ITALIAN REAL ESTATE INVESTMENT FUNDS

US buyers – private individuals or companies - can invest in Italian Real Estate also through special Real Estate Investment Funds (Fondi di Investimento Immobiliare - REIFs). As a result of recent regulatory amendments, the new REIFs are more flexible and more attractive for tax reasons to foreign investors interested in Italian Real Estate.

- REGULATORY ASPECTS

The Italian REIF legal regime was first introduced in 1994; at the end of 2003, however, the REIF tax regime was substantially amended for the purpose of making it more advantageous both for domestic and foreign investors.

Italian real estate funds are regulated by provisions contained in several statutes and regulations issued by the Bank of Italy (Banca d’Italia), the Ministry for Economic Affairs (Ministero dell’Economia e delle Finanze) and by the Italian regulatory authority for financial markets (CONSOB - Commissione Nazionale per le Società e la Borsa).

An Italian REIF is a tax exempt fund that invests exclusively or predominantly in real estate, immovable assets, and equity interests in real estate companies. A REIF is not a legal entity, but rather a pool of investment jointly held by multiple unit holders. The fund is managed on behalf of and in the interest of the unit holders (partecipanti) by a “savings managing company” (società di gestione del risparmio).

Investment funds and savings managing companies are separate “entities” and the assets of the funds cannot be held directly by the savings managing company; they must be deposited, indeed, with an authorized bank (the depository bank - banca depositaria), which carries out each transaction upon instructions by the savings managing company.

Specifically, a savings managing company must be an Italian joint-stock company (societa’ per azioni – SPA), and have its registered office and head office in Italy; a savings managing company can carry out its activity of management of investment funds upon authorization by the Bank of Italy.

The depository bank must be an Italian bank (or an Italian branch of an EU bank), and must comply with certain specific regulatory requirements which are under the supervision of the Bank of Italy.

In the presence of specific circumstances, the filing of a prospectus (prospetto informativo) may be required; in particular, a prospectus must be filed if the units of the fund are to be offered to the public.

Under Italian law, the managing company is charged with the drafting of the Regulation (Regolamento) of the fund; the Regolamento set forth the fund’s operational rules, and must be approved by the Bank of Italy before any offer of the fund units (quote di partecipazione al fondo) to the investors take place.

In particular, the Regolamento governs the investors’ participation in the fund, the respective rights and obligations of the fund’s investors, of the managing company, and of the depositary bank, the distribution of earnings, the procedures for the fund’s winding up, and the subscription and redemption of the funds units. In addition, the Regolamento determines the managing
company’s officers who are responsible for the selection of investments, and sets forth the investments criteria, the types of securities and other assets in which the fund’s assets may be invested, as well as all other relevant issues.

Italian REIFs can be formed through contribution or through subscription. Investors usually subscribe for fund units in cash; however, subscription by contribution of real estate assets, real estate rights or interests in real estate companies is also permitted.

In broad terms, the legal form of Italian REIFs can be twofold:

-“closed ended” REIFs (fondi chiusi); or
-“semi-closed ended” funds (fondi semi-chiusi).

Closed ended funds are funds in which the entire amount of the capital is determined at the time of its formation and cannot be subsequently modified; this type of funds does not allow its unit-holders to sell their participations to third parties.

Semi-closed ended funds are funds that are allowed to increase the value of their initial capital by issuing new units, on the condition that such issue is provided for in the fund’s by-laws (a recent Communication of the Bank of Italy has made clear that if further units are to be issued, they must be subscribed within the time period of 18 months after the publication of the prospectus).

An Italian REIF can be either listed or not listed. It is possible to set up a fund with only a few participants. However, to guarantee small investors the possibility of liquidating their investment in the fund, Italian law requires the filing of an application for listing (quotazione) on the Italian Stock Exchange within 24 months after the closing of the initial offer if the minimum fund unit is worth less than euros 25,000.

The type of investors to whom the fund’s units may be offered is set forth in the fund’s Regulation.

As a general rule, units may be made available to:
- the general public, whether through listing or not; or
- only to specific categories of investors.

In this latter regard, it is possible to organize “reserved funds” (fondi riservati) that are accessible only to qualified investors (e.g., pension funds, insurance companies, investment firms, banks and banking foundations, stockbrokers, savings management companies, foreign persons/entities who, pursuant to the regulatory laws of their respective home countries, conduct the same type of activities carried on by the foregoing persons, as well as individuals/entities who can demonstrate the possession of specific expertise and experience in transactions involving financial instruments, etc.) and for which investment restrictions are looser than those affecting general funds; in addition, Italian law allows the formation of “speculative funds” (fondi speculativi), accessible only to a maximum of 200 investors, whose minimum units must be worth more than euros 500,000, and which can operate virtually without limitations.

Italian REIFs were generally not allowed to directly engage in activities of building construction; however, a recently-issued Regulation by the Bank of Italy now allows even such type of activity, directly or indirectly through controlled companies (societa’ di costruzione), provided such activity does not exceed 10% of the fund’s overall activity.
Notably, an Italian REIF:
- may not invest, directly or through controlled companies, more than one third (1/3) of its assets in one single real estate asset having unitary, urban, and functional characteristics;
- may not invest more than 10% of its equity in the shares of the same building company;
- may enter into loan agreements as borrower up to 60% of the value of the real estate assets, real estate rights, and interests in real estate companies owned by the fund and up to 20% of the value of other assets owned by the fund. REIFs are permitted to apply loan capital, within the indicated limits, to carry out operational activities (including changing the commercial designation of the real estate, etc.) of the assets in which the fund’s capital is invested;
- has generally no obligation to distribute its profits during its lifetime; however, it must distribute all the proceeds deriving from its activities at the end of its duration.

- FISCAL ASPECTS
Real estate investment funds are subject to special tax rules, the main set of which was introduced in 2001, and to which substantial amendments were subsequently introduced effective as of year 2004.
Notably, as of January 2004, Italian real estate funds are tax exempt: therefore, they are not subject to the Italian “Corporate Income Tax” (IRES) and to the Italian “Regional Tax on Productive Activities” (IRAP).
In addition, no withholding tax is generally levied on income from capital derived by the fund (e.g., dividends, interests, etc.).

- Individual Investors
Income and dividends distributed by REIFs to individual investors are usually subject to a 12.5% withholding tax (ritenuta alla fonte) withheld by the managing company.
For the purpose of application of the 12.5% withholding tax the term dividend includes:

- distribution executed by the fund;
- the difference between the official value of the unit upon redemption and the official value upon acquisition or subscription;
- the difference between the official value of the unit upon sale and the official value upon acquisition or subscription.

Notably however, the 12.5% withholding tax does not apply if the foreign individual recipient is a non-Italian resident who is resident of a country with which Italy has entered into an effective exchange of information - a list of the countries providing adequate exchange of information is laid down in an Italian ministerial decree; generally speaking, the list includes those countries which have entered into a tax treaty with Italy containing a specific clause for a fully-fledged exchange of information (e.g., the United States of America).

Capital gains (plusvalenze) on the transfer of the units of a real estate fund are generally included in the overall income of the individual investor and are subject to Italian Personal Income Tax (IRE/IRPEF); capital gain tax is applied at a 12.5% rate.
Notably however, **capital gains on the transfer of the units of a real estate fund are tax exempt in Italy if they are realized by non-resident individuals without a permanent establishment in Italy**, provided that:

- the units are listed on a regulated market; or
- if the units are not listed on a regulated market, the nonresident individual is resident of a country which allows an effective exchange of information with the Italian tax authorities (e.g., the United States of America).

- **Corporate Investors**
  Income and dividends distributed by REIFs to corporate investors are usually subject to a 12.5% withholding tax withheld by the managing company. Notably however, the **12.5% withholding tax does not apply if the foreign corporate investor/recipient is a non-Italian resident entity which is resident of a country with which Italy has entered into an effective exchange of information** - e.g., the United States of America.

Capital gains on the transfer of the units of a real estate fund are generally included in the overall income of the foreign corporate investor and are subject to **Italian Corporate Income Tax (IRES)**; capital gain tax is applied at a 12.5% rate. Notably however, **capital gains on the transfer of the units of a real estate fund are tax exempt in Italy if they are realized by non-resident foreign companies without a permanent establishment in Italy**, provided that:

- the units are listed on a regulated market; or
- if the units are not listed on a regulated market, the non-resident foreign company is resident of a Country which allows an effective exchange of information with the Italian tax authorities (e.g., the United States of America).

- **Fund’s Managing Company**
  The fund’s managing company is subject to **IRES** and **IRAP**; the managing fees paid to company, indeed, must be included in the company’s overall income and are subject to the ordinary **IRES** flat rate of 33%.
  **IRAP** is currently levied at the rate of 4.25%.

- **Indirect Taxes**
  The deed of formation of an Italian REIF, its capital subscription, as well as the issuance of the fund’s certificates are **not** subject to the Italian registration tax (**imposta di registro**).

**ICI (Imposta Comunale sugli Immobili - the municipal tax on real estate)** must be paid by the managing company on all real estate properties and assets located in Italy and owned on behalf of the fund (the usual tax rates are between 0.4% - 0.8% of the estimated value of the property fixed by government tables, depending upon the municipality where the property is located).

Furthermore, **VAT at a 20% rate is usually levied on the sale of real estate assets; however, depending upon the type of real estate assets - e.g., non-buildable land, or agricultural land - and the subjective characteristics of the seller, exceptions may be available. The VAT taxpayer for the activities carried out by the REIF is the fund’s managing company; the company needs to**
calculate VAT in accordance with applicable VAT law, but it is generally allowed to offset its own VAT against that of the fund (and vice versa).

In this latter regard, the managing company can ask for reimbursement within six (6) months on the related VAT credit from the acquisition of real property by the REIF and the costs associated with the management of that property. Otherwise, the VAT credit can be either set off against other taxes due or transferred to a third party.

Alternatively, transfers of real estate assets not subject to VAT are subject to registration tax, levied at different rates depending upon the type of real estate assets transferred.

Transfers of Italian real estate properties/assets are also subject to the mortgage and cadastral taxes (imposte ipotecarie e catastali), currently levied at the aggregate rate of 3% on the value of the transfer or, alternatively - for transactions subject to VAT – at a fixed amount cumulatively equal to euros 336.