Investment Incentives

Assessing international real estate programmes

Virtual Round Table Series

Real Estate Working Group 2019

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In 1900, just 15 per cent of the world's population were city dwellers. Today, more than half of humanity lives in urban areas, and by 2030 this figure is expected reach 60 per cent.

A recent report from Euromonitor, predicts that, by then, the world will have 39 megacities, with a population of more than 10 million each. The report estimates they will house 9 per cent of the global population and contribute 15 per cent of the world's GDP, while taking up about 3 per cent of global land mass.

These numbers highlight the increasing pressure being exerted on the infrastructure of fast-growing urban areas; whether that is transport, services or housing. They also indicate the drain of resources and human capital that will be experienced by those cities, towns and rural areas that are not lucky enough to be considered 'mega.'

In established mega cities like New York and Paris, there are already extensive regulations in place to control both residential and commercial building. Similar restrictions are in the process of being implemented in newer, faster-growing mega cities such as Shanghai or Mumbai. Land is so valuable in these places, that high taxes are levied on building projects with purely profit-driven motives, meaning real estate investors must sign up to incentive schemes in order to mitigate these punitive taxes.

The schemes are designed to ensure that housing remains affordable for the people who live in the city. Many are extremely complex to negotiate.

One good example of innovation comes from Germany, where smaller companies can partner with others to construct affordable housing for key staff. Financing is provided via loans and grants from cooperative members, credit institutions and public development banks. One good example of complexity comes from New York, where signing up to an inclusionary housing scheme includes a zoning bonus. This bonus can be sold-on to other developers at a profit to finance the commitment to build affordable housing.

The flipside of the concentration of humanity and wealth in urban centres, is the decay and demise of smaller economies. While innovative schemes are being launched to encourage controlled real estate investment in areas of high demand, there are also schemes designed to encourage investment into areas of high unemployment and low economic growth.

Many of these incentives are tied into citizenship visas, enabling governments to access investment capital from overseas. An expanding global population is likely to make citizenship of developed countries, such as the USA, more attractive. Innovative governments are using this demand to funnel much needed investment capital into deprived areas. The EB-5 Visa in the US, offers citizenship to foreign individuals who invest USD 500,000 and create more than 10 jobs in certain regions.

Other real estate investment incentives are tied into tax breaks and allow investors to find reductions on capital gains tax or real estate transfer tax (RETT).

One such example from the US, is the New Market Tax Credit Programme. It attracts investment for real estate projects, community facilities, and operating businesses through the grant of federal income tax credits to private investors investing in low-income communities.

The range and complexity of real estate investment programmes is set to grow exponentially, as countries compete for international capital and look for new ways to control construction to suit their own needs. International investors who wish to spend their money efficiently, will need the right schemes to suit their specific proposals. The only way to do this properly is to consult an expert advisor.

In the following pages, you will hear from six legal professionals, who have proven experience of guiding multi-national real estate deals to success. They offer the benefit of their deep knowledge and expertise, and provide an update on recent and current regulatory developments in their respective jurisdictions.

The View from IR

Ross Nicholls

Business Development Director

Our Virtual Series publications bring together a number of the network's members to discuss a different practice area-related topic. The participants share their expertise and offer a unique perspective from the jurisdiction they operate in.

This initiative highlights the emphasis we place on collaboration within the IR Global community and the need for effective knowledge sharing.

Each discussion features just one representative per jurisdiction, with the subject matter chosen by the steering committee of the relevant working group. The goal is to provide insight into challenges and opportunities identified by specialist practitioners.

We firmly believe the power of a global network comes from sharing ideas and expertise, enabling our members to better serve their clients' international needs.

GERMANY

Dr. Peter Diedrich

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Dr. Peter Diedrich is the Managing Partner of DSC Legal and specialises in advising national and international clients in nearly all aspects of real estate investments in Germany.

For more than 20 years, he has been advising clients in real property acquisitions, investments and financing. Peter also has experience and expertise in mergers and acquisitions, corporate law, and international arbitration. He is a double qualified lawyer with admission in Germany and Poland and appointed as notary public in Berlin.

After having successfully completed his parent house apprenticeship at Siemens, Peter studied law at Freie Universität Berlin and passed his bar exam in Berlin in 1989. From 1989 until 2010, Peter worked as an attorney-at-law and partner at firms including Gaedertz, Haarmann Hemmelrath, Ernst & Young and Olswang.

In 1994, Peter received his doctor's degree from the Faculty of Law of Freie Universität Berlin. In 1997, Peter was officially appointed as a notary in Berlin.

He is also admitted to the Polish Bar (Adwokat).

U.S - CALIFORNIA

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In cooperation with Robert Blanchard - Co-Founder at Blanchard, Krasner & French

Jordan Ondatje guides individuals and business entities through real estate and business transactions as well as dispute resolution. Jordan assists clients in the formation of qualified opportunity zone funds and counsels opportunity zone investors through the complex requirements with the goal of maximising their tax benefits.

Blanchard, Krasner & French is a regional law firm with offices in California and Nevada. The firm has particular expertise in tax incentive transactions and serves U.S. clients with opportunities throughout the 50 states and overseas. Working in conjunction with colleagues from other jurisdictions, the firm also assists non-U.S. clients with investments in the United States.

U.S – NEW YORK

Michael Lefkowitz

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Michael Lefkowitz specialises in representing clients in commercial real estate transactions. For years he has been representing lenders and borrowers in completing financing transactions, and workouts of loans on troubled assets. Since joining Rosenberg & Estis, he has greatly expanded the firm's expertise in this sector. Mr. Lefkowitz has a national practice representing lenders, sponsors and equity investors in the purchasing, sale, financing and leasing of real estate in all types of asset classes.

ENGLAND

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Jo Farr is head of the Commercial Property team in Barlow Robbins' Guildford office.

She has worked as a property lawyer for more than 15 years, building up technical know-how and wide con¬nections with property professionals both locally and further afield. Her work usually involves one or more of the following: sales and acquisitions, commercial leases; development work and property finance.

She deals with a wide client base from local independent retailers to investment landlords and from property devel¬opers to banks, which means she is able to see transac¬tions from various perspectives.

Jo takes the time to get to know her clients and their businesses, so that she can understand their priorities and concerns. She has always found that a no nonsense approach gets the best results.

U.S – NEW YORK

Richard Sussman

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Richard Sussman is known for his breadth of knowledge and experience which have solidified his status as a skillful and highly valued practitioner at Rosenberg & Estis, P.C. For Richard, the goal is creativity, creating solutions to complex problems toward the goal of achieving the objectives of his clients.

Richard has had no shortage of opportunities to engage in creative solutions. His wide-ranging and sophisticated practice encompasses all phases of real estate transactions in both New York City and elsewhere.

Richard's client base is unusually broad. He represents everyone from individual and institutional developers, owners and lenders to syndicators, investors and brokers. He has structured and negotiated complex transactions involving multi-family buildings and complexes, office buildings, shopping centers, hotels, air and development rights, development parcels and mixed-use facilities. The nature of the transactions on which Richard has worked is also diverse, including purchases and sales, partnerships and joint ventures, workouts, and complex leasing and financing.

LUXEMBOURG

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Marc Theisen was admitted to the Luxembourg bar on 18 February 1981. He holds a law degree from the Université libre de Bruxelles (Belgium).

His main areas of practice are administrative law, property and construction law, banking & finance law, family law, divorce, law of succession, investment funds and Islamic finance.

Theisen and Marques is an independent law firm based in Luxembourg. The firm offers a wide range of legal services both in litigation and advice for private and professional clients as well as for financial and / or industrial investors.

With strong experience in litigation, the team supports clients in legal proceedings from the Justice of Peace to the Court of Cassation, as well as before the administrative courts.

Are there government grants and incentives in your jurisdiction that encourage investment in specific areas or regions? If so, how do they work?

Michael Lefkowitz – U.S - New York (ML) Opportunity Zones are a new community development programme established by Congress in the Tax Cuts and Jobs Act of 2017, to encourage long-term investments in low-income urban and rural communities throughout the USA.

The Opportunity Zones programme provides a tax incentive for investors to re-invest their unrealized capital gains into Opportunity Funds that are dedicated to investing into Opportunity Zones designated by the chief executives of every U.S. state and territory. By law, governors can nominate up to 25 per cent of their state's qualified census tracts for inclusion. Up to 5 per cent of the state's 25 per cent can be non-low-income tracts.

It's very lucrative to people who have had substantial gains, let's say in the stock market selling their Google stock, taking the gains and then investing into real estate. Investors can defer tax on any prior gains until the asset is sold or exchanged, as long as the gain is reinvested in a Qualifying Opportunity Fund.

An Opportunity Fund can be any investment vehicle organised as a corporation or partnership, for the purpose of investing in Qualified Opportunity Zone Property. Opportunity Zones are the talk of the town in the US, as every real estate developer is looking to raise funds for the investments in these designated areas throughout the United States.

Richard Sussman – U.S - New York (RS) Just to expand upon that a little bit, the investments are not restricted to real estate, so it applies to other sorts of business opportunities conducted within the Opportunity Zone as well. It's a fairly expansive programme which is intended to promote development and economic growth within these areas.

Jordan Ondatje – U.S - California (JO) Some more detail on Opportunity Zones from our perspective. The Tax Cuts and Jobs Act (the Act) provides a new tax incentive for investments in Qualified Opportunity Zones. A Qualified Opportunity Zone (QO Zone) is a low-income area that has been designated by the State and approved by the Secretary of the Treasury (the Secretary). The Secretary has approved QO Zones in all states and each of the US territories. Those investing in QO Zones can receive significant tax benefits, including tax deferral for capital gains reinvested in QO Zones, elimination of up to 15 per cent of the tax on the gain reinvested, and elimination of the tax on any additional gain from the investment in the QO Zones.

To benefit from investment in a QO Zone, the taxpayer must reinvest gain in a Qualified Opportunity Fund (QO Fund). A QO Fund is a corporation or a partnership that is organised for the purpose of investing in Qualified Opportunity Zone Property (QOZ Property) and that holds at least 90 per cent of its assets in Qualified Opportunity Zone Property purchased after December 31, 2017. A QO Fund must self-certify by attaching a certification form to its federal income tax return.

QOZ Property includes Qualified Opportunity Zone Stock (QOZ Stock), Qualified Opportunity Zone Partnership Interests (QOZ Partnership Interests), and Qualified Opportunity Zone Business Property (QOZ Business Property). QOZ Stock and QOZ Partnership Interests are stock and interests issued by a corporation or partnership which is a Qualified Opportunity Zone Business and acquired by the QO Fund solely in exchange for cash.

A Qualified Opportunity Zone Business (QOZ Business) is a trade or business that meets certain parameters, including that it cannot be a golf course, country club, massage parlour, hot tub facility, suntan facility, racetrack or facility used for gambling, or any store which has the principal business of selling alcoholic beverages for consumption off premises. A QOZ Business may consist of improving, leasing, and managing commercial and residential real property.

The tax benefits of making a Qualified Opportunity Fund investment can be illustrated as follows.

Assume Taxpayer A invested a USD1,000,000 gain in a QO Fund in 2018 and sells the investment in 2028 for USD2,000,000.

Taxpayer A may only defer the capital gains tax on the original investment until December 31, 2026. Because Taxpayer A will have held the investment for more than seven years at this point, Taxpayer A's basis in the deferred gain will be increased to USD150,000 (15 per cent of the deferred amount). Accordingly, Taxpayer A must only recognise a gain of USD850,000 (USD1,000,000 deferred gain - USD150,000 step up in basis). Even though Taxpayer A must recognise this gain by December 31, 2026, Taxpayer A can continue to hold the investment in the QO Fund beyond that date. When Taxpayer A sells the investment for USD2,000,000 in 2028, the additional gain from the investment in the QO Fund will not be recognised because Taxpayer A held it for ten years.

Accordingly, Taxpayer A will only pay taxes on USD 850,000 of the total USD 2,000,000 gain. The result is Taxpayer A pays only USD170,000 of tax in 2026 on a total gain of USD2,000,000 over ten years, which provides an effective tax rate of 8.5 per cent on the total gain.

Peter Diedrich – Germany (PD) Incentive programmes in Germany are available through different public funding instruments and for different funding purposes. The individual funding requirements may, for example,result from investment projects, research and development activities, personnel recruitment, working capital needs or other specific purposes. The different incentives instruments including grants, loans and guarantees are generally available for all funding purposes and can ordinarily be combined; thus matching the different business activity needs at different development stages of the company.

Richard Sussman pictured at the 2018 IR 'On the Road' in Toronto

Non-repayable grants are an effective means of significantly reducing production or service facility set-up costs. Germany offers one major programme directing the allocation of these investment grants throughout Germany: The Gemeinschaftsaufgabe 'Verbesserung der regionalen Wirtschaftsstruktur' (GRW – Joint Task for the Improvement of Regional Economic Structures).

The GRW is a national incentives programme that steers the distribution of direct subsidies for different investment projects across Germany in specified areas. Its main objectives are job creation and promoting regional economic development. Eligible costs include capital expenditures or personnel costs during the establishment phase.

The European Commission defines the regions and the maximum funding rates across the entire EU, conducting audits at regular intervals. A new GRW regional aid map came into effect in Germany in July 2014, and is valid through 2020. The region's previous economic outputs are used to define so-called C and D areas with different maximum funding rates.

The whole of eastern Germany (excluding Berlin) is classified as a C region. A special set of circumstances apply to eastern German municipalities, administrative regions, and unincorporated areas along the Polish border. Here, companies are eligible to apply for a compensatory differential to the Polish assisted region until the end of the present funding period (December 31, 2020). These regions have the highest funding rates in Germany.

Investments are also funded in certain regions of western Germany, where D regions dominate.

The maximum level of support that is permitted varies across the country. At its simplest, it depends on two factors: the size of the requesting company (classification as a small, medium-sized, or large enterprise) as well as its investment location within Germany. In the maximum-support areas in Germany, large companies can receive up to 20 per cent of eligible investment costs reimbursed; medium-sized companies up to 30 per cent; and small companies up to 40 per cent. These maximum-support areas are located in eastern Germany.

The GRW programme defines industries as well as forms of investment (e.g. greenfield projects or expansions) eligible for funding. International investors are subject to exactly the same conditions available to German investors. A set of criteria (including company size, planned investment project location et al.) determines individual investment project incentive levels.

Who and what can be funded with GRW grants is determined at the federal level by the GRW coordination framework. The GRW programme is focused on manufacturing and service industries. Pure sales or marketing activities are not covered by the programme.

Project costs form the calculation basis for determining the possible amount of cash incentives. Eligible costs are either project-related capital expenditures (e.g. for new buildings, equipment, machinery) occurring in the first three years after project start or the personnel costs of the newly created jobs in the first two years. Investors are free to determine whether to take capital expenditures or personnel costs as calculation basis for determining the possible amount of cash incentives. In the case of the wage cost option, lower and upper wage limits apply subject to federal state GRW regulations.

Luxembourg - MT Over recent years the Luxembourg real estate market has experienced rapid development, which continues today, in both office and residential property, with growth of 50 per cent and 60 per cent respectively.

This has been helped, partly by accommodative government policy, and also by a severe imbalance between supply (4,500 units per annum) and demand (6,000 units per annum). As a consequence, there are potential gains to be made on resale, providing an interesting investment opportunity for private, professional and institutional investors alike.

There are few speculative projects and the risk of not finding lessees is limited, considering the strong demand, with promising rates of return.

Offices attract a yield of around 5 per cent, while residential blocks can provide yields up to 8 per cent.

In 2020, total residential real estate transactions will reach a volume of EUR158 billion, reflecting an increase of approximately 30 per cent from today. For offices that number is EUR 32 billion, meaning an increase of 40 per cent from today.

With a view to financing, the banks generally require a personal contribution in the order of 20 -25 per cent to 30 per cent. Depending on the specific case, it is possible to opt for fixed or variable interest rates or a mix, and even the possibility of repaying interest only with a deferred repayment of the principal amount.

For several years the Luxembourg market has seen extremely strong interest on the part of private, professional and institutional investors. This is a phenomenon that was rare previously, but has been fostered by government policy, political stability, sound economic prospects, resistance to the financial crisis, still attractive taxation and, above all, high returns. This makes Luxembourg a most interesting platform on which to purchase or to invest in real estate.

Interest paid to finance the property and the maintenance and management costs can be deducted. Then there is the deduction within the framework of the depreciation schedule of 6 per cent of the price of construction. By way of example, with an investment of EUR 375,000, and a consequential depreciation of EUR 19,500 to be deducted, the owner would not be taxed for six years on rents of up to EUR18,000.

England - JF For decades, the UK housing market has proven to be a sure-fire success for UK and overseas investors. Property prices, in particular residential property, have enjoyed a significant upward trend despite a number of recessions where dips have only been transient. This reliable increase has been particularly bullish since the 1970s.

However, with limited space and an ever increasing population, the UK has suffered a housing shortage for many years and the UK government is still to get on top of the problem.

Limited supply has, as you would expect, driven prices up, however, recent tax and lending rules and of course the interminable uncertainty of Brexit has significantly impacted on investment potential.

Opportunities therefore for overseas investors are increasingly limited, particularly in the buy-to-let market with no notable few tax shelters or opportunity zones.

Stamp Duty Land Tax rates for buy-to-let or second homes rises to 15 per cent for every pound spent over GBP 1.5 million which has proven to be a disincentive for both UK and overseas investors.

However, there are other factors which also impact more favourably.

The success of regional cities such as Manchester and Liverpool are proving popular with Asian investors looking outside of London for more affordable prices with better yields also boosted by the HS2 project and rising local employment.

Liverpool has become one of the UK's leading business destinations with its far-reaching generation project and again has been very popular with Asian Investors.

Also relevant of course is the weakening of the pound and if Brexit does negatively impact on the property market, as it is expected to do so (should it happen!) then property prices may well drop by a significant percentage. Ultimately therefore this may encourage investment despite the lack of targeted incentives and the significant chunk of Stamp Duty Land Tax payable.

SESSION TWO

What other incentives does your jurisdiction provide to make real estate investment attractive to international investors? Any examples?

U.S - New York - ML The United States (US) EB-5 programme is a lot like other programmes that have existed throughout Europe. It's a Visa programme where an individual invests a certain dollar amount in a real estate project that creates a certain number of jobs in exchange for an opportunity to make a monetary return on the investment and, the investor obtaining a US Visa. The programme started in the 90s and wasn't particularly popular until about 2010, right after the global economic crash. That's when the program began to be heavily marketed to the individuals looking for US visas for their children to study in the US.

From 2010/11 through to 2015/16, many major real estate development projects, in New York and other large US cities used this programme and an alternative financing tool. Projects which required hundreds of millions of dollars in capital have utilised the programme because the cost of EB-5 capital is low compared to the cost to bring in an equity investor.

Post 2015/16, there's been a slowdown in the use of EB-5 for multiple reasons. One is the political climate here in the US and another is because of how the visas are processed. Most of the investors were coming from China and there was a backlog, because only a specific number of visas per country per year are allowed to be issued. The government is in the process of reforming the programme, including implementing higher investment thresholds while trying to alleviate the Visa processing backlog. There continues to be political debate over the reforms to be implemented to keep the program viable.

The projects that Rosenberg & Estis has worked on, range from several hundred million US dollars to two billion dollars. We've done several mixed-use buildings in Times Square in New York City, and we've also done hotel, retail, rental and office buildings in New York City and in cities outside of New York. I think the best use of the programme today is on a smaller scale. Our firm is now doing fewer USD100 million - 300 million EB-5 loans, and has moved more towards USD20 – 40 million loans, on smaller projects.

U.S - California - JO As Michael has illustrated, the EB-5 programme was created in 1990 to stimulate the US economy through capital investment by foreign investors. The programme is administered by United States Citizenship and Immigration Services (USCIS). Through the EB-5 programme, eligible investors may obtain permanent visas for themselves and their immediate family members by investing funds into United

States businesses and creating jobs for American workers. The requirements for obtaining an EB-5 Visa are as follows:

The investor must invest USD1,000,000 into a United States business, with funds from a legitimate source. The entire amount of the investment must be 'at risk,' meaning the investor must actually contribute capital to a commercial enterprise. The investment must also result in the creation or preservation of at least ten full time jobs.

There are various other ways to minimise capital gains taxes associated with real estate investment. These include;

Section 1031 Like-Kind Exchange – If a taxpayer sells real property held for investment (or productive use in a trade or business), he or she can defer the associated capital gains tax by rolling the proceeds from the sale into like-kind property within 180 days.

The Home Sale Exclusion – Unmarried individuals can exclude up to USD250,000 in profit from the sale of their primary residence, and married couples can exclude up to USD500,000.

Donation of Appreciated Real Property to Charitable Organisation – A taxpayer may donate appreciated real property to a charitable organisation to avoid paying capital gains taxes. Such taxpayer will also benefit from an income tax deduction in the amount of the fair market value of the donated real property.

Other schemes to consider include the New Market Tax Credit Programme, which also attracts investment for real estate projects, community facilities, and operating businesses through the grant of federal income tax credits to private investors investing in low-income communities. Through the programme, individual and corporate investors can receive tax credits against their federal income tax in exchange for making equity investments in financial intermediaries called Community Development Entities (CDEs).

A CDE is a domestic corporation or partnership that provides loans, investments, and financial counselling to low-income communities. An entity must be certified as a CDE to participate in the programme. The tax credit received by CDE investors is equal to 39 per cent of their total investment in the CDE. The credit is claimed over a seven-year period, in instalments of 5 per cent of the investment for the first three years, and 6 per cent of the investment for the following four years

Germany - PD Public loans occupy an important position in the German funding system – at federal (KfW Group), federal state (state development banks – e.g. the business development bank of the Federal Land of Berlin) and EU (European Investment Bank) levels.

Long credit periods, attractive interest rates and re-payment-free periods are the most important features of this funding instrument. Small and medium-sized enterprises, in particular, are often entitled to preferential conditions. A further advantage exists for investors through the possibility of combining public loans with other forms of incentives such as grants for investments, R&D projects or personnel.

One example is the KfW Entrepreneur Loan (KfW-Unternehmerkredit), which is for self-employed professionals, enterprises and leasing companies from Germany and other countries that have been in the market for longer than five years and want to invest in Germany. These loans have a maximum sum of EUR 25 million with a maximum term of 20 years, and are meant for capital expenditure and working capital in and outside Germany.

The loans can be used to finance 100 per cent of the cost of a project and have attractive interest rates fixed for up to 20 years, or for the entire term of the loan. They have particularly favourable interest rates for small and medium-sized enterprises and a repayment-free start-up period. They can also be combined with other KfW programmemes and public promotional funds.

KfW also promotes the construction of new energy-efficient homes, the energy-efficient refurbishment of older residential buildings, the expansion of renewable energies and the creation of barrier-free housing.

German real estate transfer tax (RETT) is generally triggered if real estate located in Germany is sold or transferred by way of an asset deal to a new owner. The transfer of shares/interest in companies owning German real estate may also trigger RETT, if at least 95 per cent of the shares/interest are (i) accumulated or (ii) transferred to new shareholder(s). This rule often triggers RETT, once the so called 95 per cent threshold is reached or exceeded.

RETT rates are currently between 3.5 per cent and 6.5 per cent of the specific tax value of the real property, based on the location of the real estate (each German Federal state is allowed to decide on the applicable RETT rate itself).

RETT can be avoided if RETT blocker structures are implemented as follows:

The purchase of shares in a property-owning corporation using the two investors-model, whereby the main investor buys 94.9 per cent and an (independent) minority investor buys 5.1 per cent.

The purchase of interest in a property-owning partnership, whereby the investor buys 94.9 per cent, and the vendor retains 5.1 per cent. After more than five years, the investor may buy the remaining 5.1 per cent from the vendor, with the result that RETT is only triggered on 5.1 per cent of the property value.

In case of refurbishment of certain historic buildings or buildings in a formal urban renewal area in Germany, the taxpayer may deduct up to 9 per cent of the costs of modernisation and reconstruction in the year of completion and the following seven years. They may deduct up to 7 per cent in the subsequent four years, instead of linear depreciation. The same may apply to a taxpayer purchasing such a property from a developer. The refurbishment has to be coordinated with certified by the relevant building administration.

DSC Legal actively supports the German Business Association e.V. (Bundesverband mittelständische Wirtschaft, Unternehmerverband Deutschlands e.V. - BVMW) in the implementation of its new SME initiative 'Job plus Dwelling'. The trigger for this initiative is the acute shortage of housing and specialist staff, which is particularly noticeable in the major German cities, where living space is becoming increasingly scarce and expensive, and well-paid and qualified specialists often have no chance to rent an affordable flat.

Mid-sized companies can participate in the construction of employee housing through the regional grouping of companies in a cooperative that builds and manages future employee housing. Each member company receives the requested number of occupancy rights to apartments to be designated in advance as part of the membership of the cooperative.

In addition to the capital contributions of the member companies, financing will be provided, in particular, through loans from cooperative members and credit institutions, as well as loans and grants from public development banks (e.g. Investitionsbank Berlin - IBB).

Peter Diedrich pictured at the 2018 IR Annual Conference in London

New York - RS There is a programme in New York City (NYC) that has existed for quite some time in order to address a few major issues affecting new development in NYC - high taxes and the inability to develop larger projects. These issues have become worse over time, and the city has had to be very creative in order to ensure economic viability and to promote development generally.

There's a real dynamic here at the moment, particularly with residential products and rental residential products. NYC needs housing and wants to promote its development, especially affordable housing, but residential real estate is taxed at extremely high rates of real property taxes.

For the last 40 years there has not been a significant residential rental building built in NYC that did not utilise one particular benefit. It's called 421a, named as such since it derives from Section 421a of the tax law.

A few years ago, the programme ceased to exist for almost two years and its future was politically uncertain, but the politicians came together and reinstituted the programme in a different manner which is now much more complicated, but essentially has similar requirements and similar benefits.

In exchange for a developer building a certain number of affordable units, they obtain an exemption from the payment of real estate taxes for an extended period of time. There's a full exemption for the period of construction (not to exceed 3 years) and - dependent upon certain facts and limitations - 35 (and possible 40) years on the assessed value of improvements. So, essentially, you're getting an extended significant benefit, and, in exchange for that, you commit 30 per cent of the apartments in your building to affordability restrictions. Affordable apartment created under the 421a programme must remain affordable for the life of the benefits. At the time of going to press, a new wide-ranging law was passed by the State of New York. This puts in place rent restrictions on the entire development, rather than just 30 per cent. We wait to see the full extent of its influence on 421a.

There are choices within the programme that involve making the apartments available to various income bands of people who can live there versus average median income in the area. It's quite complicated and there are different windows of affordability for which the benefits vary slightly. Essentially what you do, is make part of your building affordable and you get an exemption in real estate taxes. Without the exemption, real estate taxes on new residential development projects would be approximately 30-35 per cent of gross income potential, often rendering the project uneconomic, certainly in the early years.

The 421a programme does not apply to commercial buildings, but there's something that NYC also does to promote the development of commercial property - the Industrial and Commercial Abatement Programme (ICAP). There is a similar abatement in taxes for investments in industrial and commercial buildings, to modernise, expand and physically improve them. It is not a complete abatement in the sense that the residential one is under 421a, but it's an abatement to compensate you for your investment and improvement of those industrial and commercial spaces. ICAP does not apply in all areas of the city (e.g., it cannot be utilized in mid-town Manhattan), but it can be used in many areas, including the presently hot, large-scale development areas in Brooklyn and Queens.

In the case of 421a, rental real estate would not continue to be built without these programmes. Another programme - called 'inclusionary housing' - doesn't create tax savings, but rather creates the right to build additional floor area and thus, allows an increase in the size of the building to be built. If you build affordable housing in certain areas, you get what's called a zoning bonus of a certain amount of square feet that you can either use in the building being constructed, or transfer to another building within a certain geographic area. Affordable apartments created under this programme must remain affordable in perpetuity.

This zoning bonus is a saleable asset, so it was often used by affordable developers developing a site in a certain area. They would spin off this inclusionary right and sell it for profit to high-end developers who would buy the right and incorporate this into their building. They could then

combine that with the 421a to get a larger building with a significant abatement of real property taxes.

In 2016, 'mandatory inclusionary housing' was instituted, which requires developers to build affordable housing in certain areas in building larger than 10 units or 12,500 square feet.

NYC can monitor the leasing of all affordable apartments, and thus, the procedures for renting affordable apartments (which are highly sought after and often conducted through a lottery process) is often done through specialised companies.

Luxembourg - MT The taxation system in Luxembourg is one of the main attractions for real estate investors. Real estate income is in principle taxed as miscellaneous income.

A corporate income tax rate of 18 per cent applies to a company when taxable income exceeds EUR 30,000. The rate falls to 15 per cent if annual taxable income does not exceed EUR 25,000. A municipal business tax also may be levied. Municipal business tax may be imposed at rates ranging from 6 per cent to 12 per cent, depending on where the undertaking is located.

Municipalities in Luxembourg impose a land tax of 0.7 per cent to 1 per cent on the unitary value of real property, including industrial plants. This is multiplied by coefficients fixed by each municipality and varies according to the type of real property.

Corporate structures offer a multitude of opportunities to optimise acquisition or investment. It is possible to leverage the investment through a mixture of equity and debt. Capital gains derived from the sale of Luxembourg real estate (including gains on the sale of land) will continue to be taxed until 31 December 2018 at one-fourth of the overall tax rate.

Indeed, this measure, introduced initially as a temporary incentive applicable during 18 months (from 1 July 2016 until 31 December 2017), has been extended to continue the efforts of the Luxembourg Government to increase the real estate offer in Luxembourg.

Luxembourg companies may benefit via applicable double tax treaties from tax exemption on income deriving from real estate locate abroad. Dividends and capital from qualifying shareholdings in real estate property companies are usually exempt from corporate income tax under the Luxembourg domestic participation exemption.

There is normally no net worth tax due on directly held foreign real estate or shareholdings in foreign companies as a result of tax treaties and domestic law exemptions. There is also no capital duty, and the annual property tax is low (generally a few hundred euros).

SESSION THREE

What structures do you recommend international investors use to facilitate a smooth and efficient investment process?

U.S - California - JO In evaluating available investment structures for an international investor, important considerations typically include tax consequences, privacy concerns, liability protection, and US filing requirements.

As a general rule, international investors are subject to a flat 30 per cent withholding tax on United States source fixed or determinable, annual or periodical (FDAP) income that is not effectively connected to a United States trade or business. FDAP income includes rental income from real property. The FDAP tax rate may be reduced by an applicable treaty for investors from certain countries.

If the income is effectively connected to a US trade or business, foreign investors are taxed under the same rules as US taxpayers, paying income tax at graduated rates up to a maximum of 37 per cent. In addition, under the Foreign Investment in Real Property Tax Act (FIRTPA), a foreign investor selling US real estate is required to withhold a tax on the amount realised, generally at a rate of 15 per cent. US estate and gift tax is also imposed on any US situs property included in a non-resident alien's gross estate at the time of death.

Investment directly through a US corporation or other entity is still subject to FIRPTA and will subject the investor to US estate and gift tax. As a result, a better option is to hold the real estate through a "'blocker' structure in which the investor invests through a foreign entity which owns the US entity holding the real estate. This provides the benefits of owning the property through a US entity, while preventing application of US estate and gift tax and potentially mitigating FIRPTA.

Investors generally use a two-tier corporate structure, but in some circumstances, a partnership structure may also be appropriate. Under the Tax Cuts and Jobs Act, the corporate income tax rate was reduced to a flat rate of 21 per cent, which provides a significant benefit to corporations. Investing through a corporation, generally subjects the investor to double taxation, however, proper structuring using qualified debt instruments can entirely or substantially eliminate double taxation.

Finally, international investors may also consider investing in US real estate through a domestically-controlled Real Estate Investment Trust (REIT). A REIT is an entity otherwise taxable as a US corporation that elects REIT status and is permitted a tax deduction for dividends paid to its shareholders. A REIT is 'domestically controlled' if more than 50 per cent of the stock is owned by US persons.

A major advantage to investing through a domestically-controlled REIT is that the investor can sell the stock in the REIT

Michael Lefkowitz pictured at the 2018 IR 'Dealmakers' Conference in Lisbon

without incurring federal income tax under the FIRPTA. In addition, because the REIT is eligible for a deduction for dividends paid, it will generally have little or no US federal income tax liability. However, REITS are designed for passive investors and thus provide investors with significantly less control over their investments.

Luxembourg - MT Private, professional and institutional investments can be made in a wide range of investment vehicles in Luxembourg. Most of these can be used to establish a real estate portfolio.

Such a corporate structure may be incorporated in the form of a non-regulated or a regulated entity.

Depending on the size of the acquisition project, this will be via a corporate form such as a Public Limited Company (SA), Private Limited Company by Shares (SARL); a corporate partnership limited by shares (Société en Commandite par actions) or the special limited partnership (Société en Commandite Spéciale, SCSp.

The common limited partnership (Société en Commandite Simple, SCS) or non-trading company (Société Civile) are also commonly chosen for companies investing in real estate.

A real estate investment fund, such as the Specialised Investment Fund 'FIS', Risk Capital Investment Company (SICAR), Alternative Fund-AIF 'Fonds Alternatifs' (RAIF) can also be used. Such vehicles present the private, professional and institutional investor with many advantages, inter alia tax optimisation including arrangements within the framework of estate planning.

Germany - PD From a German tax perspective, offshore structures are basically not beneficial for German real estate investments as the profits are subject to German income tax anyway.

The investment as an individual can be disadvantageous with regard to the income tax rate on a nameable current rental income, as the tax rate is linear-progressive and may increase up to more than 47 per cent for very high income. On the other hand, an individual may sell his German property income tax-free after more than 10 years, if it is owned as a private asset.

In contrast, investment via a corporation may be advantageous with regard to current rental income, as a flat rate of 15.825 per cent corporate income tax is applicable, even for very high incomes. This tax burden may further be reduced by interest on (shareholder) loans. In extreme cases, taxable profits in Germany may be neutralised, provided the loans were granted under arm´s length conditions and the interest payable is not subject to the Earning Stripping Rule.

On the other side, a sale profit will always be subject to corporate income tax as the property of a corporation is considered as a commercial asset. When investing via a special purpose vehicle (SPV), we recommend the use of a foreign SPV, without a permanent establishment in Germany, in order to avoid German trade tax as well as withholding tax on dividends.

Trade tax is an additional municipal tax with varying rates, depending on the municipality of the permanent establishment. It is only triggered on commercial income, i. e. derived from a commercial activity, or on certain legal forms of the property owning company (e.g. corporation or commercially infected partnership).

Alternatively, the investment may be made with a non-commercial partnership. Such a partnership is considered as transparent for income tax purposes. Any profits are directly attributed to and taxed at its partners, so that no withholding tax is triggered by profit distributions.

U.S - New York - ML There is a substantial benefit to foreign investors having their structures as debt structures versus equity structures, because you can avoid having to pay income taxes based on the interest earned. This structures the US income tax into a debt vehicle versus an equity vehicle. There are certain cases in which the purchaser of a property in New York and the US is required to withhold taxes where the seller is not a US taxpayer, but it really depends on the situation.

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