaty applies.

To the extent a distribution exceeds earnings & profits but does not exceed the shareholder's basis in the shares of the U.S. subsidiary, the distribution is tax-free in principal. It is treated as a return of basis in a U.S.R.P.H.C. For that reason, a withholding certificate must be obtained from the I.R.S. in order to avoid the imposition of refundable F.I.R.P.T.A. withholding tax.

Once all U.S.R.P.I.'s are sold by the U.S. subsidiary and gain is fully recognized, the subsidiary can notify the I.R.S. of its early termination of U.S.R.P.H.C. status. At that point, a tax-free liquidating distribution can be made by the U.S. corporation.[43]

TRANSITIONING TO A MORE COMPLEX STRUCTURE

In some cases, a foreign investor may have acquired U.S. real estate before taking into account planning considerations. Upon consulting a tax adviser, the investor may wish to alter the already-created structure to one described above. But the investor may face obstacles in achieving the desired structure through a tax-free transaction.

Straightforward Two-Step Transfer

If the investor wishes to form a foreign blocker to hold U.S. real estate, the contribution of the real estate to the foreign blocker would trigger tax by default.[44] To avoid tax on the contribution, the investor could instead first form a U.S. corporation to which the real estate is contributed, after which the shares of the U.S. corporation would be contributed to the foreign corporation. In principle, the first contribution meets

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40 Code §884(e)(3)(A).

41 Code §884(e)(3)(B) and (f)(3)(A) and (B). See also Code §861(a)(2)(B) for the characterization of the dividend as U.S. source income.

42 Treas. Reg. §20.2105-1(f).

43 Code §332(a).

44 As discussed earlier, F.I.R.P.T.A. by default turns off nonrecognition.

the U.S.R.P.I.-for-U.S.R.P.I. requirement for F.I.R.P.T.A. nonrecognition exchanges, since the newly formed U.S. corporation is a U.S.R.P.H.C. However, the immediate second contribution could cause problems for achieving the expected tax-free treatment of the first contribution. Under Code §351, the contributing shareholder must be in control of the transferee corporation "immediately after" the transfer, and it is unclear whether this is satisfied if the shares of the transferee corporation are immediately transferred to another taxpayer (*i.e.*, the foreign corporation).

Assuming that the risk can be addressed, the second contribution could qualify for the exception for foreign-to-foreign Code §351 exchanges discussed earlier. However, the second contribution would likely be characterized as an inversion transaction, *i.e.*, a transaction where a U.S. corporation is effectively redomiciled by means of a transfer to a foreign corporation.[45] Where the former shareholders of the transferred corporation directly or indirectly own at least 80% the new foreign parent, the foreign parent is treated as a U.S. corporation for all U.S. tax purposes,[46] thereby eliminating the estate tax benefits of including a foreign corporation in the structure.

One possible solution is for the foreign corporation to elect to be treated as a U.S. corporation for purposes of F.I.R.P.T.A., known as a "Code §897(i) Election."[47] This could eliminate the issues with contributing property to a foreign corporation, but the foreign status would be preserved for estate tax purposes. Note, however, that to make an 897(i) Election, a foreign corporation must be resident in a country that has an income tax treaty in effect with the U.S. that contains an adequate nondiscrimination provision. This means it must be viewed to be a qualified resident under the limitation-on-benefits article of the treaty. As a final point, the tax law of the treaty country must provide favorable tax treatment for (i) the receipt of dividends from the U.S. subsidiary, (ii) the recognition of gains from the disposition of the U.S. subsidiary, and (iii) the distribution of dividends to the shareholder.

Investment in Multiple Properties

When a foreign person invests in multiple properties in the U.S., additional considerations apply. On a disposition, the investor likely values the ability to sell a single property and distribute the proceeds with just one level of U.S. tax, *i.e.*, avoiding a second level of tax on the distribution. At the same time, the investor may wish to invest in multiple properties and allow operating losses realized in certain properties to offset taxable income from other properties.

Single U.S. Blocker

One option is to have a single U.S. corporation hold direct interests in the different pieces of U.S. real estate, either directly or through multiple single-member D.R.E.'s. For U.S. income tax purposes, there is only one taxpayer, the U.S. corporation that owns the D.R.E.'s. The U.S. corporation is subject to Federal corporate income tax at 21% on rental income, plus applicable state and local taxes. The upside of this

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45 See Code §7874.

46 Code §7874(b). Here, there would be 100% commonality because the investor would be the sole shareholder of both the U.S. corporation (pre-inversion) and the foreign corporation (post-inversion).

47 This election is only available if the foreign corporation was formed in a jurisdiction with an income tax treaty with the U.S. that broadly entitles the foreign corporation to be given the same rights as a U.S. corporation under the treaty.

arrangement is that losses from one property can be used to offset income from one or more profitable properties. The downside of this arrangement is that cash generated from sales cannot be distributed in many instances without the imposition of dividend withholding tax.

Multiple U.S. Blockers

As mentioned, having a blocker for each property denies the ability to offset income from different properties. However, on a sale of a particular property, the proceeds can be distributed tax-free its foreign holding company as a tax-free liquidation, once an early termination of U.S.R.P.H.C. status is filed with the I.R.S. and a plan of liquidation is adopted and notice of the plan is furnished to the I.R.S. by filing Form 966 (Corporate Dissolution or Liquidation). If some or all of the liquidation proceeds are reinvested in a new U.S. corporation, the I.R.S. may treat the new corporation as if it were the old corporation under the liquidation-reincorporation theory, asserting that the liquidation distribution should be treated as a taxable dividend distribution.

"It is not uncommon for a first-time investor in U.S. real property to evaluate an investment through a binary analysis . . ."

CONCLUSION

It is not uncommon for a first-time investor in U.S. real property to evaluate an investment through a binary analysis, such as any of the following:

- Should I invest in property A or property B?
- Should I establish one foreign blocker corporation that holds shares in only one U.S. real property holding company or should it hold shares directly in several U.S. real property holding companies?
- Can I contribute my shares in a U.S. holding company to a foreign blocker because I now realize I face estate tax in the U.S. by reason of the decision I made initially?

This article demonstrates that the analysis of how to structure an investment is non-binary. Over time, many tax and non-tax factors come into play, and solutions to one part of the analysis may adversely affect tax and non-tax issues that need to be faced over time. The prudent investor and his or her foreign adviser should take all these factors and more into account when considering whether to make an investment in U.S. real property and how it should be structured.

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STILL FOURTH DOWN AND GOAL FOR MEDTRONIC TRANSFER PRICING CASE

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INTRODUCTION

In an article published in *Insights* in 2022,[1] the following comment was made regarding two seemingly never-ending transfer pricing battles being conducted, one between Medtronic and the I.R.S. and the other between the U.S. Tax Court and the 8th Circuit Court of Appeals:

> [The Tax Court] court adopted a standard under which the ends justified the means, which differs from the norm under which the means justify the ends. The [Tax Court] knew where it wanted to end up, and simply looked for a method that was consistent with its destination.

In early September, the Eighth Circuit issued its long-awaited decision in *Medtronic, Inc. v. Commr.,*[2] vacating the U.S. Tax Court's second decision and remanding the case for further proceedings.

The opinion marks a pivotal moment in the ongoing saga over transfer pricing of intangible property between Medtronic and its Puerto Rican manufacturing subsidiary ("M.P.R.O.C."), and provides critical guidance on the application of the best method rule under Treas. Reg. §1.482-1(c).

STILL AT ISSUE

The controversy remains centered on the appropriate royalty rate for M.P.R.O.C.'s use of intangible property, including patents, know-how, and regulatory approvals, licensed by Medtronic, Inc. Medtronic relied on the Comparable Uncontrolled Transaction ("C.U.T.") method, referencing a licensing agreement with Siemens Pacesetter. The IRS instead applied the Comparable Profits Method ("C.P.M."), arguing that M.P.R.O.C.'s profitability should be benchmarked against selected comparable manufacturers.

After the Tax Court initially sided with Medtronic in 2016, the Eighth Circuit vacated that decision,[3] citing insufficient factual findings. On remand, the Tax Court

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1 Michael Peggs, "Medtronic Part Deux: the Best Method is Yet to Come?" *Insights* Vol. 9 No. 5, page 40, 46. (September 29, 2022.)

2 __ F. 3rd __ (Docket No. 23-3281, 8th Cir., September 3, 2025.) The case is reported unofficially at the following link.

3 *Medtronic, Inc. v. Commr.,* 900 F.3d 610 (8th Cir. 2018), T.C. Memo. 2016-112.

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abandoned its earlier C.U.T. conclusion and adopted a hybrid, three-step unspecified method. This method combined elements of the C.U.T. and C.P.M. methods, ultimately allocating 68.7% of profits to Medtronic, Inc. and 31.3% to M.P.R.O.C..

THE EIGHTH CIRCUIT'S DECISION

In its most recent decision, the Eighth Circuit rejected the Tax Court's use of the Pacesetter agreement under both the C.U.T. method and the unspecified method. The court held that the Pacesetter agreement failed the "similar profit potential" requirement under Treas. Reg. §1.482-4(c)(2)(iii)(B)(1)(ii), and thus could not serve as a reliable benchmark, even as a starting point in an unspecified method.

The appellate court also found that the Tax Court misapplied the legal standard in rejecting the I.R.S.'s C.P.M. analysis. Specifically, the Tax Court overemphasized product similarity, ignoring regulatory guidance that states that the C.P.M. method is less sensitive to product differences. The Eighth Circuit directed the Tax Court to reconsider the CPM using the correct comparability criteria, including assets used and created, functions performed, and product liability risk.

IS THE BEST METHOD YET TO COME?

The article in the September 2022 volume of *Insights* asked whether "the best method is yet to come," and in hindsight offered a reasonably good forecast of the path ahead in the Medtronic controversy and the Tax Court's approach to the best method rule. The article correctly anticipated several key themes that emerged in the 2025 appellate decision:

Skepticism of the CUT Method: The article noted that the Pacesetter agreement lacked comparability in terms of profit potential and scope of licensed I.P. The Eighth Circuit confirmed this, ruling that the agreement could not be used under either C.U.T. methor or unspecified method.

Critique of the Unspecified Method: The article noted that the Tax Court's hybrid method a "no-recipe recipe," combining unreliable elements from both the CUT and the CPM. The Eighth Circuit mostly echoed this concern, emphasizing that unreliable data cannot be repurposed under or an unspecified method.

Misapplication of the Best Method Rule: The article argued that the Tax Court sought an "ideal method" rather than applying the regulatory standard of reliability. The appellate court agreed, finding that the Tax Court's reasoning was result-driven rather than methodologically sound.

Need for Detailed Findings: The article highlighted the lack of factual findings on asset base, functions, and risk. The Eighth Circuit's remand instructions focused precisely on these gaps, requiring the Tax Court to quantify and evaluate these factors under CPM.

CONCLUSION

The Eighth Circuit's 2025 decision reaffirms the primacy of the best method rule as a reliability-based standard, not a quest for perfection. It underscores that comparability must be rigorously tested, and that methods must be applied consistently with regulatory guidance. The 2022 article anticipated these conclusions and discussed the broader implications for transfer pricing jurisprudence.

As the case returns to the Tax Court, companies will be watching closely. The decision may reshape how the I.R.S. and taxpayers approach method selection, comparability analysis, and the use of unspecified methods under Section 482.

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BIGGER BENEFITS FOR (BIGGER) SMALL BUSINESSES: Q.S.B.S. CHANGES IN O.B.B.B.

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INTRODUCTION

Among the slew of changes in tax law from the One Big Beautiful Bill ("O.B.B.B.") are increased benefits to taxpayers who own "Qualified Small Business Stock" ("Q.S.B.S.").

The Q.S.B.S. regime was created by the Revenue Reconciliation Act of 1993. The goal was to assist start-ups by incentivizing entrepreneurs and investors to invest sweat or money in small businesses and start-ups. The House Ways & Means Committee at the time explained the purpose of the Q.S.B.S. as follows:

> The committee believes that targeted relief for investors who risk their funds in new ventures, small businesses, and specialized small business investment companies, will encourage investments in these enterprises. This should encourage the flow of capital to small businesses, many of which have difficulty attracting equity financing.[1]

The Q.S.B.S. rules broadly allow for tax-free sales of Q.S.B.S., up to a certain limit. The benefit is subject to meeting several requirements, among which is a requirement for a five-year holding period by the seller.

PRINCIPAL REVISIONS

The O.B.B.B. makes the following changes, which apply to stock acquired after July 4, 2025, the date on which the O.B.B.B. was enacted into law:

- The limit on the amount of gain that can be excluded in a given year is now the greater of (i) $15 million, adjusted for inflation and (ii) 10 times the adjusted basis of all Q.S.B.S. from the same issuer sold in that year. Previously, the $15 million limit was $10 million with no inflation adjustments.
- The holding-period requirement is softened by allowing partial exclusions of 50% of gain and 75% of gain for holding periods of three years and four years, respectively.
- To be a small business eligible to issue Q.S.B.S., a company's gross assets used in its trade or business cannot exceed $75 million, an increase from $50 million.

[1] H.R. Rep. No. 103-111 (1993).

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PRIOR RULES AMENDED

Code §1202 lays out the requirements for and benefits of Q.S.B.S. As in effect through July 4, 2025, 100% of the gain from the sale of Q.S.B.S. stock could be excluded from taxable income if the seller held the Q.S.B.S. for more than five years.[2] The amount of gain that was excluded was limited to the greater of (i) $10 million or (ii) 10 times the aggregate adjusted bases of all Q.S.B.S. issued by a particular corporation and sold by the seller during the taxable year.[3] For stock issued as of the effective date of the amendment, the $10 million cap is $15 million, adjusted for inflation.

Stock was required to meet the following conditions in order to qualify as Q.S.B.S.: [4]

- The stock was required to be issued by a "qualified small business." No change was made to this requirement.
- The stock was required to be acquired at its original issuance.[5] An exception existed for stock acquired by gift. The transferee was treated as having acquired the stock in the same manner as the transferor (piggybacking on the transferor's acquisition at "original issuance") and having held the stock for the period the transferor held the stock (piggybacking on the transferor's holding period in getting to the required holding period of three, four or five years). No change was made to this requirement.

Because the per-issuer limitation on gain exclusion applied to each "taxpayer," in cases where the $10 million limit (for stock issued on or before July 4, 2025) or $15 million limit (for stock issued after July 4, 2025) applies, making an eligible transfer "by gift" to another taxpayer, such as an adult child or a trust treated as a separate taxpayer, has the effect of multiplying the potential overall gain exclusion.

- The stock was acquired (i) for money or other property besides stock or (ii) as compensation for services provided to the issuing corporation. No change was made to this requirement.
- The issuing corporation must be involved be an active business, as defined. No change was made to this requirement.
- The issuing corporation must be a taxable C-corporation, not an S-corporation, a quasi-flow through predecessor of an L.L.C. No change was made to this requirement.

QUALIFIED SMALL BUSINESS

To be a qualified small business, a corporation must meet the following requirements:[6]

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2 Code §§1202(a)(1), 1202(a)(4)(A).

3 Code §1202(b)(1).

4 Code §1202(c).

5 Certain redemptions can cause a violation of this requirement.

6 Code §1202(d)(1).

- The corporation must be a domestic C corporation.
- At all times from August 10, 1993 (when the Revenue Reconciliation Act was enacted) to immediately after the issuance of the Q.S.B.S. in question, the "aggregate gross assets" of the corporation never exceed $50 million. The cap on gross assets used in its trade or business is now $75 million.
- The corporation agrees to submit reports to the I.R.S. and to its shareholders as the Treasury may require.

The following rules apply for measuring aggregate gross assets:

- The amount of "aggregate gross assets" is equal to the amount of cash and the aggregate adjusted bases of other property held by the corporation.[7]
- Property contributed by a shareholder to the corporation is treated as having a basis equal to its fair market value at the time of contribution.[8]
- The amount of aggregate gross assets immediately after the issuance is determined by taking into account amounts received in the issuance.[9]
- Corporations that are part of the same parent-subsidiary group (greater-than-50% common ownership measured by vote or value) are treated as one corporation.
- In measuring greater-than-50% ownership, options are treated as stock, and stock owned by (i) partnerships or (ii) estates or trusts are attributed to partners or beneficiaries.[10]

ACTIVE BUSINESS

To meet this requirement, the corporation must meet the following tests:[11]

- It must use at least 80% of its assets in the active conduct of one or more qualified trades or businesses. For this purpose, assets are measured by fair market value, with a look-through rule interests in greater-than-50% subsidiaries.
- It must not be a current or former D.I.S.C., R.I.C., R.E.I.T., R.E.M.I.C., or cooperative.

A trade or business that is a "qualified trade or business" generally means any trade or business other than the following businesses:

- Businesses that provide services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, and any trade or business where the principal asset is the reputation or skill of its employees

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7 Code §1202(d)(2)(A).

8 Code §1202(d)(2)(B).

9 Code §1202(d)(1)(B).

10 Code §1563(d)(1).

11 Code §1202(e)(1).

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- Banking, insurance, financing, leasing, investing, or similar businesses
- Certain businesses involved in mining, oil or gas wells, and similar fields.
- Hotels, motels, restaurants, or similar businesses

There is relatively little guidance on businesses that are considered to be qualified. The tax laws permit certain start-up and research and development activities to qualify as being used in an active business. The active business requirement will not be satisfied if either (i) real estate not used in an active trade or business or (ii) stock or securities in non-subsidiary corporations exceed 10% of the total value of the corporation's assets. An active trade or business does not include (a) ownership of real estate, (b) dealing in real estate, or (c) renting real estate.

CONCLUSION

The O.B.B.B. changes make the Q.S.B.S. rules significantly more taxpayer-friendly by allowing for more gain exclusion, bigger businesses to qualify as qualified small businesses, and partial exclusions for holding periods shorter than five years.

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