European REITS and Cross Border Investment

The Tax Treatment of REITs

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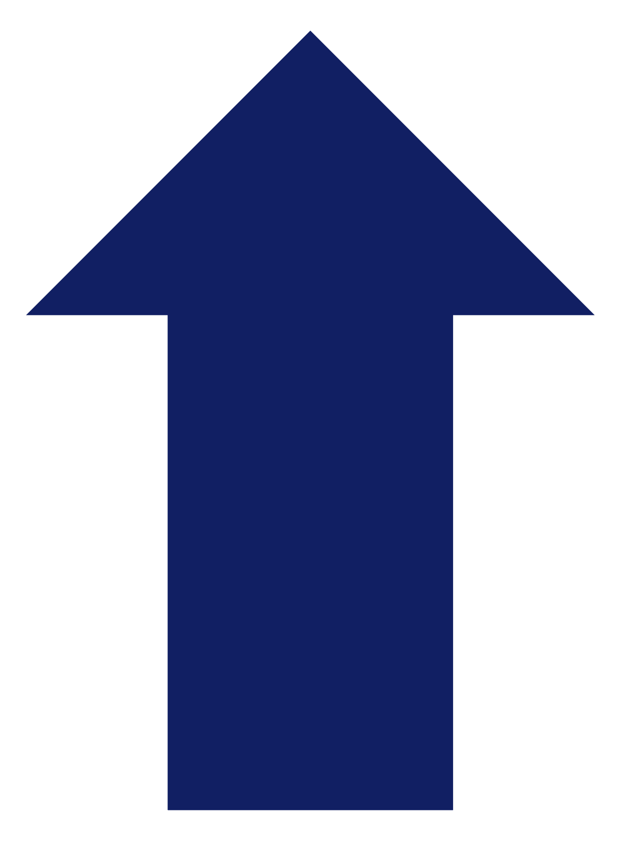
What is the most essential aspect of a REIT ?



The Point of Taxation is moved from the company to the shareholder

Overview of some REIT regimes

	Intro	Payout	Gearing
United States	1960	> 90%	No Limit
Netherlands	1969	100%	< 60%
Australia	1985	100%	No Limit
Canada	1995	> 85%	No Limit
Belgium	1995	> 80%	< 65%
Japan	2000	> 90%	No Limit
Singapore	2002	> 90%	< 35%
France	2003	> 85%	No Limit
UK	2007	> 90%	>1.25 (interest cover)
Italy	2007	> 85%	No Limit
Germany	2007	> 90%	< 60%
Spain	2009	> 80%	No Limit

Number of REIT regimes

- EPRA Global REIT Survey
- 37 Countries
- New regimes:
  - China
  - India
  - Finland
  - Spain
  - Dubai ??
- Europe – 16 REIT and "REIT-like" regimes

What do REITs provide? – for the investor

- Liquid/low cost access to an illiquid asset class
- Medium/long term correlation to direct property
- Access to high quality commercial real estate for the full spectrum of investors (democratization)
- Co-investment opportunities with long term institutional investors
- Access to expert management teams
- Improved investment through greater transparency
- Possibility of cross border investment

What do REITs provide? – for Markets and Governments/EU

- All of the above
- On the forefront of sustainable real estate (green buildings);
- Key parties in large infrastructure and regeneration solutions
- Bringing Long term financing and investment to property markets
- Improved market stability and lower systemic risks
- Better governance

How would an ideal REIT look like ?

Legal Form	• Stock company
Shareholders' requirements	• Preferably only listing • Other shareholders requirements: often complicated
Scope Activities	• Property in broadest sense • TRS for related services with clear limitations
Leverage restrictions	• Yes • Probably saved many REITs
Distribution obligation	• Yes • 80% to 90%

How would an ideal REIT look like? (con’d)

Conversion charge / Exit Tax	• **YES !!**

Important to improve liquidity in a market, etc.

Flow through principle:

Point of taxation is moved from the company to the shareholder

- Works perfectly in domestic situation

In cross border situations, flow through principle gives rises to tax issues

- Two critical issues…..

Two critical issues *from the REIT's perspective*

The REIT residence State whishes to secure taxation on distribution to foreign shareholder

The foreign property situs state wants to tax property income earned by a foreign resident REIT

Upstream Issue: Tax Position Foreign shareholders

State A

State B

B-REIT

- Point of taxation is moved from B-REIT to shareholders, so State B insists on minimum withholding tax as final levy
- E.g., by applying OECD REIT concept, or imposing stringent shareholders' conditions, excluding beneficial treaty reductions
- State B runs risk that (exempt) foreign investors will claim refund of withholding tax if domestic investors are entitled to an exemption/refund/credit: EU free movement of capital

Foreign shareholder issue (upstream)

What works under the OECD concept does not necessarily work in the EU, because of EU Freedoms demanding a 'level playing field' cross border

System must be 'EU law compliant'

Some EU countries impose a ' corporate income tax on distributions' (e.g., Spain and France, others create very restrictive shareholders' restrictions

How can a MS avoid undue restrictions of EU Freedoms and at same time secure a fair share of tax on distributions by a REIT of local property income?

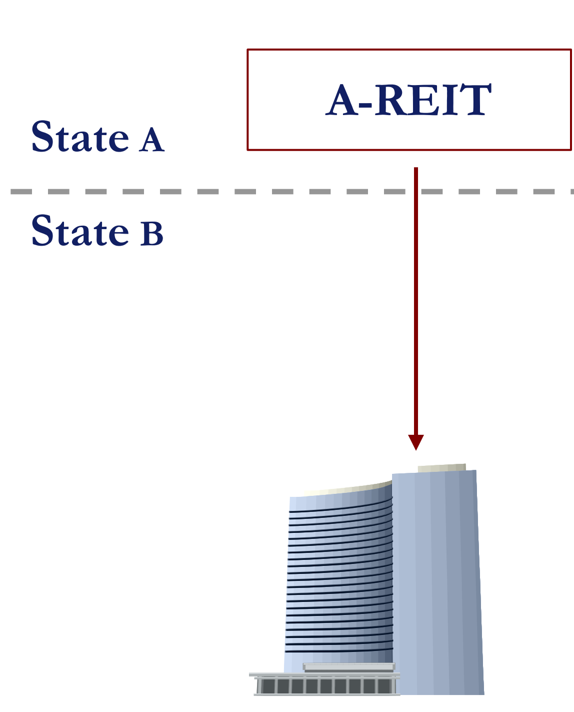
Solution for foreign shareholder issue

REIT residence state always entitled to a withholding tax at, e.g., 15%

Foreign shareholder to receive a full credit at the gross amount of the withholding tax

Bilateral or multilateral agreement

Downstream Issue: REIT-Status for foreign REITS



- A-REIT in Country A can often not benefit from REIT regime in Country B
- Investments by A-REIT in State B subject to tax in Country B
- Investments in Country A benefit from exempt REIT-regime
- This is an obstruction to cross border investments

Critical issue - fear of a loss of tax if foreign REITs are given benefits of local REIT: **how to retain a fair share of tax for State B ?**

Key proposal – Mutual Recognition

- In Situs-State REIT treatment to foreign REITs, if certain conditions are met:
  - foreign REIT regime meets certain minimum criteria in accordance with the REIT regime in its own country (REIT-State)
  - observes certain ‘investment criteria’ in according with the REIT regime of the investment country (situs State)

- Process of mutual recognition between two Member States, based on a framework laid down in an EC Communication

- “European REITS and Cross-Border Investments, (www..epra.com/media/EU REIT Summary Paper 110909.pdf)

Mutual Recognition – Criteria

- ***REIT Country / non-investment*** minimum criteria observed in accordance with the REIT home country legislation:

  - corporate form / capital
  - listing requirement / broad ownership
  - mandatory annual distribution (>80%)

- ***Investment (country)*** criteria to be observed in accordance with investment country REIT regime:

  - financing limits
  - restrictions on permitted activities

Key issue: Fair allocation of tax revenues

- Problem: In cross-border REIT-situations economic double taxation / distortions

- EPRA's suggested approach aims to combine both the flow through character of a REIT and the prevention of the situs state taxation rights by:

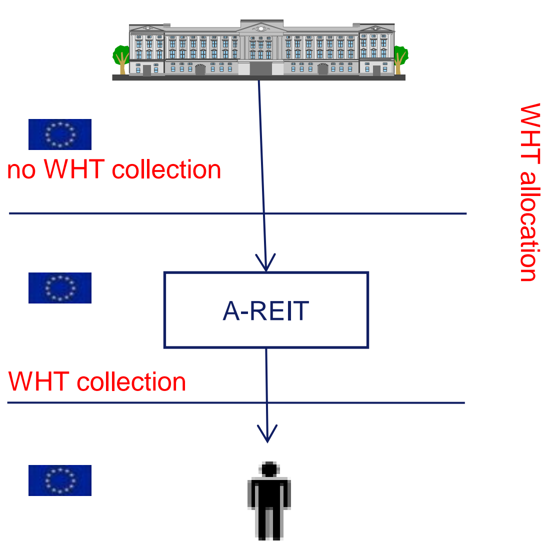
  - Single Country approach (taxation only in REIT country and subsequent allocation of such tax to the various situs countries) or
  - Situs Country approach (taxation by each situs country with tax credit on investor level)

Single Country approach

- Mechanism:

  - country of the residency of the REIT collects the WHT which becomes due on distribution to its shareholders
  - situs state recognizes tax-exempt nature of the foreign REIT and does not levy WHT on its profit
  - situs state receives from the country of residency of the REIT the share of WHT which is attributable to direct or (certain) indirect investment of the foreign REIT in the situs state

Single Country approach



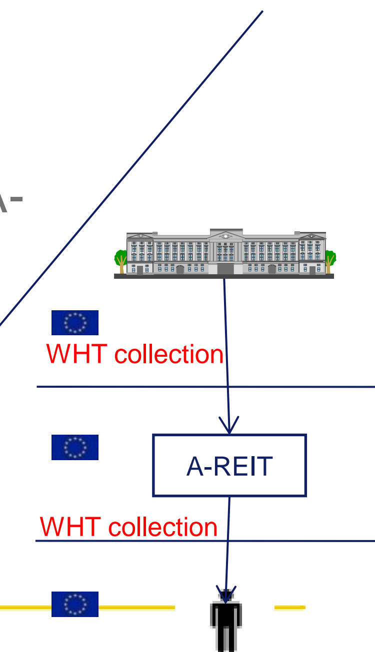
- Situs State (Country B):
  - tax exemption of the REIT
  - taxation right on the rental income but no tax collection in Country B
- REIT-Country (Country A):
  - tax exemption of the REIT
  - taxation of investors due to distribution
  - WHT allocation between A and B
- Investor Country (Country C):
  - taxation of the investor in C
  - tax credit of the B-WHT

Situs Country approach

- Situs State (Country B):
  - situs state recognizes the tax-exempt nature of the foreign REIT, but does levy tax on the local profit of the foreign REIT
  - such taxation would take the form of a (quasi) dividend WHT, the rate of which could be harmonized from one country to the other (between 10% and 15%).

- REIT-country (Country A):
  - tax exemption of the REIT
  - WHT levied by Country B creditable against Country A tax on A-REIT distributions (creditable against Country A dividend WHT

- Investor country (Country C):
  - Country B withholding tax borne by investor in Country C
  - Full tax credit of the B-WHT in Country C



Single vs Situs Country approach

	Single Country	Situs Country
Pros.	- One single level of taxation that fully respects the tax transparent status of the REIT - Avoidance of triangular situations	- Likely to be more acceptable by Member States as the levy of tax by the situs Country does not depend on country of residence
Cons.	- Situs country has to rely on country of residence for the collection of its own taxes - Situs country may loose taxes if A-REIT is making losses on other activities	- Leads to double taxation when situs country tax exceeds country of residence tax on distribution by A-REIT of situs country source income.

Threat: OECD BEPS Action 6: Treaty Abuse

- Based on proposed LOB: many REITs may not qualify;
- Proposed share trading test is in violation with EU Freedoms
- Despite detailed comments by REIT industry, no mentioning of REITs
- OECD seems to have forgotten its own REIT report

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