Tax efficient Real Estate Investments into Western Europe

BOSCO-CONFERENCE on 22nd February 2019 in KIEV

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Agenda

A. Why Real Estate in Western Europe UK / US?
B. Tax Environment in D, UK, F & I
C. Regulatory Aspects
D. Suitable Holding Jurisdictions
E. Suitable Fund Vehicles
F. Q&A / Case Study

A. Почему недвижимость в Западной Европе / Англия / Америка ?

- Добрый день, Киев!

- Мой колега Oliver Klein из Германии, а я из Швейцарии, и мы очень рады сегодня утром быть здесь вместе с вами.
- Мы оба обслуживаем много состоятельных инвесторов из бывшего Советского Союза. Большинство из них инвестируют часть их имущества в недвижимость в Германии, Англии или Америке. Такие инвестиции пользуются у нас спросом, и их прибыль часто составляет выше 10 % (десяти процентов).
- Мы расскажем вам о том, какие налоговые и нормативные аспекты надо учитывать при инвестициях в недвижимость.

- Добро пожаловать к нашему реферату!

B. Tax Environment in D, UK, F & I

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Tax Considerations Of Cross Border Real Estate Investments

The taxation of investments can be divided into five phases:

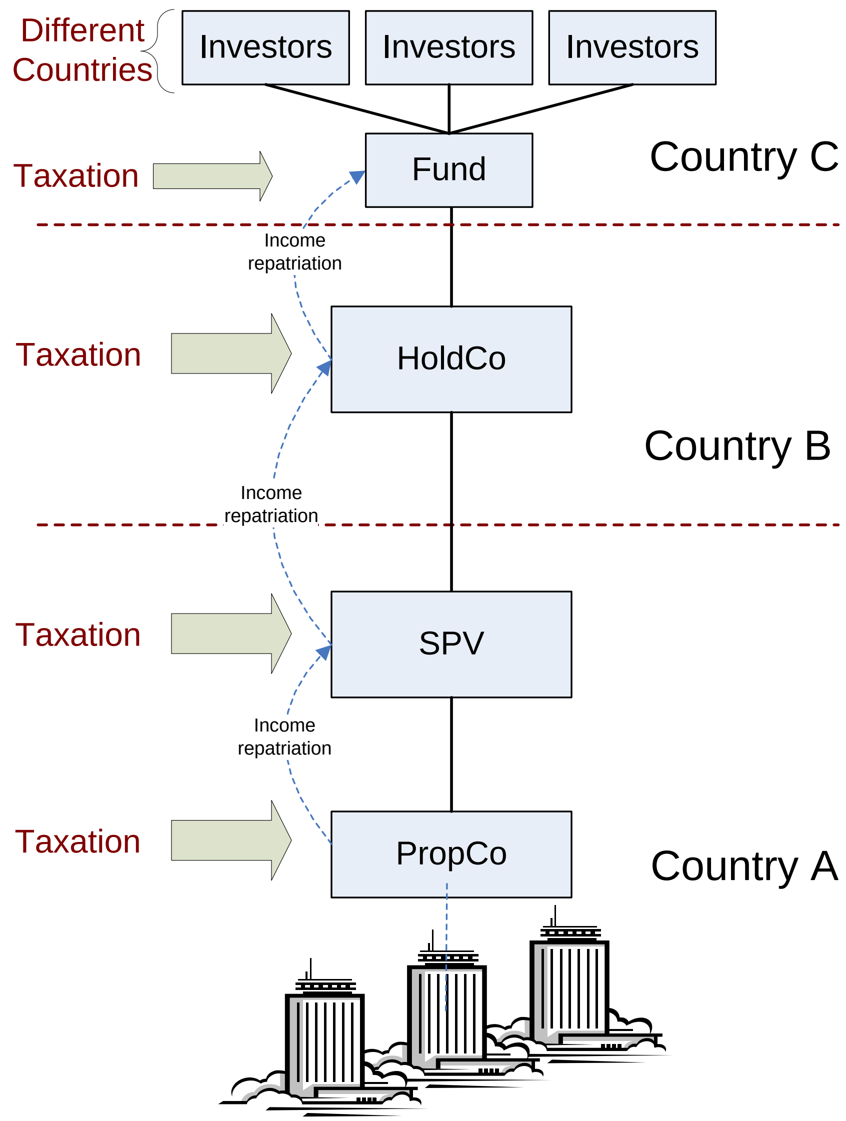
- Funding
- Investment
- Holding period
- Divestment
- Repatriation

Basic taxation principles

Ignoring tax considerations may result in multiple taxation of the same income:

- Capital Gains Tax
- Capital Tax
- Income Tax
- Withholding taxes
- Transfer Tax / Stamp Duties
- VAT

A significant amount of potential returns may be neutralized by taxes



Basic taxation principles

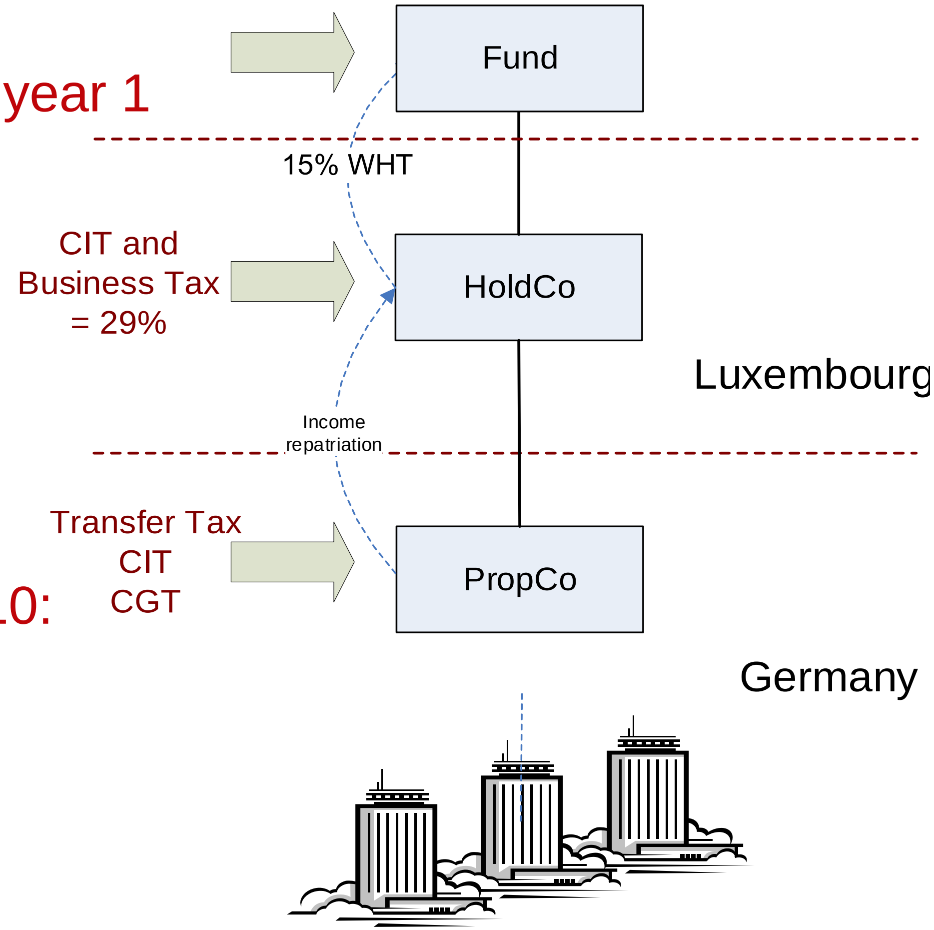
Acquisition of German portfolio in year 1

- $100m purchase price
- Transfer tax (3.5-6.5%)

Rental Income: € 10m p.a.

Exit by way of asset deal in year 10:

- Disposal proceeds = €110m



Tax environment in Western Europe

Jurisdiction	CIT	Other income taxes	Dividend WHT	Interest WHT	RETT/ stamp duty	VAT	Comments
Germany	15.825%	7%-17.5%	26.375%	0%	3.5%-6.5%	19%	Substance requirements + anti avoidance rules
United Kingdom	19%	0%	0%	20%	5%-15%	20%	Favourable capital gains tax regime phased out
France	31%	0%	30%	0% unless lender in black-listed country	5.09%	20%	3% Tax Very formalistic tax authorities
Italy	24%	3.9%	26%	26%	9%	22%	Very formalistic tax authorities

Furthermore, a wealth of other taxes may be triggered – e.g.:

- Property tax
- Inheritance / gift tax
- Capital gains tax etc.

Reducing income tax burden – debt financing

Debt:

Most cross border real estate investments are highly leveraged because:

- Usually tax efficient financing (Capital duty exempt, etc..) upon infusion
- Usually tax deductible expense
- More flexible and faster repatriation of cash flows

Equity:

- Taxable upon contribution
- Dividend distributions subject to withholding tax
- However, dividend income usually is subject to favorable tax treatment.

Challenges for debt financing

From a tax perspective, there are usually limits to the extent of possible leverage in real estate investment:

- Thin capitalization rules
- Interest capping rules
- Transfer pricing rules

Thin capitalization rules

Financing structure of two companies

Assumption: **Debt-to-equity ratio is 3:1**

Interest capping rules

Concept : Similar to thin capitalization rules, but taxable event is determined by other complex set of rules without reference to debt-to-equity ratio (US, Germany, Italy, etc.).

- May apply to all debt liabilities including third party debts

Determinants of interest capping rules:

- **(US)** If debt-to-equity ratio exceeds 1.5:1, interest on debt is deductible to the extent it does not exceed 50% of EBITDA

- **(Germany)** If interest exceeds € 3m, interest on debt is deductible to the extent it does not exceed 30% of EBITDA

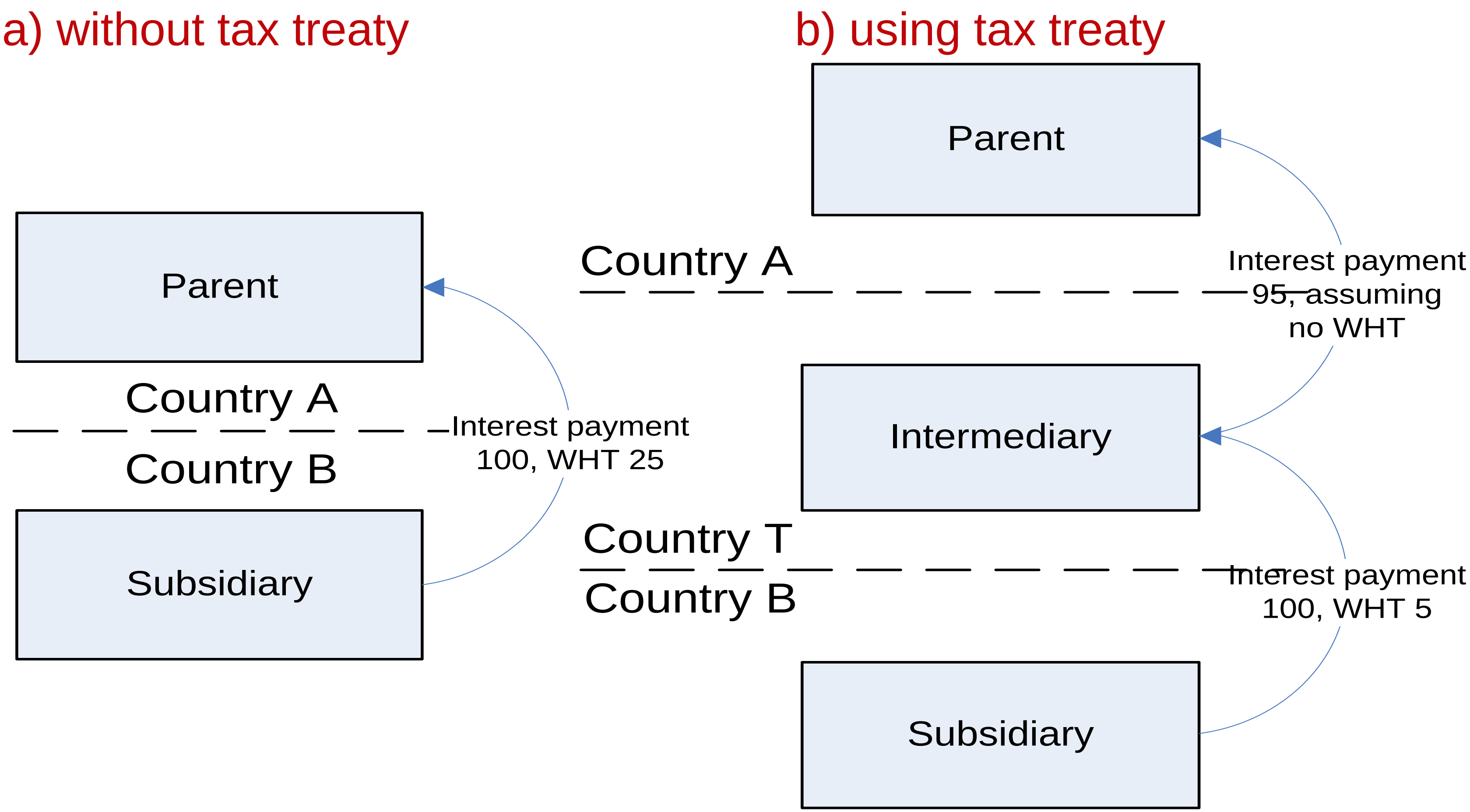
Transfer pricing

Concept: Interest paid by corporate taxpayer is tax deductible only if the rate is at “arm’s length”

- “arm’s-length standard” and reference rates:
  - average annual floating rate applied by banks
  - average rate at market for such loans
  - sufficient documentation required
- If the actual interest rate exceeds arm’s length rate:
  - Tax authorities adjust the interest rate for “arm’s-length” rate
  - excess interest may not be deductible for tax purposes
  - excess interest may be treated as dividend distribution

Withholding taxes – Treaty Shopping

Utilizing “treaty sandwich” method:



C. Regulatory Aspects

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C. Regulatory Aspects

- Alternative Investment Fund Manager Directive (AIFMD)
- Malta Cyprus / Swiss Solutions / Cayman / Co-Investments
- AML/Compliance: Swiss Banking

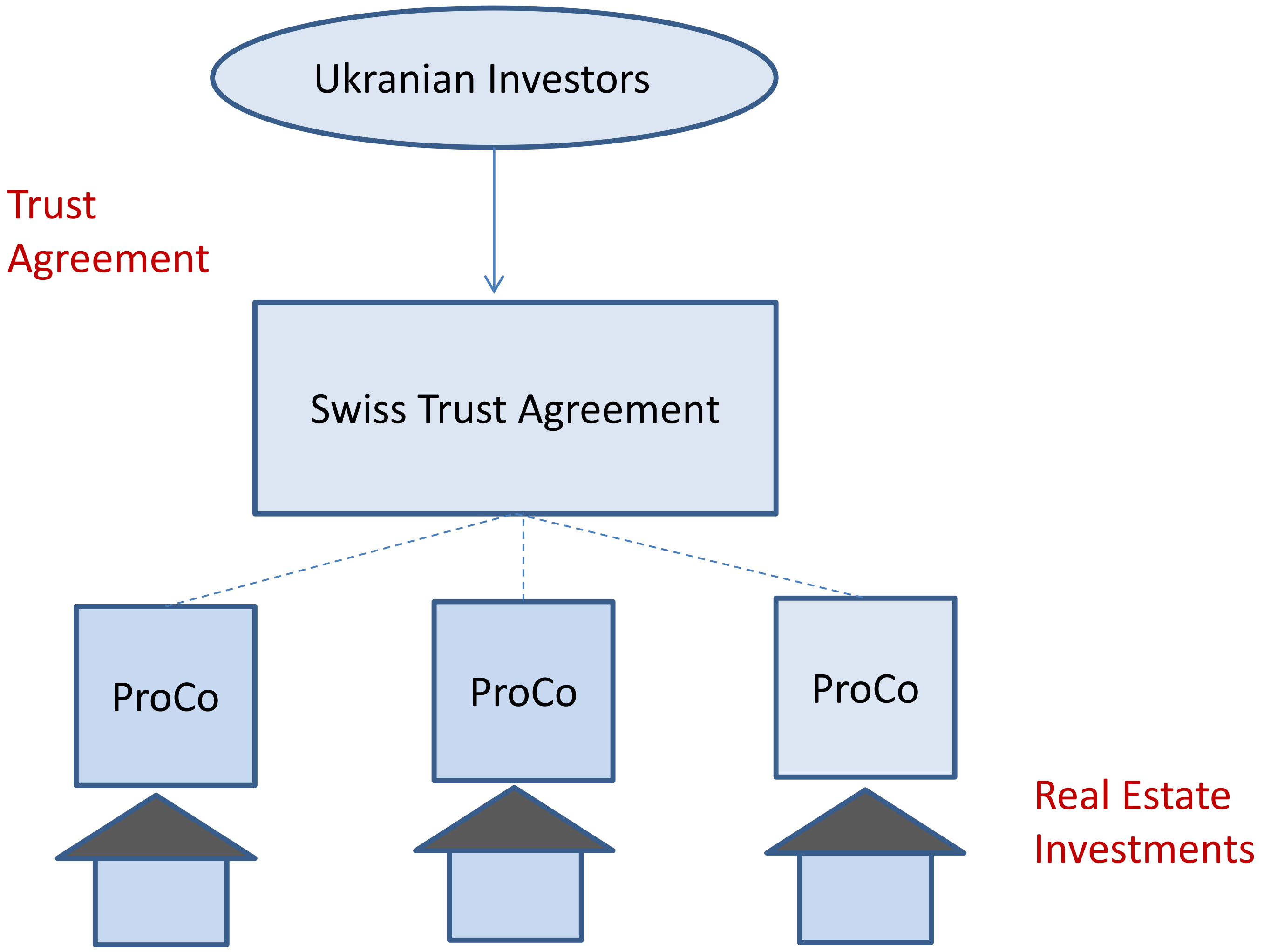
C. 1. European Alternative Investment Fund Manager Directive («AIFMD»)

- If more than one investor invests into Real Estates, we have to comply with the regulation of the European Alternative Investment Fund Manager Directive («AIFMD»).

- Ways of structuring are e.g.

- Loan Agreements
- Trust Agreements
- Co-Investments (one single Real Estate)
- Vehicles outside Europe, e.g. Cayman Funds

C.2. Swiss Trust Agreement



C. 3. Anti Money Laundry Rules / Compliance

- Anti-Money Laundry Rules / Compliance take very much time these days.
- Some countries have no expertise with Clients from Former Soviet Union Countries like Ukraine, Russia or Kazakhstan.
- In Switzerland every private bank has a “CIS-Desk”. In Swiss banks work large teams from Ukraine, Russia or Kazakhstan. They have understanding of Eastern European culture. Compliance is much faster and more pragmatic in Swiss Banks.

D. Suitable Holding Jurisdictions

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Holding company

General considerations

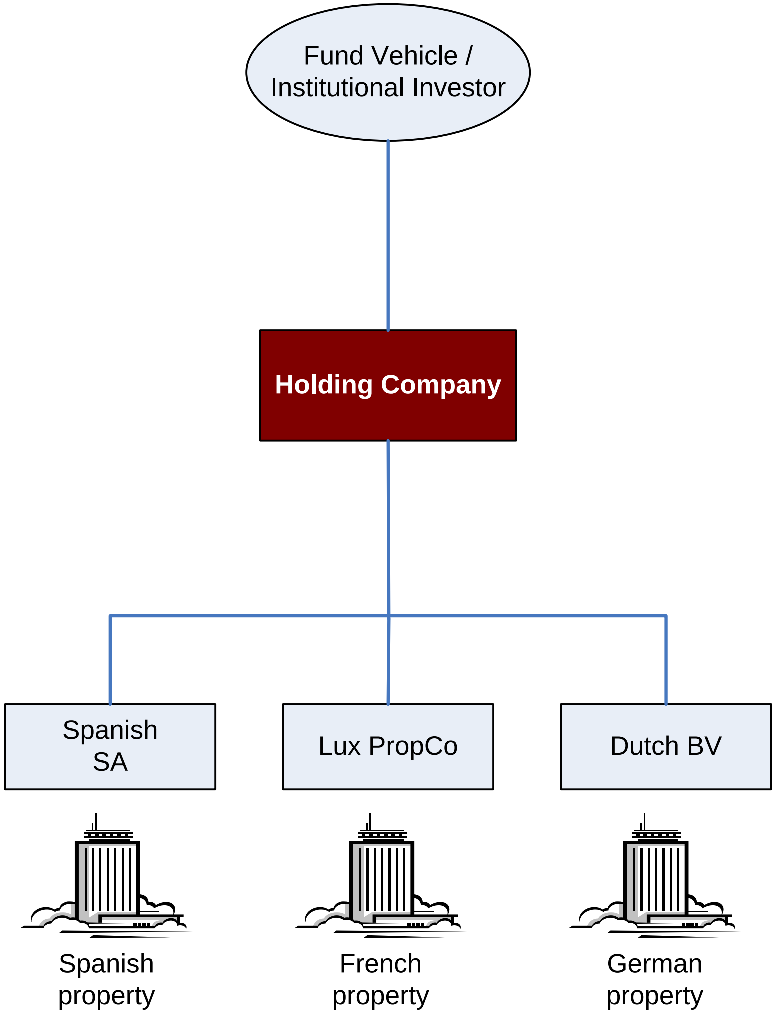
- Generally non-regulated corporate entity
- Business friendly – fast and easy setup
- Flexible exit

Tax considerations

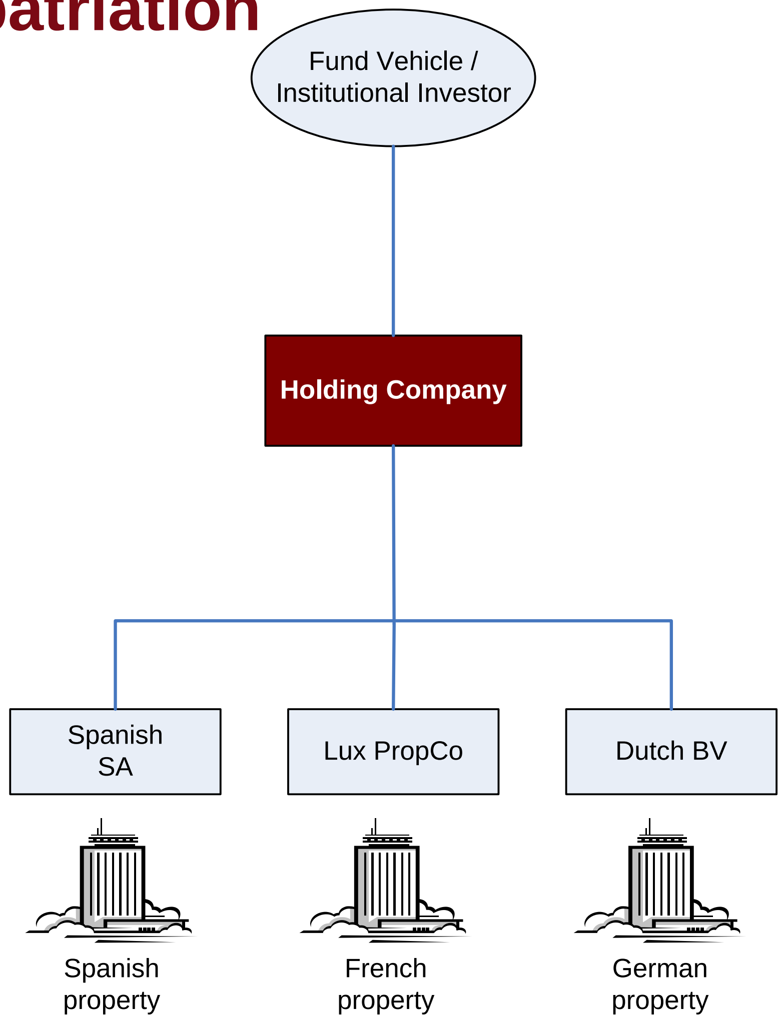
- Avoidance of Withholding taxes → minimization of "tax leakage"
- Extensive treaty network
- Access to EU directives
- Flexible participation exemption

Common holding jurisdictions:

- Luxembourg, Netherlands, Singapore, Cyprus, Malta, Mauritius



Profit repatriation



Frequent tax issues

- Substance:
  - Demonstrate absence elsewhere (management or control test for tax residence etc.)
  - Economic substance
  - Physical substance - employees, offices, board meetings
- Beneficial ownership (especially for investments in Spain, Germany, Korea and Japan)

Common holding / finance jurisdictions:

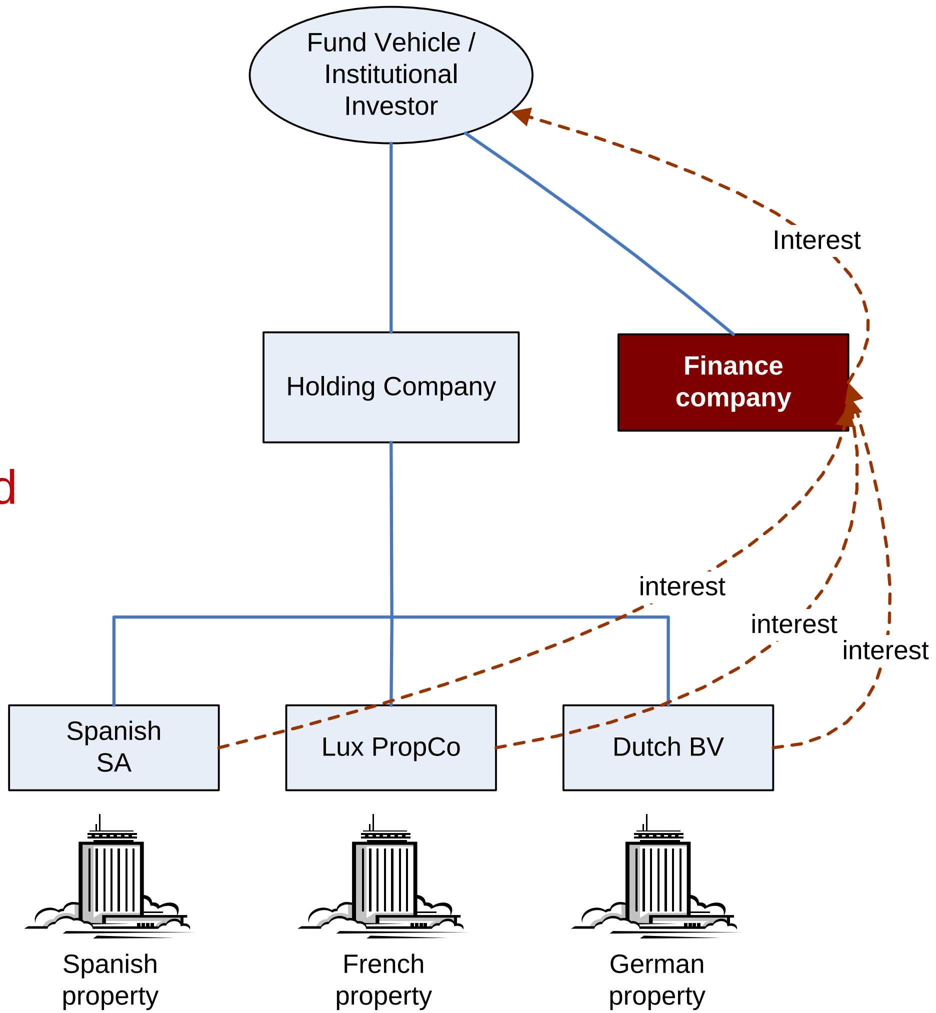
- Luxembourg, Netherlands, Singapore, Cyprus, Malta, Cayman Islands (e.g. for PRC), Mauritius (for India)

Profit repatriation through interest

General

Interposing Finance Company enables:

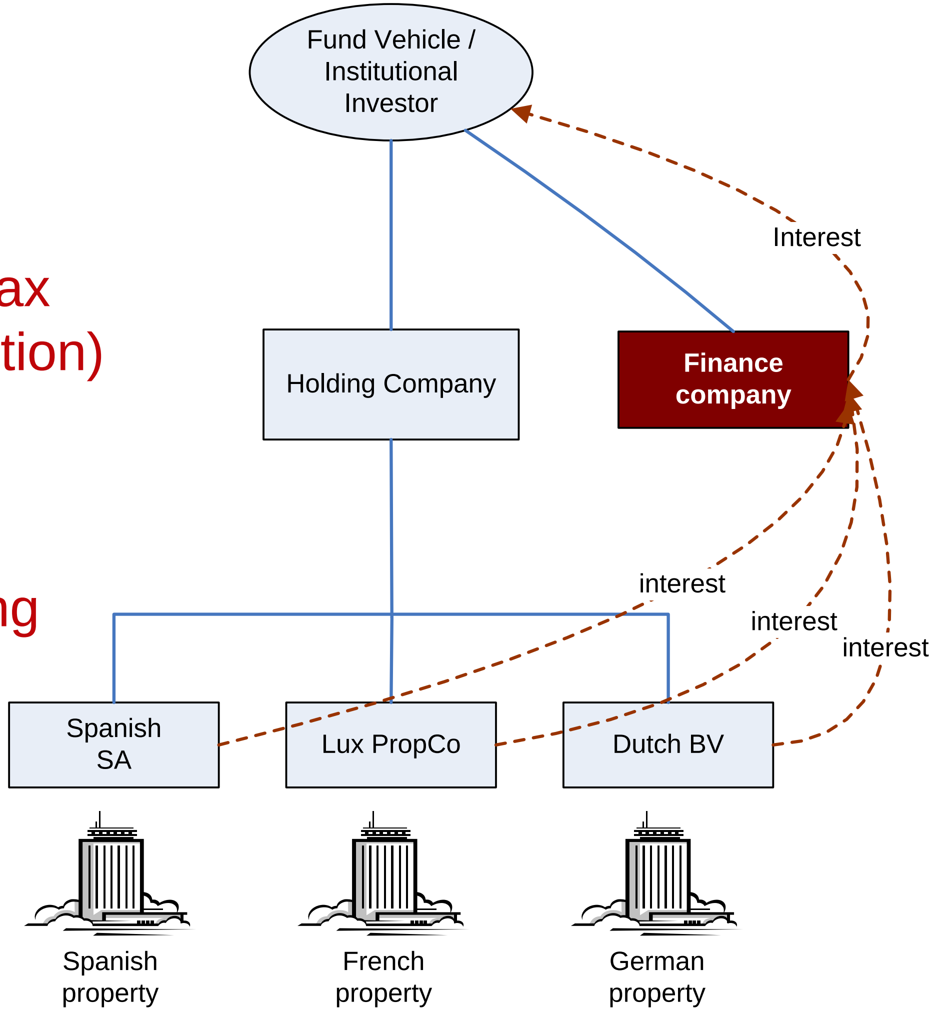
- Tax efficient shareholder financing for the acquisition (no stamp duty, capital duty)
- Flexible funding (repayment of accrued interest and loan principal quicker and less complicated, no shareholder resolution required)
- No need to source distributions through accounting profits – solution for trapped cash
- Tax efficient repatriation of income (no or less WHT provided)



Profit Repatriation Through Interest

Tax considerations

- Avoid withholding tax on interest (tax treaty, EU Directive or local exemption)
- Internal leverage issues
  - Transfer pricing
  - Thin capitalization
- Need for obtaining binding tax ruling
- Beneficial ownership & substance issues
- FinCo is usually taxed on interest spread



Common vehicles for real estate investments

Funds can be structured as:

- Open-ended funds
- Closed-ended funds
- REITs – Real Estate Investments Trusts

E. Suitable Fund Vehicles

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Popular Fund Vehicles – United Kingdom (UK)

Jurisdiction	United Kingdom	
Vehicles	Limited Partnership	Open Ended Investment Company (note 1) / Authorised Unit Trust (AUT)
Level of regulation	Light / None	Medium
Set-up time	1 week – 1 month	3 months
Paid-up capital	£ 1	Variable capital
Foreign funds	Some restrictions	Some restrictions
Investment restrictions	Yes	Yes
Borrowing restrictions	Yes	Yes
Taxation of fund	No	Yes (note 2)
Treaty access	No	Yes

*note 1 – OEICs can be either be Property Authorised Investment Funds (‘PAIF’) or not
note 2 – although if the OEIC is established under the PAIF regime this acheives effective tax exemption at the fund level

Popular Fund Vehicles – Luxembourg

Jurisdiction	Luxemburg	
Vehicles	SICAV	FCP
Level of regulation	Heavy	Heavy
Set-up time	2 – 3 months	2 – 3 months
Paid-up capital	€ 125,000	€ 125,000
Foreign funds	No restrictions	No restrictions
Investment restrictions	Yes	Yes
Borrowing restrictions	Yes	Yes
Taxation of fund	No	No
Treaty access	Limited	Limited

Popular Fund Vehicles – United States (DELAWARE)

Jurisdiction	United States - DELAWARE
Vehicles	Limited Partnership / Company
Level of regulation	Light / None
Set-up time	3 days – 1 week
Paid-up capital	$ 0
Foreign funds	Some restrictions
Investment restrictions	Yes
Borrowing restrictions	Yes
Taxation of fund	Yes
Treaty access	Yes

Popular Fund Vehicles – Cyprus

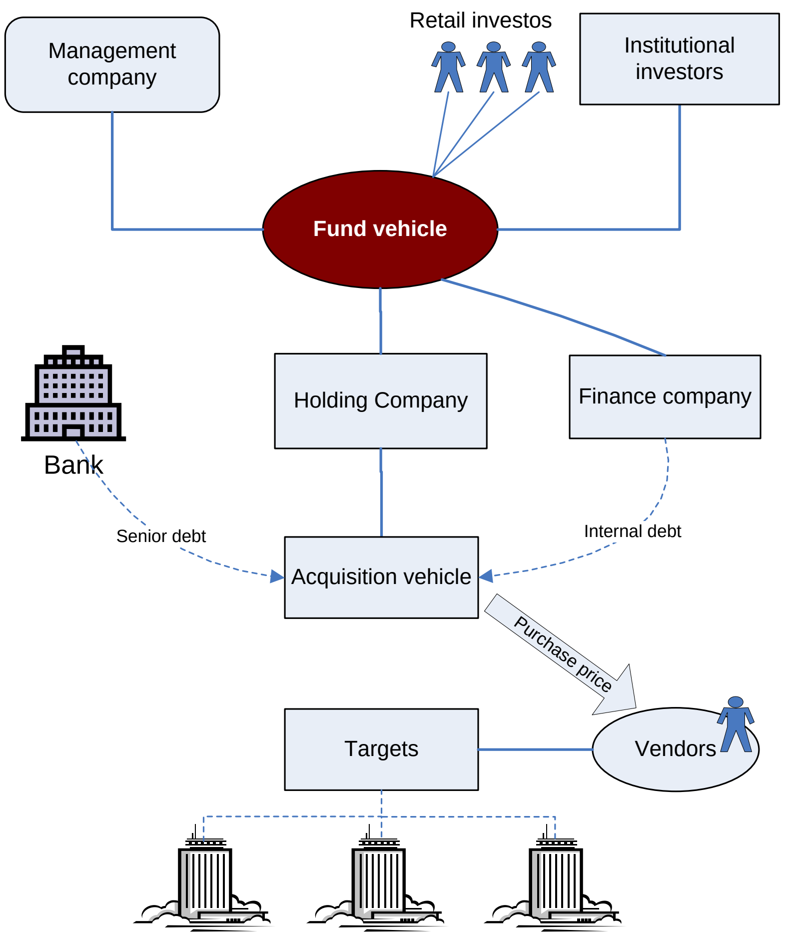
Jurisdiction	Cyprus	
Vehicles	SICAV/FCP	Holding Company
Level of regulation	Heavy	No
Set-up time	2 – 3 months	3 working days
Paid-up capital	€ 125,000	€ 0
Foreign funds	No restrictions	No restrictions
Investment restrictions	Yes	No
Borrowing restrictions	Yes	No
Taxation of fund	No	No
Treaty access	Limited	Full

Fund vehicles

Luxembourg

Regulatory

- Investment company (SICAV/SICAF), Unit trust (FCP)
- Generally, management company must be located in Luxembourg (outsourcing possible)
- Some vehicles are subject to extensive investment and borrowing restrictions
- No restriction on ownership percentage



Fund vehicles

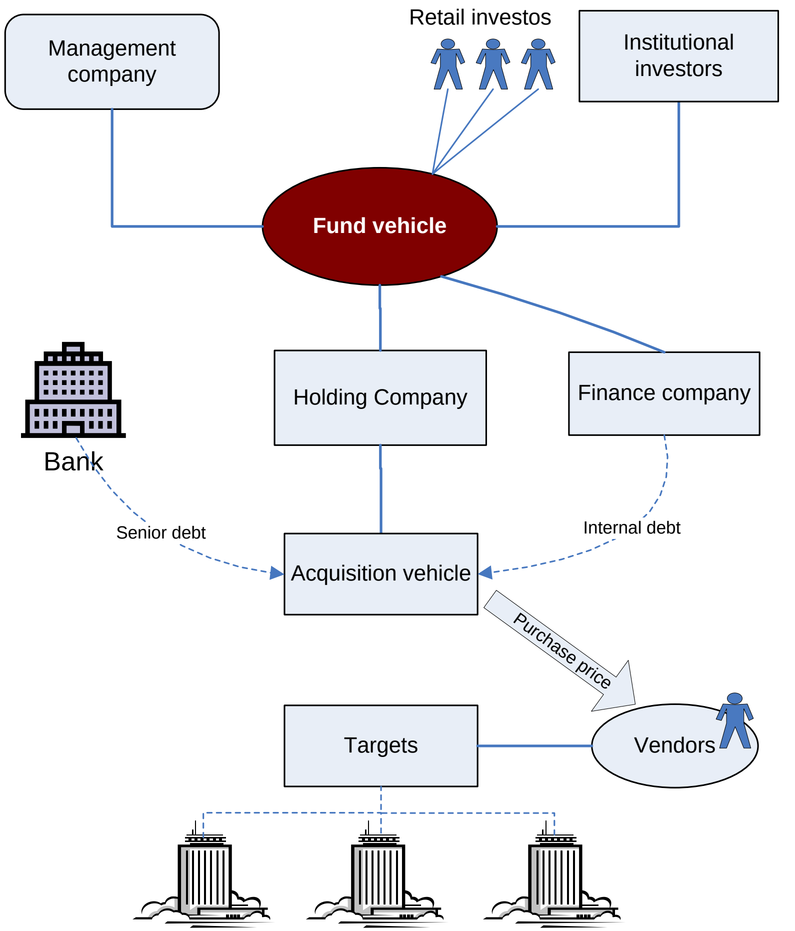
Luxembourg

Taxation

- Annual fixed registration duty (€1.250) and annual subscription duty in SICAV (0.01%-0.05%)

- Non-resident unit-holders may be subject to capital gains tax if participation is > 10 % within 5 years and sale takes place < 6 months. This does not apply to FCPs.

- Double tax treaty either for fund or investor is normally accessible

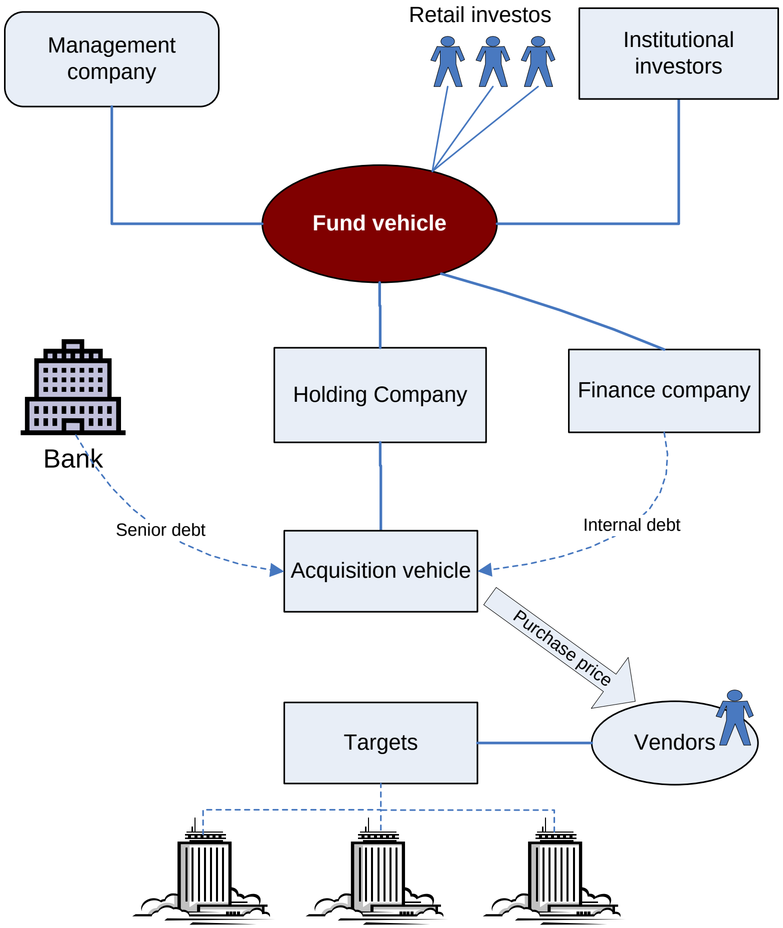


Fund vehicles

UK

LP Regulatory

- A limited partnership is governed by the Limited Partnerships Act 1907.
- A limited partnership requires to be registered with the Registrar of Companies.
- There is a very small registration fee and there are no annual fees.

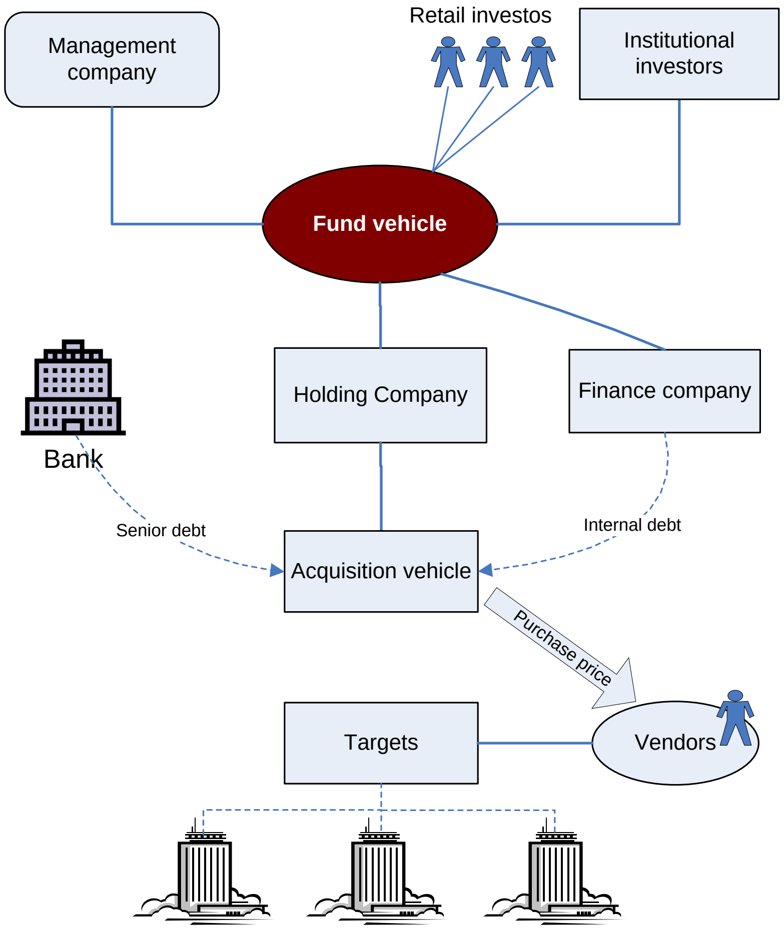


Fund vehicles

UK

LP - Taxation

- No taxation for fund, or non UK resident investors provided that there is no UK source income
- As it is a transparent entity, investors will be subject to tax dependent on their own tax status
- No double tax treaty benefits but investors may look though to the underlying assets
- There is an annual tax filing requirement if there are UK resident investors or a UK resident General Partner



F. Q&A / Case Studies

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THANK YOU
for YOUR Attention!

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