

Real estate acquisition structures in Europe: the main tax issues

The increasing budget requirements of European countries and their implications for taxpayers

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Real estate acquisition in Europe: the main tax issues

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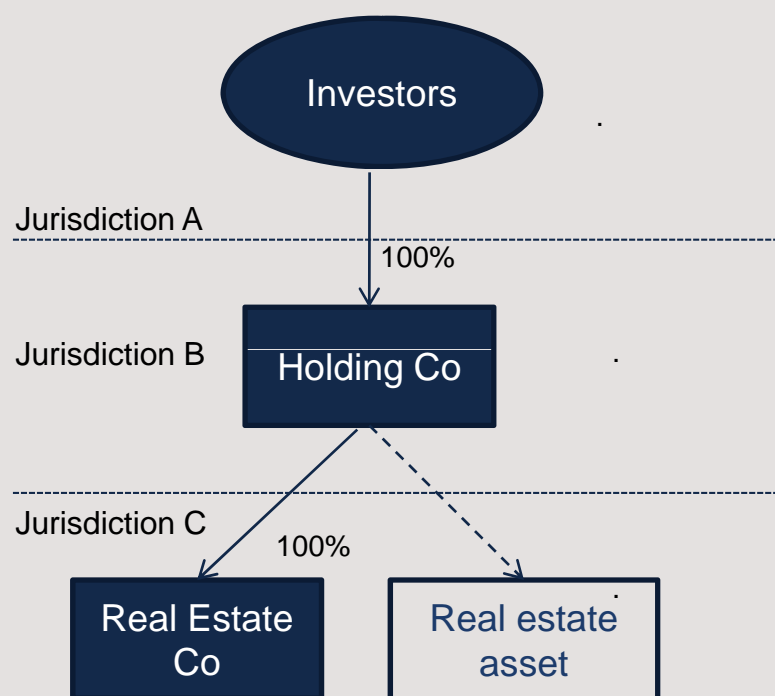
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Programme

- Real estate acquisitions in Europe
- Holding structures
- Tax audits

Acquisition structure

— Acquisition structure



1. Real estate acquisition in Europe

1.1 Dividend taxation for the investor

— France

- Participation exemption for dividends from participations (5% of the dividend is taxable at 33.1/3%)
- No participation exemption for dividend from a listed REIT (*SII*C or equivalent)
 - Taxation at the ordinary CIT rate 33.1/3%

— Germany

- Tax exemption for dividends from participations (5% of the dividend taxable as “non-deductible expenses” at a rate of about 30%)

1. Real estate acquisition in Europe

1.1 Dividend taxation for the investor

— UK

- Tax exemption for dividends from participations
 - Not deductible in the source country
 - Not interest treated as dividend
 - Paid by a company in a qualifying territory
 - Not part of a tax advantage scheme

— Russia

- Tax exemption for participations (>50%) held for more than 1 year
- Not applicable to dividends from participations in black-listed countries (currently including EU countries Cyprus and Malta)

1. Real estate acquisition in Europe

1.2 Interest deduction

— France

- Interest for the acquisition of assets or shares is deductible
- Thin capitalization rules
- New limitation (2012) for French holding companies that have no effective control over their subsidiary
 - Not applicable to acquisition financing of French real estate company
 - Not applicable to acquisition financing of foreign real estate company

— Germany

- Interest for the acquisition of assets or shares is deductible
- Limitation on the deduction of interest based on the “interest barrier rules” (generally limited to 30% of the tax EBITDA; exemptions available)

1. Real estate acquisition in Europe

1.2 Interest deduction

— UK

- Interest for acquisition of shares or assets is generally deductible
- Thin capitalization rules applicable

— Russia

- General interest tax deductibility rules applicable (thresholds)
- Thin capitalization rules applicable

1. Real estate acquisition in Europe

1.3 Capital gains

— France

- Capital gain on the sale of real estate assets is taxable in France but tax treaties allocate to the taxing right to the country in which the assets are located
 - Previous loopholes in tax treaties with Luxembourg and Denmark
- Capital gain on the sale of shares is tax exempt (with 10% of the capital gain taxable at a 33.1/3% rate)
 - Exemption not applicable to sale of subsidiaries qualifying as real estate companies (*société à prépondérance immobilière*)
- Reduced capital tax rate (19% instead of 33.1/3%) applicable to the sale of listed REIT shares (*SIIC* or equivalent)

1. Real estate acquisition in Europe

1.3 Capital gains

— UK

- Capital gain on the sale of shares is taxable in the UK
- Exemption for substantial shareholding not applicable for property investment activities
- No tax should arise in the UK on the sale of a real estate company if non resident Holdco

— Germany

- Capital gain on the sale of shares is tax exempt (with 5% of the capital gain taxable at about 30% tax rate)
- Capital gain on the sale of real estate assets directly held by a German company is taxable in Germany, unless a double tax treaty allocates the taxation right to the country in which the assets are located

1. Real estate acquisition in Europe

1.3 Capital gains

— Russia

- Capital gain on the sale of shares is taxable in Russia (20%)
- Tax treaties often reduce the withholding tax rate on capital gains to 0%
 - But renegotiation of tax treaties (Switzerland, Cyprus, Luxemburg) as to withholding on capital gains of property companies
- Exemption in local legislation exists: 0% on capital gains if the relevant shares have been acquired after 1 January 2011 and have been held for at least 5 years
 - Practically it will be possible to benefit from this exemption as from 1 January 2016 at the earliest
 - Exclusions as to listed joint-stock companies exist

1. Real estate acquisition in Europe

1.4 Registration duties

— France

- No transfer taxes on the transfer of non-French company shares, except if executed in France
- Transfer taxes (5%) on acquisition of French or foreign real estate companies owning mainly real estate assets in France (*société à prépondérance immobilière*) even if executed outside France
- Notary deed mandatory for transfer of French or foreign real estate companies owning mainly real estate assets in France
- Transfer tax on acquisition of French or foreign real estate partnerships owning mainly real estate assets in France calculated on:
 - (i) the real estate assets' fair market value and
 - (ii) the other assets fair market value
 - after deduction of acquisition debt other than acquisition debt of real estate assets

1. Real estate acquisition in Europe

1.4 Registration duties

— Germany

- No transfer taxes on the transfer of shares
 - May change regarding shares in publicly held entities in 2012
- Transfer tax (3,5%-5%) on acquisition of real estate located in Germany and generally on a transfer of at least 95% of the shares in a corporation or partnership holding German real estate; no such transfer tax if foreign real estate is concerned

— UK

- No transfer taxes on the transfer of non-UK company shares, except if executed in UK

— Russia

- No transfer taxes in Russia

1. Real estate acquisition in Europe

1.5 Latest changes in REIT regime

— France

- Reduced capital gain rate for sale of real estate assets or real estate partnerships to REIT no longer applicable (from 2012)

— Germany

- A German REIT is exempt from income taxes if all conditions (e.g. regarding assets, income, dividends) are met
- Currently only few German REITs are existing

— Russia

- No REIT concept provided for by the legislation

1. Real estate acquisition in Europe

1.5 Latest changes in REIT regime

— UK – from July 2012

- No conversion charge (formerly 2%)
- Diverse ownership rule to encourage institutional ‘clubs’
- Secondary stock market listings allowed
- But new REITs still suffer SDLT entry cost

— European REIT is some way off!

1. Real estate acquisition in Europe

1.6 Local taxes

— Germany

- Where the investment is held through a German private equity fund (partnership), it may be subject to local trade tax if specific requirements set by German tax authorities are fulfilled (guidelines of 16 December 2003); part of expenses may not be deductible and may be qualified as acquisitions costs of the shares

2. Holding company for real estate investments in Europe

— Common holding structures are located in:

- France
- Luxembourg
- Netherlands
- Cyprus
- Malta

— Fiscal advantages

- Interest deduction
- Capital gains
- Withholding tax
- Registration duties and transfer taxes

— Advantages other than fiscal

2. Holding company for real estate investments in Russia Onshore versus offshore SPV?

— Offshore SPV

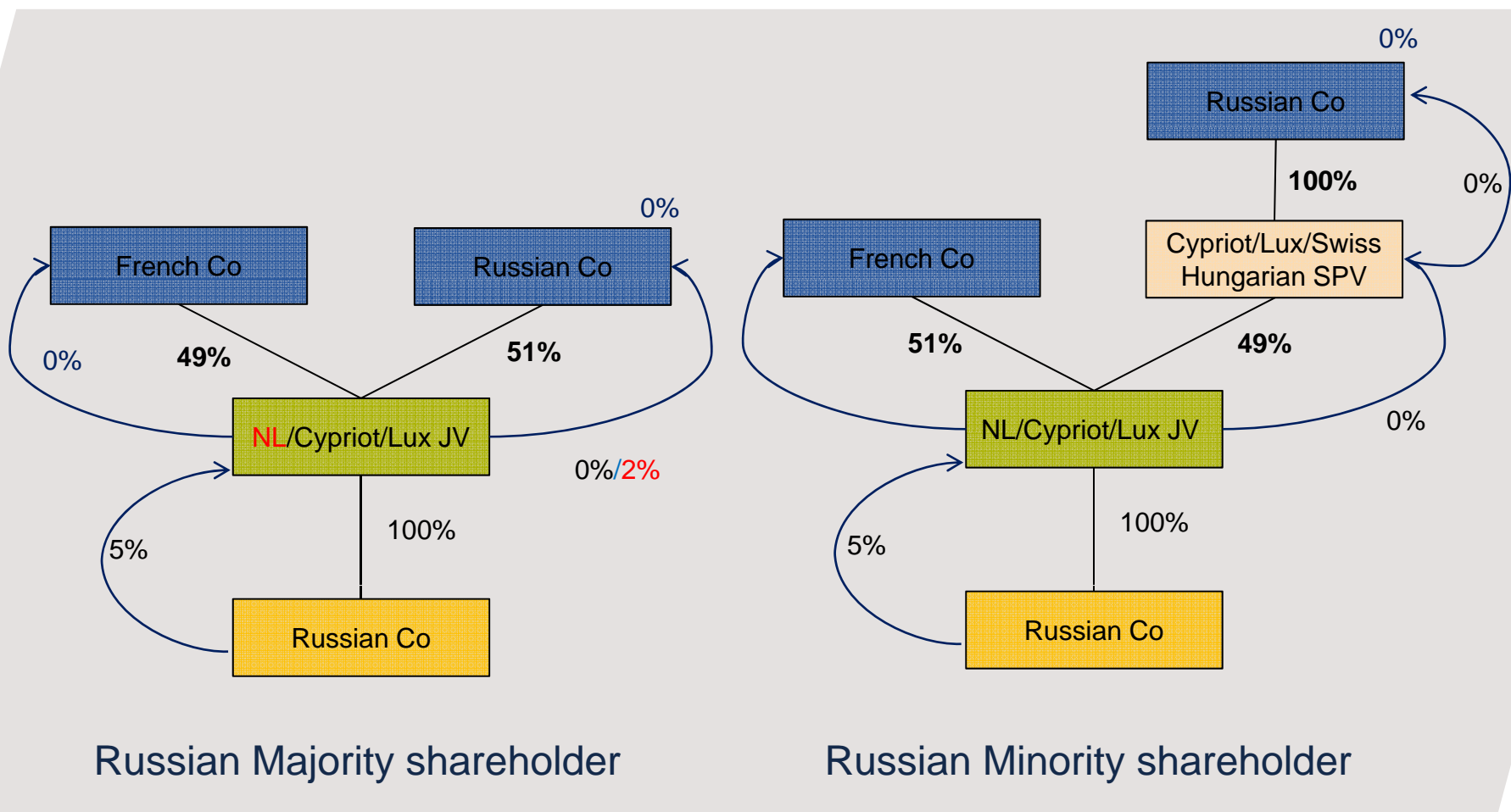
- Enforcement of SHA provisions (corporate governance and enforcement)
- Anti-Bribery legislations (FCPA, Russian & UK Anti-Bribery Acts)
- Tax Optimization of passive income (capital gains, dividend, interest)
 - Localization: Luxembourg/Netherlands/Cyprus/Switzerland/France?

— Onshore (Russian) SPV

- Project's constraints
 - State Partner and/or investment in a strategic sector
 - Russian partner with no or limited assets abroad
 - Regular income/cash repatriation
- Tax considerations
 - Minority Russian partner
 - Debt push-down

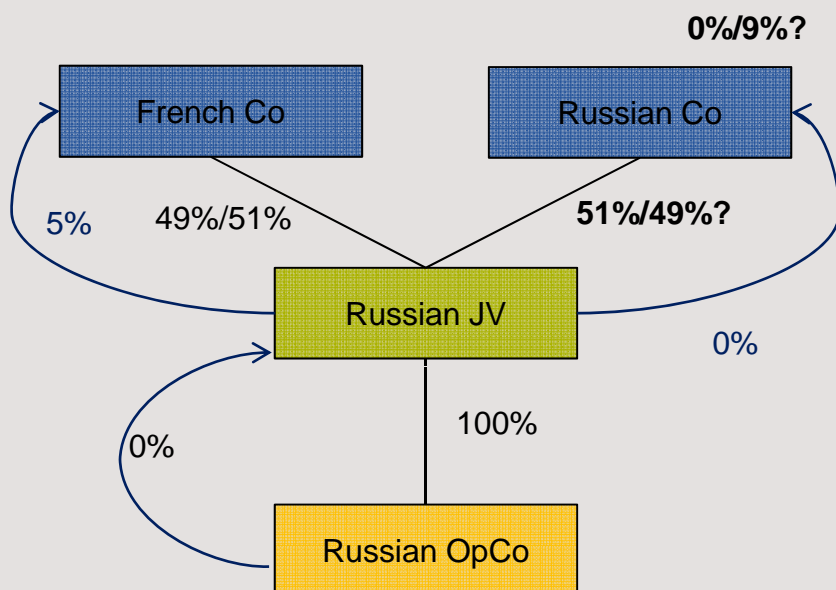
2. Holding company for real estate investments in Russia

Typical offshore structures



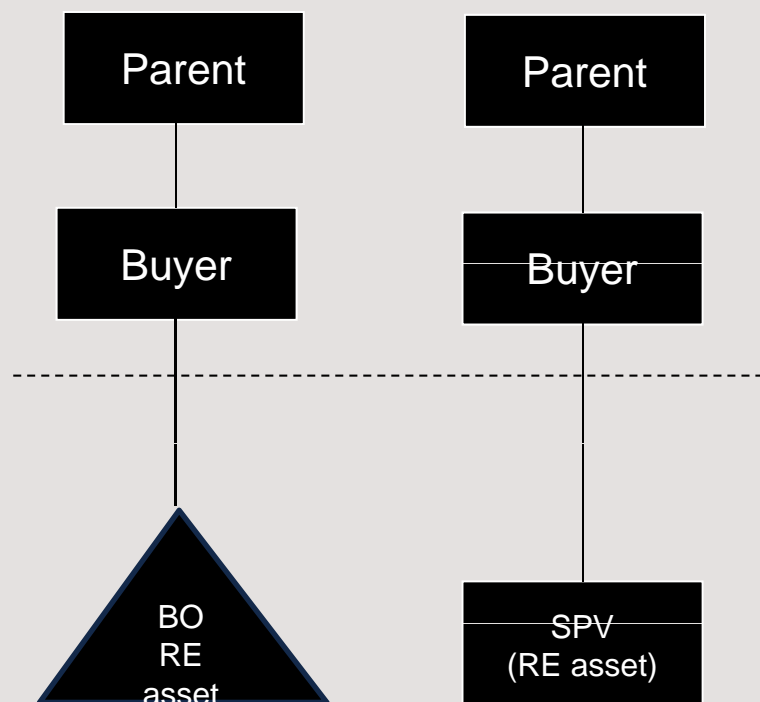
2. Holding company for real estate investments in Russia

Typical onshore structures



- Russian shareholder with a 50% or more stake:
 - No capital tax for Russian Co and Russian JV (under conditions)
 - No taxation of dividends flow up to Russian JV and Russian Co
- Russian shareholder with a less than 50% stake:
 - Capital tax for Russian Co
 - Dividend taxation for Russian Co (9%)
- Other considerations
 - Shareholders' agreement under Russian law
 - Less attractive to foreign investors upon exit

2. Holding company for real estate investments in Russia Foreign SPV vs. Branch of a Foreign SPV?



— Branch structure

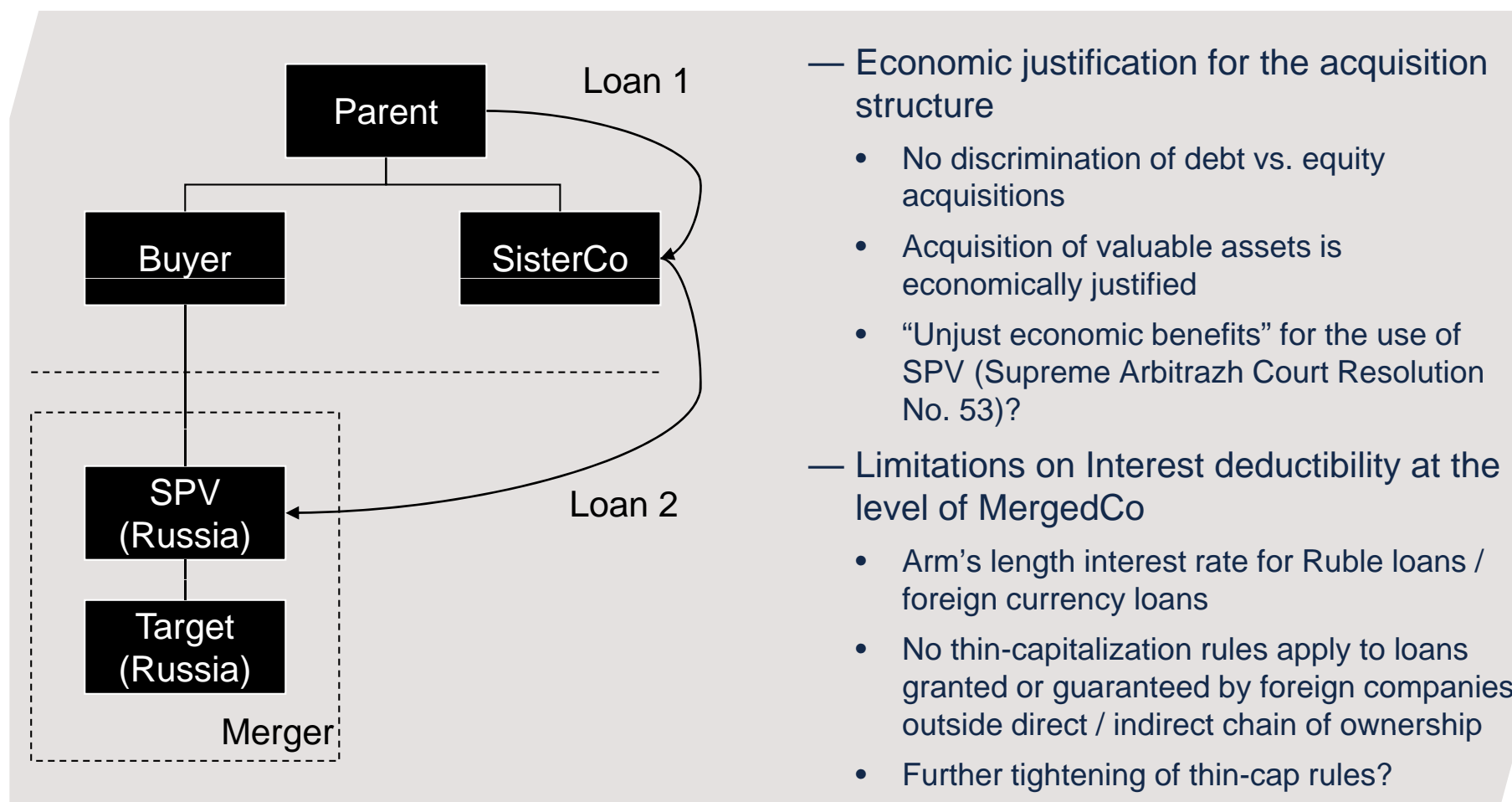
- Fiscal personality
- Easy cost reallocation (order of the GM)
- No branch remittance tax on profits flow up
- No thin cap rules
- Appropriate for regular income activities
- BUT, capital gains taxation

— SPV structure

- Optimization of capital gains tax
- Pure cost reallocation forbidden
- WHT on dividend flow up (5% to 15%)
- Thin cap rules
- Appropriate for portfolio investment/exit strategies

2. Holding company for real estate investments in Russia

Debt push-down in Russia



3. Tax audit

3.1 Latest trends in tax audits

— France

- PE issue relevant for realtors (*marchands de biens*) previously established in Luxembourg or Denmark for assets located in France
- Fiscal police: new powers to determine the tax residency of individual or corporate investors

— Germany

- focus on qualification of expenses as non-deductible acquisition costs of the shares in (foreign) subsidiary; review of so-called leverage structures, e.g. regarding interest deduction
- focus on the acquisition structure with respect to the qualification of income (e.g. income from trade or business versus income resulting from the (pure) holding and administration of shares or real estate; trade tax issues)

3. Tax audit

3.1 Latest trends in tax audits

— UK

- Focus on level of interest deductions claimed for ‘shareholder debt’
- Compliance errors more likely to be penalised

— Russia

- Refusal to take into account non-discrimination clauses in the application of Russian thin capitalization rules
- Use of “unjustified tax benefit” concept when:
 - Absence of reasonable business aim
 - Presence of intermediate entities
 - Absence of useful effect from the deal
 - Interdependency of parties to the transaction

3. Tax audit

3.2 CFC rules

- France: CFC rules apply where the subsidiary's effective corporate tax rate is below 16.6%
 - These rules do not apply to subsidiaries in EU if not tax driven
- Germany: if income tax rate of the Holding company is below 25% (income calculated on the basis of German tax law) and "passive income" is received, the annual income of the subsidiary may be taxed at the level of the Investor
- UK: if income tax rate of the Holding company is less than 75% of the UK corporate tax rate (income calculated on the basis of UK tax law), the annual income of the subsidiary may be taxed at the level of the Investor
- Russia: no CFC rules apply

3. Tax audit

3.3 Fiscal residency

— France

- the administration challenges the application of EU directives where the beneficial owner cannot prove effective residency
- the tax administration so far does not challenge the application of tax treaties where the entity is fully recognized as a taxpayer in the foreign country

— Germany

- attention paid to the effectiveness of tax residency and to the beneficial owner
- WHT reduction is challenged if the shareholder cannot prove sufficient “substance”

— UK

- focus on the effectiveness of tax residency

— Russia

- attention paid to the “beneficial ownership” concept