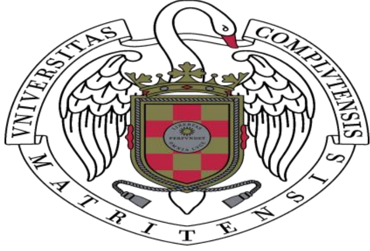

EXIT TAXES; AN EASY WAY INTO THE REIT?

JOSÉ MANUEL ALMUDÍ CID
COMPLUTENSE UNIVERSITY OF MADRID
jalmudi@ucm.es

INTRODUCTION

- Different reasons for adopting a REIT regime.
- The REIT status and the subsequent absence of corporate taxation makes a country attractive for both national and foreign investors. ¿Is this enough?
- One of the most relevant changes in European REIT regimes is the elimination or reduction of the exit/entry tax.

EXIT/ENTRY TAX CONCEPT

- Certain REIT regimes require de **payment of taxes upon the option for the regime**.

- When a corporation becomes eligible for the REIT specific tax privilege, all **hidden reserves have to be disclosed** (may affect **all the assets** of the conversing company or exclusively to the **asset and rights used in the exempt business**).

- Similarly, a sale or transfer of real estate to a Pre-REIT or REIT might result with the **seller realizing hidden reserves**.

- The disclosure and realization of hidden reserves **increases** the taxable income and thereby the **tax burden of the selling entity/person or converting corporation**.

JUSTIFICATION OF THE EXIT/ENTRY TAX

- Qualified income connected with the disposal or transmission of an asset used for the purposes of tax exempt business will be tax exempt (v. gr.: Belgium, France, Italy, Germany, Netherlands, Spain UK).

- In cases of unrealized capital gains generated previously to the conversion into a REIT, the exit tax on the conversion of a company into a REIT may be justified when a **step-up of the accounting cost** or a **carry-forward of losses** is also provided.

- Entry/exit taxes are generally applied at **favourable rates**.

- However, some countries (v. gr: Spain) don't link the exemption of capital gains in the CIT upon conversion with an "exit/entry tax".

DIFFERENT WAYS OF TAXING CONVERSION INTO A REIT

- Alternatives for taxing the unrealized capital gains:
  - Taxable base: **market value** of the properties used in the tax-exempt business.
  - Taxable base: **Unrealized capital gains** on property or assets
- **Deferral or payment facilities** may be granted in both cases (4-5 years)
- **Carry forward of losses** generated in the non tax-exempt period may also be granted.

EXAMPLES OF EXIT TAXATION (I)

- **FRANCE (SIIC):**
  - Unrealized capital gains are taxed at **a reduced corporate tax rate** (19%) on the assets in the tax-exempt portfolios.
  - The tax debt must be paid in four years.
  - **Step-up** of the asset value is provided (market value).

EXAMPLES OF EXIT TAXATION (II)

- **BELGIUM (SICAFI):**

  - Unrealized capital gains are taxed at **a reduced corporate tax rate** (16.995% plus a crisis tax uplift of 3%) at the moment of conversion.

  - SICAFI'S capital gains exempt from the CIT and are **not included in the 80% distribution obligation**.

  - Tax losses generated in the non-exempt period are fully **deductible**.

EXAMPLES OF EXIT TAXATION (III)

- **GERMANY:**

  - Since 2010, the disposal of assets to a REIT and the conversion of a taxable stock corporation to a REIT is subject to the general income taxation rule. The conversion is treated as a **liquidation of the prior taxable stock corporation**.

  - Before 2010, the **50% of the unrealized** capital gains of the seller or the conversing corporation have been tax exempt.

  - REIT's capital gains are exempt from the CIT.

EXAMPLES OF EXIT TAXATION (IV)

- **ITALY (SIIQ):**
  - Taxation at **20% of the unrealized capital gains** on properties held at the regime election date for the tax-exempt business and step-up of the tax value of the assets (market value).
  - Same rate applies to capital gains realised by corporate **shareholders contributing property** (in kind contributions) to SIIQs (three years holding period).
  - Tax losses arising from pre-conversion tax periods may be carried forward and offset against capital gains affected by the substituted tax or against the taxable income deriving from the taxable business.

EXAMPLES OF EXIT TAXATION (V)

- **UNITED KINGDOM**:
  - There is an entry charge of **2% of the gross value** of assets on entering the REIT regime.
  - A loss of the property rental business arising from a non-exempt period may not be offset against any profits of the tax exempt business.
  - **No step-up** of the asset value is provided.

EXAMPLES OF EXIT TAXATION (VI)

- **UNITED STATES**:
  - **No effective taxation at entity level** at the time of conversion into a REIT.
  - The tax is due if the REIT sells de immovable property in 5 years after becoming a REIT (built-in gain rule). However, “like-kind” exchanges of real property are not dispositions for this purpose.
  - Additionally, the accumulated earnings and profits generated before becoming a REIT must be distributed (dividends) to the shareholders during the first taxable year.

EXAMPLES OF EXIT TAXATION (VII)

- **NETHERLANDS (BI):**
  - The unrealized capital gain is subject to corporate income tax without any tax benefits upon conversion (25%).
  - There is no incentive for becoming a REIT in the Netherlands.
  - Therefore, step-up of the value at the end of the year prior to the Dutch entity is converted into a REIT is needed.
  - Additionally, when a Dutch REIT looses its status the unrealized capital gains are fully taxable.

EXAMPLES OF EXIT TAXATION (VIII)

- **SPAIN (SOCIMI):**

  - Unrealized capital gains are **not taxed** if a regular corporation becomes a REIT.

  - However, unrealized gains from **real estate owned before the conversion** of the Spanish company into a REIT will be taxed presuming that the income was generated linearly during the ownership period.

  - Tax losses arising from pre-conversion tax periods may be carried forward and offset against against the taxable income deriving from the taxable business (transfer of properties or shares before 3 years).