

# Belgian Government Proposes VAT Regime for Real Estate Rentals

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After a budget review, Belgium's federal government proposed in its summer budget in March an optional VAT regime for rental agreements, starting October 1.

## Background

Belgium is one of the last EU member states to use its right to exempt the leasing or letting of immovable property from VAT (article 137 (1) (d) of Directive 2006/112/EC).

That makes Belgium less competitive than other EU member states. If the leasing or letting is not subject to VAT, the landlord does not charge VAT on the rent but, most importantly, he cannot recover the VAT he paid to build or renovate the property. That VAT is then an additional cost that is charged back to the tenant, resulting in higher rent, and the tenant cannot recover the VAT.

As a result, VAT payers have had to look for alternative routes, including:

- Rental of storage facilities: Rental agreements for warehouses and other facilities for the storage of goods and merchandise are subject to VAT if they are separate from a factory or production facility. The storage facilities are subject to VAT even if they include other facilities (such as offices and sanitary facilities) for stock administration and management of the warehouse. The other facilities must not exceed 10 percent of the entire building. The 10 percent threshold is not to be measured exclusively in terms of floor space, but rather in terms of volume (Ruling 2015.035, dated March 3, 2015).
- Finance leases for real property: Another exception to the general VAT exemption for real property is an agreement with a leasing company to finance the acquisition of real property. Finance leases are subject to VAT under the following conditions:
  1. the lessor acquires or builds the property in accordance with the lessee's instructions and charges VAT, and the lessee uses the property for activity that is subject to VAT and deducts the VAT;
  2. the lease installments due during the first 15 years must reconstitute the capital invested by the lessor;
  3. the lease agreement cannot be terminated anticipatively and it cannot automatically transfer title to the property at the end of the contract; and
  4. the lessee must have the opportunity to acquire the property for a price that can be determined based on criteria specified in the lease agreement. (If the above conditions are not strictly met, the lease may be recharacterized as a VAT-exempt rental agreement.)

- VAT groups: Two Belgian companies (or establishments of overseas companies) that have close financial, economic, and organizational links may opt to set up a VAT group among themselves.

A VAT group or VAT unit is a transparent structure in which the members are regarded as a single taxable person. This means that goods or services supplied to one member of the VAT unit by third parties are considered to have been supplied to the VAT unit, and that goods or services provided by the individual members of a VAT unit to third parties are considered to have been provided by the VAT unit. Transactions between members of the VAT unit fall outside the scope of VAT. As a result, the VAT status of the VAT unit, and its right to deduct input VAT, is determined solely on the basis of its transactions with third parties.

If a VAT unit is set up between a company that holds property and an industrial or commercial company that uses that property, the property can be made available without charging VAT while the VAT group can deduct the VAT on the purchase or construction because the ultimate destination of the property takes precedence.

## New Optional VAT Regime

The optional VAT regime that Belgium intends to introduce would simplify the distinction between VAT-liable and VAT-exempt rental and lease agreements, and would also offer opportunities to provide the use of real property in a VAT-neutral manner, making Belgium more competitive with its neighboring countries.

A property rental would be subject to VAT under the following conditions:

- both the landlord and the tenant must opt for the VAT regime (the details would be determined by royal decree);
- VAT status must be chosen (and maintained) for the entire duration of the rental agreement;
- the tenant must be a VAT payer and use the building exclusively for activity that is subject to VAT;
- the property must be a new building as of October 1, 2018 (meaning that no invoices for a real estate project, not even invoices from architects, may have been received before that date);
- converted existing buildings would qualify for the optional VAT regime if they are renovated after October 1, 2018, in such a way that they become new for VAT purposes;
- the optional VAT regime could apply to a part of a building if it can be rented out and used as a self-contained unit (meaning, inter alia, that it has separate access);
- if the land is leased with the property, the optional VAT regime would apply to the land as well; and
- if the tenant does not have a full right to deduct VAT and is related to the landlord, the rental must be at arm's length.

The period for adjusting the VAT deduction (in accordance with article 184 of Directive 2006/112/EC), which is normally 15 years for real property, would be extended to 25 years to allow for annual adjustments.

At the same time as the optional VAT regime for rental agreements, an obligatory VAT regime would be introduced for short-term rental agreements with a maximum of six months, regardless of the VAT status of the tenant, although it is expected that there will be exceptions for social purposes.

There may be some last-minute changes to these general principles in the final texts and the practice notes to be issued by the VAT administration, but this new VAT regime would generally make it easier to charge VAT on rental agreements, allowing the landlord to recover the VAT on the building, construction, renovation, and refurbishment of the property so that he does not have to charge it back to the tenant in the form of higher rent. It would also give the rental market an important boost, although only from October 1, 2018, and for properties that are new or were renovated after that date.

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