

Real Estate Tax Services Newsalert

Italy

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An update on the Italian SIIQ regulation

The SIIQ (*"Società di Investimento Immobiliare Quotata"*) is a new vehicle for investments in Italian real estate, the Italian version of the better known REITs in force in other countries.

The basic Italian SIIQ regulation, provided by the 2007 Financial Bill, has recently been completed by Ministerial Decree dated September 7, 2007, no. 174 (*"the Decree"*). The Decree provides some of the expected implementation rules. Furthermore, the Head of Tax Office's Decision of November 28, 2007, provides for regulation governing the exercise of option to switch to the SIIQ regime and approving the relevant application-form.

The option for the SIIQ regime can now be exercised by eligible companies, taking into consideration that for those having tax periods corresponding to the calendar year, the first tax period from which the new civil and tax regime will be applicable will be the tax period starting from January 2008.

Brief summary of the SIIQ regime

The SIIQ regime was introduced by Law no. 296/2006 of (*"2007 Financial Bill"*) and represents a new vehicle for real estate investments. It consists of a special civil and tax regime applicable to Italian companies limited by shares (*"SpAs"*), provided that the following conditions are met:

- shares of the company - whose *"prevalent"* business is the leasing of real estate - shall be listed on an Italian regulated stock market;
- no shareholder shall hold, directly or indirectly, more than 51% of the voting rights nor be entitled to more than 51% of the profits; and
- at least 35% of shares shall be held by shareholders each one holding, directly or indirectly, not more than 1% of the voting rights nor entitled to more than 1% of profit.

To this end, a leasing business is deemed *"prevalent"* when:

- at least 80% of the assets are represented by real estate properties and used for such leasing business or investments in other SIIQs; and
- at least 80% of the annual turnover is derived from the leasing business or dividends distributed by SIIQs.

The SIIQ is required to distribute annually at least 85% of its net profits deriving from its leasing business and from investments in other SIIQs.

From an income tax standpoint, income deriving from the leasing business and from investments in other SIIQs is exempt from corporate income taxes.

Dividends distributed to shareholders are subject to a 20% withholding tax at source. The withholding tax is not applied for distributions to: SIIQs, Italian pension funds, Italian undertakings for collective investments and private wealth management subject to substitute tax regime.

This special regime may also be applied by non-listed Italian companies limited by shares provided they are controlled by a SIIQ or are jointly controlled by

SIIQs, for at least the 95% of the voting rights and participation to profit and the other SIIQ requirements are met.

The special regime is applicable, upon prior irrevocable option, starting from the first period commencing after 30 June 2007.

The switch to the special regime implies the realisation, at fair market value, of the real estate properties owned and used for the leasing business. The net capital gain will be subject to a 20% substitute tax - payable over a period of 5 years -, rather than to the ordinary corporate income taxes.

A favourable indirect taxes regime and reduced substitute taxation are provided for contributions of real estate properties to SIIQs.

The SIIQ implementation rules

The Decree has regulated some implementation aspects of the SIIQ regime, as provided by the 2007 Financial Bill, and has clarified some aspects of the SIIQ regime not previously detailed in the 2007 Financial Bill, including among others:

Investment rules – The SIIQ's by-laws must regulate the SIIQ's investment policies.

Limits to risks concentration – This matter has to be ruled by the SIIQ's by-laws.

Gearing – The definition of the maximum admitted leverage, both at the SIIQ and at the group level, is delegated to the SIIQ's by-laws.

Supervision – SIIQ will be supervised by the Bank of Italy and by the CONSOB (the Italian National Commission for Listed Companies and the Stock Exchange).

Prevalence requirement – For the purpose of the asset test, the real estate properties VAT credits and other assets attributable to the SIIQ's own operating business are excluded from the computation.

Prevalence requirement – For the purpose of the income test, income related to buildings under construction and destined to be used in the leasing business are excluded from the computation. With respect to capital gains, specific rules are provided.

Loss of the SIIQ status – In addition to the cases stated by the law, the SIIQ status is lost in the tax period in which both prevalence requirements (concerning asset and income) are not observed.

Asset contributions - The 20% substitute taxation for net capital gains deriving from contribution of real estate properties to the SIIQ may be applied also for properties not attributed to the exempt business.

Regional tax on production - For the purposes of the regional tax (IRAP), which has taxable base different than the corporate income tax, the tax exemption applies on the part of the taxable income attributable to the revenues derived from the exempt business.

Costs carried forward - Costs incurred in tax periods prior to that from which the SIIQ regime applies, carried forward according to tax rules, are split in equal amount between the exempt and the taxable businesses if not referable to specific activities/assets.

Tax losses - Tax losses deriving from the exempt business cannot be used to offset the income of the taxable business, and are deemed to be “virtually” offset with the exempt income of the following years (within the time limits provided by ordinary rules). In case of withdrawal from the regime, the carried forward tax losses of the exempt business can be used, in accordance with ordinary tax losses carry-forward rules, to offset taxable income raised in the tax periods after the withdrawal from the regime.

Tax credit for foreign taxes – The tax credit for foreign taxes suffered in respect of real estate properties held abroad and related to the exempt business is recognised under conditions and within limits applicable as in absence of the special regime.

Distributions and reserves – For the purpose of the annual distribution requirement, it is stated that if the profit derived from the exempt business is reduced by a loss from the taxable business, the profit from the same business realized in subsequent years is considered as derived, up to the amount of the reduction, from the exempt business, with consequent relevance for distribution. The Decree regulates the utilisation of reserves set up before and during the regime.

Tax consolidation – The SIIQ can apply for the tax consolidation regime as a consolidating entity. The SIIQ may be a consolidated entity only if the consolidating entity is another SIIQ.

Formalities to exercise the option

With the Head of the Tax Office's Decision of November 28, 2007, the Italian tax authorities have defined the formalities to be fulfilled for the exercise of option for entry into the SIIQ regime and have approved the application form to be used for this purpose.

The option has to be exercised by filing the approved form to the tax authorities before the end of the tax period prior to the first one under the new regime. The option is irrevocable.

The requirements to switch to the SIIQ regime have to be met from the beginning of the first tax period from which the SIIQ regime is intended to be applied.

With particular reference to the listing requirement for SIIQ's shares, as a transitional rule applicable only for the first tax period commencing from June 30, 2007, the option is deemed valid if filed by the stated deadline and the shares are admitted for trading on a regulated market by April 30, 2008.

Closing remarks

Some relevant aspects of the SIIQ regime still remain unclear.

For example, it is not clear if SIIQ's may apply Double Tax Treaties and EU Parent-Subsidiary Directive for dividends paid in connection with the exempt

income. The relevance of this point is emphasized considering that certain foreign investors may be exempt from Italian taxation for distributions made by Italian real estate investment funds.

These aspects, among others (such as the tax treatment of capital gains derived from disposal of assets related to the exempt business), also require official clarifications.

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