Real Estate Newsletter

The framework in which the real estate sector is currently operating, is rapidly evolving. This contribution zooms in on some operational trends as well as some tax measures / clarifications affecting the real estate sector.

The operational trends addressed in this edition result directly or indirectly from the COVID-19 crisis, e.g. the increasing and accelerating digitization and more strategic facility management in relation to the new office environment.

Important changes to the tax landscape are also the result of recently proposed measures by the Belgian government in the context of COVID-19. Besides, the tax administration has also provided a welcome clarification for real estate (development) groups in relation to the interest limitation rule, which is addressed in this newsletter.

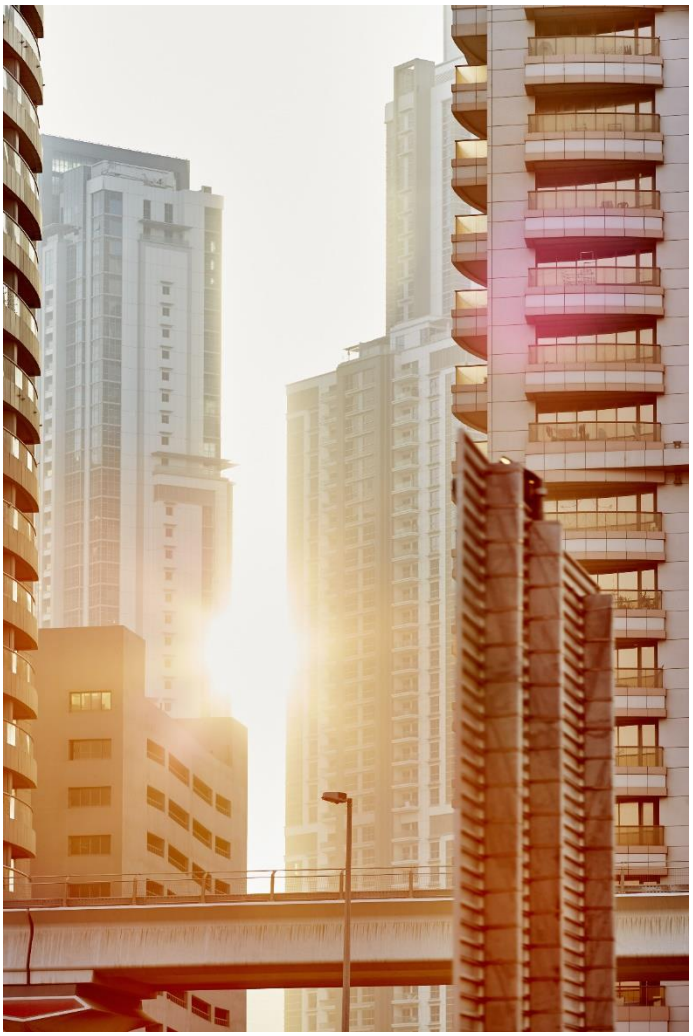
And finally, Flanders has introduced new rules for asbestos, which should speed up the asbestos removal in the Flemish Region, with calendar years 2034 and 2040 being set as milestones

The acceleration of the digital transformation in the real estate sector

Introduction:

COVID-19 has brought great challenges and disruptions to business and (global) supply chains. But it has also demonstrated that in many cases technologies made it possible to operate remotely, without access to corporate real estate. Even though the technologies were mostly available before the pandemic, COVID-19 forced organisations to accelerate the implementation of technologies and/or increase the speed of adoption.

In this newsletter, we list a number of digital trends within the real estate sector that have improved the effectiveness of the companies' operations. All trends arose from the need to work remotely, adapt to rapidly changing realities, minimise the health risks for employees and comply with COVID-19 related regulations imposed by the Belgian government.



General insights:

1 Due to the pandemic outbreak, many real estate developers and construction companies have not been able to fulfil contractual obligations. Most contracts have 'force majeure' clauses that include specific cases in which companies cannot be held accountable for delays in the execution of the contract.

To understand the exposure related to 'force majeure' clauses, developers and construction companies identified the need for a **central database, contract management solution or ERP system**, where all contracts are bundled. This database or system can be used efficiently to analyse back-to-back contract clauses and minimise exposures towards clients. E.g. A construction company has rightfully invoked the 'force majeure' clause in its contract with a developer but does the developer have the same 'force majeure' clause in its contract with the owners of the real estate development?

2 Due to the high uncertainty related to COVID-19, many companies needed to rapidly adjust planning, budgeting and forecasting when new information became available or new regulations were communicated. Some companies are realising that 'traditional' spreadsheet models might not always be the most suitable solution to provide the essential information in a short timeframe. Dedicated **performance management solutions** (such as Anaplan, CCH Tagetik and others) allow companies to better respond to the situations unfolding and make it easier to keep track of everything from project timelines to cash flows.

3 The majority of a real estate companies' (excluding the construction companies) workforce are still working remotely, which increases the **strain on IT resources**. This has led to high-speed adoption rates of digital solutions. As the situation continues to evolve, corners may be cut to "get the work done". It is however important to assess security of remote access, review the governance around VPN use and assess the security of the deployed remote workspace capacities. It is vital to understand the **cyber security** risks related to new ways of working. If available, internal audit function may be involved to assess the newly introduced risks and evaluate the relevant controls.

4 Companies have observed an increase in **phishing and hacking** activity and are proactively communicating with their workforce to create security awareness with a clear focus on prevention.

5 **Virtual collaboration** with tools such as Microsoft Teams, Skype and Zoom are the "new" norm and have replaced the majority (if not all) of physical meetings.

Market specific digital solutions:

In addition to the general insights, applicable to all players in the real estate industry, specific digital solutions are implemented and used by specific real estate players.

Owners / Investors:

With an increasing number of tenants being unable (or unwilling) to pay the rent, real estate owners / investors are faced with a new operational challenge: how to efficiently process short-term rental relief to hundreds, sometimes thousands, of tenants who have been financially impacted by COVID-19. For many real estate owners / investors, the rental concession process consists of numerous manual steps and inputs that are prone to errors, and are slow and challenging to manage. Moreover, in these times, it is vital for owners / investors to be able to continuously analyse their rental income (revenue), vacancy rates and other key parameters.

Performance management solutions can deliver accuracy, agility and transparency to your concession process. They also enable owners / investors to model different scenarios in real time, understand the impact of different abatements and concessions to a **lease**, an **asset** and a **portfolio** and adjust their strategy in accordance with the rapidly changing revenue forecasts.

Additionally, performance management solutions may feed **data visualisation and dashboarding solutions** (such as Microsoft Power BI, Tableau, Qlik and others) to visualise the results, scenarios and forecasts in a clear and effective manner.

Real Estate Brokers and Service Providers:

More and more brokers introduced new digital formats that replaced physical property visits by setting up **virtual house tours** and documenting **360° video footage** of properties to share with potential new owners or tenants.

Construction companies:

BIM (Building Information Modelling/Management) allows the different stakeholders (not only construction companies but also the developer, architects, engineering companies and others) to collaborate and exchange information more efficiently and effectively throughout the entire lifecycle of an asset. BIM combines technology, process improvement and digital information to optimise results of the construction or renovation of real estate or infrastructure. When setting up a BIM solution, at the start of a project, it is crucial to include as many stakeholders as possible. This maximises the efficiency gains of the solution, decreases adaptation costs needed for the solution to stay relevant during the entire lifecycle and increases the adoption rate.

New dedicated tools and initiatives are also introduced to facilitate social distancing on construction sites. A fine example is the DeliverApp, an initiative of the ADEB-VBA, allowing the use of a smartphone to sign off delivery notes and digitally process deliveries by both the vendor and the buyer.

COVID-19 has clearly accelerated the digital transformation initiated by many companies in the sector during the last couple of years.

Owners / Investors

Real Estate Brokers and Service Providers

Construction companies

Changes and clarifications to the tax landscape for real estate (development) companies

1. COVID-19 measures

In the context of COVID-19 several tax measures have been proposed. Two of these measures, i.e. the tax-free loss carry-back reserve (recently adopted) and the tax-free recovery reserve (not yet adopted as this article is published) could also be interesting for real estate companies in order to reduce their cash tax exposure;

It should be noted that the company's taxable result and the interaction with other Belgian tax regimes, such as the group contribution rule, will need to be monitored closely to maximize the potential benefit from these measures.

Tax-free loss carry-back reserve

Parliament has recently adopted the tax-free loss carry back reserve. As a result, companies will be able to compensate the profits of tax years 2019 or 2020 (i.e. relating to financial years closed between 13 March 2019 and 31 July 2020) with the losses (expected to be) incurred - in the subsequent tax years (i.e. 2020 or 2021 respectively). The benefit is granted through the creation of a tax-exempt reserve in the fiscal year in which the taxpayer elects to apply the measure. The taxpayer is free to choose the tax year in which the reserve is applied but the measure can only be applied once.

The purpose of this measure is to strengthen the financial position of companies affected by the COVID-19 outbreak, allowing them to:

- Reduce the income tax liability for tax years 2019 or 2020.
- Claim a refund for income tax prepayments made or income tax already assessed (or to be exempt from paying it).

The total amount of the reserve is limited to the amount of the taxable result of the year, prior to certain tax deductions (broadly speaking the taxable profit after the first operation – i.e. the net profits plus non tax-deductible expenses - minus the deduction of dividends received, innovation income and patent income). The maximum limit is set at EUR 20 million.

The losses carried back should be reintegrated into the taxable basis of the subsequent year, to avoid any double deduction. The reversal of the tax exempt reserve is also increased to avoid intentional shift of profits that are taxable at a more beneficial rate in the subsequent year (i.e. 29.58% in financial year 2019 and 25% in financial year 2020).

It is important to note that the taxpayer needs to estimate - as correctly as possible - the expected losses. A penalty, calculated through a dedicated formula, will be levied on companies having overestimated the losses by more than 10%.

The carry back of losses is prohibited for companies that, during the period from 12 March 2020 to the date of the fiscal year 2021 tax return's filing:

- buy back own shares, distribute a dividend (including a distribution of liquidation reserves), reduce their capital or execute any other reduction or distribution of equity;
- hold a direct interest in a company established in a tax haven;
- make payments of at least EUR 100,000 to companies established in a tax haven, unless justifications are provided.

Finally, the loss carry back is not available for companies subject to a special tax regime (e.g. Belgian REITs, pension funds and investment companies) and companies in distress at the date of 18 March 2020.

Tax-free recovery reserve

As briefly mentioned in our previous Real Estate Newsletter, the Belgian Government also announced the introduction of a tax-free recovery reserve. Although this measure has not yet been adopted by Parliament, it is worth explaining the highlights of this measure (although potentially still subject to amendments).

The proposal would allow companies to establish a tax-exempt recovery reserve in tax years 2022, 2023, and 2024. The recovery reserve should allow companies to maintain future profits by exempting the profits from tax and thus restore the company's pre-COVID-19 equity.

The maximum amount of such a reserve would be limited to the amount of operational losses ("bedrijfsverlies") recorded in the company's financial statements for 2020 or 2021 (if the accounting year ended between 1 January 2020 and 31 July 2020, the company has the option to determine the amount of the tax-free recovery reserve based on the operational losses of the financial year ended in 2021 or 2020) with an absolute maximum of EUR 20 million. Companies recording no operating losses for financial year 2020 or 2021 (depending on the case) would not be eligible for the regime. In any case, the tax free recovery reserve in relation to each tax year cannot be higher than the taxable reserves of the taxable period (to be determined as if no tax free reserve would have been recorded).

The recovery reserve should meet the intangibility condition, i.e. it needs to be booked and maintained as an unavailable reserve on the balance sheet.

The benefit of this measure will be conditional to the company maintaining its level of equity and personnel costs. The recovery reserve would have to be recaptured and would become (partially) taxable in the taxable period during which the company either carries out an equity distribution, or significantly reduces its personnel costs.

As for the tax-free loss carry back reserves, some companies are excluded from the benefit of the measure (please see *supra*).

Temporary 25% investment deduction for SME's

In a new law dd. July 15th – so-called Corona III-law - further measures have been proposed in order to boost the economy. Amongst these measures is the temporary 25% investment deduction that would be made available to SME's that acquire or produce fixed assets between 12 March and 31 December 2020. In addition, the carry-forward of any unused investment deduction for investments made in 2019 is extended for two years.

Were SME's to perform new investments in real estate in the period between 12 March and 31 December 2020, such investments might – subject to conditions - become eligible for the temporary 25% investment deduction.

2. Clarification in relation to the interest deduction limitation rule: joint-controlled companies are considered stand-alone entities for application of interest deduction limitation rule

The Belgian Tax Authorities have recently specified that a jointly controlled company, i.e. a so-called joint venture, should apply this rule as if it were a stand-alone entity. This clarification is especially relevant for Belgian real estate development groups.

As of tax year 2020, any arm's length "exceeding borrowing costs" are, as a rule, only deductible for up to the higher amount of either a maximum 30% of the taxpayer's "EBITDA" or EUR 3 million, except for the so-called 'grandfathered loans' (i.e. loans concluded before 17 June 2016 that have not been substantially amended).

If there is only one taxpayer in Belgium, its EBITDA can be easily determined based on the tax return data. The situation is different if there are 2 or more Belgian "group members". In such a hypothesis, a tax consolidation has to be simulated among Belgian group members. Furthermore, in a Belgian group context, the *de minimis* threshold of EUR 3 million is applicable at group level (and thus not at of each individual Belgian company level). This means that the EUR 3 million should be spread across all Belgian entities within the group, based on certain methods and in function of their interest deduction capacity need.

A 'group' is not defined separately for purposes of the new interest limitation rules. Hence, recourse should be made to the Belgian Code of Companies and Associations. Based on this Code, companies that are 'jointly controlled', i.e. joint ventures controlled by joint venture partners collectively, should in principle be considered as belonging to two groups.

Such reasoning would result in a highly technical and inadvertently complex calculation of the interest deduction capacity at jointly controlled entity level, and would also raise certain questions (e.g. to which group should this company be allocated for purposes of the rule, or should the interest deduction capacity of the joint venture be shared among the two groups?).

The Belgian tax authorities have therefore specified in a recent decision, obtained by Deloitte, that a joint venture should be considered as being part of neither (controlling) group, i.e. the joint venture should apply the interest limitation rule as if it was a stand-alone entity (or as a member of a stand-alone group if it has any subsidiaries).

As a result, a joint venture (with its subsidiaries, if any) can always benefit from interest deduction for up to the higher of either 30% of its (own) taxable EBITDA or the *de minimis* threshold of EUR 3 million, for purposes of the interest limitation rule. No intercompany corrections need to be undertaken for interest and fee flows between the joint venture on the one hand, and the joint venture partners on the other.

For many real estate development groups, this clarification from the central tax authorities will be most welcome (also in view of the corporate tax returns to be filed shortly). Belgian developers frequently set up joint venture (50/50) companies – sometimes highly leveraged - with other real estate (development) partners for the joint development of a real estate project.

As these joint venture companies should not be taken into account in the *de facto* tax consolidation exercise of each joint venture partner group itself (cf. *supra*), this position will also facilitate their individual EBITDA calculations.

Changes in asbestos legislation in Flanders

New rules for asbestos in the Flemish Region

The Flemish Region introduced, by a Decree dd. 29 March 2019 (hereinafter the "Decree"), a new section on asbestos-containing materials within the so-called "Materials Decree" dd. 23 December 2011. The new rules on asbestos-containing materials should speed up the asbestos removal in Flanders, with calendar years 2034 and 2040 being set as milestones. The first milestone (2034) relates to the phasing out of asbestos-containing materials presenting the highest risk (such as roof and façade materials), whereas the second milestone (2040) is the expected deadline for an asbestos-safe Flanders.

At present, the only provisions that have entered into force – with effect as from 27 April 2019 – are general rules applying to all types of buildings (such as prohibitions to conduct certain actions on asbestos-containing materials and the obligation for the person who manages asbestos-containing materials to take precautions) and specific rules relating to public buildings that are outlined hereunder. The other provisions, as introduced by the Decree and as further described below, have not yet come into force and we have no information on the expected date of entry into force.

Definitions

For a full understanding of the following, it is important to define some terms:

- *Owner*: the full owner or the bare owner. In case of division of the ownership right, each of the undivided holders of the ownership right is jointly and indivisibly considered as owner;
- *Accessible building*: any building that is located on the territory of the Flemish Region into which it is possible to enter, i.e. any building consisting of a roof supported by building elements and/or where a person can stand or walk inside (e.g. house, store, factory, sports hall, etc.);
- *Public building*: any building that is located on the territory of the Flemish Region in which a public organization that provides public services to a large number of people is located;
- *Transfer*: the transfer of a right of ownership and the establishment or transfer of a right in rem (but not the termination of a right in rem). E.g. sale, exchange, gift as well as a merger, demerger, operation assimilated to a merger/demerger, contribution or transfer of the universality or branch of activity of a legal person, to the extent that such corporate transaction involves a transfer of a right of ownership or a right in rem. Expropriation and inheritance are not considered as a transfer.

Moreover, it should be noted that even if the Decree only refers to the 'owner' of a building, the modalities and financing of the execution of the legal obligation could be contractually regulated, while taking into account the rights of management, use and/or enjoyment that have been granted to third parties. From a landlord's point of view, contracts with occupants for instance lease agreements should therefore include provisions shifting the responsibilities in terms of works and costs associated with current and future mandatory rules on asbestos as much as possible towards the occupant.

Asbestos inventory certificate

All (private or public) owners of an accessible building built in or before 2000 will be required to have a so-called "asbestos inventory certificate" by no later than 31 December 2031 (note that an extension can be granted by the Flemish Region in certain cases for a maximum of 4 years). A certified asbestos expert will have to examine the building and list all the materials containing asbestos. The OVAM will issue the certificate after the inventory has been carried out. The validity

term of the certificate is still to be decided on by the Flemish Government.

In the event of a forced (or ordinary) co-ownership, each owner is required to have a specific certificate for the common areas as well as for their private area.

The lessor will have to communicate this certificate to the tenant at the beginning of the lease or within the month of the issuance of the certificate.

Transfer

In the case of a transfer of an accessible building built in or before 2000, the aforementioned asbestos inventory certificate will have to be communicated to the acquirer and compliance with this obligation must be mentioned in the (private and authentic) deed of transfer (together with the date, conclusion and unique code of the certificate). This obligation is similar to the obligation to provide a soil certificate and an EPB certificate.

In the event of forced (or ordinary) co-ownership, the transferor shall communicate the contents of a distinct certificate for the common areas as well as for each private unit involved in the transfer.

The acquirer may request the nullity of the transfer if this communication obligation has not been complied with. This sanction is, from a legal perspective, a case of relative nullity ("relatieve nietigheid" / "nullité relative"). As a consequence thereof, only the acquirer can invoke the nullity of the transfer. The possibility to request the nullity of the transfer will no longer exist if (and when) the acquirer has explicitly waived his right to invoke nullity in the authentic deed and if he is in possession of a valid asbestos inventory certificate.

Public buildings

In a will to "lead by example", the Flemish authorities are stricter with themselves and the provisions relating to public buildings have therefore already entered into force. Hence, public buildings built in or before 2000 will have to be 100% asbestos-safe by 1 January 2040 (and maintain that asbestos-safe conditions from that moment onwards). This means that public organizations are obliged to remove some asbestos-containing materials (the list of which can be found in article 33/5 of the Materials Decree) from their buildings. The deadline for removal of easily accessible asbestos-containing materials presenting the highest risk is even shorter (1 January 2034 but an extension can be granted by the Flemish Government in certain cases – extension for a maximum of 2 years, and in certain cases even until 2040).

What about Brussels and Wallonia?

As per today, neither Brussels nor Wallonia have (yet) adopted similar measures. Hence, only Federal legislation applies in the Brussels Capital Region and Walloon Region including the prohibition of the use of asbestos and the obligation for employers to carry out an asbestos inventory. Nevertheless, one can expect that those two Regions will draw inspiration from Flemish legislation to create their own asbestos legislation and that eventually asbestos management will be comparably governed throughout the Country.

Sanctions

The Decree does not provide for specific sanctions in the event of non-compliance with asbestos-related obligations (with the exception of the nullity of the transfer). The sanctions of title XVI of the decree of 5 April 1995 containing general provisions on environmental policy therefore apply.

Conclusion

In view of the increased Regional focus on asbestos removal, businesses should consider provisioning the costs that the asbestos removal may represent in their hands in the mid-term and clearly consider this as a point of attention when proceeding to real estate acquisitions. M&A processes targeted by this new legislation on asbestos should be adapted accordingly. Moreover the non-compliance of the property being transferred with applicable legislation on asbestos might become a real deal breaker, especially in the Flemish Region where for instance the absence of a valid asbestos inventory certificate at the time of signature of the sale deed shall give the right to the acquirer to request the nullity of its acquisition in the near future.

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