EPRA

European Public Real Estate Association

EUROPEAN REIT REGIMES AND THE IMPACT OF THE EC TREATY FREEDOMS

August 2005

EU REIT REGIMES

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Preface

The mission statement of the European Public Real Estate Association (EPRA) is to promote, develop and represent the European public (quoted) real estate sector. EPRA strongly supports tax transparent initiatives throughout Europe. In general, evidence shows that tax transparency has stimulated growth and development in listed markets.

This report contains a comparative description of the European REIT and REIT-like tax regimes, and an in-depth and unique analysis of the impact of the EC Treaty freedoms on such tax regimes. Probably the most important objective of the EC Treaty is the creation of a common market. A true common market for quoted Real Estate Investment Trusts (REITs) can only be created if certain cross border tax barriers are removed; if a certain "tax transparency" is established. The 'EC Treaty freedoms' are the principal 'tools' of the EC Treaty to help remove the main obstacles to a common market. This report analyses what these tools mean for the various REIT regimes in Europe and where they should be applied.

As you can read from the report, the tax treatment of foreign shareholders plays a significant role in this analysis. The closing part of the report serves to debate solutions to make REIT regimes 'EU law proof', and makes a first prudent endeavour to formulate the principles of a uniform EU REIT regime.

EPRA hopes that the outcome of this report will inspire governments, interest groups, etc. in the various European countries to pay more attention to the EU law dimension of REIT regimes and stimulate the debate about the EU tax treatment of REITs. In this respect, EPRA encourages all interested parties to comply with the request of the authors of this report to contribute their comments, suggestions and experience.

EPRA would like to thank the authors for their contribution to this unique report. The preparation of the report is a true example of European cross border cooperation. A special expression of gratitude is extended to Rob Cornelisse and Dennis Weber of the University of Amsterdam and Ronald Wijs, partner of Loyens & Loeff and chief editor of the EPRA Global REIT Survey, for their dedicated commitment to this report.

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1 Introduction

The introduction in France of the SIIC regime in 2003 has given new impetus to the debate about REIT regimes in Europe. More and more EU Member States are introducing Real Estate Investment Trust regimes (REIT regimes) in their national tax laws. The Member States that already have a special REIT regime are the Netherlands (BI), Belgium (SICAFI), Luxembourg (REIF) and France (SIIC). Today, the UK and Germany are considering introducing a REIT regime in order to increase liquidity and access for small investors to the property market and raise productivity of the local economies. Outside the European Union, countries like Australia, Canada, the United States, Mexico, Japan, Korea, Hong Kong and Singapore have REIT regimes. Other countries may not have a special regime for investment in real estate but they do have regimes that tax (certain) investments differently (and often less heavily) as compared to the normal corporate income tax burden. Investment in real estate is (often) taxed under this kind of regime. Examples of this type of 'REIT like' regimes are found in Austria (IIF), Germany (IF), Italy (FII), Spain (SII en FII) and Luxembourg (FCP).

In this report, we draw a comparison between the various REIT and REIT-like regimes in a selected group of European countries, which is set out in chapter 2. The purpose of this comparison is not only to give stakeholders a good overview of the various regimes but also to test whether or not these regimes, applicable in the EU Member States, are compatible with the EC Treaty freedoms. In chapter 3, we elaborate on the compatibility of the various regimes with the EC Treaty freedoms and identify the major violations of the EC Treaty freedoms in the various REIT and REIT-like regimes.

When comparing a number of the REIT regimes in the European Union, a striking feature is that many of them contain elements that lead to a restriction of the EC Treaty freedoms. These restrictions make the REIT regimes in the various Member States unattractive for foreign investors. EU law does not permit many of these restrictions and it may simply be a matter of time before these impediments are challenged by taxpayers or by the European Commission.

Countries considering the introduction of a new REIT regime are clearly struggling with the Community law angle of a REIT. The fear exists that foreign shareholders could benefit from a domestic REIT regime and repatriate property profits abroad tax free or at a very low tax rate in the source country (where the property is located). This report focuses on this issue of the tax treatment of foreign shareholders of REITs (chapter 4) and discusses potential solutions to tackle this problem in an adequate –'Community law proof' – way.

The most definitive way to eliminate the distortions and barriers in the European cross border tax treatment of REITs would be the introduction of a uniform EU REIT regime in Europe. Section 5 of this report serves to set out the rough contours of how such a European uniform regime could be structured. The authors of this report herewith cordially invite you to comment and contribute to the Community law analysis, as well as to the potential solutions and the preliminary sketch of a uniform EU REIT regime.

2 REIT Comparison

2.1 Introduction

This section of the report contains a comparative description of the REIT and REIT-like systems in Austria, Belgium, France, Germany, Italy, Luxembourg, the Netherlands and Spain. Of these countries, only Belgium, France and the Netherlands have a classical REIT regime in operation. The framework of this comparison strongly resembles that of the EPRA Global REIT Survey 2004. However, the comparison has been designed such as to enable an analysis of the compatibility of the various regimes with the EC Treaty freedoms. This is because the objective of the comparison is to serve as a basis for the main topic of this report: a detailed description and inventory of the violations of the EC Treaty freedoms contained in the various regimes (see section 3 and 4).

2.2 General introduction / history

Austria	IIF	2003
Belgium	SICAFI	1995
France	SIIC	2003
Germany	IF	1969
Italy	FII	1994
Luxembourg	REIF (FCP/SICAV/F)	1988
Netherlands	BI	1969
Spain	SII / FII	1992

Austria
In 2003, the IIF (*Immobilien Investmentfonds)* regime for collective investment in real estate was introduced. The underlying principle for this introduction was to enable long-term portfolio investments in real estate structured under the risk diversification principle and protected by banking supervision.

The IIF is a pool of assets administered by a management company. The IIF has no legal personality. Therefore, the assets are (deemed to be) owned and held by the management company. This management company acts on account of the fund investors. The investors qualify as the economic owners of the fund assets. The Austrian IIF is a tax-transparent fund. Consequently, the investors are treated in the same way as direct investments in real estate.

Belgium
In 1995, the SICAFI (*sociétés d'investissement à capital fixe en immobilière*) regime came into existence. The Belgian legislator created a favourable tax regime for SICAFIs in order to boost the development of Belgian real estate. Another reason was to compete with similar vehicles in Luxembourg and the Netherlands. The SICAFI is an investment institution specific to real estate investment. It is best described as a listed property company with a fixed share capital, the aim of the SICAFI regime is to provide tax neutrality for collecting and distributing the rental income. It is a non-transparent vehicle.

France
In France, the SIIC (*sociétés d'investissements immobiliers cotées*) tax regime is very recent; it only entered into force in tax years closed in 2003. The underlying principle for introducing the SIIC regime was twofold. France wanted to strengthen its competitive position with Dutch, Belgian and German funds by aligning the French tax regime with the exemption regimes applicable in neighbouring countries. Moreover, it wanted to generate non-recurring budget resources to help reduce the French deficit, by way of the 'exit tax' to be paid by property companies that are converted into an SIIC. The SIIC is a non-transparent vehicle, with a corporate income tax exemption for specific items of income.

Germany
The regime for collective investment in real estate which is most similar to a REIT regime is the IF (*open-end real estate Investment Fund*) regime for an 'open-end real estate investment fund'. A real estate investment fund is defined as a public separate pool of assets (*Publikums-Sondervermögen*) for collective investment which is administered by a management company (*Kapitalanlagegesellschaft*). The fund has no legal personality.

Domestic IFs enjoy an exemption from German income tax. In principle, the investor is treated as earning income from capital rather than income from real property. To some extent the rule of transparency applies. The special IF is subject to a different and more favourable set of rules.

Italy
In Italy the FII (*fondi di investimento immobiliare*) regime was introduced in 1994 and amended substantially in 2003. The underlying principle for the introduction of this favourable regime was to dispose of the real estate patrimony owned by the Italian Government. An FII is best described as a pool of investment held jointly by the unit holders, without legal personality and managed by a management company (*società di gestione del risparmio,* SGR). The FII is not tax-transparent. The FII is tax exempt. The unit-holders of FIIs are taxed only when a profit is distributed or when they dispose of their units.

Luxembourg
Particular rules apply in respect of enterprises for collective investments (UCIs), the principal object of which is the investment in real estate assets. Real Estate UCIs (REIFs) may thus invest in:

- property consisting of land and/buildings registered in the name of the REIF;
- shareholdings in real estate companies (including claims on such companies) the exclusive object and purpose of which is the acquisition, promotion and sale as well as the letting and agricultural lease of property, provided that these shareholdings must be at least as liquid as the property rights held directly by the REIF;
- property related long-term interests such as surface ownership, leasehold and options on real estate assets.

A REIF may be formed under two types of legal regimes. In Luxembourg, the REIF (*real estate investment fund)* is the only expressly real estate driven regime. A REIF may be formed as an undivided collection of assets managed by a management company (a *fonds commun de placement*, or FCP). A REIF may also be formed as an investment company with fixed or variable capital (a *société d'investissement à capital variable/fixe*, SICAV/F). An FCP REIF does not have a legal personality. It is managed by a management company according to the principle of risk spreading on behalf of joint owners who are only liable up to the amount of their contributions. The REIF-FCP is a transparent vehicle. Apart from capital duty, it is not subject to Luxembourg tax.

A SICAV/F is a REIF in the form of a joint stock company (*société anonyme*) whose exclusive object is to invest its funds in accordance with the principle of risk spreading, whose shares are placed with the public by means of a private or public offer, and whose articles of association provide that the amount of its capital will at all times be equal to the net asset value of the company (except for the SICAF which has a fixed capital).

Netherlands
The Netherlands introduced the BI regime (*fiscale beleggingsinstelling*) – into the Dutch Corporate Income Tax Act in 1969. The underlying principle of the Dutch legislator for introducing the BI was to provide for a vehicle through which individual investors could pool their portfolio investments. This vehicle would bring its investors into the same after tax position they would be in if holding the investment directly. The BI is not a 'flow through' regime, nor does it benefit from a tax exemption. The BI is subject to a rate of corporate income tax of zero percent.

Spain
The Spanish SII (*sociedad de inversión inmobiliaria*) and FII (*fondo de inversión inmobiliaria*) regime provides for a REIT regime. The SII and the FII are not considered to be a 'flow through' regime. They are subject to corporate income tax. However, if certain conditions are met, they are entitled to apply a reduced 1% corporate income tax rate.

In the near future, a change could be made to some of the features of SII and the FII described below due to expected new regulations.

2.3 Requirements

2.3.1 Formalities / procedure

Austria
The rules governing the Austrian IIF, *i.e.* the legal and tax framework for IIFs, can be found in the *Immobilien-Investmentfondsgesetz* (ImmoInvFG). In order to qualify for the principle of transparency, a domestic IF should comply with the ImmoInvFG and a foreign entity should fall within the scope of Sec 42 ImmoInvFG. When defining the concept of a real estate fund, the legal approach applies to domestic funds whereas a foreign entity is defined on the basis of economic criteria.

Belgium
The SICAFI is subject to a specific regulatory regime. The rules governing SICAFIs can be found both in the regulatory laws and in the tax laws. SICAFIs are subject to strict supervision by the Belgian Banking and Finance Commission.
The key requirements can be summarized as follows:

- the SICAFI must be registered on a list containing all of Belgium's recognized investment institutions;
- the SICAFI must obtain a licence from the Belgian Banking and Finance Commission;
- the articles of association of the SICAFI must contain a number of specific provisions and have to be accepted by the Belgian Banking and Finance Commission; and
- the SICAFI must appoint a custodian who is accepted by the Belgian Banking and Finance Commission.

France

For a French company to meet the conditions for the SIIC regime, it must comply with the following regulations:

- file a formal election letter with the French tax administration within 4 months from the beginning of the relevant tax year; and
- payment by the SIIC and the SIIC subsidiaries of an 'exit tax' levied at the flat rate of 16.5% on the latent capital gains on (i) real assets; and (ii) on interest in qualifying real estate partnerships.

An election may also be made by any subsidiary directly or indirectly held for 95% at least by the SIIC parent and having a qualifying activity. Foreign entities meeting the conditions for the SIIC regime are also eligible for the SIIC status, provided they recognize the existence of a French permanent establishment, the assets of which consist of real estate directly held in France by the foreign entity as well as of the shares of its qualifying 95% corporate French subsidiaries which also elect for SIIC treatment.

Germany

In Germany, open-end real estate investment funds must comply with a host of regulations laid down in the Investment Act and the Investment Tax Act in order to be eligible for the IF regime. The purpose of these rules is to provide the investors with protection against mismanagement of their investments. Application of the regime requires, for instance, that the assets of the fund are administered by an investment company. The management company must obtain a licence and comply with specific regulations.

Italy

Since the Italian FIIs are special kinds of investment funds, setting them up has to comply with a number of detailed regulatory provisions. Many of the regulatory provisions must be included in the by-laws of the fund. For instance, they must provide the modalities applicable to the profit distribution and the types of financial instrument in which the fund may invest.
Furthermore, the by-laws of FIIs must be scrutinized and approved by the Bank of Italy. If the Bank does not explicitly deny the approval within a four-month period after the by-laws have been filed, the approval is deemed granted.

Under certain circumstances, the filing of a prospectus might be required. In particular, the prospectus must be filed if the units of the fund are offered to the public (the definition of 'public offering' is laid down in the Italian regulatory provisions. For instance, the prospectus is not required if the face-value of the units exceeds € 250,000, if the potential investors are more than 200, etc.).

Luxembourg

All REIFs must obtain prior authorization from the Luxembourg supervisory authority of the financial sector (CSSF). The promoter/sponsor of a REIF has to file its licensing request accompanied, amongst others, with draft management regulations of the FCP or articles of association of the investment company, a full prospectus, various service level agreements

(e.g., with custodian, paying agent, investment manager, etc.), information to demonstrate that the central administration will be located in Luxembourg and the identities of the directors of the management company of the FCP, or the board of directors of the SICAV/F, who must be of good repute and have the required experience in real estate matters.

The management company of an FCP must fulfil the following obligations:

- its activities must be limited to the management of enterprises for collective investment, the administration of its own assets being only an ancillary activity;
- it must have sufficient financial resources to conduct its business and meet its liabilities.

Netherlands

The BI regime is a pure tax regime. Application of the BI regime is not dependent on satisfying certain regulatory requirements (security laws). A company can simply elect to apply the BI regime in its corporate income tax return, which is filed after the end of the year for which the BI regime is to apply. BIs, which are listed or marketed to the public, fall under the supervision of the Dutch Financial Market Authority. Foreign entities cannot obtain BI status.[1]

Spain

In Spain, in order to qualify as collective investment institutions, the SII and FII are required to obtain regulatory investment status. In order to obtain this status, they have to fulfil the following requirements:

- the memorandum explaining their project of incorporation must be authorized by the Spanish Stock Exchange Commission (CNMV);
- these must be filed with the Spanish Stock Exchange Commission Registry.

2.3.2 Legal form / minimum share capital

2.3.2a Legal form

Austria	IIF	Real Estate Investment Fund *(Immobilien-* Investmentfonds*)*
Belgium	SICAFI	Belgian Limited Liability Company or a Belgian limited partnership with shares.
France	SIIC	Corporation (SA) or any other company with a share capital divided into shares
Germany	IF	Real Estate Investment Fund *(Sondervermögen)*
Italy	FII	Closed-end or semi-closed end funds *(Fondi di investimento immobiliare)*
Luxembourg	REIF	Undivided collection of assets managed by a management company (FCP) or an investment company with variable or fixed capital (SICAV/SICAF)
Netherlands	BI	Public company (NV), limited liability company (BV) or Investment Fund *(fonds voor gemene rekening)*
Spain	SII FII	Corporation *(Sociedad Anónima (SA))* Investment Fund *(Fondo)*

[1] In exceptional cases (entities having the legal form of a Netherlands Antilles NV) an exception to this rule is possible. see the Letter form the Dutch State Secretary of October 20, 1995/ DB95/2762M.

Austria
In Austria, the favourable regime concerning domestic IIFs only applies to qualifying real estate investment funds. Such an IIF can be defined as a collective undertaking investing its funds in real estate. A foreign entity is considered a qualifying real estate fund when (i) it mainly derives income from real estate (more than 50%) and when (ii) it structures its investments under the principle of risk spreading.

Belgium
The SICAFI must have the form of a Belgian corporation, Belgian limited liability company or a Belgian limited partnership with shares. Foreign entities cannot qualify as a Belgian SICAFI.

France
The SIIC regime is only available to parent companies whose share capital is divided into shares. Among French companies, only SAs (*sociétés anonymes*) and SCAs (*sociétés en commandite par actions*) qualify. However, a 95% subsidiary of a parent SIIC can obtain the SIIC regime even though it is not a company with a capital divided into shares. The subsidiary has to be subject to French income tax.

The French tax authorities have taken the following position on foreign entities complying with the conditions for the SIIC regime. Foreign entities must recognize the existence of a French permanent establishment, the assets of which consist of real estate directly held in France by the foreign entity as well as by its qualifying 95% subsidiaries which also elect for the SIIC regime.

Germany
With regard to domestic entities, the IF regime is only applicable for *Sondervermögen*, i.e. an open-end or special real estate investment fund. A foreign entity is considered as qualifying real estate fund if, amongst others, its investments are made in accordance with the principle of risk diversification. This requirement is met if the foreign entity invests in at least three real properties.

Italy
THE FII has to be set up in Italy as a:
- Closed-end FII; the capital of the FII cannot be modified. The units cannot be reimbursed before termination of the fund; and
- Semi-closed-end FII; the capital of the FII can be increased.

Luxembourg
The net assets of an FCP may not be less than € 1,250,000.

The management company of an FCP must have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities. This management company has to be incorporated under Luxembourg law in the form of a public limited partnership, a private limited company, a cooperative or a partnership limited by shares. A formal authorisation is required from the CSSF and the management company must entrust the audit of its annual accounts to an auditor (*réviseur d'entreprises*).

SICAVs may either be self-managed or appoint a management company.

Netherlands
Under Dutch tax laws, a BI must be incorporated in the form of a public company (NV) or a limited liability company (BV) and must be resident in the Netherlands. The BI regime is also open to investment funds (*fonds voor gemene rekening*), which do not have legal personality. Under certain circumstances, these mutual funds are subject to Dutch corporate income tax (called 'open' funds). A BI must be resident in the Netherlands.

Spain
In Spain an SII must be incorporated in the form of an SA (*Sociedad Anónima*). FIIs are a joint ownership without legal personality. Both SIIs and FIIs must be domiciled in and effectively managed from Spain.

2.3.2b Minimum share capital

Austria	IIF	N/A
Belgium	SICAFI	€ 1,250,000
France	SIIC	€15,000,000 none for a SIIC subsidiary of an SIIC
Germany	IF	N/A
Italy	FII	N/A
Luxembourg	REIF	€1,250,000
Netherlands	BI	nil (fund), €18,000 (BV) or € 45,000 (NV)
Spain	SII FII	€ 9,015,181.56 € 9,015,181.56

For the Spanish SII and FII, is to be expected that the minimum capital requirements will be increased by the future regulations that are close to being approved by the Spanish Government. According to an unofficial draft of the future regulations provided to us, both minimum requirements will be increased to € 12,000,000.

2.3.3 Listing requirements / shareholder requirements

		Shareholder requirements	***Listing mandatory***
Austria	IIF	N/A	N/A
	Special IIF	Not more than 10 investors, other than individuals.	N/A
Belgium	SICAFI	N/A	Listing on a Belgian stock exchange is required
France	SIIC	N/A	Listing on a French stock exchange is required
Germany	IF	N/A	N/A
	Special IF	Not more than 30 investors, other than individuals.	N/A
Italy	FII	N/A	If value of unit is less than € 25,000
Luxembourg	REIF	N/A	Optional
Netherlands	BI	Max. 45% of the share capital may be held directly or indirectly by a single entity – not being a listed entity – that is subject to tax. Max. 25% may be held directly- by a single non-resident shareholder and max. 25% indirectly by resident shareholders through non-resident entities. Additional for a BI that is not subject to regulatory supervision: no individual may have an interest of 5% or more.	N/A
Spain	SII / FII	The shares must be held by at least 100 persons or entities.	N/A

Austria
Austria has no listing requirements. When domestic IIFs are characterized as open-ended funds, its units are considered to be offered in a public placement.
Shareholders conditions only apply to *special* IIFs, and are as follows:
- the number of investors is limited to 10;
- the investors are non-individuals;
- the individuals are known to the management company; and
- the transfer of the fund units is subject to the approval of the management company.

Belgium
In Belgium a SICAFI must be listed on a Belgian stock exchange or any regulated stock exchange established in EU Member States. A SICAFI is allowed to hold shares in subsidiaries investing in real estate. The subsidiary itself can qualify as a SICAFI provided it is listed.

France
In order to be able to elect for the French SIIC regime, the parent company must be listed on a French stock exchange. However this condition does not prevent the SIIC from being listed on a foreign stock exchange as well. It is also possible for foreign SIICS to be listed on a French stock exchange.

Germany
Listing on a German stock exchange is not required. However an individual foreign investor may not have a direct interest in a Special REIF, but may own an indirect interest in a Special REIF.

Italy
In Italy, listing of the FII is not required when the value of the units of the fund exceeds € 25,000. Below this value, listing is mandatory.

Luxembourg
Luxembourg law contains no provisions for shareholder requirements. The shares or units of a REIF are deemed to be offered to the public but may be placed publicly or privately.

Netherlands
The Dutch regime imposes the most complex shareholders' conditions. It is the only regime that imposes such conditions on foreign shareholders which are more burdensome than those imposed on domestic shareholders. Vehicles listed on the Official Segment of the stock market of Euronext Amsterdam, have to fulfil the following requirements to be eligible for the BI regime:

- a single entity (including affiliated entities) that is subject to tax on income, or the profits of which are subject to tax on income at the level of its shareholders or participants, cannot own 45 percent or more of the shares in a BI; this 45% test is not applicable to a shareholder that itself is a BI listed on the Amsterdam stock exchange (an Amsterdam listed BI can hold 100% of the share capital in another BI);
- none of the individual shareholders may have an interest equal to or in excess of 25%;
- the interest in the vehicle may not, through the interposition of a mutual fund or corporate entity that is not resident in the Netherlands, be ultimately held for 25% or more by entities resident in the Netherlands;
- the interest in the vehicle may not be held for 25% or more by a mutual funds or corporate entity resident outside the Netherlands.

If a BI is not quoted on a stock exchange and it is not subject to regulatory supervision, in addition to the above mentioned requirements, no individual may hold a substantial interest; a substantial interest is – generally speaking – an interest of 5% or more.
A BI can, in principle, only have one class of shares.

Spain
Spanish legislation does not contain any listing requirements for the SII/FII. Although SIIs are free to opt for public listing the majority do not. Either way they have to be supervised by the Spanish Stock Exchange.

Contrary to SIIs, FIIs cannot be listed, but they do come under the supervision of the Spanish Stock Exchange Commission. Management companies must inform on a monthly basis of the net value of FIIs. Furthermore, unit holders are entitled to request redemption of their units at least once a year. The shares/units of the SII/FII must be held by at least 100 investors. There is

a possibility that in the near future, a maximum percentage of participation of a single investor will be introduced.

2.3.4 Asset level / Activity test

Country	Vehicle	Assets
Austria	IIF (domestic) Foreign real estate fund	Real estate and cash Real estate investment (mainly) and other investment
Belgium	SICAFI	Immovable property
France	SIIC	Real estate
Germany	IF	Real estate and cash
Italy	FII	Immovable assets, leasing rights, shareholdings in FIIs
Luxembourg	REIF	Real estate assets (directly or indirectly)
Netherlands	BI	Passive investments in real estate
Spain	SII / FII	Urban real estate for rental activities

Austria

Austrian legislation distinguishes between domestic and foreign real estate funds with respect to the restrictions applicable to their investments.

Domestic IIF

- the IIF must invest a minimum of 10% up to a maximum of 40% of its assets in cash or cash equivalents.
- the IIF may not invest more than 20% of its assets in real estate located outside the EU or EEA.
- the IIF may invest in the development of real estate. This may not exceed 40% of the total market value of the fund assets
- the IIF has to diversify its investment in cash or cash equivalents as well as real estate.
- the REIT must consist of at least 10 real estate units and none of the properties may exceed a value of 20% of the market value of the fund's total assets.

The real estate must be located within the European Union or in the European Economic Area. The real estate fund may acquire real estate located outside the EU or EEA provided that:

- the real estate qualifies as such under Austrian legislation;
- the acquisition is explicitly provided for in the articles of association of the fund; and
- the real estate is expected to yield constant and permanent return.

The market value of such real estate may not exceed 20% of the market value of the fund's total assets.

Provided certain conditions are met, a domestic IIF may hold shares in another real estate company. However, one of these conditions excludes the acquisition of foreign real estate.

Foreign REIT

The definition of a foreign real estate fund follows an economic approach. In order for the foreign vehicle to qualify as a foreign real estate fund, it must invest mainly in real estate and it must structure its investments under the principle of risk spreading. Other conditions to comply with are:

- the REIT must have at least 10 different kinds of projects; and
- the REIT may not invest more than 20% in the same project, exceeding on a short-term basis is not harmful; and
- the leverage must not exceed 50%, exceeding on a short-term basis is not harmful.

These conditions have been developed by the Ministry of Finance and are not stated in the law.

Belgium

Under Belgian legislation, the SICAFI has to invest in immovable property. The term 'immovable property' includes:

- real estate in its literal sense;
- option rights on real estate,
- shares in affiliated companies investing in real estate; and
- real estate certificates.

However, the SICAFI is allowed to invest in movable property, provided and to the extent the articles of association authorize such investment. A SICAFI may develop real estate, provided that the SICAFI holds the completed developments for at least five years. The SICAFI may not invest more than 20% of its assets in the same property.

Furthermore, a SICAFI is not obliged to invest in Belgian real estate.

France

The main object and activity of the French SIIC must be (i) the purchase or development of buildings with a view to leasing them; and (ii) participation in corporate subsidiaries or partnerships having the same activity. The non-qualifying activities do not prevent the SIIC from enjoying the SIIC regime. They are, however, fully taxable. The non-qualifying activities may not exceed a value of 20% of the total gross asset value of the company. For financial leasing, which qualifies as a non-qualifying activity, a percentage of 50% applies instead of 20%. Development activities are allowed, provided that the developed property is kept and leased by the SIIC.

A SIIC is also allowed to invest in foreign real estate, either directly or through subsidiaries.

Germany

Under German law, the IF has to comply with the following assets requirements:

- the domestic IF must invest a minimum of 5% up to a maximum of 49% of its assets in cash or cash equivalents; and
- the domestic IF may not invest more than 15% of its assets in the same property.
- in order to qualify as an IF for tax purposes, a foreign IF is obliged to invest in at least three real estate properties.

An IF does not usually act as a property developer or performs other similar activities such as the rehabilitation and parcelling of real estate. It is, therefore, highly recommended that the investment companies contact the BaFin in advance if an unusual activity such as property developing is envisaged.

A domestic IF may invest in foreign properties; however, additional restrictions apply if the real estate is located outside the EU or EEA.

Italy

These matters are regulated by the Bank of Italy. In particular, Regulations of the Bank of Italy provide that FIIs may not:

- lend money in forms other than forward transactions on financial instruments; it is expressly stipulated that funds investing in immovable property may lease the assets to third parties and a purchase option may be granted to the lessee;
- sell short term financial instruments or other assets;
- invest in financial instruments issued by the management company;
- invest in financial instruments that are not publicly traded, issued by companies of the group of the management company.

Even if normally closed-end funds are not allowed to conduct building construction activities, according to a recent Regulation issued by the Bank of Italy, FIIs may deal with this kind of activity, directly or through controlled companies, provided these activities do not exceed 10% of the overall activity.
Nevertheless, the literal translation of the regulatory provisions seems to allow FIIs to carry out such activity indirectly without limitations, for instance, by letting it out on contract to a construction company. Moreover, the text only refers to construction activities, whereas terms referring to other similar activities (e.g., the change of the commercial destination and parcelling of real estate) are used elsewhere in the legislation governing FIIs.
This could give rise to the conclusion that the prohibition does not cover activities that have not been mentioned. It is advised, however, to verify future interpretation of this provision.
Besides the above-mentioned investment prohibitions, The Regulations of the Bank of Italy set out the following limitations on the activities of FIIs in order to guarantee an appropriate level of risk diversification.

These limits apply in general to investment funds of whatever nature, and it is fair to conclude that they also apply to FIIs:

- immovable property - the FII may not invest, directly or through controlled companies, more than one third (1/3) of its assets in one single asset having unitary, urban and functional characteristics;
- financial Instruments - the FII may not invest in non-negotiated financial instruments of one single issuer for a value exceeding 20% of its assets; this limit is higher under particular circumstances; moreover, if the financial instruments are issued by companies of the same group the limit is raised to 30%;
- bank deposits - the FII may not invest more than 20% of its assets in bank deposits with one single bank (30% with banks of the same group).

Italian law does not differentiate between domestic and foreign activities.

Luxembourg

Under Luxembourg law, the REIF must invest in real estate, which comprises:

- domestic or foreign property consisting of land and/or buildings registered in the name of the REIF;
- shares in domestic or foreign real estate companies (including claims on such companies) the exclusive object and purpose of which is the acquisition, promotion, project development and sale as well as the letting and agricultural lease of property

provided that these shareholdings are at least as liquid as the property rights held directly by the REIF; and
- property related to long-term interests such as surface ownership, leasehold and options on real estate assets.

A REIF has to comply with the rules of risk diversification. Therefore, a REIF may not invest more than 20% of its total assets in one single property. Investments in cash and securitisations may only be made on an exceptional basis and must, in all events, comply with general risk diversification rules.

Netherlands
In the Netherlands, the company qualifying for the BI regime is required to be exclusively involved in portfolio investment activities (passive investments). This means that a minimum of activities that could be qualified as businesslike would imply that the BI is conducting non-qualifying activities that fall outside the scope of the regime.
Portfolio investment activities comprise regular investment activities, including investments in shares, bonds, other securities, and real estate. With respect to the latter investment objective, the company must restrict its activities to the 'passive' renting out of and investment in the real estate. Also, the shares in subsidiaries should qualify as passive investments, thus the subsidiaries' activities must also be restricted to passive investments. Participating in real estate development activities is not considered a portfolio investment activity. A BI is entitled to self-manage its real estate portfolio.

Debate is ongoing between the Dutch BI community and the tax authorities as to whether a BI can conduct, within certain limits and subject to certain conditions, development activities for its own portfolio, provided the developed real estate is held for the long term.
A BI is allowed to invest in foreign assets; the same restrictions apply as to domestic assets.

Spain
The Spanish SIIs and FIIs are registered collective non-financial investment institutions with the exclusive purpose of investment in urban real estate for rent.
'Urban real estate' comprises:
- real estate already built;
- real estate under construction;
- option rights over real estate assets; and
- the rights to rent the real estate.

As additional requirements, an SII or FII may not invest more than 35% of its assets in the same property and investments in real estate under construction and option rights on real estate are limited to 20% of the total assets of the SII/FII.
Furthermore, SIIs must invest at least 90% of its assets in real estate. The remaining 10% may be invested in fixed-yield securities listed in an OECD market. FIIs have to invest at least 70% of their assets in real estate. 10% has to be kept in cash. The remaining 20% may be invested in fixed-yield securities listed in an OECD market.

Finally the SIIs and FIIs also have to comply with the following requirements:
- at least 50% of the total assets of the SII/FII must comprise houses, student residents and dwellings for elderly people and
- SIIs and FIIs are obliged to keep their real estate for at least three years after acquisition date.

There is no difference between domestic and cross-border investment activities.

2.3.5 Leverage

Austria	Domestic IIF Domestic Special IIF Foreign real estate fund	Loans may not exceed 20% of the market value of the fund assets Loans may not exceed 40% of the market value of the fund assets investment Loans may not exceed 50% of the market value of the fund assets
Belgium	SICAFI	Total debt may not exceed 50% of the total assets
France	SIIC	No specific limitations
Germany	IF	Limited to 50% of the fair market value of the IFs real property
Italy	FII	Limited to 60% of the real property and 20% of its other assets
Luxembourg	REIF	Borrowings may not exceed 50% of the total assets
Netherlands	BI	Limited to 60% of the real estate and 20% of all other investments
Spain	SII / FII	Limited to 50% of the total assets

Austria
Under Austrian law loans may not exceed 20% of the market value of the fund assets. This percentage is enlarged when it concerns a Special IIF. As for qualifying foreign real estate funds, the leverage is set at 50%, exceeding on a short-term basis is not harmful.

Belgium
Belgian legislation requires that the aggregate of the borrowings does not exceed 50% of the total assets of the SICAFI at the time of entering into the loan. Furthermore, the annual interest costs may not exceed 80% of the total annual profits. If the SICAFI holds shares in affiliated companies investing in real estate, the leverage restrictions will be applicable on a consolidated base.

France
French law on SIICs does not envisage any specific limitations concerning the leverage.

Germany
Loans taken up for the account of the IF may not exceed 50 % of the fair market value of the real estate owned by the IF.

Italy
Italian law contains the following specific restrictions concerning leverage of FIIs:
- the loan capital is limited to (i) 60% of the book value of the immovable assets, the rights to lease immovable assets and the shareholdings in real estate companies; and (ii) 20% of its other assets;
- money borrowed for advance reimbursement of units may not exceed 10% of the value of the total assets.

Luxembourg
The aggregate of all borrowings of the REIF may not exceed an average 50% of the valuation of all its properties. Exceptions may be granted on a case-by-case basis.

Netherlands
The Dutch regime sets out specific restrictions on leverage of a BI. The underlying principle of prohibiting high gearing is that a highly geared real estate portfolio is deemed a speculative activity and, not a passive investment activity. Loan capital is defined as total debt borrowed (calculated on a non-consolidated basis, the consolidated level of debt is often in excess of the formal gearing limits). The loan capital may not exceed 60% of the fiscal book value of the real property; and 20% of the fiscal book value of all other investments.

Spain
Spanish legislation allows SIIs and FIIs to finance the acquisition of their assets through mortgage loans. However, the total amount of leverage may never exceed 50% of the total assets.

2.3.6 Profit distribution obligation

		Dividends	Rental income	Capital gain	Timing
Austria	IIF	N/A	N/A	N/A	N/A
Belgium	SICAFI	80%	80%	80%	Annually
France	SIIC	100%	85%	50%	Divers
Germany	IF	N/A	N/A	N/A	N/A
Italy	FII	N/A	N/A	N/A	N/A
Luxembourg	REIF	N/A	N/A	N/A	N/A
Netherlands	BI	100%	100%	capital gains/losses are allocated to a tax free reserve and do not form part of the taxable profit distribution obligation	Within 8 months after the close of the financial year
Spain	SII / FII	N/A	N/A	N/A	N/A

Austria
Austrian law does not impose a profit distribution obligation on a domestic IIF. Tax terms consider non-distributed profits to be distributed by expiration of four months following the funds fiscal year end. There are also no specific obligations for qualifying real estate funds; the deemed distribution applies in the same manner as for domestic funds.

Belgium

Belgian legislation requires that 80% percent of the net profits (minus costs) have to be distributed on an annual basis.

Profits are the realized benefits, minus

- the net instalments made on the loan capital;
- the write-offs of participations; and
- capital gains on the disposition of assets, which are not reinvested in qualifying assets within four years. The capital gains which are reinvested remain tax free.

A subsidiary of a SICAFI, qualifying as a SICAFI itself, is not subject to any profit distribution obligations.

France

French law contains the following distribution obligations:

- dividends received by the SIIC from a subsidiary having elected for the SIIC regime; 100% has to be distributed immediately in the financial year following the year of the receipt;
- rental income; 85% has to be distributed before the end of the financial year following the year in which it accrues;
- capital gains; consist of (i) sale of real estate; (ii) sale of shares in a subsidiary SIIC; and (iii) sale of interest in a qualifying real estate partnership. 50% has to be distributed before the end of the second financial year following the year in which the gain is recognized.

The fully taxable profits and gains from the ancillary non-qualifying activities are not subject to any compulsory distribution.

Germany

German law does not envisage any profit distribution obligations.

Italy

Italian FIIs have no obligation to distribute profits during their lifetime, unless the by-laws of the FII so require. In any event, they have an obligation to distribute all the proceeds deriving from their activity at the end of their duration.

Luxembourg

According to the Luxembourg regulations, REIFs may implement a distribution obligation. This is however not obligatory. The redemption of units at the request of the unit holder is in principle mandatory for the REIF. However, the redemption may be restricted and any repurchase restrictions must be stated in the prospectus.

Netherlands

Dutch law requires that the BI distributes all or most of its profits to the shareholders within 8 months after the close of the financial year. The Dutch regime is the only regime requiring a distribution of the *full* annual income to the shareholders. Capital gains/losses are not included in this distribution obligation of a BI.

Spain

Under Spanish law, SIIs/FIIs have to follow the standard rules applicable to Spanish corporations. Dividends may only be distributed from the income for the financial year or from unrestricted reserves. The SIIs net worth may not, as a result of this distribution, fall below the nominal share capital.

2.3.7 *Management / Management Company*

Austria

The management of the IIF should be carried out by a management company.
The management company may be a limited liability company (*Gesellschaft mit beschränkter Haftung*, hereinafter GmbH) or a corporation (AG). Other legal forms (e.g. partnerships, trusts) are not permitted.

The management company must have an initial capital of at least € 5,000,000 contributed in cash. The assets and liabilities of the management company must be kept and accounted for separate from assets and liabilities of the real estate fund.

Belgium

Belgian law does not require a management company.

France

French law does not require a management company.

Germany

The management of the IF must be carried out by a management company.
The management company must obtain a licence from the BaFin and comply with specific regulations. The Management Company must have a capital of at least € 2,500,000. The management company must be a Stock Corporation (*Aktiengesellschaft*) or a limited liability company (GMBH). Management companies are treated as credit institutions and are as such subject to the regulatory regime applicable to banks and other financial institutions.

Italy

The management of the FII should be carried out by a management company (*società di gestione del risparmio*, SGR). An SGR must be incorporated in the form of a company limited by shares (*società per azioni*) having a minimum shareholding capital of € 1,000,000. SGRs must comply with certain patrimonial ration. The registered office and principal place of business of the SGR must be in Italy.

The shareholders and directors must satisfy certain requirements (for instance, the directors must have certain professional requirements). An SGR can exercise its activity only after having obtained authorization from the Bank of Italy.

Luxembourg

The management of an FCP is required to be carried out by a management company established in Luxembourg.

The management company must fulfil the following obligations:

- its activities must be limited to the management of enterprises for collective investment, the administration of its own assets being only an ancillary activity;
- it must have sufficient financial resources to conduct its business and meet its liabilities;
- the directors and managers of the management company must be of good repute and have the required experience in real estate matters;
- it must have a capital of at least € 125,000;
- the management company is subject to the prior authorisation and ongoing supervision of the CSSF.

If the REIF is structured as a SICAV/F, it will, in principle, be self-managed by its board of directors. It may also retain the services of a management company established in Luxembourg.

The Netherlands

If the BI is a fund (*fonds voor gemene rekening*) a management company is required. A BI can be self-managed if the BI is a corporation, however, a management company can also be used in that situation.

Spain

Mandatory requirements are, for Real Estate Investment Funds, that they be managed by Management Companies, whereas real estate management companies may opt to 'self-manage' their investments. For Collective Investment Institutions Management Companies ("*Sociedades Gestoras de Instituciones de Inversión Colectiva*"), these must be incorporated under the business form of 'corporations' ("*Sociedades Anónimas*") and must obtain an authorization from the Spanish Stock Exchange Commission ("*Comisión Nacional del Mercado de Valores*"). This authorization is subject to several requirements, of which the most important are:

- a minimum capital stock which is fully paid up;[2]
- a proper business organization, including appropriate human and material resources;
- untainted reputation and professional capability of the Directors of the Company.

Furthermore companies wishing to operate under this status must apply for the corresponding authorization to the Spanish Stock Exchange Commission, which is only authorized to deny an application the applicant does not comply with all the requirements laid down in the regulations.

2.4 Tax treatment at level of the REIT

2.4.1 Corporate tax / withholding tax

		Income	Capital gain	Withholding tax
Austria	Domestic IIF Foreign IIF	N/A N/A	N/A N/A	25% 25%
Belgium	SICAFI	Excluded	Excluded	15%
France	SIIC	Exempt	Exempt	N/A or 25%
Germany	IF	Exempt	Exempt	31.65%
Italy	FII	Exempt	Exempt	0%-12.5%
Luxembourg	REIF	Exempt	Exempt	N/A
Netherlands	BI	0%	Exempt	15%
Spain	SII / FII	1%	1%	15%

2 The recently published (July 2005) bill of new regulations on Spanish CII establishes a minimum figure of € 300,000 which increases according to a progressive scale depending on the total funds managed by the entity.

Austria

Domestic IIF

The IIF is transparent for income and inheritance tax. Consequently income tax is levied at the level of the investors. The investors are taxed according to their share in the IIFs profit. The profit consists of:

- income derived from domestic real estate; this income is reduced by (i) certain deductible expenses, which do not include the depreciation and maintenance costs and by (ii) 20% of the rental income, which is allocated to the deferred repairs reserve;
- capital gains from revaluation of real estate; A domestic real estate fund is required to revalue its real estate assets once a year, but in any case upon acquisition, alienation, pledge or if the custodian bank requires so. This capital gain does not have to be realised. It can, under conditions, be reduced by 20%. The reduction applies to open-ended REIFs, but not to special REIF;
- current income from cash management;
- income derived from foreign real estate; if tax treaties are applicable rental income and income from revaluation of real estate are exempted from Austrian income tax if the tax treaty provides for exemption with progression method; in a non-treaty case, an exemption only applies if the effective tax burden is at least 15%, otherwise the foreign income tax is credited; compared to domestic cases, the rule discriminates against foreign real estate in a non-treaty case;
- profits received from a real estate company in which the domestic IIF has a share; these profits are not taxable at IIF level. Instead, the profits are attributed to the unit holder of the IIF; the principle of transparency does not apply to IIFs who receive dividends of a foreign real estate company. In tax treaty terms, their income is deemed dividend income, which in general, is taxable in Austria; compared to domestic IIFs investing via a domestic IIF, this might be a discrimination against domestic IIFs investing via a foreign real estate company;
- losses from renting activities, revaluation losses and losses from cash and cash equivalents may, under conditions, be set off against the gains, but not carried back or forward.

A withholding tax of 25% is levied on distribution of the domestic IIF.
If no distribution takes place, the withholding tax of 25% of the non-distributed amount is paid by the depositary bank of the IIF to the domestic coupon agent. No withholding tax is imposed on the income share of (i) private foundations; (ii) domestic fund in funds; and (iii) companies under certain conditions.

Where income of the IIF is paid or attributed to non-residents, the withholding tax is levied on the part of the profit of the domestic IIF that relates to domestic real estate. Thus, there is no withholding on income on foreign real estate or income from cash management.

Foreign real estate funds

Foreign real estate funds are categorized as follows:

- white - the earnings are disclosed by an Austrian tax representative to the tax authority;
- black - the earnings are not disclosed by an Austrian tax representative to tax authority.

An investor holding a White fund is, generally, treated the same way as a domestic vehicle. A Black fund is treated differently, as its determined profit diverges. The taxable amount consists of a distribution and the highest of (i) 10% of the last redemption price fixed in the calendar year;

or (ii) 90% of the balance between the last and the first redemption price fixed in the calendar year.

As for the withholding tax treatment, this is the same as for domestic vehicles, but the following exceptions apply:

- the withholding tax is levied on actual distributions only, whereas deemed distribution is taxed by way of annual tax assessment at the flat rate of 25%;
- the withholding tax must be, in the opinion of the tax authorities levied on the total amount of distribution; thus, no relief from double taxation is available at source; and
- the withholding tax is final.

Belgium

The Belgian SICAFI does not qualify as a tax transparent vehicle. The normal tax rate is 33.99%. However, some elements of income are exempt from Belgian tax:

- qualifying real estate as well as income other than real estate is excluded from the taxable basis provided it is at arm's length (e.g. not higher than market conditions);
- capital gains are not included in the taxable profit provided they are at arm's length; (e.g. not higher than market conditions);
- dividends distributed by the SICAFI to its shareholders are subject to withholding tax at a rate of 15%, to be reduced under the tax treaties concluded by Belgium. If the SICAFI invests more than 60% of its assets in real estate located in Belgium, which is used for private accommodation, a unilateral exemption from withholding tax will apply.

France

The French SIIC regime is not tax transparent. Income derived from ancillary non-qualifying activities is fully subject to French corporate income tax. The qualifying activities are not subject to French tax. There is no specific withholding tax regime applicable to SIIC dividends. When distributed to non-resident shareholders, SIIC dividends are normally subject to a 25% withholding tax, which may be reduced by tax treaties to 15% or 5%. Distributions to French tax residents are not subject to a withholding tax. A SIIC can only credit withholding tax if it has paid French corporate tax.

Germany

In Germany, domestic IFs are not fully tax transparent; however, they do enjoy an exemption from German income tax. In principle, the investor is treated as earning income from capital rather than income from real estate. To some extent the rule of transparency does apply as far as the income earned by the IF consists of dividends received, capital gains earned on the disposition of shares in corporations and income derived from foreign real property.
The domestic IF is exempt from corporate income tax and local trade tax. Corresponding with this exemption, the investors are subject to income tax with their portion of the income earned by the IF whether or not the income is distributed to the investors. The investor is treated as earning income from capital rather than income from real property.

A foreign real estate fund is not eligible for the tax exemption. However, investors in a foreign real estate fund are basically taxed in the same manner as an investor in a domestic IF, provided that the foreign real estate fund complies with the very detailed reporting obligations imposed on domestic IFs. If the foreign real estate fund does not fully comply with the reporting obligations, the domestic investor is taxed with the sum of (i) distributions received; plus (ii) 70% of the appreciation of his investment in a given year but in any case with an amount equal to 6% of the fair market value of the interest in the foreign IF at the close of the calendar year (penalty taxation). Since most foreign real estate funds will probably regard complying with the reporting

obligations as too burdensome, domestic investors have a strong (tax) preference for domestic IFs over foreign real estate funds. This is only not the case with respect to foreign real estate funds qualifying as special investment fund since the penalty taxation does not apply.

The withholding tax levied by the IF is reduced in the following situations, provided that the reporting obligation is fulfilled:

- the applicable withholding tax is 21.1%, if the distribution comprises dividends earned by the fund on shares in (domestic or foreign) corporations;
- there is no withholding tax if the distribution comprises (i) a capital gain earned by the fund on the disposition of securities and subscription rights with regard to shares in corporations, (ii) income from futures and (iii) capital gains from the disposition of real property that the fund has owned for more than 10 years; and
- there is no withholding tax if the distribution comprises foreign source income that is exempted from German corporate income tax under a tax treaty.

Italy

Italian FIIs are fully tax exempt. Any withholding tax applied to income paid to an FII, such as withholding tax incurred on foreign source income, is a final withholding tax. There is no mechanism to allow the FII to offset such tax withheld at source.

Dividends distributed by FIIs are subject to a 12.5% withholding tax withheld by the SGR. For the purpose of application of the 12.5% withholding tax, the term dividend includes (i) distribution executed by the fund; and (ii) the balance between the official value of the unit upon redemption and the official value upon acquisition or subscription; and (iii) the balance between the official value of the unit upon sale and the official value upon acquisition or subscription.
Whereas the withholding tax represents an advance withholding tax if the unit holder is an Italian resident enterprise, corporate entity or an Italian permanent establishment of a foreign entity, it represents a final withholding tax in all other circumstances.

The withholding tax, however, does not apply if the beneficial owners of the proceeds are:

(i) Italian pension funds;
(ii) Italian investment funds;
(iii) foreign persons that are resident in countries which allow an adequate exchange of information with the Italian tax authorities (provided that certain formalities are satisfied).

Luxembourg

The FCP is tax transparent. The SICAV/F is a fiscally opaque corporate body.

Apart from the capital duty and subscription tax, REIFs are not subject to any tax in Luxembourg. The subscription tax (0.01% to 0.05%) is assessed on the net asset value of the REIF. The FCP itself is not subject to capital tax. Instead, the capital duty charge applies at the incorporation of the management company with a maximum €1,250, if the management company manages only one REIF.

FCPs are excluded from the benefits of all double tax agreements entered into by Luxembourg (with, in practice, certain exceptions).

Furthermore REIFs are not subject to withholding taxes on distributions or capital gains.

Netherlands
Technically, the taxable profit of a BI is subject to a rate of corporate income tax of zero percent. All income or losses from the investments of a BI and all capital gains or losses from the disposal of its investments constitute taxable income of the BI. Capital gains and losses can be eliminated from the taxable income and allocated to the tax free reinvestment reserve. The taxable income, after allocation of capital gains/losses to the tax free reinvestment reserve, constitutes the annual distribution obligation (see above).

Under Dutch tax law and tax treaties, foreign withholding tax may, in general, be set off against corporate income tax payable by a resident company or income tax payable by resident individuals. As a BI is subject to a zero per cent corporate income tax rate, it cannot benefit from this tax credit. However, the income received by a BI will become taxable in the hands of its shareholders due to the distribution obligation. In view of this 'flow through' nature of a BI, it is entitled by law to obtain a 'tax credit' for foreign withholding taxes levied on its foreign source income. This credit payment is only available to the extent that the BI is held by Dutch resident shareholders. Distributions of dividends by a BI are subject to withholding tax at a rate of 25%. A distribution of the reinvestment reserve is not subject to withholding tax. Redemption of nominal share capital is generally tax free, redemption of share premium is tax free only if there are no profit reserves and hidden reserves.

Spain
The Spanish SIIs and FIIs are regular corporate taxpayers and not subject to a flow-through regime. However the SII and FII are entitled to apply a reduced tax rate (1%) if the requirements as described are met. SIIs and FIIs are not entitled to benefit from the exemptions provided for in the Spanish regulations to avoid double taxation. SIIs/FIIs may bear withholding taxes over different categories of income (e.g. interests and dividends). The withheld taxes are considered pre-payments on account of their final CIT debt. Where the amount of taxes withheld exceeds the amount of the gross tax due, the Spanish tax Administration will refund the excess. FII/SIIs who benefit from the 1% reduced rate are not allowed to credit the foreign withholding tax against their Spanish tax liability. This withholding tax levied by the SIIs/FIIs is a pre-payment on account of the final tax liability of domestic shareholders. Non-resident shareholders will also be subject to a 15% dividend withholding tax (unless a lower rate is provided for in a Tax Treaty). The incorporation, capital contributions, mergers and spin offs are exempt from Capital Duty.

2.4.2 Transition regulations

This part describes the tax treatment if an existing real estate company is converted into a REIT with a special tax status.

Austria
Under Austrian law, transition of a real estate company into an IIF is treated as liquidation of the real estate company. The investor is expected to be taxed on liquidation proceeds of the real estate company whereby the following rates apply:
- private investor: withholding tax or special income tax of 25% or lower income tax rate computed under progressive scale;
- company: 34% (25% as from 2005); and
- private foundation: interim taxation at 12.5% (for concept, see in the following).

Belgium
Upon conversion into a Belgian SICAFI, all unrealized capital gains of normal real estate will be taxed at a reduced corporate tax rate (17%).

France
As a result of the election for the SIIC regime, the SIIC and its electing corporate subsidiaries experience a change in tax regime which, under ordinary regulations, would trigger the immediate taxation of deferred profits and latent capital gains. The statute and administrative comments, however, provide for the following favourable rules:

- a payment of an exit tax (16.5% flat rate) on latent capital gains on (a) real estate assets and (b) interest in qualifying real estate partnerships held by the SIIC and the SIIC subsidiaries is mandatory. No taxation of the latent capital gains on shares in SIIC subsidiaries;
- tax losses carried forward are deductible from the exit tax basis;
- remaining losses are cancelled.

The election for the SIIC regime does not trigger any taxation at shareholders' level, either pursuant to a constructive distribution rule or on the latent capital gains on shares of the SIIC.

Germany
German law does not allow for a conversion of a real estate company into an IF. If properties are transferred from the company to an IF, the company must recognise capital gains. Such capital gain is taxed at ordinary rates. The acquisition of the properties by the IF causes real estate transfer tax at a rate of 3.5% of the consideration.

Italy
In Italy it is not possible to convert a company into an FII. On the contrary, a company is allowed to contribute real property in exchange of the units of the FII. Under Italian income tax law the contribution of the real property is equated to an alienation for consideration (the consideration is equal to the fair market value of the units received in exchange of the real property) and, therefore, may trigger income tax.

The transfer of real property to an FII may also trigger the application of indirect taxes (see paragraph 2.3.3).

Luxembourg
The conversion of a regular Luxembourg capital company owning real estate investments into a REIF is subject to the ordinary tax rules applicable to a liquidation of the company in Luxembourg and is thus a taxable event. From a legal and regulatory point of view, such conversion may, in principle, be organised with full legal and corporate continuity (except where a company is converted into an FCP, which does not have a legal personality).

Netherlands
At the end of the year prior to the year the entity is converted to a Dutch BI, step-up takes place of all assets/liabilities to market value. The 'built-in' capital gain is subject to Dutch CIT at normal rate. Tax free reserves should be added to the taxable income.
The exit tax is levied at the ordinary corporate income tax rates in the Netherlands.

Spain
Under Spanish law, FIIs can only be transformed into other type of non-financial collective institutions. SIIs may be transformed into entities that do not qualify as collective investment institutions. This transformation, which is subject to previous authorization of the Spanish Stock Exchange Commission, results in the loss of the tax benefits applicable to collective investment institutions. A Spanish company cannot be converted into an FII. If a real property company and its shareholders want to set up an IF, there are the following two possible scenarios:

Application of the Tax-Neutral Regime
Under some circumstances, it would be possible to elect for the 'tax-neutral' restructuring regime provided for in the Spanish CIT Law. This regime is based on the EU Merger Directive, but in certain aspects it is more beneficial than the EU rules. Specifically, it is possible to elect the tax-neutral regime for contributions in kind when the following conditions are met:

- the entity receiving the contributions is a Spanish resident for tax purposes or it operates in the Spanish territory through a permanent establishment to which the contributions are attributed;[3]
- the contributing entity holds at least 5% of the capital stock of the entity receiving the contribution.

The following three main tax consequences derive from the application of the tax-neutral restructuring regime:

- the contributing shareholder benefits from a 'roll-over' relief, and thus will not be taxed for the hidden reserves of the assets until the sale of the shares/units;
- the contribution does not trigger transfer tax/capital tax.
- if the REIT entity receiving the funds benefits from the special 1% CIT rate and it sells the assets, the capital gain it may obtain would be considered for tax purposes as having originated 'straight-line' during the whole period the asset has been held by both the contributing shareholder and the institution selling the asset.

This rule implies that the ordinary CIT rate would be applicable on the proportion that the period of maintenance of the asset by the share/unit holder bears to global period of maintenance held by both the contributing share/unit holder and the institution.

Non-application of the tax-neutral regime
If the contribution of the assets does not qualify for the tax-neutral regime, the contributing entity would be taxed in its CIT tax on any existing underlying gains, following standard tax rules. Non-resident entities are usually taxed at a 35% rate on the underlying gains of their **Spanish** real estate assets which are contributed to the REIT.[4]

Under Spanish general tax principles, conversions of entities do not trigger taxation. However, to avoid the application of the special 1% tax to underlying gains arising before the company acquires the SII/FII status, gains obtained in the sale of assets by the 'converted' entity will be treated as having originated 'straight-line' during the whole period of maintenance of the asset by the selling entity. Hence, the standard CIT would apply on the part of the gain that is proportionally allotted to the period when the company was taxed under ordinary tax rules.

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3 The Spanish Administration has interpreted that non-monetary contributions to REIT Companies can benefit from this regime. Although they have not analyzed the scenario where a REIT Fund receives the contributions, a similar conclusion should be reached, as these funds are considered 'entities'" for CIT purposes.

4 All Double Tax Treaties signed by Spain follow the OECD Model Convention with regard to income and gains from real estate assets and allow Spain to tax gains on the transfer of real estate properties located in Spain.

2.4.3 Registration duties

Austrian

There is neither capital tax due nor stamp duties when the investor acquires units in a domestic or foreign real estate fund. The acquisition of Austrian real properties by the management on behalf of an IIF is subject to transfer tax (3.5%) and – depending on the situation – additional stamp duties (1%-2%).
The acquisition and alienation of Austrian located real estate is subject to a transfer tax (3.5%). The transfer of fund units (e.g. alienation of units in the IIF) is not subject to real estate transfer tax as the transfer tax is based on a civil law approach and the management company qualifies as legal owner of real estate. The acquisition of real estate is also subject to stamp duty at a rate of 1%-2% depending on the kind of transaction.

Belgium

No capital duty is due concerning contributions in cash or kind to a SICAFI.
Under Belgian legislation, the SICAFI itself is subject to transfer tax (at a rate of 10% or 12.5% depending on the location of the real estate) if it sells Belgian real estate, unless the sale is subject to VAT. A purchase of Belgian real estate by a SICAFI is, under conditions, subject to 5% (instead of 10% or 12.5%) unless the purchase is subject to VAT. The purchase of shares in a SICAFI is not subject to any transfer tax. The SICAFI is subject to a real estate tax, which is based on the net rent value of the real estate.

France

Contributions into a SIIC are not subject to any stamp duties or capital tax. However, in the case of a contribution in exchange for shares a fixed duty of € 230 will be due.
Under French law direct acquisition of real estate is subject to transfer duties of 4.89%.
The acquisition of shares or interests in an unlisted company, which assets consist mainly of French located real estate, is subject to 4.8%. The 4.80% transfer duty does not apply to the acquisition of shares in the SIIC as SIICs are listed companies.

Germany

In Germany, the acquisition and disposal of domestic real estate is subject to transfer tax (3.5%). Transfer tax is levied if the IF acquires an interest in a partnership/company holding domestic real estate providing the IF with ownership of at least 95% of all interests.
In general, the acquisition or disposal of interests in a domestic IF is not subject to transfer tax. Apart from real estate transfer tax, Germany does not impose stamp duty or capital tax concerning contributions into an IF.

Italy

In Italy, the transfer of real estate may be subject to VAT (20% or 10%) or alternatively, to transfer taxes (*i.e.* registration mortgage and cadastral taxes whose rates are 7%, 2% and 1% respectively). Normally when the transfer qualifies as a supply relevant for VAT purposes, transfer taxes are applied in the fixed amount of € 168 each, unless the supply is VAT exempt. In the latter case, transfer taxes are, in principle, levied at the standard rates.
Input VAT can, in principle, be recovered by the FII (subject to the usual limitation, such as the application of the pro-rata).

Special rules apply to contribution of real property to an FII. In particular, the contribution of real property to an FII is subject to the following regime:

- the contributor qualifies as a VAT taxable person - the contribution is subject to VAT and to registration, mortgage and cadastral taxes in the fixed amount of € 168 for each tax. However, if the real property comprises multiple assets which at the moment of the contribution are mainly rented, the contribution is being relevant for VAT purposes. In the latter case registration, mortgage and cadastral taxes are subject to the fixed amount of € 168 for each tax;
- the contributor does not qualify as a VAT taxable person nor is the supply VAT exempt - the contribution is subject to registration tax in the fixed amount of € 168 and to mortgage and cadastral tax at a rate of 3 per cent.

Luxembourg

Disposal of an interest in a REIF set up as an FCP and directly owning real estate assets is, in principle, deemed a disposal of a portion of the underlying real property. Such a transfer would potentially trigger real estate transfer taxes and duties (7%-10%) if the property is located in Luxembourg. Therefore, in practice, real property is always held by an intermediate real property (opaque) company. The transfer of shares in such a company will not give rise to transfer duty. Disposal of an interest in a SICAV or SICAF does not give rise to transfer tax.

Netherlands

Under Dutch law, a BI has to pay registration duties on capital contributions and acquisition or disposal of real estate. This can be summarized as follows:

- 0.55% capital duty on capital contributions in cash or kind to a BI. The taxable basis is the higher of (i) the fair market value of the contribution received; or (ii) the nominal value of shares issued in exchange for the contribution.
- 6% real estate transfer tax if the BI itself acquires or disposes of real estate and/or shares in real estate companies.

The 0.55% capital is to be abolished per 2006.

Spain

Contributions to an FII/SII are not subject to stamp duty or capital tax, provided the following two conditions are met:

- at least 50% of their total assets must comprise houses, student residences and dwellings for elderly people;
- the real estate assets are not sold within three years from their date of acquisition, unless prior authorization to transfer is granted by the Spanish Stock Exchange Commission.

As a general rule, transfers of real estate properties are subject to VAT. Some transactions, however, may fall outside the scope of or may be exempt from VAT. In both cases, a transfer tax is levied at a tax rate of 6%-7%. SIIs and FIIs benefit from a 95% reduction on this tax.

2.4.4 Loss of status

Austria

In Austria, the domestic IIF loses its status in the following cases:

- termination of the fund management by the management company;
- liquidation of the management company;
- liquidation of the real estate fund;
- merger with another real estate company; and
- transition into a real estate company.

Whether the IIF will lose its status if it does not comply with the investment rules is unclear. The law does not provide for any sanctions in that respect. When losing its status, taxation takes place as if the units had been redeemed.

No special rules apply where a foreign REIF loses its status. If the foreign real estate vehicle qualifies as real estate fund in year 1, but loses its status in year 2, the investor would be treated as holding units in a foreign REIF in year 1 (with the tax consequences set out below) and as holding shares in a company in year 2. The latter means that the investor will only be taxed if a distribution is made by the foreign vehicle (i.e. no deemed distribution or a look-through approach will apply). If the foreign REIF is liquidated, the consequences are much the same as those for domestic REIFs.

Belgium
In Belgium, SICAFIs are subject to strict and ongoing supervision by the Belgian Banking and Finance Commission. If a SICAFI does not comply with its articles of associations, the Belgian Banking and Finance Commission can order the SICAFI to regulate the situation. If the SICAFI does not fulfil this obligation the Belgian Banking and Finance Commission can take suspended measures. The most far-reaching measure is loss of status. If the SICAFI loses its special status, it will become subject to the normal Belgian corporate income tax regime as of the moment of loss of status.

France
In France, a SIIC parent company, which no longer complies with the conditions for SIIC treatment (in the case of de-listing for instance, or if the non-qualifying ancillary activities exceed the applicable threshold), rental income and gains, becomes fully taxable from the beginning of the financial year in which the triggering event takes place. In addition, if such event takes place within 10 years from the initial election for SIIC regime, the latent gains recognized upon such election are retroactively subject to corporate income tax at a standard rate (currently 33.33 % increased to 35.43% by surcharges) with a deduction for the 16.5% exit tax already paid on such latent gains. Should one of the qualifying 95% corporate subsidiaries that has elected for the SIIC regime no longer fulfil the conditions (such as in the case of sale of more than 5% of its share capital to an unrelated person), it loses the benefit of the exemption of the leasing profits and gains from the beginning of the financial year in which the triggering event takes place. There is no recapture, however, of the latent gains recognized upon the initial election and which benefited from the exit tax at 16.5%.

Germany
In Germany, there are no specific rules pertaining to losing IF status. Non-compliance with the reporting obligation will cause penalty taxation levied on the investor. An investor in a Special IF, however, is not subject to the penalty taxation.

Italy
Italian law contains no regulation as to circumstances which would cause the FII to lose its status, nor does it stipulate any consequences of the loss of status.

Luxembourg
The loss of the REIF (UCI) status will lead to the liquidation of the REIF, with liquidation payments being treated as a capital gain (see above) for domestic tax purposes.

Netherlands
In the Netherlands non-compliance with any of the requirements will retroactively lead to loss of status. As a result, the profit in the relevant year will be taxed at the ordinary rates instead of the 0% rate.

Spain
Under Spanish law, upon losing its status, a SII/FII would be taxed under the standard CIT rate (35%).

2.5 Tax treatment at shareholders' level

2.5.1. Domestic shareholder

			Dividends	Capital gains	Return of capital	Tax Credit
Austria	IIF	Corp sh	34% or 25%	25% or 35%	no taxation	yes
		Ind sh	25% up to	50%	no taxation	N/A
Belgium	SICAFI	Corp sh	taxable(33.99%)	taxable(33.99%)	taxable (33.99%)	sometimes
		Ind sh	wht is final	not taxable	taxable (10%)	N/A
France	SIIC	Corp sh	taxable(33.3% - 35.43%)	taxable(19%- 20.2%)	tax free	N/A
		Ind sh	taxable(48.09%)	taxable (27%)	tax free	N/A
Germany	IF	Corp sh	95% exempted	95-100% exempted	38%-40%	yes
		Ind sh	50% exempted	50-100% exempted	16%-50%	yes
Italy	FII	Corp sh	taxable	taxable	not taxable	yes
		Ind sh	12.5%	12.5%	not taxable	yes
Luxembourg	REIF	Corp sh	30.38%	30.38%	30.38%	yes
		Ind sh	38%[5]	max 38%	N/A	yes
	SICAV/F	Corp sh	30.38%	30.38%	tax free	yes
		Ind sh	max. 38%[6]	N/A	max 38%	N/A
Netherlands	BI	Corp sh	taxable(31.5%)	taxable(31.5%)	not taxable	yes
		Ind sh	taxable(1.2%)	taxable(1.2%)	not taxable	yes
Spain	SII / FII	Corp sh	taxable(35%)	taxable(35%	tax free	yes
		Ind sh	taxable(15%-45%)	taxable(15%-45%))	tax free	yes

Austria
Corporate shareholder
Any income on participation in a domestic or foreign fund is considered business income, subject to Austrian corporate income tax (34% and 25% as from 2005). The domestic participation exemption does not apply. The international participation exemption, in the case of a foreign real estate fund, also does not apply. Under certain conditions, foreign real estate companies are discriminated against as compared to domestic real estate companies because the participation exemption is applicable to the latter. Furthermore, capital gains derived upon

5 Conditional 50% exemption may apply.

6 Conditional 50% exemption may apply.

alienation of the fund unit are treated as business income. Corporate domestic shareholders are entitled to credit the withholding tax. However, a withholding tax exemption will mostly apply.

Individual shareholder
The distributed profits are taxed at a flat rate of 25%. The income tax is levied by way of a withholding tax (25%) in the case of a domestic coupon paying agent or the annual income tax assessment (flat rate of 25%). Capital gains derived upon alienation of the fund unit are split up into deemed distribution and capital gain. The deemed distribution is also taxed at the flat rate (25%). The capital gain is taxable at a progressive rate (up to 50%), provided it has been realised within a holding period of one year. Capital gains are not taxable outside the holding period of one year.

For individual domestic shareholders, the withholding tax is final. It can be credited when the paid withholding tax exceeds the average income tax rate computed under progressive scale and claimed by the unit holder. In such case, the withholding tax is credited against the annual income tax liability.

Belgium
The tax treatment of a domestic corporate shareholder of a foreign fund depends on the specific characteristics of this fund.[7] If it concerns a foreign fund without legal personality, the corporate investor is deemed to have invested in real estate himself. On the basis of the applicable tax treaty, the non-Belgian real estate income will most likely be taxed in the country where the real estate is located and tax exempt in Belgium.

As concerns a foreign fund with legal personality, the corporate investor will not be deemed to have invested in real estate but in the fund itself. The income received from the fund will be taxed according to the rules of the dividend taxation. Dividends received are, generally speaking, fully taxable (33.99%). Under the Belgian participation exemption regime, dividends received are however 95% exempt, provided that, amongst others, the subject-to-tax requirement is met. This means that the application of the Belgian participation exemption regime is excluded if the dividend income is received from, amongst others:

a. a company that is not subject to a corporate income tax similar to the Belgian corporate income tax or that is resident in a country the normal tax regime of which is substantially more advantageous than the Belgian normal tax regime.[8] The normal tax regimes applicable to companies resident in an EU Member State are deemed not to be substantially more advantageous than the Belgian normal tax regime; or
b. a finance company, a treasury company or an investment company subject to a tax regime that deviates from the normal tax regime applicable in its country of residence.

On the basis of the general features of the real estate funds mentioned in this survey, it is unlikely that these funds will meet the subject-to-tax requirement. Consequently, the dividends received will most likely be taxable in the hands of the Belgian resident corporate investor.

The foreign withholding tax levied on dividends received from a non-Belgian real estate fund is a tax deductible item.

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[7] We do not elaborate further on 'hybrid funds', i.e., funds that have legal personality but that are treated as tax transparent.

[8] A tax regime is deemed to be substantially more advantageous if, generally speaking, the overall tax burden is lower than 15%.

Capital gains realised on the participation in a foreign fund without legal personality, will be considered capital gains on real estate. On the basis of the applicable tax treaty, the capital gain realised on non-Belgian real estate will most likely be taxed in the country where the real estate is located and tax exempt in Belgium.

Capital gains realised on the participation in a foreign fund with legal personality are tax exempt provided that the Belgian participation exemption regime is applicable to all dividends that the foreign fund may distribute. Since it is unlikely that this will be the case (see above), the capital gains will most likely be fully taxable (33.99%) in the hands of the Belgian corporate investor.

Individual shareholder
The 15% dividend withholding tax (if any) is the final levy. No tax credit for the withholding tax.

Capital gains realized on SICAFI shares are, in principle, not taxable unless the Tax Administration is able to demonstrate that the capital gain was not realized within the limits of normal management of (private) assets.

Under Belgian tax law, a return of capital is not taxable unless, upon public offering of the shares in Belgium, the SICAFI guarantees a certain repayment or rate of return for a period of 8 years or less to its investors. In that case the return is deemed to constitute an interest payment and is subject to a 15% withholding tax.

The tax treatment of a domestic individual shareholder of a foreign fund depends on the specific characteristics of this fund. When it concerns a foreign fund without legal personality, the individual investor will be deemed to have invested in real estate himself. Just as for corporate investors, the non-Belgian immovable income will, as a rule, most likely be taxed in the country where the real estate is located and tax exempt in Belgium on the basis of the applicable tax treaty.

As concerns a foreign fund with legal personality, the individual investor will not be deemed to have invested in real estate but in the fund itself. The income received from the fund will be taxed according to the rules of the dividend taxation. Consequently, the dividends will be taxable against a rate of 25/15%. If the dividends are received through a Belgian intermediary, the tax will be levied by way of withholding tax, which is the final levy. If the dividends are received directly from the non-Belgian real estate fund, they will need to be reported in the Belgian personal income tax return and will be taxed against a fixed rate of 25/15% (plus communal surcharges). The foreign withholding tax levied on the dividend income will be deductible from the Belgian taxable basis.

Capital gains realised on the participation in a foreign fund without legal personality, will be considered capital gains on real estate. On the basis of the applicable tax treaty, the capital gain realised on non-Belgian real estate will most likely be taxed in the country where the real estate is located and tax exempt in Belgium.

Capital gains realized on foreign real estate fund shares are, in principle, not taxable unless the Tax Administration is able to demonstrate that the capital gain was not realized within the limits of normal management of (private) assets.

France

Dividends received from a SIIC or a qualifying subsidiary are subject to a different tax treatment depending on whether or not they are paid out of exempt taxable profits and gains.

Corporate shareholder investing in a domestic SIIC

- Dividends paid out of the exempt profits and gains are subject to corporate income tax (33.33% increased to 35.43% by surcharges). They do not carry any '*Avoir fiscal* tax credit' since there is no underlying corporate income tax. The domestic Parent-Subsidiary exemption is also not applicable.
- Dividends paid out of taxable profits and gains will be exempted up to 95% of their amount if the Parent-Subsidiary provision is applicable. If this provision is not applicable the dividends will be fully taxable. Due to the ongoing reform of the French domestic mechanism to alleviate economic double taxation on dividend distributions, no *avoir fiscal* credit will be available with respect to dividend distributed from 2004 onwards.
- Capital gains realised on the sale of the SIIC shares are subject to corporate income tax at standard rate. A reduced rate (19%-20.2%) is applicable upon the disposal of a qualifying participation.
- Return of capital contribution is normally tax free.

Individual shareholder investing in a domestic SIIC

- Dividends paid, in 2004, out of the exempted profits and gains are subject to French income tax (top rate is 48.09%) and to additional social insurance contributions. They do not carry any *avoir fiscal* tax credit.
- Dividends paid in 2004 out of the taxable profits and gains are subject to French income tax (top rate is 48.09%) and to additional social insurance contributions. However dividends received until 31 December 2004 carry an *avoir fiscal* tax credit equal to 50% of the dividend received in cash.
- Dividends paid as from 2005 will be subject to income tax *de facto* for 50% only of their amount and will not carry any *avoir fiscal* tax credit. Such dividends will also benefit from a yearly allowance of € 1,220 (for single tax payers and tax payers subject to separate taxation) or € 2,440 (for couples subject to joint taxation) and give rise to a tax credit corresponding to 50% of the distributed dividends within the limit of € 115 (for single tax payers and tax payers subject to separate taxation) or of € 250 (for couples subject to joint taxation). The 11% social contributions will apply to the full amount received.
- Capital gains realised on the sale of the SIIC shares are only taxable at a flat rate of 16% (increased to 27% by social contributions) if the total sale proceeds exceed € 15,000.
- Return of capital contribution is normally tax free.

Individual shareholder investing in a foreign real estate fund

- Dividends received by French resident individuals from a foreign REIT are subject to French individual income tax and taxed according to a progressive scale system. In addition, such dividends are subject to social contributions at a rate of 10.3%.
- Dividends received as from 1 January 2005 should benefit from a 50% abatement and from a yearly allowance of € 1,220 (for single taxpayers or taxpayers subject to separate taxation) or € 2,440 (for couples subject to joint taxation) provided that the foreign REIT is an EU company or it is resident in a country which has concluded a double tax treaty with France for the avoidance of double taxation (note that dividends distributed as from 1 January 2009 by companies which are not EU companies would benefit from the above deduction and allowance provided that the double tax treaty concluded with France contains a mutual assistance clause).

- Dividends received as from 1 January 2005 should also give rise to a tax credit corresponding to 50% of the distributed dividends within the limit of € 115 (for single taxpayers or taxpayers subject to separate taxation) and € 230 (for couples subject to joint taxation).[9]
- Capital gains realised by French individual shareholders on the sale of shares in a foreign REIT are taxed at 16% as from the first euro of gain provided the global amount of the sale of securities which has taken place during the same calendar year exceeds € 15,000 as from 1 January 2003. In addition, such income is subject to social contributions at a rate of 10.3%.
- Capital losses may be set off against capital gains of the same nature during the same year or the ten following years for capital losses incurred as from 1 January 2002, provided the above-mentioned sale threshold has been exceeded during the year where the capital loss is incurred.
- The sums received by French individual shareholders as a result of a capital reduction or liquidation of the foreign REIT are subject to corporate income tax at progressive rates and to social contributions at a rate of 10.3% except for the portion of the sums which correspond with reimbursement of the initial contribution made by the shareholder or share premium. The sums received are deemed to be reimbursement of initial contribution or share premium provided that all the reserves and profits of the foreign REIT had been distributed.

  However, when the shares in the foreign REIT have been acquired from a third party at an acquisition price higher than the initial contribution, the taxable basis is limited to the difference between the sums received by the French resident individual and the acquisition price paid by him.

Corporate shareholder investing in a foreign real estate fund

- Dividends received by a French corporate shareholder subject to French corporate income tax are subject to corporate income tax at standard rate increased by surcharges (current global rate of 35.43%). However, they would be exempted up to 95% of their amount if the Parent-Subsidiary exemption applies (i.e. domestic SIIC are expressly excluded from the Parent-Subsidiary 95 % exemption; as foreign funds are not expressly excluded from the Parent-Subsidiary 95% exemption, there should be arguments to sustain that the Parent-Subsidiary 95% exemption is applicable with respect to investments in foreign funds. Under most treaties concluded by France, a French corporate shareholder would be entitled to credit the foreign withholding tax, if any, against the French income tax paid on the dividends.
- Capital gains are subject to corporate income tax at standard rate. A reduced rate (19%-20.2%) is applicable on the disposition of a qualifying participation.
- Return of capital contribution is normally tax free.
- Dividends received in 2004 are subject to individual income tax and taxed according to French income tax (top rate is 48.09%). In addition, such dividends are subject to social contributions at a rate of 11%.

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[9] According to France/US, France/Netherlands and France/Belgium double tax treaties, a French individual shareholder would be entitled to credit the foreign withholding tax against the French individual income tax paid on the dividends. The amount of the foreign tax credit which could be offset against the French individual income tax paid on the dividends should correspond with the amount of the foreign withholding tax and should not exceed the amount of the French income tax due on such dividends.

Germany

Corporate shareholder

If the IF fully complies with the reporting obligations, a tax exemption is applicable to the extent the earnings of the IF consist of:

- dividends received; an exemption for corporate and trade tax of 95% is applicable;
- capital gains earned on the alienation of shares; an exemption for corporate and trade tax of 95% is applicable;
- capital gains earned on foreign-source real property that is exempted under a tax treaty; an exemption for corporate and trade tax of 100% is applicable.

A Special IF does not have to comply with the reporting obligation in order to obtain these exemptions.

Capital gains deriving from the disposal of the interest in a domestic IF are fully taxable. However, the part of the capital gain which represents dividends earned by the IF is exempted for 95%, provided that the reporting obligation is complied with. A 100% exemption is granted for recognised and unrecognised capital gains relating to foreign real estate provided that an applicable tax treaty provides for such exemption. Any remaining part of the capital gain is subject to corporate and trade tax at a typical combined rate of 38% - 40%. Return of capital is only taxable to the extent that it exceeds the investment costs made by the investor.
Withholding tax levied by the (Special) IF is creditable at the level of the domestic investor. There will be a refund if the withheld tax exceeds the tax liability of the investor. If the domestic investor is a domestic (Special) IF, withholding tax levied by the subsidiary IF is refunded to the domestic parent IT.

A domestic corporate investor in a foreign REIT qualifying as real estate investment fund in the meaning of the Investment Tax Act is taxed in the same way as a domestic investor in a domestic IF. Accordingly, if the foreign REIT fully complies with the reporting obligations the domestic investor will obtain the same beneficial tax treatment that is obtainable by investing in a domestic real estate-Sondervermögen.

Individual shareholder

A tax exemption is applicable if the earnings consist of:

- dividends received; an exemption for income and trade tax for 50% is applicable;
- capital gains earned on the disposition of shares; an exemption for income and trade tax for 50% is applicable; a full exemption applies if the investor holds the interest in the fund as private asset;
- capital gains earned on foreign-source real property that is exempted under a tax treaty; an exemption for income and trade tax for 100% is applicable;
- capital gains achieved by the IF on the disposal of domestic real property that the IF has held for more than ten years is exempted from income tax, provided that the individual is holding the interest in the fund as a private asset.

Capital gains derived from the disposal of an interest in a domestic REIF are not taxable provided that the individual holds the interest as a private asset for more than 12 months. If the interest is not held for more than 12 months, the capital gain is fully taxable at progressive income tax rates ranging from 16% to 45%.

Capital gains deriving from the disposal of the interest in a domestic IF held as business assets-are fully taxable. However, the part of the capital gain which represents either dividends earned by the IF or recognised and unrecognised capital gains relating to shares in foreign corporations

is exempted for 50%, provided that the reporting obligation is complied with. A 100% exemption is granted for recognised and unrecognised capital gains relating to foreign real estate provided that an applicable tax treaty provides for tax exemption. Any remaining part of the capital gain is subject to income and trade tax at rates ranging from 16% to approx. 50%. Return of capital is only taxable to the extent that it exceeds the investment costs made by the investor.

Withholding tax levied by the (Special) IF is creditable at the level of the domestic investor. There will be a refund if the withheld tax exceeds the tax liability of the investor. A refund will not be given, however, if the taxes are withheld by a foreign fund.

A domestic individual investor in a foreign REIT qualifying as real estate investment fund in the meaning of the Investment Tax Act is taxed in the same way as a domestic investor in a domestic IF. Accordingly, if the foreign REIT fully complies with the reporting obligations the domestic investor will obtain the same beneficial tax treatment that is obtainable by investing in a domestic real estate-Sondervermögen.

Italy

The unit holders of FIIs are taxed only when a profit is distributed or when they dispose of their units.

Corporate shareholder

- Dividends distributed by the FII are subject to Italian corporate income tax (33%). The withheld tax represents an advance withholding tax so that the withheld tax is creditable against the corporate income tax liability of the recipient.
- Return of capital is not taxable in Italy.
- Capital gains are fully taxable at the ordinary rates.

Corporate unit holders in foreign real estate funds can credit taxes applied abroad, subject to a per-country limitation. Any excess foreign tax credit is not refunded by the Italian Treasury but can be carried forward or back. This does not apply if the participation in the foreign fund can be assimilated to a participation in the share capital of a foreign company. In that case, the dividend paid by the fund will be exempted up to 95% of its amount and the foreign tax credit will be reduced accordingly.

Individual shareholder

- Dividends distributed by the FII are subject to withholding tax (12.5%), which constitutes a final levy so that the withheld tax is not creditable against the individual income tax liability of the recipient.
- Return of capital is not taxable in Italy.
- Capital gains deriving from the alienation of the units are subject to a capital gains tax (12.5%).

Individual unit holders in foreign real estate fund would be, in the majority of cases, taxed by applying a 12.5 % substitute tax on the net amount paid by the foreign fund (e.g. on the amount after the withholding taxes applied abroad). The foreign withholding tax cannot be credited against the substitute tax applicable in Italy. Exceptions might apply if the unit holder is not a portfolio investor.

Luxembourg

Corporate shareholder

A corporate domestic shareholder is fully subject to tax (at a rate of 30.38%) on any income derived from a REIF. Therefore, dividends and capital gains are, in principle, fully subject to corporate income tax (30.38%). The return of capital should, in principle, not be taxable. Due to the fiscal transparency of an FCP a corporate domestic shareholder may be allowed to adopt a look through approach and consider the tax characteristics of the income produced by the underlying assets of the FCP. The tax characteristics of the underlying assets are thus relevant and the tax treatment may thus vary and result in a substantial or complete reduction of the income tax burden.

Individual shareholder

Dividends paid by an FCP are, in principle, taxed according to the underlying qualification of such income at source. Dividends distributed by a SICAV/F are fully subject to tax in the hands of the recipient (max. 38%). The alienation of shares in a SICAV/F is not subject to tax, provided that the resident shareholder does not hold a substantial participation (< 10%) and alienates such participation within the first 6 months.

Netherlands

Corporate shareholder – Dutch REIT

- A Dutch corporate investor in a BI cannot invoke the participation exemption on its investment in the BI. The return on the investment in the BI is, therefore, subject to Dutch corporate income tax (rate 31.5% for the year 2005).
- Capital gains realised by a corporate shareholder on the disposal of shares in a BI, are included in the taxable profit and, therefore, are subject to tax.
- Dutch corporate investors can credit the withheld taxes against their Dutch corporation tax liability, any excess is refundable.
- If a Dutch corporate shareholder has an interest of 25% or more in a BI, at the end of each tax year the interest in the BI has to be revalued to fair market value. The amount of revaluation is taxable income.

Corporate shareholder – Foreign REIT

- A Dutch corporate investor in a foreign REIT cannot invoke the participation exemption on its investment in the BI. The return on the investment in the BI is therefore subject to Dutch corporate income tax (rate 31.5% for the year 2005).
- Capital gains realised by a corporate shareholder on the disposal of shares in a foreign REIT are included in the taxable profit and, therefore, are subject to tax.
- If a Dutch corporate shareholder has an interest of 25% or more in a foreign REIT, at the end of each tax year the interest in the REIT has to be revalued to fair market value. The amount of revaluation is taxable income.

Individual shareholder

- The income tax treatment for a Dutch individual shareholder of his investment in a BI or a foreign real estate fund depends on the qualification of this investment for the investor. In most cases, however, the investment qualifies as an ordinary portfolio investment in which case, generally, income tax will be levied on a 'deemed income basis'. Rather than taxing the actual dividends received, the taxpayer is taxed on the basis of a deemed income, resulting in an effective income tax burden of 1.2 percent of the average value of the investment during the calendar year.
- Capital gains upon disposal of BI shares are deemed to be covered by this forfeited income tax (provided the capital gains are not considered 'income from work').

- Distributions by a Dutch BI give rise to 25% Dutch dividend withholding tax. The individual investor can credit this withholding tax against any personal income tax liability, any excess being refundable.

An individual Dutch taxpayer having a 'substantial interest' in a (quoted) BI or foreign fund is taxed on the basis of the 'substantial interest tax regime', which is outside the scope of this report.

Spain

Corporate shareholder

- Dividends are treated as normal business income.
- Capital gains are treated as normal business income.
- Return of capital; is not taxable because of an exemption provided for SIIs and FIIs.
- The withholding tax is a pre-payment on account of the final tax liability of the domestic corporate shareholders. The participation exemption is not applicable.

Individual shareholder

- Dividends distributed by an SII/FII are subject to personal income tax (15%-45%)
- Capital gains deriving from the sale of shares/units are subject to personal income tax (15%-45%). However, the share/unit holder can apply for a 'roll-over' relief. Provided that (i) the gross capital gains received are reinvested in assets of a similar nature; (ii) the seller did not have an interest in the SII/FII which exceeded 5% within the last year before the transfer; and (iii) The SII/FII has to have more than 500 share/unit holders. As a result of the roll over relief, no personal income tax will be levied.
- Return of capital is not taxable, because of an exemption provided for SIIs and FIIs.
- The withholding tax is a pre-payment on account of the final tax liability of resident individual shareholders.

Tax treatment of corporate/individual shareholders in foreign REIT

There are three different scenarios, depending upon the nature of the foreign real estate-fund:

1) Foreign funds which are similar to Spanish REITs (*i.e.*, they are not 'look-through' vehicles). Income or gains deriving from this type of foreign funds would be treated similarly to those deriving from Spanish funds.

2) Foreign funds which are 'look-through' vehicles.
   Spanish shareholders, whether entities or individuals, holding units in foreign institutions 'with an akin nature to Spanish entities taxed under the income attribution system' will be taxed under such 'income attribution system', i.e. like partners in a transparent partnership. Therefore, Spanish shareholders would be obliged to add to their taxable income the part of the income of the transparent foreign entity which corresponds with their participation, whether or not such income is effectively distributed.

   A major reform on the taxation of foreign 'look-through' entities entered into effect on 1 January 2003. The criteria for the classification of foreign entities as 'look-through' vehicles are very vague.

Contrary to other jurisdictions, there are no official lists of foreign 'look-through' entities and thus deciding whether income from a foreign vehicle should be taxed as such in Spain should be done on a case-by-case basis.[10]

3) Foreign funds resident in a 'tax-haven' territory.

Investments in a collective investment institution with a legal entity (i.e. those which are not taxed under the 'income attribution system') do not trigger any taxation for the participant until the participation is alienated or the institution makes distributions to its participants. To hinder investments in tax haven jurisdictions, however, under Spanish law, the Spanish participant must recognize the annual increase in the value of its investments as part of the year's taxable income, whether of not such income is distributed. Unless evidenced to the contrary, it is presumed that such revaluation equals 15% of the acquisition cost of the participation.

2.5.2. Foreign shareholder (assuming no treaty applies)

			Dividends	**Capital gains**	**Return of capital**	**Tax Credit**
Austria	IIF	Corp sh Ind sh	25% 25%	N/A N/A	not taxable not taxable	partially partially
Belgium	SICAFI	Corp sh Ind sh	not taxable not taxable	not taxable not taxable	not taxable in principle not taxable	N/A N/A
France	SIIC	Corp sh Ind sh	taxable (25%) taxable (25%)	taxable (27%) taxable (27%)	tax free tax free	N/A N/A
Germany	IF	Corp sh Ind sh	95% exempt or limited liability 50% exempt or limited liability	not taxable not taxable	not taxable not taxable	refund refund
Italy	FII	Corp sh Ind sh	12.5% 12.5%	12.5% 12.5%	not taxable not taxable	N/A N/A
Luxembourg	REIF	Corp sh Ind sh	exempt exempt	exempt exempt	exempt exempt	N/A[11] N/A[12]
Netherlands	BI	Corp sh Ind sh	wht (25%) is final wht (25%) is final	wht (25%) is final wht (25%) is final	not taxable not taxable	N/A N/A
Spain	SII / FII	Corp sh Ind sh	taxable(15%) taxable(15%)	taxable(15% taxable(15%)	not taxable not taxable	N/A N/A

[10] To date, there are no official rulings or guidelines on specific foreign funds the income of which should be taxed under the attribution rules. In our view, however the key criteria would be whether a given vehicle is treated as transparent by its State of domicile. In this event, it should very likely be treated as such also in Spain.

[11] Except if REIF is an FCP.

[12] Except if REIF is an FCP.

Austria

Corporate shareholder

Tax liability arises only in respect of domestic real estate, other profits are non-taxable. Distributed profits are subject to income tax, which is levied by way of a withholding tax (25%). Non-distributed profits are taxable by way of withholding.

Capital gains derived upon alienation of the fund unit are split up into deemed distribution and capital gain. The deemed distribution is also taxed at the flat rate (25%). The capital gain is taxable at the general corporate income tax rate (34% and 25% as from 2005).
There is no possibility to claim taxation at the general corporate income tax rate or to have refinancing and other related expenses deductible. Foreign corporate shareholders are not entitled to a credit for withholding tax.

Individual shareholder

Tax liability arises only in respect of Austrian domestic real estate. Other profits are non-taxable. Distributed profits are subject to income tax, which is levied by way of a withholding tax (25%). Non-distributed profits are taxable by way of withholding.
Capital gains derived upon alienation of the fund unit are split up into deemed distribution and capital gain. The deemed distribution is taxed at the flat rate (25%). The capital gain is taxable according to progressive rates.

Belgium

Corporate shareholder

- The 15% withholding tax on the dividends (if any) will constitute the final levy but tax treaty reduction may be available.
- In principle, no withholding tax is due on a return of capital by a SICAFI.
- Capital gains are in principle not taxable in Belgium.
- The Belgian dividend withholding tax constitutes a final levy; no tax credit possibility.

Individual shareholder

- The 15% withholding tax on the dividends (if any) will constitute the final levy but tax treaty reduction may be available.
- A return of capital is not taxable unless upon public offering of the shares in Belgium, the SICAFI guaranteed a certain repayment or rate of return for a period of 8 years or less to its investors. In that case, the return is deemed to constitute an interest payment and is subject to 15% withholding tax. This withholding tax may be reduced by virtue of a tax treaty.
- Capital gains are, in principle, not taxable in Belgium.
- The Belgian dividend withholding tax constitutes the final levy; no tax credit possibility.

France

Corporate shareholder

- Dividends; paid by a SIIC to a non French corporate shareholder are subject to a withholding tax of 25%, subject to tax treaties.
- Capital gains; realised on the sale of the SIIC shares are only taxable in France (16%) in the case of a substantial participation in the SIIC and subject to tax treaties.
- Return of capital contribution; is normally tax free.

Individual shareholder

- Dividends; paid by a SIIC to a non French corporate shareholder are subject to a withholding tax of 25%, subject to tax treaties.
- Capital gains; realised on the sale of the SIIC shares are only taxable in France (16%) in the case of a substantial participation in the SIIC and subject to tax treaties.
- Return of capital contribution; is normally tax free.

Germany

Corporate shareholder

A foreign corporate investor is only subject to German corporation tax to the extent that the distribution comprises either dividends received by the IF or certain interest earned by the IF. The tax is collected by way of a withholding tax (21.1% for underlying dividends; 31.65% for underlying interest). A double taxation treaty might reduce this withholding tax. The withholding tax constitutes a final levy. The rules for domestic corporate investors will apply for foreign corporate investors if the interest of the foreign corporate investor is attributable to a German permanent establishment.

A foreign corporate investor in a domestic IF is not subject to German capital gains tax with respect to a capital gain achieved upon the disposition of interests in a domestic IF nor is it liable for German tax on a return of capital. A foreign investor in a domestic Special IF is deemed to have earned the income and capital gains derived from domestic real property. This income is subject to German corporation tax (26.375%). Foreign investors who are entitled to claim benefits under a tax treaty between Germany and their country of residence may apply for a refund of withheld tax. Foreign investors in a Special IF are entitled to a tax credit for the withheld tax.

Individual shareholder

A foreign individual investor is only subject to German income tax to the extent that the distribution comprises either dividends received by the IF or certain interest earned by the IF. The tax is collected by way of a withholding tax. The rules for domestic individual investors will apply to foreign individual investors if the interest of the foreign individual investor is attributable to a German permanent establishment. A foreign individual investor in a domestic IF is not subject to German capital gains tax. Nor is a return of capital subject to German tax. An individual foreign investor with an indirect interest in a Special IF will be subject to German tax (15% - 42%) for the income of the fund derived from domestic real estate including capital gains.

Foreign investors who are entitled to claim benefits under a tax treaty between Germany and their country of residence may apply for a refund of withheld tax. Foreign investors in a Special IF are entitled to a tax credit for the withheld tax.

Italy

Corporate shareholder

- Dividends distributed by the FII are subject to a withholding tax (12.5%). This constitutes a final levy, unless the unit-holder is a corporate entity or the Italian permanent establishment of a foreign entity in which case the withheld tax is creditable against the corporate income tax liability. However, the dividends will be exempted if the resident's country is on the White list.
- Return of capital is not taxable in Italy.

- Capital gains are subject to a substitute tax (12.5%), unless (i) the units of the funds are traded on a regulated market or (ii) the unit holders are resident of a country that is on the White list.

Individual shareholder

- Dividends distributed by the FII are subject to a withholding tax (12.5%). This represents a final levy. The dividends will be exempted, however, if the resident's country is on the White list.
- Return of capital is not taxable in Italy.
- Capital gains are subject to a substitute tax (12.5%) unless (i) the units of the funds are traded on a regulated market; or (ii) the unit holders are resident of a country that is on the White list.

Luxembourg

Corporate shareholder

Capital gains realised on the sale of FCP units potentially trigger transfer real estate taxes and duties (if the real estate is held directly). The alienation of shares in a SIVAV/SICAF is not subject to tax provided the shareholder does not alienate a substantial interest within the first 6 months.

Individual shareholder

The alienation of shares in a SIVAV/SICAF is not subject to tax provided the shareholder does not hold a substantial participation and alienates such participation within the first 6 months.
In the case of alienation after 6 months or more, the alienation could be subject to tax in Luxembourg if the alienating shareholder has been a Luxembourg resident taxpayer for more than 15 years and has become a non-Luxembourg taxpayer less than 5 years before the alienation takes place.

Netherlands

Generally speaking, foreign investors should not be liable for Dutch income or corporate income tax with respect to an investment in a BI, except for Dutch dividend withholding tax withheld on (deemed) dividend distributions by the BI. A foreign investor holding a substantial interest in a Dutch BI (e.g. 5% - 25%) will be taxed for the actual received dividends (including capital reductions provided certain conditions are met). A foreign investor holding an interest below 5% will be taxed for the deemed dividend distribution.

Spain

Corporate shareholder

- Dividends distributed by the SII/FII are subject to a withholding tax (15%). This could be reduced under tax treaties.
- Capital gains deriving from the sale of shares/units are taxable (15% of 35%) in Spain and subject to tax treaties. However, an exemption is applicable to non-residents who are resident in a country which has a double-tax treaty and an exchange of information clause with Spain, provided that the SII is listed on a Spanish official market and that the FII daily publishes its net assets value in the gazette of a Spanish stock market.
- Dividend withholding tax is not refundable.

Individual shareholder

- Dividends distributed by the SII/FII are subject to a withholding tax (15%). This could be reduced under tax treaties.
- Capital gains deriving from the sale of shares/units are taxable (15%) in Spain and subject to tax treaties. An exemption is applicable, however, to residents who live in a country which has a double-tax treaty and an exchange of information clause with Spain, provided that the SII is listed on a Spanish official market and that the FII daily publishes its net assets value in the gazette of a Spanish stock market.
- Dividend withholding tax is not refundable.

3 The impact of the EC Treaty Freedoms on REIT regimes

3.1. Introduction

To date, in the field of taxation of European REIT and REIT-like regimes, little attention has been focused on the potential incompatibilities of these regimes with Community law. On the basis of the descriptions of the various REIT and REIT-like regimes in the preceding chapter, this chapter of the report contains an inventory of the potentially discriminatory or distorting elements of REIT and REIT-like regimes (section 3.3). First, as a basis for this inventory, a brief summary is given of the basic framework of the application by the ECJ of the EC Treaty freedoms to direct taxation matters (section 3.2).

3.2. The EC Treaty freedoms: negative integration

The comparison made in chapter 2 clearly demonstrates that the tax (and regulatory) treatment of REITs in the various Member States is far from being harmonized. The main reason for this lack of uniformity is the current status of European Community law. At present, direct taxes do not fall within the jurisdiction of the Community. The Court of Justice of the European Communities (hereinafter: ECJ) has stated that in the absence of unifying or harmonizing measures adopted in the Community in the area of direct taxes, the Member States are 'at liberty […] to determine the connecting factors for the purpose of allocating powers of taxation (…) between themselves'.[13]

The sovereignty of the Member States concerning their direct taxes, however, is not unlimited. The ECJ has reiterated in many cases that the Member States must exercise their taxation powers consistently with Community law.[14] The most important elements of Community law that must be observed by Member States in exercising their national sovereignty are the six fundamental freedoms, which are contained in the EC Treaty:

- the free movement of citizens of the Union;
- the free movement of goods;
- the free movement of persons;
- the free movement of services;
- the free movement of capital;
- the free movement of payments.

These freedoms are aimed at securing the creation of a common market within the European Union and thus require the abolition among Member States of obstacles and distortions that could hinder this common market. The EC Treaty freedoms are directly binding on Member States, have direct effect (they can be relied on directly before national courts) and prevail over incompatible domestic law.

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[13] See case C-307/97, Saint Gobain, [1999] ECR I-6161, para. 56 and case C-336/96, Gilly [1998] ECR I-2793, para. 24.

[14] See, for instance, case C-279/93, Finanzamt Koln-Altstadt v Roland Schumacker, [1995] ECR-I 225 and case C-264-96, ICI, [1998] ECR I-4695.

From the above, it appears that even though direct taxation remains the prerogative of Members States their national sovereignty is seriously restricted by the Treaty freedoms.[15] In exercising their direct taxation powers, Member States may not discriminate directly or indirectly on the basis of nationality and may not impose distinctions or restrictions that could be seen as an infringement of the above-mentioned freedoms.

A growing number of ECJ decisions have considered national direct tax measures to be incompatible with Community law. Member States are being forced by this case law to remove discriminatory and restrictive direct tax provisions. This on-going development, also referred to as 'negative integration', has a clear and substantial harmonizing influence on the direct taxation regimes of the various Member States. In the field of corporate taxation, one example of an ECJ case that has had a substantial impact on the Member States' corporate direct taxation regimes is the *Lankhorst-Hohorst GmbH* case[16], where the Court concluded that the German thin cap restrictions amounted to a covert discrimination of cross-border group financings. This decision is believed to have had a major influence on the thin cap legislation of many Member States.

Tax regulations discriminating directly or indirectly against nationality or restricting free movement within the European Community are prohibited if the Member State involved is not able to show an objective and relevant factual difference between domestic and cross-border situations, or to put forward an overriding reason of public interest. In this context, nationality as a connecting factor for imposing tax is suspect.[17] Making a link to place of residence and establishment may also be prohibited, given that this results in indirect discrimination against nationality. On the other hand, fiscal connecting factors that discriminate on the basis of the principle of territoriality (the principle of origin[18]) are, according to *Futura Participation*[19], above suspicion.

Notwithstanding the above, in the area of direct taxes, the ECJ has accepted a distinction between resident and non-resident taxpayers as long as the distinction in levying tax is based upon an objective distinction in situation.[20] With regard to the free movement of capital, Art. 58 (1)(a) EC Treaty explicitly provides that the Member States may distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to where their capital is invested. In the *Verkooijen* case[21] and the *Lenz* case[22], the Court explains this Treaty provision in keeping with the above case law, which means that regarding the free

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15 See: Ben J.M. Terra, Peter J. Wattel, European Tax Law, 2005, Fed Fiscale studieserie nr. 29, Kluwer Deventer.

16 Case C-324/00, Lankhorst-Hohorst GmbH, [2002] ECR I-11779.

17 See Art. 12 EC: "Within the scope of application of this Treaty, and without prejudice to any special provision contained therein, any discrimination on grounds of nationality shall be prohibited". See case C-221/89, Factortame II [1991] ECR I- 3905 and see also case C-336/96, Gilly, in which the European Court allowed a nationality criterion to be included in a bilateral treaty (which can be compared to the nationality criterion as included in Art. 19 of the OECD Model Convention). In our opinion, this decision has to be regarded as an exception because, among other things, the nationality criterion as included in Art. 19 OECD Model Convention can be justified under the Vienna Convention of 18 April 1961 on Diplomatic Relations and the Vienna Convention of 24 April 1961 on Consular Relations.

18 See E.C.C.M. Kemmeren, Principle of origin in tax conventions- a rethinking of models, 2003, EUCOTAX Series on European Taxation 8, Kluwer Law International.

19 Case C-250/95, Futura Participations and Singer, [1997] ECR I-2471.

20 For individuals, see case C-279/93, Schumacker, for companies, case C-311/97, Royal Bank of Scotland, [1999] ECR I-2651 para. 27.

21 Case C-35/98, Verkooijen, [2000] ECR I-4071.

22 ECJ 15 July 2004, case C-315/02, Lenz, not yet published, paras. 26 and 27.

movement of capital, the Member States are allowed to enforce their tax legislation that draws a distinction between taxpayers who are not in the same situation regarding their place of residence or the place where their capital has been invested in so far as this applies to situations that cannot be compared objectively.

Not only are the above-described measures of distinction that are harmful to free movement prohibited (the discrimination prohibition), but it has become clear from the case law that measures which are applicable *without* distinction may also constitute an infringement of the freedom of movement[23] (the restriction prohibition). Measures that fall under the *restriction prohibition* are regulations that apply without distinction but which make the cross-border exercise of freedom of movement less attractive, although they also apply, under similar conditions, to domestic situations.

3.3. Discrimination/restrictions of free movement in REIT regimes

3.3.1. Introduction

The limitations to the direct taxation powers of Member States, as described under section 3.2. here above, also apply in the field of the taxation of REITs and their shareholders. The comparative analysis made in section 2 of the REIT and REIT-like regimes in several Member States shows that domestic situations are often treated differently to cross-border situations. When examining the REIT and REIT-like regimes of the Member States, we see various types of direct and indirect discrimination against nationality, and restrictions of free movement that seem incompatible with Community law. Below, we provide an overview of the major discriminations and restrictions under Community law based on the comparative analysis of the various REIT regimes in the EU Member States described in section 2 above. In making this analysis, a distinction can be drawn between discriminatory and restrictive measures in relation to:

(a) the conditions imposed on a company to be eligible for a treatment as a REIT; and
(b) the tax regime/treatment applicable to the REIT itself or to shareholders of a REIT.

With respect to the latter category (tax treatment of shareholders of REITs), this report dwells particularly on the combination of REIT regimes and a differential withholding tax treatment between domestic and foreign shareholders. Many Member States try to secure their right to tax the income from domestic property by imposing measures that should prevent foreign shareholders from benefiting from the same (withholding) tax exemption and/or reductions granted to (certain) local resident tax payers. This important subject is dealt with in section 4.

3.3.2. Discrimination/restrictions relating to REIT regime conditions

3.3.2a. Legal form requirements

In most Member States (Belgium, Italy, Luxembourg, the Netherlands and Spain) the REIT, and in Austria, Germany and Luxembourg the management company, must be incorporated under domestic law. This means, for instance for Spain, that companies which are formed under foreign law but which are comparable with companies formed under Spanish law are excluded from the Spanish REIT regime. This requirement is a direct discrimination against nationality

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[23] Case C-55/94, Gebhard, [1995] ECR I-4165, para. 37.

that is forbidden under the EC Treaty Freedoms (especially under Art. 12 EC Treaty). See under b. below for the French SIIC regime, which does not impose a legal form of requirement.

3.3.2b. Residence requirement

Another example of incompatibility with EU law is the following requirement. In the Netherlands, Belgium and Spain, the REIT is required to be a resident. A non-resident company with property investments in these Member States is, therefore, not eligible for the REIT regime.

Making a distinction between a resident and a non-resident is indirect discrimination against nationality. See, for instance, the *Avoir fiscal* case[24] and the *Commerzbank* case.[25] Only when there is an objective difference between resident and non-resident REITs is there no discrimination. To date, the Court has not accepted such an objective difference.

The French SIIC regime does not impose a residence condition (or the condition that a French legal form must be used). The French tax administration has already accepted that foreign companies are eligible for the SIIC regime in respect of their French property portfolio, provided the other conditions for the application of the SIIC regime are met.

3.3.2c. Shareholder requirements

The Dutch REIT regime imposes several complicated shareholder requirements. The first is that the shares in the REIT are not permitted to be ultimately held – directly or indirectly – for 25% or more by Netherlands-resident entities through the interposition of non-resident entities. The second is that shares in the REIT are not permitted to be directly held for 25% or more by one non-resident taxpayer. These shareholder requirements are suspect in light of the *Metallgesellschaft and Hoechst* case.[26] In this case, the ECJ ruled that shareholder requirements that differentiate between resident and non-resident shareholders are not in line with the freedom of establishment. In March 2005, the Dutch Under-Minister of Finance announced that he anticipated changing the shareholder requirements.[27]

3.3.2d. Listing requirements

In Belgium and France, the company must be listed on a domestic stock exchange in order to become eligible for the REIT regime. A company that is a Belgian or French resident but which is listed on a foreign stock exchange will, therefore, not be able to qualify as a REIT.

This requirement results, just like the above-mentioned distinction between resident en non-resident companies, in indirect discrimination on the basis of nationality. See in this regard, Advocate General Alber's Opinion on the *Royal Bank of Scotland* case[28], in which he remarks that the requirement of quotation on a domestic stock market is discrimination on the basis of nationality, because 'quotation on any stock market within the Community ought to be sufficient'.

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24 Case 270/83, Commission v. France, 1986 [ECR] 273.

25 Case C-330/91, Commerzbank. In this case a company established under German law with its seat in Germany (Commerzbank), had a branch in the United Kingdom. Commerzbank was refused interest on a tax refund by the United Kingdom because Commerzbank did not have its tax residence in the United Kingdom. The Court held that here there could be said to be indirect discrimination on the grounds of nationality. A distinction on the grounds of the criterion of tax residence, although it is applicable regardless of the seat of companies, will generally be disadvantageous for those companies in particular that have their seat in another Member State. These are, after all, mostly the companies that have their tax residence outside the territory of the Member State in question.

26 Joined cases C-397/98 and C-410/98, Metallgesellschaft and Hoechst case, 2001 [ECR] I-1727.

27 See the letter to the Chairman of the second chamber of Dutch Parliament dated 23 April 2005, no. FM 2005 – 00317 U; WWW.minfin.nl

28 Case C-311/97, Royal Bank of Scotland, Opinion, point 42.

This position was confirmed by the ECJ in case C-219/03, *Commission vs. Spain*[29], in which case it was decided that a Spanish capital gains tax which is less favourable to shares quoted on a foreign stock exchange as opposed to shares quoted on a Spanish exchange is not in line with the free movement of services and capital.
The Netherlands REIT regime provides for more lenient shareholder conditions where the REIT is quoted on the Amsterdam stock exchange (as opposed to other EU stock exchanges). This restriction to a quotation on the *Amsterdam* stock exchange is obviously also a violation of the free movement of capital.

3.3.2e. Asset level/activity test

Under Austrian legislation, a resident REIT may not invest more than 20% of its assets in real estate located outside the European Union or the European Economic Area. This rule forms a restriction of the free movement of capital with third states (on the free movement of capital with third states, see the pending *Van Hilten* case[30], *Lastertec* case[31], the *A* case[32] and the *A&B* case[33]).

3.3.3. EU incompatibilities relating to the tax treatment of REITs

3.3.3a. Tax treatment at the REIT level

As discussed in section 2.3, most REIT regimes provide either for an (effective) exemption from tax of REITs or qualifying REIT income. The application of these exemptions should not give rise to discrimination or restrictions under EU law.

In this respect, it should be noted that Austria grants an exemption from corporate income tax in relation to rental income from foreign sources and revaluations of real estate located in a foreign country provided a tax treaty is applicable. However, in a non-treaty case, an exemption applies only if the effective tax burden is at least 15% in the country where the real estate is located. Absent such a minimum effective tax rate, the Austrian REIT receiving the foreign real estate income is only entitled to a credit of the foreign income tax, if any. This system discriminates against foreign real estate in a non-treaty case compared to domestic cases. There is no justification for this discrimination. Austria has concluded tax treaties with almost all of the Member States;[34] therefore, this situation could occur in relation to third countries, constituting a restriction of the free movement of capital.[35] Considering the Opinion of the Advocate General Kokott in the *Manninen* case[36] and the position of the European Commission in the *Lenz* case[37], it appears defensible that the foreign level of taxation may be invoked as a general reason of public interest within the meaning of Art. 58 EC Treaty.

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[29] See ECJ, 9 December 2004, case 219/03, not yet published.

[30] Case C-513/03, Van Hilten, OJ C 85, 03.04.2004, p.12.

[31] Case C-492/04, Lasertec, OJ 31, 05.02.2005, p. 11.

[32] Case C-101/05, Skatteverket and A, OJ C 106, 30.4.2005, p. 10.

[33] Case C-102/05, Skatteverket and A and B, OJ C 106, 30.4.2005, p. 10.

[34] There is no tax treaty with Latvia and Lithuania, but negotiations are currently pending.

[35] Please note that the grandfathering provision of Art. 57 EC Treaty may not be invoked (i.e. the rule did not exist on 31 December 1993).

[36] Opinion of 18 March 2004, C-319/02.

[37] Case C-315/02, see the Report of the hearing.

In the Netherlands, a REIT is entitled to a cash payment in connection with foreign withholding tax imposed on income received by the REIT. As the REIT is not able to credit the foreign withholding tax and such withholding tax cannot be used by the REITs shareholders upon re-distribution of the foreign-source income to its shareholders, the REIT is entitled to a cash payment in lieu of a tax credit. Such a payment is only available to the pro rata part of the foreign withholding tax that relates to the percentage of Dutch-resident taxable shareholders of the REIT. That is to say, no payment is made if the REIT shares are owned by non-resident shareholders or Dutch shareholders that are not subject to tax (such as pension funds). This restriction to the pro rata part relating to the Dutch-resident taxable shareholders is suspect. In the *Metallgesellschaft and Hoechst* case[38], the ECJ held that shareholder requirements which differentiate between resident and non-resident shareholders are not in line with the freedom of establishment. The Appeal Court of Amsterdam has already ruled that the said limitation of the payment in lieu of a tax credit to the proportionate part allocable to Dutch resident (taxable) shareholders is not in line with Community law. This case is now pending before the Netherlands Supreme Court.

Recently, Peter Wattel, the Advocate General to the Supreme Court rendered his conclusion in this case.[39] Wattel takes a different approach than the Amsterdam Appeal Court. According to Wattel, the *Manninen* case[40], as well as the *Verkooijen* (C-35/98), *Commission versus France* (C-334/02), *Weidert-Paulus* (C-242/03) and *Lenz* (C-315/02) cases of the ECJ lead to the conclusion that the free movement of capital principle does not, in principle, permit a less favourable treatment of income from capital located in another Member State as compared to income from domestic capital. Hence, a Dutch REIT should also be entitled to claim a refund of foreign withholding tax on dividends it received, as it is also entitled to claim the refund of Dutch withholding tax on Dutch source dividends under Dutch domestic tax laws. Wattel is of the view that this entitlement to a refund of foreign withholding tax is limited by the amount of tax that the Netherlands are entitled to levy on such foreign source dividends received by a Dutch REIT. His view is based on an interpretation of the ECJ's judgement in *Gilly.*[41] As the REIT itself is not subject to corporate income tax, Wattel links this limitation to the Dutch (withholding) tax imposed on a re-distribution of the foreign source dividend by the REIT.

3.3.3b. Income tax treatment of REIT shareholders

Various countries differentiate the income tax treatment of shareholders in REITs depending on the features of the REIT regime of the underlying company.

- Under Spanish legislation, non-resident shareholders only obtain an exemption for capital gains tax in the case of a sale of shares/units when the REIT is listed on a Spanish official market and when there is a tax treaty with an exchange of information clause. Such rules not only constitute indirect discrimination on the basis of nationality, they are also a restriction of the free movement of capital.
- The Austrian regulations draw a distinction between foreign REITs categorized as 'white funds' (having an Austrian tax representative) and 'black funds' (where there is no Austrian tax representative). In both cases there is discrimination when compared with

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38 Joined cases, C-397/98 and C-410/98, Metallgesellschaft and Hoechst case, [2001] ECR I-1727.

39 Date of conclusion 3 May 2005, LJN: AT7672, not yet published.

40 (Case C C-319/02). In the Manninen case, the ECJ ruled that a Finnish resident should obtain the same credit for underlying corporate income tax, irrespective of whether the dividend is coming from Finnish source or from a source in another (Member) State.

41 See (Case C-336/96) Gilly [1998] ECR I-2793 para.24.

domestic REITs. Austrian shareholders in a foreign white fund are discriminated against because there is no relief from double taxation available at the time of distribution. An Austrian resident investor in a foreign black real estate fund is taxed on a lump-sum basis. The Austrian Supreme Administrative Court recently observed that the lump-sum method in determining the taxable profit (i.e. black funds) may be in conflict with the free movement of capital. Furthermore, the Constitutional Court has initiated an examination procedure and has observed that the tax treatment of black funds may be unconstitutional. Both proceedings deal with the rules for regular foreign investment funds, which include REITs.

3.3.3c. Specific withholding tax treatment of REITs

Some countries also differentiate in the withholding tax treatment of dividends distributed by REITs:

- The Belgian REIT regime provides for an exemption from withholding tax on distributions made by a Belgian REIT under the condition that such a REIT invests more than 60% of its assets in real estate located in Belgium. Without doubt, such a rule restricts the free movement of capital. For recent examples, see the *Weidert* case[42] and the *Lenz* case[43] in which there was also a restriction of the free movement of capital because domestic investments were treated more favorably than cross-border investments.
- The Italian REIT regime provides for a specific withholding tax exemption for REITs. Dividends distributed by REITs will be exempt if the receiving shareholders are resident in a country that is mentioned on the 'white list'.[44] Because of this white list requirement, the Italian legislation implicitly differentiates between shareholders in different Member States or third states. The issue is whether a difference *between* Member States is allowed under the EC Treaty freedoms. There is no clear answer to this question.

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[42] ECJ 15 July 2004, case C-242/03, Wiedert, not yet published.

[43] ECJ 15 July 2004, case C-315/02, Lenz, not yet published.

[44] A country is on the white list if it allows exchange of information with the Italian tax authorities.

4 REIT regimes and taxation of non-residents

4.1. Introduction

Above, we looked at the potential discriminations and restrictions included in the specific REIT tax regimes and the specific tax treatment of REIT shareholders. It becomes increasingly clear that the general withholding tax regimes of various Member States, which often differentiate between domestic and cross-border dividend distributions, are a key issue in the discussion about the EU law compatibility of European REIT regimes. These differential treatments are often motivated by the wish to safeguard that a proper level of tax is levied from foreign shareholders on the distribution of dividends by domestic companies. This is all the more important in the case of REITs, as the tax exempt (‘flow-through’) model is moving the point of taxation from the REIT to the shareholder. If the shareholder is a foreign resident and is entitled to a reduction or even an exemption from withholding tax, the domestic property income of the REIT could flow to the foreign shareholder at a very low or zero tax rate. The idea of the *situs* state (state where the property is located) not being able to levy tax on income from domestic properties is simply inconceivable in the minds of any taxing authority.

The legislation in the existing REIT jurisdictions often provides for measures to avoid that foreign shareholders (of REITs) can benefit from a reduction or exemption from withholding tax under domestic law or pursuant to tax treaties. Exemptions/refund claims available to domestic persons (e.g., pension funds) are simply not available to foreign shareholders, or certain requirements (e.g., shareholders’ conditions) make it impossible for foreign shareholders to benefit from a low rate of withholding tax provided for in the prevailing tax treaty between the REIT State and the state of residence of such shareholder (see section *3.3.2.c.* above). In respect of many of these “protective” tax measures, there is a serious risk that a different withholding tax treatment of foreign REIT shareholders is incompatible with current EU law.

A second problem is the taxation of foreign REITs. The Dutch and Belgian REIT regimes do not extent the benefits of these regimes to foreign vehicles owning directly domestic (Dutch and Belgian, respectively) properties, and which satisfy the conditions to be eligible for the REIT regime (apart from the residency and legal form conditions). As discussed above in section *3.3.2.*, there is a serious risk that such limitation of the REIT regime to domestic REITs is incompatible with Community law.

It is interesting to note that the Member States which are considering the introduction of a REIT regime (notably the UK and Germany) are struggling with the subject of the taxation of non-residents. These Member States seem to be very much aware of the problems they are facing to secure that a sufficient level of tax is safeguarded in respect of local property income distributed by a REIT to foreign shareholders, or earned by a foreign REIT.

4.2 EU law, the future of withholding tax

On the basis of the *Lenz* case and, more in particular, the recent *Fokus Bank* decision rendered by the EFTA Court[45], it is very likely that the majority of differences in withholding tax treatments between domestic and cross-border distributions constitute a restriction of the free movement of capital:

- The most obvious differential treatment of domestic and cross-border distributions can be found in France. Dividends paid by a REIT to a non-resident shareholder are subject to dividend withholding tax[46], whereas there is an exemption if the dividends are paid to a resident shareholder.
- In the Netherlands, certain categories of domestic taxpayer are entitled to an exemption from withholding tax, whereas foreign shareholders are not. More generally, all domestic taxpayers that are not entitled to an exemption may credit the withholding tax. Foreign shareholders are not entitled to such tax credit (with the exception of 'substantial interest holders').
- Most other Member States with a REIT or REIT-like regime do not grant the same exemptions or tax credits to foreign shareholders that are granted to domestic shareholders.

The French Conseil d'Etat recently referred a request for a preliminary ruling to the ECJ in the proceedings between Société Denkavit International BV and Denkavit France Sarl and the French Ministry of Finance.[47] The referred questions concern the admissibility of the French withholding tax system, where no withholding tax is levied on distributions to domestic shareholders, whereas distributions to foreign shareholders are always subject to withholding tax under the French domestic laws.

If it is indeed confirmed by the ECJ that these withholding tax regimes are incompatible with the freedom of movement, many Member States may be in a situation where income earned by local REITs can flow to shareholders resident in other Member States free of any tax: the REIT regime will provide for an exemption from tax at the REIT level and, at the same time, Community Law prohibits the effective imposition of withholding tax on cross-border distributions of dividends by REITs.

4.3. New future REIT regimes: UK, Germany and the Netherlands

Under the pressure of local interest groups and in view of the success of the 2003 introduction of a REIT regime in France, the UK and Germany are now seriously considering the introduction of REIT regimes.[48] In both countries, the authorities are well aware of the following dilemma: how can a REIT regime be introduced on the basis of the tax-exempt (flow through) model,

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45 See OJ 2005, L 46, p. 2, 2005/C40/07.

46 There is only an exemption when the Parent-Subsidiary Directive is applicable.

47 Date 15 December 2004, Case C-170/05.

48 Reference is made to, inter alia, the UK consultation paper alongside the Budget 2004 and the March 2005 discussion paper entitled 'UK Real Estate Investment Trusts: a discussion paper', both papers are available on the Treasury's internet site: WWW.hm-treasury.gov.uk; For Germany, consult the report 'Real Estate Investment Trust, Internationale Erfahrungen und Best Practice für Deutschland', by the Centre for European Economic Research and the European Business School; WWW.zew.de\REITS and WWW.EBS.de.

while at the same time the risk should be avoided that the right to impose tax on domestic real estate income is forfeited in connection with distributions made to foreign shareholders.

The UK Government seems to be aware that it has no choice other than to make the UK-REIT regime compatible with Community Law. The March 2005 Discussion Paper issued by the UK Government sets out that the '[…] UK-REIT regime must be consistent with obligations under its network of Double Taxation Agreements (DTAs), and under European Law. To this end, the Government envisages a regime whereby a company resident outside the UK could have broadly equivalent tax treatment on its property investment activities, provided it met the appropriate requirements applied to UK resident companies. Restricting the regime to only UK resident companies is unlikely to be compatible with the UK's international treaty obligations'.[49]

The paper goes on by stating that the objective of a REIT regime is to achieve a closer alignment between the taxation of direct and indirect property investments, which is achieved in most REIT jurisdictions by moving the point of taxation from the company to the investor. Any income distributed by a REIT to non-residents, however, would, in principle, be treated as ordinary company dividends. According to the paper, it may be difficult to tax such dividend at the appropriate level (or to tax these dividends at all in the case of a non-UK resident REIT owning UK properties). The UK Government fears that it cannot, in general, impose a higher effective tax on distributions to foreign shareholders than 15%, which is generally the reduced treaty rate applicable to dividends. Moreover, the Government does not see how it can tax distributions made by non-UK resident REITs that invest in UK properties.

In this respect the paper states that it is difficult '[…..] to design a UK-REIT structure that taxes non-UK residents investing indirectly in UK property in broadly the same way as if they were to invest directly. Putting in place a regime that complies with international obligations but fails to collect any UK tax from non-resident investors holding UK property (at either the vehicle or investor level) is likely to have a significant impact on the Exchequer and may lead to unintended and undesirable behavioural effects. Furthermore, it breaches the UK's right to maintain a fair proportion of tax on UK land and property from all types of investors.'[50]

In Germany, the *Zentrum für Europäische Wirstschaftsforschung* (Centre for European Economic Research), published an extensive study called, 'Real Estate Investment Trusts: Internationale Erfahrungen und Best Practise für Deutschland'.[51] The report notes that the introduction of a REIT regime bears the risk that German REITs will be used by foreign shareholders to receive German property income free of any German tax. This is because foreign shareholders could use the EU Parent – Subsidiary Directive or the zero rates of withholding tax that are granted by Germany under certain tax treaties concluded by Germany with other States. The study does not really elaborate on the impact of the EU case law that would disallow Germany to put up a withholding tax 'ring fence' around Germany, if this should result in a differential treatment of foreign (EU resident) shareholders.

Recently, the Dutch Under Secretary of Finance announced that the Netherlands is considering the introduction of a REIT-like regime that would be very similar to the Luxembourg SICAV regime. For the time being, it is not known if this new Dutch regime (also referred to as the

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[49] UK Real Estate Investment Trusts: a discussion paper, HM Treasury and Inland Revenue Service, page 12, paragraph 4.4., www.hm-treasury.gov.uk

[50] Infra, footnote 49, page 13, paragraph 4.7.

[51] See www.zew.de\REITS or www.ebs.de

‘luxury variation’) will be open for investment in (Dutch) property. We believe that, if the ‘luxury variation’ is to be introduced soon, it will exclude real estate from the permitted investment scope, to avoid the risk that non-residents can receive Dutch property income free of Dutch tax.

It is remarkable to see that the French SIIC regime was introduced in 2003 with little regard being paid to the tax position of foreign shareholders and the impact of EU law. Today, several non-French quoted REITs are benefiting from the SIIC regime in connection with their portfolios of French properties. Property income of the French subsidiaries, benefiting from the SIIC regime are flowing to the foreign EU parent companies/REITs, free of any French tax, as the French tax authorities have accepted opening up the SIIC regime to foreign companies that meet the conditions for the SIIC status. Moreover, as explained above, it is most likely that France cannot impose withholding tax on dividends distributed by a French resident SIIC, as France does not impose a withholding tax on domestic dividends.[52]

4.4. Dilemma: restrictions of the freedom movement have to be abolished, but how?

From the discussion above of whether certain aspects of the REIT regimes currently applicable in the various EU Member States infringe the Treaty freedoms it can be surmised that these regimes should be adapted. If the adaptations are not implemented shortly, various Member States risk loosing the right to impose withholding tax on certain distributions to foreign shareholders and possibly also corporate income tax on property income realised by foreign REITs. Moreover, the Member States considering introducing a new REIT regime are struggling with the question of how to introduce a regime that will allow them to levy tax on distributions of property income to foreign shareholders without introducing incompatibilities with EU law or treaty obligations, which would risk making the right to levy tax obsolete.

Furthermore, as explained above, Member States also run the risk of non-resident REITs potentially being able to take advantage of the REIT regime in the country where the property is located.[53]

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[52] See sections 2.5.1., 2.5.2. and 4.2. of this report.

[53] Infra footnote 49, page 12; we assume that ‘international treaty obligations’ is meant to include obligations pursuant to the EC Treaty.

4.5. Potential solutions

4.5.1. Introduction

The above demonstrates that the ideal REIT regime would meet the following three requirements as far as it concerns the taxation of foreign shareholders:

I the regime is 'EU proof';

II it enables a Member State to respect its obligations under the existing tax treaties;

III it allows a Member State to impose tax on foreign shareholders at a reasonable level ("fair tax share").

4.5.2. Discussions in the UK and Germany

In the UK and Germany, certain solutions have been proposed to deal with the taxation of non-residents.

The UK government is seeking the industry's view in relation to the taxation of foreign shareholders of a REIT that would enable the vehicle to be exempt, while also meeting the above-mentioned objectives (in particular the objective of receiving a fair tax share). In the Discussion Paper[54], the UK Government indicates that it is prepared to consider taxation at company level, rather than at shareholder level.

According to our information, a working group set up by the Treasury, is also considering the various alternatives[55], whereby it is recognised that a withholding tax which is refundable to certain categories of UK investors, may be considered as a distortion of the free movement of capital. Levying tax from the company would mean that also tax exempt investors are faced with a tax burden on the property income and goes against the very nature of a REIT regime. Making such company tax refundable for certain UK based shareholders would, again, raise EU concerns.

Another alternative the Treasury working group is investigation is a relatively complicated hybrid structure whereby shareholders in a REIT are also given direct rights to the underlying property income so that tax can be levied directly on property income earned by foreign investors without the constraints which arise on the payment of dividends.

The report of the German Centre for European Economic Research[56], discusses various ways to avoid there not being an appropriate level of taxation due to the application of tax treaties:

- making the REIT an exempt company which would not be a resident for tax treaties;
- introducing a limit to the maximum shareholder's percentage that one shareholder could own in a domestic REIT;
- re-qualifying the REIT distributions as property income.

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[54] Infra, footnote 49.

[55] Steven Edge of Slaughter & May London was so kind to inform us of the current thinking in the working group.

[56] Infra, footnote 51, See pages 154 and 155.

On 18 May 2005, the German association *Initiative Finanzstandort Deutschland* ("IFD") issued a paper[57] elaborating on two alternatives to secure a proper taxation of foreign shareholders: the 'unit model' (*Einheitsmodell*) and the 'division model' (*Trennungsmodell*).

Under the unit model, the proposal is to shape a distribution made by a G-REIT as a direct right / claim for the shareholders with respect to the G-REIT's profits. Hence, no separate distribution resolution by the shareholders' meeting is required for the distribution of the G-REIT income. It is argued that since no distribution resolution by the shareholders' meeting is required, the G-REIT income will not qualify as 'income from shares' but rather as 'income from other corporate rights'. Based on article 10 paragraph 3 of the OECD Model Convention - upon which most tax treaties concluded by Germany are based -, such 'income from other corporate rights' will only qualify as 'dividends' if it is subject to the same tax treatment as income from shares in Germany. Under the unit model the G-REIT income would need to be qualified as income from real estate under German domestic tax law. As a result, under (most) tax treaties concluded by Germany, the G-REIT income derived by the shareholders would also qualify as income from real estate taxable in Germany, see article 6 of the OECD Model Convention.

In the division model, the real estate portfolio is not held for the account of the G-REIT company, but as a separate class of assets (*Sondervermögen*) for the account of the G-REIT's shareholders. This idea is very close to the hybrid system which is being investigated in the UK. Legal title to the real estate portfolio is held by the G-REIT company. The G-REIT's shareholders hold the shares in the G-REIT company, as well as a separate class of securities which entitle these shareholders to the benefits from the real estate portfolio. Both are traded on the stock exchange where they cannot be separated from each other.

According to the IFD paper the income from the real estate portfolio will not qualify as 'income from shares' for the shareholders, as mentioned in article 10, paragraph 3 of the OECD Model Convention, since there are no 'shares'. The paper continues that the income will also not qualify as 'income from other corporate rights', since there are no 'corporate rights' (there is only a separate class of assets). Consequently, the income from the real estate portfolio derived by the shareholders will qualify as income from real estate taxable in Germany - see article 6 of the OECD Model Convention.

It is very likely that a distribution made by a REIT, having the legal form of a stock company, will fall within the scope of the dividend article of most tax treaties concluded by Member States, even if such distributions are reclassified under domestic law as property income subject to a special property income tax levied at source. This means that, pursuant to the applicable tax treaties concluded with the countries where the shareholders are resident, most Member States would be obliged to reduce the property income tax to the prevailing treaty rate. Most European countries would probably be obliged to reduce the withholding tax on distributions to foreign shareholders to 15% or sometimes even lower.

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[57] www.initiative-finanzstandort.de.

4.5.3. Analysis of potential solutions

4.5.3a. Foreign shareholders taxation

As mentioned in section 4.5.2., the issue which is the most debated in Germany and the UK, is the fear that tax treaties and the EC Parent-Subsidiary Directive will allow foreign shareholders to receive dividends at too low a rate of tax (or even a zero rate).

The fear expressed in the German ZEW report that certain foreign substantial shareholders could obtain a reduction of withholding tax to zero per cent under the Parent-Subsidiary Directive merits further reflection. In our view, it will be possible for Member States to exclude REITs from the scope of the exemption from withholding tax pursuant to the EC Parent-Subsidiary Directive. Article 2, (c) of the EC Parent-Subsidiary Directive prescribes that 'a company of a Member State shall mean any company which […] is subject to one of the following taxes, without the possibility of an option or being exempt'. A REIT benefits either from an exemption or from an option to be eligible for a special tax deduction or a special zero tax rate. Hence, Member States should be in the position to refuse Parent-Subsidiary Directive tax treatment to distributions of dividends by domestic REITs.[58]

The issue of tax treaties obliging a Member State to reduce the withholding tax on distributions by domestic REITs to foreign shareholders to a rate which is considered to be too low, can be solved by either re-negotiating its tax treaties and/or by introducing a maximum share ownership condition. The US has systematically included special treaty clauses with respect to tax on distributions made by US REITs in order to preserve their right to tax US property income. EU Member States need to actively pursue a tax treaty policy to exclude REIT distributions from the special low tax treaty rates.

The real problem of introducing a maximum share ownership condition is that such system should be implemented in an EU law compliant way. If the share ownership rules do not apply to certain categories of domestic shareholders (e.g. a parent REIT or pension funds), then there is a serious risk that foreign shareholders with similar characteristics may also claim a waiver of the ownership condition (see paragraph 3.3.2c.). If, for instance, a domestic parent with REIT status is allowed, as an exception to the ownership rules, to own 100% of the shares of a local REIT subsidiary, EU law would allow a REIT in another Member State also to benefit from this exception to the maximum ownership rule.

The same applies to the tax treatment of shareholders itself: most Member States are granting an exemption from tax or an entitlement to a refund of (withholding) tax to certain domestic not-for-profit organisations, like pension fund, charitable foundations, or domestic REITs (a domestic REIT owning another domestic REIT). Often these exemptions are motivated by the wish to stimulate these entities to invest in the local capital markets. In our view, such advantageous tax treatment of specific categories of domestic tax payers, are in any event discriminatory and incompatible with EU law (see paragraph *4.2.* above).

This issue could, of course, be solved by treating the similar foreign categories of tax payers in the same way (e.g., foreign pension funds), but it is clear that Member States with a large capital market and a large property market are not willing to run the risk that foreign shareholders would benefit from the same exemptions.

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[58] For example, the Dutch Minister of Finance takes the position that dividend distributed by a BI does not fall within the scope of the Parent-Subsidiary Directive. The same seems to go for France (see France an introduction of a new tax regime available to quoted Real Estate Investment Companies, H. Lazarski, European Taxation April 2003).

In our view, the above demonstrates that it is not so much the tax treaty obligations as such which are creating the problem of a loss of revenue, but the EC Treaty freedoms which are imposing on Member States the obligation to treat foreign shareholders in an equal way.

The question is whether the latest UK and German 'hybrid' type of alternatives to secure a proper level of taxation of foreign shareholders are feasible solutions. We see the following main issues in relation with the hybrid solutions discussed in section 4.5.2. above:

- These solutions assume that a classification as property income will always be followed for tax purposes in the country of the foreign shareholder. We believe that it is not certain that the country of the foreign shareholder will indeed consider the income as property income and provide relief for the avoidance of double taxation (this would in particular be a problem for the German unit model). Hence, these solutions may create double taxation of the REIT income.
- More importantly, we are not convinced that these solutions will always be Community law compliant! Application of the EC Treaty freedoms could create "holes" in the system. If a domestic REIT or a domestic pension fund owning shares in a hybrid REIT is entitled to an exemption from tax or a refund of tax in respect of the property income distributed by the property holding entity, foreign similar shareholders might also claim such exemptions / refunds on the basis of the EC Treaty freedoms.
- The hybrid systems are complicating the REIT structure, in particular if the hybrid REIT also owns foreign properties, directly or via foreign subsidiaries.

These issues could well mean that a hybrid type of REIT, if introduced, will not be fully accepted by the market, in particular not by foreign capital markets.

Based on the above considerations, a potential solution would need to be designed along the following lines:

- The starting point for an EU proof system would be a special REIT property tax levied at source on distributions made a REIT to its domestic and foreign shareholders. Such tax should, in principle, be the final levy and is not refundable to any shareholder, be it domestic or foreign.[59]
- Although no absolute certainty can be given on the basis of the current case law of the ECJ, it seems that the simple option for domestic shareholders to credit the special property income tax against the normal 'mainstream' income tax would not constitute a discriminative difference in tax treatment of foreign shareholders (who are generally not entitled to such tax credit in the source state, but in their residence state).[60]
- In our view a discriminative difference in tax treatment could be present under Community law if a domestic shareholder were entitled to a formal or de facto exemption at source, or a refund of the property withholding tax, whereas a foreign shareholder would not. Thus, a system whereby the property income tax levied at source is either creditable against the income tax, or consititutes the final levy (i.e., no refund) seems to be a safe system from an Community law perspective.

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[59] See also: European Tax Law, Ben J.M. Terra and Peter J. Wattel, Fed Fiscale studieserie, Deventer 2005, page 260-271.

[60] In our view, the *Fokus bank case* (EFTA court 23 November 2004, no. E-1/404) does not amount to the obligation to grant an income tax credit to foreign shareholders, if such credit is also granted to domestic shareholders. *Fokus bank* case seems to impose that a foreign shareholder should also be entitled to a tax credit at source, which is essentially exempting a distribution of a domestic shareholder from withholding tax and income tax.

- Also with respect to distributions between REITs (REIT subsidiary distributing to shareholder being a REIT), the property withholding tax is levied and no exemption or refund is given. Domestic REITs will be able to credit the property withholdng tax against the withholding tax due on a re-distribution of the distribution received. Foreign REITs should request a credit of the property withholding tax in their own country. As a result, there will not be an effective tax at the level of either the subsidiary REIT or the REIT / shareholder, provided the REIT / shareholder will indeed immediately re-distribute the income received from the subsidiary REIT. The property withholding tax will effectively be for the account of the shareholder of the REIT / shareholder. As domestic REITs are treated in the same way as foreign REITs, this credit system should be Community law compliant.

This model does not solve the issue of shareholders that are entitled to a full and final exemption or a refund. The most important category are the pension funds. In our view, foreign pension funds stand a good chance under the case law of the EU to claim an identical exemption or refund in the source country as domestic pension funds. If Member States are not willing on an unilateral basis to provide foreign pension funds with the same exemption or refund, the only other solution would consist of a multilateral system, based on the principle of reciprocity, whereby any pension fund, whether domestic of foreign, provided the pension fund is a resident of a Member State, is entitled to the same exemption or refund. This would, in fact, require a certain harmonisation of the REIT system between Member States.

4.5.3b. Foreign REITs owning domestic properties

The other issue to be solved is the direct ownership of domestic properties by foreign vehicles that meet the conditions to be eligible for the REIT regime. As explained above, it is very likely on the basis of current EU law that a REIT resident in one Member State can claim the benefits of the REIT regime in another Member State in respect of properties situated in such other Member State.[61]

If tax is imposed on the domestic property income of the foreign REIT, Community law would probably require doing the same with domestic REITs. This would go against the very nature of the REIT (flow through character; taxation at the level of the shareholder).

Imposing tax on the distribution by the foreign REIT of domestic property income would seem acceptable from an EU law point of view. However, it is questionable whether the current tax treaties concluded between Member States allow the levy of such property withholding tax from a non-resident corporate vehicle. Many tax treaties contain a clause identical or similar to article 10, paragraph 5 of the OECD Model Tax convention on Income and on Capital. This paragraph reads as follows:

[61] Member States could hope that the ECJ will accept as a justification for a different tax treatment of cross-border situations as compared to similar domestic situations, the so-called “fiscal territoriality” or ‘fiscal coherence” principle. However, in our view, the recent case law of the ECJ makes it very questionable whether any of these justifications will be accepted.

> *"Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State"*

This particular tax treaty clause would make it impossible for a Member State to tax distributions of domestic property income by non-resident REITs. A solution to this problem would require either a renegotiation of the relevant tax treaties, or Member States accepting a certain harmonised system of taxing REITs.

4.5.3c. Harmonisation of REIT regimes ?

The above shows that in particular the position of foreign pension funds and foreign REITs earning income from properties situated in another Member State, are difficult to tackle on a unilateral basis, if the requirements set out in 4.5.1. are to be met.

Technically the best way to assure that Member States will get their fair tax share of income from property located within their territory would indeed be a certain harmonisation of the REIT tax regime and the tax treatment of its shareholders. In section 5 below, we will be drawing a first sketch of a uniform EU REIT regime.

5 A uniform EU REIT regime

5.1. Introduction

In section 3.3 an inventory was made of the (potential) problems that arise in connection with the application of REIT regimes across borders. The taxation of foreign shareholders and foreign REITs owning domestic properties is a particularly serious bottle-neck, which could inhibit the development of REIT regimes in Europe. It is not clear whether the solutions discussed in section 4.5 will resolve all the issues and at the same time, satisfy the various Member States from a budgetary perspective.

The EPRA wishes to stimulate the discussion amongst experts from the various Member States about the potential solutions to the international tax issues surrounding the introduction of new and the modification of existing REIT regimes in Europe. Moreover, EPRA wishes to explore the possibility of a uniform REIT regime in Europe. EPRA asked the authors of this report to prepare a first rough outline of a possible EU REIT regime. This chapter of the report contains the first proposal for such an EU REIT regime. Hopefully, this preliminary proposal will challenge experts from the various Member States to express their view on the subject and contribute to a discussion on the feasibility of an EU REIT regime.

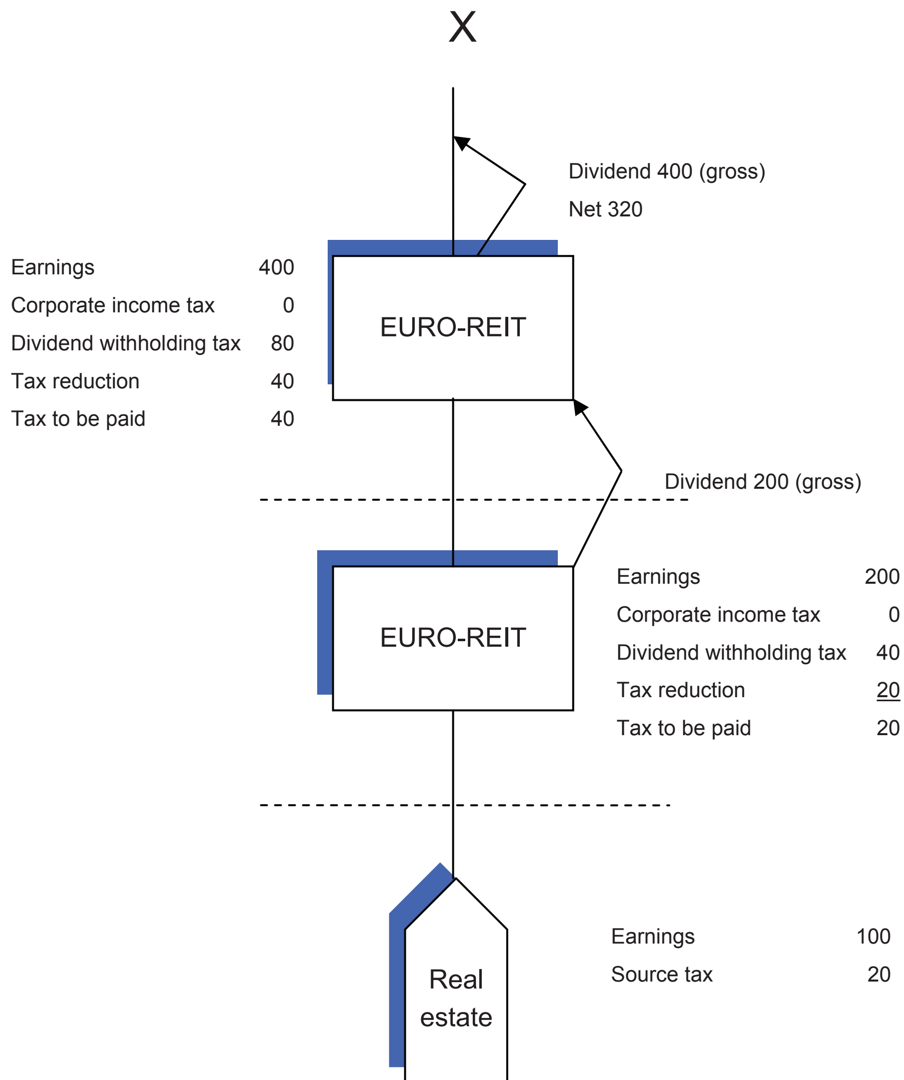
5.2. Sketch of a possible EU REIT regime

The preliminary proposal for an EU REIT regime could be summarised as follows:

- the EU REIT is exempt from corporate income tax in the Member State in which it is actually established;
- with respect to property held by the EU REIT located in a Member State other than the one in which it is established, it is subject to a source tax in the *situs* state at a flat rate, uniform within the European Union, of 20%;
- the above source tax levied by the situs state may be set off (as a reduction of payment of tax) against the dividend tax that the EU REIT has to withhold on its profit distributions;
- the assets held directly and indirectly (through the interposition of an EU REIT) by the EU REIT consist for at least 70% of immovable property held for investment purposes;
- on a consolidated basis, the assets of the EU REIT are not financed for more than 60 to 70 per cent with loan capital;
- the capital gains realised by the EU REIT on properties may be written off against the cost price of other property, subject to a term of three financial years, provided the property is located in the same Member State as the property that was sold;
- the profits made by the EU REIT in a given financial year must be fully distributed within eight months after the end of the financial year;
- a withholding tax is levied at a rate of 20% of the profit distributions of the EU REIT. If so desired, this withholding tax may be a final tax with respect to participation holders in the EU REIT. In such case, the Member States in which the participation holders in the EU REIT are resident or established grant an exemption of the income arising from the holding of a participation in the EU REIT;

- the dividend tax withheld on the profit distributions on shares in an EU REIT (subsidiary) held by another EU REIT (parent) may also be set off against the dividend tax owed by the latter EU REIT (parent) with regard to its own profit distributions;
- the EU REIT does not have to fulfil shareholder requirements;
- with respect to pension funds established in the European Union that hold participations in the EU REIT and which are either not subject to or are exempt from corporate income tax, a special rule applies: these pension funds are entitled to a refund of the dividend tax that was withheld on the profit distributions they received. This refund is given by the Member State in which the pension fund is established. The Member State of residence of the pension fund receives a reimbursement from the other Member States for the refund by way of a clearing system;
- the tax regime for the EU REIT is laid down in a regulation on the basis of Art. 249, EC Treaty in conjunction with Art. 308 EC Treaty. In this way, the regulation has direct effect and, to the extent necessary, bilateral tax treaties can be adapted without reopening negotiations. Furthermore, when the EU REIT is laid down in an EU-regulation, Art. 57(2) EC Treaty provides for the possibility of making a distinction in relation to third countries (for EU REITs resident in third countries or for EU REIT with shareholders in third countries). Unanimity is required for the adoption of a regulation, but an exception may be made, if so desired, under the provisions on 'enhanced cooperation' as provided for in Arts. 43 through 45 EU Treaty.

On the following page, a diagram reflects the EU REIT structure holding real estate, indirectly, in a Member State other than the Member State in which the EU REIT is established.


X
Dividend 400 (gross)
Net 320
Earnings 400
Corporate income tax 0
Dividend withholding tax 80
Tax reduction 40
Tax to be paid 40
EURO-REIT
Dividend 200 (gross)
EURO-REIT
Earnings 200
Corporate income tax 0
Dividend withholding tax 40
Tax reduction 20
Tax to be paid 20
Real estate
Earnings 100
Source tax 20

5.3. Underlying principles of the preliminary proposal

In determining the above preliminary proposal for an EU REIT regime, the following principles were taken into account.

- First, the tax regimes currently applicable to the REITs in the various Member States are generally based on the idea that a REIT should be viewed as a form of collective investment whereby the investments held by the REIT must be subject to the same tax burden as would be the case if its shareholders had invested directly in the properties of the REIT (the 'flow-through' principle). Examples of this principle are fiscal transparency[62], a subjective exemption (taxpayer exemption)[63], an objective exemption (exemption of income)[64] or a (practically) zero rate.[65] Application of one of these techniques means that no additional tax burden is created when capital is invested in a REIT compared to direct investment.
- Second, in determining the preliminary proposal, the point of assumption was that the EU REIT has the objective of holding property for investment purposes. This assumption - in light of the fact that in the OECD Model Convention (2001 version) lays down the principle that the state in which the immovable property is located has taxation rights on the income from immovable property (Article 6 OECD Model Convention) and the capital gains with respect to such immovable property (Article 13(1), OECD Model Convention) - means that the state in which the immovable property is located should have primary taxation rights over the profits from the real estate held by the EU REIT.
- Third, notwithstanding the fact that the EU REIT has the holding of property for investment purposes as its objective, it may be assumed that it has other investments as well, in the form of shares, bonds, bank deposit and so on. From this perspective, it is of importance, given the principle underlying the current tax regimes for REITs in the various EU Member States, that the EU REIT be entitled to treaty benefits or that there is some other guarantee that the returns from other investments will reach the ultimate shareholders in the EU REIT, on balance, free of (withholding) tax (other than in the form of dividend tax on the profits distributed by the EU REIT).
- Fourth, it seems to be of great importance that the erosion of taxation rights on immovable property located in the European Union is prevented with respect to shareholders in an EU REIT who are resident or established in a non-Member State.[66]

The above considerations on the flow-through character of a REIT, the taxation rights allocated to the state in which the immovable property is located, avoidance of withholding taxes "sticking" to other tax revenues *and* prevention of the erosion of the above taxation rights with regard to EU REIT shareholders who are non-resident or not established in the European Union have led us to form the background for the preliminary proposal summarised above.

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[62] The REIT in Austria and the FCP in Luxembourg are examples.

[63] The REIF in Germany and the FII in Italy are examples.

[64] The SICAFI in Belgium and the SIIC in France.

[65] The zero rate is applicable to Dutch investment institutions and a 1% rate applies to the Spanish SII and FII.

[66] This would be made possible, for example, by a zero rate at the REIT level in combination with a reduced (withholding) tax rate under a tax treaty on profit distributions made by an EU REIT.

5.4. Next step: comments and consultation

EPRA and the authors of this report plan to start consultations with experts in the various Member States and Governments. The object of these consultations is to try to find common ground on how REIT regimes could be made EU law compliant and whether a uniform EU REIT regime could help resolve the bottle-necks in connection with the taxation of foreign shareholders. A series of round table meetings / work shops are being scheduled for autumn of 2005.

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