

We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest. We would welcome any comment you might have.

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**THE UNLISTED INVESTMENT INSTRUMENTS FOR THE ITALIAN REAL ESTATE SECTOR: R.E.I.F. AND S.I.C.A.F.**

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**Introduction** – Real estate investments in Italy by foreign investors can be carried out via two different types of regulated collective investment vehicles, namely real estate investment funds (fondi comuni di investimento immobiliare, REIFs) and real estate closed-ended investment companies (SICAF immobiliari, R-SICAFs), both of which offer an attractive tax regime.

REIFs and R-SICAFs are both undertakings for collective investments (organismi di investimento collettivo del risparmio, OICR) that primarily invest in real estate assets and rights.

The difference among them is that a REIF is set up in a contractual common fund form (i.e. it is not a legal entity, but rather a pool of investments jointly held by multiple unit holders), while an R-SICAF is set up in corporate form. They both qualify as alternative investment funds (AIFs) under the provisions implementing the Alternative Investment Fund Managers Directive (AIFMD) in Italy.

**Real estate investment fund – R.E.I.F. -**

The Real Estate Investment Fund (REIF) is one of the most appealing forms to direct the collective savings towards real estate in Italy.

The current tax regime is based on income tax exemption, with taxation in the hands of the investors, and tax benefits for certain investors and real estate operations.

**Legal form** - The Italian REIF is a regulated collective investment vehicle devoted to invest in real estate. It is a closed-end contractual “investment fund” without legal personality, established and managed by a management company: the Società di Gestione del Risparmio (SGR). The SGR is an Italian regulated joint-stock company, which can manage one or more investment funds.

The investments fund’s assets are separated from those of: 1) the SGR, 2) the other funds managed by the same and 3) each unitholder. The investment fund is solely liable, with its own assets, for the obligations incurred on its behalf by the SGR.

**Tax status** - REIF is included among subjects liable to income tax, although exempt from the Italian corporate income tax (IRES – ordinary rate: 27.5%) and regional tax on production (IRAP – ordinary rate: 3.9%).

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REIF's profits are conversely taxable in the hands of the unitholders, pursuant to different methods and/or limits in consideration of the unitholders' nature/tax status.

**Tax treatment at entity level** - Dividends received, capital gains realized and other incomes earned by REIF are exempt from corporate income taxation at the level of REIF. For income normally subject to withholding tax at source, the withholding tax (generally at a rate of 26%) applies as a final payment, unless its application is excluded for REIFs by the law (e.g. interest from bank deposits and income from certain foreign funds). REIF units are not subject to registration tax.

For real estate properties held by the REIF, local property taxes (particularly: IMU, the municipal tax on properties and TASI, the recent municipal tax on indivisible services) apply according to ordinary rules.

As far as VAT and other indirect taxes are concerned, REIF follows the ordinary rules. However, it can benefit from some tax reliefs with regard to indirect/transfer taxes.

**Treatment of investors** - In the current framework, two categories of REIFs are identified, according to the nature of the unitholders:

- institutional funds: REIFs entirely owned by "institutional" investors;
- non-institutional funds: REIFs owned also by investors different from "institutional" ones.

For this purpose, "institutional" investors are deemed to be for instance undertakings for collective investment of savings or pension funds, banking and financial intermediaries subject to prudential surveillance; non-profits/charities resident in Italy; or SPVs owned for more than 50% by any of these entities.

The SPVs can be established in Italy or abroad (White List countries). The control on such SPV can also be indirect (in this case, the percentage of interest must be properly adjusted – e.g., an indirect control on 60% of a Luxembourg SPV through 90% of a US corporation, equates to 54% actual control on the SPV).

With reference to "institutional funds", REIF's profit distributions are subject to a 26% withholding tax at source (certain reductions/exemptions are provided): for investors subject to corporate/business income tax, REIF's profits collected are taxed accordingly and the withholding tax is credited against the income tax due. In the other cases the withholding tax, unless excluded by the law, is a definitive taxation.

Regarding "non-institutional funds", the following rules apply:

- for institutional investors (regardless the amount of their interest in the REIF) and non-institutional investors owning (directly or indirectly) up to 5% of the REIF, REIF's profit distributions are subject to the 26% withholding tax at source according to the ordinary rules (with reductions/exemptions, where applicable); for investors which are subject to corporate/business income tax, REIF's profits collected are taxed accordingly and the withholding tax is credited against the income tax due. In the other cases the withholding tax, unless excluded by the law, is a definitive taxation;
- for resident non-institutional investors that own (directly or indirectly) more than 5% of the REIF, the annual REIF's profit is attributed to them proportionally with their interest in the REIF (which, as a result, acts as a tax-transparent entity/partnership), regardless of its actual distribution, and is taxed in their hands according to their tax regime/status



(consequently, withholding tax at source does not apply);

- for non-resident investors, REIF's profit distributions are in any case taxable according to the ordinary rules, thus upon distribution through the 26% final withholding tax at source (with reductions/exemptions stated).

**Withholding tax** - Withholding tax is levied on the REIF's profit distributions, even on redemption, at a rate of 26%. However, there are some cases where the withholding tax is not applicable, like for instance non-institutional relevant unitholder subject to transparency taxation.

Profits distributed to investors, resident in countries for which a treaty against double taxation exists may benefit from the more favorable tax regime set out in the treaty (reference can be made to provisions concerning "interest", unless the relevant treaty expressly regulates the income from real estate funds).

In principle, capital gains derived from the disposal of REIF units are subject to 26% substitute tax, excepted for gains realized:

(i) in the context of a business activity, thus subject to business income taxation rules; or

(ii) by non-institutional investors with respect to "relevant" interest into non-institutional REIFs, which are exempt at 50.28% while the rest is included in the global taxable income and taxed ordinarily.

Non-residents, under the following circumstances, may benefit from tax exemption:

- REIF units listed in a regulated market;

- for unlisted REIF units, if 1) the recipient is the beneficial owner of the capital gain (or, being a fund or a transparent entity, it qualifies as institutional investor), 2) does not have a PE in Italy to which the income is referable and 3) its residence

country is White Listed (it allows an effective exchange of tax information with Italy).

For other cases, the application of treaties against double taxation may be claimed.

**Treaty and EU Tax Directive status** - As it's included among subjects liable to income tax, although tax-exempt, from the Italian perspective REIF should benefit from Treaties application (reciprocity condition with the relevant foreign Country may be required).

The lack of subjective and objective requirements does not give access to the EU Tax Directives.

**Surveillance** - The REIF and the SGR are subject to the supervision of the Italian regulatory authority, the Bank of Italy.

The rules provide a form of deregulation for certain investment funds. In particular, for investment funds that are not subject to the rules established to mitigate and diversify risks (i.e. investment funds "reserved" to institutional/professional investors), the adoption and amendment of the fund's rules no longer require prior approval by the regulatory authority. In addition, mergers of these funds no longer have to meet the regulatory provisions established for mergers between regulated funds.

**Investment restrictions** - REIF invests mainly or exclusively in real estate assets, property rights over real estate and shareholdings of real estate companies, for at least two-thirds of its value (some exceptions are provided).

Investment diversification requirements have to be observed. In particular, direct investment (or indirect, through controlled companies) into a single property, with single urban and functional characteristics, cannot exceed 20% of the REIF's assets



value. This limit is increased to 33% for properties leased out, provided the annual rentals from the main tenant (and from subjects of the same group) do not overcome 20% of annual aggregated rentals. Investments in companies allowed to carry on the building development business are limited to 10% of the total REIF's assets value.

Reserved funds are not subject to these limitations, although their regulations have to provide minimal assets and risk diversifications rules to comply with.

Direct building development business is forbidden.

**Minimum level of investment** - The REIF does not require a minimum level of investment, unless established as reserved fund, for which the minimum level is EUR 500,000 for retail investors, apart from being accessible to professional investors.

### Pros

- REIF is not subject to income taxes: limitations provided in the corporate income taxation system do not apply (e.g., thin capitalization rules/interest deductibility limitations).
- REIF's profits are taxed only upon distribution and/or reimbursement of the units, with the exception of unit-holdings exceeding 5% held by resident non-institutional investors.
- Tax exemption for certain foreign qualifying institutional investors is available. Other foreign investors can benefit from DTTs reduction/exemption.
- REIF benefits from several tax reliefs in terms of indirect taxes.

### Cons

- REIF's profits in favor of resident non-institutional investors holding more than 5% are taxed on an accrual basis (tax transparency taxation method).
- Unitholders cannot manage the REIF: this role is executed by the

management company (SGR), which is (and has to be), independent from the investors.

- Due to the fact that the REIF is a regulated entity, it is subject to supervision by regulatory authorities (this implies higher operating costs).
- Real estate properties have to be evaluated twice each year on the basis of external appraisals.
- Less favorable tax treatment for REIF's profit distributions to foreign unit-holders different from certain institutional investors.

**SICAF** - The "SICAF" ("Società di Investimento a Capitale Fisso") is an investment company with fixed capital.

The SICAF is a regulated closed-end fund with corporate form. If it invests prevalently in real estate (as stated for Italian Real Estate Investment Funds, REIFs), it qualifies as "Real Estate SICAF" and is thus entitled to take advantage of the same tax regime and benefits provided for the Italian REIF (with just one specific exception).

Thanks to its corporate form and to the fact that investors are the SICAF's shareholders, with the rights and powers peculiar of this role, investors should be able to influence to a certain extent (i.e. within the limits of the shareholders' powers) the SICAF's real estate assets management, by-passing some of the governance constraints of the investment through contractual real estate funds.

**Legal form** - The SICAF is an undertaking for the collective investment of savings with closed-end form, incorporated as limited company by shares (and so with legal personality), with fixed capital, registered office and general management in Italy and whose sole purpose is the collective investment of savings raised through the issuing of its shares and other equity instruments.



The SICAF is a regulated investment vehicle and is subject to regulatory authorities' authorization and supervision (this requires the fulfilment of several requirements).

The SICAF shares/equity instruments may be listed.

**Tax status** - The SICAF is liable to income tax. However, as OICR, it is exempt from the Italian corporate income tax (IRES – applicable rate: 27.5%) and regional tax on production (IRAP – applicable rate: 5.57%), but with just an exception, as we will explain.

Real estate SICAF's profits are taxable in the hands of the shareholders-investors, pursuant to different methods and/or limits in consideration of their nature/tax status.

**Tax treatment at entity level** - As a closed-end (corporate) fund, the SICAF is allowed to invest in real estate. When the investment in real estate is prevalent (as stated for Italian REIFs, this condition is met if investments in real estate, rights on real estate – including those from financial leasing contracts – real estate companies and REIF units are at least two-thirds of the SICAF's value, with some exceptions), the SICAF qualifies as “real estate SICAF” and is subject to the same tax regime of Italian REIFs (with a little difference with respect to IRAP).

Consequently, for a real estate SICAF, dividends received/capital gains realized/other incomes earned are exempt from corporate income taxation. For income normally subject to withholding tax at source, the withholding tax (generally with rate of 26%, with a few exceptions) applies as a final payment, apart cases where its application is expressly excluded by the law (e.g. interest from bank deposits and income from certain foreign funds).

As far as IRAP is concerned, the SICAF is subject to tax, but only with regard to its net

commissions' income (i.e. underwriting commissions collected, net of commissions eventually paid to distributors).

As stated for Italian REIFs, local property taxes (namely IMU and TASI) and VAT apply according to ordinary rules. With regard to VAT and other indirect taxes, the tax reliefs stated for REIFs are applicable also to the real estate SICAF.

**Treatment of investors** - The shares of the SICAF can be subscribed/purchased by either institutional investors or any other investors, even retail, in compliance with the provisions of the SICAF's by-laws.

As for REIFs, according to the nature of the shareholders, two categories of real estate SICAFs can be identified:

- institutional real estate SICAF: SICAF entirely owned by institutional investors;
- non-institutional real estate SICAF: SICAF owned also by investors different from the institutional ones.

With reference to the institutional real estate SICAF, profit distributions are generally subject to a 26% withholding tax at source (certain reductions/exemptions are provided); for investors subject to corporate/business income tax, SICAF's profits collected are taxed accordingly and the withholding tax is credited against the income tax due. In the other cases the withholding tax, unless its application is expressly excluded by the law, is a definitive taxation.

Regarding the non-institutional real estate SICAF, the following rules apply:

- for institutional investors (regardless the amount of their interest in the SICAF) and non-institutional investors owning (directly or indirectly) up to 5% of the SICAF, profit distributions are subject to the 26% withholding tax at source,



according to the ordinary rules (with reductions/exemptions, where applicable); for investors which are subject to corporate/business income tax, SICAF's profits collected are taxed accordingly and the withholding tax is credited against the income tax due.

In the other cases the withholding tax, unless excluded by the law, is a definitive taxation;

- for resident non-institutional investors owning (directly or indirectly) more than 5%, the annual profit is attributed to such investors in proportion to their interest in the SICAF (which, as a result, acts as a tax-transparent entity/partnership), regardless of its actual distribution, and is taxed in their hands according to their tax regime/status (consequently, withholding tax at source does not apply);
- for non-resident investors, profit distributions are in any case taxable according to the ordinary rules, thus upon distribution through the 26% final withholding tax at source (with reductions/exemptions stated below).

**Withholding tax** - Withholding tax is levied on the profit distributions, even on redemption, at a rate of 26%.

However, there are some cases where the withholding tax does not apply, like for instance non-institutional relevant shareholders subject to transparency taxation.

SICAF's profits distributed to investors, resident in countries for which a treaty against double taxation exists, may benefit from the more favorable tax regime set out in the treaty.

In principle, capital gains derived from the disposal of real estate SICAF shares are subject to 26% substitute tax, with the exceptions of gains realized:

- (i) in the context of a business activity, thus subject to business income taxation rules;

- (ii) by "non-institutional" investors with respect to "relevant" interest into non institutional SICAFs, which are exempt at 50.28% while the rest is included in the global taxable income and taxed ordinarily.

Non-residents, under the following circumstances, may benefit from tax exemption:

- real estate SICAF shares listed in a regulated market;
- for unlisted SICAF shares, 1) if the recipient is the beneficial owner of the capital gain (or, being a fund or a transparent entity, it qualifies as institutional investor), 2) does not have a PE in Italy to which the income is referable and 3) is resident in a White List Country (its residence country allows an effective exchange of tax information with Italy).

For other cases, the application for treaties against double taxation may be claimed.

**Treaty and EU Tax Directive status** - Because the SICAF has corporate form and is included among subjects liable to income tax, although tax-exempt, from the Italian perspective it should benefit from Treaties application (reciprocity condition may be required).

Conversely, its exemption from Italian corporate income tax should prevent access to the EU Tax Directives.

**Surveillance** - SICAFs are subject to the supervision of the Italian regulatory authorities, the Bank of Italy and Consob (i.e. the regulatory body for the Italian Stock Exchange).

In principle, the SICAF is managed internally (as such, it qualifies as Alternative Investment Fund Manager - "AIFM"). However, the management can be also entrusted to an external AIFM (i.e., a SGR).



**Investment restrictions** - Investment diversification requirements have to be observed. In particular, direct investment (or indirect, through controlled companies) into a single property, with single urban and functional characteristics, cannot exceed 20% of the assets value. This limit is increased to 33% for properties leased out, provided the annual rentals from the main tenant (and from subjects of the same group) do not overcome 20% of annual aggregated rentals.

Investments in companies allowed to carry on the building development business are limited to 10% of the total SICAF's assets value.

Reserved SICAFs are not subject to these limitations, although their regulations have to provide minimal assets and risk diversifications rules to comply with.

Direct building development business is forbidden.

**Minimum level of investment** - The SICAF does not require a minimum level of investment, with the exception of the reserved SICAF for which there is a minimum level of investment of EUR 500,000 for retail investors.

## Pros

- As real estate corporate fund, SICAF is not subject to income taxes (with the exception of the net commissions income, which generally pays IRAP).
- Real estate SICAF's profits are taxed only upon distribution and/or reimbursement of the shares, with the exception of holdings exceeding 5% held by resident non-institutional investors.
- Tax exemption for certain foreign qualifying institutional investors is available; other foreign investors can benefit from DTTs redaction/exemption.

- Real estate SICAF (corporate fund) benefits from the several indirect tax reliefs provided for the REIF (contractual fund).

- Investors, as SICAF's shareholders, by way of SICAF's directors' appointment, can influence, to a certain extent, the real estate assets management, more than in the REIF.

## Cons

- Real estate SICAF's profits in favor of resident non-institutional investors holding more than 5% are taxed on an accrual basis (tax transparency taxation method).
- SICAF is subject to authorization and supervision by regulatory authorities (this implies higher operating costs).
- Real estate properties need to be evaluated twice each year on the basis of external appraisals.
- SICAF can't issue corporate bonds.

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