

The International Tax Letter

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International news and analysis to help you in your international tax strategy.

Focus on: ITALY- Finance Bill 2007: New real estate investment vehicles and new trust regulations



On 27 December 2006, the Finance Bill was finally approved and converted into Law N. 296/2006. It introduced, a new real estate investment vehicle called "*Società d'investimento immobiliare quotata*" (SIIQ), and provided new tax rules with respect to trusts.

Società di Investimento Immobiliare Quotate

The SIIQ is not a new corporate entity but an *ad-hoc* regime applicable to ordinary joint stock companies that will fulfil (and maintain) certain requirements. It is expected to become the Italian equivalent of the US's Real Estate Investment Trusts and the French *Société d'Investissement Immobilier Cotee*. The SIIQ regime will be available upon election to Italian resident joint stock companies whose prevailing business activity is the rental of real estate and whose shares are listed in the Italian Stock Exchange. The SIIQ regime can also apply to a non-listed resident joint stock company.

In general, business income deriving from the real property leasing activity and dividends received from other SIIQs or Unlisted SIIQs (to the extent such dividends are formed with income deriving from leasing activity) are exempt from corporate income tax (i.e. IRES) and from regional tax (i.e. IRAP). However, income arising from other activities is ordinarily taxable. The relevant capital gain (net of any capital loss) can be subject to an *ad-hoc* 20% substitutive tax, payable in up to five yearly instalments of equal value. The above fair market value will be recognised for tax purposes starting from the fourth fiscal year after the election takes place.

Opportunities for property companies: special Fiscal system, no limitation in risk underwriting, not subject to administrative control of the Authority for saving protection, self governing.

Taxation of trusts

The Law provides that resident and non-resident trusts are subject to Italian corporate income tax (IRES) in accordance with the general principle provided by Art. 73(3) of the TUIR (i.e. a company is considered resident if its legal seat, place of effective management or main business purpose is in Italy for the greater part of the financial year). Furthermore, if a trust is incorporated in a country with which Italy does not have an adequate exchange of information system, it is deemed to be resident in Italy (unless proof to the contrary is given) if:

- at least one of the beneficiaries and one of the settlors is tax resident in Italy; or
- an Italian resident person, whether an individual or a corporation, transfers to the trust a real estate or any right thereof.

The Law also provides that if the beneficiaries of the trust are identified, incomes derived by the trust are attributed proportionally to the beneficiaries and qualify as income from capital in their hands.

Be careful! Income derived from foreign Trusts could be taxed in Italy.

EUROPEAN UNION

The EU Commission adopted Communications on coordination of direct taxation.

EU Commission adopted Communications on:

1. an EU co-ordinated approach of national direct tax system,
2. an EU-coordinated approach with respect to exit taxation,
3. a co-ordinated approach on cross-border loss relief.

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On 19 December 2006, the European Commission announced that it had adopted 3 Communications. The main object of the Communication on a coordination of national direct tax systems. The main objectives are:

- the removal of discrimination and double taxation
- the prevention of non-taxation and abuse;
- the reduction of compliance costs suffered by taxpayers who are subject to more than one tax system.

With reference to the Communication that invites Member States to adopt an EU-coordinated approach on exit taxation. Commission gave specific guidance for the EU Member States on how to implement the coordinated approach of national direct tax systems, specifically in designing exit tax mechanisms compatible with EC law principles.

In the third Communication the Commission invites Member States to adopt an EU coordinated approach to cross-border loss relief as the limited availability of cross-border loss relief within the European Union is considered to be one of the main obstacles to cross-border investments within the European market.

LUXEMBOURG

Vehicle for private wealth management introduced

As announced by the Luxembourg government, following the recent abolition 1929 holding companies (due to a decision of the European Commission), Luxembourg is introducing a new investment vehicle for private wealth investment. A draft law was put before the Luxembourg Parliament on November 20 2006, defining the characteristics and conditions of the *Société de Gestion de Patrimoine Familial* (or SPF).

An SPF is defined in the draft law as a company whose purpose is limited to the acquisition, holding, management and disposal of financial assets excluding any type of commercial activity. The shares of the SPF have to be exclusively held by eligible investors and its bylaws make a specific reference to the present law. SPFs have to be set up under specific legal forms defined in the draft law. SPFs will perform private wealth management activities only; any commercial activity is therefore prohibited.

The SPF is exempt from corporate income tax, municipal business tax and net-worth tax. It is also exempt from Luxembourg withholding tax on distributions. Income from financial assets, exempt at the level of the SPF, will be taxed once the income is distributed to the private investor.

SPAIN

Tax reform 2007 approved

The tax reform on individual, corporate, non-resident and wealth taxes was approved by parliament through Law 35/2006. Furthermore, the *Tax Fraud Prevention Law* was published. The most significant amendments introduced by the two acts are summarized below.

Personal income tax

- Tax brackets and marginal rates. The number of the individual income tax brackets is reduced from five to four. The minimum marginal rate is increased from 15% to 24%, while the maximum marginal rate is reduced from 45% to 43%.
- Taxation of savings: tax rate on savings will be 18%, regardless of the origin of the savings (dividends, capital gains, certain interests, etc...). For dividends, the imputation method of avoidance of double taxation is abolished; however, dividends are exempt up to the amount of 1,500, and the remainder is taxed at the rate of 18%.
- Personal and family allowances increased.

Corporate income tax

- Tax rate: The tax rate will be reduced from 35% to 30%. This reduction will take place over two fiscal years (2007 and 2008) at a reduction rate of 2.5% per fiscal year (32.5% in 2007 and 30% in 2008).
- Tax benefits: Tax benefits such as R+D, export activities and environmental investments will be abolished as compensation for the reduction in income tax due to the aforementioned tax cuts. The act establishes in certain cases a progressive reduction of tax benefits up to 100% reduction.

Wealth tax

The exemption of participations in companies engaged in economic activities (the so called family business exemption) will be calculated according to the proportion of assets related to business or professional activity not only in the first tier, but also in its subsidiaries.

Tax havens

Spanish regulation on tax havens, based on a closed list (i.e. blacklist), has been completed with a new open category of 'null taxation territory' and 'uncooperative in terms of exchange of information territory'. A definition of low-tax jurisdiction and of effective exchange of information has been introduced.

INTERNATIONAL MODELS

How to use a UK LLP

A Limited Liability Partnership (LLP) is an alternative corporate business vehicle that gives the benefits of limited liability but allows its members the flexibility of organising their internal structure as a traditional partnership. The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of the members will be limited. The internal structure of the LLP is similar to that of a partnership. The members provide working capital and share any profits.

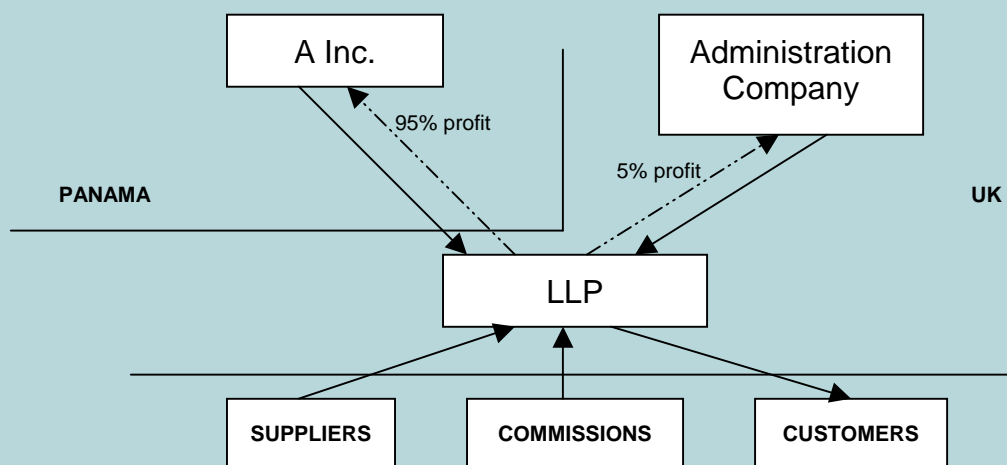
Unlike sole traders and partners of ordinary partnerships, the LLP itself is responsible for any debts that it runs up, unless individual members have personally guaranteed a loan to the business. A deed of partnership is a legally binding agreement between the partners that are setting up in business together. It describes how the partnership will be run and the rights and duties of the members themselves. LLPs must produce and publish financial accounts with a similar level of detail to a similar sized limited company and must submit accounts and an annual return to the Registrar of Companies each year. This publication requirement is far more demanding than the position for normal partnerships and specific accounting rules may lead to different profits from those of a normal partnership.

UK LLPs are tax transparent. Income and capital gains are therefore treated as income and gains of the partners, as set out in the deed of partners.

Non-UK residents can, in certain circumstances, use a LLP as a tax-efficient vehicle for international trade. If the members are not resident in the UK and the income and gains are not from a UK source or trade, then they will have no UK tax liability.

There are some anti-avoidance provisions to ensure that a LLP is not used to mitigate UK tax that might otherwise be payable.

Structure for Non-UK Trade by Non-UK Resident Members:



In the above example, we have a Panama company and a UK company which is administered from the Channel Islands, both of which are members of a UK LLP. The UK LLP will have a UK address and will file accounts and annual returns at Companies House.

It will trade outside of the UK, as well as receive commissions and consultancy fees. In our example, the Panama company would receive 95% of the profit and as it is not UK tax resident, there will be no UK tax liability in respect of this income.

The UK company, on the other hand, will be entitled to 5% of the profits, on which it will pay corporation tax at a rate of 30% after deduction of the company's expenses.

Although there is no requirement for LLP members to be resident in the United Kingdom, a United Kingdom company with directors outside of the United Kingdom has been included to provide some tax base since, although the company's affairs would be entirely organised outside of the United Kingdom, the profits of the United Kingdom company, being the 5% of income, less expenditure for the maintenance of the company, would be subject to corporation tax.

The accounting for the LLP would be dealt with by way of an administration agreement with an accounting organisation in the United Kingdom to enable a United Kingdom VAT number to be established for the LLP.



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