

Family Owned Business & Private Wealth

Supreme Court rules: the Dutch box 3 wealth tax is still discriminatory

6-6-2024



On 6 June 2024, the Dutch Supreme Court issued an important ruling in five cases on the net wealth income tax in box 3 of the Dutch personal income tax.

The Supreme Court rules that both the Legal Redress Act (“Herstelwet”; 2017-2022) and the Bridging Act (“Overbruggingswet”; from 2023) still result in a violation of the right to property and the prohibition of discrimination in cases where the deemed (flat-rate) return is higher than the actual return. The Supreme Court also provides further guidance for calculating the actual return.

This ruling has far-reaching implications for taxpayers with box 3 assets as well as for the Dutch tax authorities and legislator.

Background

Christmas judgment

On 24 December 2021, the Dutch Supreme Court ruled in its ‘Christmas Judgment’ that the taxation in box 3 since 1 January 2017 violated the right to property and the prohibition of discrimination under the European Convention on Human Rights (ECHR). The Supreme Court offered legal redress to the taxpayer by limiting the taxation to the actually realized return (instead of a deemed flat rate return under the then applicable box 3 system).

Legal Redress Act and Bridging Act

In response to the Christmas ruling, the State Secretary of Finance initiated a recovery operation by offering taxpayers compensation for past taxation in box 3 (2017-2022; via the Legal Redress Act) as well as ensuring future taxation by amending the then scrutinized box 3 taxation (from 2023; via the Bridging Act). Taxation under the Legal Redress Act and the Bridging Act is based on the so-called “flat-rate savings variant” (in Dutch: “*forfaitaire spaarvariant*”) and calculates the compensation by applying a flat-rate return on a taxpayer’s box 3 assets.

Under the flat-rate savings variant, the box 3 income is based on deemed flat-rate of returns on three different asset classes, being (i) savings (including cash), (ii) investments/other assets (e.g., investment portfolios, Dutch real estate, etc.) and (iii) debts. The deemed return is linked to each asset class and the total taxable box 3 income is – in short – calculated by adding up the deemed return on asset class (i) and (ii) and subtracting the deemed return on asset class (iii). This deemed return is taxed in box 3 at a rate of 36% (2024 rate).

The legislator's aim with the flat-rate savings variant is to (better) approach a taxpayer's actual return by (i) taxing the actual composition of assets (instead of a deemed asset base) and (ii) basing the flat-rates of return on current interest rates (for the savings and debt categories) and a multi-year weighted average return over a given asset mix (for the investments/other assets category).

Law questions

The Supreme Court answered the following key questions in five judgments on 6 June 2024:

1. *Do the Legal Redress Act (2017-2022) and the Bridging Act (from 2023) remove the violation with the ECHR's property right and prohibition of discrimination found by the Supreme Court on 24 December 2021?*

The Supreme Court ruled that the Legal Redress Act does not remove the previously identified violation with the property right and prohibition of discrimination. Indeed, the flat-rate of return for taxpayers with other assets is still calculated in the same way as under the original box 3 system (based on average rates of return achieved over the long term with the most common types of other assets). As a result, the discriminatory treatment of investors identified by the Supreme Court in the Christmas ruling remains: successful investors are undertaxed and unsuccessful investors are overtaxed. In cases where the flat-rate return is higher than the actual return, it follows that box 3 still violates the ECHR. The actual difference between the deemed return and the actual return is irrelevant (i.e. there is no margin of tolerance).

The Supreme Court ruled that the foregoing also applies to the Bridging Act (from 2023 onwards) because it is based on the Legal Redress Act and follows the Legal Redress Act to a large extent.

2. *Should restoration of rights be granted on the basis of actual returns achieved and, if so, what is meant by that?*

If the actual return is lower than the deemed flat-rate return, legal redress should in principle be granted on the basis of the actual return. This involves a comparison between the actual and the deemed flat-rate return in respect of all box 3 assets (including savings) without deduction of the exempt tax-free basis in wealth. The Supreme Court provided guidance on calculating the actual return:

- The actual return consists of all regular income (e.g. interest, rents and dividends) and all realized and unrealized changes in the value of assets in both positive and negative terms (e.g. capital gains or losses on shares and increases or decreases in property values).
- The actual return must be determined without taking costs into account (e.g. costs of (leased) property belonging to the box 3 assets). However, actual interest costs of debts belonging to the assets in box 3 may be taken into account.
- When determining the actual return in a given calendar year, positive and negative returns in other years are not taken into account.
- In determining the actual return, only the 'nominal' return is in scope (therefore inflation is not taken into account).

It is up to taxpayer to establish facts, and, in case of dispute, demonstrate, that the actual return is lower than the flat-rate return.

3. When the assessment is reduced, is there also a right to an interest payment by the Dutch tax authorities?

Dutch tax law lacks a regulation requiring the Dutch tax authorities to pay interest when reducing a tax assessment. In general, this is not contrary to the ECHR according to the Supreme Court. Given case law of the ECHR, there is only an exception to this rule in cases where the amount of statutory interest exceeds the amount of the tax reduction in box 3. In other cases, no interest needs to be paid.

Significance for practice

In these cases, the Supreme Court the Legal Redress Act and the Bridging Act are still found to be inconsistent with the ECHR. This means that many taxpayers will be compensated, provided they establish facts to that effect, and in the event of a dispute make it plausible, that the actual return on the entire box 3 assets in a year has been lower than the flat-rate return for which they have been taxed. As unrealized changes in the value of assets are also included in the actual return from year to year, this will not be so easy (in terms of proof) for a (large) number of taxpayers.

Note that the Supreme Court did not yet rule in the pending case on whether the rulings of 6 June 2024 apply to all taxpayers who are subject to box 3 taxation, or only to taxpayers that have timely objected to their final tax assessments. This is of particular relevance with respect to the years 2017 – 2020.

Way forward

The Supreme Court's ruling has major budgetary implications (which were not foreseen in the new government's budget) and will also trigger some implementation issues on the side of the Dutch Tax Administration. In an initial response, the State Secretary of Finance indicates that he is studying the rulings and mapping out the consequences. He expects to need about eight weeks to do so. After that, he will indicate which possibilities have been explored and where any issues remain. The intention is that political decision-making will then take place by the next government.

The State Secretary of Finance says that taxpayers affected by the Supreme Court ruling will receive a letter from the Tax Administration. According to him, they do not need to do anything thereafter and will be informed as soon as there is more clarity.

Finally, the State Secretary of Finance indicated that, in his opinion, the Supreme Court's ruling is in line with the draft bill for taxation in box 3 based on actual returns. The outgoing cabinet plans to introduce this new box 3 system from 2027. More will probably be known about the design and timing of this bill on Budget Day 2024.

Contact

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