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INSIGHTS

2025: A YEAR IN REVIEW

A YEAR OF GUEST FEATURES

Insights Vol. 12 No. 7

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EDITORS' NOTE

As is our tradition at *Insights*, the December special edition acknowledges the contributions of guest authors throughout the year.

This year, 18 articles were written by 32 guest authors hailing from 11 countries.

To our guest authors, we extend our heartfelt thanks. To our readers, we wish you all the best in 2026.

Happy Holidays!

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About Us

B.V.I.: BENEFICIAL OWNERSHIP REPORTING AND CONSULTATION ON ACCESS TO BENEFICIAL OWNERSHIP INFORMATION

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Tags
Access
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B.V.I.
B.O.I.

INTRODUCTION

In an article published in *Insights* last year,[1] selected developments in regulatory and tax-related law and practice that affect end-clients, advisors and intermediaries were surveyed in the British Virgin Islands ("B.V.I."), Cayman Islands and Bermuda. In the period since that article was published, amendments to the B.V.I. beneficial ownership regime have come into force and the B.V.I. Government has issued a consultation document (the "Consultation") regarding rights of access to the beneficial ownership register. As part of the process, comments were requested from the public. The period for responses to the Consultation closes on February 28, 2025.[2]

This article provides an overview of the key changes under the new regime, and highlights important aspects of the ongoing consultation process.

OVERVIEW

As of January 2, 2025, a new beneficial ownership reporting regime under the B.V.I. Business Companies and Limited Partnerships (Beneficial Ownership) Regulations, 2024 (the "Regulations") has come into effect. This regime replaces the previous beneficial ownership reporting framework under the Beneficial Ownership Secure Search System Act, 2017 ("B.O.S.S. Act"), although that Act has not yet been repealed. The new regulations aim to enhance transparency while maintaining the B.V.I.'s reputation as a leading international financial center.

These changes have been expected for some time. Amendments were previously announced to the BVI Business Companies Act, Revised Edition 2020 (as amended, the "B.C. Act") and the Limited Partnership Act, Revised Edition 2020 (as amended, the "L.P. Act"). Those amendments are now in force and the Regulations promulgated under the B.C. Act and the L.P. Act provide the details of the new regime. The amendments and Regulations create a centralized Register of Beneficial Ownership administered by the Registrar of Corporate Affairs (the "Registrar"), which is a division of the B.V.I. Financial Services Commission ("F.S.C.").

Broadly, the regime applies to all companies or limited partnerships registered in the B.V.I. ("Entities"), although certain exemptions are available. Transitional periods of at least six months apply to Entities registered in the B.V.I. prior to January 2, 2025, ("Existing Entities"). As companies limited by shares incorporated under the B.C. Act are by far the most popular B.V.I. corporate entity, this update deals only with those companies unless otherwise stated.

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[1] Joshua Mangeot, "The B.V.I., Cayman Islands, and Bermuda – Current practice, Enforcement, and Emerging Trends," *Insights* Vol. 11, No. 6, p.68 (2024).

[2] Available here.

On January 17, 2025, the B.V.I. Government launched a consultation on a draft policy regarding rights of access to the Register. In line with commitments made by other United Kingdom Overseas Territories, this policy proposes a framework for granting access to certain beneficial ownership information ("B.O.I.") to persons demonstrating "legitimate interest" regarding information. At the same time, it seeks to balance transparency with privacy and security concerns.

There will be no legitimate interest access until the Consultation concludes and further legislation has been passed implementing the final policy. Based on public commitments made by the B.V.I., Bermuda and Cayman to the United Kingdom, final legislation is expected to be published in April, with implementation by the end of June 2025.

FILING AND DEADLINES

Broadly, new Entities must identify and file with the Registrar adequate, accurate, and up-to-date B.O.I. reports as prescribed by the Regulations. Reports are due within 30 days of registration in the B.V.I., including on continuation into the B.V.I. Existing Entities have until Julyl 2, 2025, to comply, benefiting from the six-month transitional period mentioned above. Any future changes to the B.O.I. must be reported within 30 days from the date the Entity first became aware of the change.

The information must be filed by the Entity's registered agent via the F.S.C.'s electronic V.I.R.R.G.I.N. platform, which is replacing the B.O.S.S. system for B.O.I. filings.

BENEFICIAL OWNERS

The regime is concerned with ultimate beneficial owners ("U.B.O."). A "beneficial owner" is broadly defined as a natural person who ultimately owns or controls 10% or more of the relevant Entity or exercises control over its management (a "10%+ U.B.O."). This definition encompasses both ownership and control and so includes legal ownership, economic ownership, and voting rights. The 10% threshold is consistent with the B.V.I.'s robust approach to anti-money laundering regulation.

However, only certain specified B.O.I. on ultimate beneficial owners with a 25% or greater interest (each, a "25%+ U.B.O.") is expected to be accessible to persons demonstrating a legitimate interest 25%+ is the usual threshold for reporting under global standards. Other information filed pursuant to the B.C. Act and L.P. Act on 10%+ U.B.O.s under the Regulations will remain accessible exclusively to competent authorities and law enforcement agencies in the B.V.I.

EXEMPTIONS

Certain Entities are exempt from filing B.O.I. but must still notify their status to the Registrar and provide basic details. Broadly, these include

- entities with shares listed on a "recognized stock exchange," which includes all the leading global stock markets;
- all B.V.I. regulated investment fund vehicles and any company whose shares are held by a trustee licensed under the Banks and Trust Companies Act,

Revised Edition 2020 (as amended, the "B.T.C.A."), in each case provided that the B.O.I. (i) is maintained by B.V.I. regulated administrator or an authorized representative or other person licensed by the F.S.C. with a physical presence in the B.V.I. and (ii) can be provided with 24 hours of request; and

- an Entity that is at least 75% owned by another Entity that complies with the beneficial ownership filing requirements or is itself exempt, thereby avoiding duplication of reporting where a chain of B.V.I. Entities exists.

Companies subject to disclosure and transparency rules contained in international standards, equivalent to those for listed companies or specified funds, may apply for exemption.

GOVERNMENT CONSULTATION

The Consultation sets out the B.V.I. Government's policy for allowing access to certain B.O.I. based on the concept of "legitimate interest." The Government recognizes that this is a question of significant interest in the B.V.I. and throughout the global financial services industry. The policy seeks to balance transparency and privacy by allowing specific stakeholders that demonstrate a legitimate interest to access information in defined circumstances, while protecting the safety and security of vulnerable individuals and sensitive personal data.

"Companies subject to disclosure and transparency rules contained in international standards, equivalent to those for listed companies or specified funds, may apply for exemption."

The policy is subject to consultation and there is a list of questions to industry participants set out in the Appendix to the Consultation.

In summary, the draft policy addresses the following points:

- It broadly defines the concept of "legitimate interest" as a demonstrable, specific, and lawful need to access information to investigate, prevent, or detect serious financial crime or to assist in ongoing legal proceedings or regulatory investigations related to the same.
- It specifies circumstances in which legitimate interest or a person's connection with an Entity or its U.B.O. may be claimed.
- It sets out categories of entities that may apply for access to the Register by demonstrating a legitimate interest, which must be directly related and proportionate to the purpose for which it is to be used.

To protect vulnerable individuals, exemptions are proposed to be granted in circumstances where

- the disclosure poses disproportionate serious risks to the U.B.O. or any individual,
- the request for disclosure relates to minors or legally incapacitated persons, or
- the Registrar determines that disclosure is against public interest.

Applications for exemptions must be submitted by the U.B.O. or a legal representative to the Registrar and must include supporting evidence. Any U.B.O. who considers that such an application may be appropriate may wish to start gathering information that supports the application.

Only limited details are expected to be disclosed, such as (i) name, (ii) month and year of birth, (iii) nationality, (iv) country of residence, and (v) nature/extent of beneficial ownership. All information is expected to be restricted to relate to the 25%+ U.B.O.'s.

The policy sets out a process for submission of requests and subsequent review and decision by the Registrar. A mechanism is proposed to notify to the relevant U.B.O. via the Entity's registered agent, so that the U.B.O. has a chance to object to release of information.

As would be expected, the policy envisions a robust framework to preserve confidentiality and data security and to allow for appeals to the Financial Services Appeal Board. The Registrar is also required to keep a record of all access requests and there are fines and other civil and criminal penalties for misuse, including the provision of false or misleading information.

PRACTICAL CONSIDERATIONS

Entities and their advisors and registered agents should take steps to ensure compliance with the new regime, such as the following:

- Ensuring new Entities comply with the new requirements and that Existing Entities will be compliant before July 2, 2025.
- Considering whether an Entity qualifies for exemption or is subject to the B.O.I. reporting requirements.
- Conducting internal reviews to identify 10%+ U.B.O.s and to ensure that any changes can be identified.
- Updating and maintaining records to ensure accuracy and completeness, gathering the B.O.I. required, and maintaining records that demonstrate the steps taken to gather the information.
- Seeking appropriate advice where (i) uncertainty exists regarding their obligations or (ii) difficulties are encountered in identifying U.B.O.s or obtaining the necessary information.
- Taking steps to seek exemption or to file objections by persons concerned (i) with violations of their rights to privacy, (ii) with risks that may arise from disclosure, or (iii) with risks to vulnerable, minors, or incapacitated individuals.

It is expected that registered agents will be contacting their clients to confirm existing B.O.I. and gather or verify the details required under the new regime.

Industry participants are also encouraged to participate in the consultation process by submitting feedback on the Consultation and the policy questions raised by Government. Feedback can be submitted via email to boconsultation@gov.vg by February 28, 2025.

CONCLUSION

The updates to the B.V.I.'s beneficial ownership reporting regime demonstrates the commitment of the B.V.I. to global standards in the fight against financial crime, while balancing transparency with individuals' rights to privacy and protection from harm.

The ongoing consultation provides an opportunity for stakeholders to shape future policy in this area. Clients and industry participants are encouraged to engage in this process to ensure that any concerns regarding privacy, security, and operational impact are addressed.

NUPTIAL AGREEMENTS IN THE CONTEXT OF AN INTERNATIONAL COUPLE – VIEWS FROM FRANCE AND SPAIN

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Tags
Autonomous Region de Ganay
France
Marital Contract
Postnuptial Agreement
Prenuptial Agreement
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INTRODUCTION

Getting married involves choosing the person with whom you want to spend the rest of your life. For most, it is a complex decision. It becomes even more complex if the parties are not of the same nationality or if one of the parties must move to another country in order to avoid a two-city lifestyle.

Many couples in France and Spain are unaware that in the absence of a duly executed prenuptial agreement, the rules that determine how property will be distributed if the marriage is dissolved due to divorce or death will be those of the first country of residence after their marriage becomes official.

This discovery often leads to many disappointments for the less fortunate party in a separation, often the wife who, as a French or Spanish woman married in France or in Spain, lived all her married life with the mistaken belief that she would be protected by French or Spanish rules governing marriage.

Conversely, other couples believe that they are protected by the provisions of a prenuptial agreement signed in France or in Spain that generally provides for separation of property. In that case, the husband is most often the one who discovers at the time of separation that the contract will not necessarily be considered in common law countries such as England, United States, English-speaking Canada, Hong Kong, or Singapore. He then learns that he must share half of his assets with his ex-wife, notwithstanding the fully executed property agreement.

The purpose of this article is therefore to give a few pointers to binational couples, whose lives are intertwined between France or Spain and a common law country such as the United States. Moreover, while France and Spain are neighbors and civil law countries, the applicable rules are actually very different on these issues and could lead to very surprisingly different results.

THE STATUS OF MARRIAGE CONTRACTS AND PRENUPTIAL / POST NUPTIAL AGREEMENTS IN FRANCE

If there is no prenuptial agreement, the spouses will be subject to a matrimonial property regime defined according to certain rules, which are rather complex in an international context.

The concept of matrimonial property regime can be defined as:

> [T]he set of rules concerning property relations between spouses and with respect to third parties, which result from a marriage or its dissolution.

French Law Applicable to Spousal Matrimonial Property Regime in the Absence of a Prenuptial Agreement in France

Historically, one's legal matrimonial property regime is the law implicitly chosen by the spouses. This is often referred to as the law of autonomy. The origin of this rule goes back to an opinion given to the de Ganay spouses in 1525 by Charles Dumoulin, a lawyer who practiced before the Parliament of Paris. He interpreted the legal matrimonial regime as a sort of tacit contract that is subject to the law chosen by the parties. By choosing their domicile, the de Ganay spouses were considered to have expressed their wish to be subject to the customs of their domicile.

This conflict of laws rule based on autonomy of will is still in effect in France for spouses married prior to September 1, 1992. It assumes that, in the absence of a prenuptial agreement and express designation of the applicable law, the judge will investigate the will of the spouses. In this respect, the first marital domicile plays a dominant role. It is the basis of a presumption of an intent to connect the matrimonial regime to the law of the country in which the spouses established their first residence after marriage. This conclusion has been reaffirmed many times in court opinions.

For spouses married after September 1, 1992, the principle is generally that, when there is no prenuptial agreement, the applicable law is the law of the country on whose territory the spouses established their first habitual residence after getting married. This is based on (i) Article 4 of The Hague Convention of 1978 on the Law Applicable to Matrimonial Property Regimes[1] and (ii) Article 26 of the European Matrimonial Property Regimes Regulation ("Article 26"), applicable to spouses married after January 29, 2019.

The application of the national law of the spouses' first "habitual" residence after marriage is thus based on the French system of private international law, which uses the criterion of the first marital domicile as the main indicator of the spouses' implicit intention. But the principle used by the Convention – that the competent law is that of the spouses' first habitual residence – is not open to interpretation. It is the spouses' first habitual residence and there is no need to investigate whether there has been a minimum duration in order to determine the spouses' common habitual residence.

Once the law is determined, the spouses' matrimonial property regime will once again be the legal matrimonial regime of that country. In France, the regime is the community of acquired assets in France.

In addition to the complexity of designating the matrimonial property regime that applies to the spouses after their marriage is the fact that it will sometimes be

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[1] This Convention relates only to property relations between spouses, to the exclusion of spousal support, surviving spouses' right to inherit, and the spouses' capacity. All issues related to personal relations between the spouses are, of course, excluded.

necessary to apply the law of several countries if, for example, the couple then lived for over ten years in a foreign country or if the couple moved to the country of their common nationality. Indeed, the Hague Convention provides for certain situations in which the matrimonial property regime is automatically mutable.[2]

For spouses married after January 29, 2019, and in the absence of a first common habitual residence, Article 26 will apply. In pertinent part, it provides as follows:

> [The law] of (b) the spouses' common nationality at the time of the conclusion of the marriage; or, failing that (c) with which the spouses jointly have the closest connection at the time of the conclusion of the marriage, taking into account all the circumstances [will govern the spouses' matrimonial regime.]

Article 26(c) clearly provides unpredictable results as it is commonly difficult to determine the law having the closest connection with the spouses at the conclusion of a marriage when spouses live in different countries. Note that for this purpose, the term "conclusion of the marriage" refers to the time of the marriage.

"Finally, one should not forget that, if French law applies, the default matrimonial property regime in France is the regime of community of assets."

Finally, one should not forget that, if French law applies, the default matrimonial property regime in France is the regime of community of assets.

Recognition in France of a Foreign Prenuptial Agreement

Now we must raise the question of how prenuptial agreements from English-speaking countries are applied in France, which is not without difficulties when it comes to issues of classification.

Provisions Dealing with the Division of Assets in the Event of Divorce

The main difficulty here is that the concept of a matrimonial property regime does not exist in a strict sense even though common law countries have default rules for the division of spousal property in the absence of a prenuptial agreement. The first question on which a French court must rule when faced with petition to enforce a prenuptial agreement is whether a marital property regime exists in the relevant common law country.

Although the classification is determined under the concept of *lex fori*, French courts generally consider definitions provided in European texts and relevant European

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[2] The Convention of The Hague also provides for certain cases of automatic mutability of the spouses' matrimonial property regime: Nonetheless, if the spouses have neither designated the applicable law nor concluded a marriage contract, the internal law of the State in which they both have their habitual residence shall become applicable, in place of the law previously applicable:

> (1) when that habitual residence is established in that State, if the nationality of that State is their common nationality, or otherwise from the moment they become nationals of that State, or (2) when, after the marriage, that habitual residence has endured for a period of not less than ten years, or (3) when that habitual residence is established, in cases when the matrimonial property regime was subject to the law of the State of the common nationality solely by virtue of sub-paragraph 3 of the second paragraph of Article 4.

jurisprudence. In its *Van den Boogaard* decision,[3] the European Court of Justice clarified that an agreement relates to a support obligation in either of two circumstances. The first is that it provides for an allowance regarding the maintenance of a spouse in need. The second is that the needs and resources of each of the spouses are taken into consideration in determining the amount of the allowance. On the other hand, when an allowance is intended only to divide property between the spouses, the decision relates to a matrimonial property regime (Recitals 21 and 22).

With this guideline in mind, and in the absence of more recent jurisprudence on these issues, it is imperative for spouses to specify in the agreement the obligations that relate to the matrimonial property regime and the obligations that relate to support obligations. A clear distinction in a prenuptial agreement will enable French courts to consider the provisions of the prenuptial agreement when liquidating the spouses' matrimonial property regime.

Provisions Dealing with Spousal Support or Alimony

In English speaking countries, it is common for prenuptial agreements to provide for alimony to be paid in the event of divorce. It is often recommended to the parties to include clauses about financial compensation and spousal support during separation (known as "*prestation compensatoire*" under French law, or "spousal support" or "alimony" in common law countries).

The issue that arises is knowing to what extent such provisions will be applied by French courts ruling on divorce proceedings.

If there is no election to apply foreign law, French law will be applied, making it impossible for a French court to determine the amount to be paid for spousal support or alimony in advance of a final decree of divorce.

The answer is different if there is an election of a foreign law to govern this issue. In principle, an election to apply foreign law would be followed by a French court if the parties (i) elect to apply The Hague Protocol of 2007 on the Law Applicable to Maintenance Obligations, (ii) select a foreign law as the law to be applied to support obligations, and (iii) the selected foreign law allows this type of provision.[4] That is the meaning of the new European text, even though the Court of Cassation has shown a certain reluctance to apply this type of clause in its decisions.

The court will undoubtedly be reluctant when the spouses have provided for a complete waiver of compensatory allowance or other form of spousal support. In fact, the Court of Cassation[5] recently stated that it was incumbent upon the Court to investigate, in a concrete manner, whether the effects of the foreign law designated in the contract were not manifestly contrary to French international public policy.

The question remains open in situations in which the prenuptial agreement provides for sufficient amounts to cover the needs of the spouse seeking spousal support. The question of the validity of such clauses of prenuptial agreements has, therefore, not yet been entirely decided under French law.

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3 ECJ, 27 Feb. 1997, case C-220/95, *Van den Boogaard*.

4 Protocol of the Hague on the Law Applicable to Maintenance Obligations, Article 8. This supposes that the substantive and procedural conditions provided by the Protocol for choosing the applicable law have been met.

5 Cass. 1st civ., 8 Jul. 2015, no. 14-17.880.

Recognition in France of a Foreign Prenuptial Agreement

To avoid future complications in an international scenario, a couple should be informed of the option of entering into a French prenuptial agreement ("*contrat de marriage*"). The idea of such contracts is to offer the spouses predictability in the event of divorce by signing a document that can be recognized and applied even if residence outside of France is taken.

The international efficacy of such contracts assumes that they can be recognized in France, in other civil law countries, and in common law countries such as England or the United States.

Recognition assumes that the couple has complied with certain legal requirements that do not exist in French law. To this end, the contract can take the form of a French separation of property contract, provided that certain substantive and procedural rules have been considered so that it is enforceable outside of France.

The question of whether French prenuptial agreements will be recognized is thorniest in common law countries where the rules that apply to prenuptial agreements are very different from the rules that exist under French law. The policy position of American courts is generally to accept the validity of foreign prenuptial agreements, but this validity also assumes compliance with certain requirements in order to increase the chances that a French contract will be recognized and applied in most states in the U.S. Consequently, the following common law concepts should be embodied in the French prenuptial agreement:

- The contract must be just and equitable for both parties ("fairness").
- Each party should receive advice from independent counsel ("independent advice").
- Each party is informed about all elements of the assets of the other party ("full financial disclosure").

Financial disclosure requirements mean that the contract must include a detailed presentation of the assets and income of each party, most often attached as an appendix to the contract. Compliance with these requirements is an important condition for validating a French prenuptial agreement from an Anglo-Saxon perspective.

THE STATUS OF MARRIAGE CONTRACTS AND PRENUPTIAL / POST NUPTIAL AGREEMENTS IN SPAIN

The situation in Spain regarding marriage contracts could be summarized as a hybrid between the French position and the Anglo-Saxon tradition of prenuptial agreements. Traditionally,[6] Spanish law is similar to French law in the sense that the autonomy of will is limited to the matrimonial property regime of the spouses through

[6] Prior to 1975, spouses were not permitted to contract marital rights regarding divorce. Law 14/1975 acknowledged the possibility for women to have legal capacity allowing them to act without the representation of husbands. This law allowed spouses to conclude marriage contracts after the celebration of the marriage.

the concept of the "*capitulaciones matrimoniales*," which translates to "matrimonial capitulations" (referred to below as "marriage contracts").

However, the desire of the spouses to have predictability regarding the consequences of a breakup has led to the use of agreements regulating other aspects of family relations through "*acuerdos en prevision de la rupture*," which translates to "agreements in anticipation of the breakup" (referred to below as "nuptial agreements"). Spanish Courts are predisposed to recognize and enforce foreign prenuptial and postnuptial agreements. Nonetheless, several caveats should be remembered where the parties have connections with Spain, or a possibility exists for review of the agreement by Spanish Courts.

Marriage Contracts Recognized Under Spanish Law Allow for the Divisions of Matrimonial Property

In Spain, it is perfectly possible for parties to have some control over the matrimonial property regime that will apply during the marriage. The validity granted to a prenuptial agreement executed under foreign law that calls for the matrimonial property regime to be governed by that law is recognized under Spanish law.[7] To illustrate, a prenuptial agreement that acknowledges the application of New York State law to property owned by the prospective spouses and specifies the way in which equitable distribution under New York State law generally will be recognized by Spanish courts if the married couple ultimately reside in Spain, albeit perhaps with limited modification.

The Object of Marriage Contracts

Under Spanish national law,[8] couples can choose the matrimonial property regime by means of marriage contracts.[9] Marriage contracts may be entered into before or during the marriage. By definition, marriage contracts choose the matrimonial property regime, meaning the set of rules that govern the property relations between the spouses and with third parties during the marriage. The Spanish Civil Code establishes different matrimonial property regimes,[10] which include the community property regime ("*sociedad de garanciales*"),[11] the participation regime ("*regimen de participación*"),[12] and the separate property regime ("*separación de bienes*").[13]

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7 Terms that would not be incorporated in such covenants are terms not related to the civil law concept of matrimonial property regime. Examples include maintenance, compensation, children's arrangement, personal obligations during the marriage, and use of the family home.

8 The term "Spanish common law" refers to the Spanish Civil Code ("CC") and other laws applicable in the national territory, when autonomous laws do not apply.

9 Articles 1315 and 1326 of the CC.

10 The autonomous laws may contain their own legislation on matrimonial property regimes.

11 Articles 1344 *et seq*. of the CC.

12 Articles 1411 *et seq*. of the CC.

13 Articles 1435 *et seq*. of the CC.

In addition to choosing one of these regimes, the marriage contract can modify or change the matrimonial property regime.[14] The modifications made cannot affect third parties acting in good faith.[15]

The Applicable Regime in the Absence of Marriage Contracts

Under Spanish national law, the applicable property regime is the community property regime.[16] This can be modified by marriage contract, which is important because the matrimonial property regimes vary depending on the connection that each of the spouses has with different parts of Spanish territory.

In the absence of a marriage contract, the domestic territorial law applicable to the matrimonial property regime will need to be determined.[17] In Spain, the determination of the law applicable to the matrimonial property regime is governed by Regulation 2016/1103 establishing enhanced cooperation in the field of jurisdiction, applicable law, recognition, and enforcement of decisions in matters of matrimonial property regimes. If the Regulation is not applicable, the conflict of law rules provided for in Articles 9.2 and 9.3 of the CC apply.[18]

For this purpose, the provisions of Article 9.2 of the CC[19] establishes that the law applicable to the matrimonial property regime is determined by reference to the following criteria:

- First, the common personal law of the spouses at the time of the marriage is applied.[20]
- If that is not determinative, the personal law of the habitual residence of either party may be chosen by both in a public document executed prior to the celebration of the marriage.
- If that is not determinative, the law of the common habitual residence immediately following the marriage is applied or, in the absence of common residence, the place of celebration of the marriage.

14 Article 1325 of the CC.

15 Article 1217 of the CC.

16 Article 1316 of the CC.

17 For examples of the application of Article 9.2 of the CC in the domestic context see Juliana RODRIGUEZ RODRIGO, Aplicación de la norma española de conflicto de leyes interno para determinar el régimen económico matrimonial, Cuadernos de Derecho Transnacional, (October 2023), vol. 15, n°2 pp. 1301-1308.

18 For an example, see Juliana RODRIGUEZ RODRIGO, Ley aplicable al régimen económico matrimonial, a propósito del comentario de la sentencia de la audiencia provincial de Madrid, de 30 Septiembre 2019, Cuadernos de Derecho Transnacional (October 2020), Vol. 12, n°2, pp. 1137-1145.

19 Article 16.3 of the CC establishes that the effects of marriage between Spaniards will be regulated by the Spanish law according to the criteria of article 9 and, in its absence, by the Civil Code.

20 Article 16.1 of the CC establishes that the personal law is determined by "*vecindad civil*." The *vecindad civil* is a civil status by which a person is considered a resident of a certain territory and determines the personal law applicable in certain matters, among which are the matrimonial regime and the inheritance law.

In the absence of a marriage contract, the application of the foregoing criteria may lead to the application of autonomous legislation when determining the matrimonial property regime. The term autonomous legislation relates to local law that is applicable in 17 autonomous regions, including Andalusia, Catalonia, the Basque Country, Galicia, the Canary Islands, and the Valencian Community. In comparison Spanish national civil law which applies the community property regime, some autonomous laws provide that have adopted the separate property regime as the default regime. Catalonia is an example.

The Validity of the Marriage Contract

When a marriage contract exists and Spanish national law applies, the applicable domestic law for assessing validity of the marriage contract is Article 9.3 of the CC. In turn, the validity of the marriage contract is governed by the general rules applicable to contracts.[21]

In addition, marriage contracts must respect laws, morality, and public order.[22] These precepts include constitutional principles, such as the principle of equality of rights of the parties.[23] Where the foregoing requirements are not wholly met, the marriage contract is not effective.[24]

The Effectiveness of the Marriage Contract

Once a marriage contract is executed, the marriage must be celebrated within one year. If no marriage is celebrated within the one-year period, the marriage contract becomes null and void.[25] With marriage, the economic regime and all marriage contract covenants must be registered in the Civil Registry.[26]

For a marriage contract executed outside of Spain, the scope of the document is limited to the choice of the matrimonial property regime and related provisions. A foreign agreement typically is recognized in Spain once it is assimilated to the traditional figure of a Spanish marriage contract.

It is common for the parties to a marital contract to address matters that go beyond the matrimonial property regime. Where that is done, questions arise as to the validity and enforceability of the terms of the contract in Spain.

Prenuptial and Postnuptial Agreements in the Spanish National Civil Law

Virtually no authoritative guidance exists concerning the legal treatment of Anglo-Saxon prenuptial and postnuptial agreements in Spain. Spanish national civil law provides no definition of prenuptial or post nuptial agreements.

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21 Article 1335 of the CC.

22 Article 1255 of the CC.

23 Article 32 of the Spanish Constitution.

24 Article 1328 of the CC.

25 Article 1334 of the CC.

26 Article 60 of the Civil Registry Law and article 1333 of the CC.

Nonetheless, this type of agreement can be looked at as an agreement to regulate the personal and economic consequences of a possible future marital breakdown.[27] Among private client advisers, these agreements are referred to as agreements in anticipation of a breakup ("nuptial agreements"). Insofar as the Spanish Civil Code does not contain any regulation, the case law of the Spanish Supreme Court provides some guidance in this matter.

The Principle of Validity of Nuptial Agreements

Since the late 1990's, the Spanish Supreme Court has been admitting the validity of such agreements by virtue of the principle of party autonomy.[28]

In a judgment of June 24, 2015, the Supreme Court ruled specifically on the conditions for the validity of a prenuptial agreement.[29] In this case, a married couple executed a marriage contract before a notary designating the matrimonial property regime and, in parallel, concluded a prenuptial agreement a few days before the wedding. In this agreement, they agreed on a monthly rent for life in favor of the wife. That arrangement was not part of the matrimonial property regime.

The Supreme Court considered that this prenuptial agreement fell within the scope of Article 1323 of the Civil Code, which establishes that spouses may transfer property and rights by any title and enter into all kinds of contracts with each other.

To conclude that the prenuptial agreement was valid, the Supreme Court considered the following factors:

- According to the agreement, compliance was not left to the discretion of the spouses, as the conditions that generated the obligation were clear.
- The agreement did not promote the crisis, since neither was in a compromised economic situation.
- The principle of was not violated, since there was no serious prejudice to the husband.
- Neither spouse was in a situation of abuse of a dominant position or in a situation of precariousness.

The Spanish Supreme Court concluded that the agreement was valid. It was negotiated by both parties, and the rent was adequate.

In a judgment of May 30, 2018,[30] the Spanish Supreme Court ruled again on the validity of a prenuptial agreement. Prior to the wedding and in the presence of a notary, the individuals waived any possible indemnities or compensatory pensions that might arise in the event of a marital crisis.

"Nonetheless, this type of agreement can be looked at as an agreement to regulate the personal and economic consequences of a possible future marital breakdown."

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27 Muñoz Navarro, A. J., "*Los pactos prematrimoniales o en previsión de ruptura matrimonial*," *La Ley Derecho de familia: Revista jurídica sobre familia y menores*. Wolter Kluwer, 2020, No. 25, p. 3.

28 STS 325/1997 (RJ 1997/3251); STS 1053/2007 (RJ2007/7307); STS 217/2011 of March 31 (RJ 2011/3137).

29 STS 392/2015

30 STS 315/2018

At some point, the couple encountered difficulties, and the wife filed for divorce. The first instance judge granted a compensatory pension to the wife, considering the agreement null and void for being contrary to the principle of equality. On appeal, the court overturned the decision, ruling that the agreement was valid.

The wife filed an appeal in cassation before the Spanish Supreme Court, which was dismissed. In its decision, the Court referred to factual elements that established informed consent of the parties to the agreement:

- The court considered that the woman was aware of what she signed because she received legal advice from the notary or lawyer.
- The agreement was not contrary to public policy because the woman's employment status, and her limited knowledge of Spanish did not place her in a precarious situation even though she was a Russian national living Spain.
- The principle of equality was not violated because it was a waiver entered into by both parties in the context of a relationship of trust.

It follows from this judgment that, although there are no statutory criteria in Spanish national law, the effectiveness of prenuptial agreements is evidenced by the following factors:

- The parties to the marital agreement each obtained independent legal advice to ensure an understanding of the terms of the agreement.
- The provisions of the marital agreement applied to both parties.
- The terms of the marital agreement were sufficiently clear, so that at the time of their application, neither party was blindsided.

These judgments emphasize that, when dealing with family matters, effectiveness of the agreements will depend on the application of concepts that protect families.

Mandatory Concepts that Apply Nuptial Agreements

As mentioned above for marriage contracts, important limitations exist in nuptial agreements that are based on public policy. When they apply, they may limit the effectiveness of the agreement. For a party to prevail, the nuptial agreement cannot violate concepts of (i) law, (ii) public order, (iii) morality, (iv) constitutional principles such as the equality of spouses in marriage,[31] (v) integral protection of the family and children,[32] (vi) rights and duties of the spouses,[33] (vi) the principle of noncausal separation or divorce,[34] (vii) the rules of the primary matrimonial property regime,[35] (viii) the rules relating to the constitution of the marriage,[36] and (ix) the limits of public order to the paternal-filial relations regarding inability to waive parental authority, custody of the common children, or alimony.

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31 Article 32.1 of the Spanish Constitution.

32 Article 39 of the Spanish Constitution.

33 Article 66 *et seq*. of the CC.

34 Articles 81 and 86 of the CC.

35 Article 1315 of the CC.

36 Article 44 *et seq*. of the CC.

The effectiveness of a prenuptial or a post nuptial agreement will depend on the facts and circumstances presented to a court. Here are several,

- **Agreements affecting minor children.** When a nuptial agreement is related to the use and attribution of the home, validity will depend on whether minor children live at home.[37] If there are minor children, the judge will give priority to the best interests of the child over any nuptial agreement. The best interests of the child will also guide the assessment of the agreements relating to custody and child support.[38] The right to child support cannot be waived.

- **Economic consequences between spouses: maintenance, indemnities, and compensatory pension.** Article 151 of the CC establishes that the right to maintenance is unwaivable. However, the parties may agree on the amounts or forms of payment. A pension or compensation for housework differs from maintenance payments. The agreement should therefore clearly distinguish between the different forms of financial compensation.

- **Provisions concerning the personal relationships between the spouses.** The drafter of the prenuptial agreement or post nuptial agreement must be mindful when including clauses that may deal with personal obligations of the spouses. Clauses that may be interpreted as obliging the spouses to have consensual relationships are not valid.[39] In the same vein, clauses sanctioning infidelity may be closely examined by the Spanish Courts and should be avoided.

"The effectiveness of a prenuptial or a post nuptial agreement will depend on the facts and circumstances presented to a court."

The Form of Nuptial Agreements

In comparison to marriage contracts, the absence of regulations applicable to nuptial agreements means that no standard forms exist. The form to be adopted will depend on the scope of the agreement. For example, if the nuptial agreement falls within the scope of a marriage contract because it relates to the choice of the matrimonial property regime, it must be executed in a public deed. In practice, resorting to a public deed is advisable since it will confer greater probative value to the nuptial agreement and will guarantee that the consent has been freely given.

When a foreign nuptial agreement deals with matters beyond marriage contracts, Spanish law applicable to international private law norms will determine whether it is valid. In other words, nuptial agreements are not regulated by the Spanish Civil Code. Consequently, the validity of the nuptial agreement in Spain will be addressed for the first time upon the breakup of the marriage. Until then, no certainty exists regarding its enforceability until a ruling is issued by a judge. If the parties reside in an autonomous region, surprises may be encountered, as discussed below.

Potential Application of Autonomous Laws

Because the Spanish Civil Code does regulate nuptial agreements, autonomous laws will apply. The law in certain autonomous regions may provide different outcomes as to the enforceability of said agreements. To illustrate, the Catalan Civil

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37 Article 96 of the CC.

38 Article 1814 of the CC.

39 Article 10.1 of the Spanish Constitution.

Code ("CCCat") establishes clear and detailed regulation of nuptial agreements. Among other things, it distinguishes between marriage contracts regulated in Art. 231-19 of the CCCat and agreements regarding a breakup regulated in Art. 231-20 of the CCCat. Regarding the latter, it establishes the conditions to enter said agreements:

- Covenants in anticipation of the breakdown of the marriage may be granted in marital contracts or in a public deed.
- Prenuptial agreements will be valid only if entered during the 30-day period before the celebration of the marriage.
- The notary must inform each of the parties separately about the scope of the changes that are intended to be introduced with respect to the default legal regime. He must also ensure that each party has all necessary information about the default regime and the modified regime.
- Covenants excluding or limiting rights must be reciprocal in nature and clearly specify the rights that are limited or waived.
- The spouse who wishes to rely on a prenuptial agreement rather than the default treatment has the burden of proof as to whether the other party had sufficient information about assets, income, and financial expectations at the time of signing the agreement.
- Covenants that are seriously detrimental to a spouse at the time of enforcement are not effective if circumstances change over time in a way that could not reasonably have been foreseen at the time the parties entered the agreement.

In addition, the Catalan Civil Code establishes substantive conditions for the effectiveness of the nuptial agreement. Here are several examples:

- In anticipation of marital breakdown, the parties may agree on the use of the home by each party.[40] Agreements that harm the interest of the children or that compromise the basic needs of one of the parties are not effective.
- In anticipation of the breakdown of the marriage, the parties can agree on the compensatory pension and the economic compensation for work,[41] including amount, duration, and period of the compensation.

The example of Catalonian law illustrates that, in Spain, the question of recognition and validity of nuptial agreements is complex. Among other things, enforcement may depend on variables such as (i) the choice of law applicable to the substance and form of the agreement and (ii) the geographical location of the Court that rules on the enforcement of the agreement.

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[40] Article 233-21 of the CCCat.

[41] Articles 232-7 and 233-16 of the CCCat.

CONCLUSION

When a client has some connection to France or Spain, whether by nationality or residence, and envisions marriage – and possibly divorce – there, assistance of a local attorney having a family law practice is helpful in navigating the uncertain waters of nuptial agreements in France and in Spain. Absent such advice, parties risk an uncertain future regarding the enforcement of a prenuptial agreement or a postnuptial agreement.

NEW BELGIAN FEDERAL GOVERNMENT ANNOUNCES SIGNIFICANT NEW TAX MEASURES

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Tags
Belgium
Capital Gains Tax
Government Agreement
Group Contribution Regime
Investment Deduction Carry-Forward
Participation Exemption
Securities Accounts Tax
Solidarity Contribution

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INTRODUCTION

Following the Belgian general elections of June 9, 2024, five political parties negotiated a new federal government agreement (the "Government Agreement"). The government formation was led by Bart De Wever, president of the largest political party, N-VA, who was sworn in as Prime Minister on February 3, 2025, by King Philip, of Belgium. The new Government Agreement consists of more than 200 pages in one language only and contains many significant tax measures.

This article contains an overview of new tax measures that are relevant for businesses in Belgium, other than employment tax measures. Many of the tax measures discussed below are described only briefly and in general terms in the Government Agreement. Advisers must wait for the publication of draft legislation to determine the potential impact of many of the rules that have been announced. Also, the Government Agreement does not contain a single, clear effective date for the new tax measures. The new government has expressed the ambition to have the bulk of the announced tax measures passed by Parliament before the summer recess, usually starting around Independence Day, July 21.

DIVIDENDS RECEIVED DEDUCTION

Current Rules

The Belgian participation exemption system currently consists of three separate rules:

- The first rule is that all dividends received are initially included in taxable income of the recipient corporation. In a later stage of the corporate tax computation, up to 100% of the qualifying dividends are deducted under the Dividends Received Deduction ("D.R.D.").
- The second rule is that capital gains on the disposal of qualifying shares are fully exempt from corporate income tax.
- The third rule is that the distribution of dividends by a Belgian corporation are exempt from dividend withholding tax, subject to a number of conditions that are similar to the conditions under which dividends received may enjoy the D.R.D.

In order for dividends received to be eligible for the D.R.D., the Belgian corporate shareholder must hold a participation of at least 10% of the shares for an uninterrupted holding period of at least one year. If the Belgian corporate shareholder's participation is less than 10%, the D.R.D. is available if the tax book value of the

participation is at least €2.5 million. These minimum thresholds are usually referred to as the "quantitative rule."

As for dividend withholding tax, the current rule is that no withholding tax is imposed when the corporate shareholder holds a participation of at least 10% of the shares. percent. If this is not the case, a Belgian corporate shareholder is allowed to credit the dividend withholding tax against its mainstream corporate income tax liability.

Announced New Rules

It is proposed that the two-step process of inclusion of all dividend income into taxable income followed by a conditional deduction of qualifying dividends will be replaced by a simple exemption for qualifying dividend income, akin to the system that is currently in place for the exemption of capital gains on qualifying shares. This should lead to a substantial simplification, and is also in line with the E.U. Parent & Subsidiary Directive.

The required tax book value under alternative threshold will be increased to €4.0 million. The Government Agreement states that an exception will be provided for small and medium size businesses ("S.M.E.'s").

It is also proposed that an additional condition will be introduced for the application of the D.R.D. The participation must be booked by the corporate shareholder as a financial fixed asset rather than a portfolio investment. This additional test will apply only if the following two conditions are met. First, the participation is worth at least €4 million. Second both the distributing corporation and the corporate shareholder are large enterprises rather than S.M.E.'s.

A third amendment to the D.R.D. regime will apply to a participation in an investment company. A 5% tax will be imposed on the capital gain upon exit. In addition, there the credit for dividend withholding tax disallowed, except when the investor company employs at least one director or manager and the annual compensation paid to at least one of the directors or managers is at least €50,000 annum to at least one of its managers or directors in the taxable period in which the dividend is declared. The €50,000 compensation base will be indexed for inflation.

IMPROVEMENT OF THE GROUP CONTRIBUTION REGIME

Current Rules

Even though Belgium does not have a full-fledged tax consolidation regime, it has a group contribution regime that is similar to the Swedish system. Under the regime, a profitable group corporation is allowed to transfer all or part of its profits to a qualifying group entity, provided that several conditions are met. The losses in the transferee group corporation may be used to offset the profits, provided both are recognized in the same taxable period. The transfer of losses is possible only when there is a direct participation of at least 90% between the transferor and transferee group members.

Under the current group contribution regime, if in any taxable period, a group entity earns dividends which it cannot deduct by virtue of the D.R.D. (see preceding section), the same entity cannot utilize any group contribution received from a related

taxpayer to use the D.R.D. in the same taxable period. As a result, the unused D.R.D. will be carried forward to future taxable periods, thereby reducing its net present value, due not only to the timing difference, but also stricter rules that often apply when unused tax attributes are carried forward.

Announced New Rules

Without going into detail, the Government Agreement announces that four changes will be made to the current group contribution regime:

- The regime will be made more flexible and simpler to administer.
- As of the effective date, indirect participations will be taken into account when determining which group members can be transferors and transferees.
- New corporations will no longer be excluded from the group contribution regime. It remains unknown whether only newly incorporated corporations will be allowed to enter an existing group or whether newly acquired corporations will be able to participate.
- Income stemming from a group contribution will no longer be excluded from compensation with any unused D.R.D. in the hands of the recipient corporation.

INVESTMENT DEDUCTION CARRYFORWARD

Current Rule

When a Belgian corporate taxpayer makes certain investments, it can deduct a specified percentage of the investment from its taxable income for the taxable period in which the investment is made (the "Investment Deduction"). If the Belgian investor does not have sufficient taxable income for this period, the unused Investment Deduction can sometimes be carried forward provided that strict conditions are met.

Announced New Rule

The Government Agreement announces that the strict conditions for the transfer of any unused Investment Deduction to future taxable periods will be eliminated.

IMPROVEMENT OF DEPRECIATION RULES

Current Rule

Under current rules, depreciation of capital expenditures ("CAPEX investments") are computed under the straight-line method over a specified number of months.

Announced New Rule

The Government Agreement announces that corporate taxpayers will be allowed to use an accelerated depreciation schemes method, thereby front-loading the amount depreciable. This provision is intended to incentivize CAPEX investments by corporate taxpayers. For large enterprises, depreciation of up to 40% of the investment value is allowed; for S.M.E.s double declining depreciation is allowed.

SECURITIES ACCOUNTS TAX

Current Rule

Since February 2021, an indirect tax of 0.15% per annum is due on any securities account held by a Belgian taxpayer, whether an individual, corporation, or non-public legal entity or body. The tax base is the average weighed value of the securities account.

Announced New Rule

The tax on securities accounts will stay at 0.15% per annum, but certain loopholes will be eliminated. Until a few days before the final Government Agreement was reached, rumors existed that the rate would be increased to 0.25% per annum).

CAPITAL GAINS TAX ON FINANCIAL ASSETS

Current Rule

Subject to certain rarely applied exceptions, capital gains on financial investments, such as shares of stock, remain untaxed in the hands of private individual taxpayers.

Announced New Rule

Private individual investors will be subject to a capital gains tax on financial assets, defined to include, *inter alia*, shares of stock, bonds and crypto assets. The tax is referred to as a "Solidarity Contribution." It will be imposed at the rate of 10% of the realized capital gain. For this purpose, assets will be rebased to eliminate existing unrealized gains. A *de minimis* amount of 10,000 euros will be exempt from the Solidarity Contribution.

At the time of writing, several uncertainties exist, including (i) whether certain life insurance contracts or physical gold will be earmarked as financial assets and (ii) whether existing, but rarely applied, capital gains taxes will be retained. The following scenario illustrates the latter issue.

> A private individual shareholder sells a substantial shareholding to a third party and is subject to the new 10% Solidarity Contribution on the realized gain. On audit, the tax inspector takes the view that the sale of the substantial shareholding was a transaction "outside the scope of the seller's normal management of his personal assets." A 33% personal income tax is imposed on the same capital gain as it constitutes "miscellaneous income." (Section 90, first limb, 9º, dash 1, Income Tax Code.) Open questions include:
>
> 1. Can both types of capital gains tax apply to the same transaction?
> 2. If so, is the Solidarity Contribution a deductible item that reduces the base against which the 33% miscellaneous income tax is applied?
> 3. Alternatively, may the Solidarity Contribution constitute a credit that can be applied against the 33% miscellaneous income tax?

Another private individual shareholder holds more than 25% of the equity of a Belgian corporation. The shares are sold to a corporate buyer established outside the European Economic Area. Apart from the Solidarity Contribution, the seller will, under current rules, be subject to 16.5% capital gains tax. (Section 90, first limb, 9º, dash 2, Income Tax Code.) Open questions include:

1. Will this tax be repealed?
2. If not, is the Solidarity Contribution a deductible item that reduces the base against which the 16.5% capital gains tax is applied?
3. Alternatively, may the Solidarity Contribution constitute a credit that can be applied against the 16.5% capital gains tax?

Based on the text of the Government Agreement, no distinction will be made for purposes of the Solidarity Contribution between shares of Belgian and non-Belgian corporations. However, it can be expected that the Belgian Revenue Service will not systematically be informed of any sales of shares of foreign corporations by Belgian residents, notwithstanding the existing network of international agreements on the automatic exchange of information.

Capital losses will be deductible but only against capital gains realized during the same taxable period. If the taxpayer ends the taxable period with an overall capital loss, the loss will not be carried back or forward to other taxable periods.

Specifically for individual shareholders holding a substantial participation, a staggered rate of Solidarity Contribution will apply.

A substantial participation means a participation of 20 percent or greater. If the shareholder realizes a capital gain on shares pertaining to a substantial participation, the rates are as follows:

Tranche of Capital Gain (€)	Rate of Solidarity Tax
0 - 1,000,000	Exempt (0%)
1,000,001 - 2,500,000	1.25%
2,500,001 - 5,000,000	2.25%
5,000,001 - 10,000,000	5.00%
> 10,000,000	10.00%

It is unclear whether shareholdings of family members will be aggregated to determine whether the selling shareholder has a substantial participation.

The Solidarity Contribution will impact the pricing of acquisitions of Belgian companies held by private individual shareholders. Under existing law, by and large such shareholders are not taxed on any capital gain realized upon the sale of their shareholdings. Going forward, those individuals will be subject to the Solidarity

Contribution. Such sellers may take into account the Solidarity Contribution when setting the sales price for their shareholdings.

DISALLOWED EXPENSES

Current Rules

Disallowed expenses are one of three types of "income" that form the tax base for a Belgian corporation. The other two are the increase or decrease of retained earnings ("Reserves") and the distributed profit ("Dividends"). Over the years, the number of various disallowed expenses and the complexity of the rules to determine their amounts have mushroomed, and pose a huge problem for tax return preparers. Sometimes they impact an otherwise legitimate form of tax planning.

Announced New Rules

Without going into detail, the Government Agreement states that the rules on disallowed expenses will be revised and simplified where possible in combination with an optional regime for a simplified reporting mechanism.

"The Government Agreement announces that the new government will introduce a tailor-made tax regime for carried interests that is intended to be competitive with the carried interest regimes of other European countries."

CARRIED INTEREST

Current Rules

Belgium does not have a specific tax regime in place for carried interests held by managers of investment funds. Most structures that are in place today make use of a taxable partnership (a "*commanditaire vennootschap*" or a "*société en commandite*") set up by the fund managers in such a way that the partnership enjoys the participation exemption with respect to income and gains from the shares in managed funds. Upon distribution of income and gains by the taxable partnership to the fund managers, 30% dividend withholding tax is due, which is the final tax for the Belgian individual fund managers.

Announced New Rules

The Government Agreement announces that the new government will introduce a tailor-made tax regime for carried interests that is intended to be competitive with the carried interest regimes of other European countries. The newly-to-be designed regime should respect existing carried interest schemes and will provide for a tax rate not exceeding 30% for carried interest income.

EXIT TAX FOR CORPORATIONS

Current Rules

Under the currently prevailing corporate income tax rules, the emigration of a Belgian corporation constitutes a deemed liquidation, but only with respect to the corporate income tax rules. Assets of the migrating corporation are deemed to be realized at arm's length value and any deemed capital gain is taxed as if it were a realized capital gain. In most instances, deemed capital gains on shares remain untaxed to

the extent that the exemption for capital gains applies, as discussed above. However, since no cash or other cash-like items are extracted from the corporation due to its emigration, no dividend withholding tax applies. Also, legal entities other than corporations are not subject to the exit tax.

Announced New Rules

In a draft version of the Government Agreement, it was announced that upon emigration of a Belgian corporation the deemed liquidation regime would be extended to the dividend withholding tax. In principle, 30% dividend withholding tax would be levied on retained earnings as well as on capital gains that were deemed realized at the time of emigration, even though they are not distributed to shareholders.

Nonetheless, this rule is not retained in the final version of the Government Agreement. According to one of the ghostwriters of the Government Agreement, the purpose is to extend the taxation upon emigration to the dividend withholding tax. The topic is quite sensitive, as in most instances the compatibility of such an additional tax with the E.U. Parent & Subsidiary Directive and/or Belgium's bilateral tax treaties must be taken into account.

BENEFICIAL TAX REGIMES FOR REPATRIATING CORPORATE PROFITS TO INDIVIDUAL SHAREHOLDERS

Current Rules

Today, two beneficial tax systems exist for Belgian individual shareholders to take earnings and profits out of their corporation. The default rule is that the distribution of a dividend is subject to 30% dividend withholding tax. As mentioned above, this is the final tax for Belgian individual shareholders. However, subject to several conditions, this tax can be reduced to 13.64% or to 15% depending on the system that is used, either the "V.V.P.R.bis" system or "liquidation reserve" system.

Announced New Rule

The Government Agreement announces that both systems will be harmonized at the 15% rate. Distributions within three years will be excluded from the harmonized regime. They will be subject to the default withholding tax rate of 30%.

CORPORATE TAX RATE FOR S.M.E.'S

Current Rule

Belgian corporations qualifying as S.M.E.'s enjoy several tax benefits, including a reduced headline corporate tax rate of 20 percent instead of 25 percent on the first €100,000 of taxable income. One of the conditions for a corporation to qualify as an S.M.E. is that it must pay at least €45,000 in compensation to at least one of its corporate officers. This threshold is not indexed for inflation.

Announced New Rule

The new Government Agreement provides that the minimum compensation will be raised to €50,000 per annum, which will be indexed for inflation on an annual basis.

SECURING TAX POSITION FOR CORPORATIONS ENGAGED IN R&D ACTIVITIES

Current Rules

In order to enjoy the Investment Deduction with respect to R&D related investments, Belgian corporations and branches of non-Belgian corporations need a certificate issued by the region where they are established, being Flanders, Brussels or Wallonia.

When applying for an exoneration from wage withholding tax of up to 80% on salaries paid to R&D workers, Belgian corporate taxpayers must register with a governmental body called the Belgian Science Policy Office ("Belspo"). Taxpayers can also apply for an exemption from Belspo to secure their eligibility for the wage withholding tax exemption. In recent years, the Belgian Revenue Service often challenged the exemption claimed by many corporate taxpayers engaged in R&D activities, claiming that their registration with Belspo is strictly not compliant with the statutory rules or is flawed due to inaccuracies by Belspo. Many corporate taxpayers have litigated the restated wage withholding tax assessments, finding it to be a painstakingly long and cumbersome procedure.

Announced New Rules

The Government Agreement announces that the regional certificates for the R&D investment deductions will be scrapped and that the interaction between Belspo and the Belgian Revenue Service will be improved.

With respect to all categories of the 80% exemption from wage withholding tax, the Government Agreement confirms that these tax incentives will continue to exist, even though the new government will run spending reviews to assess their effectiveness. Also, the Government Agreement announces that, for ongoing litigation concerning the 80% exemption of wage withholding tax, a more transparent communication with the Belgian Revenue Service will be adopted.

INCENTIVIZING INVESTMENTS IN EQUITY INSTRUMENTS

Current Rules

Under current rules, there are only very limited incentives for individual investors to invest in "risk-taking" capital or equity. Even though dividends stem from income that is taxed at the level of the distributing corporation, the individual income tax rate is the same as for passive interest income, 30% with no underlying tax credit.

Announced New Rules

The Government Agreement announces that a new specific tax regime will be proposed to incentivize the investment by private individuals in equity of Belgian corporations.

In the mid-1980's, a highly successful regime was available. Subject to certain investment obligations, Belgian corporations were exempt from corporate income tax on dividend distributions to the extent that distributions did not exceed 13% or 8% of the earmarked share capital stemming from fresh capital contributions made in covered years1982 or 1983. This exemption was valid for 10 or 5 consecutive years. At the same time, the personal income tax rate for such dividends was limited to the dividend withholding tax which was not the default rule at that time. In addition, families were granted a tax deduction for up to BF40,000 (approximately €1,000) + BF10,000 (approximately €250) per dependent family member of investment in qualifying newly issued shares. Adjusted for inflation, (i) €1,000 in 1982 correspond to approximately €3,000 in 2025, and (ii) €250 in 1982 correspond to approximately €750 in 2025.

No further details are provided in the Government Agreement regarding the new tax incentive that is announced. One question that comes to mind is whether this new incentive will be restricted to equity investments in Belgian corporations. At first glance, it would appear that any such restriction would constitute an infringement of the freedom of establishment or the free movement of capital in the E.U. By the same token, this type of incentive could constitute impermissible state aid under E.U. rules.

PUBLICLY TRADED SHARES

Announced New Rules

Without going into much detail, the Government Agreement announces several measures to improve the tax regime for publicly traded shares, including the removal of certain existing prohibitive rules for I.P.O.'s.

CLIMATE-FRIENDLY INVESTMENTS

Announced New Rules

Without going into much detail, the Government Agreement announces several measures to streamline and improve the tax regime for climate-friendly investments.

NONDEDUCTIBLE EXPENSES

Current Rules

The current rules on nondeductible expenses for corporations are complex and the number of nondeductible expenses has grown substantially over the years. As previously mentioned, nondeductible expenses are one of three categories of income that comprise the tax base of a Belgian corporation. The other two categories are increases in retained earnings and dividend distributions. Nondeductible expenses

are primarily a technical tool to tax certain items that do not show up in the taxpayer's financial statements. Over the years, the reporting of nondeductible expenses has become disproportionately complex.

Announced New Rules

As part of an overall attempt to simplify the corporate income tax rules, the Government Agreement announces a simplified but optional system for the reporting of nondeductible expenses of corporations. No further details are known at the time of writing, except that the new government will strive to simplify the rules on nondeductible automobile costs and expenses, which are among the most complex examples of nondeductible expenses.

Among the other simplifications of the corporate income tax return, the Government Agreement announces the scrapping of the tax exemption for (i) social liabilities regarding potential future costs of redundancy of staff), (ii) private personal computers, and (iii) exemptions for capital gains on cars and vehicles.

REDUCED V.A.T. RATES FOR CLIMATE-UNFRIENDLY COSTS AND INVESTMENTS

Announced New Rules

Among the limited indirect tax measures announced in the Government Agreement, is a plan to scrap the reduced V.A.T. rate which typically is 6% instead of the standard rate of 21% for non-climate-friendly costs and investments. Since input-V.A.T. for businesses is by and large deductible against output-V.A.T., these measures will be less relevant for corporate taxpayers. However, the Government Agreement also announces other tax measures to discourage the use of environmentally unfriendly activities, such as the extension of the lump-sum boarding tax for E.U. and non-E.U. flights departing from Belgium and a specific indirect tax on kerosene which is currently zero-rated for V.A.T.-purposes.

INTRODUCTION OF A DIGITAL TAX

Current Rules

Prior to the roll-out of the worldwide minimum tax known as Pillar II, Belgium announced the introduction of a digital tax. Its purpose was to impose corporate tax on digital service providers that have no physical presence and no permanent establishment in the country but generate income from the exploitation of personal data of the users of their digital platforms. When Pillar II was eventually transposed into Belgian law, the plans for the introduction of a digital tax were stalled.

Announced New Rules

The Government Agreement announces that, in addition to Pillar II, Belgium will introduce a digital tax by no later than 2027, with a view to creating a level playing field between Belgium-based and nonresident digital service providers.

Without mentioning it as such, the Government Agreement also seems to confirm that Belgium will align itself with any new O.E.C.D. and E.U. initiatives to harmonize

taxation rules. In principle, it is understood that the competitive position of Belgian businesses will be safeguarded at all times.

ENHANCED LEGAL CERTAINTY

Announced New Measures

With a view to strengthening the position of taxpayers in relation to the Belgian Revenue Service, the Government Agreement announces a number of positive measures. Here is a non-exhaustive list:

"With a view to strengthening the position of taxpayers in relation to the Belgian Revenue Service, the Government Agreement announces a number of positive measures."

- Special attention will be given to applications for Advance Tax Rulings relating to projects that have a substantial impact on investment and employment in Belgium.
- Streamlining of the communication between the taxpayer representatives and the different branches of the Belgian Revenue Service, such as corporate income tax, V.A.T., and wage withholding tax.
- The publication by the Belgian Revenue Service of all case law, including court rulings that are in favor of taxpayers.
- Tax audits will follow a standardized reporting system.
- Administrative guidance will be published faster.
- No disadvantageous tax rules will be introduced with retroactive effect; the government will create a committee to rewrite the Income Tax Code with a view to making the current rules simpler and more transparent.
- A new "charter of the taxpayer" will be adopted to improve the position of the taxpayer in relation to the Belgian Revenue Service, including a procedure for complaints about errors and suboptimal performance within the Belgian Revenue Service.
- Horizontal monitoring will be revitalized.
- The role of the Ruling Commission will be maintained, and the internal functioning will be improved.
- The functioning of the Tax Mediation Service will be assessed and tax inspectors handing disputes will be encouraged to call on the Tax Mediation Service in order to settle disputes with taxpayers out of court.
- Measures are announced to reduce the lead time of tax cases in the courts.
- No penalties will be imposed when a taxpayer makes an initial unintentional mistake.
- Under current rules, no tax attributes can be utilized in any taxable period for which a penalty of 10% or greater is imposed for underreporting- or misreporting. According to the Government Agreement, when a penalty of 10% or greater is imposed, the deduction of tax attributes will again be allowed, with the exception of tax losses incurred during the taxable period.

- Efforts will be made to reduce the number of disputes that are submitted to the courts; one such measure is the introduction of binding arbitration in tax matters; according to one of the ghostwriters of the Government Agreement, this would only be possible for disputes with a certain – yet to be determined – amount of disputed taxes at stake.
- The legal status of unlawfully obtained information will be regulated.
- Procedures and due dates will be harmonized for direct tax and V.A.T., whereby a level playing field will be created between the Belgian Revenue Service and the taxpayer.
- The standard term for the Belgian Revenue Service to investigate and adjust tax returns will continue to be to three years, in general, and four years for complex and semi-complex returns. This is down from six years. When there are indications of tax fraud, the standard term for investigation and adjustment will be reduced to seven years, in general, and eight years for semi-complex and complex tax returns. This is down from ten years.
- Lists of tax havens will be established on January 1 of each year and will not be updated during the taxable year. Jurisdictions that are not on the list on January 1 will not become tax havens during the balance of the taxable year.

Several other measures will be taken to ensure proper tax reporting and assessment:

- Accounts containing cryptocurrency will be open for inspection by the Belgian Revenue Service.
- Belgium will endeavor to enter into as many treaties for cross-border exchanges of information as possible, especially with emerging economies.
- Exchanges of information between various divisions of the Belgian Revenue Service be amplified.
- The federal government commits to help the regions of Flanders, Brussels, and Wallonia to fight against share deals for real estate corporations.
- The government commits to transposing the F.A.S.T.E.R. Directive into Belgian national law. The F.A.S.T.E.R. Directive aims to facilitate a speedier reimbursement and recovery of excessive withholding taxes levied at source on intra-E.U. payments of passive income such as interest, dividends and royalties. The directive was adopted by the Council of Ministers of the E.U. on December 10, 2024, and must be transposed into national law of the Member States by December 31, 2028.

CUSTOMS DUTIES

Announced New Measures

Among the new measures announced in the field of customs duties is the possibility of requesting binding information on the applicable tariffs for the importation of goods into the E.U.

TAX ON PUBLIC TRADING OF SECURITIES

Announced New Rule

The tax on public trading of securities will be modernized and simplified in order to eliminate existing issues and to create a level playing field for securities, corporations, and funds. The rules for funds-of-funds will be revamped. Formalities and regulations regarding I.P.O.s will be reduced and simplified.

IMPROVEMENT OF THE PRIVATE P.R.I.V.A.K. FUND ANNOUNCED

Announced New Rule

Shortcomings in the current regulatory regime for Private P.R.I.V.A.K. Funds will be remedied, such as the limited duration of a Private P.R.I.V.A.K., the number of shareholders, and the scope of permitted investments.

Conversely, the deductibility for a private individual investor of any capital loss upon the liquidation of a Private P.R.I.V.A.K. will be scrapped.

"The new government in Belgium has announced ambitious plans to modernize the tax law and the operations of the Belgium Revenue Service."

INVESTMENT IN SHARES OF STOCK FOR INSTITUTIONAL INVESTORS

Announced New Rule

For institutional investors such as insurance companies and pension funds, the limitation on investment in equity instruments will be softened, in order to allow those investors to invest easily in the real economy.

CONCLUSION

The new government in Belgium has announced ambitious plans to modernize the tax law and the operations of the Belgium Revenue Service. To date, details have been limited. As a result, it is difficult to tell which portion of the Government Agreement reflects must-have items and which portion reflects hopes and dreams. According to people close to the legislative process, the aim is to have the initial draft legislative text ready around Easter. The aim is to enact final legislation before the summer recess in mid-July. The people close to the legislative process have also committed to be open to input and comments from stakeholders once the first draft texts are available pursuant to the public consultation process.

FRENCH BUDGET 2025 – SIGNIFICANT PROVISIONS AFFECTING INDIVIDUALS

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Tags
French Finance Act
Management Packages
Misdeclared Tax Residency
Statute of Limitations
Social Contribution

INTRODUCTION

Th French Budget for 2025 reflects significant political instability caused by two factors. The first is the fragmentation of the French Parliament after elections last summer. The second is a significant budgetary deficit.

The French Finance Act for 2025 was adopted on February 14, 2025, after an earlier Finance Bill was rejected in December 2024, resulting in a change of government. Due to the use of Article 49.3 of the French constitution, parliamentary debates were limited. After an unusually stable period in French tax policy dating back to 2017, important measures were introduced. More are expected in future Budgets.

BUDGET AT A GLANCE

Key measures to note for individuals include the following:

- Introduction of a new contribution on high incomes, with an instalment due in December 2025
- Reform of the tax and social security treatment of management packages, including those already in existence
- Overhaul of the tax framework for the B.S.P.C.E., one of the main employee shareholding tools
- Tax incentives for gifts received to acquire a new primary residence or to finance energy-efficient renovations
- Clarification on the supremacy of treaty law in determining tax residency
- Expansion of the partial exemption from transfer taxes imposed on the transfer of rural property
- Introduction of a special reassessment period in cases of misreported tax residence.

Key measures to note for businesses include the following:

- Additional contribution for companies with revenues over a €1 billion
- Tax on capital reductions linked to share buybacks by companies with revenues exceeding a €1 billion
- Strengthened measures against dividend arbitrage schemes such as “Cum-Cum” transactions

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- Adjustments for the implementation of Pillar 2
- Postponement of the abolition of the C.V.A.E., a local business tax
- Increase in the financial transaction tax.

Other notable measures:

- Temporary 0.5% increase in registration duties on real estate acquisitions
- Crypto-asset reforms, including the transposition of DAC-8 and the adoption of new compliance measures
- Clarification of the tax regime for the new *société de libre partenariat spéciale*

The balance of this article focuses on the principal tax reforms affecting individuals and provides insights into foreseeable changes for high net worth individuals in France.

MANAGEMENT PACKAGES/INCENTIVE PLANS

Previous Landscape for Management Packages and Incentive Plans

In France, management packages are typically divided into two main categories.

The first category includes legally framed incentive plans, *i.e.*, the French commercial code and tax code contain dedicated provisions that specify the legal features, procedures, and tax regimes. Three schemes benefit from a dedicated legal and tax regime:

- **Stock Options**. Due to a lack of tax advantages, stock options have rarely been used in recent years.
- **Free Shares**. Typically used by larger or more mature companies once B.S.P.C.E.'s are no longer available, due to certain tax benefits. However, the employer's social security contribution on the acquisition gain has been increased from 20% to 30% under the Social Security Finance Act 2025.
- **B.S.P.C.E.** ***(Bons de Souscription de Parts de Créateurs d'Entreprise).*** These are essentially Founder Warrants. The B.S.P.C.E. regime benefits from the most advantageous tax treatment. However, they are subject to strict conditions. The company must be in existence for less than 15 years, unlisted, or a small cap (<€150m), with minimum equity held by individuals, either directly or through an intermediary. This management package has features that are similar to those of stock options, such as a strike price. A recent court ruling allowed tax deferral on share-for-share transactions involving B.S.P.C.E.-subscribed shares and a management company, an arrangement that was challenged unsuccessfully by French tax authorities.

The second category encompasses all other incentive plans or management packages. They typically include warrants, commonly referred to as B.S.A.'s (*Bons de Souscription d'Actions*), golden shares, and hybrid instruments. These plans are designed to allow managers to recognize capital gains subject to a more favorable tax rate than salary income.

Over the past decade, the French Supreme Administrative Court (*Conseil d'État*) for taxation and the French Supreme Judicial Court (*Cour de cassation*) for social security have progressively established a framework for reclassifying such gains as salaries. A milestone ruling was issued by the *Conseil d'État* on July 13, 2021 (n°428506, n°435452, and n°437498), distinguishing three types of taxable gains:

- **Acquisition Gain.** The difference between the acquisition price and the fair market value is taxed as salary.
- **Exercise Gain (if applicable).** The difference between the fair market value and the exercise gain is taxed as salary.
- **Capital Gain Upon Sale.** Generally taxed under the capital gains regime, unless there is evidence linking the gain to the beneficiary's role as an employee or executive.

Commonly followed practices in drafting management packages remove or adjust conditions designed to limit the connection between employment at the company and the gain recognized in a transaction involving company shares. Nonetheless, uncertainty surrounding taxation and risks of severe penalties have limited the use of these arrangements. This led advisers to call for a clear legal framework for management packages, similar to those that exist in other jurisdictions.

New Legal Framework for Management Packages and Incentive Plans

Effective for transactions occurring on or after February 15, 2025 even for plans already in existence, capital gains realized upon the sale of shares realized by an employee or director of the company issuing the shares are subject to taxation as salaries. The top rate of tax for such salaries is 59%, a substantial increase from the rate of 34% for classical capital gains. This applies to all management packages and incentive plans, whether covered by a dedicated legal and tax framework or not, subject to certain exception.

Under certain conditions and within specific limits, capital gains on the sale of shares can fully or partly remain taxable under the capital gains regime:

- The transferred shares must contain a risk of loss compared to their acquisition or subscription value.
- A holding period of at least two years is required, except for legal incentive plans which usually have their own conditions on holding periods.

The portion eligible for capital gains taxation is limited to the following formula:

> Subscription price ("S.P.") × financial performance multiple (*i.e.* 3 × fair market value of the company / fair market value of the company at the subscription date) minus the S.P.

The fair market value is defined by law as the fair market value of the equity plus shareholder and related-party loans to the company, with adjustments to account for capital operations between the subscription date and the sale date.

Also, management packages could previously be combined with a highly favorable tax wrapper known as the P.E.A. (*Plan d'Épargne en Actions*) or Savings Plan in Shares, provided that strict conditions were met and capped at certain limits.

However, this combination was often challenged by the French tax authorities and became increasingly restricted over time. Now, management packages are explicitly excluded from this tax wrapper.

The new legal framework leaves certain questions unanswered.

- The first fact pattern involves a cashless reorganization of shares received as a result of management packages or incentive plans, typically a transfer of such shares into a Managers Company ("ManCo"). The Finance Act of 2025 overruled a favorable decision in a recent case and made it clear that B.S.P.C.E.'s exercise gain is taxable. Remaining unanswered is whether the tax on capital gain is imposed immediately or is deferred until the ManCo shares are sold.
- The second fact pattern involves gifts of shares received as a result of management packages or incentive plans. Ordinarily, French tax law allows a step-up in cost basis upon a gift resulting from the actual taxation of the gift. Here, the donor would remain taxable upon the disposal of the shares by the donee. What is the tax basis of the donor? Would there be an elimination of double taxation involving capital gain tax and gift tax?
- If the taxpayer relinquishes tax residence in France, will exit tax be imposed on the gain or is the inherent gain free of French exit tax since it now has the character of salary?
- Will the refinancing or repayment of shareholder loans impact the fair market value used for the computation of the gain's portion subject to capital gain tax rather than tax on salary?
- What reporting obligations will apply?

"Beyond considering this new regime in designing future management packages, individuals benefitting from French source management packages or incentive plans should review whether the change in law may impact their existing packages."

Beyond considering this new regime in designing future management packages, individuals benefitting from French source management packages or incentive plans should review whether the change in law may impact their existing packages.

SPECIAL REASSESSMENT PERIOD IN CASES OF MISDECLARED TAX RESIDENCY

Existing French tax law provides tax authorities strong tools to combat international tax evasion, notably extended statutes of limitations and a flexible definition of individuals' tax residency. The French Budget for 2025 enhances those provisions by introducing an extension of the statute of limitations to ten years in cases where an individual falsely claims tax residency abroad. Highlights regarding income tax and other taxes are as follows.

- **Income Tax**. In principle, French tax authorities have three years after the after the close of the relevant tax year to reassess income tax. However, in specific cases such as hidden activities or undeclared foreign financial assets, the period extends to ten years. The new law confirms that this ten-year applies to false claims of tax residence abroad.

- **Registration Duties, Gift Tax, Inheritance Tax and Real Estate Wealth Tax ("*Impôt sur la Fortune Immobilière*" or "I.F.I.").** French tax authorities can reassess such taxes up to three years or six years after the relevant tax year, depending on the efforts needed to proceed to reassessment. In addition, French tax authorities can reassess unreported foreign assets such as offshore bank accounts, insurance contracts, and trusts for up to ten years. The ten-year period explicitly covers cases of false claims of tax residence abroad.

The reform completes the already existing extension of statutes of limitations. This reinforcement makes detailed analysis of tax residence more critical than ever. It is not unusual for an individual to become a tax resident unknowingly. In comparison to the substantial presence test in the U.S. and comparable rules in the U.K., French domestic law contains no mathematical approach that looks to residence based solely on the number of days on which an individual is present in France. Instead, an individual is considered to be a French tax resident by satisfying any of the following criteria:

- **Home (or Principal Place of Stay in rare cases).** A person is considered a tax resident in France if a primary home (*foyer*) or a principal place of residence exists in France. The primary home refers to the place where the individual habitually resides and family life is centered.

- **Professional Activity.** A person is considered a tax resident in France if a professional activity is conducted in France, whether salaried or non-salaried, unless the activity is shown to be incidental to an activity that is regularly carried on abroad.

- **Center of Economic Interests.** A person is considered a tax resident in France if the center of the person's economic interests is in France. This includes the location where most of the income is derived, or the place where the main investments are made, or the place where the assets are managed.

These criteria are far from clear and are subject to differing interpretations by taxpayers, tax authorities, and courts. In cases of dual tax residency involving a country that has an income tax treaty in effect with France, the tiebreaker test for residence under the income tax treaty applies, taking precedence over French domestic law. Tiebreaker tests under income tax treaties generally provide the order in which tests are applied, and once an earlier test confirms a conclusion as to sole residence, the matter is settled.

In addition to extended statutes of limitations, significant fiscal and criminal penalties may be imposed when a person makes a misdeclaration of residence. Though mistakes in tax residence are clearly possible, they are no longer tolerated. A thorough review of tax residency status is now essential for individuals with ties to multiple jurisdictions.

On a side note, it is worth noting that French tax authorities access publicly available information on online platforms, including those that require account registration. It reported that they can engage targeted individuals in electronic exchanges, just like undercover agents in movies. Digital footprints are problematic.

MINIMUM TAXATION RATE FOR HIGH NET WORTH INDIVIDUALS

France has developed a strong capacity to multiply the number of taxes that are imposed on individuals, possibly to avoid an overt increase in tax rates. While different taxes may share similar mechanisms, such as application to revenue or benefits, they often have unique characteristics, which allow certain classes of individuals to be taxed, but not other classes of individuals.

The following list illustrates several of the multiple classes of taxes that may apply to individuals' income:

- **Income Tax.** Up to 45% in general, 12.8% flat tax in principle for dividends, interest and capital gain on shares, 19% flat tax on capital gain on real estate
- **C.S.G. (Social Contribution).** Usually 9.2%
- **C.R.D.S (Other Social Contribution).** Usually 0.5%
- ***Prélèvement de Solidarité* (Another Social Contribution).** 7.5% on passive income
- **E.C.H.I. (Exceptional Contribution on High Income).** Up to 4%

The 2025 Finance Act implemented a differential contribution on high income aimed to serve as a minimum tax of 20%. Such 20% minimum tax does not account for the social contributions mentioned in the above list but only income tax and E.C.H.I. The differential contribution has a scope and tax base similar to the E.C.H.I., with a triggering threshold of €250,000 of income for a single person and €500,000 of income for a couple filing jointly. The tax amount corresponds to the difference between 20% of their adjusted annual income and the sum of income tax plus E.C.H.I. applicable to that income. Exceptional income would be considered at one-quarter of its amount, and the same adjustment applies to the related tax. At the time or writing, the definition of exceptional income has not been published

In practice, this minimum taxation seeks to mitigate the favorable tax rate of 30% to 34% (including E.C.H.I.) applied to dividends, interest, and capital gains, which could now reach an effective rate of 37.2%.

The initial installment of the differential contribution is due in December 2025, based on a preliminary computation of income received between January and November and an estimate of December income, along with related income taxes.

The differential contribution was originally intended to last for three years. However, further steps are considered to combat planning strategies such as the use of holding companies to manage income that is eventually received at the personal level. As a result, the reform is limited to 2025, and the current government is considering a broader overhaul for ultra-high net worth individuals starting in 2026, which would shift the tax base from income to wealth. The reform would resemble the policy of O.E.C.D. Pillar 2, the minimum global tax for large businesses. The government initially proposed a 0.5% global tax on wealth, excluding professional assets. However, an alternative bill, supported by the left-wing but not by the government, proposes a 2% global wealth tax that includes professional assets, with a threshold set at €100 million.

CONCLUSION

France has long been eager to combat tax evasion and aggressive tax planning with a comprehensive set of anti-abuse measures, extended reassessment periods, and significant penalties. The 2025 Finance Act exacerbates an already stringent system, where tax increases often appear as the most immediate solution to projected deficits in public finance.

The news is not all bad, however, as France continues to maintain several relatively stable and competitive tax regimes, such as the inpatriate regime for newcomers, which can be combined with the U.S.-France Income Tax Treaty to offer favorable benefits for U.S. citizens arriving in France as senior corporate executives.

N.H.R. 2.0 IN PORTUGAL – A BETTER REGIME FOR SKILLED WORKERS AND THEIR EMPLOYERS

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Tags
Eligible Activities
N.H.R. Regime
N.H.R. 2.0 Regime
Portugal
Tax Incentive for Scientific Research and Innovation

INTRODUCTION

Through December 2023, Portugal had in place a successful tax regime aimed at individuals considering a relocation to the country. Known as the Non-Habitual Resident ("N.H.R.") regime, it was introduced in 2009 and was up and running by 2012. All told, the N.H.R. regime attracted well over one-hundred thousand highly skilled professionals and high-net worth individuals and had a positive impact on Portugal's economy.

By 2023, however, Portugal experienced an unrelenting boom in the value of residential real estate. As a result, the Government announced the termination of the N.H.R. regime, effective as of the close of the calendar year, with a transition period running to December 2024. Everyone that was in the N.H.R. regime or was in the process of taking actions to move to Portugal to become eligible for the N.H.R. were not impacted by the change of law. They are able to carry on their N.H.R. status until the end of their 10-year period, as if nothing had happened.

INTRODUCING THE N.H.R. 2.0

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At the same time as the N.H.R. was terminated, a new regime was adopted to attract qualfied individuals to move to Portugal. Labelled as the "Tax Incentive for Scientific Research and Innovation," it is commonly referred to as "N.H.R. 2.0." N.H.R. 2.0 came into effect on January 1st, 2024. Implementing regulations were published in December 2024, and again in February 2025. Online forms for application are now available and N.H.R. 2.0 is in full force and effect.

Eligibility Criteria

In order to be eligible for the N.H.R. 2.0, a nonresident individual must meet three tests:

- The first is that the applicant must not have been a tax resident of Portugal at any time within the five years preceding the move.
- The second is that the applicant must become a tax resident of Portugal.
- The third is that the applicant must carry on an eligible activity in Portugal for an eligible company.

The regime does not apply to those who benefit or have benefited from other special tax regimes, such as the N.H.R. regime. Once participation in the N.H.R. 2.0 regime is granted, it remains valid for 10 consecutive, non-renewable years. During each year in that period, the individual must (i) maintain Portuguese tax residence and

(ii) carry on an eligible activity. If the activity ceases for any reason, a firm six-month period is allowed to seek an eligible activity.

Benefits

The benefits granted by the regime can be broadly summarized as follows:

- A 20% flat rate on income earned from an eligible activity in Portugal rather than the progressive rates which would generally apply, with no maximum salary cap; and
- general tax exemption on all foreign income, apart from pension income and certain income sourced in blacklisted jurisdictions.

In comparison to the original N.H.R. regime, the new regime grants a much broader exemption for foreign source income. All foreign source income is tax free apart from pensions and certain income sourced in tax havens.

Application Process

The individual must apply to the regime by January 15th of the year following the move. The employer is part of the process. The degree of its involvement ranges from issuing a simple statement to filing supporting documentation to the Portuguese tax authorities and depends on the eligible activity carried out in Portugal.

ELIGIBLE ACTIVITIES

In order to be granted access to the N.H.R. 2.0 regime, an individual must carry out at least one of following activities for the benefit of a qualifying entity:

- Be a member of the board or carry on a qualified employment position for a company carrying on an economic activity in a sector considered relevant for the national economy. The list of sectors considered relevant for the national economy is quite broad and includes, among others, the following sectors: (i) high tech companies, (ii) holding companies, (iii) regulated asset management entities, (iv) service centers and head office companies, (v) almost all types of manufacturing and mineral extraction entities, (vi) engineering and constructions companies, (vii) film production companies, (viii) R&D companies, and (ix) certain companies in the health sector.
- Be member of the board, or be employed, by an entity certified as a start-up.
- Carry on a qualified employment position for the benefit of a company that participates in the Investment Support Tax Regime (“R.F.A.I.”) or for a industrial or service company that (i) operates in certain sectors and (ii) exports at least 50% of its annual turnover.
- Carry out a listed activity, including (i) teaching at a university, (ii) working in certain scientific research entities, (iii) holding a qualified position or be a board member of a social body that qualifies for specified benefits.

While the Portuguese entity must be a qualifying entity, there are no limitations as to the makeup of its ownership. It can be owned by Portuguese residents, by European

based corporations, or by corporations based outside of Europe other than in non-cooperative jurisdictions.

CASE STUDY

Facts

An individual who has never lived in Portugal is planning to relocate to Portugal in 2025. The individual has a bachelor's degree. He will be employed, as a financial advisor, by a Portuguese asset management company that is licensed by the Portuguese regulator.

The individual has not been a resident of Portugal for the period running between 2020 and 2024. In addition, the employer is engaged in an economic activity recognized as relevant to the Portuguese economy. The individual will be taking a qualified job position and has the necessary academic qualifications.

"N.H.R. 2.0 is a clear sign that Portugal is very much open for business and keen to attract talent, companies and investment."

Result

In the above fact pattern, the individual will be eligible for the new N.H.R. 2.0 regime. To obtain benefits, he must apply no later than January 15th, 2026.

Apart from the flat rate of 20% over his Portuguese employment income, the individual will benefit from an exemption on his foreign income provided the foreign income is not pension-related or blacklisted. The benefit of the exemption is not lost merely because funds are remitted to Portugal.

CONCLUSION

Following the unexpected termination of the N.H.R. regime, effective as of the December 31, 2023, a new regime was offered to newly arriving residents, known as N.H.R. 2.0. The new regime attracts working individuals, investors and international groups planning on setting up Portuguese subsidiaries. N.H.R. 2.0 is now fully operational for those within scope of eligible activities, which is very wide. The goal is to attract individuals working for a wide range of entities such as manufacturers, tech companies, management companies, family offices, private or corporate holding structures, and many others.

N.H.R. 2.0 is a clear sign that Portugal is very much open for business and keen to attract talent, companies and investment. With proper thought and planning, the new N.H.R. 2.0 can be even more advantageous than the previous tax regime.

FRENCH TAX INVESTIGATIONS TARGET H.N.W. INDIVIDUALS

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Tags
Data Analysis
France
H.N.W.I.
International Cooperation
Lifestyle Audits
Tax Evasion

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INTRODUCTION

Tax evasion and avoidance have been significant concerns for governments worldwide, and France is no exception. In recent years, the French government has ramped up efforts to investigate high net worth individuals ("H.N.W.I.'s") suspected of tax evasion, particularly as global scrutiny increases over the wealthy's financial practices. France, with its robust tax system and a tradition of enforcing tax compliance, utilizes a range of investigative techniques to target H.N.W.I.'s. This article delves into how French tax investigations are carried out, focusing on methods, legal framework, and high-profile cases involving the wealthy.

THE FRENCH TAX AUTHORITY: A POWERFUL ENTITY

The French tax system is managed by the *Direction Générale des Finances Publiques* ("D.G.F.I.P."). It is one of the most powerful government bodies in France, responsible for managing all aspects of taxation. In its efforts to combat tax evasion, the D.G.F.I.P. works closely with other national and international entities such as the French National Financial Prosecutor's Office ("P.N.F."), the police, and financial intelligence agencies.

The French government has been particularly proactive in targeting H.N.W.I.'s and ultra-high-net-worth individuals ("U.H.N.W.I.'s") due to expectations of large tax revenue that can potentially be collected from such individuals, who are believed to use complex financial structures, offshore accounts, and other sophisticated tax avoidance schemes.

INVESTIGATIVE METHODS: A COMPREHENSIVE APPROACH

To investigate high-net-worth individuals, French authorities employ several sophisticated techniques and tools. Some of the key methods used in these investigations are described below.

Lifestyle Audits

One of the most common methods used to target H.N.W.I.'s is the lifestyle audit. French authorities scrutinize the apparent discrepancies between an individual's reported income and visible wealth. These audits can involve analyzing the target individual's spending patterns, assets, luxury purchases, and travel habits. Red flags

pop up if someone with modest declared income is seen purchasing expensive real estate, or high priced automobiles, or traveling frequently to exclusive destinations.

Tax Evasion and Fraud Investigations

French authorities have specialized units dedicated to investigating complex cases of tax fraud and evasion. These units track down individuals who utilize offshore trusts, shell companies, or other financial tools to hide their wealth from tax authorities. In some cases, this involves cross-border collaboration with international organizations such as the Organisation for Economic Co-operation and Development ("O.E.C.D.") or tax jurisdictions like Luxembourg and the Cayman Islands that serve as financial hubs for offshore accounts.

Data Leaks and Whistleblower Revelations

High profile cases have been exposed through data leaks from whistleblowers or investigative journalists. A notable example is the Panama Papers leak of 2016, which revealed how many of the world's richest individuals and corporations use offshore companies and trusts to evade taxes. Following such leaks, the French tax authorities initiated investigations into several French nationals who were named. Leaked data provides a goldmine of information that tax authorities can use to probe further into potential tax evasions.

Cross-Border Cooperation and International Agreements

Tax authorities in France have benefited from increased international cooperation in recent years, thanks to agreements like the Common Reporting Standard ("C.R.S.") and the Automatic Exchange of Information ("A.E.o.I."). These agreements allow tax authorities to receive details about foreign bank accounts, assets, and income of French citizens and residents. These systems help investigators track down financial activities in offshore jurisdictions, providing the necessary data to conduct thorough audits.

FRENCH LEGAL / REGULATORY FRAMEWORK

France has a well-defined legal framework for investigating and prosecuting tax evasion. Under French law, tax evasion can lead to hefty fines, asset seizures, and in extreme cases, prison sentences. Some key legal provisions include:

The French Tax Code

The French Tax Code is designed to ensure that taxpayers comply with their obligations, and it grants authorities broad powers to investigate and enforce compliance. Provisions under the Code allow the D.G.F.I.P. to inspect private and corporate financial documents, audit businesses, and issue penalties for fraudulent activities.

Criminal Liability for Tax Fraud

Tax fraud in France is considered a criminal offense. Article 1741 of the French Tax Code allows for the imposition of financial and criminal penalties for individuals who are found to have deliberately evaded taxes. Depending on the scale of the fraud, penalties can range from fines to imprisonment. The penalties for major cases of tax evasion can also include asset forfeiture and the dismantling of illicit financial structures.

FRENCH ANTI-MONEY LAUNDERING LAWS

Anti-money laundering ("A.M.L.") legislation in France plays a crucial role in combating tax evasion. The Law Sapin II, passed in 2016, includes provisions for preventing corruption and increasing the transparency of financial dealings. This law obliges financial institutions to report suspicious activities, which helps identify illegal financial flows linked to tax evasion schemes.

HIGH-PROFILE CASES: EXPOSING THE WEALTHY

France has witnessed several high-profile cases in which prominent individuals were investigated or prosecuted for tax evasion. These cases often attract media attention and serve as a warning to others in similar situations.

The Case of Gérard Depardieu

One of the most well-known cases in France was that of the actor Gérard Depardieu, who famously became a tax exile to Russia after disputes over France's high tax rates. Although Depardieu was not directly accused of tax evasion, his move drew attention to the lengths some wealthy individuals would go to avoid high taxes in France. He became a Belgium tax resident in February 2024, and is under investigation in France for tax fraud because of his residence in Belgium.

The Cahuzac Affair

One of the most dramatic cases involved Jérôme Cahuzac, the former French Minister for the Budget, who was found to have hidden significant sums of money in offshore accounts. Cahuzac initially denied the accusations but was later convicted of tax fraud and money laundering. He was finally sentenced to three years' imprisonment and five years' ineligibility.

His case highlighted the significant risks involved in evading taxes at the highest levels of government.

The Bettencourt Affair

The L'Oréal heiress Liliane Bettencourt was involved in 2011 in a major tax evasion case when it was revealed that her wealth, estimated at several billion euros, had been hidden in various offshore accounts. While the Bettencourt family was not directly prosecuted for evasion, the case underscored the intensity of scrutiny that France places on wealthy individuals suspected of financial mismanagement or fraudulent behavior.

The Role of Transparency in Combatting Tax Evasion

As the global community becomes more focused on ensuring that the wealthy pay their fair share of taxes, French authorities are continuously strengthening transparency measures. The Public Country-by-Country Reporting ("C-b-C Reports") requirement, which mandates that multinational corporations must report their profits and tax contributions in each country they operate, is a step towards greater accountability.

In addition, the French government has also supported international initiatives to eliminate tax havens and increase cooperation between tax authorities globally. The European Union's anti-tax avoidance directives ("A.T.A.D.") and the O.E.C.D.'s Base Erosion and Profit Shifting ("B.E.P.S.") framework have further strengthened France's resolve in tackling tax evasion by H.N.W.I.'s.

NEW TAXATION PROVISIONS AND 2025 FINANCE BILL

The 20% Minimum Contribution Requirement

Under the 2025 Finance Bill, a new minimum contribution requirement will be applied to individuals whose income exceeds a certain threshold. This contribution is designed to ensure that high-income earners pay at least 20% in taxes on their total income, after deductions and allowances.

If an individual's total tax rate (including income taxes and social contributions) falls below 20%, a surtax must be paid to increase the total tax liability to the 20% minimum. This measure ensures that even those with complex financial arrangements or significant deductions contribute fairly to the tax system.

Taxation of Management Package Gains

The 2025 Finance Bill also introduces new provisions aimed at more aggressively taxing management package gains.

The management package refers to the equity-based compensation given to executives and high-level employees, often in the form of stock options, performance shares, or bonuses tied to the long-term performance of a company. For many years, management packages have been a way for high-income earners to benefit from lower tax rates compared to regular salary income by classifying the gains as capital gains rather than income.

In recent years, there has been growing concern over the tax inequities associated with these compensation structures. In response, the 2025 Finance Bill introduces a new tax regime specifically designed to increase the tax burden on management packages. The goal is to align the taxation of these packages with ordinary income and curb potential tax avoidance by wealthier individuals.

Under the previous tax regime, gains from management packages were often classified as capital gains if certain conditions were met. Such gains were taxed at favorable rates when compared to regular income. For example, the capital gains tax rate was around 30%, which is significantly lower than the rates for income tax, which top out at 45%.

The 2025 Finance Bill introduces a new tax structure under which management package gains will be treated as ordinary income and will be taxed progressively. Consequently, these gains will be taxed at the same rates as regular salaries. In addition, a 14% social security contribution applied to these packages, resulting in a combined tax rate of 59%. The 59% tax rate for management package gains is among the highest in Europe, marking a stark contrast to the previous regime where management packages were often taxed more lightly. The goal of this policy is twofold:

- **Equalize Taxation.** Ensure that executives and top earners are taxed at the same rates as ordinary employees, thus closing the gap between their income and the tax burden borne by regular workers
- **Discourage Tax Avoidance.** Discourage the use of management packages as a means to avoid higher income tax rates. Previously, many top executives took advantage of these packages to reduce their effective tax rate, sometimes by classifying compensation as capital gains rather than ordinary income

Some exceptions to the 59% tax rate may apply.

- Stock options and performance shares may still benefit from lower rates depending on the length of the holding period and the type of package. Executives may still benefit from a lower tax rate if the package was granted several years prior to being exercised or realized.
- The tax rate on capital gains from company shares may remain lower if the shares are sold after a holding period of more than two years. This aspect is designed to encourage long-term investment in the company they manage. However, such capital gain tax treatment will apply only under certain conditions.

This new management package tax regime reflects increasing calls for wealthy executives and entrepreneurs to contribute more to the tax system, especially U.H.N.W.I.'s who derive much of their income from performance-based equity compensation.

"Consequently, for 2025, the wealth tax remains applicable only to real estate."

Proposal to Expand the Scope of Assets Subject to Wealth Tax

A proposal was put forth for the transformation of the current wealth tax into an unproductive wealth tax. Under the proposal, other assets would be added to the tax base, such as (i) saving accounts (ii) literary, artistic and industrial property rights of which the taxpayer is not the author or inventor, and (iii) cryptocurrencies. To counterbalance the new base, the tax threshold at which a taxpayer becomes liable would have been raised from the current €1.3 million to €2.57 million.

The proposal was abandoned by the Parliament during the final vote of the 2025 Finance Bill). Consequently, for 2025, the wealth tax remains applicable only to real estate.

CONCLUSION

Tax investigations targeting H.N.W.I. individuals in France are becoming increasingly sophisticated as the country employs a combination of data analysis, international cooperation, and lifestyle audits to combat tax evasion. Additionally, the 2025 Finance Bill and recent actions by the French Senate are reshaping the taxation of the wealthy. As transparency increases and international tax regulations continue to evolve, France is positioning itself as a key player in global efforts to enforce tax compliance among its wealthiest citizens, fostering a fairer and more balanced tax system according to proponents of higher taxes.

TAX NEUTRAL OR CAUGHT IN THE NET? WORLD OF LUXEMBOURG SECURITIZATION VEHICLES

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Tags
Hybrid Mismatch
Interest Limitation Rule
Investor Payments
Luxembourg
S.C.W.G. Exception
Securitization Vehicle
Stand Alone Entity
Structured Arrangements

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INTRODUCTION

The Luxembourg securitization vehicle ("Lux S.V."), governed by the Securitization Law of 22 March 2004 ("Lux Securitization Law"), remains a core pillar in structured finance and asset repackaging across Europe. As Luxembourg continues to implement European Union ("E.U.") directives such as A.T.A.D. I & II, D.A.C.6., and the O.E.C.D.'s B.E.P.S. action plan – Including Pillar Two and substance-driven anti-abuse frameworks – Lux S.V.'s face growing scrutiny. This article analyzes how two of the principal, potentially applicable anti-abuse rules to Lux S.V.'s – namely A.T.A.D. I & II's Anti-Hybrid Rules ("Hybrid Mismatch Rules") and A.T.A.D. I's interest limitation rules ("I.L.R.'s") – can still be successfully navigated in the appropriate set of facts, thus preserving their tax neutrality.

We focus on these two rules in particular. First, as we elaborate below, the Lux Securitization Law allows tax deductibility on all forms of payments to investors of Lux S.V.'s. For example, a Lux S.V. will often issue profit participating loans ("P.P.L.'s") or could even issue types of share classes. In all such cases, payments on these financial instruments would be considered from the Lux Securitization Law as deductible for tax purposes. Tax deductible payments on such equity like financial instruments (the elusive "tax deductible dividend") would lead a skillful tax practitioner to question such presumably deductible dividend payments as a trap for the anti-hybrid rules now enacted across the E.U. and elsewhere. However, as we will discuss below, despite such "deductible dividends," the Lux S.V. can navigate through the anti-hybrid rules when the right conditions are fulfilled.

Secondly, under the Lux Securitization Law, all such deductible payments to investors ("Investor Payments"), from a Luxembourg tax point of view, are essentially characterized as interest expenses. Accordingly, any Lux S.V. contemplating holding assets that generate income other than interest or its economic equivalent is exposed to the risk of the application of the I.L.R.'s, which generally limit the deduction of interest quite dramatically. As explained below, Luxembourg as an E.U. Member State dutifully enacting A.T.A.D. has I.L.R.'s that limit interest expense financing of other types of income (*e.g.*, equity returns, royalties, other types of investment income, etc.) to 30% of E.B.I.T.D.A. or, to put it more bluntly, denying up to 70% of interest expense attempting to offset these other types of income. Nonetheless, Lux S.V.'s even when investing into these noninterest income generating assets may still achieve tax neutrality when certain conditions are fulfilled.

As we elaborate below, Lux S.V.'s can often still achieve tax neutrality with the right set of facts, even when applying the Hybrid Mismatch Rules and I.L.R.'s.

LUX S.V.'S IN CORPORATE FORM: LEADING CONTENDER IN STRUCTURED FINANCE

Lux S.V.'s are often chosen as the cross-border structured financing vehicles, establishing Luxembourg as a leading hub for securitization both in Europe and globally.[1] As of March 2025, there were over 1,586 active Lux S.V.'s operating under the Lux Securitization Law. In 2022, Luxembourg accounted for more than 28% of all Euro area Financial Vehicle Corporations, second only to Ireland, and ranked just behind Ireland and Italy in terms of securitized asset volumes.

The legal and regulatory framework in Luxembourg is both flexible and robust, having proven resilience through various market cycles going back over twenty years, when Luxembourg's securitization regime was first enacted. Issuers and their senior creditors may benefit from compliance with E.U. securitization requirements and the cost advantages offered by compartmentalization. Luxembourg's status as Europe's largest fund center has fostered a strong financial services industry, with deep expertise in securitization.[2]

The vast majority of these vehicles (approximately 95%) are structured as corporate entities (*i.e.*, as Luxembourg S.A.'s, S.A.R.L.'s, or S.C.A.'s) treated as Luxembourg tax resident companies, though benefitting from the Lux Securitization Law's tax efficient regime.[3] On the other hand, only around 5% are established as securitization funds that are tax transparent, often in the form of a Luxembourg Fiduciary Estate.[4]

Notably, most vehicles utilize a multicompartment structure, with many having between two and ten compartments, and some exceeding 500 compartments. It is also worth noting that 98% of Lux S.V.'s opt not to be subject to regulation in Luxembourg, whereas 2% or so of Lux S.V.'s are under regulation by Luxembourg's *Commission de Surveillance du Secteur Financier* ("C.S.S.F.). These supervised entities

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1 Securitization in Luxembourg, PwC Market Survey 2024 (in Cooperation with the Luxembourg Capital Markets Association ("PwC-LuxCMA 2024 Survey").

2 Luxembourg: The Global Fund Centre, Association of the Luxembourg Fund Industry, 2021.

3 PwC-LuxCMA 2024 Survey. In Luxembourg, the three forms of tax resident companies include the *Société Anonyme* ("S.A." or public company), the *Société à Responsibilité Limitée* ("S.A.R.L." or private company), and the *Société en Commandite par Actions* ("S.C.A." or Partnership Limited by Shares).

4 PwC-LuxCMA 2024 Survey. Lux S.V.'s can also be set-up as "Luxembourg securitization funds" in the form of a Fiduciary Estate. In this respect, the Fiduciary Estate ("*fiducie*") is similar to a Common Law trust. Under Luxembourg law, the Fiduciary Estate is a contractual arrangement pursuant to which the "Principal" (similar to a trust's settlor) confers the legal title ownership to a credit institution or regulated entity called the "*Fiduciaire*" (similar to a trustee) to act pursuant to the instructions of the Principal towards the beneficiaries of the Fiduciary Estate. The Lux Securitization Law allows the *Fiduciaire* to be an unregulated Luxembourg company (also often in the form of an S.A.R.L.) rather than a credit institution or regulated entity. The Lux Securitization Fund (as a Fiduciary Estate) is tax transparent and so provided the beneficiaries do not have contacts in Luxembourg (*e.g.*, resident, permanent establishment).

are typically those that issue financial instruments to the public on a continuous basis and involve tranching.[5]

As over 90% of Lux S.V.'s are established in the form a Luxembourg S.A.R.L., the analysis will focus on the application of the Luxembourg tax treatment for such forms of Lux S.V.'s. We briefly highlight that, should the Lux S.V. vehicle be in the form of the Fiduciary Estate, it is generally considered as tax transparent and so the actual application of the Hybrid Mismatch Rules (in particular the anti-financial instrument rule) as well as the I.L.R.'s should not be applicable.

As the name implies, a securitization vehicle is essentially used for the acquisition of income generating assets and the financing of such acquisition by the issuance of securities. The Lux Securitization Law provides for a very broad definition of "securities" which can be issued to its investors.

LUXEMBOURG S.V.'S IN THE FORM OF AN S.A.R.L. – OVERVIEW OF LUXEMBOURG TAX TREATMENT

The Lux S.V. in the form of an S.A.R.L. is considered from a Luxembourg tax point of view as a tax resident company subject to Luxembourg corporate income tax at an aggregate rate of 23.87%.[6] In addition, the investment made by the investors through the subscription of securities issued by the securitization vehicle must be linked/indexed to the assets funded thanks to their investment.

"As the name implies, a securitization vehicle is essentially used for the acquisition of income generating assets and the financing of such acquisition by the issuance of securities."

However, the Luxembourg Income Tax Law ("L.I.T.L.") provides that all payments made to investors and all other types of creditors ("Investor Payments") are characterized, for Luxembourg tax purposes, as deductible expenses. As a result, these payments benefit from a deduction from the Luxembourg corporate tax base of the Lux S.V.[7] As previously mentioned, the Lux Securitization Law provides a very broad definition of the types of financial instruments that a Lux S.V. can issue to its investors, which generate deductible "Investor Payments," such as preferred shares and P.P.L.'s.

Unlike other tax resident Luxembourg companies, the Lux Securitization Law removes the application of withholding tax on Investor Payments by characterizing all such Investor Payments as interest expenses for Luxembourg tax purposes.

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5 PwC-LuxCMA 2024 Survey. These supervised Lux S.V.'s are Securitization entities within the meaning of Article 2, point 2, of Regulation (EU) No 2017/2402 of the European Parliament and of the Council of 12 December 2017 creating a general framework for securitization and a specific framework for simple, transparent, and standardized securitizations, and amending Directives 2009/65/EC, 2009/138/EC, and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

6 The Luxembourg aggregate income tax rate consists of Luxembourg corporate income tax at 16%, a surcharge for the unemployment fund of 7% on the corporate income tax charge, and municipal business tax of 6.75% (assuming Luxembourg City's rate).

7 L.I.T.L. Article 46.14 provides that expenses paid to investors and all other forms of creditors of a securitization company are considered as deductible business expenses (*les engagements assumés vis-à-vis des investisseurs et de tout autre créancier par une société de titrisation rentrent parmi les dépenses d'exploitation*).

Under Luxembourg tax law, interest payments are excluded from the application of withholding tax.[8]

ANTI-ABUSE RULES IMPACTING LUX S.V.'S

Hybrid Mismatch Rules Impact on the Lux S.V.

As discussed above, the Lux S.V.'s Investor Payments are tax deductible under the Lux Securitization Law due to their automatic characterization as interest expenses. This invariably result in outcomes that normally trigger the Hybrid Mismatch Rules – particularly involving the anti-hybrid rules aimed at financial instruments discussed in more detail below. As mentioned earlier, it is not uncommon for Lux S.V.'s to be P.P.L.'s or even classes of shares with dividend rights, which include a provision entitling the investor to a *pro-rata* percentage of the Lux S.V.'s profits. As a result, such characterization could lead to such deductible "interest expense" from the Luxembourg tax perspective that could be treated as tax exempt dividends in the investor's jurisdiction, as would occur under a participation exemption that does not tax dividends received. This would seem at first glance to be an ideal mismatch scenario with a deductible dividend on the Luxembourg side of the equation and similarly risk of exemption in the investor's jurisdiction. However, as discussed further below, the O.E.C.D. addresses this issue in its B.E.P.S. Report which enables the Lux S.V. to maintain its tax neutrality.[9]

The E.U. Anti-Tax Avoidance Directive II ("A.T.A.D. II") rules aim to prevent tax benefits, such as an interest deduction claimed through Lux S.V.'s, from being obtained under a variety of circumstances involving transactions between Associated Enterprises[10]

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[8] L.I.T.L. Articles 97.1(5) provides that interest expense is a type of income from capital and Article 97.6. specifically provides clarification that "distributions and other products allocated to investors and other creditors of a securitization entity constitute income from capital within the meaning of paragraph 1, number 5 of this article" (*Les distributions et autres produits alloués aux investisseurs et autres créanciers d'un organisme de titrisation constituent des revenus provenant de capitaux mobiliers au sens de l'alinéa 1er numéro 5 du présent article*). L.I.T.L. Article 146 lists the types of income from capital subject to withholding tax and does not specifically enumerate interest expenses as defined in L.I.T.L. Article 97.1(5).

[9] O.E.C.D.'s Final Report on B.E.P.S. Action 2 on Hybrid Mismatches, 2015.

[10] As detailed in LITL Section 168ter(18) "Associated Enterprise" is generally defined as provided for in the A.T.A.D I & II Directives and includes the following: (i) an entity or individual owning directly or indirectly 50% (for a hybrid entity) or 25% (for a hybrid instrument) of votes, capital, and profits of a taxpayer (and vice versa); (ii) an entity forming part of the same consolidated financial group; (iii) an enterprise having a noticeable influence on management of a taxpayer (and vice versa); or (iv) an individual or entity "acting together" with another individual or entity in respect of the voting rights or capital ownership of an entity, should be considered as holding a participation in all of the aggregated voting rights or capital ownership of that entity that are held by the other individual or entity. If the aggregated ownership or rights is above the 25% (for hybrid instruments) or 50% (for hybrid entities), these persons or entities acting together can be in scope of the hybrid mismatch, even if individually they would not make the threshold. Two persons should be treated as acting together in respect of ownership or control of any voting rights or equity interests if, *inter alia*: (i) one person regularly acts in accordance with the wishes of the other person in respect of ownership or control of such rights or interests, (ii) they have entered into an arrangement in respect of ownership or control of any such rights or interests; or (iii) the ownership or control of any such rights or interests are managed by the same person or group of persons. For Luxembourg investment funds, investors holding less than 10% of capital or voting rights in the fund are assumed not to be acting together (unless proven otherwise).

that use, *inter alia*, hybrid entities or hybrid financial instruments ("Hybrid Mismatch Rules").[11] A hybrid entity is generally considered tax transparent in one jurisdiction but tax opaque in another. To illustrate, Country A considers the entity a corporation, but Country B considers the same entity a transparent partnership. A hybrid instrument is generally considered equity in one jurisdiction but debt in another. To illustrate, Country A considers the instrument debt giving rise to a taxable deduction, but Country B considers the same payment a dividend and exempts it from tax. The A.T.A.D. II anti-hybrid rules focus on shutting down hybrid mismatch outcomes, where for example, an item of income is deductible in one jurisdiction but not included as taxable income in any other jurisdiction ("deduction / no inclusion" or "D/NI") or when there is a double deduction ("D/D"). Luxembourg has implemented A.T.A.D. II's Hybrid Mismatch Rules in 2020.

Specifically, Hybrid Mismatch Rules include the following categories, which could most often apply to Lux S.V.'s:[12]

- **Hybrid Instrument:** A hybrid mismatch involving a hybrid instrument between "associated enterprises"
- **Structured Arrangement:** A "structured arrangement," broadly defined as an arrangement involving a hybrid mismatch, where the mismatch is priced into the terms of the arrangement, or an arrangement that has been designed to produce a hybrid mismatch

Policy Impacting Hybrid Financial Instruments and Lux S.V.'s

It is important to highlight that the E.U. Council has taken the position that the interpretation of the A.T.A.D. Directives should be based on the "final reports on the O.E.C.D. Action Items against B.E.P.S." and that the E.U.'s anti-hybrid rules should also be "consistent with O.E.C.D. B.E.P.S. conclusions."[13] Furthermore, the preamble to A.T.A.D. II makes clear the following rule of application:

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[11] European Council Directive 2017(952 of 29 May 2017 ("A.T.A.D. II Directive"), amending European Council Directive 2016/1164 as Regards Hybrid Mismatches with Third Countries ("A.T.A.D. II").

[12] Other anti-hybrid rules which are described in L.I.T.L. Article 168ter but not elaborated on in this article include: (a) reverse hybrid mismatch: a hybrid mismatch resulting from a payment to or from a hybrid entity to an associated enterprise; (b) dual residency: a situation of dual residency (*i.e.* being subject to tax in two or more jurisdictions); (c) no tax residency: a situation where the entity is not tax resident in any jurisdiction; and (d) Imported hybrid mismatches: occurs when a taxpayer in one country (Country A) claims a tax benefit (such as a deduction) as a result of a hybrid mismatch (*e.g.*, D/NI or DD) that actually takes place between two other countries (Countries B and C) and the benefit is "imported" into Country A because the taxpayer is connected, directly or indirectly, to the arrangement in Countries B and C. Additionally, there is the reverse entity hybrid under L.I.T.L. Article 168quater that is only applicable to Luxembourg tax transparent entities. It should not impact Lux S.V.'s in corporate form as discussed in this Article.

[13] E.U. Council Directive 12 July 2016 (2016/1164) laying down rules against tax avoidance practices that directly affect the functioning of the internal market ("A.T.A.D. I"), preamble, paragraph 2.

> Member States should use the applicable explanations and examples in the O.E.C.D. B.E.P.S. report on Action 2 as a source of illustration or interpretation to the extent that they are consistent with the provisions of this Directive and with European Union law.[14]

In the O.E.C.D.'s Final Report on B.E.P.S. Action 2 on Hybrid Mismatches ("O.E.C.D. B.E.P.S. Action 2 Final Report") for Recommendation 1.5, the O.E.C.D. specifically addressed the situation where investment vehicle regimes, including R.E.I.T.'s and S.V.'s, are allowed to have tax deductible dividend payments because of a tax policy of preserving the tax neutrality of both the payer and payee. This report specifically cites the following:

> Although the payment of a deductible dividend is likely to give rise to a mismatch in tax outcomes, such a payment will not generally give rise to a hybrid mismatch under Recommendation 1 provided any resulting mismatch will be attributable to the payer's tax status rather than the ordinary tax treatment of dividends under the laws of that jurisdiction.[15]
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> * * *
>
> Accordingly, the exception applies where the regulatory and tax framework in the establishment jurisdiction has the effect that the financial instruments issued by the investment vehicle will result in all or substantially all of the income of the vehicle being paid and distributed to holders within a reasonable period of time and where the tax policy of the establishment jurisdiction is that such payments will be subject to tax in the hands of investors. Recommendation 1.5 specifically notes that the defensive rule in Recommendation 1.1(b) should continue to apply to such payments on receipt.[16]

The O.E.C.D. Final Report even provides specifically in Example 1.10, that if a "deductible dividend" occurs due to the tax status of the payer and not due the specific terms and conditions of the hybrid instrument, then even if this would otherwise result in a "D/NI" hybrid mismatch, the hybrid mismatch rule should not apply. The O.E.C.D. Final Report states, that in such cases, it is the responsibility of the payee jurisdiction to enact a defensive rule under Recommendation 2.1. (*i.e.*, tax an otherwise deductible dividend). However, whether or not the payee jurisdiction has enacted a rule for Recommendation 2.1 should not impact the deductibility of the dividend payment in such cases (*i.e.*, due to the tax status).

As mentioned above pursuant to the O.E.C.D. B.E.P.S. Report, the special tax status of the Lux S.V., benefitting from the Lux Securitization Law, is what enables the tax deductibility of these Investor Payments (whether P.P.L., preferred share, or other similar instrument with strong equity-like characteristics) and not due to the terms and conditions of the instrument itself. Going back to our example above,

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[14] AT.A.D. II, Preamble, paragraph 28.

[15] O.E.C.D. Action 2 Final Report, Paragraph 100.

[16] *Id.*, Paragraph 101.

dividends paid by a Lux S.V. which are deducted for Luxembourg tax purposes might be considered to be equity in another jurisdiction and thus result in a "D/NI" outcome. However, because the tax deduction would be a result of the "tax status" rather than the terms of the financial instrument, this mismatch should be outside the scope of the hybrid mismatch rules per O.E.C.D. Policy and the E.U.'s deference to such policy recommendations. Accordingly, Lux S.V.'s in most cases should be able to navigate successfully a D/NI outcome based on this policy.

Structured Arrangements

Generally speaking, Lux S.V.'s should fall outside the scope of structured arrangements. A key requirement for an arrangement to be classified as a "structured arrangement" and thus trigger this anti-abuse rule is the presence of a hybrid mismatch that is either intentionally priced into the terms of the arrangement or where the arrangement has been designed to produce a hybrid mismatch outcome. In the absence of these elements, Lux S.V.'s would typically not be considered structured arrangements for the purposes of the anti-abuse rules.

In addition, the Luxembourg State Council stated the following in its opinion to the draft Luxembourg law implementing A.T.A.D. II:

> * * * if a Luxembourg company issues a financial instrument on the market without knowing at the time of issuance who the subscribers will be and without having deliberately drawn up the terms of that financial instrument with a view to actively approaching investors for whom that instrument will be the source of a hybrid mismatch, the State Council considers that there can be no question of a structured arrangement.[17]

"Generally speaking, Lux S.V.'s should fall outside the scope of structured arrangements."

As discussed above, Lux S.V.'s are chosen in light of the various legal and regulatory reasons, including the significant legal and regulatory benefits, as well as the policy objective of creating a tax neutral vehicle for cross-border structured finance. Given that all securities owed to investors are already structured to enable tax deductibility, such abusive scenarios as described by the Luxembourg State Council should generally fall outside the scope of the Lux S.V. and their approach to investors.

INTEREST LIMITATION RULES ("I.L.R.'S"): POTENTIAL BRUTAL APPLICATION & EXEMPTIONS AVAILABLE TO LUX S.V.'S

Overview of the I.L.R.'s in Luxembourg

Luxembourg's I.L.R.'s were introduced as part of the implementation of A.T.A.D. I, effective from January 1, 2019. The I.L.R.'s are designed to limit the deductibility of

[17] Opinion of the State Council (*Avis du Conseil d'Etat*), 10 December 2019.

excess "exceeding borrowing costs" ("E.B.C.'s") for corporate taxpayers, thereby preventing base erosion through excessive interest deductions.[18]

The I.L.R.'s provide that the deduction of E.B.C.'s of a taxpayer is limited to 30% of its taxable E.B.I.T.D.A. (earnings before interest, tax, depreciation and amortization) or €3.0 million, whichever is higher. The E.B.C.'s correspond to the amount by which the deductible borrowing costs of a taxpayer exceeds taxable interest income and other economically equivalent taxable revenues accrued.[19]

Consequently, if a Lux S.V. receives interest income and equivalent taxable revenues that equal or exceed its tax-deductible borrowing costs, the Lux S.V. will have no E.B.C. and will therefore not be impacted by the E.B.C. disallowance rules. However, if (i) the Lux S.V. is set up to receive other types of income such as dividends or other returns on equity, royalties, lease payments, or any other type of income not qualifying as interest or its economic equivalent and (ii) the E.B.C.'s exceed €3.0 million, then up to 70% of its revenue would be taxed. To put this in perspective, if the I.L.R.'s were to hit with full force and fury, the Lux S.V. would end-up with an

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[18] L.I.T.L. Article 168bis. The Luxembourg law of 21 December 2018 implemented the I.L.R.'s of A.T.A.D. 1. Borrowing costs are defined as interest expenses on all forms of debt (to both related and unrelated parties), other costs economically equivalent to interest and expenses incurred in connection with the raising of finance, including, without being limited to (non-exhaustive list): payments under profit participating loans, imputed interest on instruments such as convertible bonds and zero coupon bonds, amounts under alternative financing arrangements (*e.g.*, Islamic finance), the finance cost element of finance lease payments, capitalized interest included in the balance sheet value of a related asset, or the amortization of capitalized interest, amounts measured by reference to a funding return under transfer pricing rules where applicable, notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings, certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance, guarantee fees for financing arrangements, and arrangement fees and similar costs related to the borrowing of funds.

[19] In practice, this means that E.B.C.'s that do not exceed € 3.0 million annually are fully tax deductible in the hands of a taxpayer, irrespective of any other element. However, where E.B.C.'s exceed €3.0 million annually, the overall deductible amount is to be computed based on the Lux S.V.'s taxable E.B.I.T.D.A. The I.L.R.'s do not define the notion of taxable interest income and other economically equivalent taxable revenues. However, a tax circular published by the Luxembourg tax authorities on 25 mars 2022 (n°168bis/1) confirms that this concept should be interpreted consistently and symmetrically with the notion of borrowing costs. From this perspective, amounts that are not considered as borrowing costs at the level of the borrower are in principle not to be considered as interest income and other economically equivalent taxable revenues. Please note that the above-mentioned tax circular has not yet clarified whether a gain on debt investments (*e.g.* nonperforming loans) should be considered as "other economically equivalent income" for the purpose of the I.L.R.'s. Such classification may depend on the accounting treatment of the gain and on the application of the economic approach concept under which the gain remunerating the risk taken by the creditor could be seen as economically equivalent to an interest payment for the purpose of the I.L.R.'s. The same circular also provides that: (1) only foreign exchange gains or losses relating to the interest of a debt are included in the definition of borrowing costs (foreign exchange gains and losses arising from the principal amount are not taken into account) and (2) deduction for impairment of loan receivables does not trigger any borrowing costs for the creditor.

effective Luxembourg corporate income tax rate of 16.71% and that would hardly be the cherished tax neutral vehicle sought after (*i.e.*, 70% of E.B.I.T.A. x Luxembourg corporate income tax at the aggregate rate of 23.87%).

However, Luxembourg I.L.R.'s provides two exemptions that could be applicable to Lux S.V.'s in particular, which are the stand-alone entity exception ("Stand Alone Entity Exception") and the single company worldwide group exception ("S.C.W.G. Exception"). These are discussed below.

We also highlight here that the vast majority of Lux S.V.'s are set up as so-called orphan structures in order to achieve bankruptcy remoteness. The most common arrangement for these orphan structures would be the establishment of a Dutch *stichting* which would hold 100% of the common shares of the Lux S.V. (often referred to as an "Orphan Structure") and the Lux S.V. would then acquire its asset portfolio with funds obtained through the issuance of P.P.L.'s or preferred shares (or a variety of their financial instruments) to a pool of investors. These profit linked securities would give rise to Investor Payments and benefit from the tax deductibility afforded by the Lux Securitization Law as described above.

We briefly also mention that the I.L.R.'s contain a comprehensive list of exceptions to the I.L.R.'s (*e.g.*, U.C.I.T.'s, alternative investment funds, insurance companies, and retirement pensions funds) but these are generally not applicable to a typical Orphan Structure involving an unregulated Lux S.V.[20] It is also worth highlighting that one of these exceptions include E.U. Regulated Luxembourg Securitization Vehicles. Note however that the European Commission ("E.C.") has warned Luxembourg (and Portugal) that such exception is not consistent with E.U. Policy on the I.L.R.'s. Nonetheless, the exception remains in the Luxembourg Tax Code despite a lingering 2022 draft tax law calling for its abolition.[21]

Stand Alone Entity Exception

The Stand Alone Entity Exception could be applicable to a Lux S.V. if it cumulatively meets three conditions:

- The Lux S.V. is not part of a consolidated group for financial accounting purposes.
- The Lux S.V. has no Associated Enterprises, including both any entity and any individual that is recognized as being an associated enterprise.
- The Lux S.V. has no permanent establishment ("P.E.") located in a jurisdiction other than Luxembourg.

20 L.I.T.L. Article 168bis (1)6 under the definition of financial undertakings.

21 On May 14, 2020, the European Commission sent formal notice letters to advise Luxembourg and Portugal to remove the exemptions from interest limitation rules currently available to certain securitization vehicles ("S.V.'s"), claiming that the respective provisions of applicable domestic legislation go beyond the allowed exemptions under Article 4 of the A.T.A.D. On March 9, 2022, the Luxembourg Ministry of Finance published draft law No.7974 proposing to abolish this exception. However, as of the writing of this article, the exception for Luxembourg E.U. regulated Lux S.V.'s remains in the Lux Tax Law (See L.I.T.L. Section 168bis(1)7.j).

Consequently, a Luxembourg company can only benefit from the standalone entity exception if it is held by shareholders holding directly or indirectly a participation of less than 25% in terms of voting rights, capital ownership, and profit entitlement.[22]

We also highlight that the prevailing interpretation of the Stand-Alone Entity Exception includes the position that "Orphan Structures" should be excluded from benefitting from this exception. The principal source of authority for this is the 2018 Opinion of the Luxembourg Chamber of Commerce on A.T.A.D. I, which concluded a Dutch *stichting* owning 100% of the common shares of the Lux S.V. is an Associated Enterprise. Consequently, the Stand-Alone Entity exception is inapplicable.[23]

S.C.W.G. Exception to the I.L.R.'s

As of January 1, 2025, Luxembourg tax law provides an exception to the application of the I.L.R.'s for taxpayers qualifying as S.C.W.G.'s. The preliminary requirements to qualify for the S.C.W.G. Exception are as follows:

- The Luxembourg entity is not part of a group which files consolidated accounts.
- The Luxembourg entity is not a taxpayer which does not have an associated enterprise or a permanent establishment outside of Luxembourg.[24]

In most cases, both of these conditions are likely to be fulfilled for the relevant Lux S.V. typically held within the Orphan Structure described above. First, the Lux S.V. in the Orphan Structure likely does not prepare consolidated accounts, nor should it be anticipated to be included in any consolidated accounts. In the Orphan Structure, the Dutch *stichting* should be considered as an Associated Enterprise, thereby fulfilling the second condition, as it would normally own 100% of both the capital and voting rights of the Lux S.V., which is well above the Associated Enterprise thresholds which requires of at least 25% of the voting, capital, or profit rights. Additionally, the Dutch *stichting* is located outside of Luxembourg, in the Netherlands.

Additionally, it is required that the Lux S.V.'s ratio of equity to total assets is equal to or greater than the equity to total asset ratio of the group.[25] In the typical Orphan Structure, the "group" should thus consist of the *stichting* and its wholly owned Lux S.V. The investors normally being third parties should not be taken into consideration. As such, the Dutch *stichting* and the Lux S.V. would be the only two entities for purposes of applying this comparative net asset ratio. However, when Lux S.V.'s are utilized within investment groups, additional analysis under the Associated Enterprise rules should be conducted to verify any potential risk of the investors possibly

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22 L.I.T.L. Article 168bis(1)6 and (8)a.

23 Opinion of the Luxembourg Chamber of Commerce (*Avis de la Chambre de Commerce*) on draft law number 7318, section 1.b

24 L.I.T.L. Article 168bis(9). It is also worth highlighting that Ireland has had a similar provision to the S.C.W.G. in its enactment of A.T.A.D.'s I.L.R. in the Irish Finance Act of 2021. See also Office of the Revenue Commissioners Irish Tax and Customs Publication "Guidance on Interest Limitation Rule Part 35D-01-01." In comparison to the receipt by Luxembourg and Portugal negative letters from the E.C. on the exception for E.U. Regulated S.V.'s, Ireland has not received any negative feedback to its S.C.W.G. exception as of the date of publication of this article.

25 *Id.*

qualifying as Associated Enterprises for purposes of applying the comparative equity-to-total assets ratio analysis.

Under the Orphan Structure, the net equity-to-asset ratio should also be fulfilled, provided that the Dutch *stichting* only holds the common shares of the Lux S.V. and Lux S.V. is not anticipated take any debt from the Dutch *stichting* (*i.e.*, only equity and zero debt issued between the Lux S.V. the stichting).

"Lux S.V.'s should remain a popular choice for structured finance vehicles."

In addition to the above requirements, the Lux S.V. must notify the Luxembourg Tax Authority, which as of the writing of this article, would simply be ticking the box on the Luxembourg corporate income tax return.[26]

The application of the S.C.W.G.'s Exception remains subject to Luxembourg's General Anti-Abuse Rule, particularly if there were any artificial steps applied with an aim to fulfilling the equity-to-total asset ratios mentioned above. We highlight that the Orphan Structure is widely implemented among existing Lux S.V. structures and benefits from a well-established and credible business purpose of obtaining bankruptcy remoteness. As such, Orphan Structures aiming to come within the S.C.W.G.'s Exception should not be at risk under the G.A.A.R.[27]

CONCLUSION

The world of cross-border structured finance seems to be growing. The amount of anti-abuse rules seems perpetually on the rise. Nonetheless, as illustrated in this article, Lux S.V.'s should be able to navigate through two or more of potentially applicable anti-abuse rules in effect in the E.U. For this reason, Lux S.V.'s should remain a popular choice for structured finance vehicles.

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[26] *Id.* As of the writing of this article, it is expected that the Luxembourg Corporate Income Tax Return (Form 500) will simply have a line where the Lux S.V. can answer "yes" that it is availing itself of the S.C.W.G. Exception.

[27] *Id.*

ARE HOLDING COMPANIES SO TWENTIETH CENTURY? A LOOK AT RECENT DEVELOPMENTS IN FRANCE

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Tags
Back-to-Back
Beneficial Owner
Danish Cases
Economic Substance
Holding Company
Intermediary

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INTRODUCTION

Historically, holding companies have been used by corporate groups to place certain assets in certain locations to serve certain markets. They have also been used by individuals for wealth management and estate planning purposes. Today, holding companies located in an E.U. Member State or elsewhere are likely to face challenges when interacting with group members in France. Claims of treaty benefits are regularly challenged by French tax authorities. Whether the benefit is a tax treaty related withholding tax exemption on dividends or royalties or access to E.U. Directives such as the Parent-Subsidiary Directive, French tax authorities regularly challenge the claim of a recipient to receive the anticipated tax benefit. Often, French tax authorities contend that the recipient of income is not the "beneficial owner" of the income, and for that reason, is not entitled to the treaty benefit claimed.

Today, French tax law attacks the use by nonresident individuals who establish foreign holding companies that own assets in France or who indirectly derive income from those assets. Examples are foreign professional athletes, performers, engineers, and the like who own holding companies located in their residence state that regularly receive revenue originating in France. These ownership structures may trigger application of certain anti-abuse rules leading to unfavorable tax consequences. Here, other anti-abuse rules come into play. Also, it is not uncommon for French tax authorities to challenge the tax residence of an ultimate beneficial owner ("U.B.O.") who is regularly present in France. For these individuals, navigating the French tax environment can be daunting as a series of anti-abuse rules can be asserted in the course of a tax examination.

This article focuses on risks faced by a foreign holding company that expects to benefit from favorable tax regimes for French-source income, only to find that French tax authorities successfully challenge its status as the beneficial owner of the income. Under the view of French tax authorities and courts, a foreign holding company is properly treated as the beneficial owner of a stream of income only when it has economic substance and plays a meaningful role in the transaction under examination.

KEY-ELEMENTS – A PRACTICAL PERSPECTIVE

Without rehashing the Danish Cases decided by the European Court of Justice ("E.C.J.") in February 2019, the decision has been followed in several French cases regarding claims of treaty benefits and the application of the E.U. Parent-Subsidiary Directive. The Danish Cases have given rise to legal uncertainty when it comes to discerning between (i) the circumstances in which a holding company will be viewed to be the beneficial owner of an income stream and (ii) the circumstances in which a holding company will be viewed to be part of an abusive tax plan. At the time the

Danish Cases were decided, French case law did not provide guidance as to the circumstances in which a purported owner was considered to be the beneficial owner. The lack of guidance in the law lead to an increase in the number of tax audits, which in turn lead to several court decisions leading to a recent clarification by the French *Conseil d'Etat*:

- Will the assertion by French tax authorities that a holding company is not the beneficial owner of an income stream trigger a general presumption of tax fraud by the taxpayer?
- Will an assertion by French tax authorities that a holding company is not the beneficial owner of an income stream trigger a presumption of abusive tax planning?
- Is an assertion by French tax authorities that a holding company is not the beneficial owner of an income stream a game changer in practice?

Several relatively recent decisions indicate that a challenge to the beneficial ownership of French source income by a foreign holding company has become a key strategy that is used by French tax authorities. In practice, it may be easier for the tax authorities to achieve a favorable decision under the beneficial ownership test than under the other standard anti-abuse rules of French tax law. Over the past few years, several decisions have addressed the issue, and the notion of beneficial ownership is a key issue to be carefully considered along with standard anti-abuse rules that are at the disposal of the French tax administration. Among such anti-abuse rules are:

- The abuse of law principle (Article L64 of the French Tax Procedure Code -"F.T.P.C.") that is applied to arrangements that are characterized exclusively as tax-driven schemes.
- The general anti-abuse rules ("G.A.A.R.") introduced to implement the A.T.A.D. Directive that allow French tax authorities to broaden tax audits of shell companies. The French G.A.A.R. is based on the principal purpose test ("French P.P.T.") set out by Article L64 A of the F.T.P.C. as a catch-all clause. It provides that no account is given to arrangements that have been put into place for the main purpose (or one of the main purposes) of obtaining a tax advantage that defeats the object or purpose of applicable tax law and that are not genuine in light of all relevant facts and circumstances.
- The specific anti-abuse rule related to the withholding tax exemption on outbound dividends under the E.U. Parent-Subsidiary Directive (Article 119 *ter* 3 of the French tax code ("F.T.C."). The withholding tax exemption for dividends paid by a French corporation to a parent resident in an E.U. jurisdiction is denied where the dividend is part of an arrangement that has as a main objective the tax exemption, itself, rather than a valid commercial reason that reflects economic reality. The French tax authorities provide in their guidelines that the notion of a "commercial reason" is understood in the broad sense of any economic justification, even if it is not linked to the exercise of a commercial activity such as defined by the French tax code. Asset-holding structures carrying on financial activities or structures serving an organizational purpose are expressly mentioned as being likely to be considered as valid commercial reasons for the application of these provisions.

- The specific anti-abuse rule related to the French corporate income tax (Article 205 A of the F.T.C.), which results, in particular, in the denial of the French participation exemption regime for intercompany dividends or capital gains realized from the disposition of shares of a subsidiary.
- The specific anti-abuse rule of the favorable French merger tax regime (Article 210-0 A of FTC).

All these recent tools provide French tax authorities with a broad choice of strategy in challenging a withholding tax exemption for a payment to a holding company based outside France.

SHIFT TOWARDS ECONOMIC JUSTIFICATION FOR THE USE OF A HOLDING COMPANY

Before the implementation of G.A.A.R. and the increased importance of the beneficial ownership concept (this concept has not been introduced recently but in 1977 in the relevant O.E.C.D. Commentary), the position of French judges regarding the use of offshore holding companies in a cross-border context was influenced the substance-over-form doctrine. In practice, tax treaty benefits and benefits under the Parent-Subsidiary Directive were allowed as long as the holding company maintained business premises, full-time employees, and business assets.

However, in line with the classical economic approach of the O.E.C.D. and the holding in the Danish Cases, discussions that are now being held with French tax authorities have a different focus. The questions raised now look to determine whether (i) the foreign holding company should be recognized as the actual beneficial owner of the French income or (ii) the foreign holding company serves merely as a conduit to other persons. Substance is no longer enough. French tax authorities follow the money trail. This approach makes it much easier for tax authorities to successfully deny a tax benefit.

Clarifications Regarding Holding Companies: Good News but Not Enough

In recent cases, French judges have attempted to identify several relevant criteria, but the relative importance of each depends on the facts and circumstances that are present in the case. There is no hierarchical value that applies to each fact pattern. The entire bundle of facts is evaluated by the judges and those facts that are viewed to be most material to the transaction before the court are given the most weight in reaching a decision. As a result, uncertainty continues to exist, especially for pure holding companies that have little substance in terms of head count, function, and activities. Typically, such companies are regarded by the French tax authorities as existing merely to receive funds mostly for the purpose of paying dividends to U.B.O.'s or reinvesting in new ventures as decided by business managers located in third countries, possibly outside the European Union and without any income tax treaty concluded with France. In other words, the structures are viewed to be established for treaty shopping purposes.

The distinction between the apparent recipient and the actual beneficial owner already existed under certain tax treaties negotiated by France. For example, the tax treaties concluded with Switzerland, Panama, Andorra, and Luxembourg exclude pass-through entities from receiving treaty benefits. Moreover, denial of treaty

benefits for double dip financing arrangements were already provided in tax treaties concluded with Italy and Qatar. Similarly, requirements under which the intent of the beneficial owner must be in line with a genuine arrangement reflecting economic reality appear in tax treaties with the U.K., Qatar, Japan, and Malta.

Decisions of French judges who apply a beneficial ownership test in various fact patterns apply all of the above concepts when evaluating factors on a case-by-case basis. In practice, factors that are not economically relevant to the facts presented should be identified first, leaving the decision of the judge to be influenced by the facts of the case deemed to be the most relevant. However, in practice it is difficult to anticipate the factors that will be viewed by a judge to be material in any particular fact pattern.

"Decisions of French judges who apply a beneficial ownership test in various fact patterns apply all of the above concepts when evaluating factors on a case-by-case basis."

Recent Cases

Recent decisions and their underlying facts are helpful guides when structuring a group of companies involving a French subsidiary. Below are a few illustrative cases in chronological order, that may provide some guidance in appropriate fact patterns. Note, however, that each case before each judge was decided based those facts that were viewed to be the most material by that judge.

Conseil d'Etat Decisions n°430594 and 432845 of February 5, 2021

These decisions confirmed that the notion of beneficial ownership is separate from the notion of abuse from a French tax point of view.

X Co. was a U.K. resident. It acted as the collector of revenue on behalf of artists that licensed the use, broadcast and distribution of musical works. X Co. argued that Article 13 of the U.K.-France Income Tax Treaty provides for a withholding tax exemption regarding royalty payments made to a U.K. licensor by a French licensee. However, X Co. was not regarded by the French tax authorities as the beneficial owner of the royalty payments. Consequently, the treaty was not regarded by the French tax authorities as applicable to X Co.

In the case, the court recognized (i) X Co had economic substance, (ii) the artists legally assigned their rights to X Co., and (iii) X Co.'s Board of Directors determined the allocation of income from the exploitation of licensed works. However, the court determined that the U.K. company was not the beneficial owner of the royalties for purposes of the exemption provided by Article 13. Of importance to the decision was the fact that the bulk of the royalties received by X Co. were ultimately paid to the composers and musicians. The court found them to be the beneficial owners of the French source income collected by X Co.

Conseil d'Etat Decision n°454980 of March 11, 2022

The case dealt with a Swiss holding company that derived dividends from its French subsidiary. The Swiss holding company was wholly owned by Mr. X, an individual who was a Portuguese tax resident.

At the time of the challenge by French tax authorities, the Swiss holding company was in existence for 36 years. It received dividends from subsidiaries in several countries including France. The proceeds of dividend income were held by the Swiss holding company. Nonetheless, the French tax authorities disallowed application of the withholding tax exemption for dividends, contending that the Swiss company

lacked substance, as it had no employees, no material resources, and no physical activity.

The court upheld the disallowance. It did not matter that dividends received by the Swiss company were not distributed to Mr. X as dividends. Nor did it matter that the profits were automatically transferred to reserves or retained earnings of the Swiss company. The funds held by the Swiss holding company were regarded as being, at the disposal of Mr. X, the sole shareholder of the Swiss company, and Mr. X had a history of borrowing funds from the Swiss holding company. These facts demonstrated that the Swiss company did not have the right to use the funds for its own needs. Rather, it acted as a mere conduit company.

Conseil d'Etat Decision n°444451 of May 20, 2022

The case involved F Co., a French company distributing sport programs to fitness clubs. F Co. had initially signed a distribution contract for fitness programs with a New Zealand company, N Co. At some point following a tax audit, the contractual arrangement was revised and F Co. signed subdistribution agreements for the same programs with a Belgian company and a Maltese company.

The payments made by the French company to the Belgian company were characterized as royalties, which were exempt from withholding tax in France in application of the France-Belgium Income Tax Treaty. In comparison, royalties paid directly to N Co., a resident of New Zealand, would have been subject to a 10% withholding tax under the France-New Zealand Income tax treaty. Sums paid as royalties to the Maltese company were subject to a withholding tax rate of 10% under the France-Malta Income Tax Treaty. The rate was identical to the 10% rate in the France-New Zealand Income Tax Treaty.

The French tax authorities challenged the application of the exemption as it considered the Belgian holding company to be a conduit company without any power to use the royalties earned. They reassessed F Co. by applying the France-New Zealand Income Tax Treaty, considering that the New Zealand company was the actual beneficial owner of the sums paid by F Co.

The court of original jurisdiction in France focused its analysis on the character of the income. Were the payments properly characterized as royalties or income from provision of services? It did not decide if the application of the France-New Zealand Income Tax Treaty was appropriate. Note that Article 12 of the France-New Zealand Income Tax Treaty refers to (i) royalties paid to a *resident* and (ii) the *resident* status of the payee, suggesting that benefits under the treaty required a direct payment of royalties to a resident of New Zealand.

The *Conseil d'Etat* refused to apply article 12 literally, concluding that when an agent or representative of a treaty resident is located in a third country, it is possible to apply the tax treaty concluded between the state of residence of the beneficial owner and the state of the income's source, provided that the beneficial owner is clearly identified. Consequently, the judges sitting in the court of original jurisdiction should have determined whether the New Zealand company was the actual beneficial owner of the royalty income.

The decision of the *Conseil d'Etat* is consistent with O.E.C.D. Commentary on point. As in effect since 2017, the O.E.C.D. Commentary provides in pertinent part as follows:

> Subject to other conditions imposed by the Article and the other provisions of the Convention, the exemption from taxation in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer, in those cases where the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1997 to clarify this point, which has been the consistent position of all member countries).[1]

In practice, the principle is important for foreign based groups that face a strict approach by French tax authorities regarding license fees paid to an intermediate holding company, even when there is no risk of treaty shopping by the U.B.O. Example include circumstances where (i) the U.B.O. sets up an intermediary licensing company that is based in the same country as the U.B.O. or (ii) the U.B.O. sets up an intermediary licensing company in a third country that has an income tax treaty in effect with France that provided equivalent relief in regard to French withholding tax on royalties.

The decision is consistent with the O.E.C.D. economic approach instead of a formalist approach where only the direct recipient of the income in question is taken into account. The *Conseil d'Etat* focused on one main purpose of a tax treaty, the elimination of double taxation. To our knowledge, the decision is among first in the E.U. to have provided clarification on that point. It provides a welcome degree of legal certainty to foreign groups operating in France through local subsidiaries.

"The Conseil d'Etat focused on one main purpose of a tax treaty, the elimination of double taxation."

Conseil d'Etat Decision n°471147 of November 8, 2024

This case is important because it confirms that in identifying the beneficial owner of a dividend, facts control rather than legal arrangements among members of a controlled group of companies.

F Co. was a French real estate leasing company, wholly owned by the L Co. 2. In turn, L Co. 2 was wholly owned by L. Co. 1. Each of L Co. 1 and L Co. 2 were Luxembourg companies. L Co. 1 entered into a trust agreement as trustee with four companies resident in Guernsey and an individual resident in Germany serving as grantors and beneficiaries. Under the trust arrangement, L Co. 1 undertook the obligation to pay 90% of the dividends it would receive from L Co. 2 to the four Guernsey companies and the German resident individual that were the trust's grantors and beneficiaries.

On July 2, 2014, F Co. paid an interim dividend of €3.6 million to L Co. 2. The next day, L Co. 2 paid the entire amount to L Co. 1. F Co. did not collect French withholding tax on the dividend payment, in accordance with Article 119 *ter* of the F.T.C., which implements the E.U. Parent-Subsidiary Directive, exempting dividends from withholding tax when distributed to an E.U. parent company.

French tax authorities challenged the application of the exemption, citing as authority Article 119 *bis* of the F.T.C. They also imposed a 10% penalty. No assertion of abuse of law was raised.

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[1] Page C(12)-4 of Model Tax Convention on income and on Capital (Full Version), which appears at page 761 of the Digital Version, as it read on November 21, 2017.

F Co argued that L Co. had real economic substance and could not be classified as a mere conduit entity. The following reasons were given in support:

- L Co. 2 was the full owner of the dividend.
- When L Co. 2 distributed the proceeds of the dividend to its sole shareholder, L Co. 1, the distribution reflected the free exercise of discretion by its directors. In support of that assertion, it pointed to a subsequent year in which L Co.2 received a dividend from F. Co and retained the entire amount received.
- The payment of €3.6 million was justified by the fact that neither the Guernsey companies nor the German resident individual ever received a return on the initial investment of €25m transferred to L Co. 1, three years previously.

The court upheld the tax assessment imposed by the French tax authorities. It considered that the undisputed facts were sufficient to conclude that L Co. 2 was not the beneficial owner of the dividend received from F Co :

- Regarding the €3.6 million distribution, L Co. 2 paid an interim dividend to its sole shareholder, L Co. 1, the day after receiving the F Co. dividend.
- L Co. 2 had no other funds available from which to pay that dividend or any other dividend at the time.
- L Co. 2's sole activity was limited to holding the shares of F Co.
- All of L Co. 2's decisions were totally controlled by its sole shareholder L Co. 1, acting through the joint managers of the two companies.

CONCLUSION

From a French tax perspective, the status of a foreign holding company as the beneficial owner of the amount it receives is determined based on facts of the particular situation. Those facts serve as clues, and no single fact controls in all circumstances.

Nonetheless, the following fact patterns have been determined to be troublesome in recent cases:

- The foreign holding company receiving a payment from a French party does not, itself, conduct a business activity of its own.
- The foreign holding company receiving a payment from a related party in France makes a payment of the same amount shortly thereafter to a related party.
- The foreign holding company receiving a payment from France does not keep any funds for use in its own business.
- The foreign holding company receiving a payment from a related party in France is an offshore holding company benefiting from a tax favorable regime in its country of residence.

- The foreign company receiving a payment from a related party in France does not make economic use of the funds for the purpose of its own business carried on in its country of residence. It does not have the power from a legal or a practical point of view, to use the income received.

Further clarifications would be welcome to enhance legal certainty for international groups operating in France and are eagerly awaited.

DOUBLE DUTCH: A UNIQUE APPROACH IN THE NETHERLANDS TO U.S. L.L.C.'S OWNED BY TRUSTS

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Tags
Classification of an L.L.C.
Classification of an L.P.
Competent **Author**ity Relief
Foreign Trusts
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INTRODUCTION

Trusts play a crucial role in U.S. estate planning. However, the use of a U.S. trust in an international context can create a multitude of challenges. As illustrated in this article, the Dutch tax system's approach to the taxation of trusts poses a number of concerns for trust beneficiaries residing in the Netherlands.

This article addresses Mrs. X, a U.S. citizen who lives in the Netherlands. Mrs. X is a beneficiary of a U.S. trust created by her mother, a U.S. resident. Due to a mismatch in the U.S. and Dutch tax treatment of the trust, Mrs. X is subject to tax in the Netherlands and in the U.S. without there being an appropriate solution to double taxation short of competent authority relief under the Netherlands-U.S. Income Tax Treaty ("the Treaty). Had the mother obtained proper planning at the time Mrs. X first became a Dutch resident, a costly and time-consuming mutual agreement procedure could have been avoided.

BACKGROUND

While Mrs. X was in university in the U.S., she elected to study abroad for one semester of her junior year.[1] She chose to study in the Netherlands where she met Mr. X, a Dutch national and resident. Soon after graduation, Mr. and Mrs. X were married, at which time Mrs. X relocated to the Netherlands.

Mrs. X is the sole beneficiary of a U.S. trust, that was established by her mother when Mrs. X was a child. Throughout her life, the mother was a U.S. citizen and a U.S. resident. At the death of the mother, a professional trustee was engaged to oversee the activities of the trust.

At all times relevant, the trust held, and continues to hold the following assets:

- A 50% interest in U.S. L.L.C. 1.The principal source of income of U.S. L.L.C. 1 is rental property located in the U.S. The L.L.C. is classified as a partnership for U.S. income tax purposes.
- A minority interest in U.S. L.P. 2. U.S. L.P. 2 owns U.S. real property which is leased to third parties and other passive assets. The principal source of U.S. L.P. 2's income is rental income from property located in the U.S.

U.S. L.L.C. 1 and U.S. L.P. 2 are profitable, and both entities make annual profit distributions to the trust. The terms of the trust deed require all income to be distributed

[1] At U.S. universities, the third year of a four-year program to obtain a bachelor's degree is referred to as the junior year.

annually. Mrs. X does not have any income other than the annual distributions she receives from the trust.

DUTCH TAX TREATMENT

Taxation of Trusts

Trusts do not exist under Dutch civil law. However, because the Netherlands is a party to the Hague Trust Convention,[2] Dutch civil law recognizes trusts created under the laws of foreign countries.

The Dutch tax treatment of a trust will generally depend on whether the trust is considered discretionary or nondiscretionary ("fixed"). For discretionary trusts, the trust is likely to be classified as separate private property, known in Dutch as *Afgezonderd Particulier Vermogen*. As a consequence, for Dutch income tax purposes, the trust's assets, liabilities, income, and expenses are attributed to the settlor of the trust.[3] After the settlor dies, the trust's assts, liabilities, income, and expenses are generally attributed to the settlor's heirs. The same attribution rules will apply for purposes of Dutch gift and inheritance tax.[4]

If a trust is classified as separate private property, the Dutch tax classification of the entities owned entirely or partially by the trust is critical to determining the Dutch tax position of the settlor during his or her lifetime, and thereafter, the tax position of the heirs.

Tax Classification Rules for Foreign Entities

The Dutch tax authority issued new rules to be used in determining the Dutch tax classification of foreign entities as of January 1, 2025. Minimizing hybrid mismatches was a specific goal of the new rules. The tax classification rules are premised on the assumption that the most appropriate method available to determine the Dutch tax classification of a foreign entity is to compare the foreign entity to a Dutch entity. This is commonly referred to as the comparison method. The Dutch authorities prefer the comparison method as it aligns with principles of Dutch taxation and is in accordance with existing European Union case law.[5]

The comparison method focuses on the following two characteristics of the foreign entity, (i) the entity's nature and (ii) the entity's design.[6] The nature of the foreign entity is determined based on the function and intent of the entity as viewed under the legal regime of its formation. The design of the foreign entity is based on the entity's individual attributes.

The Dutch tax authority issued a decree (the "Decree") on the comparison of foreign legal forms that explains when the characteristics of a foreign entity are sufficiently comparable to those of a Dutch entity so as to allow the comparison method to be

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2 Convention on the Law Applicable to Trusts and on Their Recognition (Concluded 1 July 1985).

3 Article 2.14a Personal Income Tax Act of 2001.

4 Article 16 and 17 Succession Act of 1956.

5 Parliamentary documents II 2023/24, 36425, no. 3, p. 4.

6 *Besluit Vergelijking Buitenlandse Rechtsvormen*, art. 2 (Nov. 9, 2024).

applied.[7] The Decree presents the essential characteristics of certain Dutch legal entities which serve as points of comparison. For a Dutch corporation such as a *Naamloze Vennootschap* ("an N.V.") or a *Besloten Vennootschap* ("a B.V."), the essential characteristics include (i) capital divided into freely transferable shares, (ii) legal personality, (iii) limited liability for shareholders, and (iv) the ability to make profit distributions.[8] For a Dutch limited partnership commonly known as a *Commanditaire Vennootschap* ("a C.V."), the essential characteristics include (a) capital divided into shares, (b) a business purpose with contributions from all members and the motive of generating profits that are divided among the members, (c) at least one managing general partner that bears unlimited liability, and (d) at least one limited partner that benefits from limited liability.[9]

Where a foreign entity is not sufficiently comparable to a Dutch entity, the comparison method is inapplicable. In these situations, the classification method will depend on the tax residence of the foreign entity. If the foreign entity is a Dutch tax resident, the foreign entity will be considered nontransparent for Dutch tax purposes. This is referred to as the "fixed method." On the other hand, if the foreign entity is not a Dutch tax resident, the foreign entity's classification for Dutch tax purposes will mirror the tax classification of the jurisdiction in which the foreign entity is a tax resident. This is referred to as the "symmetrical method."

The Dutch tax authority utilizes the comparison method to determine the Dutch tax classification of certain commonly encountered foreign entities. While the Dutch tax authority's classification of a foreign entity can be challenged by a taxpayer, there is a rebuttable presumption that the tax classification adopted by the Dutch tax authority is correct. To overcome the presumption of correctness, a taxpayer must demonstrate that the characteristics of the foreign entity are sufficiently different in order for a different tax classification to be accepted.

Relevant for this article is the Dutch tax classification of U.S. L.L.C. 1 and U.S. L.P. 2. The Dutch tax authority has determined that a U.S. L.L.C. is comparable to a Dutch corporation while a U.S. L.P. is comparable to a Dutch limited partnership. This means that, for Dutch tax purposes, a U.S. L.L.C. is a nontransparent entity while a U.S. L.P. is generally a transparent entity.

Dutch Tax Position of Mrs. X

Mrs. X, as a Dutch tax resident, is subject to Dutch income tax on her worldwide income. Determining Mrs. X's Dutch income tax exposure requires application of the tax rules in relation to the classification of trusts and foreign entities. Mrs. X's interest in the trust qualifies as separate private property. Because the settlor of the trust no longer is alive, Mrs. X is considered to directly own the trust's assets and liabilities, and directly receive the trust's income and expenses, for Dutch tax purposes. She is considered to be a shareholder of U.S. L.L.C. 1 and a partner of the U.S. L.P. 2.

Accordingly, Mrs. X is deemed to receive the following income for Dutch tax purposes:

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7 *Id.*

8 *Id.*, art. 3 (Nov. 9, 2024).

9 *Id.*, art. 11 (Nov. 9, 2024).

- Profit distributions from a foreign corporation, of which she is a 50% shareholder
- Rental income from U.S. real property held via a foreign partnership

U.S. TAX TREATMENT

The trust is subject to U.S. income tax on income that is accumulated, rather than distributed to beneficiaries.[10] On the other hand, the trust is allowed a deduction against its U.S. income for the income distributed to Mrs. X.[11] The trust distributes all of its net income annually to its sole beneficiary, Mrs. X. Consequently, the trust effectively does not pay U.S. income tax on its rental income derived from U.S. L.L.C. 1 and U.S. L.L.P 2.

"The trust is subject to U.S. income tax on income that is accumulated, rather than distributed to beneficiaries."

Mrs. X is a U.S. citizen and subject to U.S. income tax on her worldwide income. Mrs. X receives annual distributions from the trust which consist primarily of rental income. The rental income received by Mrs. X was generated from U.S. real property and for U.S. tax purposes is U.S. source income. Therefore, Mrs. X is not entitled to a foreign tax credit against her U.S. income tax for the income tax paid in the Netherlands.

THE TREATY

Asymmetrical Treatment of L.L.C.'s

Mrs. X is subject to income tax in both the Netherlands and the U.S. However, the rationale for being taxed is quite different in the two countries.

- In the U.S., both U.S. L.L.C. 1 and U.S. L.P 2 are deemed to be transparent. Income flows up to the trust automatically. Under rules applicable to the taxation of nongrantor trusts, Mrs. X recognizes income only to the extent the trust distributes proceeds to her during the year or within the first 65 days of the following year and is specially designated by the trust as a distribution of the prior year's income. Where those facts exist, all of the income that that is recognized by Mrs. X is properly characterized by reference to the character in the hands of U.S. L.L.C. 1 and U.S. L.P. 2.
- In the Netherlands, U.S. L.L.C. 1 is characterized as the equivalent of a B.V. which is taxed as a corporation. Only U.S. L.P. 2 is viewed to be tax transparent. Consequently, only the revenue of U.S. L.P. 2 is considered to be immediately recognized by the Trust when and as generated by U.S. L.P. 2. Only that income is treated as rental income by the trust. Because U.S. L.L.C. 1 is treated as an opaque entity for income tax purposes, meaning that it is not transparent, the trust recognizes income only when it receives an actual distribution from U.S. L.L.C. 1. Finally, the trust's income is attributed to Mrs. X for personal income tax purposes.

While one aim of the Treaty is to prevent double taxation, the Treaty does not

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[10] Code §641(a).

[11] Code §651(a) in the fact pattern presented. Also see Code §661 in other circumstances.

effectively achieve that goal in the situation of Mrs. X. Unfavorable treatment arises from the saving clause of the Treaty and the scope of the withholding tax provision for dividends.

As with all income tax treaties entered into by the U.S., the Treaty contains a savings clause that allows the U.S. to tax a U.S. citizen as if the Treaty had not come into effect.[12] As a result, reductions in U.S. tax for income items such as dividends, interest, and royalties are not enjoyed by a U.S. citizen who is a tax resident of the Netherlands. Instead, a form of relief is provided in Article 25 (Methods of Elimination of Double Taxation).[13]

Where the saving clause applies to a U.S. citizen residing in the Netherlands who receives a dividend from a U.S. corporation, the Netherlands is required to allow a reduced tax credit for U.S. taxes paid on U.S. source dividend income. The credit is capped at the applicable rate of withholding tax provided by the Treaty, 15% for individuals. In turn, the U.S. is required to allow a foreign tax credit for the residual Dutch tax paid in excess of the 15% deemed withholding tax and will treat the income as if it were derived from foreign sources. However, a profit distribution by an L.L.C. to a resident of the Netherlands is generally not treated as a dividend. In discussing the scope of Article 10 (Dividends), the Technical Explanation of the 2004 Protocol to the Treaty prepared by the Treasury Department states the following:

> [A] distribution by a limited liability company is not characterized by the United States as a dividend and, therefore, is not a dividend for purposes of Article 10, provided the limited liability company is not taxable as a corporation under U.S. law.

The same problem does not exist with regard to U.S. L.P. 2, which as mentioned above, is treated as a tax transparent entity in the U.S. and the Netherlands. Also as mentioned above, both U.S. L.P. 2 and the trust are treated as transparent for Dutch tax purposes. In the U.S., similar treatment is provided to U.S. L.P. 2, and the trust is treated as a conduit to Mrs. X to the extent that the proceeds of income recognized by the trust are distributed to Mrs. X in the year income is recognized or deemed distributed in that year under the 65-day rule discussed above.

DUTCH VIEW OF ECONOMIC DOUBLE TAXATION

In 2010, when the regime for the taxation of separate private property was introduced in the Netherlands, the risk of double taxation as a result of the attribution rules was recognized by Dutch lawmakers, as illustrated by the following quote from the discussion of the new regime in the Dutch Second Chamber (the Dutch "House of Representatives"). An unofficial, but accurate, translation of the quote is as follows:

> In principle, a tax treaty does not limit the Netherlands to determine, due to a change in the law, that its residents will be deemed to receive income from the APV and subject this income to personal income tax, while another country taxes the same income at the level of a different person with personal income tax. Then, the result

[12] Paragraph 1 of Article 24 (Basis of Taxation).

[13] Paragraph 6 of Article 25 (Methods of Elimination of Double Taxation).

is economic double taxation in the sense that the same income is taxed at the level of more than one taxpayer. There is no legal double taxation in the sense that the same income is taxed twice at the level of the same taxpayer. In principle, the purpose of a tax treaty is not to prevent economic double taxation and as such does not protect against this.[14]

POTENTIAL SOLUTION

In the scenario that an applicable tax treaty does not provide a solution for double taxation issues, and neither country provides a unilateral solution, double taxation may be solved by competent authority proceedings under Article 29 of the Treaty.

In 2019, the competent authorities of the Netherlands and Germany reached a competent authority agreement in a case that is somewhat similar to that of Mrs. X.[15] In that case, a Dutch tax resident held an interest in a German *Kommanditgesellschaft* ("KG"). From a Dutch tax perspective, the KG was a non-transparent entity. From a German perspective the KG was a transparent entity. As a consequence, the German tax authority considered the Dutch Tax Resident to have a permanent establishment in Germany. At the same time, the Dutch tax authority considered the taxpayer to hold the shares in a German corporation. As such, the taxpayer was subject to Dutch income tax on profits received from the corporation. The applicable tax treaty did not provide for a solution for double taxation in this scenario.

The competent authorities agreed to relieve the double taxation by treating the KG as an opaque entity under German law. As a result, the Netherlands decreased its taxable income with a notional deduction of 30% to allow for a fictitious German income tax on the profits of the permanent establishment. In addition, the Netherlands allowed for a 15% foreign tax credit, to simulate the tax credit on dividends received by a Dutch taxpayer from a German company.

If, in the case of Mrs. X, a similar approach is applied, the distributions from U.S. L.L.C. 1 that are included in the Dutch taxable income of Mrs. X could be decreased by 21%, the U.S. Federal corporate income tax rate. In principle, the remaining 79% would be taxable in the Netherlands at a rate in the range of 31%, depending on various factors. On this fictitious profit distribution, Mrs. X should be allowed to claim a 15% foreign withholding tax credit. As a result, Mrs. X would pay 24.5% Dutch personal income tax on the income she receives from the trust insofar this income is allocable to U.S. L.L.C. 1. In principle, the U.S. should allow Mrs. X to claim a foreign tax credit for the residual Dutch personal income tax she incurs and to treat most of the income as foreign source income for foreign tax credit purposes.

Alternatively, the competent authorities may simply determine that an approach similar to that which appears in Paragraph 6 of Article 25 (Methods of Elimination of Double Taxation).

If self-help is required to address the issue, U.S. L.L.C. 1 may consider converting itself to a limited partnership under relevant state law. Because U.S. L.L.C.1 is currently classified as a partnership for U.S. income tax purposes, this would not

[14] Parliamentary documents II 2009/10, 31930, no. 18, p.2.

[15] Decree of 14 December 2020, no. 63177.

require the admittance of an additional partner. Under U.S. tax law, a conversion of a partnership from L.L.C. form to L.P. form is generally treated as a continuation, which is a nonrecognition event in the U.S.[16] It is likely, however, that such a conversion would result in capital gain recognition for Dutch tax purposes, assuming that the interest in U.S. L.L.C. 1 has increased in value when measured in terms of euros.[17]

CONCLUSION

It is often thought that the use of U.S. trusts can be disastrous for Dutch taxpayers. This article illustrates that, while the tax treatment of a structure involving a trust and an L.L.C. can result in very high taxation, with proper planning and restructuring it is possible to obtain a favorable outcome. If it is too late for tax planning, as was the case for Mrs. X, a solution can be sought via the competent authorities of the Netherlands and the U.S.

"It is often thought that the use of U.S. trusts can be disastrous for Dutch taxpayers."

[16] Code §708.

[17] Article 4.16(1)(g) Personal Income Tax Act of 2001. Also see the publication of the Knowledge Group of the Dutch tax authority of July 18, 2023, KG:003:2023:3, holding that the conversion of an opaque Dutch partnership into a transparent Dutch partnership results in a capital gain.

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

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Tags
Anti-Avoidance Rule
G.A.A.R.
Nordcurrent
P.S.D.
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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

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.

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.

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.

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

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.

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.

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.

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.

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.

---

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.

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.

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

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.

Special deductibility restrictions apply for transactions with noncooperative states[5]

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

[5] Noncooperative states are those that are not member states of the EU, whose

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 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.

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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.

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."

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.

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

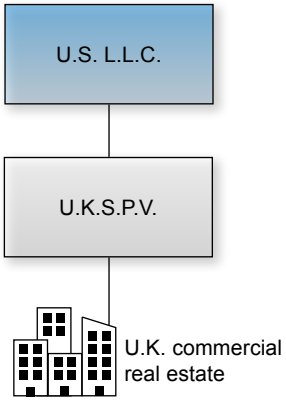
Under the Income Tax Treaty, the U.K. is entitled to tax gains realized by a U.S. resident on the disposal of real property located in the U.K. Further, in contrast to the Estate Tax Treaty, the U.K.'s taxing rights extend to shares in a company that derives its value directly or indirectly from U.K.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

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.

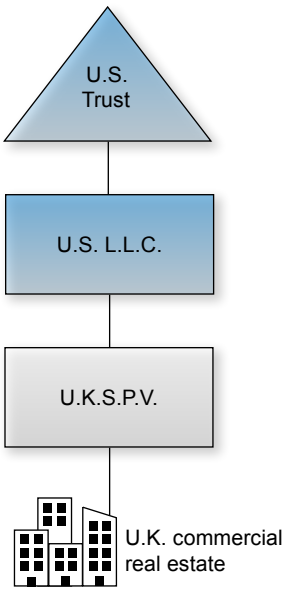
It is generally considered optimal to have a separate S.P.V. for each property – on an onward sale, a purchaser of the shares in U.K. S.P.V. will pay stamp duty (at 0.5%) rather than S.D.L.T. on the transaction.

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."

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.
Italy
Real Estate
Redditi d'Impresa
Redditi Diversi
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.

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.

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."

STRATEGIC CONSIDERATIONS FOR INTERNATIONAL INVESTORS IN DUTCH REAL ESTATE

Author
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Tags
C.I.T.
Netherlands
Real Estate
R.E.T.T.
T.O.G.C.
Vastogoedlichaam
V.A.T.
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.

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.

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.

A.L.P. OR B.L.T. FOR A.M.P.? FULL DEDUCTIONS FOR ADVERTISING, MARKETING, AND PROMOTIONAL ACTIVITY ON TRIAL IN INDIA

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Tags
A.M.P. Expenses
Arm's Length Principle
B.L.T.Brand Building Expenses
India
Intangible Property
Transfer Pricing

INTRODUCTION

Several Indian transfer pricing cases regarding the treatment of marketing expenses are about to be addressed by the Indian Supreme Court on appeal by the Indian tax authorities ("I.T.A."). This controversy will be of interest to multinational groups with Indian operations that incur advertising, marketing and promotion ("A.M.P.") expenses to attract customers[1] and generate sales when the group must follow the arm's length principle ("A.L.P.") when pricing intercompany transactions.

This article addresses the differences between the Indian and U.S. administrative rules and controversy environments. Through the use of a Q&A format, the authors have been asked questions reflective of international norms and respond with insights on the arguments critical to the resolution of cross border A.M.P. cases.

BACKGROUND TO THE A.M.P. CASES

The A.M.P. cases reflect a series of long-running controversies between (i) the Indian subsidiaries of various multinational enterprises such as Suzuki Motors, Sony Ericsson, Whirlpool, Canon, Toshiba, PepsiCo and (ii) the Indian transfer pricing officer ("T.P.O.") concerning the annual level of deductible A.M.P. expenses. While it is clear that the purpose of the expenses in issue was to increase brand awareness in the Indian market designed to increase sales volume of Indian subsidiaries, the use of globally well-known trademarks in India has caused the I.T.A. to question which company – the Indian subsidiary or its foreign parent – should incur the A.M.P. expense under relevant A.L.P. rules. The approach taken by the I.T.A. differs from the approach under U.S. transfer pricing rules that appear in Treas. Reg. §1.482-4 and under their counterpart in Chapter VI of the O.E.C.D. Guidelines. This divergence is not unexpected.

The Indian approach to transfer pricing has departed from international norms for many years, and the country routinely stands out as (i) a vocal defender of its tax base in O.E.C.D. proceedings and draft policy releases[2] and (ii) a key promoter of U.N. transfer pricing policy as an alternative to the O.E.C.D. approach. It is not surprising, therefore, that the Competent Authority is known for promoting bilateral acrimony, although its relationship with the U.S. has been repaired in recent years.

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[1] A.M.P. expenses do not include selling activities such as trade discounts or volume discounts.

[2] The O.E.C.D. Amount B draft contained 12 notes, seven of which were marked "Note by India." India was the only country to request notes. (O.E.C.D. (2024), *Pillar One - Amount B: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris, https://doi.org/10.1787/21e-a168b-en.)

The country's history in transfer pricing matters has been influenced by its unique factors:

- Considerable population and productive capacity
- Relatively low cost of labor
- High skill levels and innovation in several sectors
- Import substitution
- Rapid technological development
- Global success of Indian multinationals
- Recent growth of household income
- A large population of consumers

Foreign multinationals recognize India as a significant consumer market with great potential. A.M.P. is needed to reach these consumers, as consumers can choose between products offered by many manufacturers or distributors.

QUSTIONS & ANSWERS

Q1. What are the A.M.P. cases in more detailed terms, and to what extent are the cases similar?

Under the Indian Income Tax Act, 1961 ("I.T. Act"), any expenditure, unless otherwise restricted, that is wholly and exclusively incurred for the purposes of the business or profession is allowable as a deduction when computing income chargeable to tax under the category of profits and gains of a business or a profession. Expenditures for marketing and advertising activities that are incurred wholly and exclusively for the purposes of the business are allowable as business expenditures.

The Indian transfer pricing ("T.P.") provisions that run parallel provide that any income arising from an international transaction must be computed at an arm's length price that is consistent with the A.L.P.

The two parallels collide when the I.T.A. makes transfer pricing adjustments, asserting that expenditures by the Indian entity on A.M.P. activities while operating under a license to use brands owned by a related foreign entity is not wholly deductible. This approach ushered in an era of litigation, which currently awaits final outcome before the Supreme Court of India.

A.M.P. disputes usually arise where a foreign brand owner owns an Indian entity that manufactures goods in India or distributes goods or services manufactured or provided by the foreign brand owner. That brand owner grants a license in favor of its Indian affiliate to use the brand, trademark, and know-how of the owner. There may or may not be a royalty paid as consideration for the license granted to the Indian entity.

The amount spent by the Indian entity on A.M.P. activities is paid to unrelated parties in India. Under a plain-language reading of the provisions of Chapter X of the I.T. Act, the expenditures do not constitute an international transaction between related

parties. To elaborate, a transaction is defined in the I.T. Act to include an arrangement, an understanding, or an action that is conducted in concert. An international transaction is defined in the I.T. Act to mean a transaction between two or more related parties, where one or both are nonresident for Indian tax purposes. Consequently, T.P. provisions for international transactions apply when at least one party to the transaction is a nonresident and both parties are related.

The I.T.A. has rejiggled the basic fact pattern involving A.M.P. activities between two Indian resident companies into an excess A.M.P. expense incurred by the Indian subsidiary in a deemed transaction with its nonresident affiliate. It contends that a portion of the A.M.P. constitutes marketing services provided to the foreign brand owner for which reimbursement plus a mark-up is due. The excess is measured using the bright line test ("B.L.T.") that compares (i) the ratio of the annual A.M.P. expense to sales of the Indian entity with (ii) the ratios of annual A.M.P. expense to sales of the comparable companies.

All cases involving A.M.P. issues are similar given they revolve around the fundamental question of whether the excess expenditure incurred for A.M.P. activities can be construed to be an international transaction between the Indian entity and its foreign related party, and thereby subject to T.P. provisions.

Q.2. Courts in India looked at the matter of A.M.P. in the LG Electronics case. Is the precedent reached in that case at stake in the three cases that will be presented to the Supreme Court?

The A.M.P. controversy first reached the courts in 2010, in *Maruti Suzuki India Ltd. (MSIL) v. ACIT.*[3] There, the Delhi High Court set aside the order of the T.P.O. and remanded the case, observing that A.M.P. expenditures from a domestic entity related to a foreign entity on A.M.P. activities regarding a foreign trademark or brand did not require any payment or compensation from the foreign owner so long as the A.M.P. expenses incurred did not exceed the A.M.P. expenses that would have been incurred by a similarly situated and comparable independent domestic entity. In the event excess expenditures were incurred by the related Indian entity, the foreign related party would need to compensate the domestic party for the excess A.M.P. expenditures. According to the court, the excess amount reflects a form of brand building that benefits the owner of the brand. The excess amount incurred by the related Indian entity must be augmented by an arm's length mark-up that compensates the Indian affiliate for the deemed performance of an intercompany service.

The decision was appealed, and in 2011, the Supreme Court of India[4] directed the T.P.O. to disregard the guidance given by the Delhi High Court in computing a T.P. adjustment on account of A.M.P. activities. Nonetheless, the decision of the Delhi High Court paved the path for the B.L.T. approach. Under the B.L.T. approach, one portion of A.M.P represents routine business expenses, and the remainder represents the amount spent on brand building.

In 2013, a special bench of the Income Tax Appellate Tribunal ("Tribunal") interpreted the T.P. provisions in a fact pattern similar to the *Maruti Suzuki India Ltd.* In *L.G. Electronics India (P.) Ltd. V. ACIT,*[5] the Tribunal determined that the ratio of A.M.P.

[3] 328 ITR 210 (Delhi High Court, 2010).

[4] *Maruti Suzuki India Ltd. v. ACIT*. 335 ITR 121 (Supreme Court of India, 2011).

[5] 22 ITR(T) 1 (Delhi -Trib. (SB), 2013).

expenditures incurred to sales was greater than the ratio found in comparable situations between two unrelated entities. That latter ratio was considered by the Tribunal to be a bright line that separated routine A.M.P. expenditures from brand building services benefiting a foreign related party. In that manner, the Tribunal inferred the existence of an international transaction between L.G. Electronics India and its foreign related entity. Viewed in this light, it was immaterial that the payments funding A.M.P. activities were made to third parties. The international transaction was embodied in the domestic payment made on behalf of the foreign related party that assisted the latter in adding value to the brand in the Indian market.

The issue arose again in 2015 before the Delhi High Court in *Sony Ericsson Mobile Communications India (P.) Ltd. v. CIT.*[6] There, Indian entities engaged in distribution and marketing of products manufactured and sold by related nonresident entities. The High Court upheld the I.T.A.'s assertion that the expenditure pertaining to A.M.P. was in the nature of an international transaction, primarily pursuant to the concession given by the entities therein that there existed an international transaction for incurring cost *vis-à-vis* A.M.P. activities. However, while doing so, the High Court held various principles applied in the case of *LG Electronics* to be erroneous. Among various guidelines in this decision, the most important was the rejection of the B.L.T. The High Court expressed concern that the B.L.T. lacked statutory authorization, and as such, would amount to judicial legislation. Additionally, the High Court observed that, in cases where the T.P.O. accepts the comparables adopted by the Indian entity using the Transactional Net Margin Method ("T.N.M.M."), no separate adjustment for A.M.P. would be warranted provided the profit margin of the Indian entity matches the margins of the comparable companies. The High Court remanded the A.M.P. issue to the T.P.O. to determine whether the A.L.P. of the international transaction was consistent with recognized T.P. principles in India. While favorable for the taxpayer, the decision applied only where a distributor accepted that the A.M.P. activity comprised an international transaction.

In December 2015, the Delhi High Court issued a revised decision in *Maruti Suzuki India Ltd. v. CIT,*[7] holding that no international transaction existed to trigger application of the T.P. provisions where an Indian manufacturing entity received no oral or written direction from its foreign related entity regarding brand building services. The I.T.A, was allocated the burden of proof to demonstrate that an agreement existed and the B.L.T. could not be used to meet that burden. The High Court went on to state that, in the absence of any substantive provisions contained in the I.T. Act to recognize the existence of an international transaction resulting from A.M.P. expenses, a T.P. adjustment could not be made. This decision has been appealed to the Supreme Court level and is currently awaiting adjudication.

In another decision, *Honda Siel Power Products Ltd vs. DCIT*,[8] the Delhi High Court held that the existence of a license giving an Indian entity the right to use a brand name does not imply the existence of a further understanding or arrangement under which the A.M.P. expense is to be used for promoting the brand of the foreign related party.

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6 374 ITR 118 (Delhi, 2015).

7 381 ITR 117 (Delhi, 2016)

8 283 CTR 322 (Delhi, 2016)

In the meanwhile, the I.T.A. identified another method to make A.M.P. adjustments, known as the intensity approach. Under this approach, A.M.P. expenditures of a taxpayer are computed as a percentage of sales as a means to compute the intensity of A.M.P. expenditures. Similar average intensity computations are made for comparable companies. To the extent the taxpayer's intensity exceeds the average intensity of comparable companies, brand awareness services are deemed to be provided to the foreign related party. In *Widex India Private Limited*,[9] the Chandigarh bench of the Tribunal characterized the intensity approach as mirror image of B.L.T., and was held to be invalid.

In a nutshell, the following main issues in relation to A.M.P. expenses are pending adjudication before the Supreme Court as of December 1, 2025:

- Do A.M.P. expenses incurred by Indian entities constitute an international transaction under the Indian transfer pricing provisions?
- If so, what methodology should be adopted to compute the arm's length price of the A.M.P. expenses?
- Can the B.L.T. be used to benchmark A.M.P. transactions?
- Is a transfer pricing adjustment regarding A.M.P. expenses warranted if the transactions are found to be at arm's length under the T.N.M.M.?

Q.3. On a global basis, are the A.M.P. cases properly viewed to be recharacterization cases?

Yes, the A.M.P. cases can be viewed to be recharacterization cases. The T.P.O. regularly construes alleged excessive A.M.P. expenditures by an Indian entity as expenditures incurred for promotion of the global brand of a foreign related entity, even when no such transaction exists in reality.

Under the law, the T.P.O. is required to examine an international transaction as he finds it. The task of the T.P.O. is to determine the arm's length price of an international transaction in accordance with the methods prescribed under the I.T. Act. Accordingly, the powers accorded the T.P.O. under the law cannot be exceeded simply by recharacterizing a transaction. The existence of an international transaction cannot be a matter for inference or surmise.

In *CIT vs. EKL Appliances Ltd.*,[10] the Delhi High Court ruled that the I.T.A. cannot recharacterize a transaction except in exceptional circumstances where

- the economic substance of a transaction differs from its form or
- the form and substance of the transaction are consistent, but arrangements made in relation to the transaction differ from those that would have been adopted by independent enterprises behaving in a commercially rational manner, when viewed in their totality.

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[9] ITA No. 269/CHD/2017

[10] 2012 (4) TMI 346

If the Supreme Court holds that A.M.P. expenditure does not constitute an international transaction, the issue of recharacterization would stand resolved. It is the position of the I.T.A. that transfer pricing adjustments are required for some or all of the A.M.P. expenses because an embedded service is provided by the Indian resident for the benefit of a related foreign person. If that approach of the I.T.A. is invalidated, no related party transaction will have been viewed to occur.

Q.4. A question exists as to why the A.M.P. cases are not viewed simply as disputes focused on the terms of a particular licensing agreement and the question of whether a third-party licensor would impose comparable A.M.P. expenses on an independent licensee. Why did the T.P.O. take the B.L.T. approach rather than relying on licensing agreement comparability analysis arguments.

It is difficult to assume the exact reason why the I.T.A. relied so heavily on the B.L.T. approach. One possible reason is that the B.L.T. method allows the I.T.A. to adopt an easier route to make an adjustment. It simply requires access to data of comparable companies in the same industry as available in the databases and usage of appropriate search query and filters.

"It is difficult to assume the exact reason why the I.T.A. relied so heavily on the B.L.T. approach."

The legal problem that has been encountered is that this approach cannot be sustained. The level and nature of A.M.P. spending depends on a variety of business factors like market share, market environment, contractual mechanisms, and management policies. All of these can differ within the same industry as many are company specific.

Q.5. Is the B.L.T. viewed as an application of T.N.M.M.? It is so different than anything we see in the U.S. that readers could confuse the approach with the ratio-driven approach taken in formulary apportionment or the Amount A and B computations underlying Pillar 1.

Use of the B.L.T. is indeed a unique phenomenon. Interestingly, there is a view that the concept originated in a U.S. case,[11] perhaps building on the Tax Court analysis of developer or assister expenses in comparison to promotional expenses of a comparable trademark licensee at arm's length.

As discussed above, the B.L.T. compares (i) the ratio of the annual A.M.P. expense to sales of the Indian entity with (ii) the ratios of annual A.M.P. expense to sales of comparable companies. The benefit of the approach from the I.T.A.'s viewpoint is that the data supporting the adjustment requires number crunching through usage of specialized databases. The weakness is the absence of qualitative adjustments based on particular facts and circumstances.

In any event, B.L.T. is a method that is not prescribed anywhere in the Indian T.P. provisions. This is the reason why the B.L.T. method was rejected by the Delhi High Court in *Sony Ericsson* and the *Maruti Suzuki* decisions.

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[11] *DHL Corp. v. Commr.*, T.C. Memo 1998-461C, *revd*. 285 F.3d 1210, (9th Cir. 2002).

Q.6. Selling and distribution cost is a wide category. Advertising and marketing expenses tend to increase with new product launches and promotions, which may differ across companies in timing and strategic emphasis. Foreign brands like Suzuki (despite the long-term Maruti association) and domestic brands advertise and promote from fundamentally different starting points. Tata is known for a great many products, including tea, Mahindra makes tractors, and Hindustan Motors stopped producing the Ambassador, known widely as a taxi model (like the Ford Crown Victoria in the latter part of the 20th century in New York City), in 2014 and might not sell any more Ambassadors with even an infinite advertising budget.

The prior decisions indicate that some comparability analysis was conducted by the Tribunal with respect to selling and distribution cost of MSIL and the selected comparable companies. This misses much of comparability analysis that is expected in transfer pricing matters under most country and multilateral rules.

Why did the T.P.O. focus on what appears to be a very simple ratio analysis and ignore the ratio components for the comparables – Tata Motors, Hindustan Motors, Mahindra & Mahindra?

Selling and distribution costs cover a wide and diverse category of expenses. Advertising and marketing expenses are highly sensitive to factors like new product launches, promotional cycles, and strategic positioning of a brand. Comparing Maruti Suzuki with companies such as Tata, Mahindra, or Hindustan Motors without unpacking those contextual drivers oversimplifies the issue.

Those differences may explain why the T.P.O. performed a simple ratio analysis rather than a deeper comparability study. Several practical reasons suggest why the T.P.O. focused on the B.L.T.

- **Ease of administration:** Ratio analysis of selling and distribution costs to sales is easy to quantify. It allowed the T.P.O. to draw conclusions about excess A.M.P. without accurately identifying the substance of the costs, the contractual responsibilities, or the brand-specific context.

- **Lack of availability of detailed data / information constraints:** Detailed cost breakdowns for comparables – such as how much Tata spends on truck promotions rather than passenger cars, or how Mahindra allocates A.M.P. between tractors and sport utility vehicles – are not typically available in the public domain. Without those granular disclosures, the T.P.O. relied on top-line ratios, even if those are not truly comparable.

- **Revenue-oriented approach:** A nuanced functional analysis would likely show that Maruti's A.M.P. expenditures were aligned with its role as a full-fledged manufacturer and market leader, and were not incurred as an excess service to Suzuki. By sticking to a simplistic ratio-based approach, the T.P.O. effectively created a framework in which excess A.M.P. would almost always be identified, thereby ensuring adjustments even when the expenditure could be commercially justified as part of a manufacturer / distributor's normal business operations.

Q.7. The examination of the MSIL 2006/2007 tax year transfer pricing positions was concluded with no change. This suggests that the notion of MSIL paying A.M.P. expenses to raise Suzuki brand awareness in India is a non-starter, as foreign tourists visiting India likely do not go home and buy a vehicle from a Suzuki dealer because they watched Maruti-Suzuki ads or visited showrooms in India.

If all the other transactions of MSIL were found to be arm's length, what does this case suggest as the means by which Suzuki obtained a benefit from the allegedly excessive MSIL A.M.P.?

A search of the WIPO brand trademark database showed MSIL to be the owner of a number of different Maruti-Suzuki marks. How can the T.P.O. contend that A.M.P. expenditure in respect of the Indian automotive market by MSIL promoted anything other than the company's own intangible property? Suzuki sells motorcycles in India under the Suzuki brand, but the positive effect of A.M.P. on motorcycle sales is not taken into account.

The identified factors go to the root of the dispute. The Delhi High Court in *Sony Ericsson* dismissed the T.P.O.'s argument that huge spending on A.M.P. expenses amounted to brand building and trademark enhancement of the brand owned by the foreign related party. To that end, the High Court observed the following:

> To assert and profess that brand building as equivalent or substantial attribute of advertisement and sale promotion would be largely incorrect. It represents a coordinated synergetic impact created by assortment largely representing reputation and quality. There are a good number of examples where brands have been built without incurring substantial advertisement or promotion expenses and also cases where in spite of extensive and large scale advertisements, brand values have not been created. Therefore, it would be erroneous and fallacious to treat brand building as counterpart or to commensurate brand with advertisement expenses. Brand building or creation is a vexed and complexed issue, surely not just related to advertisement.[12]

"The Delhi High Court in Sony Ericsson dismissed the T.P.O.'s argument that huge spending on A.M.P. expenses amounted to brand building and trademark enhancement of the brand owned by the foreign related party."

The Delhi High Court in the above case also held that brand-building is a journey and brand value depends on a number of factors including the quality and nature of goods and services. Therefore, it would be incorrect to state that advertising is synonymous with brand-building as the latter in a commercial sense involves several factors and components, the primary element being the quality and reputation of the product or the name, which is acquired gradually and silently over a span of time.

Judicial precedents have held that merely because there is an incidental benefit to a foreign related party, it cannot be said that the A.M.P. expenses incurred by the Indian entity were made to promote the brand of a foreign related party. The increase in brand value happens at a very slow pace over a long period of time and there

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[12] Taxbymanish. "Transfer Pricing Applicable on AMP, Brightline Test Rejected: Delhi HC." Tax of India, February 13, 2016.

cannot be direct correlation between A.M.P. expenditure and brand value because brand value depends upon numerous other factors which may not be linked with A.M.P. expenditure.

Thus, the arguments of the I.T.A. to connect 'brand building' with substantial A.M.P. spending have been rejected in the cases discussed above.

Q.8. Several references were made in the lower court decisions to a batch approach for transfer pricing cases. The procedure seems to be to hear a number of like cases at once, as opposed to the U.S. approach of individual cases being designated for litigation by the I.R.S. due to their potential precedential value and the high possibility of success. What advantage do you see to the Indian batching approach?

The volume of income-tax litigation currently pending before the Courts in India is significant. To address situations where multiple taxpayers face a common legal issue, the appellate courts in India often consolidate such matters into a batch of cases involving a shared/similar question of law. This approach facilitates a more efficient and consistent adjudication, enabling speedier resolution of a recurring tax dispute.

Q.9. In the U.S., the I.R.S. field examiner and the national equivalent of the T.P.O. cease direct involvement in a case generally at the Appeals level, unless directed by a court. The T.P.O. remained engaged throughout almost all levels of appeals in India. Does this approach in India help with the application of transfer pricing case law precedent in India to ongoing field audit controversy in India?

Even in India, T.P.O.'s usually take a back seat once an assessment is concluded. They generally are not involved if an assessment is challenged before the appellate authorities. However, since transfer pricing is a technical subject, T.P.O.'s are consulted by counsel representing tax authorities on various occasions – and in some instances by the judicial authorities – to provide comments and assistance on the approach they adopted in a particular matter. This helps the judicial authorities and counsel for the revenue authorities in understanding the intricacies of a transfer pricing dispute.

Q.10. Might the cases awaiting a decision in the Supreme Court of India be resolved differently by Competent Authorities engaged in a Mutual Agreement Procedure under the relevant tax treaty?

Why did the A.M.P. cases end up in protracted litigation in India rather than in Competent Authority proceedings, especially as Competent Authority decisions made under an income tax treaty, if accepted, supersede country law in many instances?

In a perfect world, the issue before the Supreme Court of India should have been addressed through the Mutual Agreement Procedure under relevant income tax treaties.

Having said that, the stakes in A.M.P. litigation are very high. The I.T.A. is not keen in resolving A.M.P. disputes under the Mutual Agreement Procedure of a relevant

income tax treaty for several possible reasons. The first is that Mutual Agreement Procedures involve a degree of "horse trading." The I.T.A. is not interested in stepping back from its position and feels it has a better opportunity to win in the Supreme Court of India. This view may be supported by institutional memory that looks back at the I.T.A.'s initial victory in the first court hearing involving an A.M.P. deduction. Second, the I.T.A. may feel uncomfortable arguing its position against senior tax officials representing the treaty partner jurisdiction. Specious arguments presented by the I.T.A. in the course of a Mutual Agreement Procedure may be met with chuckles from the other side, resulting in a loss of "street cred" among Competent Authority peers.

CONCLUSION

The transfer pricing issue involving A.M.P. expenditures by Indian entity of foreign multinationals is now under consideration the Supreme Court of India. Nothing will change until a decision is entered.

ABOLITION OF THE NON-DOM REGIME: THE STATE OF TAX PLANNING FOR U.S. PERSONS WITH U.K. CONNECTIONS

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Tags
Bare Trust
F.I.G.
I.H.T.
L.T.R.
Substantive Trust
T.R.F.
U.S.-U.K. Estate Tax Treaty

INTRODUCTION

For over 100 years, individuals who were domiciled outside of the U.K. have benefitted from the non-dom tax regime. Many readers will be familiar with the key features of this regime. It allowed individuals who were not domiciled in the U.K. to defer the imposition of U.K. taxation on income and gains derived from sources outside U.K. until remitted. It also meant that only U.K. situs assets of an individual domiciled outside the U.K would be subject to U.K. inheritance tax ("I.H.T.").

The non-dom tax regime was abolished earlier this year and was replaced with a new system based on residency rather than domicile. The new system came into place on April 6, 2025, with the start of the new fiscal year. This article will explain the key features of the new rules and explore the impact on tax planning for U.S. persons with U.K. connections.

KEY FEATURES OF THE NEW REGIME

- For I.H.T. purposes, from 6 April 2025, individuals who have been resident in the U.K. for at least ten of the previous twenty tax years are regarded as long-term residents ("L.T.R.'s") in the U.K. The worldwide estate of an L.T.R. will be subject to I.H.T. on death and in relation to certain lifetime gifts, subject to any available reliefs and exemptions.
- Potential I.H.T. exposure will continue for a tail period of between three and ten years once the L.T.R. ceases to be a U.K. resident. The length of the tail will depend on the number of years during which the L.T.R. was resident in the U.K. The tail will be subject to the limitations provided in the U.K.-U.S. Estate Tax Treaty ("E.T.T.").
- The remittance basis has been abolished. It has been replaced with the new Foreign Income and Gains ("F.I.G.") regime. In any particular tax year, it is only available to individuals who were not U.K.-resident in any of the previous ten tax years. If eligible for the F.I.G. regime, newly U.K.-resident individuals may claim an exemption from U.K. tax on non-U.K. source income and gains.

We will explore these rules in further detail by reference to a case study. The new rules are complex and, as ever, a detailed understanding of the new rules is crucial in understanding recent tax legislation. The examples in the two case studies that follow provide an overview of the types of issues that U.S. persons with U.K. connections may face at the time of arrival and departure.

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CASE STUDY NO. 1

Background Facts

Kate is a U.S. citizen. She was raised in New York where she attended university. On being graduated in 2000, she took a job at a global corporation based in New York. After ten years, she was offered the chance to move to London to lead a team in the London office. She accepted the transfer and moved to the U.K. Her first year of tax residency in the U.K. was in the U.K. tax year 2010/11.[1]

In 2017, Kate married Alan. Alan is a U.K. national. They have two children, Joe who is four years old and Charlotte who is three years old.

In 2025 Kate and her family decide to move to New York. Their plan is to spend Christmas in London and move to the U.S. in January 2026. Kate will remain a U.K. resident in the tax year 2025/26 and will lose U.K. residency as of April 6, 2026.

Kate owns a small apartment in New York which she has been renting out since she left New York City in 2010. She intends to retain the rental unit after her return to New York. She also has an investment portfolio custodied in New York and an individual retirement account ("I.R.A."). Kate and Alan also jointly own a house in London which they plan to sell when they leave the U.K.

Residency Status

Kate has been resident in the U.K. for more than ten tax years and is designated as an L.T.R. under the new tax regime. This means that should her life end within a specified period of time after her departure, her worldwide estate will be subject to the U.K. I.H.T. regime. This is often referred to as a tail period. The length of the tail will depend on the number of years she was resident in the U.K.

Length of Residence	Date When Tail Terminates
Under 10 years	Not L.T.R. at all
10 to 13 years	After 3 more tax years
14 years	After 4 more tax years
15 years	After 5 more tax years
16 years	After 6 more tax years
17 years	After 7 more tax years
18 years	After 8 more tax years
19 years	After 9 more tax years
20+ years	After 10 more tax years

[1] The U.K. tax year runs from April 6 of one calendar year to April 5 of the next calendar year.

Kate has been resident in the U.K. since the tax year 2010/11. Consequently, she will have been resident for 16 years at the point she ceases to be U.K. resident, determined as of the start of the next following U.K. tax year, April 6, 2026. This means her tail period will last for six tax years. She will cease being an L.T.R. on April 6, 2032.

The same set of rules apply to Alan. Since he has been U.K. resident for more than 20 years, he will have a tail period of 10 years. He will cease being an L.T.R. on April 6, 2036.

"It remains to be seen whether the U.K. will seek to amend the treaty, but for now there seems to be consensus among advisors that this is how the I.H.T. and the E.T.T. will operate."

E.T.T. Relief

There may be some protection available to Kate under Article 5 (Taxing Rights) of the E.T.T. As a U.S. citizen, so long as Kate has never acquired U.K. nationality, the E.T.T. may reduce or eliminate the I.H.T. tail exposure. At present, the relevant paragraphs for Kate to be taxed only in the U.S. are Paragraphs 1 and 5. They provide as follows:

> (1)
>
> (a) Subject to the provisions of Articles 6 (Immovable Property (Real Property)) and 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services) and the following paragraphs of this Article, if the decedent or transferor was domiciled in one of the Contracting States at the time of the death or transfer, property shall not be taxable in the other State.
>
> (b) Sub-paragraph (a) shall not apply if at the time of the death or transfer the decedent or transferor was a national of that other State.
>
> * * *
>
> (5) If by reason of the preceding paragraphs of this Article any property would be taxable only in one Contracting State and tax, though chargeable, is not paid (otherwise than as a result of a specific exemption, deduction, exclusion, credit or allowance) in that State, tax may be imposed by reference to that property in the other Contracting State notwithstanding those paragraphs.

It remains to be seen whether the U.K. will seek to amend the treaty, but for now there seems to be consensus among advisors that this is how the I.H.T. and the E.T.T. will operate.

For the purposes of the case study, let us assume that Kate acquired U.K. nationality and so is not assisted by Article 5 of the E.T.T.

Kate's U.S. Estate Plan

In September 2026, Kate decides that she needs to think about her estate plan and visits an attorney in New York City to discuss her options. Her attorney suggests

setting up a revocable living trust and transferring her assets into it. This will enable her estate to avoid probating her will. It also means it would be easier to manage assets on her behalf if she were to become incapacitated. The trust is a grantor trust for U.S. income tax purposes, and for that reason, will be disregarded under U.S. income tax rules. Consequently, all income and gains of the trust will be treated as belonging to its grantor, namely Kate.

Notwithstanding the favorable tax treatment in the U.S., Kate still needs to think about the U.K. tax implications of setting up a revocable living trust because she remains an L.T.R. until April 6, 2032. Tax law in the U.K. does not provide for the concept of revocable living trusts in the same way as the U.S. The general position is that, during the lifetime of the grantor, the trust will be treated as either (i) a bare trust (*i.e.* a nominee arrangement for the grantor, also found in Canadian tax law) or (ii) a fully constituted substantive trust. There are no clearly defined rules to determine whether a trust is bare or substantive. The final determination will depend on the terms of the trust and whether, on balance, the U.K. tax authority considers the trust is more akin to a U.K. bare trust or to a U.K. substantive trust.

A bare trust will be treated as a look-through for U.K. purposes, much like in the U.S. A substantive trust will instead be taxed under a separate taxing regime for trusts. If Kate sets up a revocable living trust and funds it while she remains an L.T.R., she risks triggering the following tax exposures:

- An immediate 20% I.H.T. charge on the value of the assets transferred and
- Ongoing 6% charges every 10 years under the relevant property regime,[2] until the tail drops away on April 6, 2032, essentially more theoretical than real in the facts presented.

To be clear, these charges will arise if the revocable living trust is treated as a substantive trust in the U.K. It does not matter that the trust will only hold U.S.-situs assets. Before she establishes the revocable living trust, Kate should take advice from a U.K. solicitor on how best to mitigate the risk of it being treated as a substantive trust.

Kate's estate is well below the U.S. estate tax exempt amount, scheduled to be $15.0 million as of January 1, 2026, and adjusted for inflation each year thereafter. In Kate's circumstances, she knows there will be no estate tax to pay in the U.S. at the culmination of her life. However, she still needs to consider the U.K. tax implications if she dies while an L.T.R. The exempt amount for U.K. tax purposes (known as the nil rate band) is only £325,000. Any amount above this will be subject to I.H.T. at a flat rate of 40%, unless other reliefs and exemptions are available. Kate plans to pass her entire estate to Alan if she dies before him, and so wants to benefit from the spouse exemption from I.H.T. As with the transfer of assets to the revocable living trust, Kate should take advice from a U.K. solicitor on how best to make sure that the provisions of her will are sufficient to capture the spouse exemption.

Lifetime Giving

Lifetime gifts are another area where it is easy to encounter a problem. While the U.K. does not impose a gift tax, it does impose I.H.T. In order for a lifetime gift to be

[2] The relevant property regime is the name for the special tax regime applying to most substantive trusts in the U.K.

excluded from I.H.T. at the conclusion of the donor's lifetime, the donor must survive the gift by seven years.[3] While Kate and Alan remain L.T.R.'s, this rule will apply.

U.K. Situs Assets

U.K. situs assets will always remain subject to U.K. I.H.T., even if the owner is not an L.T.R. Let us assume that Kate and Alan decide to keep their London home as an investment property, rather than sell it shortly after leaving the U.K. If the property is owned at the time of their respective deaths, Kate's half share will be included in her estate for I.H.T. purposes even after she loses L.T.R. status. The same treatment will apply to Alan.

If, for any reason, it is projected that neither Kate's estate nor Alan's estate pay any U.S. estate tax because, for example, the total value of assets is below the lifetime exclusion in the U.S., the 40% U.K. I.H.T. is a real cost. Even though the U.K. I.H.T. may be claimed as a credit against U.S. estate tax due on the U.K. property, no U.S. tax is due.

Paying the I.H.T. Bill

To the extent that the estates of Kate and Alan have an I.H.T. liability, they could consider taking out life insurance to cover the projected cost. The policy would usually be placed into trust so that the proceeds are kept outside their estates for tax purposes. The policy payout could be used to settle the I.H.T. bill without needing to sell or dip into assets earmarked for family or other priorities.

If the policy is denominated in terms of pounds sterling, risk of currency movement between the I.H.T. anticipated and the face amount of the policy can be eliminated by taking out a policy denominated in pounds sterling with an insurance carrier based in the U.K. However, premiums paid with regard to a life insurance policy issued by a non-U.S. insurance company that covers the life of a U.S. citizen or resident may be subject to a 1% excise tax.[4] Where the insurance company is a resident of the U.K., the excise tax may be waived if the U.K. resident insurance company has entered into a closing agreement with the I.R.S. and the U.K. company is not acting as a conduit to an insurance carrier based in another country. Advice of U.S. legal counsel should be taken to confirm that the conditions are met for the elimination of the excise tax.

The Other Tail

For completeness, it is also important for those leaving the U.K. to be aware of a rule relating to U.K. capital gains tax ("C.G.T."). This is a five-year rule and comes into play where (i) individuals leave the U.K., (ii) dispose of assets that do not trigger U.K. C.G.T. due to their nonresident status in the U.K. at the time, and (iii) return to the U.K. within five years of their departure. These are known as temporary nonresidence rules and are noted because of the U.K. C.G.T. implications they can cause.

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[3] This is in relation to outright gifts made to individuals or institutions. Gifts made into trust are subject to I.H.T. at the time of the gift, unless reliefs or exemptions are available

[4] Code § 4371(2).

CASE STUDY NO. 2

Kate has a brother, Nick. Like Kate, he was raised in New York where he attended university. After graduation, he moved to Silicon Valley and helped build a technology company. He still holds a 1% stake in the company although he no longer works there. He built a large investment portfolio from his salary and bonuses over the years.

Nick has been offered an executive role at a start-up in the U.K. He has decided to accept the job but doesn't know how long he will stay in the U.K. He will arrive in London on April 6, 2026, and his first tax year of U.K. residency will be 2026/27.

Nick lived in the U.K. once before. He was U.K. resident in U.K. tax years 2005/06 and 2006/07. During that time, he claimed the benefit of remittance basis taxation and sheltered all his non-U.K. income and gains from U.K. income tax and C.G.T. During that period, he participated in a liquidity event involving a U.S. business and recognized a significant gain. He invested the proceeds of that sale in a portfolio which remained segregated from his other accounts, and all the income has been paid to him every year since.

The F.I.G. Regime

Nick has not been U.K.-resident in any of the ten tax years preceding tax year 2026/27. He will therefore be eligible for the F.I.G. regime. He can claim an exemption from U.K. income tax and C.G.T. on all of his non-U.K. income and gains. He will still need to pay U.K. income tax on his U.K. salary but will not suffer any U.K. tax on his U.S. income and gains.

Tax treatment is the same under the F.I.G. regime whether the U.S. income and gains are left in the U.S. or are brought into the U.K. He will be able to claim this exemption for his first four years of U.K. tax residence. Nick could consider the following:

- If Nick thinks he is going to stay in the U.K. for longer than four years, he could sell and reinvest, or otherwise reset the value of key investments, during the four-year period. For example, he could sell out of non-reporting mutual funds, which are common in the U.S. but highly tax-inefficient in the U.K. The U.K. may treat gains from such funds as income rather than capital gains, taxing them at rates of up to 45%.
- Nick should review any U.S. L.L.C. structures which he has. Although commonplace in the U.S. and typically treated as transparent for U.S. tax purposes, the U.K. tends to treat L.L.C.'s as opaque entities for tax purposes. This means that they are treated as the equivalent of U.S. privately held corporations. This mismatch can cause double taxation problems. The U.S. will tax Nick directly on the income of the L.L.C., when and as earned. In comparison, the U.K. will tax Nick only when he receives distributions from the L.L.C. Moreover, the U.K. will provide no foreign tax credit relief for taxes previously paid by Nick in the U.S. with regard to the L.L.C.'s income.

The F.I.G. regime provides a four-year window to eligible individuals during which strategic planning can be carried out. It will be important for Nick to consider tax planning options and take implementation steps prior to becoming resident in the U.K.

The Temporary Repatriation Facility ("T.R.F.")

Nick can also make use of the T.R.F. if he brings additional funds to the U.K. The T.R.F. is a new regime which is available for a limited time and only for certain individuals. The relief may be claimed by individuals who have been U.K. residents in previous years and claimed the benefit of remittance basis of taxation during that time.

As mentioned above, prior law allowed persons domiciled abroad to defer tax on non-U.K. income and gains until proceeds were remitted to the U.K. Under the T.R.F., those individuals can now bring the proceeds of previously deferred income and gains into the U.K. tax net at a beneficial tax rate.

- Funds that are brought into the U.K. tax net in tax years 2025/26 and 2026/27 will be taxed at a flat 12% TRF rate.
- Funds that are brought into the U.K. tax net in tax year 2027/28 will be taxed at a flat 15% TRF tax rate.

The funds do not have to be physically brought into the U.K. in order to benefit from the T.R.F. Instead, by participating in the T.R.F. and paying the flat rate of tax now, Nick can bring the proceeds into the U.K. in future years without paying any additional U.K. tax. Whether it makes sense to use of the T.R.F. depends on certain variables:

- Does Nick need to supplement his U.K. salary?
- Does Nick plan to stay in the U.K. for the long term?
- Does he need capital in the U.K. to purchase real estate?

If Nick does not participate in the T.R.F. he will pay tax at full rates at the time of repatriation.

"During times of change, the value of advice of competent tax counsel is at a premium."

CONCLUSION

During the past two calendar years, tax rules in the U.K. have changed dramatically. The concept of domicile is no longer relevant to taxation, having been replaced with a residence-based test. U.S. persons with connections to the U.K. should take steps to understand the impact of the new tax rules especially with regard to I.H.T. There are also opportunities to carry out pre-arrival planning for those intending to move to the U.K. During times of change, the value of advice of competent tax counsel is at a premium.

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