

FANTOZZI & ASSOCIATI

STUDIO LEGALE TRIBUTARIO



MIPIM March 2007, Cannes

INVESTING IN REAL ESTATE IN ITALY

A Tax brief

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SUMMARY

		SLIDE
Direct Acquisition of RE properties	VAT & Transfer Taxes	3
Acquisition of Shares in companies owning RE properties	Transfer Tax	8
Financing the Acquisition of RE properties	<ul style="list-style-type: none"> • Interest • Thin capitalization • Stamp duties on financing • Financial Lease 	10
Taxation of Re business	<ul style="list-style-type: none"> • VAT & Registration Tax • CIT & Regional Tax • Municipal Tax on RE properties 	15
Repatriation of profits	WHT on interest & dividends	26
Exit Strategies	Taxation of Capital Gains	29

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Direct Acquisition of RE properties

VAT & Transfer Taxes



ACQUISITIONS OF RESIDENTIAL BUILDINGS

SELLER	BUYER	VAT	REGISTRATION TAX	MORTGAGE TAX	CADASTRAL TAX
Firm which built or refurbished the building (building to be sold within 4 years after works ended)	First-home buyer	4%	168 €	168 €	168 €
	Other subjects	<ul style="list-style-type: none"> • 10% non-luxury houses • 20% luxury houses 			
Other VAT taxable subjects	First-home buyer	VAT exempt	3%	168 €	168 €
	Other subjects	VAT exempt	7% (3% for historical & fine arts buildings)	2%	1%

ACQUISITIONS OF COMMERCIAL BUILDINGS – 1

SELLER	BUYER	VAT	REGISTRATION TAX	MORTGAGE TAX	CADASTRAL TAX
Firm which built or refurbished the building (building to be sold within 4 years after works ended)	Anybody (other than Financial lease Co' and REITs)	<ul style="list-style-type: none"> • 10% refurbished buildings • 20% new building 	168 €	3%	1%
	Financial lease Co' and REITs	<ul style="list-style-type: none"> • 10% refurbished buildings • 20% new building 	168 €	1,5%	0,5%

ACQUISITIONS OF COMMERCIAL BUILDINGS – 2

SELLER	BUYER	VAT	REGISTRATION TAX	MORTGAGE TAX	CADASTRAL TAX
VAT taxable subjects (other than building or refurbishing Firms) which DO NOT ELECT the option to charge VAT	VAT taxable subject having input VAT deductible on a proportion < 25%	20%	168 €	3%	1%
	VAT NON-taxable subject	20%	168 €	3%	1%
	Financial lease Co' and Italian REITs	VAT exempt unless the seller elected the option to charge VAT	168 €	1,5%	0,5%
	Other subjects	VAT exempt unless the seller elected the option to charge VAT	168 €	3%	1%

ACQUISITIONS OF COMMERCIAL BUILDINGS – 3

SELLER	BUYER	VAT	REGISTRATION TAX	MORTGAGE TAX	CADASTRAL TAX
VAT taxable subjects (other than building or refurbishing Firms) which DO ELECT the option to charge VAT	Financial lease Co' and Italian REITs	20%	168 €	1,5%	0,5%
	Other subjects	20%	168 €	3%	1%
VAT NON-taxable subjects	Financial lease Co' and Italian REITs	Out of scope of VAT	7% (3% for historical & fine arts buildings)	1,5%	0,5%
	Other subjects	Out of scope of VAT	7% (3% for historical & fine arts buildings)	3%	1%

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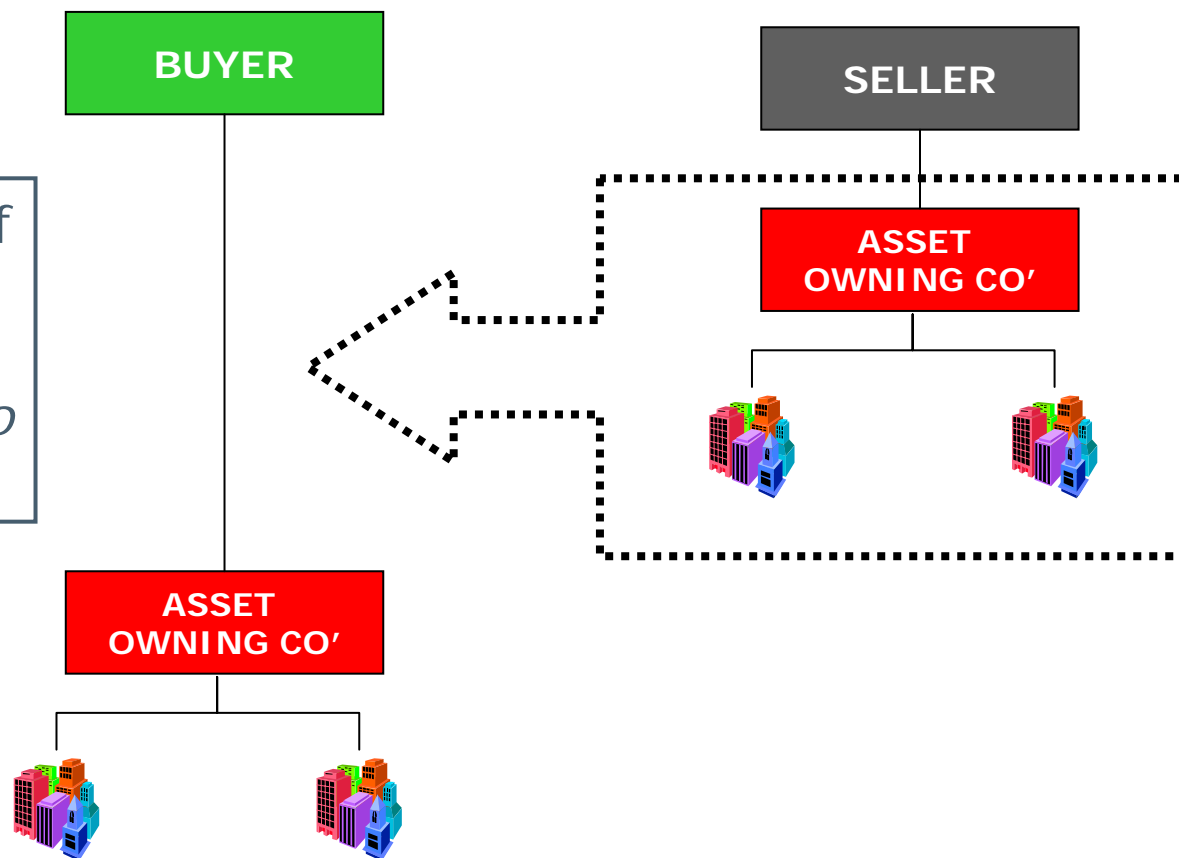
*Acquisition of shares in
companies owning RE properties*

Transfer Tax



SHARE DEAL

The consideration of a Share Deal is subject to a 0,14% stamp duty (*"fissato bollato"*)



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*Financing the Acquisition of RE
Properties*

*Interest, Thin Capitalization, Stamp Duties
on financing and Financial Lease*



TAX DEDUCTIBILITY OF INTEREST EXPENSES

- Interest expenses are in principle deductible for CIT, not for Regional Tax purposes (IRAP at a rate ranging from 4.25 to 5.25%), with some restrictions:
 - Thin capitalization
 - Asset-based ratio (i.e.: *pro-rata patrimoniale*), generally not applicable to Co' owning RE properties
 - Due to the earning of exempt income

THIN CAPITALIZATION – KEY FEATURES

Thin cap ratio	4-to-1
Applicable financing/loans	financing/loans granted or guaranteed by a qualified shareholder or related parties
Qualified shareholder	Shareholder holding directly or indirectly more than 25% of share capital
Equity to be adjusted for thin cap purposes	among other things, the equity has to be decreased by the lower amount between the BV of shares in subsidiaries and their equity
Interest relating to debts exceeding the 4-to-1 ratio	not deductible for tax purposes and re-characterized as dividend

■ STAMP DUTY ON LONG-TERM FINANCING LOANS

- Italian banks are obliged to pay a 0,25% stamp duty (*imposta sostitutiva*) on long-term (more than 18 months) financing loans they have granted
- Such a 0,25% is then re-charged to borrowers
- The 0,25% stamp duty does take the place of any other stamp duty applicable with respect to the financing involved (e.g.: Registration tax on loans and guarantees, Mortgage Tax on mortgages, etc.)
- According to Italian GAAP, the 0,25% stamp duty can be capitalized by the borrower as “others intangibles” and amortized over the duration of the loan

FINANCIAL LEASES OF RE PROPERTIES

- In a financial lease of RE properties, lease payments are tax deductible by the Lessee on condition that the duration of the lease:
 - is not shorter than $\frac{1}{2}$ of the theoretic depreciation process (which would be applicable in case of direct acquisition of the property), and
 - in any case for RE properties, is not shorter than 8 and not longer than 15 years
- Interest expenses implicit in each lease payment are not deductible for Regional Tax (IRAP) purposes
- A quota of 20% (or 30% for industrial buildings) of each lease payment – net of implicit interest – is not deductible for tax purposes, since it is considered as attributable to the underlying land (which would not be depreciable in case of direct acquisition of the property)
- The above tax treatment applies irrespective on whether the financial lease is booked:
 - according to IAS/IFRS no. 17, where the property is booked as an asset by the Lessee or
 - according to Italian GAAP, where the property does remain as an asset in the books of the Lessor

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Taxation of RE business

VAT & Registration Tax

Corporate Income Tax (IRES) & Regional Tax (IRAP)

Municipal tax on RE properties (ICI)



RENTAL OF RESIDENTIAL BULDINGS

OWNER	TENANT	VAT	REGISTRATION TAX
Firm which built or refurbished the building (building to be rented within 4 years after works ended)	Anybody	10%	168 €
Other VAT taxable subjects	Anybody	VAT exempt	2%

RENTAL OF COMMERCIAL BUILDINGS

OWNER	TENANT	VAT	REGISTRATION TAX
VAT taxable subjects which DO NOT ELECT the option to charge VAT	VAT taxable subject having input VAT deductible on a proportion < 25%	20%	1%
	VAT taxable subject having input VAT deductible on a proportion > 25%	VAT exempt	1%
	VAT NON-taxable subject	20%	1%
VAT taxable subjects which DO ELECT the option to charge VAT	Anybody	20%	1%

CIT & REGIONAL TAX – KEY FEATURES/1

FEATURE	CIT – IRES	IRAP
RATE	33%	from 4,25 to 5.25% depending on the Region where income is yielded
TAXABLE BASE	Net statutory result from P&L, adjusted according to tax law	<ul style="list-style-type: none"> • Net “production value”, that substantially corresponds to business revenues less costs, depreciation and expenses • Labor costs, interest income & expenses, dividends and extraordinary gains and losses are not included in the IRAP taxable base • Apart from the above, the IRAP taxable base is adjusted by the same adjustments done for CIT purposes, unless specific rules are provided for IRAP purposes

CIT & REGIONAL TAX – KEY FEATURES/2

FEATURE	CIT – IRES	IRAP
DEPRECIATION	<ul style="list-style-type: none"> • 3% basic rate for buildings • other rates for buildings is specific industries: 4, 5, 5½, 6, 7 • 6% for buildings of large-scale retail trade industry • Depreciation rates are reduced to ½ in the first FY 	Same as CIT
ACCELERATED DEPRECIATION	<ul style="list-style-type: none"> • In the first 3 FY, the basic depreciation rate can be doubled (taking also into account that in the first FY the rate is reduced to ½) • in case of second-hand assets, the basic depreciation rate can be doubled only in the first FY 	Same as CIT
DEPRECIATION OF BUILDINGS	<ul style="list-style-type: none"> • The portion of cost of a building attributable to the underlying land is not depreciable • such a non-depreciable portion cannot be lower than 20% (or 30% for industrial buildings) of the total cost of the property 	Same as CIT

CIT & REGIONAL TAX – KEY FEATURES/3

FEATURE	CIT – IRES	IRAP
DIVIDENDS	95% exempt (tax burden = 5% * 33% = 1,65%)	Not subject to IRAP
CAPITAL GAINS FROM SALE OF RE PROPERTIES	<ul style="list-style-type: none"> • Taxable at 33% standard rate • in case the property sold has been held for at least 3 years, the taxation can be spread over 5 years 	<ul style="list-style-type: none"> • Taxable at IRAP standard rate • Even though extraordinary gains are in principle not subject to IRAP, capital gains from sale of capital goods or equipments are included into the IRAP taxable base
CAPITAL GAINS FROM SALE OF SHARES	<ul style="list-style-type: none"> • 84% participation exemption applies upon some conditions (tax burden = 16% * 33% = 5,28%) • However, participation exemption does not apply to shares in Co' whose assets are mainly represented by RE properties 	Not subject to IRAP

OTHER CIT FEATURES

FEATURE	CIT – IRES	IRAP
TAX LOSSES CARRY FORWARD	<ul style="list-style-type: none"> • TL can be carried forward over 5 FY • losses suffered in the first 3 FY from incorporation of a Co' can be carried forward with no limit in time • no carry-back 	Not applicable
TAX GROUP CONSOLIDATION	<ul style="list-style-type: none"> • Optional regime for 3 FY: control requirement > 50% • 100% consolidation of income/loss of each company electing the option, irrespective of the % held • 100% exemption for intra-group dividends 	Not applicable
CONSORTIUM RELIEF	<ul style="list-style-type: none"> • Optional regime for 3 FY: control requirement no less than 10% and no more than 50% • Income/loss is attributed to shareholders in proportion to their shareholding, irrespective of dividends distributed • Joint liability for tax & penalties assessed 	Not applicable

■ NON-OPERATING COMPANIES REGIME/1

- When revenues in the P&L are below the amount calculated by applying certain rates to the value of assets, the non-operating companies regime applies
- In case the minimum-revenues-test is not passed, a minimum income for both CIT & IRAP purposes is calculated by applying certain rates to the value of assets
- Value of assets is taken as the average of the FY involved and 2 previous FY
- Applicable also to assets owned through a financial lease

NON-OPERATING COMPANIES REGIME/2

MINIMUM-REVENUES-TEST	RATE
Shares or equity interest in companies, bonds, and account receivables	2%
Commercial RE properties (other than offices) and Ships	6%
Offices	5%
Residential RE properties	4%
Other fixed assets	15%
TOTAL	MIN revenues
In case MIN revenues are higher than revenues in P&L the rates below apply to calculate the MINIMUM income	
Shares or equity interest in companies, bonds, and account receivables	1,50%
Commercial RE properties (including offices) and Ships	4,75%
Residential RE properties	3%
Other fixed assets	12%
TOTAL	MIN income

NON-OPERATING COMPANIES REGIME/3

- Regime applicable also to non-resident companies having a PE in Italy
- Regime not applicable in the first FY after the setting up of a company/PE
- VAT credit shown in the yearly VAT return can be only carried forward, not asked for refund
- In case the minimum-revenues-test is not passed for 3 FY in succession, the VAT credit is lost and cannot be further carried forward
- The regime can be avoided only in case the company get a positive ruling by the Revenue Agency

MUNICIPAL TAX ON RE PROPERTIES (ICI)

- Municipal Tax due each year by owners and lessees of RE properties
- Rates varying from 0,4% to 0,7% depending on the municipality where the property is situated
- Taxable base = “cadastral income” (average estimated income as recorded in the RE Property Official Registry), increased by 5% and multiplied by:
 - 100, for residential and public buildings
 - 50, for commercial buildings, including offices
 - 34, for shops
- Non-deductible for CIT; deductible for IRAP purposes

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Repatriation of Profits

■ *Withholding Taxes on Interest & Dividends paid to non-residents*



WHT ON INTEREST FROM LOANS

- Domestic WHT on interest from loans paid to non-residents: 12,5% (27% for residents in black-listed countries)
- Most of Tax Treaties signed by Italy are providing for a WHT reduced down to 10%
- No WHT in case the EU Interest/Royalties Directive 2003/49/CE applies:
 - in case of 25% shareholding
 - 1 year holding period
 - not applicable to interest re-characterized as dividend due to thin cap regulations

WHT ON DIVIDENDS

- Domestic WHT on dividends paid to non-residents: 27%
- Possibility to ask a refund of WHT:
 - to the extent of taxes paid in the country of residence on the dividend, and
 - within the limit of 4/9 of the WHT (i.e.: possible tax burden = $[27 - (27 * 4/9)] = 27 - 12 = 15$)
- Most of Tax Treaties signed by Italy are providing for a WHT reduced down to 15%
- No WHT in case the EU Parent/Subsidiary Directive applies:
 - 1 year holding period
 - 25% shareholding [a Decree not yet approved is decreasing the minimum shareholding down to 20% (1.1.2005), 15% (1.1.2007), 10% (1.1.2009)]
 - to interest re-characterized as dividend due to thin cap regulations

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Exit Strategies

Taxation of Capital Gains from Sales of RE property or Shares








TAXATION OF CAPITAL GAINS (RESIDENT CO')

SALE OF RE PROPERTIES by a Italian Co' or PE in Italy	SALE OF SHARES by a Italian Co' or PE in Italy
<ul style="list-style-type: none">• Capital gain fully subject to CIT and IRAP• in case the property sold has been held for at least 3 years, the taxation can be spread over 5 years	<ul style="list-style-type: none">• Capital gain fully subject to 33% CIT• not subject to IRAP• 84% Participation exemption does not apply to capital gains from sale of shares in Co' whose assets are mainly represented by RE properties• In case of a sale of shares by a non-resident, possible Tax Treaty protection





TAXATION OF CAPITAL GAINS (NON-RESIDENT CO')

SALE OF RE PROPERTIES by non-resident Co'	SALE OF SHARES by non-resident Co'
<p>In case the RE property is owned directly from abroad, by a Co' not having a PE in Italy, the capital gain:</p> <ul style="list-style-type: none"> • is NOT subject to tax in Italy when the property sold has been held for at least 5 years • otherwise, if the property is sold within 5 years from the acquisition, the capital gain is subject to a 20% substitute tax 	<p>Co' which are qualified shareholders (more than 20% of voting rights or 25% of paid-in share capital):</p> <ul style="list-style-type: none"> • capital gain subject to 33% CIT • 60% Participation exemption applies (tax burden $33\% * 40\% = 13,2\%$) • capital gain not subject to IRAP • possible Tax Treaty protection <hr/> <p>Co' which are non-qualified shareholders (up to 20% of voting rights or 25% of paid-in share capital):</p> <ul style="list-style-type: none"> • No taxation in Italy in case of residents in white-listed countries





TAX TREATIES

COUNTRY		DIVIDENDS	CAPITAL GAINS
AUS		15% WHT	Taxation in Italy when assets of ITA-Co mainly consist of RE property
AUT		15% WHT	NO TAX in ITALY
BEL		15% WHT	NO TAX in ITALY
CAN		15% WHT	Taxation in Italy when assets of ITA-Co mainly consist of RE property
FRA		<ul style="list-style-type: none"> • 5% companies owning > 10% for 1y • 15% other cases 	<ul style="list-style-type: none"> • Taxation in Italy when assets of ITA-Co mainly consist of RE property • Taxation in Italy if shareholding > 25% of share capital




TAX TREATIES

COUNTRY		DIVIDENDS	CAPITAL GAINS
GER		<ul style="list-style-type: none"> • 10% companies owning > 25% • 15% other cases 	<ul style="list-style-type: none"> • NO TAX in ITALY • special rule for change of residence and shareholding > 25%
IRL		15% WHT	NO TAX in ITALY
JAP		<ul style="list-style-type: none"> • 10% companies owning > 25% for 6 months • 15% other cases 	NO TAX in ITALY
LUX		15% WHT	NO TAX in ITALY

TAX TREATIES

COUNTRY		DIVIDENDS	CAPITAL GAINS
NL		<ul style="list-style-type: none"> • 5% companies owning > 25% for 1Y • 10% companies owning > 10% for 1Y • 15% other cases 	NO TAX in ITALY unless change of residence 5Y before the sale
POR		15% WHT	NO TAX in ITALY
RUS		<ul style="list-style-type: none"> • 5% companies owning > 10% for 100K US\$ • 10% other cases 	NO TAX in ITALY
SP		15% WHT	NO TAX in ITALY

TAX TREATIES

COUNTRY		DIVIDENDS	CAPITAL GAINS
SVI		15% WHT	NO TAX in ITALY
UK		<ul style="list-style-type: none"> • 5% companies owning > 10% • 15% other cases 	NO TAX in ITALY unless change of residence 5Y before the sale
USA		<ul style="list-style-type: none"> • 5% companies owning > 50% for 1Y • 10% companies owning > 10% for 1Y • 15% other cases 	Taxation in Italy when assets of ITA-Co mainly consist of RE property

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This guide is correct at the best of our knowledge and belief at March 2007.
It is however written as a general guide, so it is recommended that specific professional advice is sought before any action is taken.