

European real estate investment structures

A comparison paper: UK LP, Lux IFs, German KG and Dutch CV



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Introduction

This brochure is intended to provide a high-level overview and comparison of some of the common European real estate investment structures, utilised for attracting institutional equity.

The limited partnership in the UK (UK LP), Luxembourg Investment Funds (LIFs), the German Kommanditgesellschaft (KG) and the Dutch commanditaire vennootschap (CV) are vehicles often used.

We examine these entities, focusing in particular on the main issues of tax, the status of investors and management. In addition, these entities and their managers may fall within the scope of the Alternative Investment Fund Managers Directive and, as a result, would need an authorized manager and comply with transparency, corporate governance and other investor protection regulations.

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UK LP

Structure

Under the Limited Partnerships Act 1907 - the principal legislation governing LPs in the UK - limited partnerships ("LPs") may be registered in either England & Wales ("ELPs") or in Scotland ("SLPs"). SLPs - unlike ELPs - enjoy separate legal personality distinct from their partners, and as such can hold real estate investments in their own name. An ELP typically holds real estate investments via a trust structure, e.g. 2 nominees.

Tax

LPs are fully tax transparent entities in relation to income and capital gains and therefore no tax is incurred at the level of the LP. Investors, limited partners (the "Limited Partners"), will be liable to tax in their domestic jurisdictions according to their own personal tax positions. Any real estate investments held through an LP will not usually make an overseas Limited Partner liable to UK tax except on rental income. Such tax may be collected by 20% deduction at source from rental payments. This can be avoided if the overseas investor registers personally (or establishes an offshore entity to register) under the 'Non-resident Landlords Scheme'. The registered Limited Partner will then account for any UK tax liability on its net rental income directly with HMRC, after deduction of its costs (including interest).

ELPs/SLPs are also tax transparent for the purposes of stamp duty land tax (SDLT), and land and buildings transaction tax (LBTT) where real estate investment is situated in Scotland. Liability for SDLT/LBTT is joint and several between the partners. When an LP acquires real estate from a third party, the Limited Partners must account for SDLT/LBTT at a rate of 4% on the consideration. Where a Limited Partner, or a person connected with a Limited Partner, transfers property to the LP, the consideration for the transfer is deemed to be the proportion of the market value of the real estate transferred that is attributable to the shares of the other investors immediately following the contribution.

For example, if A, B, C and D are members of an LP holding 25% each and A contributes real estate worth 1 million GBP, the chargeable consideration will be 750,000 GBP (250,000 GBP x 3) since this is the value deemed to be transferred from A to B, C and D. If there were a later transfer of a partnership interest so that D conceded 15% of his interest in

equal shares to the other three investors, and the real estate still had a market value of 1 million GBP, each of A, B and C would have to pay SDLT/LBTT on 50,000 GBP. If, instead, D were to drop out of the LP completely, there would be SDLT/LBTT payable on chargeable consideration of 250,000 GBP shared equally between the remaining investors, since they would have acquired a further 25% interest in the real estate.

Liability of investors

The Limited Partnerships Act 1907 provides that if a Limited Partner takes part in the management of the LP business it shall be liable for all debts and obligations of the LP incurred during that time. Effectively the Limited Partner loses their limited liability status and is treated as though it were a general partner. This means that a limited partner should not take any active role in management decisions to ensure that its limited liability is secured.

Involvement in management decisions

The management of the LP should be carried out by the general partner who is responsible for the management of the LP and liable for all debts and obligations of the LP. The general partner is typically a limited company, a limited liability partnership or another limited partnership formed by the fund's sponsor and/or manager.

It is common for funds to have an advisory committee comprised of representatives of the Limited Partners and members of the management team. This committee enables the general partner to consult with the investors in conjunction with those undertaking the daily management of the LP, for example, on key decisions and conflicts of interest.

Luxembourg Investment Funds

Luxembourg offers a range of vehicles suited for real estate investments.

I. UNREGULATED INVESTMENT VEHICLES

The SOPARFI (société de participations financières) is governed by the 1915 law on commercial companies and can take different corporate forms:

- Public limited liability company (société anonyme – SA);
- Private limited liability company (société à responsabilité limitée – SARL) ;
- Partnership limited by shares (société en commandite par action – SCA) ;
- Cooperative company (société coopérative – SC).

Since the modernisation of Luxembourg's legislation on partnerships in 2013, also the common limited partnership (société en commandite simple – SCS) and the special limited partnership (SCSp) have become increasingly popular as real estate vehicles ("LuxLPs"). While the SCS has legal personality, the SCSp takes a pure contractual form and has no legal personality distinct from its partners.

No investor restrictions or risk diversification rules regarding their investments apply to the Soparfi and the LuxLPs (unless they opt for a specific regulatory regime – see below).

II. REGULATED INVESTMENT VEHICLES

a) The SIF

The specialized investment fund (SIF) is the most popular of the regulated real estate investment vehicles. The SIF (including its constitutional and offering documents) must be approved by the Luxembourg regulator (CSSF) prior to its launch.

The SIF is reserved to well-informed investors (i.e. professional or institutional investors and other qualified investors) but is flexible in terms of structuring and can invest in any type of real estate or real estate related assets subject to minimal risk diversification rules: generally not more than 30% of its gross assets should be invested in the same property.

The SIF may be formed either as an investment company (taking one of corporate forms set forth above) with fixed (SICAF) or variable capital (SICAV) or take a contractual form as a common fund (fonds commun de placement – FCP) or a SCSp.

The SIF can further be formed as a single fund or as an umbrella fund with multiple compartments.

b) The SICAR

The investment company in risk capital (SICAR) can be used for real estate investments provided it does not hold directly on its own the real estate and the proposed investment qualifies as "risk capital" as set forth by the CSSF in its circular 06/241. Given that the SICAR is not subject to any risk spreading rules, it can invest all its assets in a single property. Like the SIF, the SICAR is reserved to well-informed investors and can be established in the same forms as the SIF.

Other types of Luxembourg vehicles used for real estate investments are the undertaking for collective investment governed by part II of the law of 22 March 2010 on collective investments vehicles and the securitization vehicle (SV). The SVs which benefit from a special legal and tax regime can hold directly real estate although they are more often set up in connection with separate acquisition or property holdings companies. The SVs are further used in combination with a SIF structure to invest in real estate.

III. INVOLVEMENT IN MANAGEMENT

DECISIONS

As a matter of principle, the investors are not supposed to be involved in the management of the investment vehicle.

However depending on the form of the relevant fund and subject to the rights granted to them in the constitutional documents of the fund, investors can exercise an influence on the management in that they can proceed with the replacement of the members of board of directors of the fund or, as the case may be, the general partner (if the vehicle has been formed as a Lux LP or SCA) or of the external management company (if the fund is set up as an FCP or is an externally managed alternative investment fund (AIF)).

Regarding real estate funds established in the form of a partnership (whether SCA, SCS or SCSp) it is worth noting that Luxembourg law sets forth a list of acts which do not qualify as "management acts" and can

hence not trigger any liability of the limited partners such as for instance any advice or authorization given to the management with regard to the investments. Further a limited partner can be a member of the management board of the GP or external manager without becoming liable for the engagements of the fund (provided he clearly indicates the capacity in which he has been acting).

IV. TAX

Unregulated investment vehicles

SOPARFI

A Luxembourg resident SOPARFI is a fully taxable Luxembourg resident company that benefits from the double tax treaty network and can take advantage of the Luxembourg participation exemption regime on dividends and capital gains (subject to conditions). A SOPARFI is in principle subject to income tax at 29.22% and to net wealth tax of 0.5% on its unitary value as at January 1st of each year.

Income derived from real estate is generally taxed in the country in which the real estate is located. When the real estate is located in a country with a relevant double tax treaty, the income derived from that real estate (rental income and capital gain in case of sale) is exempt from income tax in Luxembourg and the property is exempt for net wealth tax purposes. A SOPARFI directly holding and managing a property will be a taxable person for VAT purposes. This may trigger some VAT compliance obligations.

A SOPARFI can hold a real estate indirectly via an intermediary property company. Dividends and capital gains realized by the SOPARFI from a qualifying property company can be tax exempt if the conditions of the participation exemption regime are met. In the situation where a SOPARFI grants loans to the property company, the interest received by the SOPARFI would be taxable. Concurrently, interest expenses on a loan financing granted to the SOPARFI would be tax deductible, i.e. the SOPARFI is ultimately taxed on a margin, which has to respect the arm's length principle. The VAT status of a SOPARFI holding the real estate via an intermediary company is to be analysed on a case-by-case basis.

Interest paid by a SOPARFI is normally not subject to withholding tax if the arm's length principle is complied with. Dividend distributions are subject to 15% withholding tax, unless a reduced rate or a withholding tax exemption applies based on the domestic tax law or based on a double tax treaty.

PARTNERSHIP

A partnership (such as SCS or SCSp) is fully tax transparent to the extent that (i) it does not perform a commercial activity or (ii) that its general partner does not hold more than a 5% interest in the partnership. When a partnership qualifies as an AIF, it is deemed not to perform any commercial activity and is therefore fully tax transparent.

Dividend distributions and interest payments made by a partnership are normally not subject to withholding tax.

Regulated investment vehicles

SICAR

A SICAR established in a corporate form is subject to income tax (rate of 29,22%) but income from risk capital securities is exempt. Other income of a SICAR that is not connected with investments in risk-bearing capital is subject to normal income tax. Moreover, a SICAR is exempt from net wealth tax.

As it is a fully taxable vehicle, a SICAR can in principle benefit from the Luxembourg double tax treaty network.

A SICAR established in the form of a partnership is treated as a tax transparent entity for Luxembourg tax purposes. By law, this SICAR is not considered to have a commercial activity and is consequently in principle fully tax transparent.

Dividend distributions and interest payments by a SICAR are not subject to withholding tax.

Depending on its activities, a SICAR may have some VAT obligations in Luxembourg. Management services rendered to a SICAR are exempt from VAT.

SIF

A SIF is subject to an annual subscription tax of 0.01% (exemption possible) computed on the net asset value but it is not subject to corporate tax and net wealth tax.

Distributions made by a SIF are not subject to withholding tax.

SIFs under the corporate form may benefit from certain double tax treaties concluded by Luxembourg with foreign countries.

SIFs qualify as taxable persons for VAT purposes. A case-by-case analysis is required to assess whether this status should result in the registration for VAT. Management services rendered to a UCI and a SIF are, in principle, VAT exempt.

German KG

The German legal system offers a variety of legal entities that can be used for real estate investments. In practice the KG in the legal form of a GmbH & Co. KG is the most common investment vehicle for real estate investments in Germany.

Structure

The KG has one general partner and one or more limited partners. The right to manage the company applies to the general partner by law. In practice (for tax reasons) the management is often delegated by the partnership agreement to one of the limited partners or to a management company that becomes additional limited partner.

One advantage of the German KG as investment vehicle is that there are very few mandatory provisions. Therefore the KG is a highly flexible legal vehicle that can be tailored to investors' needs. In practice this is particularly relevant for the structuring of the management of the company and to make payments to limited partners out of the liquidity of the company and independent of the determined gains in the companies' balance sheet.

In case the KG or the managers fall within the scope of the AIFMD additional regulatory provisions apply to the managers and/or the KG.

Tax

For income tax purposes the KG is fully tax transparent for its limited partners (the investors), i.e. the annual profits and losses of the KG are automatically allocated to the partners as if they owned a portion of the assets and liabilities of the KG directly. The income tax on the level of the limited partners arises independently if there are distributions of profits to the partners.

The profits of the KG can also be subject to German trade tax on income. In this case the tax arises directly at the level of the KG. Therefore if a KG is subject to German trade tax, it is strictly more correct to state that the KG is semi-tax transparent (i.e. transparent with regard to income tax but non-transparent with regard to German trade tax). If a KG is subject to trade tax depends on its corporate structure and on the type of investment made (certain kind of real estate investments can cause trade tax implications). However, in most cases investments in real estate can be structured in a way avoiding trade tax.

In Germany the purchase/sell of real estate is taxed by real estate transfer tax. This tax is different depending on the federal state the property is located. The use of a KG as investment vehicle can offer the opportunity to avoid real estate transfer tax, if certain conditions are

met.

Liability of investors

While the general partner of the KG is fully liable, the liability of the limited partners is limited to the amount registered in the German commercial register as the limited partner's liability amount. The liability amount can be determined freely. If the liability amount has been paid and not been repaid the liability of the limited partners is excluded. In most cases as general partner of a KG a GmbH is used.

Involvement in management decisions

According to German law the involvement of limited partners in management decisions or making limited partners to managers of the company is possible without affecting the general limitation of the liability of limited partners.

Limited partners can be involved in the management of the KG by giving them management authority or by reserving matters to the partners meeting. Further, limited partners can be involved in decision making through other bodies, i.e. an investment advisory committee.

Dutch CV

A CV is a contractual joint venture vehicle established by one or more general partners and one or more limited partners. Partners commit themselves to contribute money or other assets to the CV with the object of sharing the proceeds.

A CV does not have legal personality. The general partners (or a custodian on behalf of the general partners) hold legal title of the CV's assets on behalf of the CV.

Tax

CV's can be either tax transparent or not tax transparent for Dutch corporate income tax purposes. A CV is transparent if under the CV agreement admission and replacement of the limited partners (being the investors) is made subject to the approval of all existing partners.

If a CV is tax transparent, the partners of the CV are pro rata subject to (corporate) income tax with regard to the income and capital gains of the CV.

For real estate transfer tax purposes, the partners of a CV are considered to be the owners of the real estate and therefore liable to pay any real estate transfer tax due. In the event the CV does meet certain criteria, an acquisition of an interest by a (existing) partner is not subject to real estate transfer tax if this interest along with his existing interest is less than one-third of the total interest of the CV.

Because of the tax transparency of the CV, any distribution made by the CV is not subject to Dutch dividend withholding tax.

For real estate transfer tax purposes, the partners of a CV are considered to be the owners of the real estate and therefore liable to pay any real estate transfer tax due. In the event the CV does meet certain criteria, an acquisition of an interest by a (existing) partner is not subject to real estate transfer tax if this interest along with his existing interest is less than one-third of the total interest of the CV.

A real estate investment CV is subject to VAT, regardless of the provisions regarding the admission and replacement of partners.

Liability of investors

A limited partner is not liable towards third parties and its exposure to losses is limited to the value of its contribution. The limitation of liability is forfeited if the limited partner represents the CV or conducts acts of administration and disposition. If a limited partner takes part in the management of the CV it shall be liable for all debts and obligations of the CV. Effectively the limited partner loses its limited liability status and is treated as though it was a general partner. This means that a limited partner should not take any active role in management decisions and should not represent the CV to ensure that its limited liability is secured.

Involvement in management decisions

The management of the CV should be carried out by the general partner who is responsible for the management of the CV and liable for all debts and obligations of the CV. The general partner is typically a limited liability company such as a B.V. Representation and acts of administration and disposition must be made by the general partner only. This does not preclude limited partners from voting on any resolutions put to vote in partnership meetings.

It is common for funds to have an advisory committee comprised of representatives of the limited partners and the general partner. This committee enables the general partner to consult with the investors in conjunction with those undertaking the daily management of the CV, for example, on key decisions and conflicts of interest.

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