



FRESHFIELDS BRUCKHAUS DERINGER

Società di Investimento Immobiliare Quotata

The Italian real estate investment company



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Introduction

2007 budget legislation sets out the rules governing Italian real estate investment company (*Società di Investimento Immobiliare Quotata*) or SIIQ. This client guide briefly outlines the key features of the SIIQ as well as the applicable tax treatment.

I Key features

In very general terms, an Italian company whose main activity is leasing real estate (*attività di locazione immobiliare*), which meets the conditions discussed in paragraph II below, may elect to be subject to a special income tax regime (the SIIQ Regime).

The SIIQ Regime provides for a favourable tax treatment for real estate properties held for leasing (*immobili destinati alla locazione*). Indeed, the income realised by the SIIQ through the real estate lease activity, to be determined pursuant to separate accounting, is:

- i exempt from corporate income tax (ie IRES, which is currently levied at the rate of 33 per cent) and regional tax (ie IRAP, which is currently levied at the rate of 4.25 per cent subject to possible regional surcharges) in the hands of the relevant company; and
- ii subject to a 20 per cent withholding tax¹ at source when distributed to the shareholders by way of dividends. Dividend distributions shall not be lower than a certain specified amount (ie the Minimum Dividend, defined in paragraph II.3 below).

This SIIQ Regime may in principle apply as from the financial year following the one outstanding at 30 June 2007. However, the SIIQ Regime is at present still a work in progress, since it will have to be defined by a ministerial decree to be issued by 30 April 2007.

The election for the SIIQ Regime must be made by the expiry date of the financial year preceding that in which the SIIQ Regime will apply. Such an election is irrevocable.

¹ A 15 per cent withholding tax applies in certain limited cases as defined in paragraph IV.2 below.

II Qualifying conditions

The following conditions must be met to qualify as a SIIQ.

II.1 Restrictions on the corporate entity

The SIIQ must be a joint stock company incorporated under Italian company law (*società per azioni*) that is resident in Italy and whose shares are listed on the Italian regulated stock exchange market².

Subject to certain conditions, non-listed joint stock companies resident in Italy, in which an SIIQ (also jointly with other SIIQs) holds at least 95 per cent of profit participation and voting rights, may also elect to apply the SIIQ Regime together with a SIIQ (the Non-Listed SIIQs).

SIIQs and Non-Listed SIIQs must lease real estate on an ongoing basis. A SIIQ (or Non-Listed SIIQ) is deemed to do this if the Asset and Income Requirements are met, ie at least 80 per cent of its:

- i revenues derive from the real estate lease activity; and
- ii total assets are real estate properties held for lease.

The concept of 'real estate properties' includes interests in SIIQs or Non-Listed SIIQs that qualify as long-term assets (*immobilizzazioni finanziarie*) according to article 11(2) of decree 28 February 2005, no 38.

Dividends on the mentioned interests in SIIQs, which are paid out of profits relating to the real estate lease activity, qualify as revenues derived from the real estate lease activity.

SIIQs must keep separate accounting for the real estate leasing. Specific disclosure regarding apportionment of overheads is required in the financial statements.

II.2 Restrictions on the shareholders

A company can elect to become a SIIQ only if:

- i there is not a single shareholder entitled, directly or indirectly, to more than 51 per cent of profit participation and voting rights; and
- ii at least 35 per cent of an SIIQ's shares are owned by shareholders individually holding, directly or indirectly, no more than 1 per cent of profit participation and voting rights.

II.3 Distribution rules

At least 85 per cent of the lesser of:

² In light of the mentioned rule, SIIQs may be formed (i) pursuant to the election for the SIIQ Regime by pre-existing eligible listed property companies or (ii) following the IPO and the election for the SIIQ Regime of previously non-listed eligible property companies.

- i the net profits derived in a financial year from the real estate lease activity of the SIIQ; and
- ii the overall distributable profits realised in that financial year by the SIIQ, must be distributed to the SIIQs' shareholders as dividends (the Minimum Dividend).

II.4 Withdrawal of the SIIQ Regime

Failing to comply with the Assets and Income Requirements discussed in paragraph II.1 above for two subsequent financial years will trigger the withdrawal of the SIIQ Regime starting from the second financial year.

Failing to comply with the distribution rules discussed in paragraph II.3 above will trigger the withdrawal of the SIIQ Regime starting from the financial year in which the non-distributed profits have been derived.

II.5 Other considerations

2007 budget legislation does not provide for any rules dealing with the minimum value of the real estate properties owned by the SIIQ, the level of the debt raised at the level of the SIIQ, the mix between commercial and residential properties etc. These aspects could be ruled by the implementative decree still to be issued.

III Entry tax

A company that elects to apply the SIIQ Regime, and to exit the ordinary income tax regime, is deemed to realise a capital gain (the Deemed Gain) on the real estate properties held for lease owned at the end of the last financial year in which the ordinary corporate income tax regime applies. The Deemed Gain is determined on the basis of the fair value (*valore normale*) of such real estate properties.

The Deemed Gain, net of any resulting deemed capital loss, is subject to a 20 per cent substitutive tax (the Entry Tax) payable in a maximum of five equal instalments³, due in lieu of IRES and IRAP⁴.

The fair value of the real estate properties on which the Deemed Gain is determined will form the new tax base of the relevant properties as from the fourth financial year following the one in which the election for the SIIQ Regime has been made.

A clawback provision applies if the real estate properties subject to the Entry Tax are sold before the fourth financial year following the one in which the election for the SIIQ Regime has been made. In such a case, the capital gain realised upon the sale of the relevant properties (determined without taking into account the step-up subjected to the Entry Tax, based upon the previous tax base) will be included in the ordinary income of the SIIQ subject to IRES and IRAP, and a tax credit would be granted for the Entry Tax.

Upon election of the SIIQ, the Entry Tax may apply also to real estate properties held for trading (ie other than those held for leasing). By doing so, the SIIQ may benefit from a step-up in the tax base of such properties, which is effective as of the fourth financial year following the one in which the election for the SIIQ Regime has been made. The clawback provision discussed above also applies to real estate properties held for trading.

³ Carried forward tax losses suffered in the ordinary corporate income tax regime may offset the Deemed Gain subject to the Entry Tax.

⁴ The company may in principle elect to apply the ordinary income tax regime under certain specific rules.

IV Ongoing tax treatment

IV.1 SIIQ

Income realised by the SIIQ through real estate leasing is exempt from IRES and IRAP.

Income realised by the SIIQ through other activities is subject to both IRES and IRAP under the ordinary rules.

At present, no rules establish if, and at which conditions, capital gains on disposal of real estate properties held for lease, and capital gains on disposal of interests in SIIQs, may qualify as 'income from the real estate lease activity' in the hands of the relevant SIIQ, and may benefit from the relevant exemption from IRES and IRAP.

IV.2 Shareholders

Dividends

Dividends distributed by a SIIQ out of the profits from leasing real estate (the Lease Dividends) are normally subject to a 20 per cent withholding tax at source when paid to shareholders, save for the cases under point (iii) below. This withholding tax is reduced to 15 per cent for the Lease Dividends paid out of profits from the lease of residential properties, subject to certain conditions.

As to the tax treatment applicable to the Lease Dividends in the hands of the shareholders:

- i the Lease Dividends are not subject to any further income tax in the hands of Italian resident individuals;
- ii the Lease Dividends are fully subject to income tax and do not benefit from the Italian dividend exemption regime normally applicable to dividends distributed by Italian corporations, if realised by the following investors: (a) Italian entrepreneurs, (b) Italian commercial partnerships, (c) Italian companies and business entities, and (d) Italian permanent establishments of non-Italian resident companies and entities. A tax credit is granted for the withholding tax levied at source on the Lease Dividends;
- iii no withholding tax at source applies to the Lease Dividends paid by the SIIQ to (a) other Italian SIIQs, (b) Italian investment funds, (c) Italian pension funds, and (d) individuals who own the SIIQ shares as part of a portfolio under management (in the latter case, if a certain election is made on the taxation of the income on the portfolio, the *regime del risparmio gestito*). For the persons under (b) to (d) above, the Lease Dividends are included in the income subject to ordinary income taxation;
- iv the Lease Dividends collected net of the withholding tax at source levied by the SIIQ, is not subject to any further income tax in Italy in the hands

of non-Italian resident investors (other than those discussed in point (ii)(d) above). Moreover:

- a non-Italian resident persons resident in a jurisdiction that has executed a double tax treaty with Italy should be able to rely on the lower dividend withholding tax rate provided by the treaty; and
- b non-Italian corporations resident in an EU member state that own a 15 per cent⁵ or greater interest in a SIIQ may benefit from the reduction of the domestic withholding tax rate to 0 per cent under the Italian provisions implementing the Parent/Subsidiary Directive.

Capital gains

As to the tax treatment applicable in the hands of the shareholders to the capital gains realised upon sale of the shares held in a SIIQ:

- i capital gains are subject to ordinary income taxation in the hands of an Italian resident. However, capital gains realised upon sale of a 'qualified interest'⁶ in an SIIQ do not benefit from the partial exemption ordinarily applicable;
- ii capital gains are fully subject to ordinary income taxation without benefiting from any capital gain exemption provisions otherwise applicable if realised by the following investors: (a) Italian entrepreneurs, (b) Italian commercial partnerships, (c) Italian corporations and commercial entities, and (d) Italian permanent establishments of non-Italian resident companies and entities; and
- iii non-Italian resident investors (other than Italian permanent establishments of non-Italian resident companies and entities) may in principle benefit from certain domestic income tax exemptions on the capital gains realised upon sale of a 'non-qualified interest'⁷ in an SIIQ. Non-Italian resident investors resident in a jurisdiction with a double tax treaty with Italy in most cases should not be subject to income tax in

⁵ The 15 per cent threshold in principle applies to dividends distributed as from 1 January 2007 under article 2(2) of the draft decree issued by the Italian government on 12 December 2006, which implements Directive 2003/123/EC amending Directive 90/435/EEC (the Parent/Subsidiary Directive). The 15 per cent threshold will be further reduced to 10 per cent for dividends distributed as from 1 January 2009. The mentioned draft decree has not already been published in the Italian official gazette.

⁶ An interest held in a company listed on the Italian stock exchange, such as a SIIQ, is defined as 'qualified' if it exceeds either (i) 2 per cent of the total number of shares with voting rights at a general shareholders' meeting or (ii) 5 per cent of the share capital.

⁷ An interest held in a company listed on the Italian stock exchange, such as a SIIQ, is defined as 'non-qualified' if it does not exceed either (i) 2 per cent of the total number of shares with voting rights at a general shareholders' meeting or (ii) 5 per cent of the share capital.

Italy on the capital gains realised upon sale of the SIIQ shares, under the conditions set out by the applicable treaty.

V Contributions to an SIIQ

V.1 Income taxes

Capital gains realised upon contribution of real estate properties (*immobili e diritti reali su immobili*) to SIIQs (or Non-Listed SIIQs) are subject, in the hands of the transferor, to a 20 per cent substitutive tax payable in maximum five equal instalments, applied in lieu of IRES and IRAP^{8,9}.

A clawback provision applies should the real estate properties contributed be sold by the SIIQ (or Non-Listed SIIQ) before a three-year holding period elapses.

V.2 VAT and transfer taxes

The contribution to SIIQs, or Non-Listed SIIQs, of a portfolio of real estate properties mainly leased (*pluralità di immobili prevalentemente locati*) (i) falls out of the scope of the Italian VAT and (ii) is subject to registration, mortgage and cadastral taxes at the fixed amount of €168,00 each.

Sales and contributions to SIIQs, or Non-Listed SIIQs, of certain real estate properties different from those mentioned above (ie portfolio of real estates properties mainly rented) are subject to mortgage and cadastral taxes at half the ordinary rate (ie the resulting reduced rates being equal to 2 per cent)¹⁰.

⁸ The company may in principle elect to apply the ordinary income tax regime under certain specific rules.

⁹ The same regime also applies to contributing real estate properties to Italian real estate funds.

¹⁰ See article 35(10-ter) of decree 4 July 2006, no 223, as converted by law 4 August 2006, no 248.

VI Preliminary remarks

In light of the provisions above, the following preliminary remarks may be made.

- 1 The SIIQ Regime seems to be favourable to property companies whose main business is leasing real estate properties. No benefit is provided to real estate investors who acquire real estate properties for trading, or to developers.
- 2 The favourable income tax regime applying to the contribution of real estate properties to an SIIQ may render the SIIQs suitable corporate vehicles to structure spin-off transactions of real estate portfolios. However, the same regime now also applies to contributions of real estate properties to real estate funds.
- 3 Looking at the tax treatment applying to the shareholders of the SIIQ, the election for the SIIQ Regime may be less or more favourable if compared to the ordinary income tax treatment applying to Italian companies, depending upon the tax status of the shareholders. Briefly, for:
 - i shareholders such as Italian pension funds or investment funds, the SIIQ Regime is favourable since the Lease Dividends and capital gains collected on the SIIQ shares are subject to ordinary income tax, even if the SIIQ has not paid tax on the lease income;
 - ii shareholders such as Italian resident companies, the full taxation of the Lease Dividends and capital gains on the SIIQ Shares means that most of the tax benefit available at the level of the SIIQ is then lost at the level of the shareholder. A benefit may still exist with regard to IRAP, should the Lease Dividends fall out of the scope of IRAP in the hands of the shareholders;
 - iii shareholders such as Italian resident individuals, the SIIQ Regime is favourable since the Lease Dividends are subject to 20 per cent final withholding tax (possibly reduced to 15 per cent under certain conditions). The aggregate income tax levied at the level of the company and then at the level of the individual shareholder under the SIIQ Regime is therefore lower than that normally applicable; and
 - iv non-Italian resident shareholders, whether the SIIQ Regime is favourable or not would depend on the applicability of tax treaties and of the dividend exemption under the Parent and Subsidiary Directive. Italian real estate funds would, in any case, be generally more tax efficient than SIIQs for most non-Italian resident investors.

VII Conclusion

The matters discussed in this document are only based on our interpretation of the SIIQ Regime enacted by 2007 budget legislation. Moreover, several aspects of the SIIQ Regime have still to be implemented through a ministerial decree to be issued by April 30 2007.

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