KPMG Meijburg & Co Tax & Legal

Transfer of leased building by developer classified as transfer of going concern for VAT purposes despite earlier decision

The Arnhem-Leeuwarden Court of Appeals delivered two important rulings for the Dutch real estate practice on May 17, 2022. Contrary to an earlier decision of 2018, the Court ruled in two cases that the transfer of a property which was leased out for a short term by a developer qualified as a transfer of a going concern for VAT purposes. In both cases, the property had been leased on a VAT-exempt basis. As a result of these decisions, the tax due is limited to the non-recoverable VAT on the renovation costs, land costs, if any, and additional costs, rather than the non-recoverable VAT on the purchase price.

1. Background and points of law

The first case concerned a situation in which the taxpayer, a property developer, purchased an office building in 2015. The building was converted into 77 residential apartments. The taxpayer signed leases for the apartments, including parking spots, from May through July 2017. An investor put in an offer for the building on June 28, 2017. This offer resulted in a signed letter of intent early in August. The tenants moved into the apartments after the building was completed on August 1, 2017. The contract of sale was concluded on October 24, 2017 and the legal transfer of the leased building to the investor took place on November 15, 2017. At that time, the building had been leased on a VAT-exempt basis for about 3.5 months.

The second case involved a situation in which a parcel of land was transferred to the taxpayer, also a property developer, in February 2017. The taxpayer signed a lease with a foundation for a newly to be constructed building in July of that year. In May 2018, the taxpayer signed a letter of intent with a potential buyer. This letter of intent resulted in a signed contract of sale around the end of September 2018. After completion, the property was leased on a VAT-exempt basis with effect from November 19, 2018. The legal transfer of the leased property to the buyer took place on November 30, 2018.

Both cases revolved around the question whether the transfer of the property which has been leased out for a short term qualified as a transfer of a going concern as referred to in Section 37d of the Dutch Turnover Tax Act 1968. What is important here is that, although the taxpayer has no right to reclaim input VAT on all building-related costs because the building is leased VAT-exempt to the tenants, no (non-recoverable) VAT is due on the higher selling price paid by the buyer.

2. Decisions of Arnhem-Leeuwarden Court of Appeals

There are circumstances under which the transfer of a leased building qualifies as the transfer of a going concern, as a result of which the transfer is not subject to VAT.

The Arnhem-Leeuwarden Court of Appeals ruled in both cases that the property can be used to carry on an independent economic activity, i.e. operating (leasing) the building. The sale of the building does not qualify simply as the sale of an asset, such as the sale of an inventory of products, but rather as a transfer of a going concern as referred to in Section 37d of the Dutch Turnover Tax Act.

By handing down this ruling, the Court of Appeals by-passed an earlier decision of April 4, 2018, which the Dutch Supreme Court upheld on May 15, 2020 without providing

any further arguments (see our earlier tax alert). In these proceedings, the Court of Appeals opined that the case involved the sale of an asset from an inventory that could not be used to carry on an independent economic activity. The property developer had not developed the building with a view to operating it itself, but rather with the aim of selling it. For this reason, the Court of Appeals felt that this case did not involve a transfer of a going concern.

In the proceedings of May 17, 2022, the Court of Appeals seems to have considered the property developer's intentions irrelevant to the qualification of a transfer of a going concern. It ruled that the European Court of Justice's interpretation of a transfer of a going concern does not include a review of the taxpayer's intentions.

3. Relevance to real estate practice

Assuming that both proceedings involved the transfer of a newly constructed building, no VAT will be due on the full purchase price of the building since the transfer qualifies as a transfer of a going concern. That is why the non-recoverable VAT (due to the VAT-exempt lease) is limited to the VAT on the renovation costs, land costs, if any, and additional costs incurred by the property developer. In contrast, the development profit is not subject to non-recoverable VAT.

In both proceedings, the legal transfer took place shortly after the building was first put into VAT use (3.5 months and 2 weeks). Although the proceedings are highly similar to those that resulted in the decision of April 4, 2018, the Court of Appeals has reached a different conclusion. Despite the fact that the Deputy Minister of Finance still has the option to appeal this decision with the Supreme Court, this is a highly welcome decision for property developers.

For the record, we would note that the European Court of Justice is currently dealing with a Polish case concerning the question whether the transfer of a leased shopping mall might qualify as a transfer of a going concern if this transfer does not, in addition to the lease or leases, include all other obligations, such as management agreements and insurance contracts.

The tax advisors of KPMG Meijburg & Co's Real Estate Indirect Tax Group would be happy to help you identify any potential tax implications of this court decision. Please feel free to contact one of them or your regular advisor.

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