



## Italian Government Introduces Measures to Stimulate Real Estate Market

On September 12, 2014, the Italian Council of Ministries enacted Law Decree no. 133 (“*Sblocca Italia*” (the “Law Decree”). The Law Decree entered into force on September 13, 2014, the day immediately following its publication in the *Italian Official Gazette*.<sup>1</sup>

The Law Decree contains, *inter alia*, a set of measures to promote the Italian real estate market. In particular, it has introduced (i) several amendments to the current regime applicable to listed real estate investment companies (“*Società di Investimento Immobiliari Quotate*” or “SIIQs”), i.e., the Italian vehicles that resemble real estate investment trusts (“REITs”), and (ii) a deregulation of commercial property leases.

The amendments to the current regime applicable to listed real estate investment companies are intended to incentivize investment in these instruments. The changes can be summarized as follows:

- Revision of requirements to qualify as SIIQs;
- Introduction of lighter investment management criteria; and
- Harmonization of the tax regime applicable to SIIQs and to Italian real estate investment funds

with the goal to erase any mismatch between the tax regime applicable to SIIQs and the one applicable to Italian real estate investment funds.

The Law Decree deregulates commercial property leases with an annual rent higher than €150,000, which exceeds the mandatory provisions of Law no. 392 of July 27, 1978 (the “Tenancy Law”). The goal is to make Italian property lease agreements more attractive by implementing regulations with flexibility similar to that found in other European Union (“EU”) member states.

### Real Estate Investment Companies

SIIQs were originally introduced in the Italian legal context by Law no. 296 of December 27, 2006 (the “2007 Italian Budget Law”). However, various constraints contained in the original legal framework have impaired the growth and development of SIIQs. The Law Decree introduces certain changes to the SIIQ regime in order to grow the instrument in the Italian market. An overview of the SIIQ regime following the enactment of the changes set forth by the Law Decree follows.

### Requirements to be Eligible for the SIIQ Regime

SIIQs must be formed as joint-stock companies, and their shares must be listed on a regulated stock exchange of a European Union member state.<sup>2</sup> They must be domiciled for income tax purposes in Italy or in another EU member state.<sup>3</sup> In the latter case, the SIIQ regime applies to the Italian permanent establishment of a non-Italian resident to the extent that its main activity consists of the leasing of real estate assets, also through the investment in nonlisted real estate companies (*Società di investimento immobiliare non quotate* or “SIINQs”) (see “Nonlisted Real Estate Companies,” below).

No shareholder can own, directly or indirectly, more than 60 percent of the voting rights or have right to more than 60 percent of the company’s profits.<sup>4</sup> At least 25 percent of the shares must be owned by shareholders who do not own, directly or indirectly, more than 2 percent of the voting rights nor have the right to more than 2 percent of the company’s profits.<sup>5</sup>

The SIIQ’s main business must be the leasing of real estate assets. The requirement is met if both an asset test and a profit test are satisfied. In particular:

- **Asset test.** At least 80 percent of the value of the company’s assets must be represented by (i) real estate assets intended to be leased; (ii) shares/equity interests—other than those held for trading—in other SIIQs or SIINQs; and (iii) units in Italian qualified real estate funds (“Italian Qualified RE Funds”) (see “Tax Treatment of SIIQs,” below).
- **Profit test.** At least 80 percent of the company’s total income in each tax year must derive from (i) the lease of real estate assets; (ii) capital gains from the transfer of such real estate assets; (iii) dividends paid out of profits relating to leasing activities by other SIIQs or SIINQs;<sup>6</sup> and (iv) proceeds distributed by Italian Qualified RE Funds.<sup>7</sup>

SIIQs must keep separate accountings for leasing activity and their other businesses, disclosing the relevant criteria of allocation of general costs and of other items. In addition, there are no set debt/equity ratios under the law.

The law does not provide for minimum capital requirements that specifically apply to SIIQs without any prejudice to the provisions on joint-stock companies provided for by the Italian Civil Code.<sup>8</sup> Nevertheless, the regulation of the Italian stock exchange (*Regolamento dei Mercati Organizzati e gestiti da Borsa Italiana S.p.A.*) provides that real estate investment companies—including SIIQs—must have a prospective market capitalization equal to €40 million and an appropriate floating regime that is presumed to be met if the SIIQ’s shares are held by professional and/or nonprofessional investors in an amount equal to 35 percent of the overall outstanding shares.

### Tax Treatment of SIIQs

SIIQs are exempt from both the Italian corporate income tax (“IRES”) and the regional tax on production activities (“IRAP”) on profits arising from:

- The leasing of real estate assets;
- Capital gains and capital losses on the disposal of real estate assets intended to be leased;
- Dividends paid out of profits relating to leasing activity by other SIIQs and SIINQs;
- Capital gains and capital losses on the disposal of shares/equity interests in other SIIQs and SIINQs;
- Proceeds arising from investments in Italian real estate funds that invest at least 80 percent of their gross asset value into (i) real estate assets, rights *in rem* on real estate assets, including those arising from lease contracts with a transferral nature as well as from license relationships (“*rapporti concessori*”) and interest in real estate companies, and (ii) other real estate investment funds leasing their real estate assets, including social housing real estate investment funds;<sup>9</sup> and
- Capital gains and capital losses on the disposal of units in Italian Qualified RE Funds (“exempt business”).

Income arising from other sources (“taxable business”) is subject to standard 27.5 percent IRES and IRAP generally levied at 3.5 percent.

With regard to joint-stock companies resident in other EU member states with a permanent establishment in Italy, the law provides that a 20 percent tax is levied on the business income that the Italian permanent establishment of the EU company derives from the leasing of real estate assets.

### Nonlisted Real Estate Companies

The SIIQ tax regime also applies to SIINQs, nonlisted real estate companies, if the following conditions are met:

- They are based in Italy for income tax purposes;
- Their main business is the leasing of real estate assets;
- They are 95 percent owned by a SIIQ (or, jointly, by more than one SIIQ);<sup>10</sup> and
- They opt for the SIIQ regime and for the domestic tax consolidation regime together with the controlling SIIQ.

### Taxation Upon Option for the SIIQ Regime

Unrealized capital gains on real estate assets that are held to be leased are deemed to be realized at the time the company opts for the SIIQ tax regime. The SIIQ can:

- Pay a 20 percent substitutive tax on the unrealized capital gain. The payment of this tax can be spread over a period of five years; or
- Include the whole amount of the unrealized capital gain in its taxable base under the ordinary tax rules.<sup>11</sup>

The SIIQ may elect to apply the 20 percent substitutive tax also to the unrealized capital gains on real estate assets held for sale (and, therefore, not covered by the SIIQ tax regime) in order to obtain a step-up in the tax value of such assets.

The new tax value (i.e., the market value) becomes effective for IRES purposes on the fourth tax year following the year during which the election is made.<sup>12 13</sup>

### Mandatory Dividend Distributions

SIIQs must distribute to their shareholders at least 70 percent of the net profits of the exempt business to the extent that such profits relate to the holding of real estate assets, shares/equity interests in other SIIQs and SIINQs, and units in Italian Qualified RE Funds.

Capital gains arising from the disposal of (i) real estate assets; (ii) investments in SIIQs and SIINQs; and (iii) units in Qualified Italian RE Funds must be distributed:

- For an amount equal to 50 percent, in lieu of the 70 percent threshold; and

- Within the two tax years following the tax year during which the capital gain has been realized.

**Tax Treatment of the SIIQ's Shareholders Dividends.** A 26 percent withholding tax<sup>14</sup> is levied on the dividends paid to the SIIQ's shareholders out of profits of the exempt business.

No withholding tax is levied on dividends paid to (i) other SIIQs; (ii) Italian undertakings of collective investment; (iii) Italian pension funds; and (iv) assets under management under Article 7 of Legislative Decree no. 461 of November 21, 1997 ("*risparmio gestito*").

The withholding tax is final if the SIIQ shares are held by non-business individuals or by nonresidents without a permanent establishment in Italy. The Italian tax authorities have taken the view that the Parent-Subsidiary Directive does not apply to SIIQs. However, nonresidents can benefit from any available reduced rates provided for the applicable double tax treaties.

Dividends paid to Italian resident entrepreneurs (individuals or companies) are subject to a withholding tax on account and then are fully included in the taxable base of the taxpayer.

**Capital Gains.** The Italian participation exemption does not apply to the capital gains realized upon disposal of SIIQ shares.

Capital gains realized by Italian resident entrepreneurs, Italian business partnerships, Italian resident companies, and permanent establishments of non-Italian residents are fully included in the IRES taxable base of such persons.

In respect of shares held by (i) resident individuals (different from entrepreneurs) or (ii) nonresident individuals or companies without permanent establishment in Italy, the regime changes depending on whether the shares represent a qualified participation or not. An equity interest in the share capital of a listed company is deemed to be a qualified participation if it exceeds 5 percent of the company's share capital or 2 percent of the voting rights in the shareholders' meeting of the company.

If the SIIQ shares represent a qualified participation, capital gains upon their disposal are fully taxed if owned by Italian resident individuals and are subject to Italian personal

income tax (“IRPEF,” currently levied at rates ranging from 23 percent to 43 percent).<sup>15</sup> An exemption may be available for nonresident individuals or companies (without a permanent establishment) under double tax treaties.

Conversely, if the SIIQ shares do not represent a qualified participation, capital gains realized by Italian resident individuals are subject to a 26 percent capital gain tax. In this case, Italy does not tax the capital gain if it is realized by nonresident individuals or companies (without a permanent establishment in Italy).<sup>16</sup>

**Contribution of Real Estate Assets into a SIIQ Income Taxes and IRAP.** As a rule, contributions of real estate assets into companies are treated as sales of real estate assets for IRES, IRPEF, and IRAP purposes. In other words, they represent a realization event. This means the contributing company (or the contributing individual) is taxed on any capital gain.

The SIIQ regime allows the contributing company or individual to pay a 20 percent capital gain tax in lieu of any IRES, IRPEF, or IRAP due. However, the contributing taxpayer may elect to subject the capital gain to IRES, IRPEF, or IRAP, as the case may be.

**VAT and Other Indirect Taxes.** As a rule, the contribution of business real estate assets is subject to 22 percent value added tax (“VAT”). Conversely, the contribution of residential real estate assets is subject to proportional registration tax.

As to indirect taxation, the SIIQ regime provides for the following tax benefits:

- The contribution of a pool of real estate assets (regardless of whether business or residential) that are mainly leased is regarded as a contribution of a going concern for VAT purposes. Therefore, VAT does not apply, and registration and mortgage taxes are levied at the nominal amount of €200 each; and
- Mortgage taxes on the contribution of single-business real estate assets are reduced to 2 percent.

**Contribution to, and Assignment from, Italian Real Estate Funds.** Should an Italian real estate fund, upon partial or total liquidation, assign to its unitholders shares in a SIIQ, such exchange does not give rise to any taxable capital gains, but

the shares in the SIIQ must keep the same tax value of the units in the real estate funds. This rule applies provided that the units were originally issued as a consequence of contributions of real estate assets to the fund.

Contributions into a SIIQ by Italian real estate funds of a pool of real estate assets that are mainly leased are subject to €200 registration and mortgage taxes. The same tax treatment applies to the assignment, upon liquidation of the units of Italian real estate funds, of such pools of assets to SIIQs.

### **Regulatory Considerations**

SIIQs do not qualify as undertakings for collective investments pursuant to the Legislative Decree February 24, 1998 no. 58 (the “Unified Financial Act”), and, therefore, SIIQs do not fall within the provisions set forth under the Directive 2011/61/EU of the European Parliament and of the Council of June 8, 2011 on alternative investment fund managers as implemented in Italy. As a consequence, SIIQs do not need to be licensed by the Bank of Italy, the Italian supervisory authority with reference to collective portfolio management services, nor fall under the Bank of Italy’s supervision as per matters of Directive 2011/61/EU of the European Parliament, and of the Council of June 8, 2011 on alternative investment fund managers.

The provisions of the Unified Financial Act on public offerings of financial products and the rule books issued by the Italian stock exchange—including the envisaged regulation—apply in connection with the listing of a SIIQ on the Italian stock exchange (e.g., duty to draft a prospectus, approval of the prospectus by the competent Italian supervisory authorities, and listing requirements). Compliance with the provisions of the Unified Financial Act on public offerings as well as with the rule books issued by the Italian Stock Exchange must be analyzed in greater detail during the listing process of a SIIQ.

In the case of contributions of real estate assets by Italian real estate funds into existing SIIQs, the contributing Italian real estate fund is not required to launch a mandatory tender offer pursuant to Article 106 of the Unified Financial Act, provided that the SIIQ shares received by the fund in exchange for the real estate assets contributed are assigned to the fund’s unitholders within 30 days from the relevant contribution required.

### Summary Chart of the Previous Regime Versus the Revised Regime

| Main changes            | Past regime prior to the Law Decree   | Revised regime following the Law Decree   |
|-------------------------|---|---|
| Shareholdings           | No corporate shareholder can own, directly or indirectly, more than 51 percent of the voting rights or have right to more than 51 percent of the company's profits.   | No corporate shareholder can own, directly or indirectly, more than <b>60 percent</b> of the voting rights or have right to more than <b>60 percent</b> of the company's profits.   |
| Floating shares percent | Thirty-five percent of the shares must be owned by shareholders who do not own, directly or indirectly, more than 2 percent of the voting rights nor have the right to more than 2 percent of the company's profits.  | <b>Twenty-five percent</b> of the shares must be owned by shareholders who do not own, directly or indirectly, more than 2 percent of the voting rights nor have the right to more than 2 percent of the company's profits.   |
| Asset test              | At least 80 percent of the value of the company's assets must be represented by: <ul style="list-style-type: none"> <li>• Real estate assets intended to be leased; and</li> <li>• Shares/equity interests—other than those held for trading—in other SIIQs or SIINQs.</li> </ul> | At least 80 percent of the value of the company's assets must be represented by: <ul style="list-style-type: none"> <li>• Real estate assets intended to be leased;</li> <li>• Shares/equity interests—other than those held for trading—in other SIIQs or SIINQs; and</li> <li>• <b>Units in Italian Qualified RE Funds.</b></li> </ul>  |
| Profit test             | At least 80 percent of the company's total income, in each tax year, must derive from: <ul style="list-style-type: none"> <li>• The lease of real estate assets; and</li> <li>• Dividends paid out of profits relating to leasing activities by other SIIQs or SIINQs.</li> </ul> | At least 80 percent of the company's total income, in each tax year, must derive from: <ul style="list-style-type: none"> <li>• The lease of real estate assets;</li> <li>• <b>Capital gains from the transfer of these real estate assets;</b></li> <li>• Dividends paid out of profits relating to leasing activities by other SIIQs or SIINQs; and</li> <li>• <b>Proceeds distributed by Italian Qualified RE Funds.</b></li> </ul>  |
| Exempt business         | <ul style="list-style-type: none"> <li>• The leasing of real estate assets; and</li> <li>• Dividends paid out of profits relating to leasing activity by other SIIQs and SIINQs.</li> </ul>   | <ul style="list-style-type: none"> <li>• The leasing of real estate assets;</li> <li>• <b>Capital gains (and capital losses) on the disposal of real estate assets intended to be leased;</b></li> <li>• Dividends paid out of profits relating to leasing activity by other SIIQs and SIINQs;</li> <li>• <b>Capital gains (and capital losses) on the disposal of shares/equity interests in other SIIQs and SIINQs;</b></li> <li>• <b>Proceeds arising from investments into Italian Qualified RE Funds; and</b></li> <li>• <b>Capital gains and capital losses on the disposal of units in Italian Qualified RE Funds.</b></li> </ul>  |
| Mandatory distribution  | SIIQs must distribute to their shareholders at least 85 percent of the net profits of the exempt business.  | SIIQs must distribute to their shareholders at least <b>70 percent</b> of the net profits of the exempt business <b>to the extent that such profits relate to the holding of real estate assets, shares/equity interests in other SIIQs and SIINQs, and units in Italian Qualified RE Funds.</b><br><br><b>Capital gains arising from the disposal of (i) real estate assets; (ii) investments in SIIQs and SIINQs; and (iii) units in Qualified Italian RE Funds must be distributed:</b> <ul style="list-style-type: none"> <li>• <b>For an amount equal to 50 percent; and</b></li> <li>• <b>Within the two tax years following the tax year during which the capital gain has been realized.</b></li> </ul> |
|                         |   |   |

## Deregulation of Commercial Property Leases

### Italian Tenancy Law

Italian commercial property lease agreements are regulated by the Tenancy Law, which contains various mandatory provisions in favor of the tenant that may not be departed from. Any departure from the provisions to the benefit of the landlord, if challenged by the tenant, can be declared null and void and automatically replaced by the relative mandatory provision of the Tenancy Law.

### Deregulation of Commercial Property Leases

The Law Decree allows the parties to a property lease agreement to depart from the mandatory provisions of the Tenancy Law in those agreements where the annual rent is greater than €150,000. As a result, large Italian property lease agreements now have the same type of flexibility as in other European markets.

Some of the main provisions of the Tenancy Law that were previously mandatory and now can be departed from in large property lease agreements include:

- **Minimum duration and renewal.** Minimum duration is six years, with automatic renewal for additional minimum six-year periods at each expiration.
- **Exit rights.** Landlords are not entitled to withdraw from a lease outside of expiration and, in any case, at the expiration of the first term, withdrawal is limited to where (i) it intends to occupy premises for its own use, or (ii) it intends to renovate the leased premises. The tenant is always entitled to withdraw from a lease in the case of so-called “serious reasons” (“*gravi motivi*”).
- **Rental increases/indexation.** Rent increases are capped at 75 percent of variation of the National Institute for Statistics (“ISTAT”) index for leases having the minimum duration (i.e., 6 + 6 years), and capped at 100 percent of the variation of the ISTAT index for a lease that exceeds minimum duration.
- **Sublease and assignment of contract.** The tenant retains the right to sublease or to assign the contract within the scope of the lease or the sale of the relevant going concern.

- **Registration costs.** No more than 50 percent of contract registration costs are chargeable to the tenant.

With respect to lease agreements where the tenant is a retailer—i.e., carrying out an activity that involves direct contact with clients and consumers (“*contatti diretti con il pubblico degli utenti e dei consumatori*”)—the following additional previously mandatory provisions of the Tenancy Law may now be departed from in large Italian property lease agreements without any prejudice to the considerations described above.

**Goodwill indemnity.** The tenant has the right to a goodwill indemnity equal to 18 times the annual rent, or 36 times the annual rent if the immediately subsequent re-letting (within 12 months) is to a tenant operating in same product category.

**Preemption rights.** The tenant has preemption rights in the case of the sale of the property, as well as re-letting of the property at the same terms and conditions of third-party purchasers or tenants.

## Lawyer Contacts

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## Endnotes

- 1 The Law Decree must be converted into law within 60 days from its publication in the Italian Official Gazette (i.e., September 12, 2014); otherwise, it will cease to be effective and will be considered as if it had never entered into force. The Italian Parliament may carry out amendments to the Law Decree during its conversion process.
- 2 Or of a European Economic Area member state allowing an adequate exchange of information.
- 3 See note 2 above.
- 4 If the 60 percent shareholding requirement is breached as consequence of corporate restructuring transactions or transactions made on the capital markets, the SIIQ regime is suspended until the shareholding requirement is reinstated.
- 5 The shareholding requirements under 3 and 4 above must be met within the end of the first tax year in relation to which the election for the SIIQ regime is made, although the SIIQ regime applies starting from the beginning of that tax year. If at the end of the first tax year during which the election for the SIIQ tax regime is made only the 25 percent shareholding requirement is met, the 60 percent requirement can be fulfilled within the subsequent two tax years. In this case, and until the 60 percent requirement is met, (i) the SIIQ tax regime does not apply; and (ii) the company is subject to ordinary taxation. Once the 60 percent requirement is met, the SIIQ tax regime applies starting from the tax period during which the requirement is met.
- 6 Provided, however, that the related shares are not held for trading and that the dividends are paid out of leasing activity profits (i.e., exempt profits).
- 7 If the asset test and/or the profit test is not met for three consecutive tax years, then the ordinary tax regime applies starting from the beginning of the second tax year of such three-year period.
- 8 In this regard, pursuant to Article 2327 of the Italian Civil Code—as recently amended by Article 20, paragraph 7 of Law Decree June 24, 2014 no. 91 (“Decreto Competitività”)—the minimum share capital of Italian joint-stock companies must be equal to €50,000, in lieu of the previous €120,000 threshold.
- 9 The 26 percent withholding tax generally applicable to proceeds paid by the Italian real estate funds does not apply to the proceeds paid by Qualified Italian RE Funds to SIIQs.
- 10 The controlling SIIQ (or the controlling SIIQs) must own at least 95 percent of the voting rights in the ordinary shareholders’ meeting, and it must be entitled to at least 95 percent of the profits.
- 11 In essence, the capital gain may be (i) fully included in the SIIQ’s taxable base of the tax year when it arises or (ii) spread in equal installments over a period of up to five years, provided that the real estate assets have been owned by the company for at least three financial years prior to the option.
- 12 In the event the real estate assets are sold before this date, the difference between the step-up and the tax book value of the real estate assets at the time of the option, net of depreciation installments calculated on such tax book value, is subject to the ordinary taxation. In this case, the taxpayer can set the 20 percent substitutive tax paid against the IRES due.
- 13 The same rules apply to SIIQs that have opted for the special regime.
- 14 The withholding tax is reduced to 15 percent with regard to dividends paid out of profits that derive from the leasing of residential properties in accordance with certain criteria laid down by local collective agreements, where applicable.
- 15 A surcharge of 3 percent on incomes higher than €300,000.00 is provided.
- 16 The transfer of the shares in SIIQs and SIIQs is, in principle, subject to, respectively, a 0.1 percent and a 0.2 percent financial transactions tax. For SIIQs with market capitalization lower than €500 million, an exemption is provided.

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