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Charting the Course: Navigating the evolving tax landscape for real estate investment in Europe

> Globalisation and digitalisation have led to greater geographical tax mobility

> Harmonised international efforts to fight aggressive tax planning have been introduced in response

> Recovery from the COVID-19 crisis and climate change challenges require more tax revenue

> Policy makers are demanding transparency and fair distribution of tax obligations

The world has witnessed profound changes as a result of intensified globalisation since the beginning of the 21st century. The rise of globalisation in the 1990s and, more recently, digitalisation of the economy, have led to much greater geographical tax mobility. This mobility sometimes created opportunities for aggressive tax planning, especially through shifting profits from high- to low-tax jurisdictions, as the increasingly global environment and digitally mobile capital have made the assessment and collection of tax by authorities more complex.

OECD and EU tax-related measures

In response to this development, the OECD recommended, and the EU adopted a number of new tax measures that are having a significant impact on non-listed real estate investment. Starting with the adoption of the Code of Conduct for business taxation in 1997, the next big step came in 2015 when the OECD issued several recommendations to equip governments with the domestic and international instruments needed to tackle Base Erosion and Profit-Shifting.

Building on the OECD recommendations, the EU quickly passed Anti-Tax Avoidance Directives 1 and 2 (ATAD1 and ATAD2) into law in 2016 and 2017. These directives contain a number of anti-abuse rules, starting with an interest limitation rule, a controlled foreign companies (CFC) rule, an intra-EU hybrid mismatch rule and provisions on exit taxation designed to strengthen the average level of protection of member states against aggressive tax planning.

Further specific provisions targeting hybrid mismatches with third countries and a larger scope of transactions were also added in the second of these directives. Shortly thereafter, EU Court of Justice decisions, including the “Danish cases” that more tightly interpret substance requirements and additional EU measures such as DAC 6 which mandates reporting of potentially aggressive tax structures, reinforced policy makers’ efforts to fight the use of aggressive tax planning.

> “To pay the right amount of tax is not only a question of public finances, but above all a question of basic fairness.”
>
> EU Commission President von der Leyen

The impact of the COVID-19 Crisis and Climate Change

More recently, the COVID-19 pandemic has accelerated digital transformation. Already underway before the pandemic, digital transformation has stimulated the adoption of new tax rules that reflect more international harmonisation, transparency, collaboration and fairness. This trend is continuing as a result of long-term political, social and economic trends that are still quickly evolving.

Climate change and the imperative to emerge from the COVID-19 crisis with greener economic policies to meet the Paris agreement goals are also influencing the development of tax policies impacting real estate investment, as revenue is needed to fund the green transition. At the same time, the need to generate tax revenue to fund massive relief measures to address the economic crisis caused by the COVID-19 pandemic puts all economic sectors and the tax rules under which they operate under even closer scrutiny.

Rules related to permanent establishment, substance requirements, tax residence, withholding tax, interest deduction limitations and anti-abuse provisions are all currently receiving renewed attention as a result. Paying the appropriate amount of tax and fighting tax arbitrage and the use of aggressive tax planning have rocketed up the public policy agenda of the EU, member states and, independently since Brexit, the UK. The OECD BEPS Pillar One and Two recommendations are at an advanced stage and will likely lead to the introduction of stricter rules and a minimum tax rate on many companies globally.

Conclusion

We are currently at a crossroads in taxation and some of the first tangible impacts on the real estate industry are already visible. Today, taxation comes with environmental, social and corporate governance aspects. These are a growing concern for policy makers as the climate changes and awareness of social responsibility evolves. Tax aspects have moved centre stage in the political landscape and are a powerful tool that policy makers are willing to deploy to achieve ecological, economic and social goals agreed to by the OECD, the EU, member states and the UK.

These trends are being closely considered by investors and investment managers in non-listed real estate both from profitability and tax efficiency perspectives. They are central in investors’ decision-making processes as behaviours are evolving, modernisation moves forward and complexity increases.

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The full report is available to members at
inrev.org/tax-regulations

> …social fairness is not just a question of time. It is also a question of fair taxation. This is why we will continue to crack down on tax avoidance and evasion. We will put forward a new initiative to address those hiding profits behind shell entities. And we will do everything in our power to seal the historic global deal on minimum taxation.
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> EU Commission President von der Leyen

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