

BENEFICIAL OWNERSHIP AND DUTCH TRANSFER TAX

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For many years, transfer tax has been a substantial source of income for the Dutch Tax Authorities. Revenue in 1999 amounted to nearly six billion Dutch guilders² and it is still increasing. Quite recently, the Dutch Minister of Finance made it clear that this rather ancient taxation would not be abolished in the future; its income was sorely needed. Transfer tax is therefore a tax not only with a long history, but also with a promising future.

1. Transfer Tax and Legal Title

Transfer tax is codified in the Taxation of Legal Transactions Act³. The tax is calculated on the value or higher sales price of the acquired Dutch property, the current tax rate is 6%. Exemptions may apply, for example, when acquiring 'building land' or newly constructed buildings.

Until 1995, transfer tax was only due when obtaining legal ownership of real estate.⁴ Under this legislation transfer tax could quite easily be evaded by acquiring beneficial ownership. In such cases, all benefits and burdens relating to the property were transferred to the purchaser. The purchaser also acquired an irrevocable mandate to obtain legal title, if desired. For the time being, however, the vendor remained the legal owner. Under this scheme, no taxable event for

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2 Approximately GBP 2 billion.

3 *Wet op belastingen van rechtsverkeer*.

4 Transfer tax is also levied when acquiring a substantial shareholding in a Dutch real estate entity (*onroerende zaaklichaam*).

Dutch transfer tax occurred, as no legal title was transferred. The transfer of beneficial ownership therefore triggered no transfer tax.

2. Taxation of Beneficial Ownership

Things changed on 31st March 1995. As of this date, transfer tax was also imposed on the acquisition of beneficial ownership. According to the Dutch Minister of Finance, reasons for the extension of the taxable event were two-fold. First of all, the transfer of beneficial ownership was frequently used when setting up VAT saving structures. Use of those VAT saving schemes was now blocked with specific anti-abuse VAT legislation. The taxation of beneficial ownership served as a supporting measure for the anti-avoidance legislation now introduced.⁵

The second governmental argument for the taxation of beneficial ownership was its use in illegal transactions. Legal ownership could only be transferred through a notarial deed. Beneficial ownership could be transferred orally, if the need arose. According to the Dutch Minister of Finance, criminals often used beneficial ownership for their illegal transactions. Since no notarial deeds were involved, those transactions could not be traced. What better way to bring those transactions into the open than through taxation?

A third argument for taxation was not stressed by the Dutch Minister of Finance, but is quite apparent; the loss of revenue for the Dutch Tax Authorities. Professional investors in Dutch real property simply evaded transfer tax on a large scale by acquiring beneficial ownership of their portfolios. Payment of transfer tax was becoming a privilege of the private house buyer.

3. Defining Beneficial Ownership

From the above it is clear that more or less valid arguments existed for the taxation of beneficial ownership. *Defining* beneficial ownership, however, proved to be a rather burdensome operation. In 1995, the concept of beneficial ownership was not yet defined in Dutch tax law or case law. Now a legal definition was needed in order to describe the new taxable event for the transfer

⁵ It is very doubtful whether this is a valid argument for taxation. However, the Dutch Parliament approved.

tax. After some amendments the following definition was introduced:⁶

‘Beneficial ownership is a composition of rights and obligations, representing an interest in Dutch real estate. This interest includes at least (i) a certain risk of changes in the value, and (ii) a certain risk of loss of the real estate’.

This definition implied that beneficial ownership depended on the transfer of two kinds of risk; a risk of changes in the value and a risk of loss. Thus a new interpretation of the notion of ‘risk’⁷ was introduced. Until then ‘risk’ implied the risk of changes in value, including the ultimate reduction in value: a loss. Now the legislator artificially split ‘risk’ into two separate ‘risks’.

The reasoning behind this redefinition of ‘risk’ was the position of the contract of sale.⁸ The mere conclusion of a contract of sale should not trigger transfer tax. According to the Dutch Minister of Finance, a regular contract of sale implied acquiring an interest with respect to real estate. The purchaser also acquired a certain risk of changes in value. The risk of loss, however, remained with the vendor until the actual transfer of the property. By including the risk of loss in the definition of beneficial ownership the contract of sale fell outside its scope.

The new definition of beneficial ownership was not particularly well received. Several authors claimed that the new definition facilitated new transfer tax-saving structures. During the legislative process, a Dutch MP⁹ argued that under the new definition transfer tax could be easily avoided. That MP explained that no transfer tax became due if all benefits and burdens were transferred under the condition that legal ownership and risk of loss remained with the vendor. The Dutch Minister of Finance behaved stoically and did not amend the definition.

As soon as the new concept of beneficial ownership came into effect, the parties tried to find their way around taxation. The structure for which the Dutch MP had warned, was now tried out in practice. Fiscal proceedings were imminent.

⁶ This definition is only relevant for transfer tax, other taxes have their own interpretation of the concept of beneficial ownership.

⁷ Dutch: *risico*.

⁸ In the Netherlands a contract of sale is referred to as: *voorlopige koopovereenkomst*, *provisional* contract of sale, a somewhat confusing name, because the contract is rather definitive (parties agreeing on *e.g.*, the purchase price and the date of transfer).

⁹ Member of the Dutch *Tweede Kamer* (House of Commons)

4. Semi-beneficial Ownership Tested by Dutch Courts

In 1999 the Dutch Supreme Court (Chamber of Taxation) dealt with a case in which a semi-beneficial ownership was transferred. In this case, the parties had transferred all benefits and burdens and the purchaser could also freely dispose of the building. The legal title remained with the vendor. Finally, the parties had agreed that the full risk of loss remained with the vendor. The parties argued that since no risk of loss was transferred the 'two-fold' condition for a taxed transfer of beneficial ownership was not met. As a result, no transfer tax was due.

The Supreme Court decided¹⁰ that in this situation the risk of loss fully remained with the vendor. According to the Supreme Court, the purchaser had not acquired *any* risk of loss. This implied that the purchaser had not obtained beneficial ownership and that no tax was due. With this judgment, the Supreme Court facilitated the semi-beneficial ownership as a tax saving instrument.

5. Beneficial Ownership Redefined

The heyday of the new legal loophole was soon over. Within nine days of the Court's decision, the legal definition of beneficial ownership was amended.¹¹ The new definition of beneficial ownership read as follows:

'Beneficial ownership is a composition of rights and obligations, representing an interest in Dutch real estate. This interest includes at least a certain risk of changes in the value.'

The new definition was identical to the old statutory provision. There was, however, one difference: acquiring the risk of loss was no longer a separate condition for acquiring beneficial ownership. Under this new definition, transfer tax could no longer be evaded by using semi-beneficial ownership.

6. Contract of Sale Taxed?

Under the new definition the position of the contract of sale became problematic. Since the risk of loss was no longer a condition for beneficial ownership, the mere conclusion of a contract of sale could imply taxation. The Dutch Minister of Finance had foreseen this complication. In order to avoid the contract of sale

¹⁰ The Supreme Court (*Hoge Raad*), 3rd November 1999.

¹¹ To this end retroactive legislation was used.

becoming subject to tax, the following was added to the legal definition:

‘The mere acquisition of the right to obtain legal ownership does not constitute a transfer of beneficial ownership.’

In my opinion this sentence does not refer to a contract of sale, but to a mere call option. Concluding a contract of sale might therefore attract Dutch transfer tax.

The Dutch Minister of Finance does not concur with this view. The Dutch Minister of Finance claims that no transfer tax is due if the contract of sale only contains ‘customary stipulations’. Although no clear legal base for this point of view exists, parties may rely on those statements since the Dutch Minister of Finance made them in his capacity as co-legislator. The question remains which stipulations are ‘customary’. The Dutch Minister of Finance refers to the standard contract as used by the Dutch Association of Real Estate Brokers.¹² The stipulations used in this standard contract are ‘customary’.

The remarks of the Dutch Minister of Finance imply that a contract of sale will attract transfer tax as soon as it deviates from the standard contract, and that transfer tax therefore becomes an issue as soon as customised contracts of sale are used. The parties should be aware of that risk.

7 Summary

Dutch transfer tax is levied when acquiring legal or beneficial ownership of Dutch real property. As of 1999, the legal definition of beneficial ownership seems to include the contract of sale as a taxed event. Based on statements by the Dutch Minister of Finance, however, a contract of sale with only customary stipulations will not attract transfer tax. Contracts that cannot be qualified as such will trigger a transfer of beneficial ownership and therefore lead to taxation.