

Italian Real Estate Investments Funds (REIFs)

TAXATION OF ITALIAN REAL ESTATE INVESTMENT FUNDS (REIFs)

INCOME TAX

Italian Real Estate Investment Funds (REIFs) are completely exempt from income tax and IRAP, the regional tax on productive activities.

Until 31 December 2003, REIFs were subject to a substitutive tax at a 1% rate on the fund's Net Asset Value (NAV), regardless of realized income or suffered losses.

The tax regime was therefore not beneficial for REIFs performing at a loss. The 1% tax regime was repealed by the Decree on 1 January 2004.

Instead, as of 1 January 2004, has been introduced a 12.5% substitute tax applicable to profits distributed by REIFs to their unit-holders. The Asset management company (SGR) has the duty to withhold the substitute tax.

The withholding tax is charged on the amount of profits distributed to investors and to the difference between the redemption value or the liquidation and the subscription or purchase cost related to each share resulting from periodical statements (*prospetti periodici*).

The new tax regime applies to profits distributed after 1 January that relate to periods of activity of the REIF commencing after 31 December 2003. Profits derived from periods of activity of the REIF up to 31 December 2003 will be subject to the old tax regime, a 1 percent tax on the fund's NAV.

The 12.50% withholding tax is a final tax for profits distributed to Italian-resident individuals and non-resident investors (without a permanent establishment in Italy to which the investment is connected), and applies as a tax advance in case of profits distributed to Italian-resident companies or permanent establishments in Italy of foreign entities, whereby profits deriving from REIFs are taxed at the ordinary 33% corporate tax.

Therefore, resident corporate investors in REIFs carrying out a commercial activity must include the shareholder income from the REIF in their

taxable income, subject to income tax at full rates (33%), being no more beneficial than the direct investment in real estate.

However, under the new tax regime, foreign investors are totally exempt from the 12.50% substitutive tax, provided that they reside in a country that permits an adequate exchange of information with Italian tax authorities (enumerated in the "white list" issued on 4 September 1996, as amended).

Finally, please note that pursuant to art. 6, para. 3-bis, of law decree n. 351/2001, sales and contributions into REIFs fall within the scope of application of the general anti-avoidance provision, contained in art. 37-bis of Presidential Decree n. 600/1973.

INDIRECT TAXATION

Since REIFs are not autonomous VAT entities, VAT duties related to the transactions of each REIF must be fulfilled by the SGR.

However, VAT on transactions of each REIF is determined and liquidated separately from the VAT due in relation to the activity of the SGR.

This provision permits a full deduction of VAT charged on properties purchased by or services rendered to the REIF, even if the managed activity carried out by the SGR is VAT-exempt (giving rise to non-deductible VAT on goods or services received by the SGR).

The SGR can benefit by significant advantages in respect of VAT reimbursement. Indeed, VAT credit from the acquisition of real property by the REIF and on costs related to the management of that property may be claimed back within six months.

Otherwise, the VAT credit can be either set off against other taxes due or transferred to a third party (belonging or not to the group of the transferor).

The Financial Law 2004 provided that VAT on contribution of real property to a REIF could be self-invoiced (reverse charge mechanism) by the SGR, thus avoiding cash disbursements in the case of funds created through real property contributions (*fondi ad apporto*) instead of sales.

The VAT debt on the contribution would be set off by the SGR against its related VAT credit so that no VAT would actually be paid. However, this application is conditioned upon its approval

by the EU Committee under article 27 of the EU Directive 77/388/CEE.

For this reason, art. 3-*quater* of law decree n. 220/2004 has introduced a special provision in art. 8 of law decree n. 351/2001 (providing for special VAT rules applicable to REIFs), which considers as VAT exempt contributions of going concerns (subject to a fixed 129,11 euros registration tax) the contribution of a plurality of properties, which are mostly rented out to third parties.

CONCLUSIONS

As opposed to REIFs, direct ownership of real estate in Italy by a non-Italian investor, or through an Italian SPV, suffers a more burdensome tax regime.

Indeed, rental income is subject to income tax in Italy at a 33% rate on foreign and domestic companies.

Conversely, capital gains are taxed at the same rate on Italian companies, whereas long-term capital gains (whereas the real property has been owned, before the sale, for a minimum period of five years), other than those connected to a permanent establishment in Italy, are generally tax-exempt on non-residents.

In addition, dividends distributed to foreign shareholders are subject to a 27% withholding tax (which may be reduced under a Double Taxation Convention or removed under Directive 435/90/EC). Interest expenses on shareholders' loans are subject to a 12.5% withholding, (which may be reduced under a Double Taxation Convention or removed under Directive 2003/49/EC – not yet implemented in Italy). Furthermore, the deductibility of interest expenses by an Italian SPV is subject to thin capitalization provisions.

On the other hand, investment through a REIF provides for full exemption on the return from the management or sale of real estate. Subsequent profit distributions to subscribers is subject to a 12.5% tax, reduced to zero for profits distributed to non-residents residing in a "white-listed" jurisdiction.



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