

Top considerations – EMEA Tax trends impacting Private Equity Real Estate in 2021

White & Case has advised a large number of high-profile international clients on cutting-edge, cross-border and domestic private equity real estate deals, providing valuable strategic tax insight to a broad range of investors and companies in the real estate market.

As we head towards the end of the Q3 2021, we have collated a select list of recent developments and top tax considerations for investors involved in the private equity real estate market across eight EMEA jurisdictions: UK, Czech Republic, Germany, Russia, France, Poland, Spain and Turkey.

As evidenced by the below, the key themes emerging across the jurisdictions over recent years include:

- **Taxation of non-residents:** an increasingly consistent approach to the taxation of capital gains by non-resident investors, with most jurisdictions now seeking to tax capital gains arising from the disposal of both physical real estate and shares in companies that hold it;
- **Restrictions on interest deductions:** though there are nuances in the mechanics, most jurisdictions have now enacted restrictions against corporate interest deductions, which counteract heavily leveraged property investment structures; and
- **New tax exemptions and deferrals:** whereas some jurisdictions now seek to more effectively or aggressively tax investors in land, either through introduction of additional withholding mechanisms and



specific land taxes, others are attempting to increase their attractiveness to foreign direct investment and/or holding company and fund formation by offering tax exemptions or deferrals. These differences should prompt fresh consideration about the most effective property investment structures going forward.

Alongside its market leading private equity investment team, White & Case has leading tax professionals operating in each of UK, Czech Republic, Germany, Russia, France, Poland, Spain and Turkey and, accordingly, can seamlessly manage and advise on the tax aspects of a range of complex cross-border EMEA real estate transactions.

Note the following highlights are not intended as a comprehensive guide to property taxation in any jurisdiction. Accordingly, we would advise that appropriate professional advice is sought prior to implementing any proposed real estate investment.

UK

- **Non-UK resident property gains** – From 6 April 2019, non-UK resident investors became subject to UK capital gains tax (or, in the case of companies, corporation tax on chargeable gains) on gains arising from the disposal of interests in UK land, and the disposal of shares and certain other interests in ‘property-rich’ companies (those that derive at least 75 % of their value from UK real estate) where the person making the disposal holds, or has held in the past two years, a 25 % or greater interest in the company.
- **Non-UK residents now subject to UK corporation tax** – From 6 April 2020, the scope of UK corporation tax was extended to cover non-resident companies in receipt of income from UK property, with the following consequences:
 - **Corporation tax on UK rental income of non-UK resident companies:** Profits are now subject to a UK corporation tax at a rate of 19%. Taxable profits includes profits from loans or derivative contracts that the non-resident company has entered into for the purposes of their UK property business. Previously, non-resident companies that carried on a UK property rental business were subject to UK income tax (at a rate of 20%).
 - **Corporate interest restriction (CIR)** – The most significant consequence for non-UK resident corporate landlords of being brought within the scope of Corporation Tax is that they are now subject to the CIR regime. Broadly, the CIR rules restrict a company’s interest expense deductions to the lower of 30% of a company’s EBITDA or a *de minimis* of

£2 million. Whereas interest expenses may have been fully deductible under the income tax rules, non-UK resident corporate landlords face potential restriction on deductions for interest and other finance costs.

As a result, non-UK resident landlords may find themselves paying more UK tax than was previously the case.

- **Non-UK resident stamp duty land tax (SDLT) surcharge** – From 1 April 2021, a new 2% SDLT surcharge will apply to non-UK resident purchasers of residential property in England and Northern Ireland. The surcharge will apply on top of the current rates (including in addition to the 3% higher rate for additional properties) and will result in a potential top rate of SDLT of 17% for non-UK resident purchasers. For the purposes of the surcharge, non-UK resident companies include a companies that are not resident in the UK for Corporation Tax purposes and UK resident companies that are under non-UK control.
- **Review of asset holding companies (AHCs) tax treatment** – The UK government is proposing to establish a bespoke tax regime for AHCs used in alternative fund structures in an attempt to make the UK a more attractive holding company jurisdiction. In specific regard to real estate, the Government is currently seeking feedback on whether there are situations where investors would want to use an AHC to invest in UK property and where a UK AHC might be used to own and receive overseas property income directly with a potential exemption from UK tax on overseas property income.
- **Reform to the Real Estate Investment Trusts (REIT) regime** – In parallel with the new AHC regime, the UK government is considering a number of changes to the UK REIT rules to make the UK a more attractive location for holding real estate assets. The reforms being considered include a relaxation of the requirement that UK REITs are listed on a recognized stock exchange where certain eligibility requirements are met (e.g. where the REIT is held by institutional investors who are themselves listed). The government is currently consulting further on these changes and is expected to publish draft legislation during 2021.

France

- **Spreading of the capital gain resulting from a building lease-back transaction** – The French Finance Act for 2021 introduces a new tax measure benefiting companies that carry out sale and lease-back transactions: gains arising to the seller/lessee on the disposal of a building can, upon election, be spread over the duration of a lease (up to 15-years) and, therefore, be

offset by deductions in respect of the lease. The purchase of the building by the lessee or the termination of the lease agreement will trigger the immediate taxation of the portion of the capital gain not yet recognized. This mechanism applies to transactions entered into from 1 January 2021 to 30 June 2023, which are preceded by a financing agreement accepted by the lessee on or after 28 September 2020 and no later than 31 December 2022.

- **New tax deferral applicable to free revaluation of assets** – French companies can reevaluate all of their tangible and financial assets on the basis of their fair market value, with value uplifts recognized being immediately taxable at the standard CIT rate (with no participation exemption for shares). To improve companies' equity and financing capacity, the French Finance Act for 2021 introduced, on a temporary basis, an optional neutralization of the tax consequences resulting from the first free revaluation of all tangible and financial assets (but not intangible assets such as ongoing concerns or IP rights) carried out by companies during a fiscal year ending between December 31, 2020 and December 31, 2022:
 - The recognition of capital gains and consequent tax charge on buildings and other depreciable assets can be spread over 15 and 5 years respectively; and
 - Capital gains on non-depreciable assets will only be recognized and tax charged on actual disposal.
- **Quoted real estate investment company's distribution obligation in case of a merger** – French quoted real estate investment companies (so called SIIC) are exempt from corporate income tax on rental income and capital gains if they meet the legal requirement of distributing of minimum portion of their profits (and certain other conditions). In a merger between two SIIC companies the obligation to distribute the capital gain realized is now 70% (increased from 60%), which is consistent with the obligation to distribute 70% of the capital gains realized on the disposal of buildings adopted in 2019 (also increased from 60%).
- **Annual tax on the market value of real estate assets owned in France** – A 3% annual tax, calculated on the market value of real estate assets owned in France, is imposed on any entity that owns, directly or through one or more intermediary entities, real estate assets whose market value represents more than 50% of the market value of all of its French assets. Exemptions from this 3% tax are available if certain reporting requirements are met on an annual basis, by May 15.

For the purpose of determining the 50% ratio above, the French Supreme Court recently ruled (*Cour de cassation, Chambre commerciale*, 2 December 2020, n° 18-22.512, Sté Cacique Investments Limited) that a current account advance granted by a foreign parent company to its French subsidiary for the acquisition of a building located in France cannot be taken into account. It is not yet clear whether the Courts would now take a similar position for other taxes such a transfer taxes or even corporate income tax as well.

- **Partial VAT option for the taxation of rents** – The rental of unfurnished premises for professional use is in principle a VAT exempt transaction but, in France, the lessor has the option to opt for the taxation of rents. The French Administrative Supreme Court (*Conseil d'Etat*, 9 September 2020, n° 439143, SCI Emo) recently ruled, contrary to the French tax authorities guidelines, that an option exercised to submit the rental of some areas of a single building to VAT does not have the effect of subjecting the rental of the whole area of the building to VAT if the lessor decides so, i.e. the option for VAT can only be partial and applicable to certain areas of a building provided that the lessor specifically identifies the part of the building whose rents are to be subject to VAT.

Poland

- **Changes of the domestic (Polish) real estate clause** – From 1 January 2021, Polish tax law was amended so that the following income is classified as having a source in Poland (subject to the wording of the respective double tax treaties, some of which are now being amended):
 - Sale of shares (stocks), all rights and obligations in an company which is not a legal person or participation units in investment fund, collective investment institution or other legal person and rights of similar nature or rights of a similar nature or receivables resulting from holding these shares (stocks), all rights and obligations, participation units or rights if at least 50% of value of assets of such entity consisted (directly or indirectly) of real estate located in Poland or rights to such real estate;
 - Sale of shares (or interest of similar nature) in a "real estate company", now defined as an entity other than natural person, which is obliged to prepare balance sheet, owns real estate that exceeds PLN 10 million and meets either of the following two tests:
 - as of the first day of the tax year at least 50% of the market value of its assets directly or indirectly consisted of market value of real estate located in

Poland or rights to such real estate (applicable in case of entities commencing their activity); or

- (i) as of the last day of the previous tax year at least 50% of the market value of its assets directly or indirectly consisted of real estate located in Poland or rights to such real estate (applicable in case of entities other than mentioned above), and (ii) in the previous tax year the company (entity) obtained at least 60% of tax revenues from the (sub)lease of real estate and agreements of similar nature, or from ownership rights relating to real estate/other real property companies.

Real estate companies may also be subject to additional developments noted further below.

- **New remitter's obligations re capital gains tax on disposal of real estate company** – When a non-Polish resident disposes of at least 5% of the voting rights/ interest of the real estate company, the real estate company (whose shares are sold) has the obligation to calculate and pay any capital gains tax on such transaction (as tax remitter, i.e. on behalf of the seller). Therefore, while the taxpayer is the seller, the real property is primarily liable with all its assets for proper calculation, collection and payment of tax to the tax office. The seller is required to transfer to the real property company the amount corresponding to the advance payment for its CIT due in Poland on sale transaction before the above-mentioned deadline, while the real property company will be obliged to inform the Seller on the advance paid. This must be taken into account when share purchase agreement is negotiated and can be applicable to other forms of disposal of shares.
- **Notification obligation on shareholders of real estate companies** – Real estate companies and taxpayers holding (directly or indirectly) at least 5% of such company's shares (or interest of a similar nature) must now notify the Polish Tax Authorities of those shareholdings by the end of the third month after the end of the financial year.
- **Obligation to have a fiscal representative for non-EU/EEA real estate companies** – Non-Polish resident real estate companies must also appoint a fiscal representative for to bear joint (with the real estate company) liability for the Polish taxes of non-Polish real estate company. This obligation does not apply to companies subject to unlimited tax liability in an EU Member State or in an EEA country. Non-compliance

with this obligation will result in a fine up to PLN 1 million on the real estate company.

- **Taxation of limited partnerships** – From 1 January 2021, limited partnerships, which are frequently used in real estate business in Poland, became CIT taxpayers. However, the new regulations allow limited partnerships to choose whether to become taxpayers from 1 January 2021 or from 1 May 2021. As a result income generated by limited partnerships may be subject to double taxation, firstly on the level of a partnership (in principle with 19% CIT) and secondly when distribution of profit is made (in principle with applicability of 19% Polish domestic WHT rate, subject to available (if applicable) lowered WHT rates).
- **Obligation to prepare (and publish) a report on execution of a tax strategy** – All Polish taxpayers whose revenues exceeded EUR 50 million in a tax year must now prepare and publish a report on its tax strategy. Therefore, real estate companies may be obliged to prepare and publish the report after the sale of its Polish real estate. Non-compliance with this obligation will result in a fine up to PLN 250k.

Spain

- **Dividend and capital gains exemption** – From 1 January 1 2021, Spain's participation exemption on both domestic and overseas dividends and on income (gains) derived from qualifying holdings in the equity of subsidiaries has been limited to a 95% exemption (implying an effective CIT of 1.25% cumulative per each Spanish entity in the chain).
In consistency, 5% of dividends received by a Spanish resident entity that is subject to the CFC rules will now be taxable. It must be noted that, under Spanish CFC rules certain real estate income derived from properties not affected to a business activity may be deemed passive and, as such, allocable for CFC purposes. Investments structures involving the use of several entities should now consider this additional tax cost.
- **Non resident's income tax law- EU residents** – From 1 January 2021, the existing exemption of interest and capital gains on movable assets applicable to EU residents not operating in Spain through a permanent establishment has been extended to European Economic Space residents provided an effective exchange of information exists between Spain and their countries of residence.
- **Corporate interest restriction** – Spain's CIT rules generally restrict a company's interest expense deductions to 30% of the year's operating profits, which

included dividends from at least 5% holdings in the distributing subsidiary's equity or whose acquisition value exceeded euro 20 million irrespective of the percentage of participation. However, from 1 January 2021, the euro 20 million criteria was removed so only minimum 5% holdings qualify for these purposes.

- **Cadastral valuation of real estate** – Cadastral values are official property valuations, which are used as a reference for several tax purposes, including real estate transfer tax. Under the new rules the Administration will objectively establish, with the limit of market value, the value of reference for each property, based on the information available to the Cadastral Office, resulting from due analysis of the prices of real estate transactions reported by Spanish Notary Publics.

Czech Republic

- **Non-Czech resident property gains** – Non-Czech resident investors are generally subject to Czech income tax on gains arising from the disposal of Czech land and buildings, and the disposal of shares in Czech resident companies, including if the purchaser is another non-Czech resident.
 - Most double tax treaties that the Czech Republic is a party to provide generally for a source-state tax exemption of non-Czech resident capital gains on disposals of shares in companies, but some treaties do not provide such exemption for 'property-rich' companies (those that derive typically at least 50 % of their value from Czech real estate).
 - A unilateral tax exemption is however available to gains on disposal of shares in Czech resident companies where a corporate seller holds a 10 % or greater interest in the company for at least 12 months, subject however to some further conditions.
- **Corporation tax on Czech rental income of non-Czech resident companies** – Non-Czech resident companies are subject to Czech tax on rental income from Czech property, including if the lessee is another non-Czech resident. Exemptions may be available under applicable tax treaties.

- **Corporate Interest Restriction** – Broadly, interest restriction rules restrict net financial expense (most notably: interest) deductions to the higher of 30% of tax-EBITDA or a *de minimis* of CZK 80 million.
- **VAT Exempt Lease of Residential Properties** – Lease of real estate is generally VAT exempt with an option to apply VAT on the lease under certain conditions, allowing for input VAT recovery by the lessor. However, there is no such option for lease of residential properties, which is always VAT exempt, disallowing recovery of input VAT.
- **Dividend tax exemption** – Dividends distributed by Czech entities to their parent entities are exempt from Czech tax, subject to conditions, including mainly that the parent holds at least a 10% share on the Czech subsidiary for at least 12 months.
- **Property tax** – There is a real estate tax, but is immaterial at, for example, 5000 EUR p.a. for an industrial property on a 10000 sqm land plot with a 5000 sqm-footprint two-story building.
- **Transfer tax** – There is no real estate transfer tax in the Czech Republic after having been abolished in 2020.

Turkey

- **Corporate interest restriction** – From 1 January 2021, Turkey introduced restrictions on available interest expense deductions. Interest expenses, foreign exchange expenses and all other financial expenses corresponding to the borrowings that exceeding the equity of the company will now be non-deductible. Capitalized financial expenses are not subject to such restriction.
- **Valuable House Tax (VHT)** – From 15 January 2021, VHT will be applicable for the first time for the residential properties whose tax value is over 5,227,000 Turkish Liras. VHT rate vary from 0.3% up to 1% depending on the tax value of property. Properties subject to VHT are also subject to real estate tax collected by municipalities.
- **WHT rate increase on construction works** – From 1 March 2021, the WHT rate applicable to progress payments for construction and repair works increased to 5% from 3%.

Russia

- **Resident and non-Russian resident disposals of interests in Russian real estate** – Russian tax at a rate of 20% applies to the disposals of the following interests:

- Russian real estate;
- Shares in real estate-rich companies—entities, whether Russian or not, whose assets, directly or indirectly, by more than 50%, consist of Russian real estate.¹

Russian residents pay tax by self-assessment, by taking into account losses (possibly, subject to limitations). In contrast, non-Russian residents pay tax through withholding (whereby buyer / payor of income is responsible for tax withholding). The Tax Code gives no guidance on how this tax to be paid in share transactions between two non-Russian entities, thus requiring additional structuring to allow for withholding and payment of tax or leaving seller and buyer in uncertainty as to whether absence of tax payment mechanism is sufficient to justify non-payment of tax. This tax obligation is subject to double tax treaty relief. However, over the recent decade, Russia has been amending its tax treaties by extending source taxation, e.g., for residents of Cyprus no relief from this tax is available since 2017.

- **Property and land tax** – Owners of Russian land plots pay land tax at rates established by municipalities (up to 1.5% max), whereas owners of Russian real estate (other than land plots) pay property tax:

- For office and shopping buildings - at a rate of up to 2% on cadaster value;
- For all other real estate - at a rate of up to 2.2% on book value (tax rates are established by regional governments).

Note that non-resident entities other than those carrying on business in Russia through permanent establishment pay property tax only on property for which cadaster value is established.

Germany

- **Non-German resident capital gains in real estate rich entities** – From 2019, non-German resident investors became subject to German source taxation on gains arising from the disposal of shares in real estate rich corporations. However, such gains are still effectively tax exempt if realized by a non-German resident corporate shareholder.
- **Reform to German Real Estate Transfer Tax** – With effect as of July 1, 2021 Germany introduced amended German Real Estate Transfer Tax (RETT) rules and, in particular, prevents certain RETT-Blocker structures for share deals. RETT will now be triggered on a transfer of at least 90% of a real estate owning entity's shares, with RETT also payable if at least 90% of an entity's shares are transferred to new shareholders (even if unrelated) within 10 years.
- **Amendment of "Extended Trade Tax Exemption" for real estate related income** – With effect as of 2021 Germany further revised its "Extended Trade Tax Exemption" (*erweiterte Gewerbesteuerkürzung*) rules economically granting exemption from German trade tax for real estate companies in relation to income derived from the administration and use of real estate. So far, already minor detrimental activities could lead to a rejection of the trade tax exemption. Going forward, there will be a 5% threshold for non-qualifying income other from real estate administration without losing the trade tax exemption.

¹ Disposal of other shares (where the 50%-threshold is not met) is:
 (i) by a Russian resident corporate seller- subject to a 20% tax, and may be exempt from this tax if the shares have been in ownership for at least 5 years;
 (ii) by a non-Russian resident company- normally not taxable in Russia.

Should you have any questions relating to the above, or would like to discuss a current or planned real estate investment, please contact your usual White & Case partner or otherwise speak to one of:

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