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EDITORS' NOTE

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

- **Belgium Makes Progress on its Long-Awaited Tax Reform.** With a coalition government in office for 19 months, Belgium is making progress on the implementation of the ambitious tax reform that was announced when the new government was about to be sworn in. Although progress is real, it is taking shape piece by piece instead of one massive overhaul. In their article, Werner Heyvaert, Of Counsel at Advisius Tax & Legal in Brussels, and Yannick Vandenplas, an Associate at the same firm, explain the myriad of changes adopted earlier this year, including (i) the introduction of a broad capital gains tax on financial assets for Belgian individual taxpayers, followed up in administrative guidance that was issued in July, (ii) stricter rules for the dividends received deduction for Belgian corporations and for the dividend withholding tax exemption allowed to nonresident corporations, (iii) changes to the company exit tax regime, allowing for taxation of the "Liquidation Bonus" realized by individual shareholders, (iv) the adoption of a special tax regime for "carried interests," (v) an overhaul of the tax regime for newly arrived expats, (vi) a revision to the Investment Deduction regime, a tax incentive allowing Belgian businesses to deduct a notional portion of the purchase price or investment cost of qualifying fixed assets made during the year, and (vii) the adoption of mandatory digital invoicing.

- **The French 3% Tax on Real Estate: A Guide to Treading in Perilous Waters.** No rule is more easily ignored than one no one seems to have heard of, and few provisions of French tax law make the point as neatly as the annual 3% tax on the fair market value of French real estate held by legal entities (*taxe annuelle sur la valeur vénale des immeubles*). Indeed, while having a very broad scope – the 3% tax is never far away where a French real estate property is not owned directly by an individual – it seems to be often overlooked by international investors, exposing them to significant tax risks. The 3% tax was initially conceived as a tracking device to seek out individuals attempting to avoid wealth tax or registration duty. Assessment of the tax is not time-barred until the end of the sixth year following the year involved, leading in the most egregious case to a 21% tax based on the real estate value. In their article, Xenia Lordkipanidze, a Partner in the Tax Department of OVERSHIELD Avocats, Paris, and Clement Pere, a Senior Associate in the Tax Department at the same firm, take a deep dive into the rules, explaining (i) how the tax is computed when a chain of corporations stands between the individual and the property, (ii) the persons who a deemed to be authorized to receive notices from the French Tax Authority, (iii) the 30-day grace period to file late that is offered to first time offenders, (iv) seven applicable exemptions to the 3% tax, (v) adverse case law for persons and entities that challenge the tax, and (vi) several items of practical guidance for affected individuals.

- **Taxation of Trusts and Foundations in the Netherlands.** Legal systems regarding taxation differ significantly between jurisdictions, and legal vehicles used to attain a specific goal often must be revised when a border is crossed. A clear illustration of this is the discretionary trust, which is a common estate planning tool in the U.S., but is often associated with tax avoidance schemes in the Netherlands. For that reason, assets, liabilities, and income of a discretionary trust are attributed to the contributor under the *Afgezonderd Particulier Vermogen* ("A.P.V.") regime. An A.P.V. is defined as a segregated estate that is intended to serve a private interest that is more than incidental. In their article, Stan Stevens, a Partner at HVK Stevens Tax and Legal in Amsterdam, and Sandra Singh, a Director at the same firm, explain the rules and how they are applied in troublesome fact patterns, including unexpectedly harsh treatment if (i) a contributor of a trust moves to the Netherlands, (ii) a nonresident contributor arranges for the trust to have Dutch source income, (iii) a nonresident contributor owns Dutch situs assets at the time of death, or (iv) a Dutch expat individual dies within ten years from the date of expatriation.

- **Beyond Form W-7: Practical Lessons From the Front Lines of I.T.I.N. Compliance.** For many non-U.S. individuals, obtaining a U.S. Individual Taxpayer Identification Number ("I.T.I.N.") represents their first substantive interaction with the U.S. tax system. At first glance, the process may appear relatively straightforward: complete Form W-7, provide the required supporting documentation, submit the application to the I.R.S., and await issuance of the I.T.I.N. In practice, however, the process is considerably more nuanced. All of these steps must be coordinated through an I.R.S. Certifying Acceptance Agent ("C.A.A."), assuming the individual does not wish include his or her passport in the packet of documents sent to the I.R.S. In his article, David te Boekhorst, the Founder and the Director of Angularis Global Services Inc., offers practical observations drawn from true life experience working in coordination with legal and tax advisors to assist international clients in navigating the administrative and compliance-related dimensions of the I.T.I.N. application process. He addresses (i) the purpose of the I.T.I.N. program, (ii) the role and responsibilities of the C.A.A., (iii) common misconceptions surrounding I.T.I.N.'s, and (iv) practical lessons learned from guiding foreign individuals through the application process

- **Form 5472 and Foreign-Owned U.S. Entities: The New Chief Counsel Guidance.** Foreign owners of single member U.S. limited liability companies ("L.L.C.'s") are often told that an L.L.C. with one member is a disregarded entity for U.S. tax purposes. They assume that it means exactly that: disregarded. The assumption is understandable. It was true in almost every relevant respect for many years. It is still true for U.S. income tax purposes. A single-member L.L.C. generally files no income tax return of its own. Its income, deductions, and assets belong to its owner. But the assumption is wrong in one important respect. Since 2017, a foreign-owned single-member L.L.C. has been treated as a domestic corporation for purposes of the reporting and record-maintenance obligations under Code §6038A, involving transactions between the L.L.C. and its foreign related parties. The reporting mechanism is Form 5472 (Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.) The I.R.S. instructions confirm that a reporting corporation includes a ≥25% foreign-owned U.S. corporation, including a foreign-owned U.S. disregarded entity. On April 24, 2026, the I.R.S. released Chief Counsel Advice 202617012 ("C.C.A."). The C.C.A. addresses when the reasonable cause exception to the Code §6038A penalty applies and, in particular, what it means for the I.R.S. to apply that exception "liberally" for certain small corporations. In her article, Galia Antebi explains (i) Code §6038, (ii) the reasonable cause standard in Treas. Reg. §1.6038A-4(b), and (c) how that standard was applied in the C.C.A. While the C.C.A. may not be used or cited as precedent, it serves to illustrate how the I.R.S. evaluates reasonable cause at the time of the C.C.A.'s issuance.

- **The I.R.S.'s Multifaceted Scrutiny of Partnership Basis-Shifting Transactions.** Over the past several years, the I.R.S. has targeted tax-free partnership transactions designed to shift tax basis to property in a way that will yield tax savings for the partner, the partnership, or both. The goal of these transactions is to use the interplay of rules governing inside basis and outside basis to shift tax basis from assets where it is less beneficial for income tax purposes to assets where a higher basis provides greater benefits, *i.e.*, because the asset offers greater cost-recovery deductions or smaller taxable gains when sold. Regulations were adopted in final form during the last days of the Biden Administration, but were withdrawn in Notice 2025-23, with effect as of the date of their issuance. In his article, Wooyoung Lee observes that, while the regulations were withdrawn, the I.R.S. has not withdrawn Rev. Rul. 2024-14, which accompanied the proposed regulations when issued in 2024 and explains the three types of basis-shifting transactions that, in the view of the I.R.S., fail the economic substance doctrine that is codified in Code §7701(o).

- **The Corporate Records Nobody Thinks About Until Someone Asks For Them.** Forming a Delaware corporation or limited liability company ("L.L.C.") is remarkably easy. Remembering what to do with its internal records afterwards can be another matter. Corporate attorneys are frequently asked to form corporations and limited liability companies for use as blockers, holding companies, or acquisition vehicles in connection with a transaction. The entity itself may be only a small part of a much larger transaction, with most of the attention being paid to the purchase agreement, financing documents, or other agreements that is entered into by the newly formed entity. Once the transaction is completed, however, the internal corporate records of the newly formed entity can easily become an afterthought. The issue often resurfaces months or years later when a lender, purchaser, investor, or foreign counsel asks to see them. In his article, Simon Prisk looks at the various ancillary documents that are executed and then frequently ignored by clients that do not have an internal legal department. Examples include (i) certificates of formation, (ii) bylaws, (iii) subscription agreements, (iv) amendments to reflect changes to formal ownership records, and (v) a physical or digital minute book.

We hope you enjoy this issue.

\- The Editors

BELGIUM MAKES PROGRESS ON ITS LONG-AWAITED TAX REFORM

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Tags
Basis Step-up
Belgium
Capital Gains
Carried Interest
D.R.D.
D.W.T.
Exit Tax
I.I.D.
Investment Deduction
Share Sale
Tax Reform

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BACKGROUND

With a new coalition government in office for 19 months, Belgium is making progress on the implementation of the ambitious tax reform that was announced on January 31, 2025, when the new government was about to be sworn in on February 3, 2025. Although progress is real, it is taking shape piece by piece instead of one massive overhaul. This is largely due to the composition of the coalition government, which is dominated by two political parties of the fiscal and economic right but needs the support of three smaller parties of the center-left side of the political spectrum who have a surprisingly strong bargaining position. More recently, the Belgian parliament adopted the Act of July 15, 2026, on the Reform of Personal Income Tax, which was gazetted on July 29, 2026. It includes several significant tax measures.

This article focuses on the most salient tax reform measures relevant to international tax advisers and their clients.

INTRODUCTION OF A BROAD CAPITAL GAINS TAX ON FINANCIAL ASSETS FOR BELGIAN INDIVIDUAL TAXPAYERS

If there is one single tax measure that keeps Belgian taxpayers, tax practitioners, financial institutions as well as the trade press awake at night, it is the new capital gains tax on financial assets for Belgian individual taxpayers. The relevant Act was adopted by parliament on April 2, 2026, signed into law by the King of the Belgians on April 6, 2026, and published on April 21, 2026. It is effective as of January 1, 2026, subject to several exceptions.

The Explanatory Memorandum that was submitted to the House consisted of no less than 78 pages and the act of April 6, 2026, itself consists of 35 articles, many of which contain several paragraphs and subparagraphs. The extremely complex and technical capital gains tax is expected to generate an annual €500 million in additional tax revenue as of 2029. Just before finalizing this article, it was announced that already one request for annulment against several provisions of the Act of April 6, 2026, had been submitted to the Constitutional Court.

For international tax advisers, the new tax initially seems to be of little interest, except that the taxation of capital gains on shares is often a stumbling block for M&A transactions. In the past, Belgian individual taxpayers rarely suffered capital gains tax when selling shares of a Belgian corporation to a foreign acquiror, provided they were adequately advised. Except in the rare case where a private individual would sell shares of a Belgian corporation that were part of his professional wealth, prior to January 1, 2026, capital gains were taxed only when (i) a more than a 25%

participation in a Belgian corporation was sold to a corporate buyer established outside the European Economic Area ("E.E.A.") or (ii) the sale involved what is commonly referred to as a "speculative transaction." Although the Belgian Revenue Service challenged quite a few transactions for being speculative, they rarely succeeded in court.

Tax Rates

The new capital gains tax is meant to "plug the hole in the bucket" where none of the existing capital gains taxes apply. Under the pre-2026 regime, a Belgian individual who sold a substantial interest – meaning more than 25% of the shares in a Belgian company, held alone or with close family at any time during the preceding five years – was taxed at 16.5% if the shares were transferred to a non-E.E.A. corporate buyer. A buyer could help the seller to sidestep the charge simply by making the acquisition through an E.E.A.-based acquisition vehicle, so that the direct transferee was an E.E.A. legal person. The new regime removes that escape route.

The default rate of the new capital gains tax is 10%, and the taxable amount is the capital gain, *i.e.*, the difference between the tax basis (see immediately below) and the price at which the relevant assets are sold or otherwise disposed of. However, in the event of a sale or transfer by a "substantial shareholder," the tax rate follows a staggered schedule:

Taxable Amount Range	Tax Rate	Tax on Full Tranche	Cumulative Total Tax
€0 – 1.0 million	Exemption (0%)	€0	€0
€1.0 million – 2.5 million	1.25%	€18,750	€18,750
€2.5 million – 5.0 million	2.50%	€62,500	€81,250
€5.0 million – 10.0 million	5.00%	€250,000	€331,250
> €10.0 million	10.00%	Varies by amount	Progressive

The first €1.0 million of capital gain is exempt but this exemption operates on a rolling five-year basis. The exempt tranche is reduced by the amount of exemption already used during the four preceding taxable periods.

In addition to the general 10% rate and the staggered schedule for substantial shareholders, the Act of April 6, 2026, confirms the tax regimes of two other pre-existing categories of capital gains.

- The first is the so-called "internal capital gains," where the purchaser is an entity controlled by the seller entity controlled by the seller. Such gains are taxed at a flat rate of 33%, with no exemption. The Belgian Revenue Service previously treated internal capital gains as being subject to the 33% rate, but taxpayers regularly contested the tax and sometimes won their cases in court.
- The second is where a substantial shareholder sells shares in a Belgian resident corporation to a non-E.E.A. legal entity. Such gains are taxed at a flat rate of 16.5 percent. Although this rule was in existence prior to January 1, 2026, the discussion now focuses on whether the shareholder is eligible for the first tranche of €1.0 million. A substantial shareholder is any shareholder

who owns 20% or more of the shares of a corporation. The ownership by two or more shareholders is not combined or aggregated in determining whether the 20% ownership trigger is breached, even if the shareholders are related.

Step-up in Basis

As for the tax base, the law provides for a step-up in basis as at December 31, 2025, the day before the effective date of the new capital gains tax. The value on this date is often referred to as the "snapshot."

The determination of the value of financial assets as at December 31, 2025, is subject to a strict hierarchy.

- For listed financial assets, the value is the last closing price of 2025.
- For unlisted financial assets, the law takes the highest of
  - the value used in an arm's length transaction or capital increase in the course of 2025;
  - the value resulting from a valuation formula in a contract or put option agreement in force on January 1, 2026; or
  - for shares and similar instruments, the net equity plus four times the E.B.I.T.D.A. of the last financial year closed before January 1, 2026. Alternatively, a valuation report may be established by a certified accountant or auditor other than the company's habitual auditor and prepared not later than December 31, 2027.
- For disposals before December 31, 2030, the taxpayer may opt to use the historical acquisition value if it exceeds the value as of December 31, 2025.

"The determination of the value of financial assets as at December 31, 2025, is subject to a strict hierarchy."

Other Rules

Not only shares are subject to the new capital gains tax. Derivate products such as options, warrants and regular or convertible bonds are in scope. For shares that are replicated by so-called certificates through the interposition of a tax transparent entity (typically a foundation), the capital gains tax applies in the event of a sale or transfer of the certificates.

For capital gains on financial assets other than shares disposed of by a substantial shareholder, there is a *de minimis* threshold of €10,000 *per annum* (indexed for inflation) of which not more than €1,000 *per annum* can be carried forward for up to five years if not used in the tax year itself.

Capital losses can only offset capital gains realized during the same year and within the same category as the loss. The categories are internal capital gains, substantial shareholder gains. Unused capital losses cannot be carried forward.

Circular Letter Providing Administrative Guidance

After the adoption of the Act of July 15, 2026, many uncertainties remained concerning the practical application of the new capital gains tax. To address some of open issues, the Belgian Revenue Service issued Circular No. 2026/C/74 on July 22, 2026, in which it provided several useful comments:

- **Share-for-share exchanges:** Capital gains crystallizing on a share-for-share exchange in the course of a reorganization are in principle a taxable realization. Nonetheless, gain is deferred for (i) contributions of shares and (ii) exchanges falling within the E.U. Merger Directive. The original acquisition value – tax basis – is carried over to the shares received.

- **Tax emigration:** Residents who relocated abroad prior to May 1, 2026, are exempt from the capital gains tax. Those relocating on or after May 1, 2026, are subject to the new tax as well as the corresponding exit tax, discussed below.

- **Nonresidents:** As a general rule, capital gains tax does not apply to nonresidents.

- **Internal capital gains:** Additional guidance is provided regarding the increased 33% tax rate applied to share transfers made to a controlled personal holding company.

- **Earn-out clauses:** For transactions involving a deferred purchase price, the tax is levied at the time of the transaction, unless deferred price has not yet been determined.

- **Bonds issued below par:** The difference between the purchase price and a greater nominal value at maturity is classified as a taxable capital gain.

Payment Options

Several options exist as to the payment of the tax. If a Belgian financial institution is involved in the settlement, a taxpayer may opt in to a procedure under which the financial institution will withhold the capital gains tax on a stand-alone basis, as if the taxpayer had no other transactions for the same year. The taxpayer must report the capital gain in a personal income tax return and may obtain a refund, if applicable. If the taxpayer opts out of the procedure, no withholding will take place, and the financial institution simply notify the Belgian Revenue Service and the taxpayer of the amount involved. It is then up to the taxpayer to report the right amount in an annual tax return and to pay the tax due upon assessment. If no Belgian financial institution is involved, it is entirely up to the taxpayer to report the gain in his personal income tax return and pay the applicable tax upon assessment.

STRICTER RULES FOR DIVIDENDS

Dividends Received Deduction

The Program Law of July 18, 2025, introduced stricter rules for the Dividends Received Deduction ("D.R.D.") to apply. Under Belgian tax law, when a corporation is entitled to receive dividends from shares of stock in which it has invested, double taxation is mitigated through a deduction of qualifying dividends from the taxable income of the shareholder corporation. In order to qualify for the D.R.D., the shareholder corporation must have owned a stake of 10% or more in the distributing corporation for an uninterrupted period of at least one year and the distributing corporation must meet a relatively complex subject-to-tax test. However, if the participation is less than ten percent, the D.R.D. is still available if the participation has a tax book value of €2.5 million or greater in the books of the shareholder corporation.

The Program Law added one additional test to the D.R.D. designed to remove portfolio shares from the scope of the D.R.D. With the exception of a corporation that is a "small corporation," a corporation that has (i) a stake of less than 10% in the shares of distributing corporation and (ii) a tax book value in that stake of at least €2.5 million must book the shares as fixed financial assets in its commercial books. By doing so, it eliminates dividends on those shares from qualifying for the D.R.D.

This additional test first applies for tax assessment year 2026. For Belgian corporations, whose financial year coincides with the calendar year, this means that dividends received in the course of 2025 are in scope.

Dividend Withholding Tax Exemption

When a Belgian corporation distributes a dividend to a nonresident corporate shareholder, an exemption from Belgian dividend withholding tax ("D.W.T.") is available subject to conditions similar to those discussed above regarding the D.R.D. Here, too, it is possible to enjoy an exemption from Belgian D.W.T. if the nonresident corporate shareholder holds a stake of less than 10% but has a book value of €2.5 million or greater. Belgium introduced this exemption in 2017 to comply with the *Tate & Lyle Investments Ltd*. judgment of the European Court of Justice ("E.C.J.").[1]

Going forward, the nonresident corporate shareholder will be required to corroborate that the shares in the Belgian corporation are reported as fixed financial assets, rather than portfolio shares, to eliminate application of the 30% D.W.T. under Belgian domestic law. Note that if a treaty applies to the foreign shareholder, the rate of D.W.T. under the treaty may be available.

Improvement of D.R.D. Regime

The Law of December 18, 2025, has improved the Belgian D.R.D. regime, to comply with the *John Cockerill* ruling of the E.C.J.[2] This is a very technical amendment which results when a Belgian corporate taxpayer (i) is part of a qualifying group, (ii) reports a tax loss for the taxable period on a stand-alone basis, and (iii) receives a group contribution from a related Belgian corporation for the same taxable period. In that fact pattern, the recipient corporation is allowed to offset any D.R.D. capacity of the same taxable period against any portion of the Group Contribution exceeding the stand-alone loss of the year ("Excess Group Contribution"). Prior to this amendment. such Excess Group Contribution was subject to a 25% Corporate Income Tax ("C.I.T.") at the level of the recipient. The D.R.D. that could not be used during the taxable period for lack of sufficient taxable income had to be carried forward.

This improvement of the D.R.D. regime entered into effect as of tax assessment year 2026 (financial years closed on or after December 31, 2025).

EXIT TAX FOR CORPORATIONS

For many years, the migration of a corporation from Belgium to any other jurisdiction was treated as a liquidation for purposes of the migrating corporation's corporate tax position in Belgium. The valuation method for all assets and liabilities was required to be switched from that of a going concern to liquidation mode. Any gains resulting

[1] Case C-384/11 dated July 12, 2012.

[2] Case C-135/24 dated March 13, 2025.

from the switch in valuation mode were added to the corporation's tax base when filing its final corporate tax return in Belgium. An exception applied to the extent the liquidation gain was effectively connected with any remaining operations conducted in Belgium through a Belgian permanent establishment. The deemed liquidation gain was not taxed as a distribution to the shareholders of the migrating corporation. In standard situations there is indeed no actual distribution to shareholders on the occasion of the migration.

Although the Belgian Revenue Service tried several times to tax a deemed dividend in the hands of the shareholders of the migrating corporation, the Belgian Tax Ruling Committee consistently rejected that view in advance tax rulings and tax courts have overruled the Belgian Revenue Service.[3]

The Program Law of July 18, 2025, introduced the taxation of what is usually referred to in Belgium as the "Liquidation Bonus," in the hands of the shareholders. Although no D.W.T. will be imposed on the migrating corporation, individuals who are shareholders of the migrating corporation are required to report their share of the Liquidation Bonus in their Belgian income tax return. The migrating corporation is required to establish pay slips and file these with the Belgian Revenue Service, with a copy to each of the individual shareholders, to enable the Belgian Revenue Service to audit and enforce the tax reporting obligation of the shareholders.

The viability of the taxation of the Liquidation Bonus is being challenged. The Council of State as well as tax experts are of the view that it constitutes an infringement of E.U. law as well as of the relevant tax treaties entered into by Belgium.

SPECIAL TAX REGIME FOR CARRIED INTEREST

The same Program Law of July 18, 2025, introduced a special tax regime for income from carried interest earned by (i) a Belgian resident individual who is a qualifying Fund Manager (ii) from a Belgian or foreign carried interest vehicle. The income derived from the carried interest is taxed as passive income and subject to a flat rate of 25%. Because it is passive income, it is not subject local surcharge, municipal surcharge, or social security contributions. The is collected through withholding by the carried interest vehicle or by the Belgian financial intermediary making the payment. The withholding tax is the final tax. Consequently, it is not reported on the recipient's personal income tax return.

Carried interest income is defined as the disproportionate return, *i.e.*, any income that exceeds the normal return that a passive investor would make on the same investment, regardless of the legal form, such as capital gain, profit share, redemption gain, or recurring income. Moreover, the income must be granted by an Alternative Investment Fund ("A.I.F.") established in Belgium, an E.U. member state or an equivalent non-E.U. jurisdiction. Included are private equity funds, venture capital funds, hedge funds, and real estate investment funds.

Gains resulting from the exercise of a Qualifying Stock Option ("Q.S.O.") are out of scope, provided the arrangement satisfies the conditions for beneficial tax treatment under the Law of March 26, 1999. Q.S.O.'s are taxed as earned income at progressive income tax rates of up to 50% at the time of grant and the taxable amount is

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3 See for example: Advanced Tax Rulings No. 2020.0054, No. 2020.0106 and No. 2020.2115; Court of Brabant Wallon, February 3, 2023.

a fraction of the Fair Market Value ("F.M.V.") of the underlying shares at the time of grant, usually 18% or 9%. The notional income resulting from the grant of a Q.S.O. is exempt from social security contributions borne by the employer (25%) and the employee (13.07%). Ordinarily, no additional tax is due upon exercise of a Q.S.O. Capital gains on the disposal of the shares received upon exercise of a Q.S.O. are subject to the new capital gains tax. They benefit from the step-up in basis to F.M.V. on the day of exercise.

The new carried interest regime entered into effect on July 29, 2025.

> ***"The new carried interest regime entered into effect on July 29, 2025."***

TAX REGIME FOR NEWLY ARRIVED EXPATS

The major overhaul of the Expat Regime by the previous government triggered a substantial decline in the number of newly arrived expats. Belgian employers with an international workforce complained about the increased cost of employing expats in Belgium. The current government decided to alleviate several conditions and caps that were imposed by the previous government with a view to making the Expat Regime more attractive for Belgian employers. It did so through the Law of December 18, 2025, gazetted December 30, 2025.

The Expat Regime is a very specific piece of tax legislation that requires careful planning and advice. The most salient improvements are as follows:

- The threshold for the gross salary of employees to be eligible for the amended Expat Regime is now set at €70,000 per annum, down from €75,000 under the predecessor regime.
- The cap on the Tax-Free Allowance for qualifying Incoming Employees is now set at 35% of the expat's gross salary, up from 30%).
- The additional cap of €90,000 per annum for the Tax-Free Allowance has been removed.

The improved Expat Regime entered into effect from January 1, 2025.

REVAMPED INVESTMENT DEDUCTION

For many years, Belgium has had a relatively attractive Investment Deduction regime in place. The Investment Deduction is a tax incentive allowing Belgian businesses to deduct a notional portion of the purchase price or investment cost of qualifying fixed assets made during the year. The Investment Deduction comes on top of the regular depreciation of the same assets. All in, the Investment Deduction helps businesses reduce the cost of capital for investments in qualifying fixed assets in Belgium. Over the years, the Investment Deduction regime has been modified multiple times, and not always for the better.

With the Law of May 12, 2024, and effective January 1, 2025, the previous coalition government enacted a significant reform of the Investment Deduction Regime. The current government adjusted the regime through the Law of December 18, 2025, gazetted December 30, 2025.

The Increased Thematic Investment Deduction

Since 2025, an Increased Thematic Investment Deduction is available for large enterprises investing in efficient energy consumption, renewable energy, CO2-free transportation, environmentally friendly investments and supporting digital systems. The base rate is 40%.

For 2025, this rate was 30% for large enterprises, meaning companies not qualifying as "small companies" under the Companies and Associations Code. As of 2026 (tax year 2027), this reduction is repealed, meaning that the 40% rate now applies to all enterprises regardless of size.

The Technology Investment Deduction

For investments in Research & Development ("R&D") and environmentally friendly patents, two options are available under the Technology Investment Deduction.

- The first is a one-off deduction of 13.5% applied to the acquisition or investment value of qualifying fixed assets. Any unused portion of this one-off deduction can be carried forward to subsequent taxable periods.
- The second, available only for R&D investments other than patents. It is a spread deduction of 20.5% of the annual depreciation charges on the qualifying assets over their amortization period. The spread deduction also allows the inclusion of capitalized R&D personnel expenses. Qualifying R&D investments are defined as fixed assets promoting the research and development of new products and advanced technologies with no or minimized negative environmental effects. Patents qualify only for the one-off.

Enterprises must elect between the one-off and spread options.

The Law of December 18, 2025, adjusted the reformed Investment Deduction Regime on several additional points:

- **Enhanced Base Deduction for Digital Investments limited to Small and Medium-size Enterprises ("S.M.E.'s"):** S.M.E.'s investing in digital fixed assets benefit from the base deduction rate increased by 10 percentage points (*i.e.*, 20% instead of 10%). This applies to assets acquired or constituted from January 1, 2025. Under the Law of May 12, 2024, it was unclear whether large companies could benefit from this enhanced base deduction. The Law of December 18, 2025, leaves no room for doubt and explicitly excludes large enterprises from the scope of these enhanced deductions.
- **Removal of the Prohibition on Combining the Thematic Investment Deduction with Regional Investment Aid:** The Law of May 12, 2024, provided that the thematic deduction could only be applied to assets for which no regional aid was requested, except in cases determined by Royal Decree. This paragraph was removed for assets acquired as of January 1, 2025, allowing enterprises to combine both incentives.
- **Changes to the Carry-Forward Rules for the Investment Deduction:** The Law of December 18, 2025, also made two important changes to the carry-forward rules for the investment deduction. First, the time limitation on carrying forward the unused base deduction was abolished. Second, the

numerical cap on the deduction of Carried-Forward Investment Deductions was removed. Previously, the annual deduction of carried-forward amounts was capped, which forced taxpayers to spread the deduction over several years and could result in the taxable base being partially offset by other deductions subject to the so-called "basket limitation." Carried-forward investment deductions can now be used without any time or quantitative limits.

Not all the amendments of the Law of December 18, 2025, have the same effective date.

- The harmonization of the Thematic Deduction at 40% for all enterprises takes effect from tax year 2027 (assets acquired from January 1, 2026). For tax years 2025 and 2026, the 30% rate continues to apply to large enterprises, provided the assets were acquired of or after January 1, 2025. investments predating that date remain subject to the pre-2024 rules.
- The combination with regional aid, the carryforward improvements, and the other clarifications apply to assets acquired or constituted as of January 1, 2025, thereby aligning with the entry into force of the Law of May 12, 2024. This avoids parallel regimes being in force during the start-up phase of the new system.

Because effective date of the legislation is tied to the date of acquisition rather than to the beginning of a tax year, the changes can have retroactive effect for companies whose financial year does not coincide with the calendar year. This may create practical difficulties. To illustrate:

- A corporation with a financial year ending March 31, 2025, that invested in assets for which regional aid was requested could not claim the Thematic Deduction when filing its return, due by October 31, 2025, at the latest. That is because the combination of both incentives was still precluded at that time.
- Now that the combination is permissible with retrospective effect the question arises as to how such taxpayers can claim the investment deduction. Pending further guidance, filing an administrative protest seems to be the most prudent action to take.
- Similarly, the link to the date of acquisition creates two categories of carried-forward investment deductions: (i) pre-2025 deductions remain subject to the former quantitative caps but (ii) post-2025 deductions benefit from unlimited carry-forward. In the absence of statutory rules, taxpayers should be free to optimize the sequence, consistent with the Minister of Finance's earlier position of October 31, 2024.

Ironically, these simplifications generate additional complexity during the transitional phase.

Improved Innovation Income Deduction ("I.I.D.")

The I.I.D., was reformed several years ago to make it compliant with the O.E.C.D.'s B.E.P.S. Action 5 on Patent Box regimes. Under certain conditions, Belgian taxpayers can deduct up to 85% of the income generated from the exploitation of qualifying innovations, reducing the effective C.I.T. rate on such income to 3.75%.

From Tax Assessment Year 2025 onwards, taxpayers may convert the I.I.D. into a non-refundable tax credit to comply with The O.E.C.D. Pillar Two worldwide minimum tax.

MANDATORY DIGITAL INVOICING

Even though the relevant legislation is not really new, it is good to remember that digital invoicing for domestic B2B transactions between Belgian-established, Belgian V.A.T.-registered enterprises is mandatory in Belgium as of January 1, 2026. Cross-border B2B invoicing, including intra-E.U. transactions, remains outside the scope of the current mandate, but is expected to be in scope as part of a next step.

An invoice on paper or a scanned invoice transmitted by email are no longer valid. They may be used for information purposes, but do not constitute a valid invoice for V.A.T. purposes. After a tolerance period of three months (January-March 2026), the Belgian V.A.T. authorities are now allowed to impose penalties on noncompliant V.A.T. taxpayers. Digital invoices must be transmitted to the recipient through the Peppol® network. The Peppol® ID of the recipient of the goods or services can be found through the Peppol® Directory, which is linked to most of the commercial software applications that are available for digital invoicing, but can also be consulted separately online at https://test-directory.peppol.eu/public.

THE FRENCH 3% TAX ON REAL ESTATE: A GUIDE TO TREADING IN PERILOUS WATERS

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Form 2072
Form 2746
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Law No. 82-1126
Seven Exemptions
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INTRODUCTION

"*No one is supposed to be ignorant of the law*," as wrote Roman lawyers.[1] Yet no rule is more easily ignored than one no one seems to have heard of, and few provisions of French tax law make the point as neatly as the annual 3% tax on the fair market value of French real estate held by legal entities (*taxe annuelle sur la valeur vénale des immeubles* or "T.V.V.I."). Indeed, while having a very broad scope – the 3% tax is never far away where a French real estate property is not owned directly by an individual – it seems to be often overlooked by international investors, exposing them to significant (though avoidable) tax risks.

Thus, for those who contemplate embarking in a French real estate acquisition adventure and for those who have already embarked, it is important to understand the implications of this very specific tax.

This 3% tax was initially conceived as a tracking device. Where French property is held through a foreign opaque structure,[2] the French tax authorities ("F.T.A.") cannot easily identify the individuals behind it for wealth tax or registration duty purposes. The 3% tax is the price of such opacity. The 3% rate applies to the value of the underlying real estate irrespective the debts of the entity owning it or the actual value of its shares. Thus, the tax amount may exceed the entity's net assets (value minus liabilities). Since the F.T.A.'s right to reassess is not time-barred until the end of the sixth year following the year of the taxable event (*i.e.* ownership of real estate in France as at January 1 of a given year), a failure to comply with the 3% tax obligations can crystallize into an exposure of up to 21% of the real estate asset value.

However, exemptions are available. The main exception relates to an annual reporting obligation, indicating (i) the location, composition, and value of real estate assets and (ii) the identity of holders of more than 1% of the "rights" in the entities owning the French real estate. The information provided must be extremely accurate, complete and verifiable because the F.T.A. and the tax judge enforcing this requirement do so with a severity that does not leave room for mistakes, even if made in good faith.

Several decades after the introduction of the 3% tax into the French legal system (with a substantial amendment in June 2026), the abundant case law of recent years

1. *Regula est iuris quidem ignorantiam cuique nocere, facti vero ignorantiam non nocere* ("the rule is that ignorance of the law harms a person, whereas ignorance of fact does not"), Digeste 22.6.9 pr. (Paul, *liber singularis de iuris et facti ignorantia*), as originally laid down in Justinian's *Corpus Juris Civilis*, before it became, under the influence of canon law, *Ignorantia facti, non iuris, excusat* ("ignorance of fact, is an excuse, not that of the law").
2. Today, French domestic entities are also included in the scope of the 3% tax.

demonstrates the continued interest which the F.T.A. takes in enforcing the regime and the extent to which the tax remains poorly understood by taxpayers.

After outlining the 3% tax regime and its exemptions, this article delves into practical difficulties of its implementation, and suggests several practical guidelines that may help a client to navigate these perilous waters.

THE 3% TAX REGIME: AN EXTREMELY WIDE SCOPE WITH NUMEROUS EXEMPTIONS

Background: a Tax Conceived as a Tracking Device

The 3% tax was introduced by Law No. 82-1126 of December 29, 1982, and entered in force on January 1,1983, one year after the introduction of the wealth tax.[3] Its objective has never changed. It keeps track of French real estate held through entities in order to support payment of the annual wealth tax and registration duties triggered when the shares of the owning entity change hands. Initially, it was aimed only at foreign companies. Later, it was extended to French companies. Ultimately, it was extended in 2007 to every structure, with or without legal personality, holding French real estate directly or indirectly.

A Deliberately Wide Scope

Pursuant to article 990 D of the French Tax Code ("F.T.C.") as construed by F.T.A. guidelines, the 3% tax is due, in principle, by every legal entity, French or foreign, that owns real estate in France or holds a real estate right[4] over a property, directly or through an interposed entity. Legal form is irrelevant, as the tax targets share capital companies, civil law and common law partnerships, and organizations of every kind, with or without legal personality, such as *Anstalten* and *Stiftungen*, as well as *fiducie*s[5] and comparable institutions, *e.g.* family foundations, trusts and investment funds without legal personality.[6]

Given the above, for the sake of simplification, we shall use the term "entity" in this article, keeping in mind that it refers to multiple legal arrangements.

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3 *Impot sur les Grandes Fortunes* (Tax on Large Wealth), the forerunner of the *Impôt de Solidarité sur la Fortune* (Solidarity Tax on Wealth) and of the current *Impôt sur la Fortune Immobilière* or IFI (Real Estate Wealth tax).

4 *Usufruct* (right to use the asset and receive income deriving from such asset), right of use, easement, etc.

5 Pursuant to article 2011 of the French Civil Code, the *fiducie* is the operation whereby (i) one or more *constituants* (settlors), (ii) transfer assets, rights or interests (present or future), (iii) to one or more *fiduciaires* (trustees), (iv) who hold them separate from their own patrimony, and (v) act for a determined purpose for the benefit of one or more *bénéficiaires* (beneficiaries). Introduced by Law No. 2007-211 of February 19, 2007, it is what comes closest in France to a trust, without corresponding to it perfectly.

6 F.T.A. guidelines: BOI-PAT-TPC-10-10 nos. 30, 40 and 50 (September 12, 2012). To be complete, only the real estate co-ownership companies of article 1655 *ter* of the F.T.C. fall outside the scope of the 3% tax. This is an extremely specific case.

Indirect holding is defined broadly. An entity is deemed to hold French property through an interposed entity whenever it has a stake, of any form or percentage, in another entity that owns the property or stake in yet another entity owning real estate, irrespective the number of interposed entities. Where a chain of ownership exists, the tax is due by the entity or entities which are closest to the property in the holding chain without qualifying for an exemption, as discussed in greater detail below. Hence, each entity in the holding chain must understand and verify its own obligation.

A Deliberately High Cost for Opacity

The 3% tax is assessed on the fair market value of built and unbuilt property located in France (established mainly by comparison with local sales of similar properties) and of real estate rights over it (*usufruct*, rights of use, etc.). Debts contracted by the entity are disregarded as are claims against the property. However, rebates might be applied in order to determine the fair market value, *e.g.* a rebate for a property which is rented, a rebate in case of joint-ownership of the property by several entities or individuals, or rebates in case of litigation related to the real estate.

Two categories of assets are excluded from this taxable base. The first is property allocated by the taxable entity, or by interposed entities to their own business activity other than a real estate activity[7] or to a nonreal estate business activity carried on by another entity belonging to the same group.[8] The second is property belonging in the trade stock of real estate dealers and developers.

Where property is held through an interposed entity, the tax base is reduced in proportion to the rights held in such entity. The F.T.A. published an example in its guidelines[9] to better understand how the rule operates in presence of a chain of ownership. In the example, a rented building located in France belongs to F, a French civil law partnership ("S.C.I."), whose shares are held equally by two foreign entities E1 and E2. All three have reporting obligations.

- F has met its own reporting obligations and is not subject to taxation, as described more fully below.
- E1 is not exempted and is thus subject to tax on 50% of the value of the building.

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[7] Furnished rental is a commercial activity for income tax purposes (article 35, I, 5° *bis* of the F.T.C.). However, it is not a genuine business activity distinct from the management of one's own real estate, unless it qualifies as para-hotel activity (*i.e.* rental with additional services). To be qualified as para-hotel activity, as defined by the F.T.A.'s guidelines, it is necessary for the taxpayer to be an operator who supplies or offers, in addition to the accommodation, at least three of the following four services, on terms similar to those of a professionally run hotel: (i) breakfast, (ii) regular cleaning of the premises, (iii) provision of household linen, and (iv) reception of customers, even if not personalized (BOI-TVA-CHAMP-10-10-50-20, no. 60 (March 26, 2025)). The courts examine the facts and require proof of the reality of the activity.

[8] Pursuant to article 39 §12 of the F.T.C., a relationship of dependence is deemed to exist between two companies when (i) one company holds, directly or through an intermediary, a majority of the other company's share capital or effectively exercises decision-making authority over the other company or (ii) when both companies are under the control of the same third company.

[9] BOI-PAT-TPC-10-20 no. 10 (September 12, 2012).

- E2 is exempt thanks to the filing of its own tax return.
- E2's capital is held half by an individual P and half by E3 (which cannot benefit from an exemption). Hence, the 25% corresponding to P are not taxable but E3 is liable to tax on the 25% it owns indirectly in the French real estate.

The 3% tax will then correspond to the product of

- the tax base, *e.g.* 100, multiplied by
- the percentage of the capital not benefiting from an exemption: E1 (50%) + E3 (25%) = 75%, multiplied by
- the tax rate of 3%.

The tax amounts to 2.25.

"Such joint liability raises a procedural question as to whether every entity that is jointly and severally liable for the payment of the 3% tax should receive all procedural documents."

<u>Statute of Limitation and Penalties</u>

In principle, the F.T.A.'s right to reassess the tax is not time-barred until the end of the sixth year following the year of the taxable event, here December 31, 2032, for the 3% tax due for assets owned on January 1, 2026. Thus, the F.T.A. is entitled to reassess a period of up to seven years, including the current year, which can result in a tax amounting to 21% of the value of the underlying real estate assets. In theory, a shorter three-year statute of limitation might be applied, where the entity has actually filed its return and that filing sufficiently revealed the tax liability, without the need for the F.T.A. to carry out any further research. In practice, the F.T.A. almost always argues that further research was necessary to identify the owners in the chain and the amount of tax due. Only a very complete tax return reporting, *inter alia*, the composition of the real estate property – square meters, number of rooms, etc. – could allow to claim the application of the shorter statute of limitation.

A lack of tax return or a late filing triggers the 3% tax to which are added a late-payment interest pursuant to article 1727 of the F.T.C. (currently 0.2% per month), plus a 10% surcharge in case of good faith (*e.g.* late filing) or a 40% surcharge, that is applied automatically and without any need to establish bad faith, where the return is not filed within 30 days from a formal request to file.[10]

<u>Interposed Entities and Procedural Consequences</u>

As mentioned above, the entity at the top of the chain of ownership might be taxed even where the entities below it have benefited from one of the exemptions, since the situation of each entity must be assessed at its own level.[11] Hence, each entity in the chain must file for itself, and every interposed entity is jointly and severally liable for the tax.[12]

Such joint liability raises a procedural question as to whether every entity that is jointly and severally liable for the payment of the 3% tax should receive all procedural documents. For a time, lower tax courts held that the F.T.A. was required to

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[10] Article 1728 of the F.T.C.

[11] Court of Appeal of Paris, February 13, 2023, no. 21/01048, *Sté Lupa*.

[12] Article 990 F of the F.T.C.

serve documents on every person that was jointly liable for the tax payment in order for the proceedings to be valid. However, the French Supreme Court recently ruled otherwise.[13]

In the case, Satofi, a Luxembourg company, held all the shares of a French partnership, S.C.I. Bayit, which owned real property in France. For the tax years 2013 and 2014, the F.T.A. considered that the exemption based on the filing was not applicable since, even if Bayit was exempted, Satofi failed to file the 3% tax return at its own level. Consequently, the F.T.A. sent a notice of tax reassessment and the corresponding tax notice to Satofi, without sending the same documentation to Bayit, which was jointly and severally liable for the tax.

Satofi won at the appeal stage on the procedural ground, but the French Supreme Court reversed the lower court decision. It distinguished between the person legally liable for the tax (Satofi) from the person only jointly and severally liable for the payment of that tax (Bayit). Since the exempted interposed entities in the chain are not the legal taxpayers of the 3% tax, the Court held that the F.T.A. was not bound to notify them of the procedural acts. As a result, an entity may pay another entity's tax debt, even though it did not take part in the taxation procedure.

This ruling in the case applies for proceedings prior to 2027. Article 102 of the Law no. 2026-534 of June 25, 2026, on the fight against social and tax fraud simplified the procedure, likely at the initiative of the F.T.A., which sought to counter the previous strict case law from the courts of appeal, prior to the Supreme Court ruling regarding Satofi.

Pursuant to the new article 990 FA of the F.T.C., any filing entity that has no permanent establishment in France must now designate, in its 3% tax return, an individual or a legal person with tax residence or its registered office in France that is authorized to receive on its behalf all of the F.T.A.'s communications, procedural documents and notifications relating to verification of the 3% tax or arising from it.

For entities that fail to provide the identity of their new 3% tax representative, the entity nearest to the property in the chain and known to the F.T.A., exempt or not, is deemed authorized to receive the notice on behalf of the actual taxpayer. Consequently, as from 2027, a single person is deemed by law to be authorized to receive all the documentation related to the 3% tax, whether or not officially appointed.

Given the 30-day deadline provided to file the 3% tax return further to the receipt of a formal notice, clarity on who receives the official notice is crucial.

The Seven Exemptions

Article 990 E of the F.T.C. provides for several exemptions, which can be divided into three categories:

- Exemptions 1 to 3, which apply due to the nature of the entity, without any filing requirement.
- Exemptions 4 to 6, which apply based on the location of the seat of the entity and the nature of the entity.

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[13] French Supreme Court, Commercial Chamber, May 28, 2026, no. 24-18.404, *Sté. Satofi.*

- Exemption 7, which applies based on the location of the seat of the entity and the fulfillment of specific filing obligations.

Exemptions 1 to 3

Exemption 1 relates to sovereign states, their subdivisions, and international organizations. Each is exempt, as are entities they control by more than 50%.

Exemption 2 relates to entities with shares that are subject to significant and regular trading on a regulated securities market and their wholly-owned subsidiaries. In order to avoid artificial listing, admission alone is not enough, as specified in the F.T.A.'s guidelines.`[14]

> In order for a legal entity whose shares, units and other rights are admitted to listing on a regulated market as provided above to benefit from [this] exemption, two conditions must cumulatively be satisfied:
>
> - its shares, units or other rights must be the subject of significant trading;
> - its shares, units or other rights must be the subject of regular trading.

Exemption 3 relates to an entity for which the value or its French real estate assets as of the beginning of the calendar year are worth less than 50% of all of its French assets.

For this computation, the numerator is the fair market value of French (and only French) real estate and real estate rights held directly or through interposed entities. Property allocated to business activities other than real estate are not taken into account, whether carried on by the entity itself, by an interposed entity, or by an entity with which it has ties of dependence.[15]

As mentioned above, leasing furnished properties is considered a real estate activity for the 3% tax purposes. The value of the real estate assets allocated to such rental activity must be included in the numerator of the fraction. In comparison, real estate assets allocated to a para-hotel activity could be excluded from being a real estate activity. The business-use carveout is assessed strictly by the F.T.A. and French judges. This is illustrated in the following decisions:

- For a business activity to exist, the company must carry on direct, habitual, and continuous acts required by the business, and must do so with a profit-oriented purpose.[16]
- The burden of proof rests with the entity claiming the tax exemption. A management mandate for furnished rental with para-hotel services, by itself, does not establish the reality of the para-hotel activity. Invoices showing only that the premises were furnished do not prove that the para-hotel services were actually supplied to guests.[17]

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14 BOI-PAT-TPC-20-10 no. 160 (September 12, 2012).

15 Within the meaning of article 39, 12 of the F.T.C. See note 8, *supra*.

16 Court of appeal of Chambéry, May 31, 2022, no. 20/00455, *SNC Carat.*

17 Court of appeal of Chambéry, September 2, 2025, no. 22/01976, *Isamo Immobilier.*

- Service contracts concluded over three consecutive years with two successive occupiers do not qualify as an active para-hotel business. Providing para-hotel services for a full 12-month term at an annual fee of between €1,251,200 and €1,481,524 and guaranteeing the occupier exclusive use of the property were mainly furnished rentals with only a limited add-on of domestic staff. In sum, the annual lessee was neither a passing customer nor an ordinary customer of the kind contemplated by usual touristic rentals.[18]

The denominator is the fair market value of all the entity's French (and only French) assets. For this purpose:

- An entity cannot take into account both the underlying property and the value of the shares of the controlled company owning the real property. Indeed, that would amount to counting the same value twice and would only unduly dilute the real estate portion.[19]
- A receivable held by a controlling entity from a French entity representing an intercompany financing of the acquisition of the property by a lower-tier entity is not taken into account when measuring total French assets of the controlling entity. Indeed, it would spare controlling companies that buy property through a French company financed by a shareholder's current accounts or loans.[20]

The 50% threshold is applied at the level of each entity in the ownership chain. The F.T.A. guidelines[21] provide an example of the computation. In the example, Entity A owns the following assets: (i) a property located in France with a value of €5.0 million, (ii) receivables from French borrowers totaling €10.0 million, and (iii) all shares of unlisted Entity B, headquartered in France, which owns real property located in France with a market value of €8 million, real property located in the U.K. with a market value equivalent to €20 million, and receivables from French debtors worth €10 million.

The market value of French real estate assets owned directly or through an interposed entity by Entity A is €13 million. The market value of its French assets (French real estate plus French receivables) is €33 million. The U.K. real estate owned by Entity B is ignored. The ratio of 13 to 33 is 39.4%, which is less than 50%. Entity A is not a predominantly real estate entity for purposes of the 3% tax.

Exemptions 4 to 6

Exemptions 4 to 6 relate to entities that, on January 1 of the calendar year maintain their corporate seat in (i) France, (ii) an E.U. Member State, (iii) a State with which France has in existence a convention on administrative assistance against tax fraud and evasion, whether or not an income tax treaty, or (iv) a State with which France has in existence a treaty that contains a nondiscrimination clause covering taxes of any kind, such as found in an income tax treaty or a friendship, commerce, and

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18 TJ Grasse, December 19, 2025, *Saxonia*

19 CA Orléans, March 1, 2012, *Neafil Anstalt.*

20 Cass. com. December 2, 2020, Cacique Investments

21 BOI-PAT-TPC-20-10 No. 100 (September 12, 2012).

navigation treaty.[22] The F.T.A. publishes a list of such treaties. The most recent list was updated as of January 1, 2025, with effect from October 8, 2025.[23]

The term "seat" means the seat of effective management, rather than a registered office identified in the bylaws. In a recent case, a Liechtenstein *Anstalt* having its registered office in Liechtenstein unsuccessfully claimed that it maintained a seat of effective management in Switzerland for the years 2004 to 2007.[24] The case serves as a road map of what not to do when contending that an office located in a treaty partner country is a place of effective management. For the years in issue, the *Anstalt* was properly registered with the Liechtenstein companies' registry and its tax authorities. No document established that the general meetings or the accounts were held in Switzerland. A Swiss-domiciled company was found to be simply a corresponding agent. The nationality and residence of the *Anstalt*'s members and of its chairman were irrelevant *per se* to characterize the location of its seat.[25]

As far as *fiducie*s and trusts are concerned, the F.T.A. applies the presumption that they are deemed to be established in the State that provides the law governing formation and administration rather than the law of the country where the trustees reside.[26] However, a trust claiming the exemption can prove that it is established in another jurisdiction.

"Once the location of seat test is met, three categories of entities are exempt, without any filing requirement."

As of the date of publication of this article, the authors are not aware of any French court decision or F.T.A. guideline that addresses how an exemption based on the location of a company's seat applies with respect to a Non-Cooperative State or Territory ("N.C.S.T.").[27] In other words, is it enough that a convention on administrative assistance exists between France and a State where it is not effectively applied due to a lack of cooperation from the tax authorities of such other State? As mentioned above, pursuant to article 990 E, 3° of the F.T.C., the seat of the foreign entity may be located, *inter alia*, in a country or territory which has concluded with France a convention on administrative assistance in matters relating to tax fraud and evasion. There is no mention that the convention must be effectively applied, or effective in practice, for the seat condition to be satisfied. Nevertheless, the rationale of the exemption is that the F.T.A. must be able to verify with the authorities of the other State concerned the information supplied by an entity established in that jurisdiction. Where a State which has concluded a treaty with France is nonetheless listed as an N.C.S.T., or which does not respond to French requests for information without being already classified as such, it is likely that the convention is not being applied and the F.T.A. cannot fully verify the information on ultimate beneficial owners. It is possible that the F.T.A. may challenge the possibility of exemption.

Once the location of seat test is met, three categories of entities are exempt, without any filing requirement.

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22 Article 990 E, 3° of the F.T.C.

23 BOI-annx-000508 (October 8, 2025).

24 France and Liechtenstein signed a tax information exchange agreement on September 22, 2009. Hence, entities maintain a seat in Liechtenstein are able to claim exemption, provided they comply with certain conditions.

25 Court of Appeal of Aix-en-Provence, March 12, 2025, no. 20/10987, *SA Flanders Establishment.*

26 BOI-PAT-TPC-20-20, no. 50 (October 5, 2016).

27 Article 238-0 A of the F.T.C.

Exemption 4 relates to entities with seat in an eligible State, where its "*share*" of the French underlying property is worth less than €100,000 or, alternatively, less than 5% of the value of that property. The computation applies on a property-by-property where several properties are held by a same entity.[28]

Exemption 5 relates to (i) entities managing pension schemes, (ii) entities recognized of public benefit, and (iii) entities with disinterested management such as foreign charities. In each instance, the holding of French real estate must be justified by the entity's activity or by the financing of such activity.[29]

Exemption 6 relates to (a) open-ended predominantly real estate investment companies ("S.P.P.I.C.A.V.'s"),[30] (b) real estate investment funds ("F.P.I.'s")[31] and (c) foreign legal entities subject to equivalent regulation in the State or territory in which they are established. The equivalent regulation test is applied strictly by reference to the (1) open-ended character of the vehicle, (2) risk-spreading, (3) shares not reserved to qualified investors, (4) redemption on demand, and (5) asset ratios of at least 5% liquidity and at least 60% real estate.[32] Investment funds which do not meet the requirements of Exemption 6 can still claim benefits under Exemption 7, subject to the reporting obligation.

Exemption 7

Exemption 7 relates to the location of the seat of the entity and the fulfillment of specific filing obligations. Until 2026, an entity in an eligible State obtained full exemption from the 3% tax by making a disclosure via a specific Form 2746[33] or undertaking to disclose[34] certain information within 60 days from the date of a request from the F.T.A. Note that Article 102 of the Law No. 2026-534 of June 25, 2026,[35] regarding social and tax fraud, removed the option of undertaking to disclose information if asked by the F.T.A. Thus, effective for 2027 and subsequent years, Exemption 7 requires the filing of the annual return.

The requested information include (a) the location, composition and value of the properties held on January 1 of the relevant year and (b) the identity and address of

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28 BOI-PAT-TPC-20-20 nos. 160 and 180 (October 5, 2016).

29 BOI-PAT-TPC-20-20 no. 190 (October 5, 2016): the real estate shall be considered as such if it generates income allocated to the financing the organization's activity.

30 *Sociétés de Placement à Prépondérance Immobilière à Capital Variable.*

31 *Fonds de Placement Immobilier.*

32 In addition, at least 51% of real estate assets other than shares of listed companies, without exceeding 90%.

33 Article 990 E, -e of the F.T.C.

34 Former article 990 E, -d of the F.T.C. Before the 2026 reform, the undertaking and the annual return were alternative routes, the latter cancelling the former. As specified in a recent French Supreme Court decision (April 1, 2026, no. 25-10.605 *F-B. Sweet Revenge*), a company, that had given an undertaking by a deed of September 8, 2004, and then filed annual returns for 2006 to 2012 of its own initiative, had, by that very step, set aside the specific procedure of the undertaking to disclose. Therefore, if a company properly entered into an undertaking to disclose, filing as a precaution actually changes the procedural regime in a way that is not in the taxpayer's favor.

35 Entered into force on June 27, 2026.

every person or entity holding more than 1% of the shares, units or other rights and the number held by each. An entity that files Form 2746 but reports less than all of its shareholders holding more than 1% of the rights obtains only a partial exemption, limited to the ownership percentage held by the reported persons. Thus, for an entity that does not wish to reveal, or cannot reveal, the identity of its members or beneficiaries, the 3% tax becomes a recurring liability.

If the entity has its seat in a non-eligible State, the 3% tax applies even if anonymity of its members is *de facto* lifted.[36] The F.T.A. wishes to ensure that it can verify information with the local authorities, which generally is not possible in connection with an N.C.S.T.

Online filing is mandatory. Consequently, every entity that must file a report is required to register with the *Système Informatique pour le Répertoire des Entreprises et de leurs Établissements* ("S.I.R.E.N.E."), France's official national business registry. Registration may take several months. Once a "S.I.R.E.N." number is obtained, the entity must subscribe to a professional tax space on the F.T.A. portal. The filing must be made not later than May 15 of the relevant year.

Finally, the F.T.A. guidelines allow for a specific extension of Exemption 7, by considering that the requirements for Exemption 7 are met at the level of the French or foreign company,[37] owning real estate, provided that the said company has duly filed a complete Form 2072 for real estate companies not subject to corporation income tax. That is. the form usually filed by a French S.C.I.[38] The extension does not work, however, for other entities in the ownership chain.

Filing Form 2072 fulfills the criteria for Exemption 7, even though the value of the underlying real estate is not required to be reported. This route is often misunderstood and underused by taxpayers. It protects the filing entity from a possible reassessment based on the allegedly incorrect valuation.

Wealth Tax Compliance Not A Free Pass

The 3% tax is independent from other French taxes. An entity still owes corporate or individual income tax on the income generated by the property and the 3% tax cannot be deducted from the taxable base for those taxes.[39] On the other hand, the 3% tax has been conceived in order to trace taxpayers subject to wealth tax. Therefore, it would not be shocking to consider that if the wealth tax is actually paid with respect to the French real estate held indirectly by individual taxpayers, the 3% tax should not apply, since the opacity of the holding structure did not prevent the collection of the wealth tax.

[36] French Supreme Court, Commercial Chamber, October 5, 1999, 97-14.410, *Berenix Finanzetablissement.*

[37] As the only criterion laid down by the FTA's guidelines is that of being a real estate company not subject to corporate income tax which rents out its properties or makes them available to its shareholders/members, foreign companies complying with these formalities also appear to be able to rely on this specific extension. An example is a *Monegasque Société Civile Particulière* ("S.C.P.").

[38] BOI-PAT-TPC-20-20 no.'s 370 and 380 (October 5, 2016) providing that look-through S.C.I.'s are not required to file Form 2072.

[39] Article 990 G of the F.T.C.

Surprisingly, in such situation, the 3% is still due. The F.T.A.'s guidelines are clear that an entity is not subject to the 3% tax only where the F.T.A.'s knowledge of the identity of its individual members subject to wealth tax results from the entity's own communication of that information under Exemption 7.[40]

Taxpayers are required to follow the reporting requirements strictly. Recourse to the courts have not been helpful. In one case, a Luxembourg company owned an apartment in Cannes and reported that it was held by an individual. However, the company's bylaws and various other documents referred to foreign companies in the chain of ownership. The Court held that the conditions for the exemption were not met and the 3% tax was due, even though the named individual timely reported and paid French wealth tax on the value of the shares of the Luxembourg company.[41]

In a recent decision of the Judicial Court of Paris,[42] a wealth tax return was filed by the individual, but the Court held that it did not establish, *per se*, his capacity as owner of the shares for the 3% tax purposes. The Court did not allow the entity to benefit from Exemption 7. Hence, it confirmed that Exemption 7 is earned only through the entity's filings, not by its shareholders/member's tax behavior.

First Time Offender Relief

An entity that could have been exempt from the reporting obligation under Exemption 7, but neither filed nor undertook an obligation to disclose information, may, at the discretion of the F.T.A., be given a 30-day notice to regularize its situation. If the entity comes into full compliance during that period, the tax is not levied and no penalty applies. Should the answer lead to a partial exemption, the tax remains due on the rights whose holders have not been disclosed. Note that where a chain of entities is involved, the F.T.A. may notify only one of the entities in the chain without notifying the others. The 30-day notice to one company should be seen as a warning for the group as the F.T.A. extends relief to entities that regularize their situation on their own initiative.[43] Note this is a one-time-only relief that has its origins in a 2000 ministerial response.[44] As in effect today, (i) the regularization possibility is available only where there has been no previous filing at all, not where the tax returns were filed incomplete or erroneous[45] and (ii) it applies only to the entity's first infringement, for its whole existence.[46]

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40 BOI-PAT-TPC-40 no. 30 (September 12, 2012).

41 Court of Appeal of Aix-en-Provence, March 5, 2019, no. 17/07724, *Sté Semiramis Investments*, and French Supreme Court, Commercial Chamber, May 25, 2022, no. 19-17.099. The appeal to the French Supreme Court was dismissed without any examination of the merits.

42 Judicial Court of Paris, January 16, 2026, no. 25/00910, *Christophorus*.

43 BOI-PAT-TPC-30 no. 20 (October 4, 2017).

44 Rép. min. Loncle, National Assembly, March 13, 2000, n° 39372.

45 Rép. min. Masson, National Assembly, March 7, 2023, n° 4005.

46 Court of appeal of Caen, February 21, 2023, n° 20/00203, *Sté Paradise Investment Corporation*.

CASE LAW IS UNFORGIVING

Exemption 7, being by far the most often claimed by taxpayers, it deserves specific attention, as the two-page tax return that is simple in appearance hides many pitfalls.

Standard Applied by Courts

The French Supreme Court reads the reporting requirements strictly, as they are a prerequisite for an exemption. The information provided in the tax return must be exact, complete and verifiable, and the entity must be as transparent with the F.T.A. to the same extent that is applicable to a company with its seat located in France.[47]

The burden of proof lies with the taxpayer seeking a tax exemption. Consequently, the taxpayer must be able to produce supporting documentation confirming the veracity of its position. The F.T.A.'s list of acceptable documents include the following:

- Corporate acts filed with the courts or public services of the State of residence of the foreign entity
- Tax returns filed with the foreign tax authorities
- Documents authenticated by a member of a regulated profession recording the allocation and movement of shares / units / other rights together with evidence of the financial flows behind them
- Any other official document issued by foreign administrations[48]

The documentation should have a demonstrable, timely date of issuance in order to prevent the F.T.A. from contending that the documents were prepared after the returns were filed.

The F.T.A. does not need to prove that the return contains errors, only that the proof offered is insufficient. Nor does the F.T.A. need to invite the filing entity to complete an inaccurate answer before refusing the exemption and applying the 3% tax.[49]

This "pursuit of perfection" can lead to particularly harsh rulings:

- Bearer shares buy no indulgence. A company must put in place a way to identify who holds such shares at all times during the relative period.[50] Where a company is unable to identify the holder at all times relevant because, for example, it never implemented a tracking system, that is the company's problem. The F.T.A. is not obliged to seek international assistance, as the F.T.A.'s duty is to examine the evidence presented by the company.[51]

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47 French Supreme Court, Commercial Chamber, October 18, 2011, no. 10-25.211, *Sté Immofra.*

48 BOI-PAT-TPC-20-20 no. 570 (October 5, 2016).

49 French Supreme Court, Commercial Chamber, June 13, 2018, no. 16-24.714 F-D, *Sté Tourism Investments and Consulting.*

50 French Supreme Court, Commercial Chamber, December 15, 2009, no. 08-20.840, *Sté Erice.*

51 Court of Appeal of Aix-en-Provence, April 11, 2023, no. 19/15297, *SA Matro.*

- A single detail can result in the loss of the exemption. In one case, a company properly revealed the identity of its shareholder but provided the wrong address. As a result, it lost the exemption even though it later rectified the error.[52]
- The company must prove the reality of the ownership. In a recent decision of the Nice Judicial Court,[53] a company duly filed the Form 2746 naming a sole shareholder with his address in France but the F.T.A. asked how a 27-year-old student came to hold all the shares of a company owning a property worth approximately €10.0 million. The F.T.A. also requested evidence of the financial flows. The explanation was that the purported owner received a gift of €20.0 million from his mother. Neither explanation survived scrutiny. The deed of gift, though translated, had no certain date, having been neither apostilled nor registered in France. The bank statements did not carry the bank's letterhead and showed funds moving between third parties. Nothing established that the declared shareholder personally paid for the shares. The 3% tax applied.

More generally, the reporting obligation concerns not only the identification of the shareholders but also the location, composition, and value of the property. The F.T.A. might refuse to accept the application of Exemption 7 if it considers that any of the information submitted is incorrect, especially with regard to valuation. Indeed, it is not unusual for the F.T.A. to disagree with a valuation of a property supported by a real estate expert opinion in an attempt to assess the 3% tax based on a valuation mistake. A formal valuation by a valuation expert is, in any case, a necessary element of the file in order to proactively address the risk. The authors are unaware of case law on this point. It remains to be seen whether courts would accept such severity where the discrepancy between value advanced by the F.T.A. and the valuation submitted in the tax return is not significant, given the potentially heavy outcome for taxpayers.

"More generally, the reporting obligation concerns not only the identification of the shareholders but also the location, composition, and value of the property."

Exclusion of Nominees

Putting forward a nominee ("*prête-nom*") does not discharge the entity from the obligation to reveal the beneficial owner. In one case, a Swiss company declared its accountant as the owner, when, as nominee, he had no decision making authority and no beneficial interest in the company, since he was only acting as a nominee. The company did not meet the requirements to benefit from the exemption based on reporting.[54]

Foreign Trusts

Foreign trusts are considered by tax authorities as institutions comparable to the French "*fiducie*." Therefore, French real estate held by a trust is within the 3% tax scope even if the trust has no legal personality. The trustee is, in principle, the one who should carry out the reporting and pay the 3% tax for failing to do so.

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[52] French Supreme Court, Commercial Chamber, October 2, 2019, no. 17-26.858, *Sté Tiana Real Estate.*

[53] Nice Judicial Court, May 26, 2025, no. 23/01740, *Ampezza*.

[54] Judicial Court of Draguignan, August 8, 2025, no. 23/00835, *S.A. Belac Handels.*

The F.T.A.'s view is as follows regarding trusts:

> Where the trust, through the trustee or another authorized member, elects to benefit from [the reporting exemption], it must state in form 2746 the following information:
>
> a. the member or members of the trust who are the actual holders of rights over the French real estate property or real estate rights placed in trust, according to an assessment made on a case-by-case basis for each trust by the trustee or the authorized member. As a general rule, and subject to the trust deed, this will be the settlor where the trust is revocable, and the beneficiaries where the trust is irrevocable,
>
> b. and, for information purposes, the other members of the trust.
>
> The information relating to the allocation of rights within the trust must also appear on this declaration.[55]

It should be noted that the broad approach of "members" of the trust to be reported – the settlor, the trustee, and the beneficiaries – is not aligned with the wealth tax rules applicable in the presence of a trust, which never target beneficiaries during settlor's lifetime, irrespective the revocable or irrevocable nature of the trust.

In short, everybody could end up being named but matters become more complex when it comes to indicating the allocation of rights in the case of an irrevocable discretionary trust with several beneficiaries, where no such allocation is provided for by the trust documentation. Such complexity and uncertainty stem from the fact that French tax law, even today, struggles to grasp these Anglo Saxon mechanisms.

The legal uncertainty of provisions in relation to trusts, pointed out by practitioners, have not prevented the French Supreme Court from refusing to refer to the French Constitutional Court a priority preliminary ruling on the issue of constitutionality (*question prioritaire de constitutionnalité*) directed at the imprecision of the terms used by the French Parliament. It held as follows:

> The contested terms "shareholders, partners or other members" of "legal entities: legal persons, bodies, trusts or comparable institutions" appearing in Article 990 E, 3°, (d) and (e) [of the F.T.C.], if they are understood broadly so as to allow all entities liable to be covered by that provision to be encompassed, whatever their legal form, are sufficiently precise for the persons and entities concerned to be identified, if need be by means of an interpretation carried out in the light of the intention of the legislator, which is, with the aim of combating tax fraud and tax evasion, to deter taxpayers subject to the wealth tax from escaping that taxation by creating, in States which have not concluded with France a tax treaty containing an administrative assistance clause, entities which become owners *of* real estate assets located in France.[56]

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55 BOI-PAT-TPC-10-10 no 120 (September 12, 2012).

56 French Supreme Court, Commercial Chamber, April 11, 2018, no. 17-21.938, *Fondation Nafond Privatstiftung*.

In light of the broad approach of the French Supreme Court, consideration should be given to amending the Form 2746, which applies to companies to properly explain in an addendum to such form the interpretation of the trust documentation leading to a certain allocation of rights among the settlor, the trustee, and the beneficiaries. Form 2746 is inapplicable when trusts are involved.

Report in Context of a *Fiducie*

The F.T.A. takes the view that a *fiducie* should be considered as a look-through entity. Hence, for the 3% tax purposes, the settlor is deemed the holder of rights over the assets held in the *fiducie* and also bears the reporting obligation.[57]

Those rules extend to foreign entities comparable to a French *fiducie* – other than a trust – which leads to a delicate assessment of comparability of legal systems.

Where There Is No One To Name

Exemption 7 assumes that there is someone to name at the end of the ownership chain. The whole reporting mechanism is built on identifying the holders of more than 1% of the rights. What happens where an entity, by its very nature, has no such holders? The French Supreme Court addressed this problem in 2024.[58]

The case concerned a Liechtenstein foundation which, by its legal nature, had neither shareholders, nor members, nor any other holders, and which was unable to designate with certainty a current beneficiary for each tax year because of a dispute between the potential beneficiaries. The founder died but the foundation could not be wound up because of pending litigation over the ownership of its assets. The foundation, wishing to be perfectly transparent with the F.T.A., named the two parties to the litigation as possible beneficiaries in its returns, namely (i) the American charitable foundation which was to receive the assets once the dissolution could be carried out and (ii) the individual claiming ownership of those assets. No current beneficiary existed.

The French Supreme Court followed the F.T.A.'s analysis and ruled that the choice of a specific structure was made by the person who arranged for the entity to be formed. If there is no one to be named as the current owner, that is a problem for the entity, not for the F.T.A. Although the foundation acted in complete good faith and disclosed the names of the two possible beneficiaries in the proper form, it ended up having to pay approximately €3.8 million for five years involved.

PRACTICAL GUIDANCE

Given that the 3% tax regime still bears many uncertain aspects, with a still evolving case law, it is necessary to analyze two items in order to reassess correctly the 3% tax situation. The first is the entity's situation upon the purchase of (i) the French real estate or (ii) the shares or rights of an entity holding, directly or indirectly, such real estate and any subsequent changes in the ownership chain as regards real estate. The second is to keep track of subsequent developments in the statute, administrative pronouncements, and case law.

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57 BOI-PAT-TPC-10-10 no 70 (September 12, 2012).

58 French Supreme Court, Commercial Chamber, May 10, 2024, no. 21-11.230 FS-B, *Fondation Beaux-Arts Stiftung*.

Here are several questions that should be asked and answered each year.

1. **Can the entity be considered as a predominantly French real estate entity for the 3% tax?**

Exemption 3 (non-predominantly real estate company) is very appealing as it is automatic and comes with no other requirements. However, the ratio computation needs to be addressed carefully.

The numerator must include furnished rental activities if they cannot be characterized as para-hotel business. Courts demand evidence of services actually supplied to guests in a manner similar to a professionally run hotel.

The denominator is narrower than the accounting figures might suggest. In the case of a chain of intermediary companies, the value of the shares in intermediaries and loans made to an intermediary company that are used by it to finance the acquisition of real estate or shares in a lower-tier company are excluded. In addition, only French assets are included in the denominator.

2. **Where is the seat of the entity?**

It is necessary to check the location of the seat of effective management, not of the registered office, to determine whether the seat is located in a State which allows Exemptions 4 to 7. It is also necessary to maintain evidence of the State in which the entity is actually managed. This entails tracking the place where (i) in-person board meetings are actually held, (ii) banking relationships are maintained, (iii) persons having signature authority are located, and (iv) accounting records are maintained. A perfectly compliant return filed by an entity that is not in the right State will result in the 3% tax being applied.

3. **Are you ready for developments in the future?**

"It is necessary to check the location of the seat of effective management, not of the registered office, to determine whether the seat is located in a State which allows Exemptions 4 to 7."

If Exemptions 1 to 6 are not available, file Form 2746 by the May 15 deadline every year for every entity in the ownership chain that owns, directly or indirectly, French real estate. As from 2027, an undertaking to disclose to provide information upon request no longer entitles a company to an exemption. Client benefiting from an undertaking must be made aware of the annual filing requirement. A foreign entity with no other French tax obligations to be able to file online (i) must register online with S.I.R.E.N.E. in France to obtain a S.I.R.E.N. number and (ii) create a professional tax space on F.T.A.'s website with subscription to the "T.V.V.I." online service, a process slow enough that it should be started at the end of 2026 rather than in the Spring of 2027.

Wherever an entity can benefit from the administrative tolerance by filing Form 2072 instead of Form 2746, it should do so. That is the preferred route because it avoids disclosing the value of the underlying real estate asset, and thus limiting the possible topics of discussion with the F.T.A. Form 2072 must also be filed online, making the registration to the online tax space a mandatory step.

If the entity is part of a chain, it must coordinate with entities higher up in the ownership chain to ensure that all entities file on a consistent basis.

4. **Who should be disclosed?**

It is necessary to disclose the actual current economic owner and nobody else. The filing should be supported by reliable evidence such as (i) official corporate filings, (ii) documents lodged with a foreign tax authority, (iii) instruments authenticated by a regulated professional, and (iv) proof of the money behind the transfer. Producing only internal documents may indeed not be sufficient for the F.T.A.

An erroneous mention may lead to a reassessment of six years of tax plus the current year. It is thus crucial to have it right as from the beginning.

5. **In which language should the evidence be produced?**

The F.T.A. is only required to examine documents submitted in French. All foreign documents must be translated into French. Where the Latin alphabet is used, a free translation may suffice, but where a different alphabet is used such as Arabic, Cyrillic, Hebrew, etc., it is recommended to call upon a certified translator in order to obtain a sworn translation.

6. **Has a trusted tax representative been appointed?**

Pursuant to new article 990 FA of the F.T.C., a French tax representative is mandatory as from 2027 for entities with no French permanent establishment. It is a practical guard against notices being served, by default, on the nearest known entity in the chain. In the latter case, the other entity receiving an F.T.A. notice must have the resources and internal procedures to forward every communication without delay, since the 30-day window to regularize a first omission runs from receipt of the correspondence.

7. **Are you prepared for the F.T.A.'s reaction to filed documents?**

The compliance file should be assembled and refreshed every year and not hastily reconstructed after the beginning of the discussion with the F.T.A. In this regard, it is recommended to have an appraisal conducted by an expert, updated every third or fourth year, with yearly updates based on the market evolution in between, in order to minimize the risk of disputes with the F.T.A. regarding the value of the property.

8. **As a purchaser, have you taken steps in the acquisition due diligence to limit joint and several liability for the 3% tax of an affiliate of the seller?**

The 3% tax liability is borne by the entity owning real property and its related companies in a chain of ownership. In a share deal, pre-acquisition due diligence should focus on compliance history of the seller and other members of the chain for (i) the six prior years and the year of purchase. In addition, the purchaser may wish to establish whether the one-time free pass regularization has already been used.

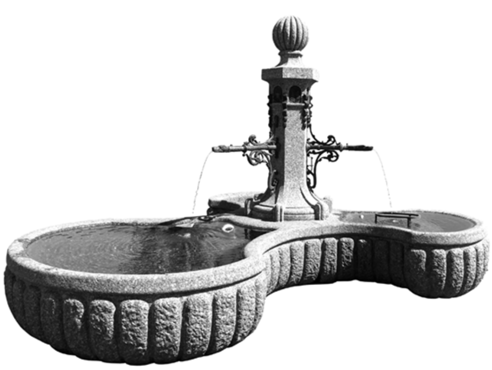
CONCLUSION

The 3% tax is unforgiving. For an entity aware of its obligations and in compliance, it can be quite straightforward, although complicated cases remain. For an uninformed entity, there are a multitude of ways to get it wrong:

- A seat located in the wrong State
- A nominee is indicated in the tax return instead of the actual beneficial owner
- A correct name is given, but with a wrong address
- A valuation is disputed by the F.T.A.
- An undertaking is jeopardized by returns that have been "filed for good measure"
- A structure which, like the unfortunate *Beaux-Arts Stiftung*, has nobody to name

The 2026 reform that first applies in 2027 calls for advance preparation to the 2027 tax season and the possible reassessment of the internal processes with respect to the 3% tax. A few hours of analysis and preparation can save months, if not years, of discussions with the F.T.A. and a significant amount of money.

Those willing to put in the time and effort may take comfort by a passage from a sailor who circumnavigated the globe in a yacht: "The art of a sailor is to leave nothing to chance."[59] Those unwilling to put in the time and effort may wish to recall the lament of the Duke of Clarence: "Me thought I saw a thousand fearful wrecks."[60]



[59] Van de Wiele, Annie. *Pénélope était du voyage*. Paris: *Éditions de la Pensée Moderne*, 1954. Translated into English, Penelope Was on the Tour. Translated by N. Johnston. London: Hodder & Stoughton, 1955.

[60] *Richard III* (Act 1, Scene 4).

TAXATION OF TRUSTS AND FOUNDATIONS IN THE NETHERLANDS

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Tags
A.P.V.
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INTRODUCTION

People cross borders. They move to other countries and they invest abroad. Crossing borders invariably raises the question of foreign tax exposure. Legal systems regarding taxation differ significantly between jurisdictions, and legal vehicles used to attain a specific goal often must be revised when a border is crossed.

A clear illustration of this is the trust, which is widely used in the Anglo-Saxon world, but not in continental Europe, where foundations are widely used. In the Netherlands, statutory law is not familiar with the trust as a legal form, even though trusts settled according to foreign law are respected under the Hague Convention on Trusts (July 1, 1985). Trusts are quite often associated with tax avoidance. For that reason, the Netherlands has implemented anti-abuse rules which can be relevant for persons living in the Netherlands or abroad.

In comparison, foundations are often used to perform the same functions as trusts. A Dutch foundation (known as a "*stichting*") has legal personality and holds assets and liabilities in its own name. However, a *stichting* is not permitted to distribute income to its founder, board members, or persons closely related to them. As a result, a *stichting* is generally not a suitable vehicle for separating assets from one's private estate.[1]

That said, in corporate structures, a *stichting* frequently is used to separate economic ownership from legal ownership of assets, particularly shares. The owner contributes assets to the *stichting*, which in return issues certificates representing the economic ownership of those assets. The certificate holder is entitled to all income, but the foundation retains and exercises the voting rights. The tax treatment of the certificates could differ depending on the nature of the assets that are linked to the certificates.

In a widely used structure, a *stichting* will hold 5% or more of the shares in a company in order to achieve a substantial participation. The *stichting* issues certificates. The certificates are treated in the same way as the underlying shares. They are also taxed as a substantial interest in the share capital of the underlying company.

A *stichting* is often used to acquire real estate, where the acquisition is partly funded by a bank loan and partly by the issuance of certificates. In this fact pattern, the certificates may be treated as a separate asset class having the form of a receivable and the certificates cannot be replaced by the underlying assets (the real estate) and the liabilities (the loan). However, the Dutch tax treatment may be different. A *stichting* that issues certificates can be used to hold investments, even though it is

1 In comparison, applicable law in some European countries allow foundations to distribute income to the founders or directors or to both.

normally not regarded as an investment fund. Nonetheless, a foundation is included in many Dutch investment fund structures to hold the legal title to the investments on behalf of the investment fund.

This article focuses on the tax treatment of the discretionary trust under Dutch law and the tax regime introduced to address the use of separated private assets.

THE A.P.V. REGIME

Discretionary trusts are more or less treated as tax transparent entities. This transparency is achieved, because the assets, liabilities, and income of a trust are attributed to the contributor as if no contribution took place. This is commonly referred to as the attribution rule which is at the heart of the *Afgezonderd Particulier Vermogen* ("A.P.V.") regime.

An A.P.V. is defined as a segregated estate that is intended to serve a private interest that is more than incidental. The definition is broad and open-ended. It encompasses various foreign legal forms used to segregate assets and to take account of international and future societal developments. Examples of A.P.V.'s include a trust, a *stiftung*, an *anstalt*, or a *treuhand* serving a private interest.

The fund must be discretionary in nature. For example, the board may freely decide how the A.P.V.'s assets are to be distributed, so that no person has legally enforceable rights against the fund. An example is a wholly discretionary trust. The term "private interest" refers to a situation in which the assets primarily benefit a limited, closed group of individuals and where admission or replacement of members is not easily possible. Typically, this involves the family circle of the original contributor and includes spouses and children. The critical question is whether the A.P.V.'s actual activities are predominantly focused on private interests and whether the nature and scope of the contributed assets predominantly indicate a private purpose.

The A.P.V. regime does not apply (i) to an arrangement that serves a social purpose or (ii) when a formal segregation of ownership interests occurs. Examples of a formal segregation include the issuance of shares, profit shares, membership rights, certificates of participation, or comparable rights. The rationale for this exclusion is that the economic interest is already held by an identifiable person who can be taxed directly.

The initial contribution of assets to an A.P.V. does not constitute a taxable event for Dutch gift tax purposes. Any distribution made by the A.P.V. to a person other than the contributor while the contributor is alive is treated as a gift. Upon the death of the contributor, any person who receives an interest previously deemed owned by the contributor is treated as receiving an inheritance.

As mentioned above, a fund will not qualify as an A.P.V. if it serves a social purpose rather than a private interest. Case law illustrates the boundary between the two. A family foundation that makes payments primarily to family members, with some minor funding for medical research, serves no social interest because payments are made only to members of a single family. The fact that a family includes a large number of members is irrelevant. Maintaining family cohesion and managing the family burial plot are not considered to be social objectives.

A fund must serve a private interest to more than an incidental extent, which is understood to mean 10% to 15%. This threshold strikes a balance between (i) preventing tax avoidance in cases of genuine private or family-oriented asset segregation and (ii) ensuring that legitimate philanthropic initiatives focusing on the general public would not be discouraged.

ATTRIBUTION OF ASSETS

Attribution to the Grantor

As mentioned above, assets, liabilities, and income of a trust are attributed to its grantor. In principle, this applies only to individuals. The attribution rule is effectively equivalent to tax transparency. As a consequence, several traps commonly exist for the unwary:

- If a grantor of a trust moves to the Netherlands, he or she will be subject to income tax in the Netherlands with regard to the worldwide income received by the trust. In addition, the grantor of the trust is deemed to be the owner of the trust assets and the obligor under the trust's liabilities.
- A nonresident grantor can be subject to Dutch income tax with regard to Dutch source income of a foreign trust. Dutch source income includes among others income from real estate situated in the Netherlands and income from a substantial interest of a company situated in the Netherlands.[2]
- If the assets of the trust pass upon the death to an heir or legatee, a deemed transfer is viewed to have occurred. This deemed transfer could potentially trigger capital gains tax depending on the assets owned by the trust. For example, under the current Dutch tax regime capital gains tax may be due in connection with the deemed transfer of a substantial interest in shares held by the trust.

Attribution to Heirs

Upon the grantor's death, the assets of the A.P.V. are attributed to the heirs. The term "heir" is interpreted in accordance with statutory inheritance law or a will. The legislature deliberately chose the term "heir" rather than "beneficiary under the law of succession" because the latter also encompasses legatees and beneficiaries under specific bequests. Inclusion of those recipients could produce unreasonable results. Allocation among heirs follows the statutory or testamentary distribution. This approach is intended to create a robust system that is considerably more difficult to circumvent through tax planning structures.

The term "heir" includes a person who has been disinherited but who, by law or in fact, directly or indirectly, is a beneficiary of the segregated private assets. It also includes a person whose partner or lineal relative is a beneficiary. The term "disinheritance" is broadly interpreted and applies not only to explicit disinheritance but also to implicit disinheritance, such as the appointment of another person as heir under a will.

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[2] Again, an interest is substantial if it represents 5% of the issued and outstanding shares.

Just like the grantor, the heirs can become subject to Dutch income tax if they live in the Netherlands. And if the successor beneficiary lives outside the Netherlands, the successor beneficiary can be taxed in the Netherlands on income derived from Dutch source assets and gains from their disposition.

Attribution to Beneficiaries

If the contributor, his or her partner, and heirs cannot be identified, the assets are attributed to the beneficiaries. The term "beneficiary" encompasses anyone who is, in substance, a beneficiary by reason of the receipt of good title to an asset. The term also includes someone designated by the board at a later date.

The Attribution-Stop

The assets of the A.P.V. are not attributed to the grantor, heirs, or beneficiaries if the A.P.V. operates a business and the income generated by that business is subject to a tax on profits. This rule applies only to business assets. All non-business assets held by the A.P.V. remain subject to attribution. In practice, most trusts hold assets passively and will therefore not benefit from the attribution-stop.

DUTCH INCOME TAX CONSEQUENCES OF DISTRIBUTIONS

Because the assets and income of the A.P.V. are directly attributed to the grantor, heirs, or beneficiaries, a distribution by the A.P.V. to such persons has no additional income tax consequences.

If an A.P.V. makes a distribution to a person to whom the assets are not attributed, there are no income tax implications in the case of a discretionary trust, because the beneficiary has no source of income to which the distribution can be attributed. The position may differ if the A.P.V. is not entirely discretionary and the beneficiary holds legally enforceable rights.

DUTCH GIFT AND INHERITANCE TAX

The Netherlands levies inheritance and gift tax at rates of up to 20% (for the spouse and children) and 40% for others where the testator or donor is a tax resident of the Netherlands at the time of death or the date of the gift. Dutch law contains a rule under which Dutch nationals who have emigrated are deemed to be a resident of the Netherlands for an additional 10 years after leaving the Netherlands. The A.P.V. regime applies equally to Dutch gift and estate taxes, which means that if a grantor, heir, or beneficiary passes away, the assets and liabilities of the trust which are attributed to him or to her are deemed to be obtained by his heirs and subject to inheritance tax. The statutory provisions of the Inheritance Tax Act 1956, including the available exemptions and the business succession scheme, apply *mutatis mutandis*.

If an A.P.V. makes a distribution, it is deemed to have been made by the contributor, heirs, or beneficiaries to whom the assets are attributed. A practical problem arises where the assets are attributed to multiple persons, as a distribution is, in principle, attributed to those various persons, and it is not possible to attribute the distribution exclusively to a single person. One approach to address the issue is to attribute the assets and liabilities *pro rata* to the value of (i) the initial contribution or (ii) the interest in the deceased grantor's estate. If a person does not receive more than the amount which is already attributed to him or her, it would be logical that no Dutch gift tax should be due. However, the law is not clear in this respect. A risk exists that a portion of a lifetime gift must be attributed to all other persons to whom the assets of the trust are attributed. If that person lives in the Netherlands, gift tax will be due.

An example illustrates the working of the law. Assume that two brothers are the sole heirs of their father's estate. Father has granted €1.0 million to a trust. One brother resides in the U.S. and the other brother in the Netherlands. The trust distributes €100,000 to the brother in the U.S. The assets of the trust are attributed 50/50 to the brothers. Therefore, half of the gift could be attributed to the brother living in the Netherlands and would then be subject to gift tax. Of course, this is not logical as long as the brother living in the U.S. does not receive more than €500,000, representing the assets that were attributed to him in the first place. This is an important issue to look into when setting up a trust structure or when people involved in the trust move to the Netherlands.

An important advantage of the Dutch system is that the contribution of assets to an A.P.V. is not considered as a donation for Dutch gift tax purposes. This represents a fundamental departure from earlier case law, under which the Supreme Court ruled that a trust could be regarded as an acquirer for gift and inheritance tax purposes.

In practice, this exemption is a useful estate planning tool as it allows assets to be set aside without incurring gift tax, which can facilitate the use of an A.P.V. for non-tax reasons. The exemption also applies to subsequent contributions of assets. Note, however, that the exemption does not apply to the extent that the A.P.V. is not discretionary.

THE DISCRETIONARY VERSUS NON-DISCRETIONARY DISTINCTION

The attribution rules apply only to the extent that an A.P.V. is non-discretionary. For assets to be classified as non-discretionary, it is not sufficient that they must be used for persons designated as beneficiaries. That circumstance, alone, does not imply that one or more beneficiaries have a concrete, legally enforceable right to those assets. To the extent that beneficiaries have specific, legally enforceable rights, the assets are not attributed to them but to the A.P.V.

Remarkably, the law does not clearly specify how attribution is to be carried out if the A.P.V. is not entirely discretionary. The beneficiary, however, is taxed independently. The beneficiary has a claim that will, in principle, be taxed as an economic right (assets). Under certain circumstances, however, it may also have the character of a *usufruct* on shares constituting a substantial interest.

The legislative history sets out the following approach:

- The discretionary portion is attributed to the grantor or, after that person's death, to the heirs.
- The nondiscretionary portion is directly attributed to the person holding that right.

In the case of a fixed trust, the beneficiaries hold enforceable rights on a distribution. The grant of these rights is seen as a direct gift from the grantor to the beneficiary. That gift is subject to Dutch gift tax if the grantor is a tax resident of the Netherlands.

CONCLUSION

The Dutch A.P.V. regime represents a comprehensive and technically sophisticated framework for the taxation of trusts and foundations. At its core is the attribution rule, which treats the assets, liabilities, and income of a segregated private estate as if no separation ever took place, attributing them directly to the grantor for tax purposes. This approach effectively renders the discretionary trust fiscally transparent under Dutch law, removing any tax advantage from the mere act of placing assets into a trust or foundation structure.

The regime presents a number of practical challenges, particularly (i) when the beneficiaries of the trust are not the same as the heirs of the person to whom the assets of the trust are attributed (or the interest in the estate and possible distributions by the trust are not the same), (ii) when the assets are contributed by more than one grantor or are attributed to more than one heir, (iii) where the discretionary and non-discretionary elements of a trust overlap, or (iv) where a contributor or heir resides outside the Netherlands and is unfamiliar with the Dutch attribution rules. These rules become particularly relevant when a contributor or heir moves to the Netherlands.

Finally, each of the persons involved in a trust, such as the grantor, the trustee, the beneficiaries, and the protector should be aware of the obligation to disclose his or her affiliation with a trust on a timely basis in a Dutch income tax return.

"The Dutch A.P.V. regime represents a comprehensive and technically sophisticated framework for the taxation of trusts and foundations."

BEYOND FORM W-7: PRACTICAL LESSONS FROM THE FRONT LINES OF I.T.I.N. COMPLIANCE

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INTRODUCTION

For many foreign individuals, obtaining a U.S. Individual Taxpayer Identification Number ("I.T.I.N.") represents their first substantive interaction with the U.S. tax system. At first glance, the process may appear relatively straightforward: (i) complete Form W-7, (ii) provide the required supporting documentation, (iii) submit the application to the Internal Revenue Service ("I.R.S."), and (iv) await issuance of the I.T.I.N. In practice, however, the process is considerably more nuanced.

In assisting international clients with I.T.I.N. applications as an I.R.S. Certifying Acceptance Agent ("C.A.A."), the most significant challenges are not always rooted in the technical completion of the application, itself. Rather, the areas that require the greatest attention involve the following:

- Identity verification
- Document collection
- International logistics
- Applicant expectations
- Compliance procedures

Many applicants are unfamiliar with the full scope of the C.A.A.'s role. A C.A.A. is not simply a passport certification service. The I.R.S. places significant responsibilities on a C.A.A., including identity verification, record retention, compliance procedures, and cooperation with I.R.S. oversight activities. Accordingly, a reputable C.A.A.'s role extends well beyond the preparation of forms and the assembly of supporting material.

This article offers practical observations drawn from true life experience as a C.A.A., working in coordination with legal and tax advisors to assist international clients in navigating the administrative and compliance-related dimensions of the I.T.I.N. application process. It examines the purpose of the I.T.I.N. program, the role and responsibilities of the C.A.A., common misconceptions surrounding I.T.I.N.'s, and practical lessons learned from guiding foreign individuals through the application process.

DEMAND FOR I.T.I.N.'S

The demand continuously increases for I.T.I.N.'s as international investment into the United States grows.

Foreign individuals routinely invest in U.S. real estate, establish U.S. limited liability companies, participate in startup ventures, acquire interests in private investment structures, or become partners in businesses operating in the United States. Obtaining an I.T.I.N. becomes a necessary component of U.S. tax compliance by those individuals.

In practice, many applicants are entrepreneurs, investors, business owners, or family members having little prior exposure to the U.S. tax system. Often, they are surprised to learn that a U.S. I.T.I.N. may be required even if they do not reside in the United States and have only limited physical presence in the country.

For these individuals, the I.T.I.N. application often becomes an introduction to the administrative and compliance expectations of the I.R.S. That initial experience can shape how applicants perceive the U.S. tax system for years to come.

UNDERSTANDING THE I.T.I.N.

An I.T.I.N. is a tax processing number issued by the I.R.S. to individuals who have a U.S. tax reporting obligation, but who are not eligible to obtain a Social Security Number ("S.S.N.").

Typical applicants include the following:

- Nonresident aliens filing Form 1040-NR
- Foreign investors receiving U.S.-source income
- Members of U.S. limited liability companies
- Partners in partnerships conducting activities in the United States
- Foreign spouses included on certain tax returns
- Certain dependents
- Individuals claiming benefits under an applicable income tax treaty

An I.T.I.N. is not an immigration document. It does not authorize employment in the United States, confer immigration status, establish eligibility for Social Security benefits, or create a right to reside in the United States.

While this distinction may be readily apparent to practitioners, it remains one of the most common areas of confusion for applicants. Many non-U.S. individuals incorrectly assume that an I.T.I.N. changes their immigration position or automatically makes them a U.S. tax resident. Neither is true.

An I.T.I.N. serves only one purpose. It allows the I.R.S. to identify taxpayers who have a U.S. tax reporting obligation but are not eligible for an S.S.N.

THE C.A.A. PROGRAM

Historically, I.T.I.N. applicants were required to submit original passports to the I.R.S. or certified copies issued by the passport authority of the issuing country. For many individuals, this requirement created understandable concerns. A passport is often a person's most important identification document and sending it through international courier systems for an extended period was viewed as both inconvenient and risky.

The C.A.A. program was designed to address this issue.[1] A C.A.A. is authorized by the I.R.S. to review original identification documents, verify identity and foreign status, complete a Certificate of Accuracy, and submit the I.T.I.N. application package on behalf of the applicant.

For most applicants, this means they can retain possession of their passport while still satisfying I.R.S. documentation requirements. Although this may appear to be a modest administrative benefit, it often removes one of the most significant practical obstacles to obtaining an I.T.I.N. For applicants who (i) travel frequently, (ii) require their passport for immigration matters, or (iii) simply do not wish to send original identification documents through the mail, the availability of a C.A.A. can make a meaningful difference.

"A C.A.A. is authorized by the I.R.S. to review original identification documents, verify identity and foreign status, complete a Certificate of Accuracy, and submit the I.T.I.N. application package on behalf of the applicant."

BECOMING A C.A.A.

Obtaining authorization as a C.A.A. involves considerably more than completing an application form. The I.R.S. requires (i) Acceptance Agent training,[2] (ii) forensic document training,[3] (iii) suitability reviews, and (iv) compliance with ongoing program requirements. The forensic document training component is particularly important. A C.A.A. is expected to review identification documents critically and identify and resolve inconsistencies or concerns before submitting a certification to the I.R.S. The training must provide skills to effectively recognize fraudulent documents, such as,

- a passport,
- a U.S.C.I.S. photo identification,
- a U.S. driver's license,
- a foreign driver's license,
- a birth certificate,
- a visa,
- a national identification card, U.S.,
- a military identification card,
- a U.S. state identification card, and
- a foreign voter's registration card.

When a C.A.A. signs a Certificate of Accuracy, the I.R.S. relies on that certification in lieu of reviewing an original passport. The level of trust that is given by the I.R.S.

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1 See ITIN Acceptance Agent Program, describing the role of Acceptance Agents and Certifying Acceptance Agents in reviewing documentation and facilitating I.T.I.N. applications.

2 "Individual taxpayer identification number acceptance agents training." Internal Revenue Service. (2025).

3 "Forensic Training." Internal Revenue Service, July 13, 2026.

is accompanied by the acceptance of significant responsibility for the C.A.A. when carrying out specified compliance functions. The objective is not simply to complete a filing, but to establish confidence that the information being submitted is accurate, properly documented, and capable of being supported if questioned at a later time.

COMMON MISCONCEPTIONS ABOUT I.T.I.N.'S

Throughout the application process, several misconceptions by non-U.S. persons arise repeatedly:

- The first misconception is the belief that obtaining an I.T.I.N. creates U.S. tax residence. An I.T.I.N. is merely an identification number. Tax residence is determined under separate rules and depends upon factors such as immigration status, physical presence, and applicable treaty provisions.
- The second misconception is that an I.T.I.N. authorizes employment in the United States. It does not. The I.T.I.N. exists solely for tax administration purposes and provides no employment authorization.
- The third misconception is that a foreign individual who owns a U.S. L.L.C. only needs the L.L.C.'s E.I.N. While the E.I.N. identifies the entity, the individual owner may still require an I.T.I.N. for reporting purposes, depending upon the circumstances.
- The final misconception is that the process to apply for an I.T.I.N. can be left until the last minute. In practice, obtaining the I.T.I.N. early often prevents tax return filing delays and allows tax return preparers to prepare returns more efficiently.

Addressing these misconceptions early in the process frequently helps avoid confusion and unrealistic expectations on the part of the non-U.S. individual.

THE CERTIFICATE OF ACCURACY

The Certificate of Accuracy lies at the heart of the C.A.A. program. When signing the certificate, the C.A.A. confirms that (i) the original documentation was reviewed, (ii) identity verification procedures were followed, and (iii) the information presented in the application is consistent with the documentation examined.

The Certificate of Accuracy is therefore much more than an administrative attachment to Form W-7. It represents a professional certification upon which the I.R.S. relies when processing an I.T.I.N. application without requiring original identification documents. For this reason, experienced C.A.A.'s generally maintain detailed records supporting each certification.

I.R.S. REVIEW AND OVERSIGHT OF C.A.A.'S

One aspect of the program that applicants rarely appreciate is the level of I.R.S. oversight imposed on C.A.A.'s.[4] A C.A.A. is not only responsible to the client; he or

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[4] See Acceptance Agent Application Frequently Asked Questions describing training requirements, Responsible Party obligations, and compliance expectations

she is also accountable to the I.R.S. The I.R.S. has the authority to conduct compliance reviews of Acceptance Agents and request documentation relating to specific I.T.I.N. applications. During such reviews, the I.R.S. may examine

- the veracity of a Form W-7 and the Certificate of Accuracy,
- copies of documentation reviewed,
- identity verification procedures,
- record retention practices,
- internal compliance procedures,
- interview records, and
- evidence supporting certifications made to the I.R.S.

The Certificate of Accuracy is not merely a form accompanying an application package. It represents a professional certification that may later be reviewed by the I.R.S. Consequently, maintaining detailed records and documenting verification procedures is not optional. Rather, it is an integral part of the C.A.A. framework. This reality also explains why reputable C.A.A.'s frequently request more information than applicants initially expect.

Questions regarding names, addresses, immigration status, supporting documentation, travel history, or other details are not simply administrative exercises. A professional C.A.A. must be comfortable standing behind the certification provided to the I.R.S. and must be prepared to support that certification if questions arise during a future compliance review. Accordingly, cooperation between the applicant and the C.A.A. is essential in order to raise the level of accuracy and detail at the outset.

From a practitioner's perspective, one of the most important aspects of the C.A.A. program is documentation. A defensible file typically includes the following items:

- Notes of meetings
- Records of passport inspections
- Copies of forms
- Supporting correspondence
- Verification procedures

While applicants understandably focus on obtaining the I.T.I.N., the compliance obligations of the C.A.A. continue long after the application has been submitted. The I.R.S. relies on C.A.A.'s to help preserve the integrity of the I.T.I.N. system. Oversight and documentation requirements help ensure that this reliance is justified.

LESSONS FROM THE FIELD

One of the more interesting observations from administering I.T.I.N. applications is the difference between the I.R.S. instructions and the practical realities of the

applicable to Acceptance Agents.

process. The forms themselves are usually not the difficult part. Identity verification, document logistics, and communication with applicants often require significantly more time and attention. Applicants frequently (i) reside in different countries, (ii) operate in different time zones, and (iii) are unfamiliar with U.S. documentation standards. Gathering information can become a project-management exercise as much as a compliance exercise. Successful I.T.I.N. engagements often depend less on tax technicalities and more on organization, communication, and attention to detail.

"The demand for I.T.I.N. services is strong and likely to grow even stronger."

Here is an example, based roughly on facts encountered in practice, that illustrates the point.

- Mr. X is a national of a Latin American country. He required an I.T.I.N. in connection with a U.S. tax filing obligation.
- The underlying tax matter was relatively straightforward. The applicant's passport was easily verified.
- However, the time required for (i) marshalling supporting documentation, (ii) reviewing documents for consistency, (iii) coordinating with the individual's tax return preparer, (iv) ensuring that all required materials were assembled properly before submission, and (v) overseeing unexpected logistical challenges relating to the transmission of documentation resulted in a time consuming process among numerous individuals that far exceeded the expectation of Mr. X.
- No matter how the process was described in the initial telephone conversation, Mr. X expected the equivalent of a simple attestation of a document by a U.S. notary public.

While every case is different, the example reinforces the importance of managing expectations of a client and close coordination with a client's legal counsel and tax return preparer.

RECENT DEVELOPMENTS

The demand for I.T.I.N. services is strong and likely to grow even stronger. Cross-border investment, international entrepreneurship, remote work arrangements, and increasing global mobility have created situations where foreign individuals require access to the U.S. tax system.

At the same time, the I.R.S. continues to modernize aspects of the Acceptance Agent Program through mandatory electronic applications, enhanced training, and improved administrative procedures. Recent regulatory developments underscore the importance of robust identity verification and documentation procedures. Earlier this year, Fin.C.E.N., together with the Federal banking regulators and in coordination with the I.R.S., issued a joint advisory addressing risks involving non-work-authorized populations, their employers, and the integrity of the U.S. financial system.[5] One portion of the advisory focused on the provenance of I.T.I.N.'s presented to

[5] FinCEN issued Advisory FIN-2026-A002, entitled "Joint Advisory on Non-Work Authorized Populations and Their Employers and Risks to the Integrity of the U.S. Financial System," June 5, 2026.

financial institutions.

> **Enhanced Due Diligence for Individual Taxpayer Identification Numbers (ITINs)**
>
> The Advisory encourages banks to consider the use of an ITIN when applying appropriate risk-based procedures for customer due diligence, in light of the totality of other factors and available information. Specifically, when an ITIN is presented in lieu of a Social Security number or valid employment authorization document to obtain credit products or open an account, banks are encouraged to assess whether the use of an ITIN may be a relevant risk factor.

From a practical I.T.I.N. perspective, the key point is not that an I.T.I.N. is improper or unusual. Rather, it is that financial institutions are expected to consider the quality of the identity documentation, customer due diligence, and surrounding facts in a risk-based manner. In short, it reinforces the need for

- accurate identity verification,
- supporting documentation,
- record retention, and
- adoption of risk-based procedures.

CONCLUSION

The I.T.I.N. is often viewed as a simple administrative requirement. It serves as the gateway through which many foreign individuals enter the U.S. tax system. The C.A.A. Program plays an important role in facilitating that process. While applicants often focus on the issuance of the I.T.I.N. itself, the broader objective is compliance. The I.R.S. relies on C.A.A.'s to verify identities, maintain appropriate records, and uphold the integrity of the application process.

In many respects, the role of a C.A.A. mirrors that of other compliance professionals. The objective is not simply to complete a filing, but to establish a process that is accurate, defensible, and capable of withstanding scrutiny if questions arise at a later point in time. For that reason, requests for additional information or supporting documentation should not be viewed by clients as obstacles. Instead, they should be viewed as essential components of a system designed to protect the integrity of the I.T.I.N. program by allowing C.A.A.-verified copies of identity documentation to be submitted to the I.R.S. instead of original documents.

As international investment and cross-border mobility continue to increase, the importance of the role played by the C.A.A. will increase. In turn, the responsibility that is imposed on the C.A.A. will increase. Experience shows that the most successful applications are not necessarily those involving the simplest facts. Rather, the most successful applications are those where the client and the C.A.A. work together to ensure the process is handled thoroughly, accurately, and professionally from the outset.

FORM 5472 AND FOREIGN-OWNED U.S. ENTITIES: THE NEW CHIEF COUNSEL GUIDANCE

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E.C.I. Tax Blocker
Foreign-Owned L.L.C.
Form 5472
Penalty Relief
Reasonable Cause
Section 6038A

INTRODUCTION

Foreign owners of U.S. limited liability companies ("L.L.C.'s") are often told that the L.L.C. is a disregarded entity for U.S. tax purposes. They assume that it means exactly that: disregarded.

The assumption is understandable. It was true in almost every relevant respect for many years. It is still true for U.S. income tax purposes. A single-member L.L.C. generally files no income tax return of its own. Its income, deductions, and assets belong directly to its owner.

But the assumption is wrong in one important respect.

Since 2017, a foreign-owned single-member L.L.C. has been treated as a domestic corporation for purposes of the reporting and record-maintenance obligations under Code §6038A. The reporting mechanism is Form 5472 (Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business). The I.R.S. instructions confirm that a reporting corporation includes a 25% foreign-owned U.S. corporation, including a foreign-owned U.S. disregarded entity.

Failure to file, or failure to maintain the required records, carries a $25,000 penalty per form per year. Additional $25,000 penalties may follow for continued noncompliance after I.R.S. notice. There is no meaningful cap.

But there may be hope for taxpayers that can show reasonable cause.

On April 24, 2026, the I.R.S. released Chief Counsel Advice 202617012 ("C.C.A."). The C.C.A. addresses when the reasonable cause exception to the Code §6038A penalty applies and, in particular, what it means for the I.R.S. to apply that exception "liberally" for certain small corporations. The C.C.A. may not be used or cited as precedent, but it is still a useful window into how the I.R.S. may evaluate these requests.

BACKGROUND

Many foreign owners missed the 2017 change to the scope of the disregarded nature of their L.L.C.'s. This is especially true where the L.L.C. was formed before 2017 and was never used to conduct an active U.S. business.

Many owners learned about the issue only when the Corporate Transparency Act ("C.T.A.") was about to become effective. By way of short reminder, the C.T.A. was enacted in 2021 to create a nonpublic beneficial ownership database. It was intended to apply to many domestic and foreign entities and to help combat money laundering, terrorist financing, tax fraud, and similar activity. In 2024, the law became effective, and existing entities were generally expected to file by January 1, 2025. Litigation then created major uncertainty. In March 2025, FinCEN issued an interim final rule removing beneficial ownership reporting requirements for U.S. companies and U.S. persons, while leaving certain foreign entities registered to do business in the United States within the narrowed regime.

For foreign owners of U.S. L.L.C.'s, the C.T.A. scare had a useful side effect. It caused them to look at their U.S. entities. When they did, many discovered that Form 5472 had been required for years.

The practical reach of this rule is broader than many expect. The foreign owner does not need to be a foreign corporation. The L.L.C. does not need to have U.S. income. It does not need to operate a U.S. business. It does not even need to have a bank account.

Form 5472 is required when the foreign-owned disregarded entity has a reportable transaction with its foreign owner or another related party. Reportable transactions include contributions, distributions, loans, interest payments, and other monetary or nonmonetary transactions. Part V of Form 5472 specifically reaches transactions of foreign-owned U.S. disregarded entities, including amounts paid or received in connection with the formation, dissolution, acquisition, and disposition of the entity, and contributions to and distributions from the entity.

Consider the following situations:

- A foreign family uses a U.S. L.L.C. to hold U.S. real estate for personal use. It is true that this, on its own, is not an estate-tax-protected structure, but other solutions for that problem may exist.
- A foreign individual uses a U.S. L.L.C. as part of a foreign tax planning structure. For example, in some jurisdictions, owning foreign real estate through a U.S. L.L.C. may convert what would otherwise be a taxable sale of real property into a potentially different local-law result on a sale of shares or interests.
- A foreign individual forms a U.S. L.L.C. to provide personal services from outside the United States to U.S. customers.

In each case, the owner will almost certainly make payments to keep the L.L.C. alive. Registered agent fees, state annual fees, tax preparation fees, and other routine expenses may be paid directly by the owner. Those payments may feel informal. They may not be labeled as capital contributions. But for Form 5472 purposes, they may be reportable transactions.

To file Form 5472, the L.L.C. must obtain an employer identification number. The Form 5472 is filed with a pro forma Form 1120, on which only limited identifying information is completed.

When the missed filing requirement is discovered, compliance often goes back at least three years. Reasonable cause statements are prepared. Late pro forma Forms 1120 and Forms 5472 are filed. The hope is that the taxpayer can come into compliance without a $25,000 penalty for each year and each relevant reporting obligation.

The new I.R.S. guidance gives some reassurance that, in certain cases, penalty relief is realistic.

C.C.A. 202617012

The Penalty and the Reasonable Cause Exception

Code §6038A(d) imposes a $25,000 penalty for failure to provide required information or maintain required records. Additional $25,000 penalties may apply for each 30-day period, or fraction of a 30-day period, during which the failure continues after 90 days from I.R.S. notice. The C.C.A. confirms both the initial penalty and the continuation penalty structure.

However, the penalty does not apply if the failure is due to reasonable cause. The regulations require an affirmative showing, made in a written statement signed under penalties of perjury, that the taxpayer acted in good faith and that reasonable cause existed for the failure. The C.C.A. confirms that the determination is made case by case, taking into account all relevant facts and circumstances.

The general reasonable cause standard applies to all reporting corporations. A separate, more favorable provision applies to certain small corporations.

The Small Corporation Provision

The regulations provide that the I.R.S. "shall apply the reasonable cause exception liberally" in the case of a small corporation that

- had no knowledge of the Code §6038A requirements;
- had limited presence in and contact with the United States; and
- promptly and fully complied with all I.R.S. requests to file Form 5472 and furnish books, records, and other relevant materials.

For this purpose, a small corporation is a corporation whose gross receipts for the taxable year are $20 million or less. The C.C.A. emphasizes that this is an overall gross receipts test, not merely a U.S. gross receipts test.

Before C.C.A. 202617012, there was very little guidance beyond the regulatory text, which itself comes from the legislative history of the statute, on how a taxpayer qualified for this relief or what "liberally" meant in practice. No court had interpreted the provision. Prior guidance acknowledged the exception without adding much substance. The C.C.A. addresses both questions.

How Qualification Works

The C.C.A. explains that the taxpayer generally demonstrates eligibility through a written submission signed under penalties of perjury. The submission should show that

- the taxpayer had overall gross receipts of $20 million or less for the taxable year
- the taxpayer lacked knowledge of the Code §6038A requirements,

- the taxpayer had limited presence in and contact with the United States, and
- the taxpayer is now in full and prompt compliance.

The I.R.S. may verify gross receipts independently.

On the knowledge prong, the I.R.S. may consider whether the taxpayer previously filed Forms 5472 and whether any owner or controlling person controlled another entity that had filed Form 5472. Prior Form 5472 history in any related entity may hurt a claim that the taxpayer did not know of the filing requirement.

On the limited-presence prong, the I.R.S. may consider the location and experience of corporate officers and managers, the number and size of U.S. customer transactions, and the degree of interaction with U.S. individuals, businesses, and Federal, State, and local government authorities.

This is where facts matter. An L.L.C. owned by a foreign family, with no U.S. employees, no U.S. customers, and no U.S. office, which simply holds a foreign asset, should present a strong case. A U.S. L.L.C. that owns U.S. real property is more nuanced. Query whether ownership of U.S. real property, by itself, creates too much U.S. presence and contact. The answer may depend on the facts. A personally used apartment with no rental activity should be easier than an L.L.C. operating a rental business, interacting with tenants, vendors, lenders, and local government authorities.

On the corrective-compliance prong, the I.R.S. may consider how promptly the taxpayer responded, how complete the responses were, whether the I.R.S. had to follow up multiple times, and whether the information supplied was consistent. A taxpayer who files all outstanding Forms 5472 promptly after learning of the obligation and responds fully to any I.R.S. request is in a significantly better position.

What "Liberally" Means

The C.C.A. clarifies that the liberal standard does not mean automatic relief. It means the I.R.S. applies a lower level of evidentiary scrutiny when a qualifying small corporation asks for reasonable cause relief.

The C.C.A. describes "liberal" by reference to the ordinary meaning of the word: generous, or not strict or exact. But the taxpayer still must make a factual showing. A conclusory submission is not enough. The I.R.S. should not ignore known facts that cast doubt on the taxpayer's good faith, the completeness of the submission, or the truth of the facts presented.

This is a helpful clarification. For small foreign-owned L.L.C.'s that genuinely did not know of the Form 5472 requirement, the C.C.A. suggests that a well-prepared reasonable cause submission should have a real chance of success. But the submission should not be casual. The taxpayer should tell the story carefully, explain why the obligation was missed, show that the taxpayer had limited U.S. contacts, and demonstrate prompt corrective compliance.

Additional Relief Paths

The C.C.A. also highlights two additional penalty relief paths that are easy to miss.

First, if Form 5472 was filed late with a late Form 1120, and the Form 1120 failure-to-file penalty is abated for reasonable cause, the Form 5472 penalty may be abated on the same basis, provided the taxpayer had no similar penalties in the three prior periods.

Second, if the Form 1120 penalty is abated under first-time abatement provisions, the Form 5472 penalty may also be abated under a derivative first-time abatement theory. This is notable because Code §6038A penalties are ordinarily not eligible for first-time abatement. The C.C.A. indicates that derivative relief may be available where the Form 5472 was filed with the late Form 1120 and the relevant prior-penalty conditions are satisfied.

These are not substitutes for compliance. They are penalty relief arguments. But in the right case, they should be included.

"The C.C.A. also highlights two additional penalty relief paths that are easy to miss."

A Parallel Trap: Foreign Gifts and Form 3520

A similar problem appears on the other side of a cross-border relationship. In the Form 5472 setting, the company is a U.S. entity, the owner is foreign, and the taxpayer may assume that the entity is "disregarded" in every practical sense. In the Form 3520 foreign-gift setting, the donee is a U.S. person, the donor is foreign, and the taxpayer may assume that a nontaxable gift does not require a U.S. information return.

That assumption can also be wrong. Form 3520 is not limited to foreign trusts. A U.S. person must also use Form 3520 to report certain large gifts or bequests from foreign persons. In general, gifts or bequests of more than $100,000 from a nonresident alien individual or foreign estate must be reported, with aggregation rules for related donors and intermediaries. Gifts from foreign corporations and foreign partnerships are subject to a lower threshold set out in the annual instructions and raise additional characterization issues.

The penalty regime is different from the Form 5472 penalty regime. For failure to report a foreign gift under Code §6039F, the penalty is generally 5% of the gift for each month the failure continues, up to 25% of the gift, unless the taxpayer establishes reasonable cause. The C.C.A. does not create a Form 3520 standard. There is no small-corporation rule and no regulatory command to apply reasonable cause "liberally" merely because the U.S. recipient is unsophisticated. Still, the practical lesson is similar. The taxpayer should explain the relationship between donor and donee, the nature and timing of the transfer, why the transfer was treated as a gift, why the filing obligation was missed, when the taxpayer learned of the obligation, and how promptly the taxpayer corrected the failure.

This is especially important where the transfer comes from, or through, a foreign corporation, partnership, trust, nominee, or other intermediary. In those cases, the I.R.S. may question whether the transfer was truly a gift or whether it was compensation, a distribution, a loan, or another taxable or reportable transaction. The National Taxpayer Advocate has reported that the I.R.S. ended its practice of automatically assessing penalties at the time of filing for certain late-filed Forms 3520, Part IV, which covers foreign gifts and bequests, and would begin reviewing reasonable cause statements before assessing certain penalties. That does not guarantee relief, but it makes the quality of the submission more important.[1]

The comparison is useful because both rules punish the same kind of mistake. In one case, the taxpayer says: the entity was disregarded, so I did not know Form 5472 was required. In the other, the taxpayer says: the transfer was a nontaxable gift, so I did not know Form 3520 was required. Neither statement is enough by itself. In both cases, the taxpayer must move from conclusion to evidence.

SUMMARY

The Form 5472 obligation for foreign-owned disregarded L.L.C.'s remains one of the most systematically missed compliance requirements in cross-border planning. The entity may be disregarded for income tax purposes, but it is not disregarded for Form 5472 purposes. The reporting obligation is not optional, and international information return enforcement remains an I.R.S. priority.

Foreign persons who have held a U.S. L.L.C. as sole owner at any point since 2017 should review Form 5472 compliance. Where multiple related L.L.C.'s are involved, each entity should be reviewed separately. Where more than one related party is involved, multiple Forms 5472 may be required.

Taxpayers seeking penalty abatement should expressly invoke the small corporation provision where the facts support it. The request should not merely say that the taxpayer was unaware of the filing obligation. It should document the taxpayer's size, lack of knowledge, limited U.S. presence, and prompt corrective compliance. It should be signed under penalties of perjury and supported by the facts.

The same lesson applies beyond Form 5472. A cross-border transaction may be nontaxable, disregarded, personal, or informal, and still carry a U.S. information-reporting obligation. Where the filing is missed, reasonable cause should be developed as a factual submission, not a slogan.

The C.C.A. is not precedent. But it is still welcome guidance. It confirms that relief is not automatic, but it also confirms that the word "liberally" has meaning. For small foreign-owned L.L.C.'s that missed Form 5472 because the owners reasonably believed the entity was disregarded, the C.C.A. provides a practical roadmap for coming into compliance.

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1 See Erin M. Collins, National Taxpayer Advocate, IRS Hears Concerns From TAS and Practitioners, Makes Favorable Changes to Foreign Gifts and Inheritance Filing Penalties, National Taxpayer Advocate Blog, Oct. 24, 2024, last updated Apr. 23, 2025; National Taxpayer Advocate, 2024 Annual Report to Congress, Most Serious Problem #9, Civil Penalty Administration, at 130-31.

THE I.R.S.'S MULTIFACETED SCRUTINY OF PARTNERSHIP BASIS-SHIFTING TRANSACTIONS

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Inside Basis
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Notice 2025-23
Partnerships
Reportable Transactions
Rev. Rul. 2024-14

INTRODUCTION

Over the past several years, the I.R.S. has targeted tax-free partnership transactions designed to shift tax basis to property that will yield tax savings for the partner, the partnership, or both. While it withdrew its initial set of regulations after widespread criticism, it has separately declared that these transactions lack economic substance.

The goal of these transactions is to use the interplay of rules governing inside and outside basis to shift tax basis from assets where it is less beneficial for income tax purposes to assets where a higher basis provides greater benefits, *i.e.*, because the asset offers greater cost-recovery deductions or will be sold.

BACKGROUND

Partnerships combine elements of tax opacity and tax transparency. In some respects, a partnership is viewed as a standalone entity. In other respects, a partnership is viewed as an aggregate of its partners. Thus, partnership tax law contains two concepts of basis: inside basis and outside basis. Inside basis represents a partnership's basis in its assets. Outside basis represents the partners' basis in their interests in the partnership. The two concepts do not always neatly align. Consequently, transfers of partnership interests or distributions of partnership property sometimes require adjustments to basis in distributed property, property held by the partnership, or both.

The general rule is that if a partner transfers its interest, the transferee partner takes over the transferor's share of inside basis.[1] This is in contrast to outside basis, where the transferee partner takes a new cost basis when the interest is transferred by sale or exchange. Similarly, on a distribution of property, the distributee partner takes a carryover basis in the property.[2]

These general rules are subject to modifications. For transfers, the Code §754 election is used to resolve discrepancies between the transferee partner's outside basis and share of inside basis. If the election is in place at the time of the transfer, Code §743(b) increases or decreases the transferee partner's inside basis to match the partner's outside basis. An increase to inside basis under Code §743(b) is also mandatory if the partnership has a substantial built-in loss. A substantial built-in loss exists if either (i) the fair market value of the partnership's assets exceeds its inside basis by more than $250,000 or (ii) the transferee partner would be allocated

1 Code §743(a).

2 Code §732(a)(1); see Code §734(a).

a loss of more than $250,000 if the partnership sold all its assets immediately after the transfer.[3]

With respect to distributions, Code §732(a)(2) provides that a distributee partner's basis in the distributed property cannot exceed the partner's outside basis reduced by any cash received in the distribution. Additionally, Code §732(b) provides that if the distribution is part of a liquidation of the partnership, the partner instead takes a basis in the property equal to its outside basis reduced by any cash received. If multiple properties are distributed to which either of these provisions apply, Code §732(c) provides rules for allocating basis among the properties. Finally, Code §732(d) allows for a partner who became a partner without a §754 election in place and who receives an asset in distribution within two years of becoming a partner to step up its basis in a distributed asset to what the basis would have been had the election been in effect. The basis increase is mandatory (including outside the two-year window) in certain circumstances involving appreciated property.[4]

Distributions are also affected by a Code §754 election. If an election is in place and the distributee partner (i) recognizes gain or loss on the distribution or (ii) otherwise takes a basis in the property different from the partnership's basis prior to the distribution, then the partnership must adjust the basis in its remaining property under Code §734(b). A partner recognizes gain if it is distributed money in excess of its outside basis.[5] A partner recognizes loss only if it receives money, unrealized receivables, or inventory property.[6] In such an event, the partner recognizes loss in an amount equal to the excess of its outside basis over the sum of the bases in the distributed properties.

As applicable, a partnership must increase its basis in its remaining property by the amount of gain recognized by the distributee partner and/or the difference between the partnership's basis in the distributed property and the partner's basis, if the partner was required to take a reduced basis under Code §732(a)(2) (which limits carryover basis to outside basis less cash) or Code §732(b) (which requires partners in a liquidating distribution to take basis equal to outside basis less cash).[7] In parallel, a partnership must decrease its basis in remaining property by the amount of loss recognized by the distributee partner and/or the difference between the partner's basis and the partnership's basis, if the partner took an increased basis in a liquidation.[8]

Finally, even if no Code §754 election is in place, the partnership must still reduce its basis in its property under the rules described above if a distribution results in a "substantial basis reduction." A substantial basis reduction occurs if the sum of a loss recognized by a distributee partner and any increase in basis taken by the partner in distributed property exceeds $250,000.[9]

3 Code §743(d)(1).

4 Treas. Reg. §1.732-1(d)(4).

5 Code §731(a)(1).

6 Code §731(a)(2).

7 Code §734(b)(1).

8 Code §734(b)(2).

9 Code §734(d)(1).

THE REGULATIONS

The I.R.S. announced it was taking aim at basis-shifting transactions in June 2024. It specified that it would scrutinize three broad groups of transactions:[10]

- A transfer of a partnership interest by a partner with low inside basis and high outside basis to a related person (or person who is related to another partner), in a way that would increase the transferee's inside basis tax-free.
    - A transferee partner who takes a high outside basis can increase its share of inside basis if a Code §754 election is in effect. If inside basis was initially low, the resulting increase in basis can be significant.
- A distribution of a high-basis asset to a related[11] partner with low outside basis, creating a reduction in the basis of the distributed asset and a corresponding increase in the basis of the partnership's remaining assets, with no adverse consequence to the other related partners.
    - A distribution to a partner with a low outside basis means that, if the partnership had a higher basis in the distributed property, the partner must reduce its would-be carryover basis under Code §732(a)(2). If a Code §754 election is in effect, the partnership correspondingly increases its basis in its remaining properties by the same amount.
- The liquidation of a partnership having related partners where (i) a low-basis asset that is either subject to accelerated cost recovery or intended to be sold is distributed to a partner with high outside basis and (ii) a high-basis asset that is either subject to longer or no cost recovery or intended to be held is distributed to a partner with low outside basis.
    - In a liquidating distribution, the carryover rule is generally overridden by Code §732(b), and the distributee partners instead take a basis equal to their outside basis. Thus, a partner with a high outside basis can increase its basis in distributed low-basis property, generating smaller gains or greater depreciation deductions. Property that is intended to be held or that does not provide as much depreciation potential can be distributed to low-basis partners, mitigating the disadvantages of a low basis in the property.

Concurrent with this announcement, the I.R.S. issued proposed regulations which were finalized and made effective January 14, 2025, as Treas. Reg. §1.6011-18. Nonetheless, the regulations imposed a six-year lookback period.[12]

Definitions

The I.R.S. outlined four transactions as "transactions of interest" ("T.O.I.'s"), divided into one "transfer T.O.I." and three "distribution T.O.I.'s."

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[10] FS-2024-21.

[11] *I.e.*, to one or more other partners in the partnership.

[12] Treas. Reg. §1.6011-18(b)(11).

The sole transfer T.O.I. was the §743(b) T.O.I., defined as a transaction in which[13]

- a partner transfers all or a portion of a partnership interest to a related partner in a nonrecognition transaction,
- the transferee partner's share of inside basis increases under Code §743(b), and
- the applicable threshold for the year is satisfied.

The three types of distribution T.O.I.'s were Code §734(b) T.O.I.'s, Code §732(b) T.O.I.'s, and Code §732(d) T.O.I.'s.

A Code §734(b) T.O.I. was defined as a transaction in which

- a partnership distributes property to a related partner in a current or liquidating distribution,
- the partnership increases its basis in one or more remaining properties under Code §§734(b) and 734(c), and
- the applicable threshold is satisfied.[14]

A Code §732(b) T.O.I. was defined as a transaction in which

- a partnership distributes property to a related partner in liquidation of the partner's partnership interest,
- the basis of one or more distributed properties is increased under Code §§732(b) and 732(c), and
- the applicable threshold is satisfied.[15]

Finally, a Code §732(d) T.O.I. was defined as a transaction in which

- a partnership distributes property to a related partner,
- the basis of one or more distributed properties is increased under Code §732(d),
- the partner acquired all or part of its interest in a transaction that would have been a Code §743 T.O.I. if a Code §754 election had been in effect, and
- the applicable threshold is satisfied.[16]

T.O.I.'s also included substantially similar transactions, including transactions that would not fit the above definitions because the partners were unrelated, but where a similar tax benefit would be achieved because one or more of the partners were

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[13] Treas. Reg. §1.6011-18(c)(2).

[14] Treas. Reg. §1.6011-18(c)(1)(i).

[15] Treas. Reg. §1.6011-18(c)(1)(ii).

[16] Treas. Reg. §1.6011-18(c)(1)(iii).

known to be tax-indifferent.[17] For example, foreign partners would not have a U.S. tax liability arising from these transactions.[18]

Partners were considered related if they were related before or after the transaction under Code §267(b).[19] Examples of related parties include (i) family members, (ii) affiliated corporations, (iii) a greater-than-50% individual shareholder of a corporation and the corporation, and (iv) a grantor and a fiduciary of a trust. Transactions excepted from T.O.I.'s included transfers of partnership interests by death and most transactions involving publicly traded partnerships.[20]

As noted above, a transaction only became a T.O.I. if all transactions in a given year collectively satisfied the applicable threshold. The applicable threshold was met if all increases in basis from the T.O.I. transactions exceeded the gains from the transactions by at least $10 million.[21] For transactions occurring during the six-year lookback period, the threshold was increased to $25 million.

Reporting Requirement

"Participating partners" and "participating partnerships" were required to report the T.O.I.'s on Form 8886 (*Reportable Transaction Disclosure Statement*).[22] Participating partners include the transferor, transferee, and distributee partners in T.O.I.'s. Look-through rules provided that where the participating partner was a disregarded entity ("D.R.E.") or grantor trust, the D.R.E. owner or grantor was considered the participating partner. Form 8886 is generally used to report reportable transactions, or transactions that the I.R.S. has deemed to have high potential for tax abuse.[23]

"As noted above, a transaction only became a T.O.I. if all transactions in a given year collectively satisfied the applicable threshold."

Failure to report a reportable transaction causes a penalty equal to 75% of the decrease in tax resulting from the transaction.[24] This penalty has a minimum of $5,000 for individuals and $10,000 for other taxpayers and a maximum of $10,000 for individuals and $50,000 for other taxpayers. Material advisers to reportable transactions must also report the transactions on Form 8918 (*Material Advisor Disclosure Statement*) maintain a list of advisees.[25] The penalties are $50,000 for failure to file Form 8918 and, if requested by the I.R.S. to furnish the list of advisees, $10,000 per day for each day after the twentieth day following the I.R.S.'s request.[26]

Backlash

Practitioners criticized the new rules for being overly broad. In response, the final regulations, compared to the proposed regulations, narrowed the scope of reporting. Examples include the following:

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17 Treas. Reg. §1.6011-18(d).

18 Treas. Reg. §1.6011-18(b)(12).

19 Treas. Reg. §1.6011-18(b)(8), (9).

20 Treas. Reg. §§1.6011-18(c)(4), -18(b)(3)(iv).

21 Treas. Reg. §1.6011-18(c)(3)(i).

22 Treas. Reg. §1.6011-18(f)(1).

23 Treas. Reg. §1.6011-4.

24 Code §6706A(b)(1).

25 Code §§6111(a), 6112(a).

26 Code §§6707(a), 6708(a)(1).

- The threshold amount was raised from $5 million to $10 million.
- The lookback period was limited to six years instead of an indefinite period, and the deadline for reporting historic transactions was extended from 90 days to 180 days after the effective date.
- "Related partners" were limited to those who are direct partners.
- Tax-indifferent parties caused a transaction to become a T.O.I. only if their tax-indifferent status was known beforehand.
- The exceptions for transfers on death and transfers involving P.T.P.'s were added.

Nonetheless, the core criticism remained unchanged: many non-abusive transactions would be caught up by the new rules largely because some of the partners happened to be related.

The I.R.S. relented. Notice 2025-23 removed the regulations and allowed taxpayers to treat them as though they had never come into effect. It also waived the penalties relating to reporting reportable transactions for participants and material advisers and the obligation of material advisers to maintain lists of advisees.

While the new rules had only required taxpayers to report transaction and distribution T.O.I.'s, the I.R.S. also issued Notice 2024-54, where they announced a plan to issue two sets of proposed regulations that would have required taxpayers to alter their tax computations where the T.O.I.'s were involved. That plan has been scrapped.

WHAT REMAINS: REV. RUL. 2024-14

The new regulations are history, but the I.R.S. indicated it is not done scrutinizing these transactions. While the T.O.I. regulations are gone, Notice 2025-23 did not mention Rev. Rul. 2024-14, which remains in effect. Under Rev. Rul. 2024-14, issued alongside the proposed regulations, the I.R.S. deemed three types of basis-shifting transactions to fail the economic substance doctrine codified in Code §7701(o). This doctrine has two prongs: a transaction lacks economic substance if it (i) fails to meaningfully change a taxpayer's economic position, disregarding tax effects and (ii) lacks a substantial non-tax purpose. A 20% penalty applies to underpayments of tax resulting from transactions lacking economic substance, which increases to 40% if the transaction is not disclosed.[27]

Rev. Rul. 2024-14 features a fact pattern involving U.S. corporation C, which has interests in several subsidiaries and partnerships, which in turn own depreciable and amortizable assets.

In Situation 1, the facts are as follows:

- C is a majority shareholder in Subs 1, 2, and 3.
- Subs 1 and 2 are 50-50 partners in Partnership A, which has a Code §754 election in place, and Subs 1 and 3 are 50-50 partners in Partnership B.

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[27] Code §6662(b)(6), (i).

- Sub 1 has high outside basis and low inside basis.
- Sub 1 contributes its interest in Partnership A to Partnership B, a tax-free transaction under Code §721(a).
- As a result of the §754 election, Partnership A increases Partnership B's portion of inside basis to match Partnership B's outside basis in Partnership A.
- The increase is allocated to depreciable or amortizable property.

In Situation 2, the facts are as follows:

- C is a majority shareholder in Subs 1 and 2, which are partners in Partnership C, which owns 100% of the shares of Sub 3, depreciable property, and cash.
- Partnership C has a Code §754 election in place. It has a small built-in loss in Sub 3 and a big built-in loss in the depreciable property.
- Sub 1 has a high outside basis in Partnership C while Sub 2 has low outside basis.
- Partnership C distributes Sub 3 stock to Sub 2. Sub 2's basis in Sub 3's stock is reduced to the value of Sub 2's outside basis. This triggers a decrease in Sub 2's outside basis under Code §733(2), which happens to fall to zero here.
- Because Sub 2 took a reduced basis in Sub 3 stock, Partnership C increases its basis in its remaining assets by the same amount.
- Under Code §755, all of the increase is allocated to the depreciable asset.

In Situation 3, the facts are as follows:

- Partnership D owns a depreciable asset with a large built-in loss and a non-depreciable asset (land) with a small built-in loss.
- Sub 1 has high outside basis in Partnership D, and Sub 2 has low outside basis.
- Partnership D adopts a plan of liquidation and distributes the depreciable asset to Sub 1 and the land to Sub 2.
- Sub 1 takes an increased basis in the property to match its high outside basis while Sub 2 does the opposite with the land. This allows additional depreciation deductions to be taken from Sub 1's distributed property.

The I.R.S. concluded that all three situations lack economic substance. Corporation C's economic position was unchanged because the transactions shuffled assets between its controlled entities. The transactions had no identifiable non-tax purpose. All three situations mirror the T.O.I.'s described earlier. Thus, even if the basis-shifting regulations have been removed, all indications are that the I.R.S. is not giving up its battle.

THE CORPORATE RECORDS NOBODY THINKS ABOUT UNTIL SOMEONE ASKS FOR THEM

Author
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Tags
Corporate Records
Limited Liability Company

INTRODUCTION

Forming a Delaware corporation or limited liability company ("L.L.C.") is remarkably easy. Remembering what to do with it afterwards can be another matter. We are frequently asked to form corporations and limited liability companies for use as blockers, holding companies, or acquisition vehicles in connection with a transaction. Understandably, the immediate focus is usually on getting the entity formed quickly so that the transaction can proceed. The entity itself may be only a small part of a much larger transaction, with most of the attention being paid to the purchase agreement, financing documents, or other agreements that the newly formed entity intends to enter into. Once the transaction is completed, however, the corporate records of the newly formed entity can easily become an afterthought. The issue often resurfaces months or years later when a lender, purchaser, investor, or foreign counsel asks to see them.

We have touched on many of the documents discussed below in previous articles dealing with the formation and governance of corporations and L.L.C.'s. We return to the subject here because we have recently encountered a number of situations in which questions have arisen concerning corporate records that actually exist, whether they accurately reflect the ownership and governance of the entity, and, sometimes most importantly, who is responsible for maintaining them.

WHAT DOES IT TAKE TO FORM A COMPANY?

A Delaware L.L.C. can be formed in a day by filing a certificate of formation with the Secretary of State of Delaware containing little more information than the name of the L.L.C. and the name and address of its registered agent and registered office in Delaware.[1] Similarly, a corporation can be formed very quickly by filing a certificate of incorporation.[2] This document requires a little more information, but not much. At a minimum, the certificate of incorporation of a typical stock corporation will set forth the name of the corporation, the address of its registered office and the name of its registered agent in Delaware, the purpose of the corporation, the number of shares the corporation is authorized to issue and their par value, and the name and address of the incorporator.[3]

There are, of course, numerous other forms of business entity available in the United States, including limited partnerships and general partnerships. For purposes of

1 6 Del. C. § 18-201(a).

2 8 Del. C. §§ 101, 103.

3 8 Del. C. § 102(a).

this article, we will focus on corporations and L.L.C.'s, the two entity types we most frequently encounter. Many of the recordkeeping issues discussed below, however, apply equally to other forms of business entity.

The filing of a certificate of formation or certificate of incorporation creates the entity, but it is only the first step in properly organizing and documenting it. The documents filed with the state provide relatively little information about how the entity is owned, governed or operated. Those matters are addressed in the governing documents and other corporate records that are created and maintained after formation.

Once the certificate has been filed, the filer receives a stamped copy from the Delaware Secretary of State confirming the formation of the entity. That copy is then sent to the client or, in many of our cross-border matters, to the instructing lawyer in another country. Often, the entity is needed within a short time frame and, once confirmation of formation is received, the immediate concern is simply to have the newly formed entity enter into the transaction for which it was created.

This is where formation and proper organization of the entity can become confused. The filing of the certificate means that the entity exists, but it does not necessarily mean that the person proposing to sign on its behalf has been properly authorized to do so. This can be a particular source of confusion in cross-border matters, where clients may be accustomed to an individual director having authority to act on behalf of a company. In a Delaware corporation, the business and affairs of the corporation are managed by or under the direction of its board of directors, and an individual director does not have authority to act unilaterally for the corporation merely by virtue of being a director.[4]

Sometimes, after the entity has been formed and the immediate transaction completed, that is the last anyone thinks about its corporate records until questions are asked months or even years later.

- Does the L.L.C. have a manager?
- Is one required?
- Where are the corporation's stock certificates—or were its shares uncertificated?
- Who are the current directors and officers?
- Who owns the entity and where is that ownership recorded?

Too often, the answers are not readily apparent from the company's records.

WHAT RECORDS SHOULD THE COMPANY HAVE?

Following incorporation, as mentioned above, the incorporator should appoint the initial director or directors. Bylaws should then be prepared, and the board should hold an organizational meeting, or act by written consent, to adopt the bylaws, appoint the officers and take the other actions necessary to organize the corporation. The initial shareholder will typically subscribe for the corporation's shares by signing

[4] 8 Del. C. § 141(a).

a subscription agreement setting out the number of shares to be purchased and the consideration to be paid. The board will then accept the subscription and authorize the appropriate officers, upon receipt of the subscription price, to issue the shares to the subscriber. The issuance should be recorded in the corporation's stock ledger and, if the shares are certificated, the appropriate stock certificate should be issued. Thereafter, the company's records should include subsequent actions taken by the board and shareholders, including changes in directors and officers and subsequent issuances or transfers of shares.

In many cases, particularly where a corporation is formed for use as a blocker, holding company, or acquisition vehicle, there may be little reason to issue a physical stock certificate. Care should nevertheless be taken in preparing the bylaws. Many forms of bylaws provide that each shareholder is entitled to receive a stock certificate, even though in practice no certificates are ever issued. If shares are intended to be uncertificated, the bylaws should contemplate that possibility and provide that the corporation's shares may be certificated or uncertificated. Whether or not certificates are issued, an accurate stock ledger recording the ownership and issuance of the shares should be maintained.

An L.L.C., on the other hand, generally has fewer formal requirements, and its L.L.C. Agreement generally controls the management and governance of the entity. Delaware does not require that an L.L.C. Agreement be in writing – some states, including New York, do – but it is nevertheless good practice to have a written agreement.[5] Apart from documenting the agreement among the members, the process of preparing one requires the owners to consider some of the basic questions concerning how the L.L.C. will operate.

An L.L.C. may be managed by its members or the members may appoint a manager to take responsibility for its management. The governance structure will ordinarily be set forth in the L.L.C. Agreement. Care should be taken, however, in deciding how much information to include in the agreement itself. For example, where an L.L.C. is to be manager-managed, we generally prefer that the L.L.C. Agreement provide for the appointment of a manager without identifying the individual who will hold that position. The manager can then be appointed by a separate written consent of the members. If the manager subsequently changes, the company's records can be updated with a simple resolution appointing the replacement rather than requiring an amendment to the L.L.C. Agreement. The same approach can be taken with officers appointed by the manager or members.

Ownership of an L.L.C. is also documented somewhat differently from ownership of a corporation. An L.L.C. interest is commonly expressed as a percentage interest, although in some transactions it may be preferable to divide the ownership into a specified number of units. Either approach can be provided for in the L.L.C. Agreement. Unlike shares of a corporation, it is relatively uncommon for L.L.C. interests or units to be represented by physical certificates. Instead, the members and their respective percentage interests or units are typically recorded on a schedule to the L.L.C. Agreement or in other ownership records maintained by the company.

This distinction can become important in cross-border transactions. We are sometimes asked by foreign counsel, investors or other parties to provide a "membership

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[5] 6 Del. C. § 18-101(9); N.Y. Ltd. Liab. Co. Law § 417(a).

certificate" evidencing ownership of an L.L.C. when no certificate has ever been issued or was required. The absence of a certificate does not mean that the ownership has not been properly documented. What is important is that the L.L.C.'s records clearly establish who its members are, and the interest held by each of them.

MAINTAINING THE CORPORATE RECORD

Preparing the appropriate organizational documents is, of course, only part of the process. Those documents also need to be signed, retained and updated as the ownership and management of the entity changes. An entity may have been properly organized when formed, but several years later its records may no longer provide a complete picture of who owns the entity, who manages it, or what corporate actions have been taken.

Maintaining these records does not necessarily require the continuing involvement of outside counsel. A company secretary, member of the legal department or other person within the organization can maintain the minute book and other corporate records. The important point is that responsibility for doing so should be clearly assigned and that the records should be updated when changes occur. Outside counsel may need to prepare documents relating to particular corporate actions, but there is no reason that the company's day-to-day recordkeeping cannot be handled internally.

This is not simply an issue that arises when a lender, purchaser, or other third party conducts due diligence. We recently spoke with a newly appointed C.E.O. of a U.S. company who was attempting to determine from the company's existing records who its current directors and officers were and what corporate actions had previously been taken. Changes in personnel over the years can mean that the people with knowledge of the company's history are no longer there to provide the answers. A company's corporate records should tell its corporate history without requiring the people who made that history to still be there to explain it.

This issue arose again in our practice only recently. Organizational documents had been prepared and sent to a client for signature with a request that the executed copies be returned for inclusion in the minute book. Some months later, we were asked to provide copies of all signed resolutions and consents relating to the company. The client had only some of the organizational documents in its files, and a complete set of executed documents had apparently never been assembled. The client sent the documents to someone else within the organization to be signed; the problem was making sure that the signed versions found their way back into the company's permanent records.

This is an area where both the company and its counsel need to pay attention. Sending a document to a client for signature should not necessarily be the end of the process. Even where outside counsel has not been asked to maintain the minute book, it is good practice to follow up for an executed copy of any corporate document it prepares and retain that copy in its own files.

DOES THE MINUTE BOOK STILL NEED TO BE A BOOK?

“The physical minute book may be disappearing, but the need for accurate corporate records remains an important task for corporate management.”

Traditionally, the documents described above would have been maintained in a physical minute book. There is no requirement, however, that a modern company’s corporate records be kept in a leather-bound book sitting on a shelf. Both Delaware and New York permit corporate records to be maintained electronically, provided they can be converted into a legible written form.[6] For many companies, an organized electronic minute book is likely to be more practical and more accessible than its physical predecessor.

What matters is not where the records are kept, but that they are complete and readily accessible, and that someone has responsibility for maintaining them. A carefully organized electronic folder containing the governing documents, stock or membership records, and signed board, shareholder, or member actions may serve that purpose perfectly well. A beautifully bound minute book containing only half of the company’s records is suboptimal.

Foreign clients sometimes assume that the company’s Delaware registered agent maintains these records. Generally, it does not. The registered agent performs an important statutory function in Delaware, including maintaining the company’s registered office and receiving service of process (a legal document that initiates litigation) and official communications, but it should not be assumed to be the custodian of the company’s minute book or other internal corporate records. Nor should the registered office be assumed to be the company’s mailing address. This can be particularly important for foreign-owned companies that do not maintain a physical office in the United States and need to consider separately where ordinary business correspondence, bank statements and other mail should be sent.

None of this is particularly complicated. Forming a corporation or L.L.C. is relatively straightforward, and maintaining its corporate records should be as well. The difficulty arises when no one takes responsibility for ensuring that the documents created at formation are signed and retained and that the records are updated as the ownership, management, and affairs of the company change.

Good corporate records should allow someone coming to the company years later – whether a new director or officer, a lender, purchaser, investor or adviser – to determine who owns the company, who has authority to act for it, and what significant corporate actions have been taken without having to reconstruct its history from old emails or the recollections of former employees.

Whether those records are maintained in a traditional minute book or electronically is ultimately less important than whether they are complete, accurate and accessible. The physical minute book may be disappearing, but the need for accurate corporate records remains an important task for corporate management.

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6 6 8 Del. C. § 224; 6 Del. C. § 18-305(d); N.Y. Bus. Corp. Law § 624(a); N.Y. Ltd. Liab. Co. Law § 1102(d).

About Us

Ruchelman P.L.L.C. is a boutique law firm based in New York City. It was founded in 1989 by an alumnus of a legacy firm that is now Deloitte's.

Our firm provides a wide range of tax planning and commercial legal services to clients across the Americas, Asia, Europe, and the Middle East. Clients include global investors, multinational corporations expanding into the U.S., and U.S. businesses with international operations. Our core practice focuses on cross-border transactions.

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Insights, the tax journal of Ruchelman P.L.L.C., provides in-depth reporting on the evolving landscape of U.S. and international taxation. It offers complex analysis of current issues, legislative updates, and practical introductions to the tax law from leading tax professionals in their respective countries.

Special features include an annual examination of the use of holding companies in European tax planning and a look at the year in review.

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