TAXING TIMES

Investors acquiring, holding or selling real estate in the UK, Germany, France and the US will all be affected by significant changes in taxation policy. Four Hogan Lovells tax partners outline the possible impact on their local markets

US

The US regulators have been working on providing guidance, mainly proposed regulations, on reforms enacted at the end of last year and known as the Tax Cuts and Jobs Act.

Of interest to the US real estate sector, on 3 August 2018 the Internal Revenue Service (IRS) issued proposed regulations (120 pages) on section 168(k) "bonus" depreciation. In doing so, the IRS did not attempt to fix the drafting glitch in the statutory language that prevents "qualified improvement property" being eligible for its intended 15-year life. That fix will have to be done by Congress in future technical corrections legislation.

Five days later the IRS issued proposed regulations (183 pages) on the section 199A deduction for "pass-through" entities. This allows individuals and some trusts to deduct 20% of their "qualifying business income", subject to limitations. Section 199A also allows individuals and some trusts to deduct 20% of their ordinary REIT dividends. However the proposed regulations did not address whether the section 199A deduction applied to shareholders invested in REITs through a mutual fund.

Cam Cosby, US tax partner, Hogan Lovells

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UK

From April 2019, UK capital gains tax will be charged on gains made by non-UK resident investors on disposals of all types of UK property (non-resident capital gains tax, or NRCGT). The charge will apply only to gains accruing from that date.

There will also be an indirect NRCGT charge when a non-UK resident realises a gain on disposal of an interest in a property-rich entity that derives directly or indirectly 75% or more of its gross asset value from UK property. This applies if the non-UK resident holds, or has in the two years before disposal held, an interest of 25% or more in the property-rich entity.

Existing reliefs such as the annual exempt amount, the substantial shareholding exemption and the tax-neutral intra-group transfer rules will apply and a gain realised by an overseas pension scheme will not be chargeable.

HMRC is still consulting on how to approach non-UK entities owned by tax-exempt institutional investors. There may be an NRCGT exemption for any gain realised by a non-UK entity (such as a Jersey unit trust) if it is owned by an exempt institutional investor or it may be able to be treated as transparent (not taxable).

Widely held offshore funds holding UK property will, subject to reporting requirements on disposals of interests by investors, be able to elect for a special exemption. Instead, investors in the fund will be charged indirect NRCGT on disposals of their interests, even if they hold less than 25%.

Elliot Weston, UK tax partner, Hogan Lovells

France-Luxembourg

On 20 March, France and Luxembourg entered into a new tax treaty that significantly amended the provisions of the one dating from 1 April 1958. The new arrangement could have a big effect on some French real estate investment vehicles (such as SIIC and SPPICAV) held by Luxembourg-resident investors.

Now, dividends deriving from property-related income paid to a Luxembourg shareholder by specialised French real estate investment vehicles – which distribute most of their profits annually and are exempt from French corporation tax on this income – would be subject to a 15% or 30% withholding tax in France depending on the nature of the recipient. This compares with 5% withholding tax under the former treaty.

The new treaty also includes provisions relating to capital gains on the sale of shares of companies qualifying as real estate entities, and French real estate wealth tax.

France and Luxembourg are currently ratifying the new treaty, but it could come into force from 1 January 2019 and affect existing and prospective investment structures.

Bruno Knadjian, France tax partner, Hogan Lovells

Germany

The most important change of law aims to tighten the real estate transfer tax (RETT) treatment of share deals.

Today, these transactions are generally structured in a RETT-neutral way. The tax does not arise if an independent co-investor acquires 5.1% of the shares in the target company or, in the case of joint ventures, if the seller retains a 5.1% interest in the target for five years.

It is proposed that the threshold is reduced from 95% to 90% and the minimum holding period increased from five to 10 years. In addition, a provision may be introduced whereby RETT is attracted if, within any given time period of 10 years, the shareholding in a company changes, directly or indirectly, by 90% or more. This latter provision would create immense tax risks and has been criticised by the industry and tax practitioners.

Capital gains realised through the sale of shares in non-German companies holding German property will be taxable from next year. Unrealised gains accrued on the shares on 31 December 2018 will not be taxed. However, non-resident holding companies should not suffer additional tax, and numerous treaties should offer protection too.

According to recent case law, the release of a non-resident entity owning German property from debt taken out for financing the acquisition or construction of that property is outside the scope of German taxation. However, the administration wants to change that through a new provision.

Michael Dettmeier, Germany tax partner, Hogan Lovells