Introduction – Signs of life in Central and Eastern European real estate

Welcome to the first edition of CEE Real Estate Insights. Central and Eastern Europe, as we see it, extends from the Balkans to the Baltics and from the old frontier of Germany and Austria across the 11 time zones of Russia, covering 28 markets. The diversity of our region is vast in many respects, both culturally and economically, and with regards to the depth of the crisis.

Having been the darling of opportunistic investors and steadily maturing to a core-plus play for the more well established institutional players in recent years, the emerging markets took a hit in late 2007, alongside all other global markets, when the world economy stalled. But life goes on and real estate activity continues.

Down from a record investment volume of EUR 14.5 billion in 2008, 2009 was a very lean year with volumes contracting to EUR 2.5 billion, of which around EUR 2 billion occurred in the second half. However there are signs that market conditions are improving. The profile of buyers has changed, with German open-ended funds dominating prime deals. There has also been an emergence of local buyers and a greater number of off-market transactions. Yield decompression has led to significant downward shifts in valuation, making anything other than prime and some secondary stock effectively non-tradable. As demonstrated in other markets, opportunistic investors have stated their intention to pick up distressed opportunities, but these have not yet arisen in the main. An expectation gap in the Bid/Ask spread has also prevented transactions. There is, however, a general feeling of stability returning and with Bid/Ask spreads narrowing significantly, there is genuine hope that more deals will be done in 2010.

An obvious impact of the crisis has been the introduction of differentiation to CEE real estate markets. As noted above, CEE as a region is very diverse, comprising a number of emerged, emerging and what were developing markets. In 2009 the market recognised that prime offices in Warsaw or Prague, for example, do not warrant the same yields as logistics or shopping galleries in secondary cities in Romania or Ukraine. Some real estate markets have also been severely impacted by the general state of the national economy, such as the Baltics and Ukraine. In some more extreme cases, like Kazakhstan, construction of real estate was one of the major factors fueling the country’s national crisis.

To contact any of the authors, please click on their names. For details of other real estate contacts across the CEE region and elsewhere, please email the CEE real estate insights team.
Introduction – Signs of life in Central and Eastern European real estate

As in other markets the liquidity situation in CEE has been severely constrained, with the supply of debt extremely tight. Rather than writing new business, we have seen a lot of banks’ time consumed by managing covenant breaches, with waivers, fees, margin increases and rescheduling all being used to varying extents. For new loans banks require a greater pre-lease (often above 50%), higher equity and higher margins than in the past making new developments very rare. The distressed transactions which had been anticipated have not happened yet, but we do see some action from the banks. In Romania, for instance, there is evidence of banks supporting development schemes to ensure that completion is reached and to help projects reach a cash generating phase, either through lettings or sales.

In the occupancy market take-up has continued but, as with investment, levels are down from record years and vacancy is increasing. The take-up is absorbing some overbuild from the past and putting downward pressure on rents. However, the tough financing environment will restrict new development in the mid-term given the requirements of high pre-leases, equity and margins. While positive in the short-term, this could lead to shortages in more sought after areas and developments in the mid-term. For developers, decompression has brought investment yields in line with development yields, removing the incentive to sell completed projects. As such, capital is not rolling into new projects and there is also a ceiling on yield uplifts.

On the opportunity side, while the investment and development markets have been challenged, asset management is the word of the moment. Distressed asset sales and debt buybacks haven’t happened yet, but the anticipated need for refinancings over the coming two years could bring some forced sales to the market. Anticipated tax changes may also require some restructuring to shore up returns in existing structures. While the difference in expectations between buyers and sellers has prevented deals from being done, there is clearly space for structured solutions either through joint ventures (JVs), earn-outs or pricing adjustments. Effective asset management and optimisation of existing portfolios also allow opportunities for both owners and occupiers in the current environment.

I trust that you will find our Insights useful and look forward to working with you across CEE as a new phase unfolds.

Glen Lonie
CEE Real Estate Leader
What price paper losses?

Recent months have seen turbulent conditions in CEE real estate markets, and most jurisdictions have experienced a marked fall in commercial property values. Transactional activity has been limited and banks have adopted a risk-averse approach to property financing, as they strive to reduce their exposure. This article looks at some of the financial and tax issues arising as a result of these market developments.

Yield shift in CEE

There seems to be consensus among the major valuation companies that prime yields have shifted upwards, although there is no clear consensus by how much, with estimates ranging from 50 to 200 basis points for various property types and locations.

It is widely agreed that it is impossible to generalise as to where yields stand for non-prime properties. What is clear is that, in the absence of significant rental growth – which does not seem to be on the immediate horizon – investors will be under increasing pressure to recognise valuation losses when reporting their financial results.

While this is a major concern for owners who are forced to sell, other investors could argue that the losses are only paper losses, as they can afford to hold on to the affected properties. So is there any real damage for such investors?

Even if debt covenants may have to be reviewed for compliance with loan-to-value thresholds, banks in general have so far not been proactive in imposing sanctions for covenant breaches, and in most cases are content to waive covenants or use breaches simply as leverage for renegotiation of terms rather than withdrawing financing altogether. As long as borrowers are able to service their interest payments, that seems to satisfy most banks right now.

Refinancing current borrowings

But what happens if the banks start to take a harder line on covenant default? Or if occupier issues start to take a toll on a property’s net operating income levels?

Tenants are increasingly likely to demand a rental decrease given the focus on cost reduction across the industries, even if only on a short-term basis. Any concessions given are going to impact net operating income and therefore interest cover, which could send a signal to the banks to start looking at things even more closely. In a worst-case scenario,
What price paper losses?

This could lead to the bank calling in part or all of a loan.

Let us look at a numerical example. Let us assume a company borrowed CZK 140 million to finance a single-tenant property at 70% LTV when yields were at 6%. Let us also assume that the bank insisted on a covenant for a minimum 70% LTV ratio. The sole tenant is now demanding a 10% cut in rent – otherwise they may run into business continuity issues themselves – and yields have just shot up by 100 basis points.

The new value of the building is CZK 154 million (down from CZK 200 million), assuming the landlord accepts the 10% cut and sees it as a sustainable rental level moving forward. The bank is therefore in theory now only able to finance CZK 94 million. The investors will need to come up with an additional CZK 46 million of financing in order to extend or repay the loan. The alternatives are for the bank to call in the collateral, ask for additional security and impose tougher conditions or waive the rather obvious covenant breach.

A little less hospitality?

Other industries with a heavy real-estate dependency also face increasing challenges in light of the downward pressure on market values.

For landlords in the hospitality industry, the issue has been compounded by the fall in tourist numbers in most CEE countries. As operating results fall, rents are likely to need to go in the same direction. With market yields going down in general, this could lead to rather a large slice being written off the value of the related properties.

It is going to require a significant amount of compromise between landlords of hotel properties and the hotel operators in order to establish the best balance to ensure survival. There is likely to be much reorganisation of pricing arrangements, as well as financing arrangements, and business plans will need to be scrutinised to the last detail to convince investors and financing institutions to continue to support the property owners and tenants through the reorganisation process.

In the end, it may be those who come up with the most innovative solutions that come out of the crisis in the best shape.

Accounting for impairment

What are the key issues management need to consider from an accounting standpoint?

Companies account for their properties using either the fair value model or the cost model. In the case of the fair value model being adopted, it is clear that a fall in the market value of a property will lead to a fall in the reported value. Under IFRS, such falls in value are reported as part of a company’s result for the reporting period. We have seen record losses reported by property companies in the past year, the one significant contributing factor behind this being losses from properties reported at fair value.

In the case of the cost model, IFRS requires impairment to be recorded where certain conditions apply. Accounting rules in many CEE jurisdictions are not as explicit as IFRS. However, given that most local accounting rules require that financial statements reflect all inherent risks relevant to an understanding of the financial statements either in the balance sheet or in the notes to the financial statements, it is often to IFRS that we turn for best practice guidance. The set of indicators set out in IAS 36 as to when a company should test for impairment are as follows:

(a) during the period, an asset’s market value has declined significantly more than would be expected as a result of the passage of time or normal use.
(b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.
(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset’s value in use and decrease the asset’s recoverable amount materially.

(e) evidence is available of obsolescence or physical damage of an asset.

(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.
If an indicator is identified, impairment must be measured and recorded. The impact of impairment, similar to that of falls in the fair value of properties, is reported as part of a company's result for the period.

What if management choose to ignore impairment indicators?

Let us look at an example to illustrate the consequences of not recording impairment properly. Suppose that Company A bought a property at a yield of 5.5% for CZK 180 million in 2008, financed by 20% equity and 80% bank debt. At the end of 2008, the yield has shifted to 6.5% and the property is now worth CZK 154 million. Suppose also that the bank waived a LTV covenant of 80% at the end of 2008, but during 2009, at the instruction of its parent company, the bank has been forced to call in the financing.

Company A is unable to raise additional funds, and therefore enters into a forced sale for CZK 140 million.

It is clear from the above that a loss of CZK 40 million has been generated by the transactions, however, only CZK 14 million of this can be attributed to 2009. The remainder was the result of yield decompression in 2008, and should therefore be matched to the financial results of that year.

If Company A had not accounted for impairment at the end of 2008, its financial results would not properly match its performance for that period and the loss due to yield decompression would be reported in the wrong period.

It is commonly argued that impairment is unlikely to arise in CEE countries, as the vast majority of transactions are share deals rather than asset deals, so for accounting purposes, historic figures are used to record properties, often at a significant discount to market value. However, as asset deals become more common as investors seek to avoid issues arising from purchasing a company with a history, impairment issues are ever more likely to arise. Furthermore, if a company has undertaken a restructuring or merger in recent years, impairment could lead to the reversal of revaluation uplifts arising from these transactions.

Continued
What price paper losses?

Time for restructuring

One consequence of impairment which also needs to be considered is a company’s thin capitalisation position. Impairment charges impact the equity position, and may therefore trigger the need for additional equity contributions or conversion of debt into equity in order to maintain the debt / equity ratio of a company and preserve the tax deductibility of financing costs.

Let us look at another example, assuming further that a jurisdiction imposes a 4:1 debt:equity limit on the tax-deductibility of financing costs from related parties. A company has equity of CZK 20 million and shareholder financing of CZK 80 million.

On obtaining its year-end valuations, the company finds that it needs to record an impairment charge of CZK 10 million, reducing its equity to CZK 10 million. In some jurisdictions, the impact is recognised through the income statement, therefore this may not impact the thin capitalisation position immediately.

However, management will at some stage need to restructure the debt:equity financing split of the company. If they fail to do so, they may find themselves in a position whereby only the interest on the first CZK 40 million of shareholder financing is allowable for a tax deduction.

What steps need to be taken by management now?

Changing things on 31 December may not always work. Some structuring arrangements take weeks or even months to organise.

The most important thing for management is to ensure that the position and the issue are properly understood. Advisors are always at hand to provide guidance, and this advice may not necessarily be cost-prohibitive.

Investors need to look at the impact of the valuation changes on their business models and may need to reconsider their exit strategies. Management need to ensure that the financial information reported to the investors is meaningful and provides the full picture.

Communication is key in ensuring that mistakes are not made which could prove costly later.

Here are some questions management and investors alike should be asking themselves:

- Have I considered whether impairment may impact my business?
- Are my impairment calculations based on reasonable forecasts and do they take into account all relevant factors (such as rent indexation, committed changes in tenancies, currency issues)?
- How can I minimise the lead time between identifying impairment and taking remedial action for any tax implications?
- Do I need to implement better communication channels with my providers of debt and equity financing?

One message we consistently hear from both market players and advisors is that you need to understand the risks in order to mitigate them. Those who are best prepared for the impacts of yield decompression are likely to come out strongest on the other side of the crisis.

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How to survive the crisis through property optimisation

With crumbling revenues and tightened bank lending, companies are now more often turning to their real estate assets in order to generate cash for operations and investment in their core businesses. This is a good time to optimize property assets, as partners on the real estate market are more flexible regarding renegotiation of earlier signed contracts.

In addition to the obvious financial merits, real estate optimisation can have a positive impact on other aspects of a business. One of the benefits is the improved organisational structure and internal communication generated from department relocation in order to use office space more efficiently. Property optimisation is also an advantage in terms of marketing and public relations.

In times of economic slowdown there are many ways to optimise the way a company uses its property, apart from simply cutting costs. Property optimisation should be focused on maximising current operational efficiency, satisfying existing and future needs while balancing the economic rationality with the overall strategy of the business.

Cost optimisation and cost efficiency index

Property cost optimisation starts with breaking down existing costs into different groups, and comparing them against an earlier agreed benchmark (i.e. an average cost derived from the broader market or average cost of a real estate portfolio). Consequently, the first step in cost optimisation is to set an accurate and appropriate benchmark as it is crucial to have a good point of reference when analysing costs. Access to local market data is vital at this stage; therefore seeking advice from companies in this area has become increasingly popular.

During benchmarking, certain cost efficiency index thresholds are established. A breach of the thresholds in any particular group will need to be investigated. After identifying appropriate savings, actions need to be undertaken in order to enhance the cost efficiency of the property. These cost efficiencies may include renegotiations of contracts for cleaning, maintenance services, energy or water. Additional savings can be derived by taking steps to promote a cost-cutting attitude among employees.

In extreme cases where buildings generate costs which are incredibly high, a cost efficiency analysis may be the basis for a decision to relocate the company to another property which is more cost efficient.

Continued
Revenue optimisation

Property optimisation concerns not only cost saving, but also identifying new revenue generating streams. It is useful to investigate if you are missing an opportunity for revenue, even if the property is owner-occupied and not held for the purpose of generating revenue from leasing. An example of a non-core revenue stream could be the surfaces on buildings that may be suitable to lease for advertising purposes, thereby providing additional inflow.

The first steps when investigating an investment property is to perform a comprehensive analysis of the level and type of revenue generated. By cross-referencing data from the market or from other properties from an investment portfolio, it is possible to assess whether a building is as profitable as possible or if there is room for improvement. There are many ways to improve the profitability of real estate property, including restructuring, redeveloping or changing the designation of a building.

We have noted that the risk of payment delinquency has recently increased. The generation of revenue from a property is important, but collection of payments is the priority. Monitoring receivables from tenant contracts can be a useful method to avoid bad debts.

Space optimisation

When searching for savings, it is worth analysing whether space is being wasted. It is very likely that savings can be generated by rearranging the physical space in which employees work. The result of space optimisation is that the same space is occupied by a greater number of people. Consequently, extra space is generated which can be used in different and more effective ways, or even sold, in order to generate significant one-off inflows of cash. In a situation when the space is being leased, savings will be generated from sub-leasing or cancelling lease contracts.

The fact that more employees are working in the same building may be desired for other reasons such as operational changes or as part of a company restructuring program. An example of space optimisation would be selling buildings belonging to the company situated in different locations and then leasing space in a different consolidated location.

In 2008 one of the leading telecom operators in Poland, advised by PwC, undertook a program to restructure its property portfolio in Warsaw. As a result, we were able to structure the biggest sale-and-leaseback deal in 2008 in the CEE region. Three office buildings were sold and then leased back to our client in order to generate cash for the future development of a single office complex for the whole company group.

An index used in determining the efficiency of a building is the space utilisation index (total surface divided by the number of employees), which provides information about the space attributable to every employee. How many people can be allocated in the building depends on the property fit-out and construction. Nonetheless, with benchmarks based on market data it is possible to judge whether space is used efficiently or not. The benchmark varies based on the type of business, though administrative properties typically apply an index of 8-10 m² per employee.

Property tax optimisation

In many countries proprietors of real estate assets are obliged to pay real estate tax. Tax legislation varies in each country but the liability is generally determined by property type and its space. PwC has identified a wide range of possibilities to optimise property tax costs.

Real estate tax optimisation includes verifying the property location declared for...
How to survive the crisis through property optimisation

Summary
When searching for real estate savings, it is essential to balance potential savings with the company’s core business as any optimisation or restructuring programmes can have a significant impact on clients and employees. Optimization efforts need to be appropriately communicated to the company’s stakeholders in order to minimize any unnecessary negative impacts.

A disadvantage of property optimisation is that it can last for many months, or even years, depending on the scale of assets being considered for optimisation. If seeking quick solutions such measures are of limited benefit. It is important to analyze and develop a viable action plan before implementing any optimisation strategy. It is crucial to start this process well before the company will actually need the additional funds or savings. An experienced real estate advisory partner should have the expertise and knowledge of the sector, matched with the aspirations of the client, while maintaining a timetable and budget.

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tax purposes and checking the accuracy of the property classification into groups, which are taxed at different rates.

Tax optimisation might also be achieved by undertaking a segregation study. From a tax perspective, the property book value combines the building, furniture and equipment. If these are treated as one or more larger assets, all elements of such a property are depreciated with the same tax rate, likely the rate for the building. Segregating all the various components of a property into groups can identify immediate savings. Furniture and equipment may be depreciated over a shorter period of time, creating higher depreciation costs for tax purposes.

In certain countries, such as Poland, another way to increase the tax base is the “step-up in tax basis”. The objective is to increase the property tax basis to market level so that the taxable capital gain on a sale could be lowered or – if disposal of the property is not intended for some time – tax depreciation could be increased.

A decision to buy or sell a property should be made in parallel with a decision on the tax structure of the transaction. Proper tax structuring of a potential deal provides the possibility to generate additional savings.

All of the above described tax optimisation opportunities may reduce tax costs and thus increase liquidity.
Russia appears to be offering some relief to taxpayers by lowering the corporate tax rate and increasing deductibility thresholds for interest, while at the same time a trend is emerging whereby the country is moving to combat treaty shopping and other potentially abusive tax practices. Of particular note are the proposed amendments to the Cyprus-Russia double tax treaty. If implemented – after a grace period of four years – disposals of shares in Russian real estate-rich companies by Cypriot shareholders will no longer enjoy treaty protection, resulting in potential capital gains taxation in Russia for such transactions. Since Cyprus was generally considered the holding structure of choice for real estate investments in Russia, it may be time to revisit existing and proposed structures to see where changes are necessary.

Transfer pricing also appears to be on the agenda across CEE, with new rules introduced or expected to be introduced in Russia, Poland, Bulgaria and Slovakia. Elsewhere around the region, the Czech Republic has finally introduced anticipated amendments to its investment fund legislation which could stimulate further development of a domestic fund industry, including real estate investment funds. Hungary has introduced a number of tax measures that are not necessarily favourable, including an increase in the corporate tax rate (but elimination of a special tax) and the re-introduction of withholding taxes on payments of interest, royalties and service fees to non-treaty countries, and an extension of the real estate transfer tax as well as capital gains tax to certain share sales. Romania has also introduced some changes aimed at generating additional tax revenues for the state budget in these loss making times, with the introduction of a “minimum tax” applicable even to companies in a loss position. On the other hand, they are also offering or proposing incentives designed to stimulate investment such as tax exemptions for reinvested dividends or profits.

We have outlined below in more detail some of the changes or anticipated changes from the aforementioned territories that may be relevant and interesting to participants in the real estate sector.

For further information on any of these issues, please feel free to contact directly the respective country real estate tax leader listed under each country heading.

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CEE Real Estate Tax Leader
Bulgaria

Contact:
Orlin Hadjiiski

New grounds for mandatory VAT registration for recipients/suppliers under supplies of services with EU

The VAT Act effective as of 1 January 2010 provides new grounds for mandatory VAT registration regardless of the taxable turnover.

All taxable persons receiving services in Bulgaria for which VAT is chargeable by the recipient are subject to mandatory VAT registration (e.g. consultancy, engineering services, services related to real estate in Bulgaria).

With respect to services received from abroad, persons who are also performing exempt supplies or non-economic activities are always to be considered as taxable persons, as are VAT registered non-taxable legal persons.

Likewise, taxable persons established in Bulgaria who render services subject to the general place of supply rule to taxable persons established in other EU Member States are required to VAT register in Bulgaria.

Persons registered solely on the above grounds will not be entitled to deduct input VAT incurred on their purchases.

The above new requirements could lead to an obligation for VAT registration of a foreign person receiving services with a place of supply in Bulgaria from a supplier not established in Bulgaria (for example, services between two foreign persons related to immovable property in Bulgaria).

Shorter VAT recovery period

The period for recovering VAT is generally shortened by approximately 45 days – previously 45 days after a three-month offset procedure, the term is changed to 30 days after a two-month offset procedure.

Amendments related to withholding tax

As of 1 January 2010, it may now be possible to obtain a partial refund of the withholding tax paid by EU/EEA entities (with some exceptions). This measure was implemented in order to allow recognition of expenses related to realised Bulgarian source income (e.g. generated capital gains from the sales of Bulgarian real estate).

The amount of the tax which could be refunded is equal to the difference between the withholding tax paid and the corporate income tax which would have been paid by that entity if it was resident in Bulgaria, to the extent this difference could not be deducted from the tax due in its country of residence.

Recalculation of the withholding tax will be made based on a standard declaration filed by the foreign entity by 31 December of the year following the year of the income accrual.

Excluded from the scope of the above refund mechanism are entities resident in EEA countries with which Bulgaria has neither concluded double tax treaties (Iceland and Lichtenstein), nor has double tax treaties providing for a mutual agreement procedure (Norway).
Broader range for determination of local taxes by municipalities

In 2010 the statutory ranges, within which every municipality is allowed to determine the rates of local taxes, will be broadened compared to those of 2009. The new ranges are as follows:

- **Real estate tax**: 0.01% - 0.25% (in 2009 0.05% - 0.2%);
- **Transfer tax applied upon transfer of real estate and vehicles**: 0.1% - 3.0% (in 2009 1.3% - 2.6%).

Amendments in the tax value of companies’ real estate

As of 1 January 2011, the tax value of a company’s real estate will be the higher of the gross book value and the tax value determined according to the rules in the Local Tax and Fees Act. The purpose of the amendment is to avoid unfair determination of the gross book value, which at present serves as a base for the calculation of the real estate tax and the garbage collection fee.

Transfer Pricing

The National Revenue Agency in Bulgaria intends to finalize and publish Transfer Pricing Guidelines in the coming months. The Guidelines will contain information on acceptable Transfer Pricing methods as well as guidelines on related documentation. Orlin Hadijiski, Bulgaria real estate tax leader, commented: “Although the Bulgarian tax legislation does not contain explicit documentation requirements, the Transfer Pricing Guidelines may provide insight about the type of documents that may be requested by the tax authorities in case of tax audits.”

Czech Republic

Contact:
Stefan Falis

Changes to FQI regime effective from 1 August 2009

A number of changes discussed over the last few years regarding Funds of Qualified Investors (FQI) were finally enacted and became effective from 1 August 2009. These changes may provide a positive stimulus to further development of the fund industry in the Czech Republic.

The main benefit of an FQI is a reduced Czech corporate income tax rate of 5% compared to the standard rate of 19%. Allowing a reduced rate of tax on income from real estate, interest, receivables and other assets will be a key incentive to set up these types of funds.

Below are the main tax and legal characteristics of FQIs:

- **Corporate tax rate of 5% compared to the usual rate of 19%**.
- **An FQI may take the form of a joint stock company, which is the most beneficial for many structures and generally allows for the application of Parent-Subsidiary and Interest-Royalty Directives as implemented in Czech tax law and access to double tax treaty protection**.
- **Flexible restructuring options including non-monetary (in-kind) contributions into an FQI or mergers between an FQI and another unregulated collective investment vehicle (including foreign entities)**.
- **The establishment and administration of an FQI is substantially simplified if the fund is administered by a licensed investment company resulting in more cost efficiency. The original maximum life limitation of 10 years of the FQI in the form of a joint stock company has been cancelled**.

The aforementioned changes will hopefully have the effect of kick-starting the true development of the fund industry in the Czech Republic in the real estate sector – not only for developers but also for manufacturers with a significant amount of real estate in their assets. Stefan Falis, real estate tax leader for the Czech Republic, said: “Given current changes in market conditions, now is a very good time for real estate professionals and other players to consider how using an FQI can help with ongoing management of their investment strategy.”
Estonia
Contact: Peep Kalamäe

The Land Tax Act amended
The amendments to the Land Tax Act which were adopted on 17 December 2009 by the Parliament came into force on 1 January 2010.

From 2010, the land tax notice will be issued by 15 February and only if the land tax payable exceeds EEK 50. Also, the land tax will be payable in two instalments, instead of the three instalments which were applicable previously.

The deadline for paying the first instalment is moved forth to 31 March, to the same date as the deadline for submitting the personal income tax return. The idea of the amendment is that it will become possible to instantly offset the land tax payable against the possible refund of personal income tax. The second instalment is due by 1 October, but only if the tax payable exceeds EEK 1000. Land tax up to EEK 1000 will be fully payable by 31 March.

The person liable to pay the land tax is the owner or usufructuary of the immovable according to information entered in the Land Register at 1 January of the respective calendar year.

In Estonia, the land is subject to annual land tax that is calculated on the assessed value of land at rates between 0.1% and 2.5%, depending on the municipality.

Currently, there is no separate net wealth or property tax in Estonia.

Hungary
Contact: Paul Grocott

Tax changes regarding real estate investment effective 1 January 2010
The Hungarian government has passed changes in tax laws that are negative for real estate investments in Hungary. The measures came into force on 1 January 2010.

The changes are as follows:

- **Gains on sale of shares in a Hungarian company owning real estate**
  Sales of shares in a Hungarian company by a foreign shareholder where at least 75% of the market value of assets is real estate (also if 75% is met on a Hungarian related party level) became taxable, provided that the foreign shareholder is not resident in a country which Hungary has a double tax treaty with (or the treaty allows the foreign exchange gain to be taxed in Hungary).

- **Corporate Taxes**
  The good news is that the 4% special tax was eliminated from 1 January 2010, but the corporate tax rate was raised from 16% to 19%. Since carried forward losses may be used against corporate tax, but not against the special tax, carried forward losses have increased value.

- **Tax losses carried forward**
  Losses may be carried forward and offset against future years’ positive tax bases without time limit. From 1 January 2010, the use of tax loss carried-forward will no longer be subject to the Tax Authority’s approval. However, in case of a Tax Authority audit, the taxpayer should demonstrate that losses are created under the due course of business. The new legislation can be applied in case of 2009 tax losses as well.

- **Withholding taxes**
  Withholding taxes were reintroduced on payments of interest, royalty and service fees to a country which does not have a double taxation agreement with Hungary. The rate of withholding tax is 30%.

  - **Real estate transfer tax on shares**
    The general rate of real estate transfer tax was reduced to 4% from 10% up to HUF 1 billion in sales value and 2% above HUF 1 billion, and the total transfer tax liability may not exceed HUF 200 million per real estate asset.

Until 31 December 2009, there has been no real estate transfer tax levied on companies that own real estate. From 1 January 2010, the acquisition of shares/quotas in a company holding domestic real property is subject to a real estate transfer tax. A company qualifies as a domestic real property holding company if it owns domestic real property, or owns directly or indirectly at least 75% of the shares of a company holding domestic real property. The tax base of the real estate transfer tax is the market value of the acquired company’s domestic real properties.
Kazakhstan

Contact:
Richard Bregonje

Corporate income tax rate reduction in 2013 and 2014

- A reduction in the standard corporate tax rate from 20% to 15% that was to commence in 2011 has been postponed. The corporate income tax rate is now scheduled to decrease to 17.5% in 2013 and to 15% in 2014.

Deductibility of interest

- For Kazakhstan tax purposes deductibility of interest associated with related party debt and/or lenders from certain black listed jurisdictions is limited based on annual average debt-to-equity ratios.
- The deductibility limits were slightly and temporarily relaxed from 1 January 2009. Currently, the debt-to-equity threshold is 9 to 1 for financial institutions and 6 to 1 for other companies. This ratio is scheduled to return to its original values (7 to 1 for financial institutions and 4 to 1 for other companies, respectively) from 1 January 2012.

Taxation of capital gains on the sale of immovable property

- Gains on the sale of immovable property are included in a resident entity's aggregate income for the reporting period, and are subject to income tax at the standard rate of 20%.
- Generally, non-resident's gains on the sale of property (including real estate) which is subject to state registration are subject to tax in Kazakhstan at 15%.
- It is the buyer’s rather than seller’s obligation to pay the Kazakhstan tax. Therefore, the tax is a withholding tax.
- To ensure only the gain is taxed, the seller has to provide the buyer with the documentation supporting its original acquisition cost. In the absence of such documentation, the tax shall be assessed on the total value of the transaction.
- Taxable non-residents have an obligation to register in Kazakhstan to fulfil their tax obligation.
- Failure to comply with the above requirements may have a significant negative impact on taxpayers.

Property tax

- The property tax rate for legal entities is 1.5% of the annual average residual value of taxable items.
- Taxable items include buildings, structures, residential buildings, premises and other constructions that are closely connected to land.

Value added tax

- The sale or lease (sublease) of land is generally VAT-exempt, except for the provision of land:
  - for transport vehicle parking and storage;
  - occupied with a residential building (part of the residential building) which is used for rendering hotel services.
- The sale or lease (sublease) of residential buildings is generally VAT-exempt, except for:
  - buildings used for the purpose of rendering hotel services; and
  - the hotel services themselves.
- The sale or lease of non-residential buildings (e.g., commercial, industrial, recreational, etc.) is considered VAT-able turnover and attracts VAT.
- The current VAT rate in Kazakhstan is 12%.

Real Estate Joint Stock Investment Fund

- A real estate investment trust (REJSIF) is a joint stock investment fund whose core activity is investment in real estate and other qualifying property in Kazakhstan.
- Generally, investment income received by joint stock investment funds is exempt from corporate income tax in Kazakhstan under certain conditions.

Double Tax Treaties

- Most double tax treaties allow Kazakhstan to tax capital gains from the sale of shares and similar rights in a company whose assets consist principally of immovable property situated in Kazakhstan.
- However, there are few exceptions, e.g. Austria.
- Most double tax treaties concluded by Kazakhstan allow for interest withholding tax rate of 10%. However, beginning 1 January 2009 Kazakhstan’s domestic legislation provides for 0% withholding tax on interest associated with debt securities listed on Kazakhstan stock exchange.
Poland
Contact: Tomasz Ozdzinski

Significant changes to VAT taxation of developed real properties as of 1 January 2009

As of 1 January 2009 major amendments to the Polish VAT regulations regarding the VAT taxation of supplies covering buildings were introduced.

According to the currently binding Polish VAT Law, sale of buildings (VAT treatment of land follows VAT treatment of the buildings) is generally exempt from VAT. This exemption is not applicable in case of transactions made before or upon the so-called ‘first occupancy’, or within two years from the first occupancy (i.e. generally taxed with VAT) is VAT exempt in cases where the vendor was not entitled to decrease the output VAT by the amount of input VAT incurred on acquisition of the building and certain other conditions are met. This VAT exemption is obligatory, i.e. the taxpayer is not allowed to opt for the VAT taxation of the effected supply.

Since cases of improper VAT treatment of the transaction adverse tax consequences may arise, prior to effecting such transaction detailed analysis of VAT treatment should be performed.

Increase of maximum real estate tax rates

Maximum rates of real estate tax in Poland (a local tax which applies to land, buildings and constructions used for business purposes) have been raised in line with Consumer Price Index, i.e. by 3.5% on average.

As of 2010, the maximum real estate tax rates related to business activities amount to:
- PLN 0.77 per square meter of land
- PLN 20.51 per square meter of usable area of buildings
- 2% of the value (generally equal to the depreciation base) of constructions

The actual tax rates applicable to properties in a given municipality are determined annually by the local council, but may not exceed the above maximum rates.

Reduction of withholding tax rate on interest, royalties and other payments of similar character

According to the Polish Corporate Income Tax (CIT) Law, revenues from interest, royalties and other payments of similar character made by a Polish tax payer to a non-resident recipient are subject to 20% withholding tax. However, when the conditions specified in the Polish CIT Law are fulfilled, withholding tax on such payments made by Polish corporate residents to EU companies (and Swiss companies) is – as of 1 July 2009 – reduced to 5%.

The said change is the result of transitional periods in unification of Polish Law with European regulations (Directive 2004/76/WE). The ultimate goal of these changes is to eliminate withholding tax on this kind of revenue originating in Poland, although the European regulations are implemented gradually. Thus, the standard 20% withholding tax rate as of 1 July 2005 was decreased to 10% and subsequently reduced again to 5% from 1 July 2009. From 1 July 2013 the full exemption should apply.

Pursuant to the Polish CIT Law, the preferential regulations apply to the following revenues:
- interest
- copyrights
- rights to invention designs
- trade marks and design patents, including revenues on the sale of such copyright
- fees for the access to a secret recipe or production process
- the use or the right to use an industrial, commercial or scientific device and also a means of transport
- the information connected with the experience acquired in the industrial, commercial or scientific field (know-how)

The reduced withholding tax rate applies only if:
- the payment is made between companies (branches) located in EU (and Switzerland); and

Continued
the payment is made by an entity (a Polish company), which holds directly not less than 25% of shares in the capital of a recipient of the payments (company from different EU member state or Switzerland); or

• a recipient of the payments holds directly not less than 25% of shares in a capital of an entity, which makes the payments; or a direct shareholder of both - an entity, which makes the payments and of a recipient of this payment - holds not less than 25% of shares in the capital of these entities.

Shares should be continuously held for at least two years. Moreover, the recipient’s place of residence should be confirmed with a certificate of residence.

Elimination of double taxation
The new decrees introduce regulations regarding the procedure of elimination of double taxation, applicable to a price adjustment in cross-border transactions between related parties or in cross-border settlements between a head office and its permanent establishment. The procedure is based on the Arbitration Convention and double tax treaties. According to the new regulations, local taxpayers are entitled to file an application to the Minister of Finance to initiate a mutual agreement procedure (“MAP”) in order to avoid double taxation. In principle, the application should be submitted within three years from receipt of a decision or a protocol that leads or may lead to double taxation. If the Minister of Finance believes the application is justified but cannot approve it under domestic proceedings, he should initiate a MAP.

Increased significance of transfer pricing documentation
Under the previous transfer pricing decree, if the taxpayer appropriately applied one of the traditional transfer pricing methods, the tax authorities were obliged to use the chosen method. The new Decrees provide an additional condition that should be met for acceptance of the method chosen by the taxpayer. The taxpayer will have to provide transfer pricing documentation compliant with the provisions of art. 9a of the CIT Law. Consequently, preparation of comprehensive transfer pricing documentation becomes even more significant.

Comparability analysis
The new decrees specify in more detail regulations concerning comparability of transactions concluded between related and unrelated parties:

• based on the TP Guidelines, five comparability aspects are determined – (i) characteristics of the subject of the transaction (ii) characteristics of the parties (iii) conditions of the transaction (iv) economic circumstances at the time and place of the transaction (v) business strategy applied;
• comparability criteria when comparing different markets;
• the importance of assets used in the transaction, including tangibles, intangibles, human capital and other assets;
• only significant economic features of a transaction should be taken into consideration;
• an analysis of the entire industry relevant to the transaction (without strict comparability of the subject of the transaction) is permitted – providing that other comparability criteria are met.

Transfer pricing methods
Significant changes were made to the profit split method. The most crucial change was deletion of the sentence permitting the decrease of profits allocated from the first stage of the residual analysis by any loss from the second stage of the analysis. Arguably this suggests that split of losses within the second stage of the residual analysis is not permitted. However, the Minister of Finance should consider the provisions of the TP Guidelines, which explicitly allow the splitting of losses under the profit split method. Therefore, this issue remains open.

The new Decrees introduce small changes to descriptions of the transfer pricing methods. The definition of the cost plus method was slightly adjusted and the term “margin” was substituted by “mark-up”.

More lenient rules on excessive costs being non-tax deductible
Under the new Decrees, taxpayers are entitled to substantiate costs incurred in related party transactions where the costs evidently exceed the expected benefits. The previous Decree was stricter in this respect and simply denied deductibility of such costs.
Romania

Minimum tax

As of 1 May 2009 a minimum tax was introduced for profit tax payers (Romanian companies as well as foreign companies operating in Romania through a permanent establishment). The minimum tax is due if the profit tax is lower than the minimum tax. Thus, even companies in a loss position will be required to pay some tax.

The minimum tax is determined based on the revenues reported on 31 December of the previous year, using the following thresholds:

<table>
<thead>
<tr>
<th>Total annual revenue (RON*)</th>
<th>Annual minimum tax (RON)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 52,000</td>
<td>2,200</td>
</tr>
<tr>
<td>52,001 – 215,000</td>
<td>4,300</td>
</tr>
<tr>
<td>215,001 – 430,000</td>
<td>6,500</td>
</tr>
<tr>
<td>430,001 – 4,300,000</td>
<td>8,600</td>
</tr>
<tr>
<td>4,300,001 – 21,500,000</td>
<td>11,000</td>
</tr>
<tr>
<td>21,500,001 – 129,000,000</td>
<td>22,000</td>
</tr>
<tr>
<td>Over 129,000,001</td>
<td>43,000</td>
</tr>
</tbody>
</table>

*The current exchange rate is 4.2 RON/EUR

Note that this tax is currently under discussion and it may be amended (or even abolished) in the future.

Step-up in value of real estate property

Previously, as a general rule, revaluations of real estate assets performed in accordance with the accounting regulations (i.e. at year-end) would also trigger a step-up in fiscal value of the respective real estate assets, which could be deducted gradually through depreciation. The resulting reserve would become taxable only at the moment of utilisation (e.g. for covering accounting losses or for distribution to shareholders). This created an effective deferral of tax up to the moment when the revaluation reserve was used.

Since May 2009, such step-up with tax deferral has not been allowed. Companies are now required to treat part of the revaluation reserve as a taxable item together with each depreciation expense (quarterly) or with the asset expense (if the asset is sold or written off), which effectively means that no step-up in tax basis is granted.

Accounting treatment of real estate property

An amendment to the accounting regulations clarified the accounting treatment of real estate investments held for sale. Qualifying assets held for sale (e.g. residential complexes) are to be treated as inventory and not as fixed assets. No revaluations are allowed for inventory.

Deductibility of interest expenses on intra-group financing

The maximum deductibility threshold for interest expenses on intra-group financing (or, more generally, on loans taken from entities other than banks and financial institutions) has been increased to 8% from 7% in previous years.

Capital gains tax for sale of shares

As a temporary measure, during the period 1 January 2009 – 31 December 2009, non-resident legal entities selling shares in Romanian companies traded on the stock exchange have been exempt from paying 16% tax on capital gains. The non-resident is still liable to file a corporate income tax return.

“While this temporary incentive is no longer available, foreign collective investment vehicles without legal personality will be permanently exempt from capital gains tax on sale of shares in Romanian companies,” said Brian Arnold, real estate tax leader for Romania.

Reduced VAT rate for dwellings

A reduced VAT rate of 5% applies to housing delivered as part of social policy, including old people’s homes, retirement homes, orphanages and rehabilitation centres for children with disabilities. The category also includes buildings and parts thereof supplied as housing with a maximum useful surface of 120 square meters, excluding outbuildings.

The reduced rate applies if the value of the housing acquired by any single person or family is less than RON 380,000 exclusive of VAT. The reduced VAT rate will also apply to the supply of the land beneath the housing on the condition that it does not exceed 250 square meters, including the footprint of the housing.

VAT treatment for construction and assembly works or for supplies of buildings

Starting from 1 January 2008, the simplification measures for construction and assembly works or for supplies of buildings have not been applicable. Therefore, the beneficiaries of such services or for such goods (provided that 19% VAT is applied) should pre-finance the VAT, irrespective of whether they are registered for VAT purposes or not.

Dividend taxation

Distributed dividends have been exempt from taxation since 1 January 2009, as long as they are invested in the same or in another Romanian company’s share capital. To benefit from this exemption, dividends must be reinvested to preserve and increase the number of employees and to develop the company’s registered object of activity. The Economy and Finance Ministry and the National Agency of Fiscal Administration were supposed to issue implementation norms for these provisions, via a joint order, but no such order has been issued to date.
Russia

Contact: Matvey Manuilov

Corporate profits tax rate reduced
From 1 January 2009, the maximum corporate tax rate was reduced to 20% from a previous level of 24%.

Increase of deductibility limits on interest
• For the “crisis period” Safe harbour interest rates were increased temporarily to two multiples of the Central Bank refinancing rate for Rouble loans and 22% for foreign currency loans.
• This temporary rule took effect retroactively from 1 September 2008 and was in force until 31 December 2009. From 1 January 2010 the allowed interest rate on foreign currency loans is 15% and 1.1 times CBR rate for Rouble loans (but for loans concluded before 1 November 2009 two times CBR rate is still allowed until 30 June 2010).
• New rule provides for the taxpayer’s right to choose between the average level of interest on similar obligations and a fixed limit for calculating tax deductible interest.

Depreciation
• New rules for using double declining balance method for tax depreciation purposes – i.e. fixed assets (FA) depreciated by declining balance method are to be included into groups. Depreciation should be charged for the group as a whole (not for each individual unit of FA).
• The depreciation rates are fixed for each such group. New rates are slightly higher than the previous ones.
• The mechanics of transition, however, are not entirely clear. Many companies also see potential difficulties in re-programming accounting software to accommodate this change.
• From 1 January 2009 one-off deduction was increased to 30% of the acquisition cost of fixed assets for assets classified into depreciation groups 3 to 7. For other fixed assets it remained at 10% (including buildings).
• If fixed assets to which an amortization premium was previously applied are sold before five years have elapsed after they were put into operation, there is a claw-back of the premium which then must be included in the profits tax base. The Law does not mention whether or not these “restored” expenses can then be deducted (through increased depreciation or otherwise). This provision applies to fixed assets put into operation from 1 January 2008.

VAT
• VAT recovery is now possible in respect of advances paid to suppliers.
• The requirement to pay VAT in cash in case of non-cash settlements has been eliminated.
• The tax authorities are now able to issue decisions on partial refund of VAT and/or partial refusal to refund VAT.

Russia/Cyprus Double Tax Treaty
• On 16 April 2009, the governments of the Russian Federation and of the Republic of Cyprus initialled a final draft Protocol to the Double Tax Treaty between the two countries. While the

Continued
Protocol had been expected to be signed in 2009 to enter into force in 2010, the signing was delayed and now the earliest it can come into force would be 1 January 2011 (if it is signed during 2010). As from the effective date, Cyprus is expected to be removed from the list of countries to which certain tax benefits are not available, which means that dividends received by Russian corporate shareholders from eligible equity participations in Cypriot subsidiaries should be eligible for the Russian participation exemption (enforcement of the Protocol was tied by the Russian authorities to this point).

• The Protocol introduces a number of important changes to benefits available under the treaty, some of which specifically apply to real estate investments. The most significant changes can be summarised as follows:

### Changes relating to capital gains

Distributions from mutual funds & depositary receipts

The Protocol clarifies an uncertainty that existed regarding the withholding tax rates that should apply on distributions from mutual funds and similar investments. Under the Protocol, such distributions will be subject to the normal dividend withholding tax rates (i.e. 5%/10%).

It has been further clarified that income of mutual funds investing only in immovable property would be treated as “Income from Immovable Property” as per article 6 of the Treaty and may be subject to tax in the country where the immovable property is situated.

### Changes relating to interest and dividends

Definition of “interest” for treaty purposes has been clarified, and most notably it is specifically stated any interest reclassified by the Russian tax authorities as dividends due to Russian thin capitalization rules will be subject to the withholding tax rates for dividends.

The definition of dividends has also been extended to cover distributions from shares held in the form of Depositary Receipts.

### Exchange of information – Assistance in Collection – Mutual Agreement

This article has been revised in line with article 26 of the OECD Model Tax Convention on Income and Capital. The changes are aimed towards alignment to OECD policy standards on fiscal transparency and exchange of information on taxation matters. It is now clearly provided that the fact that one country may not need information for its own purposes should not prevent it from collecting this information in reply to a request from the other country. At the same time, it also remains clear that information cannot be supplied which is not obtainable under the laws or in the normal course of the administration of a contracting state.

The article on “Assistance in Collection” has also been aligned to the OECD Model Tax Convention on Income and Capital. This will come into effect only upon the introduction by Cyprus of the necessary legal framework necessary to provide the Assistance in Collection. The amendments to the article on Mutual Assistance procedures are also aimed towards bringing this article in line with the OECD standard.

### Changes in tax legislation anticipated in the future

**Property tax reform**

Russian Federation government is pondering introduction of changes to property tax legislation where property tax would be levied based on some type of “market value” of relevant property (versus current system based on balance sheet value (for companies) or certain stated values (for physical persons). It is not clear whether these plans to change the method relate to property of physical persons only or also to those of companies.
Russian transfer pricing rules
A framework for new Russian transfer pricing rules has been drafted and passed first reading in the Duma. The work on this new law is actively being pursued and it is expected that new transfer pricing rules may become effective from 1 January 2011.
Key points of the draft that we are aware of include the following:
• Significant reduction of the list of transactions where the Russian tax authorities may control prices for tax purposes.
• Expansion of the list of related parties.
• Abolishment of the present safe harbour provision (the allowable 20% fluctuation of prices of controlled transactions from market prices).
• Introduction of the arm’s length concept.
• Expansion of the list of informational sources for determining market prices.
• Introduction of new methods for determining market prices. Changes to the existing pricing methods to make them more in line with the internationally accepted transfer pricing principles.
• Introduction of reporting and transfer pricing documentation requirements.
• Introduction of penalties for non-compliance with reporting requirements and failure to prepare transfer pricing documentation.
• Burden of proof that prices of controlled transactions correspond to market will rest with the tax authorities.
• Introduction of Advance Pricing Agreements (APAs) (possibly with effect from a later stage).

Consolidation for profits tax purposes
There is a draft law in circulation to allow consolidation for profits tax purposes. Key points of the draft law that we are aware of include the following:
• It will be possible to form a consolidated taxpayer group of entities for profits tax purposes, thus creating the ability to offset tax losses of one legal entity in the group against profits of another entity.
• The rule will apply only to Russian legal entities. There would be certain revenue and assets thresholds (not specified yet), as well as minimum ownership requirements (current draft sets at 90%).
• Current draft does not envision any de-grouping charges.
• May be exempt from intra-group transfer pricing rules.

• The rule will not apply to VAT – companies will still have to maintain the relevant documentation (including on individual transactions for VAT purposes.)

Although doubtful at this stage, there is a possibility that the relevant law may be introduced with effect from 2011.

Serbia
Contact: Peter Burnie
During 2009, the most significant development in Serbian real estate market was the introduction of private ownership over urban construction land. All construction land was previously public owned and it was possible only to acquire the right of usage over it or to take it into long term lease. The introduction of new legislation will facilitate the transition from public to private ownership over construction land, firstly by converting the existing right of usage and long term lease (50+ years) into ownership right over land, and secondly by allowing to acquire ownership over such land in future transactions. The conversion from public to private ownership is conducted at no additional charge, provided that the owner is identified as such in the land book registry.
In cases where right of usage over land was acquired from a company that was subject to privatization, bankruptcy or enforcement procedures, a conversion to right of ownership may be effected only after additional charges are settled. These charges would equal the market value of the land in question reduced by the expenses incurred in acquiring the right of usage. Disposal of construction land left in public ownership will, as a general rule, be conducted through public bidding or tender procedures.
Slovakia

Contact: Viera Hudečková

New currency
Slovakia adopted the Euro as its currency as of 1 January 2009.

Legislative changes in taxation

Transfer Pricing Legislation
In 2009, the Slovak Ministry of Finance issued a guideline setting detailed transfer pricing documentation requirements. Based on our current practical experience, the Slovak tax authorities are increasingly focusing on transfer pricing during their tax inspections.

Tax depreciation of buildings
Component tax depreciation of buildings has been introduced into Slovak tax legislation. This enables an entity to depreciate certain fixtures in buildings at a faster rate for tax purposes than that applied to the building as a whole (buildings being generally depreciated over 20 years for tax purposes). However, this new rule applies only to buildings first put into use from 2009 onwards.

Deductibility of bad debt provisions
The rules for tax deductibility of bad debt provisions have changed, and the underlying bad debt now needs to be overdue for a longer period before the provision can be considered tax deductible.

Other relevant changes

- Significant changes in the tax treatment of mergers / demergers and acquisitions, in-kind contributions to a company’s share capital and the sale of all or part of a business as a going concern allowing step-up of tax values of transferred assets.
- A Slovak tax resident entity can deduct a tax loss (as calculated for Slovak tax purposes) made by its foreign taxable permanent establishment outside Slovakia regardless of whether or not that tax loss can be utilized under the law of that foreign country.
- The period for utilizing prior year tax losses against future tax losses is extended from five to seven years.
- Automatic extension of the deadline for filing a tax return upon advance notification to the tax office (i.e. a filing deadline of 30 June instead of 31 March after the end of the tax period). Thus, the extension of the deadline would no longer be at the discretion of the tax authorities.
- Significant changes in the tax penalty system whereby the level of penalties has generally increased. The minimum amount of penalty for an additional tax liability assessed by tax authorities is currently 10%. The minimum amount of late payment interest is 15% p.a. of the outstanding amount for each day of delay.
- Currently, there are no thin capitalization rules in Slovakia.

VAT

- The VAT refund period has been shortened from around 60 days to 30 days if certain conditions are met.
- Slovakia introduced VAT legislation.
- A lessor can now charge VAT on the rent of premises to all taxable entities (i.e. the lessee does not need to be a VAT payer). This potentially increases the recovery of input VAT of the lessor.
- Retroactive VAT registration is now allowed where an entity met the conditions for obligatory VAT registration prior to actually registering.
- From 1 January 2010 EC Sales lists can be filed electronically only. The taxpayers are obliged to file EC Sales lists on a monthly basis in case they reach the threshold of EUR 100,000 for Intra-community supply of goods or services to the other EU member states.
- Transfer pricing for VAT purposes has been introduced since 1 January 2010 for supplies to certain related party recipients. The output VAT should be calculated from open market value.
- From 1 January 2010 there is a new tax point for partial and recurring supplies and services received from foreign supplier

VAT refund period has been shortened from around 60 days to 30 days if certain conditions are met.
Emerging Trends in Real Estate Europe 2010 sounds a note of cautious optimism for European real estate markets.

The long, slow haul to recovery

A sense of cautious optimism is the prevailing sentiment of the latest Emerging Trends in Real Estate Europe 2010 survey published by the Urban Land Institute and PricewaterhouseCoopers. While 2009’s survey painted a particularly bleak vision of the market, a vision which many in the industry have been coming to terms with over the past 18 months, there is strong sentiment that the easing of credit and stabilising property values should see Europe’s real estate industry improving in 2010. Even so, the industry still faces a ‘long, slow haul’ to recovery.

Central European countries did not rank particularly highly in the 2010 survey, however that is hardly surprising, as investor sentiment has turned to larger, more liquid markets, leaving central and eastern Europe generally out of favour. Yet Warsaw held its own, ranking 4th for development prospects and 8th for investment opportunities.

Prague, Budapest and Moscow managed to maintain their previous rankings in some categories, but showed an overall fall in comparison with prior years. Further afield, Istanbul attracted much positive comment, topping the rankings for development prospects.

Into the unknown

There is still some concern that the impact of government intervention has skewed the wider picture, and a number of interviewees expressed a note of caution that the potential impact of withdrawal of government stimulus packages is still a fairly significant unknown. Furthermore, with base interest rates at historical lows, it is unclear what is going to happen when central banks finally hike the rates up. Some investors are predicting a W-shaped recovery and expecting further value losses and liquidity issues to hit the market during 2010. Fears about occupier markets are cited as one risk factor which has led a lot of correspondents to put development on the back burner. The squeeze on debt available for European real estate is easing, but credit is expected to remain tight in 2010. Given the Catch-22 situation resulting from this lack of finance coupled with the difficulty of securing pre-sales or pre-leases in the current environment, this is likely to be a story which will continue deep into 2010.

The maturity of debt drew comment from a large number of correspondents. There is a huge amount of debt tied to European...
Emerging Trends in Real Estate 2010

real estate which is due to roll over in the coming four years. Much of the underlying real estate was financed at the height of the boom, and there is a large amount of real estate financed with loan-to-value ratios a long way off those which banks are comfortable with in today’s market. In some cases, banks may have little option but to foreclose on loans, particularly where occupier issues start to affect interest payments. Could this finally lead to the distressed disposal opportunities which were conspicuous by their absence during 2009?

Against all of this pessimism, there is still talk of a “wall of money” waiting to be invested in European real estate, and it seems that a sizeable portion of this capital may be available for Central European investments. The report quotes some sources as estimating that private property vehicles are sitting on a war chest earmarked for European real estate investment of USD 35 billion.

The continued flight to quality

There is a widespread view that the quality of the tenant is now more important than the city or asset type. The value of an institutional grade pre-lease to a developer can be a necessity in the quest for affordable development finance, and it is likely to be those developers who align themselves with the right tenants that are best able to generate opportunities from the downturn.

Green issues are very much at the forefront across Europe, spurred on partly by the effect operational efficiency and ecologically sound construction can have in reducing operating costs over the long-term.

The lessons for CEE

What lessons are there to be learned from the report for the CEE markets? In some ways, it is more telling to look at the development of each city’s ratings over the past years than at the current year snapshot. Markets with higher risk ratings in the past have seen sentiment tumble in the 2010 report, while more stable markets such as Prague and Warsaw seem to offer more comfort for the cautious investor.

One correspondent noted that “in the first half of 2010, investments will be made in Prague, which is expected to remain an interesting market.” Indeed, market evidence seems to show that for investors and vendors alike, if realistic pricing can be achieved, deals are there to be done. As in 2009, Budapest falls below the other Central European cities, with interviewees expressing concerns about the state of the Hungarian economy. The question there must be whether the drastic measures taken by the state during 2009 were so extreme that they may have actually given the market a cushion to help it compete with other markets as recovery starts to emerge.

Moscow is, as ever, tied strongly to the price of oil. Prices remain high, however the city has fallen out of favour with many international investors. The appetite of local investors is largely unchanged from prior years, but more institutional players are sounding a note of caution. “Russia is a big marketplace and a place to be in the future, but has enormous political and social issues,” warned one correspondent.

The year ahead

2009 was “hunkering down” time. This year was supposed to be the year of distress. The question remains whether that distress is still waiting to take the market by storm, or whether the bankers’ approach of pretend and extend has sheltered CEE from the worst impacts of the credit crunch.

Only time will tell, but the study provides some useful advice for those who still feel uncomfortable in current market conditions. Here are the top tips from the report’s respondents:

- Keep it simple: Go for “plain vanilla real estate investments that everybody understands.”
- Best buys: Core is king. Stick to core and core-plus investments in large, liquid markets.
- Development: For those with the stomach for risk, buy land and start building up a pipeline of projects. Residential and mixed-use are the best sectors.
- Go for debt: Buy a bank or set up a lending platform. Now is a great time to lend on real estate, if you have the right skill-set and no legacy issues. Values are low and “the gap between cost of funds and loan margins is as good as it gets”. Or, buy distressed debt at a discount.
- Green is good: Real estate is on the front line in the battle against climate change. “There is now a clear realisation that environmental and social responsibility is connected to economics. It has become an action issue.”

Glen Lonie is PwC Real Estate Leader for Central and Eastern Europe.

Richard Jones leads PwC’s Czech Republic Real Estate Industry Group.
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