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Tax and Estate Planning Considerations for Foreign Persons Under Philippine Law

By Maria Gracia M. Pulido Tan

Tan Venturanza Valdez (Philippines)

The Philippines, like many of its Asian neighbours, is host to a growing expatriate community. Most work in international organizations, development partners, multinational companies, and local firms. Many have also set up businesses here and established homes because of family, retirement, or the sheer pleasure of the Philippines' world-class beachfronts. Others, while not taking up residence in the Philippines, have been investing in local enterprises, directly or through the stock exchange.

These ties to the Philippines have tax and other legal implications under Philippine laws – notably, in the estate planning context, because the Philippines effectively imposes an estate tax on the net worldwide assets of resident alien decedents. Moreover, it is a civil law jurisdiction where trusts have limited use and application and may create choice-of-law or other private international law issues.

THE ESTATE TAX

Rate of tax

The net Philippine estate of a foreign individual, whether or not a resident of the Philippines at the time of death, is subject to an estate tax at a flat rate of 6%. This is one of the more welcome amendments introduced by a recent legislation, the Tax Reform for Acceleration and Inclusion[1], which took effect in 2018. For decades, the rates were graduated with the top rate at 20%.

The net estate is essentially the remainder when the value of the gross estate is reduced by the sum of allowable deductions and the conjugal share of a surviving spouse, if any.

Gross estate

The gross estate consists of "all property, real or personal, tangible or intangible, wherever situated" of the decedent at time of death[2]. Property transferred revocably, by trust or otherwise, in contemplation of death

[1] Rep. Act No. 10963, popularly known as the TRAIN Law.

[2] Sec. 85, The National Internal Revenue Code of the Philippines, as amended by Rep. Act No. 10963; hereafter, the "Tax Code."

forms part of the gross estate[3]. So does property passing under a general power of appointment[4]. These gross estate inclusions are similar to counterparts in U.S. law. In fact, the Philippine Supreme Court has remarked that the estate tax laws are copied from U.S. law, and interpretations adopted by U.S. courts have "some persuasive effect" on the interpretation in Philippine estate tax law[5].

Tax and Estate Planning Considerations for Foreign Persons Under Philippine Law

In the case of a **non-resident** alien decedent, however, "only that part of the entire gross estate which is situated in the Philippines" is considered in computing the gross estate[6]. In comparison, in the case of a **resident** alien decedent, the entirety of the worldwide assets forms the gross estate for Philippine estate tax purposes.

The following intangible properties are expressly given Philippine situs: (a) a franchise that is exercised in the Philippines; (b) shares, obligations, or bonds issued by a Philippine company; (c) shares, obligations, or bonds issued by a foreign corporation with 85% of its business located in the Philippines; and (d) shares, obligations, or bonds issued by any foreign corporation if any of such issuances have otherwise acquired a business situs in the Philippines[7]. These intangibles can be excluded from the gross estate based on concepts of reciprocity where the country of citizenship and residence of the alien decedent does not impose a similar tax on, or granted an exemption from, such similar tax to Philippine citizen decedents who are not residents of that country[8].

The assets comprising the gross estate are generally valued at fair market value, which is the "higher of the fair market value as determined by the Commissioner [of Internal Revenue], or the fair market value as shown in the schedule of values fixed by the Provincial and City Assessors."[9] For purposes of the estate tax, the Commissioner-determined value is generally the "zonal value" established by the Bureau of Internal Revenue under Sec. 6(E) of the Tax Code. This is usually higher than that of the Assessor's.

Allowable deductions

For a **resident** alien decedent, the following items are deductible from the gross estate[10]:

1. A standard deduction equivalent to PHP 5,000,000[11].
2. Claims against the estate, provided the debt instrument was duly notarized.
3. Claims of the decedent against insolvent persons and unpaid mortgages, provided these are *bona fide* and the amount is included in gross estate.
4. Casualty losses not compensated for by insurance.
5. Property previously taxed or "vanishing deductions."
6. Transfers to the government of the Philippines or any of its political subdivisions exclusively for public use.
7. A family home deduction of up to PHP 10,000,000 of fair market value.

For a **non-resident** alien decedent, only the (a) standard deduction, (b) vanishing deductions, (c) transfers for public use, and (d) a proportionate amount of unpaid mortgages, indebtedness, and casualty losses are allowable[12].

Who is a resident?

Clearly, it is important to determine whether an alien decedent was a resident of the Philippines at the time of death. Neither the Tax Code nor its implementing

[3] Sec. 85(C), Tax Code.
[4] Sec. 85(D), *ibid.*
[5] *Commissioner v. Court of Appeals*, 328 SCRA 666 (2000).
[6] *Ibid*; see also Sec. 104.
[7] Sec. 104, Tax Code.
[8] *Ibid*
[9] Sec. 88, Tax Code.
[10] Sec. 85(A), *ibid.*
[11] Current exchange rate to the US dollar is about PHP 96,000.00.
[12] Sec. 85(B), Tax Code.

regulations define a "resident alien" for estate tax purposes. In practice, however, the definition for income tax purposes is applied, i.e., "an individual whose residence is within the Philippines and who is not a citizen thereof."[13] A "non-resident alien," on the other hand, is "an individual whose residence is not within the Philippines and who is not a citizen thereof."[14] In a recent case, the Philippine Supreme Court emphasized that residence refers to actual or physical residence and not "legal residence" or domicile.[15]

Given these rather expansive definitions a foreign individual working in the Philippines under an Alien Employment Permit is a resident. A retiree residing in the Philippines under a Special Resident Retiree Visa[16] is a "resident;" so is an investor holding a Special Investor's Resident Visa under the provisions of the Omnibus Investments Code of 1987[17]. However, a non-resident alien not holding any of such visas who stays in the Philippines for an aggregate period of more than 180 days during any calendar year is deemed a "non-resident alien doing business in the Philippines."[18]

Conjugal share

Should there be a surviving spouse, one-half of the difference between the gross estate and the allowable deductions is attributed to the spouse and, hence, not subject to the estate tax[19]. This aligns with Philippine law on property relations between spouses, where the default regime is one of absolute community[20] should the spouses not have entered into "marriage settlements" before the marriage. It is submitted that the exemption of the conjugal share from estate tax would be applicable only if the property regime of the spouses is absolute community or conjugal partnership of gains, which produces the same half-and-half effect at dissolution of net conjugal assets. Hence, if, under the national law of the alien decedent, the spousal property relations are not any of these two, there may be no conjugal share to reckon with. In an appropriate case, however, as when there is no proof of contrary applicable foreign law, it will be deemed that the foreign law is the same as Philippine law.[21]

Filing and payment

An estate tax return must be filed within one year of the date of death, and estate tax must be paid along with the filing.[22]

A credit is allowed for a proportionate amount of estate tax paid to any foreign country.[23] Currently, this is the only statutory authority for handling multijurisdictional interests, as the Philippines does not have any estate tax treaties in place.

Effect of non-payment of tax

Transfers of the Philippine property cannot be registered unless the tax is paid; thereby, heirs and beneficiaries are effectively prevented from acquiring certificates of title in cases of non-payment.

Further, Registers of Deeds are prohibited from registering any documents transferring real property or rights, or chattel mortgage, without a certification from the Commissioner of Internal Revenue that the estate tax has been paid.[24] The same prohibition applies to the concerned corporate officers, with respect to shares of stock, bond, or indebtedness issued by a corporation.[25]

On the other hand, a lawyer who intervenes in the preparation or acknowledgment of any document regarding the partition or disposal of inheritance is required to furnish the Bureau of Internal Revenue

[13] Sec. 22(F), *ibid.*

[14] Sec. 22(G), *ibid.*

[15] *Garcia v. Belen*, G.R. No. 189121, 31 July 2013.

[16] See Letter of Instruction No. 1470, 4 July 1985.

[17] Executive Order No. 226, as amended.

[18] Sec. 25 (A)(1), Tax Code.

[19] Sec. 86(C), *ibid.*

[20] See Arts. 74, 80, and 88, Civil Code.

[21] (conflicts provision).

[22] Secs. 90(B) and 91(A), Tax Code.

[23] Sec. 86(D), *ibid.*

[24] Sec. 95, *ibid.*

[25] Sec. 97, *ibid.*

with copies of such documents and "any information whatsoever which may facilitate the collection" of the estate tax.[26] Should there be judicial estate proceedings, the judge shall not authorize the executor or administrator to deliver a distributive share to any party-in-interest (as defined below) without certification from the Commissioner of Internal Revenue.[27]

Tax and Estate Planning Considerations for Foreign Persons Under Philippine Law

SUCCESSION TO THE ESTATE

While the reach of Philippine estate tax may be extraterritorial, the Philippines adheres to the nationality principle with respect to both intestate and testamentary succession. The order of succession, the amount of successional rights, and the intrinsic validity of testamentary provisions are regulated by the national law of the person whose succession is under consideration, whatever the nature of the property and regardless of the country where it is located.[28]

Validity of wills

In the case of testamentary succession, a will executed abroad by a non-resident may be given effect in the Philippines if it was made in accordance with the laws of the person's country of residence or citizenship or in accordance with the Philippine Civil Code.[29] This encapsulates the principle of *lex loci celebraciones* to which the Philippines adheres, whereby the forms and solemnities of wills are governed by the laws of the country where they are executed that are in force at that time. Consequently, a will executed in the Philippines by a foreigner may be given effect here.

Will format

Philippine law provides for two types of wills: the "holographic will" and the "attested will.

A holographic will is written, dated, and signed entirely by the hand of the testator. This form does not require a witness, and it may be made executed in the Philippines or in another jurisdiction.[30] It is subject to no other formal requirement.

An attested will, is witnessed by at least three people and subscribed by the testator and the witnesses in the presence of each other before a notary public.[31] It is much more formal and elaborate than a holographic will and requires very specific acts:

1. It must be signed on the left margin of every page except the last and at the end by the testator (or by another person in the testator's presence and by express direction) in the presence of the instrumental witnesses. In this respect, the Philippine Supreme Court has held that signing by the testator in the presence of the witnesses is essential to the due execution of the will. The execution of a will is supposed to be one act. The will cannot be certified as valid if the testator and the witnesses sign on different days or occasions and in different combinations.[32]

2. It must be attested by at least three credible witnesses and subscribed (signed) by them on the left margin of every page and at the bottom of the attestation clause, in the presence of the testator and of each other. In a long line of cases, the Philippine Supreme Court has defined "attestation" as the act of witnessing the testator's execution of the will in order to see and take note mentally the requirements for the execution of a will are met and that the signature of the testator exists as a fact. "Subscription," on the other hand, is the signing of the witnesses' names upon the same paper for the purpose of authenticating and identifying the paper as the same will that was executed by the testator.[33] The witnesses must also sign below the attestation clause; it is not enough that they signed on the

[26] Sec. 95, *ibid.*

[27] Sec. 94, *ibid.*

[28] Art. 16, Civil Code of the Philippines.

[29] Art. 816, *ibid.*

[30] Art. 810, *ibid.*

[31] Art. 805, Civil Code of the Philippines.

[32] *In re Estate of Nepomuceno*, 28 Phil. 638; *Caneda v. Court of Appeals*, G.R. No. 103554 (28 May 1993).

[33] See Caneda, *ibid.*

left hand margins of the will.[34]

Any person may be a witness to a will if of sound mind; at least 18 years of age; not blind, deaf, or mute; able to read and write; domiciled in the Philippines; and not been convicted of falsification of a document, perjury, or false testimony.[35] If any legacy or devise is made in the will in favor of a witness, or a witness's spouse, parent, or child, the devise or legacy will be void. [36]

3. Each and every page of the will must be indexed alphabetically with a letter on the upper part of each page. The purpose of this requirement is to safeguard against possible interpolation or omission of one or more pages and to prevent any increase or decrease in the number of pages.[37]

4. The will must contain an attestation clause. The attestation clause is the part of the will where the attesting witnesses certify that the instrument has been executed before them. Once signed, it affirms compliance with the essential formalities required by law. It therefore provides a strong legal guaranty for the due execution of a will and insures the authenticity. Conversely, the complete absence of an attestation clause results in the invalidity of the will.[38]

   The attestation clause should state (a) the number of the pages of the will; (b) that the testator signed, or expressly caused another to sign, the will and every page thereof in the presence of the attesting witnesses; (c) that the attesting witnesses witnessed the signing by the testator of the will and all its pages; and (d) that the witnesses also signed the will and every page thereof in the presence of the testator and of one another.

5. The will must be acknowledged before a notary public by the testator and the witnesses. Acknowledgment is an act where a person (a) appears before the notary public and presents an integrally complete instrument or document; (b) is attested to be personally known to the notary public or identified by the notary public through competent evidence of identity; (c) represents to the notary public that the signature on the instrument or document was voluntarily affixed by that person for the purposes stated in the instrument or document; and (d) declares that the execution of the instrument or document was a free and voluntary act and deed.[39]

   In the Philippines, notaries public are commissioned to perform notarial acts by a Court, and they may perform such acts only within the territorial jurisdiction of the commissioning court.[40]

Probate of a will in the Philippines

No will is competent to pass title to real or personal property within an estate unless the will is proved and allowed in the proper court. Subject to the right of appeal, judicial allowance of the will is conclusive as to its due execution.[41] The proper court is the regional trial court (R.T.C.) of the province in which the testator resided at the time of death or, "if he [or she] was an inhabitant of a foreign country," the R.T.C. of any province in which the person had an estate.[42] To reiterate, "residence" refers to actual or physical residence and not "legal residence" or domicile.[43]

Any executor, devisee, or legatee named in the will, or any other interested party, such as an heir, may petition for probate.[44] The testator may petition for probate of his or her will during a lifetime.[45] The court shall fix a time and place for proving the will when all concerned may appear to contest the allowance thereof and shall publish a weekly notice of such time and place, for three successive weeks prior to the

[34] *Azuela v. Carpio-Morales*, G.R. No. 122880 (12 April 2006).
[35] Arts. 820 and 821, Civil Code of the Philippines.
[36] Art. 823, *ibid.*
[37] *Caneda, ibid.*
[38] *Ibid.*
[39] 2004 Rules on Notarial Practice, A.M. No. 02-8-13-SC, as amended.
[40] 2004 Rules on Notarial Practice, *ibid.*
[41] Section 1, Rule 75, Rules of Court.
[42] Sec. 1, Rule 73, *ibid.*
[43] *Garcia v. Belen*, G.R. No. 189121, 31 July 2013.
[44] Sec. 1, Rule 76, Rules of Court.
[45] *Ibid.*

appointed time, in a newspaper of general circulation in the province.[46] Without publication of such a notice, the proceedings are void and should be annulled.[47]

The court shall also cause copies of the notice of hearing to be sent to the designated or other known heirs, legatees, and devisees who are residents of the Philippines.[48]

Generally, only parties-in-interest are allowed to intervene in the probate proceedings, and where an attested will is contested, the subscribing witnesses and the notary public must personally attend court or submit depositions if they reside outside of the province where the will is being probated.[49]

In the case of a holographic will, it is necessary that at least one witness who knows the handwriting and signature of the testator explicitly declares that the will and the signature are in the handwriting of the testator. In the absence of any such competent witness, and if the court deems it necessary, expert testimony may be utilized.[50]

Where the testator petitions for probate of the holographic will, and no contest is filed, the fact that the testator affirms that the holographic will and the signature are in his or her own handwriting, shall be sufficient evidence that the will is genuine and duly executed. If the holographic will is contested, the contestant is burdened with disproving that the will is genuine and duly executed.[51]

Probate of a foreign will

A will that has been duly probated outside the Philippines according to the laws of the country where probated may likewise be given effect in the Philippines, provided it is also probated in the Philippines in the same manner as described above.[52] The petition for probate may be filed by the executor or another interested party, in the court having jurisdiction. Duly authenticated copies of the will and of the order or decree evidencing its allowance must be attached to the petition.[53]

Appointment of executor

Upon the will having been probated, the court issues testamentary letters to the executor named in the will, if (i) the executor is competent, (ii) accepts the trust, and (iii) files a bond.[56] In any case, *the executor must be a resident of the Philippines*.[55]

An executor is allowed to recover the necessary expenses for the care, management, and settlement of the estate and to receive a fee for such services, in an amount that may be provided in the will.[56] When the executor is an attorney, the fees for legal services rendered must be stated separately.[57]

CONCLUDING REMARKS

As we all know, we are all just pilgrims on this earth. Death is inevitable and we know not when it comes, nor where and how. It behooves us then to meticulously prepare and put our material affairs and interests in order. As tax advisers to an international, globe-trotting clientele, it is in our best interest and theirs to acquire a working knowledge of the broad strokes of relevant and applicable laws of jurisdictions where they may sojourn or invest.

[46] Sec. 3, Rule 76, Rules of Court.
[47] *De Guzman v. Angeles*, 162 SCRA 347.
[48] Sec. 4, Rule 76, Rules of Court.
[49] Sec. 11, Rule 76, Rules of Court.
[50] Sec. 5, *ibid.*
[51] Sec. 12, *ibid.*
[52] Sec. 1, Rule 77, Rules of Court.
[53] Sec. 2, *ibid.*
[54] Sec. 4, Rule 78, Rules of Court
[55] Sec. 1, *ibid.*
[56] Sec. 7, Rule 78, Rules of Court. The rules provide for a schedule of fees which, however, generally yields to agreement.
[57] Ibid.

The Opportunity Zone Tax Benefit: How Does It Work and Can Foreign Investors Benefit?

By Galia Antebi and Nina Krauthamer
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State Aid, intended to entice investment and development in a specific region, is considered an unfair advantage and a violation of one of the central tenets of European law. In comparison, state funded assistance is often encouraged in the U.S., where Federal, state, and local governments typically offer tax benefits to businesses for the purpose of encouraging economic growth and investment in certain industries and geographic areas. To that end, the Tax Cuts and Jobs Act of 2017 ("T.C.J.A.") added a significant tax break for investors realizing a liquidity event in the U.S.

Provided that the gain proceeds in excess of adjusted cost basis and recapture income are invested in a certain way in low-income communities, the gain from the liquidity event can be deferred and, in some circumstances, the appreciation on that investment can be completely free of Federal income tax. The provision is expected to unlock an estimated $6 billion or more for investment in "Opportunity Zones" located in low-income community census tracts.

The key to the tax deferral is a reinvestment in a "Qualified Opportunity Fund." New Code §1400Z-2 provides for the following three tax benefits for investors using gain proceeds to invest in a Qualified Opportunity Fund:

- A temporary deferral of gain realized through the end of 2026 on a sale or exchange of any appreciated capital asset
- A step-up in basis for up to 15% of the deferred gain invested in the Qualified Opportunity Fund
- A complete exclusion for appreciation on the deferred gain if the investment in the Qualified Opportunity Fund is held for at least ten years

This provision appeals to investors wanting to enjoy the benefit of deferred tax and real estate developers and business owners wishing to raise capital. Both must have a long-term view for the investment, as the major tax benefit is obtained only after a ten-year holding period. Savvy

investors are unlikely to tie up funds for that period of time or take the risk of investing in unfamiliar territory without considerable due diligence. Consequently, the Opportunity Zone arrangement incentivizes investments that make economic sense over the long haul in order to enjoy the desired tax benefits.

The Opportunity Zone Tax Benefit: How Does It Work and Can Foreign Investors Benefit?

This article discusses the law, the proposed I.R.S. regulations published in October 2018, and the opportunity for non-U.S. investors who recognize U.S. taxation on F.I.R.P.T.A. gains.

A QUALIFIED OPPORTUNITY FUND

Opportunity Zone

An Opportunity Zone is an economically distressed community that has been designated by any of the 50 states of the U.S. and certified by the I.R.S. Roughly 8,700 areas have been designated.[1] Once the designation is approved, a Qualified Opportunity Zone retains its designation for ten years.

Qualified Opportunity Zone Funds

A Qualified Opportunity Fund is a U.S. investment vehicle organized as a domestic corporation or partnership, or the equivalent in a U.S. possession. Its purpose must be limited to making investments in qualified opportunity zone property ("Eligible Property").

Eligible Property may take any of the following forms:

- Qualified Stock: Stock in a domestic corporation that operates a "Qualified Opportunity Zone Business" (as defined below) on the date of acquisition by an investor. The shares must be issued to an investor entirely for cash after 31 December 2017. The Qualified Opportunity Zone Business must continue to be carried on for substantially all of the Qualified Opportunity Fund's holding period.
- Interest in a Qualified Partnership: A capital or profits interest in a domestic partnership that operates a Qualified Opportunity Zone Business on the date of acquisition by an investor. The partnership interest must be issued to an investor entirely for cash after 31 December 2017. The Qualified Opportunity Zone Business must continue to be carried on for substantially all of the Qualified Opportunity Fund's holding period.
- Qualified Business Property: A tangible property acquired to be used in a Qualified Opportunity Zone Business and which (i) meets the "original use" test or the "substantial improvement" test and (ii) substantially all of the use of the tangible property was in a qualified Opportunity Zone during substantially all of the Qualified Opportunity Fund's holding period.

Investment standard to be met

To be a Qualified Opportunity Fund, Eligible Property must be purchased after 31 December 2017 and must comprise at least 90% of the entity's assets on average as measured on two dates each year. The measurement dates are the last day of the sixth and last months of the taxable year. Investments in other Qualified Opportunity Funds are not considered to be Eligible Property unless that other fund directly operates a Qualified Opportunity Zone Business.

If a Qualified Opportunity Fund prepares certified financial statements for investors and creditors, or is required to prepare such statements by the S.E.C. or another Federal agency other than the I.R.S., the carrying value of each class of asset reported in the certified financial statement may be used when making the computation. A Qualified Opportunity Fund that does not prepare certified financial

[1] The U.S. Treasury Department provides a wealth of Opportunity Fund Resources, including a full list of designated zones and a map.

statements may use the original cost of the assets in measuring for the 90% test.

The Opportunity Zone Tax Benefit: How Does It Work and Can Foreign Investors Benefit?

This rule is designed to prevent funds from holding substantial cash prior to the start of a project. At the same time, in recognition that development projects deploy cash over the period of buildout, a safe harbour presented in the proposed regulations allows for a reasonable amount of working capital to qualify during a start-up period. Under such provision, prudent deployment of cash will not provide for disqualification of the fund.

If the 90% test isn't met, the Qualified Opportunity Fund is subject to a penalty for each month in which the failure continues. There is an exception for reasonable cause.

Qualified Opportunity Zone business

To be a Qualified Opportunity Zone Business, a series of tests must be met:

- Substantially all of the property owned or leased by the business must be Qualified Business Property.
- At least 50% of its gross income must be from the active conduct of the business.
- A substantial portion of its intangible property must be used in the active conduct of the trade or business in the qualified Opportunity Zone.
- Less than 5% of the average unadjusted basis of all of its property may be attributable to nonqualified financial assets.

Qualified Business Property

As mentioned in the discussion of Eligible Property above, Qualified Business Property must be tangible and either its "original use" must commence with the entity or the property must be "substantially improved" by the entity. Additionally, substantially all of the property's use must be in an Opportunity Zone for substantially all of the holding period maintained by the entity.

While the proposed regulations do not elaborate on the meaning of original use at this time, additional guidance is expected to be published by the I.R.S. Until such time, it is generally viewed by commentators that the purchased property must not have been used in the Opportunity Zone before it was purchased by the Qualified Opportunity Fund. Consequently, if an entity purchases new manufacturing equipment to be used in its Qualified Opportunity Zone Business, the equipment's original use in the Opportunity Zone must commence with the Qualified Opportunity Fund. However, if an entity purchases an existing factory building in an Opportunity Zone, the original use of the property in the Opportunity Zone will not commence with the Qualified Opportunity Fund and the Qualified Opportunity Fund would be required to improve the building substantially for it to be treated as a Qualified Business Property.

A property is considered to be substantially improved if, at the end of a 30-month period, the adjusted basis of the property is more than double the original basis. For property located in an Opportunity Zone that is in need of capital improvement, purchasers are incentivized to negotiate a reduction in price in lieu of seller repair so that the capital improvement counts toward substantial improvement.

The proposed regulations use a standard of 70% when determining whether substantially all of the property owned or leased by an entity is Qualified Business Property. The 70% threshold applies in this context only, even though the phrase "substantially all" is used throughout the statute and the proposed regulations.

Exclusion of Certain Businesses

Certain businesses cannot be treated as Qualified Opportunity Zone Businesses. These include, *inter*

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alia, casinos, liquor stores, golf courses, and country clubs.

Working Capital Assets

In applying the nonqualified financial asset requirement, reasonable amounts of working capital held in cash, cash equivalent, or debt instruments with a term of no more than 18 months are excluded. The proposed regulations provide a safe harbour for determining whether working capital amounts are reasonable. The test is described below. If the safe harbour requirements are met, reasonable amounts of working capital will not be counted towards the 5% test, and income derived from such amounts will be counted towards the satisfaction of the 50%-gross income test.

The safe harbour treats working capital as reasonable in amount if the following conditions are met:

- There is a written plan that identifies the working capital assets as assets held for the acquisition, construction, or substantial improvement of tangible property in the Opportunity Zone.
- There is written schedule consistent with ordinary business operations, according to which the property will be used within 31 months.
- The business substantially complies with the written plan and the written schedule in the manner that it employs the assets.

To avoid adverse consequence from a *de minimis* failure of the asset test, the proposed regulations allow a business to be considered as meeting the asset test if it proceeds in a manner that is substantially consistent with the safe harbour requirements. Where that occurs, the business will be treated as meeting the intangible assets use test.

The proposed regulations also provide that if tangible property is expected to be substantially improved as a result of expending the working capital, an entity that meets the working capital safe harbour requirements will not be treated as failing to meet the Qualified Business Property requirements solely because the scheduled consumption of the working capital is not yet complete.

THE OPPORTUNITY ZONE TAX BENEFITS

Tax benefits

Two principal benefits are available to an investor in a Qualified Opportunity Zone Business after having recognized a substantial capital gain on an unrelated investment.

The first benefit is that tax on the capital gain from the disposed original investment can be deferred until the investment in the Qualified Opportunity Zone is disposed of or until 31 December 2026, whichever comes first. The amount that must be reinvested to obtain complete deferral of gain is the gain itself. Proceeds need not be invested to the extent attributable to cost basis or recapture income arising from the sale of depreciable property. Recapture income is the portion of the gain that is attributable solely to reductions in cost basis arising from depreciation or amortization deductions while the property was owned by the seller. This treatment differs from the requirement to invest the full proceeds in an exchange real estate transaction (swap).

The second benefit relates to the computation of tax basis in the Qualified Opportunity Fund and the taxation of the investment in the Qualified Opportunity Fund:

- As a corollary to tax deferral on the gain from the disposed original investment and the investment of the gain proceeds in the Qualified Opportunity Fund, the investment in the Qualified Opportunity Fund is given a zero basis at the time made. If more than the deferred gain

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is invested in the Qualified Opportunity Fund, the additional amount (including the proceeds attributable to basis recovery or recapture income) is treated as a separate investment which will not trigger a taxable event in 2026 and which cannot benefit from the tax-free appreciation after a ten-year holding period.

- The zero basis can be increased over time. If the investment in the Qualified Opportunity Fund is held for five years, the basis in the Qualified Opportunity Fund is increased by 10% of the deferred gain. Then, if the investment in the Qualified Opportunity Fund is held for two additional years, so that the total holding period is seven years, the basis in the Qualified Opportunity Fund is further increased by 5% of the deferred gain. At that point, the total tax exposure at the time deferral ends is reduced by 15% because the basis has been stepped up.

- If the taxpayer holds the interest in the Qualified Opportunity Fund on 31 December 2026, the deferred gain inherent in the investment in the fund is recognized. If the fair market value of the interest in the Qualified Opportunity Fund is less than the deferred gain, the gross amount realized will be equal to fair market value. If the basis in the fund has been increased at the fifth and seventh years as discussed above, the gain on 31 December 2026, amounts to only 85% of the originally deferred gain. The gain recognized at this time results in an increase in the basis of the interest.

- Finally, gain from the disposition of the interest in the Qualified Opportunity Fund will be deemed to be zero if the interest in the fund has been held for ten years or more at the time of the sale. Gain is zero because the basis in the Qualified Opportunity Fund is stepped up to is fair market value on the date of sale. This benefit is elective.

In sum, an investor who takes advantage of the various opportunity zone benefits can defer tax on the gain from the unrelated investment until 31 December 2026 by investing in a Qualified Opportunity Fund. At the same time, the gain derived from a ten-year holding and sale of the Qualified Opportunity Fund becomes tax-free. In all instances, a mandatory recognition of the deferred gain – capped at the excess of fair market value over basis – will take place on 31 December 2026, or sooner if there is an early disposition of the interest in the Qualified Opportunity Fund. At that time, if no corresponding disposition takes place, the investor will be obligated to pay tax on the phantom gain and should plan to have cash available.

Eligible taxpayers (including non-U.S. taxpayers)

The proposed regulations provide that any person who is required to report recognized gains is eligible for the deferral benefit. This includes individuals; C-corporations, including R.I.C.'s and R.E.I.T.'s; L.L.C.'s; partnerships; S-corporations; trusts; and estates.

The Code and the proposed regulations do not limit eligible taxpayers to U.S. taxpayers. Accordingly, non-U.S. persons, including foreign trusts[2], may benefit from the provision as long as the investment arise from funds that would be gains for U.S. Federal income tax purposes but for the Opportunity Zone tax provision.

While non-U.S. persons generally do not recognize capital gains on the disposition of U.S. stocks and securities, a non-U.S. person may recognize capital gains under F.I.R.P.T.A. in connection with the disposition of a taxable U.S. real property interest ("U.S.R.P.I.") and, following recent tax reform, on the

[2] Certain U.S. trusts controlled by foreign persons have seen a rise in popularity in recent years, following the implementation of the C.R.S. These trusts are generally taxed as foreign (non-U.S.) trusts for U.S. tax purposes.

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disposition of an interest in partnerships engaged in business in the U.S. The Code and the proposed regulations do not address the withholding obligations applicable to non-U.S. persons on any gain realized under F.I.R.P.T.A. and the new provision applicable to a sale of a partnership interest. Since the gross consideration may be subject to 15% F.I.R.P.T.A. withholding, or to the new 10% withholding on the sale of a partnership interest, foreign taxpayers may find it complicated to utilize the new provision without advance planning.

For those non-U.S. persons who take steps to plan, the key step will involve filing a timely application with the I.R.S. requesting a withholding certificate to eliminate withholding tax. There is no doubt that this would impose some complications. The full extent is unknown at this time. The process to obtain an I.R.S. withholding certificate normally takes 90 days and first requires the issuance of a U.S. Tax Identification Number, which may take time. Well-advised taxpayers who plan in time may still be able to invest the proceeds within the required 180 days and reap the benefits of the new provision.

Note, that in addition to the general eligibility of non -U.S. persons, it is common for non-U.S. persons to use U.S. structures, specifically U.S. domestic trusts, to benefit family members who are U.S. citizens or resident. These structures can surely benefit from the provision when cashing out on appreciated portfolios comprised of taxable assets.

Eligible capital gain

As indicated earlier, the opportunity to defer tax is limited to the portion of gain treated as *capital gain* for U.S. Federal income tax purposes. This includes gain from a deemed sale or exchange of a capital asset or a depreciable asset used in a trade or business in the U.S. for which gain is treated as capital gain but excludes the portion of the gain attributable to basis reductions arising from the claim of depreciation or amortization deductions. That portion is recaptured as ordinary income.

There is no limitation on the benefit based on the source of the gain other than that the gain must be taxable, which is a rare occurrence for non-U.S. persons. In the limited circumstances where it occurs, foreign-source gains may be taxed outside the U.S. and, with certain exceptions, those taxes may be available to offset a U.S. tax liability under the foreign tax credit provisions of U.S. tax law.

Requirements to defer tax by investing in a Qualified Opportunity Fund

To receive the tax deferral benefit, taxpayers must fulfil certain requirements:

- Sell an appreciated capital property to an unrelated person before 31 December 2026.[3]
- Make an election to defer the gain (or the invested amount, if lower) in the tax return for the year of the sale.
- Not have another election to defer the tax in effect with respect to the same sale or exchange.
- Invest the deferred gain in one or more Qualified Opportunity Funds within 180 days from the day of the disposition.

While the tax is deferred, the disposition transaction must be reported in the year it was made on Form 8949, *Sales and Other Dispositions of Capital Assets*, which will also be used to make the election to defer the tax, pending further instructions from the I.R.S.

The proposed regulations clarify that a second election with respect to the same transaction does not violate the rule against multiple elections as long as not all of the gain was previously deferred. For example, assume a taxpayer has $1,000,000 in capital gains and makes an election to defer $500,000, which

[3] In determining whether two persons are related, certain modified constructive ownership rules apply.

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is invested in a Qualified Opportunity Fund in a timely manner. The taxpayer is permitted to elect, within the timeframe allowed, to defer recognition of the balance of the gain.

Tax attributes of gain recognized

The tax attributes of capital gains deferred under the provision are preserved. Those include the holding period determining whether the gains are short-term or long-term. The proposed regulations provide ordering rules that address a fact pattern in which a taxpayer disposes a portion, but not all, of an interest in a Qualified Opportunity Fund when not all the gain invested has the same attributes. An example might involve sales of several assets, some producing short-term gains and others producing long-term gains through an investment in a single Qualified Opportunity Fund. Under these rules, the "first in first out" ("F.I.F.O.") method is applied. In certain circumstances when the F.I.F.O. method is insufficient, a *pro rata* method may be applied.

Expiration of the Opportunity Zone designation

The Federal designation as an Opportunity Zone expires on 31 December 2028. Therefore, investments made after 31 December 2018, and for which taxpayers wish to benefit from the ten-year fair market value step up, must be sold or disposed of after the designation has expired. The proposed regulations clarify that as long as the investment is disposed of before 31 December 2047, the expiration of opportunity zone status will not create a problem for taxpayers electing to step up the basis of their investment to its fair market value.

SAMPLE APPLICATION[4]

The application of the new provision is best illustrated through an example.

In October 2018, a taxpayer sells appreciated property that is not depreciable and is not a collectible for which higher capital gains tax is due. The taxpayer realizes a gain of $1,000,000. No tax is paid in 2018 on the gain because within 180 days, the taxpayer invests the full amount into a Qualified Opportunity Fund.

Assume the investment in the Qualified Opportunity Fund is sold in less than five years for $1,200,000 and all tax rates remain the same as in effect in 2019. The following will apply:

- The amount realized is $1,200,000.
- The basis in the investment is zero.
- The gain realized is $1,200,000 - $0 = $1,200,000.
- The tax due is $240,000.

Now assume the investment in the Qualified Opportunity Fund is sold prior to 2026, after it was held for more than five years but less than seven years, for $1,200,000 and all tax rates remain the same as in effect in 2019. The following will apply:

- The amount realized is $1,200,000.
- The basis in the investment is $100,000 (deferred gain of $1,000,000 x 10%).
- The gain realized is $1,100,000 ($1,200,000 - $100,000 = $1,100,000).
- The tax due is $220,000.

Now assume the investment in the Qualified Opportunity Fund is sold before 31 December 2026, when it was held for more than seven years but less than ten years, for $1,200,000 and all tax rates remain the same as in effect in 2019. The following will apply:

- The amount realized is $1,200,000.

[4] For ease of computation, the example uses a 20% Federal rate and does not apply the 3.8% N.I.I.T.

- The basis in the investment is $150,000 (deferred gain of $1,000,000 x 15%).
- The gain realized is $1,050,000 ($1,200,000 - $150,000 = $1,050,000).
- The tax due is $210,000.

Now assume the investment in the Qualified Opportunity Fund is held on 31 December 2026, when it was held for more than seven years. The fair market value of the property is $1,200,000, and all tax rates remain the same as in effect in 2019. The following will apply:

- The amount realized is $1,200,000.
- The basis in the investment is $150,000 (deferred gain of $1,000,000 x 15%).
- The gain realized is $1,050,000 ($1,200,000 - $150,000 = $1,050,000).
- The tax due is $210,000.
- The tax must be paid with taxpayer's own funds on hand.

Now assume the investment in the Qualified Opportunity Fund is sold in 2028 for $2,200,000 and all tax rates remain the same as in effect in 2019. The following will apply:

- The amount realized is $2,200,000.
- The basis in the investment is $2,200,000 (equal to the fair market value of the fund).
- The gain realized is $0 ($2,200,000 - $2,200,000 = $0).
- The tax due is $0.

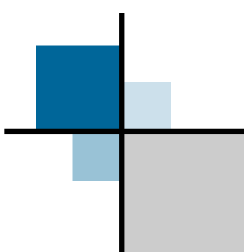
For comparison, if the taxpayer invested in a private equity fund that isn't a Qualified Opportunity Zone Fund, the $200,000 tax due on the $1,000,000 gain realized in 2018 would have been due in 2018. Only the net amount of $800,000 would have been available for investment, and the appreciation would have been fully taxed.

CONCLUSION

The advent of the Opportunity Zone has created a huge commotion. It is viewed by many as one of the biggest tax benefits offered in the history of the U.S.

Yet, many have criticized the provision – claiming that, despite the well-intended mission, capital investments in distressed areas could end up benefiting cities that are already experiencing growth. This is the case in Long Island City, an Opportunity Zone in New York, one of the country's most prosperous cities. The area has already seen extensive development of new luxury rental buildings for the city's professionals. The trend is not expected to stop, even after Amazon pulled back its plans to build a new HQ2 there. In fact, this provision is likely to make it easier for developers in the area to raise funds.

Ultimately, though the tax benefits are great, it remains to be seen whether the stir around Opportunity Zones is justified. The holding period requirement is significant; unlike Long Island City, many of the Opportunity Zones are unfamiliar territories; and substantial improvement requirements could double the cost of the property, consuming funds that might otherwise not be spent on improvement and which could ultimately reduce the anticipated yield of a project.



Austria: Highlights of the Annual Tax Act of 2018

By Niklas Schmidt, Eva Stadler, Melanie Dimitrov and Cynthia Pfister

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INTRODUCTION

The Annual Tax Act of 2018 (*Jahressteuergesetz*) is mainly aimed at implementing Council Directive (E.U.) 2016/1164 of 12 July 2016 into Austrian law. This directive sets out rules against tax avoidance practices that directly affect the functioning of the internal market and is generally referred to as the Anti-Tax Avoidance Directive (A.T.A.D.). The Annual Tax Act of 2018 also strives to strengthen legal and planning security and to combat tax fraud on a national and international level. This article provides an overview of the most important amendments emanating from this act.

C.F.C. RULES

The A.T.A.D. specifies that Member States are to enact controlled foreign company (C.F.C.) rules. Previously, Austria did not have any C.F.C. legislation. Following the Annual Tax Act of 2018, C.F.C. rules apply from 1 January 2019. Pursuant to the C.F.C. provisions, non-distributed passive income of a low-taxed C.F.C. (wherever resident) is to be included in the tax base of the controlling corporation if the following prerequisites are fulfilled:

- The passive income of the C.F.C. exceeds a third of its total income (the income is to be calculated in line with Austrian tax provisions, whereby tax-exempt dividends and capital gains are included when calculating the total income).
- The controlling corporation, alone or together with its associated enterprises, holds a direct or indirect participation of more than 50% of the voting rights or owns directly or indirectly more than 50% of the capital or is entitled to receive more than 50% of the profits of the C.F.C.
- The C.F.C. does not carry out a substantive economic activity supported by staff, equipment, assets, and premises (in cases where a substantive economic activity exists, the controlling corporation must furnish proof thereof).

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Passive income encompasses the following types of income:

- Interest or any other income generated by financial assets;
- Royalties or any other income generated from intellectual property;
- Dividends and income from the disposal of shares, insofar as these would be taxable at the level of the controlling corporation;
- Income from financial leasing;
- Income from insurance, banking, and other financial activities; and
- Sales and/or services income generated by invoicing companies from goods and services purchased from and sold to associated enterprises, which add no or little economic value.

A foreign company is low-taxed if its effective foreign tax rate is not more than 12.5%. In order to determine the effective foreign tax rate, the foreign company's income is to be calculated in line with Austrian tax provisions and compared with the foreign tax actually paid.

For purposes of the C.F.C. rules, an associated enterprise exists if:

- the controlling corporation holds directly or indirectly a participation in terms of voting rights or capital ownership of at least 25% in an entity or is entitled to receive at least 25% of the profits of that entity; or
- a legal person or individual or group of persons holds directly or indirectly a participation in terms of voting rights or capital ownership of at least 25% or is entitled to receive at least 25% of the profits of the corporation (if a legal person or individual or group of persons holds directly or indirectly a participation of at least 25% in the corporation and one or more entities, all the entities concerned, including the corporation, shall also be regarded as associated enterprises).

Where the C.F.C. provision applies, the amount of the C.F.C.'s passive income to be included in the tax base of the controlling corporation is calculated in proportion to the (direct or indirect) participation in the nominal capital of the C.F.C. If the profit entitlement deviates from the participation in the nominal capital, then the profit entitlement ratio is decisive. The passive income of the C.F.C. is included in the financial year of the controlling corporation in which the C.F.C.'s financial year ends. C.F.C. losses, if any, are not includable.

In order to prevent double taxation, the following rules apply:

- A C.F.C.'s passive income is not to be included in the tax base of a controlling corporation which only holds an indirect participation in the C.F.C. in cases where such passive income is already included in the tax base of an Austrian controlling corporation holding a direct participation in the C.F.C.
- If the controlling corporation disposes of its participation in the C.F.C., any capital gains are tax exempt insofar as they have previously been included in the controlling corporation's tax base.
- When including the C.F.C.'s passive income in the controlling corporation's tax base, upon application, the tax effectively levied on such passive income at the level of the C.F.C. is credited, as is passive income included at the level of the C.F.C. due to comparable foreign C.F.C. legislation. If the foreign tax to be credited exceeds the controlling corporation's Austrian corporate income tax, tax credits can, upon application, also be claimed in the following years.

The C.F.C. rules also apply to Austrian corporations having their place of management outside of Austria and to foreign permanent establishments (even if an applicable double tax treaty provides for a tax exemption in Austria).

In the absence of the C.F.C. rules, the Austrian tax system previously prevented taxpayers from transferring excess liquidity to low-taxed foreign subsidiaries and from repatriating the resulting income in a tax-free manner through the so-called switch-over provision: Dividends and capital gains from low-taxed passive income earning subsidiaries could not benefit from the international participation exemption but were taxable, with a credit for any underlying taxes. (Thus, there was a switch from the exemption to the credit method.) This switch-over provision is still applicable to the following types of participations if the predominant focus of the low-taxed foreign corporation is on earning passive income:

- Shareholdings of at least 10% held for a minimum duration of one year in a foreign subsidiary qualifying under the E.U. Parent Subsidiary Directive or being legally comparable to an Austrian corporation
- Shareholdings of at least 5% in a foreign subsidiary qualifying under the E.U. Parent Subsidiary Directive or in a foreign subsidiary being legally comparable to an Austrian corporation and having its legal seat in a state with which Austria has agreed to the comprehensive exchange of information

The switch-over provision does not apply if passive income has demonstrably been taken into account under the C.F.C. provision mentioned above.

Both the C.F.C. rules and the switch-over provision will not be applicable to foreign financial institutions if not more than one-third of the passive income stems from transactions with the Austrian controlling corporation or its associated enterprises.

IMPLEMENTATION OF THE INTEREST LIMITATION RULE CONTAINED IN THE A.T.A.D.

The A.T.A.D. further requires Member States to implement an interest limitation rule in their domestic laws. Pursuant thereto, the tax deductibility of net interest (i.e., interest expense minus interest income) shall be limited insofar as it exceeds 30% of the taxpayer's E.B.I.T.D.A. (earnings before interest, tax, depreciation, and amortisation). In general, this rule should have been implemented by 31 December 2018. However, Member States which have national targeted rules for preventing base erosion and profit shifting (B.E.P.S.) risks as of 8 August 2016, which are equally effective to the interest limitation rule set out in the A.T.A.D., may delay the implementation of the interest limitation rule until 1 January 2024 at the latest.

For several years already, Austrian tax law has provided for non-deductibility of interest paid to a corporation if the payer and recipient are, directly or indirectly, part of the same group, or have, directly or indirectly, the same controlling shareholder, and the interest paid at the level of the recipient (or the beneficial owner, if different) is:

- Not subject to corporate income tax owing to a comprehensive personal or material tax exemption;
- Subject to corporate income tax at a rate of less than 10%;
- Subject to an effective tax rate of less than 10% owing to an applicable reduction; or
- Subject to a tax rate of less than 10% owing to a tax refund (refunds to the shareholder are also relevant).

This Austrian non-deductibility rule was implemented in the wake of the O.E.C.D.'s first steps against B.E.P.S. It is probably for this reason that the Austrian Ministry of Finance believes that Austria already has equally effective rules allowing Austria to delay implementation of the 30% E.B.I.T.D.A. rule. Austria has not, therefore, implemented the A.T.A.D. interest limitation rule.

The European Commission recently published a list of Member States which, in its view, fulfil the requirements as per art. 11(6) of the A.T.A.D. (*cf.* Commission Notice 2018/C 441/01). When drawing up the list, the European Commission assessed the legal similarity and the economic equivalence of measures notified by Member States:

- The basic assumption for the examination of legal equivalence was that only measures which ensure a limitation on the deductibility of excessive borrowing costs in relation to a taxpayer's profitability may be primarily regarded as equally effective in targeting excessive interest deductions.
- The analysis of economic equivalence in turn involved two criteria: First, the notified national measure should not produce significantly less revenue than the A.T.A.D.'s interest limitation rule. Second, the notified national measure should lead to a similar or higher tax liability for a majority of large undertakings as compared with the estimated result under the A.T.A.D.

Applying these criteria, the European Commission concluded that specific measures in force in France, Greece, Slovakia, Slovenia, and Spain fall under art. 11(6) of the A.T.A.D. The list, however, does not include Austria, meaning that Austria has, in the European Commission's view, failed to implement the A.T.A.D.'s interest limitation rule. It remains to be seen how the Austrian Ministry of Finance will react.

EXIT TAX

The A.T.A.D. obliges Member States to implement exit taxation rules regarding corporations. The Austrian provisions dealing with exit taxation had already been amended some time before the A.T.A.D. was adopted and largely comply with the requirements of the A.T.A.D.

In general, the Austrian exit tax scheme aims to tax hidden reserves of certain assets that accrued while Austria had a taxation right but which can no longer be (fully) taxed in Austria due to circumstances leading to a restriction of Austria's taxation right *vis-à-vis* other states (such as transfers of business assets abroad).

If the restriction of the Austrian taxation right is in relation to a Member State of the E.U. or a country which is party to the E.E.A., the exit tax can be paid in instalments. Previously, the tax burden could be spread over seven years (for fixed assets) or two years (for current assets). Under the Annual Tax Act of 2018, the taxpayer continues to be able to pay the tax burden in instalments; however, the seven-year payment period for fixed assets is shortened to five years in order to fall within the terms of the A.T.A.D. The instalment period for current assets remains unchanged.

Any outstanding instalment payments are immediately due if assets, businesses, or permanent establishments are alienated, otherwise disposed of, or transferred to a state outside of the E.U. or the E.E.A. In addition to these circumstances, the Annual Tax Act of 2018 includes the following situations that require immediate payment:

- The place of management of a corporation is relocated to a state outside of the E.U. or E.E.A.;
- The taxpayer declares bankruptcy or is wound up; or
- The taxpayer (partly) fails to pay an instalment within 12 months of the due date.

ANTI-ABUSE RULE

The A.T.A.D. requires Member States to have a general anti-abuse rule in place. As with many other jurisdictions, Austrian tax law has always contained the principle that taxpayers are free to arrange their economic affairs in the manner they deem most beneficial to themselves, which includes choosing those structures and approaches that incur the lowest

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tax costs. Nevertheless, Austrian law also contains a general anti-abuse provision, pursuant to which a tax liability cannot be avoided or reduced by abusing the legal forms or methods available under civil law. If such an abuse has been established, the tax authorities may compute the tax liability as if the abuse had not occurred. The Austrian Supreme Administrative Court (*Verwaltungsgerichtshof*) has, in the past, defined abuse of law as a legal structure which has an unusual and inappropriate economic objective and, in the light of the objective of the tax law, can only be understood by virtue of the associated tax savings. Further, the Austrian Supreme Administrative Court has held that abuse of law cannot usually be caused by a single legal step, but rather, it presupposes a chain of legal acts.

Following the Annual Tax Act of 2018, for the first time, a definition of abuse of law has been incorporated into statutory law. According to the guidance accompanying the enactment of the Annual Tax Act of 2018, the chosen wording of the new definition shall not lead to a restriction of the previous scope of abuse of law. It aims at preserving the traditional interpretation as much as possible. However, the definition partly contradicts the previously prevailing understanding of the term. The new definition reads as follows:

> *Abuse of law is deemed to exist in cases where a legal structure,* ***that may involve one or more steps,*** *or a sequence of legal structuring, is inappropriate in light of the economic purpose. The term 'inappropriate' refers to structures that would be rendered meaningless without the tax benefit, as the essential purpose or* ***one of the essential purposes*** *of such structures is to obtain a tax advantage which is contrary to the aim or purpose of applicable tax legislation. However, abuse of law is not existent if there are valid economic reasons that reflect economic reality.*

Consequently, contrary to the traditional notion of abuse of law, the newly created definition stipulates that any isolated legal step, and not just a sequence of legal acts, can lead to an abuse of law. Another tightening of the concept is achieved by the fact that abuse of law may already be assumed if only one of several purposes is to obtain a tax advantage. In the past, abuse of law mainly targeted structures where the sole purpose was to obtain a tax benefit. It is to be expected that abuse of law will play a more significant role in tax proceedings in the future.

NEW TYPES OF FORMAL TAX RULINGS

The Annual Tax Act of 2018 introduces new types of formal tax rulings. In general, a tax ruling may be defined as the confirmation by a tax authority of the interpretation of tax law presented by a taxpayer (or his adviser). Previously, legally binding tax rulings (*Auskunftsbescheide*) could only be obtained in Austria for the following topics:

- Reorganisations;
- Group taxation; and
- Transfer pricing.

The Annual Tax Act of 2018 provides an extension to include the following topics (in addition to the topics mentioned above):

- International tax law (*i.e.,* transfer pricing and tax treaties, but not domestic law provisions, as of 1 January 2019);
- Value added taxation (as of 1 January 2020); and
- The existence of abuse of law in an envisaged structuring (as of 1 January 2019).

In addition, organisational measures will improve the opportunity for the recipient to raise queries to the responsible tax officer in case of ambiguities after the tax ruling has been issued. A tax ruling shall be issued within two months of receiving an application.

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CLARIFICATION ON REAL ESTATE TRANSFER TAX

The Austrian Annual Tax Act of 2018 includes important clarifications on share consolidation in the context of real estate transfer tax (R.E.T.T.). Pursuant to the Austrian Real Estate Transfer Tax Act, R.E.T.T. is triggered not only upon the transfer of Austrian real estate but also if at least 95% of the shares in a property-owning company are transferred or consolidated in the hands of a single owner (or corporations which are part of the same tax group for Austrian corporate income tax purposes). It has been unclear for some time whether only direct share transfers or also indirect share transfers can trigger R.E.T.T.

The Annual Tax Act of 2018 clarifies that real estate is attributed to the company and not to its shareholder. In this way, the Austrian legislator clearly states that changes in indirect shareholding of a property-owning company do not trigger R.E.T.T., since shareholders are not regarded as property owners.

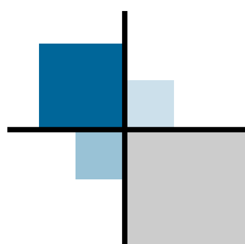
HORIZONTAL MONITORING

The Annual Tax Act of 2018 implements horizontal monitoring for companies as an alternative to the normal audit procedure. Horizontal monitoring has been available since 1 January 2019 upon application by the taxpayer. It differs from external audits in several areas.

Firstly, a uniform audit of a group of companies is possible, which shall facilitate the communication with the tax authorities. Secondly, during the horizontal monitoring, there is an increased obligation to disclose any circumstances for which there is a serious risk of divergent assessment by the tax office, unless such circumstances do not have a significant impact on the tax. Thirdly, there shall be continuous contact between the company and the tax authorities in the form of at least four meetings per calendar year.

An application for horizontal monitoring may be lodged by an entrepreneur or a private foundation holding alone, or together with other private foundations, more than 50% of the share capital and voting rights of an entrepreneur. Further, the following prerequisites must be fulfilled:

- There must be an Austrian nexus in the form of a place of management, legal seat, permanent establishment, or residence in Austria of the entrepreneur and all associated entrepreneurs.
- Each entrepreneur is obliged to keep books in accordance with Austrian law provisions or voluntarily maintains books.
- No entrepreneur has been penalized or fined in the five years preceding the application for a financial offence committed intentionally or through gross negligence in the last seven years prior to the application.
- At least one entrepreneur had, *inter alia*, revenues exceeding €40 million in the two years prior to the application.
- There is an opinion of an auditor or tax advisor that each entrepreneur has implemented a special tax control system.



Acquiring and Owning Greek Real Estate: Costs, Evaluation and Taxation

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INTRODUCTION

For persons resident in Northern Europe or North America, the image of Greece often is embodied in the image of the Greek coastline. It is a paradise of rugged hills, deep blue seas, and white painted houses, a place where a person may wish to invest in real estate.

For those contemplating an acquisition of Greek real estate, there is more to the picture than the views. Investments in Greek real estate, whether made directly or through a special purpose vehicle, are subject to many direct, indirect, and transactional costs and taxes, as detailed in this article.

COSTS RELATED TO THE ACQUISITION OF REAL ESTATE

The cost of preparing and signing the acquisition document includes the notary's fee (which is usually paid by the purchaser) as well as the fees for the lawyer and estate agent (if any) for each party.

The notary's fee is usually estimated at 1.2% of the contractual value of the property. As the presence of a lawyer before the notary is optional, the legal fees are not fixed, but rather are negotiated between the attorney and the client. The estate agent's fee is subject to negotiation and a written agreement. Usually a fee of 2% of the purchase price is agreed, but this may vary depending on property value and other factors.

There is also a cost to register the contract with the land registry office and/or the cadastre office and to register the pre-notice of a mortgage. These are paid by the purchaser.

BANK FINANCING FOR THE ACQUISITION OF REAL PROPERTY

Often in Greek real estate transfers (as is common elsewhere), the price paid to the seller is partially financed by way of a loan granted to the purchaser by a bank. Where this occurs, and for the discharge of the loan to the bank, a pre--notice of a mortgage is granted in favour of the bank. In terms of process, the registration of a pre-notice follows the signing of

the contract of transfer and the contract of loan agreement, and it takes place by filing an application before the court of first instance of the district where the property is located.

Acquiring and Owning Greek Real Estate: Costs, Evaluation and Taxation

An attorney for the bank usually is present and submits an application before the competent court, as well as the buyer or an authorized attorney, who consents to the registration of the pre-notice. The decision is issued on the same day and is recorded in the land registry office or the cadastre office of the region of the property.

The pre-notice of a mortgage is removed by the same procedure, i.e., by a decision of the court of first instance following a request from the buyer and with consent from the bank that the mortgage has been paid.

VALUATION OF REAL PROPERTY

The value of land in Greece is assessed according to a "system of objective value" (or tax value). This system provides a minimum value for real property according to objective criteria such as location, size, access to public facilities, and age of a building. This system has been imposed so that the tax authorities have a minimum value reference according to which tax can be imposed.

Not all areas in Greece have been valued. It is not unusual for the tax authorities in rural areas to estimate the value based on comparable sales or other available data.

Under Circular no. 1113/2018 of the Ministry of Finance, the objective values of the properties used as minimum values have been readjusted from 1 January 2019.

TRANSFERS OF REAL PROPERTY

In cases of land transfers, a transfer tax is imposed on the objective value of the land or the value agreed in the contract, whichever is highest. Similarly, most other fees and charges imposed in a land transfer contract are dependent on the objective value or the contractual value of the land, whichever is highest. The objective value is usually significantly lower than the market value of the property.

A V.A.T. charge of 24% is imposed on the initial sale of new buildings constructed by a developer or another person who deals professionally with the construction and the sale of buildings. For all other properties, the transfer is subject to a 3% real estate transfer tax.

The introduction of a betterment tax on real estate transfers, which was suspended until the 31 December 2018 by Article 57 of Law 4509/2017, has been further suspended until 31 December 2019.

The acquisition of a primary residence is exempt from transfer tax if the purchaser or the purchaser's spouse or minor child is domiciled in Greece and are first-time purchasers of a place of residence (Article 1 of Law 1078/1980, as amended). The limitation of the law to persons domiciled in Greece was found to violate European law in Case C-155/09 (OJ C 167, 18.7.2009) and has been revised. As a result, the exemption applies to contracts for the purchase of property where the purchaser resides in Greece or intends to do so and falls into any of the following categories of beneficiaries:

- Greek citizens
- Repatriates from Albania, Turkey, and the former Soviet Union
- Citizens of E.U. and E.E.A. Member States
- Recognised refugees, in accordance with the provisions of Presidential Decree 96/200
- Third-country nationals who enjoy long-term resident status in Greece, in accordance with the provisions of Presidential Decree 150/2006

The above-mentioned tax exemption is granted to an unmarried individual for the purchase of a residence

with a total value of up to €200,000, including the value of a parking space and a storage space of up to 20m^2 each, provided that those spaces are part of the same property and are acquired simultaneously within the same purchase contract. It also applies to a land purchase of total value up to €50,000. These exemption thresholds can be increased, depending on the marital status of the purchaser, the number of dependent children, and other factors.

The exemption is granted provided that the buyer retains the property for a period of at least five years. If the purchaser further transfers the property or grants a right to the property (other than a mortgage) within the five-year period, the purchaser must first submit a property transfer tax return and pay the tax for which an exemption was granted previously.

Due to frequent changes in the Greek taxation of real property, it is strongly recommended that all property -related taxes and charges are considered and re-estimated before any purchase.

PRINCIPAL ANNUAL TAXES AND CHARGES RELATED TO PROPERTY OWNERSHIP

Single real estate property tax

All Greek properties belonging to individuals or legal entities on 1 January of every year are subject to the single real estate property tax (E.N.F.I.A.), adopted by Law 4223/2013.

In this context, "property" includes:

- the right to full and bare ownership, usufruct, and habitation on a property; and
- the right to the exclusive use of parking spaces, auxiliary spaces, and swimming pools that lie at the jointly-owned part of a basement, terrace, or non-covered building space of these properties.

The taxable value of buildings (main and auxiliary spaces) is determined by several factors, such as the living space (area of usable space), the prices in the area, the floor, the age of the building, the facade, the percentage of ownership, and other special circumstances.

E.N.F.I.A. includes not only the principal tax but also an additional amount, which is imposed at rates that appear in the following chart when the value of property held by an individual exceeds €300,000.

Portion of value (if total exceeds €300,000)	Tax rate
€0.01-250,000.00	0.00%
€250,000.01-300,000.00	0.15%
€300,000.01-400,000.00	0.30%
€400,000.01-500,000.00	0.50%
€500,000.01-600,000.00	0.60%
€600,000.01-700,000.00	0.80%
€700,000.01-800,000.00	0.90%
€800,000.01-900,000.00	1.00%
€900,000.01-1,000,000.00	1.05%
€1,000,000.01-2,000,000.00	1.10%
Over €2,000,000.00	1.15%

If the property is held by a legal entity rate of the additional E.N.F.I.A. is 5.5%. This rate is reduced to 1% on properties that are occupied by the entity for its business activity subject to E.N.F.I.A.

Special real estate tax

It is a common phenomenon that offshore companies acquiring property in Greece are special purposes vehicles that carry on no activity other than the ownership, maintenance, and leasing of the property. In order to address this phenomenon (and possibly because the owners do not vote in Greek elections), the Greek legislator introduced Law 3091/2002, which provides for a general annual liability on legal entities that have full property rights or bare ownership or usufruct in Greek property (initially at 3% of the value

of property, increased to 15% by Law 3842/2010).

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The law provides for many exemptions, based mainly on the nature of the activity of the legal entity. Also, companies that have their headquarters in Greece or another E.U. Member State are usually exempt provided they fall within one of the following categories:

- S.A. companies (limited by shares) with registered shares held by individuals or S.A. companies that indicate the individuals who own their shares, provided those individuals have been awarded a tax registration number in Greece
- Companies (other than S.A. companies) having limited liability, if the shares are owned by individuals or if the companies disclose their ultimate beneficial owners, provided that those individuals have been awarded a tax registration number in Greece

Municipal tax

Real estate ownership is subject to a municipal real estate tax (T.A.P.), which is imposed at rate of 0.025% -0.035% of the objective value of the real estate. T.A.P. is payable by the owner of the real estate, and it is charged through electricity bills.

Income from property rentals

Income derived from property rentals is taxed as capital income at the following rates.

Income from property	Tax rate
€0-12,000	15%
€12.001-35,000	35%
>€35,001	45%

Gross income from rental property is automatically subject to a 3.6% stamp duty (not applicable to housing rentals).

REAL ESTATE INVESTMENT COMPANIES

Real estate investment companies (R.E.I.C.'s) are companies limited by shares (i.e., S.A. companies) that are established with the sole aim of acquiring and managing real property. Their minimum share capital must be €25,000,000, fully payable upon the establishment of the company. Prior to the issuance of permission for establishing a R.E.I.C., permission by the Stock Market Commission is required. A similar permission is required for an existing company that is converted into a R.E.I.C. For granting its permission, the Stock Market Committee evaluates the investment plan, the organisation, the company's technical and financial assets, the reliability and experience of the individuals that will manage the company, and the suitability of the owners in order to ensure the good management of the company. The company has the obligation to invest its funds only in certain types of assets:

- Real estate, which should comprise at least 80% of its assets
- Deposits and stock market instruments, according to Article 2, paragraph 14 of Law 3606/2007
- Other movable assets required for the company's operational needs that, in addition to the real estate acquired by the company to service such needs, must not exceed 10% of the asset value at the time of acquisition

The company must apply to the Athens Stock Market or another organised market for the listing of its shares within two years of its establishment. Where there is a conversion of an existing company into a R.E.I.C. the application for listing the stock on an organised market must be effectuated within two years of the end of the conversion process. The listing of the company's shares is effectuated according to the provisions in force that regulate the

listing of stock in Athens Stock Market S.A. or another organized market.

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The company must pay annual dividends to its shareholders of at least 50% of its annual net profits. A lower percentage may be distributed or distributions can be deferred following a decision within a general meeting, provided the company statutes include such a provision, either for the creation of an extraordinary non-taxable reserve made up of other earnings besides capital profit or for distributing free shares to the shareholders by increasing the share capital.

Real property of the company cannot be distributed to company founders, shareholders, members of the board of directors, general managers, or managers or their wives or blood and affinity relations up to the third degree of kinship. A R.E.I.C. may be converted into a real estate mutual fund, under certain conditions.

The shares of stock issued by a R.E.I.C., as well as transfers of real estate to a R.E.I.C., are exempt from any kind of tax, duty, stamp duty, contribution, right, or any other charge in favour of the State, public legal entities, or third parties in general. The exemption does not apply to the capital gains realised by the seller at the time of the sale of real estate to a R.E.I.C. Transfers of real estate by a R.E.I.C. are subject to ordinary tax rules.

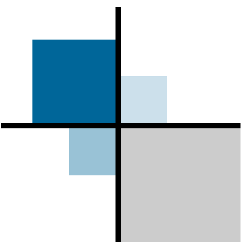
R.E.I.C.'s are exempt from income tax on the income derived from securities, whether in Greece or abroad, except for dividends from Greek companies. Interest received in connection with publicly-traded bonds is exempt provided the bond is held at least 30 days prior to the payment date set under the bond indenture.

A R.E.I.C. generally does not pay income tax. However, a R.E.I.C. must pay tax on the value of its holdings at a rate set at one-tenth of the European Central Bank intervention rate (Interest Reference Rate) plus one percentage point. It is calculated on the average value of the investments, plus the available funds, in current prices. Where there is a change in the Interest Reference Rate, a new calculation applies from the first day of the month following the change. The tax is payable to the competent tax authority within the first 15 days of the month following the period recorded in the bi-annual investment tables. No other tax is due.

In general, favourable tax treatment is provided to reorganizations of R.E.I.C.'s under Law 2166/1993. Thus, no tax is imposed when a R.E.I.C. is established either by the merger of two or more companies that own real estate or by the splitting-off or dilution of a company sector owning real estate. In addition, no tax is imposed when a R.E.I.C. acquires real estate, whether through a merger absorbing another company owning real estate or a split-off or dilution of a company sector owning real estate.

CONCLUSION

Real estate professionals working on a global basis understand that, ultimately, all real estate is local. In Greece, a potential first-time investor will find their own local flair, including a panoply of Greek taxes that may apply to the acquisition of real property either for personal use or for investment through the collective investment vehicle known as a R.E.I.C.



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- Charperson, Commission on Audit, Philippines (2011-2015)
- Undersecretary of Finance, Revenue Operations, Philippines (2002-2005)
- Commissioner, Presidential Commission on Good Government, Philippines (2002)
- International consultant, multilateral development organizations
- Tax counsellor since 1987
- Professor of tax law

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- Chairman, United Nations Independent Audit Advisory Committee
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PROFESSIONAL HIGHLIGHTS

- Head of the F.A.T.C.A. practice of Ruchelman P.L.L.C.
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- Guest Speaker on F.A.T.C.A. for the American – German Business Clubs in Munich and in Frankfurt, Germany.
- Master of Laws in Taxation from the Graduate Tax Program at the NYU School of Law.

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PROFESSIONAL HIGHLIGHTS

- Former chair of the Subcommittee on Foreign Investors of the American Bar Association (ABA) Section of Taxation;
- ABA Section of Taxation Panel Chair of "The ABC's of FIRPTA Withholding" (May 1985 ABA Tax Section Meeting)
- Panel Participant of "Fundamentals of International Taxation" (June 1999) of the Association of the Bar of the City of New York where she received the highest speaker rating.
- Adjunct Professor in the Baruch College Masters of Taxation Program (1991 – 1995).
- Numerous publications on international tax matters
- Nina has assisted many charities involved in disaster and humanitarian relief, including Nino's Restaurant 9/11 Fund (in response to the 9/11 disaster) and S.O.S. (Save Our South) Foundation in connection with Hurricane Katrina, as well as the American Jewish Joint Distribution Committee, Inc. (the overseas arm of the American Jewish community) and the Conference on Jewish Material Claims against Germany, commonly known as the Claims Conference, which aids victims of Nazi persecution. She has advised the Visiting Nurse Service of New York, the largest home healthcare charity in the United States.

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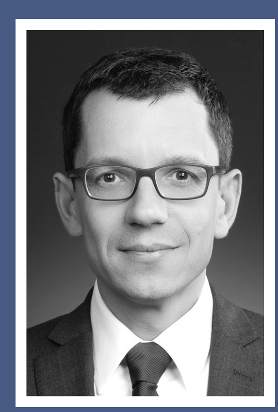

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- Officer of the International Bar Association's Individual Tax and Private Client Committee
- Member of the Committee of the International Tax Planning Association (I.T.P.A.)
- Member of the editorial board of the "taxlex" magazine
- Member of the editorial board of the "SteuerExpress" magazine
- Lecturer at the private wealth management course of the Westfälische Wilhelms-Universität Münster
- Member of the Examination Commission for the Certified Financial Planner (C.F.P.) Exam
- More than 150 public lectures on various topics of tax and corporate law
- Senior Associate, WOLF THEISS, 2000 – 2004
- One of Austria's top ten tax lawyers according to the Austrian magazine FORMAT (most recently in the 2014 edition)
- Visiting Lecturer at the University of Applied Sciences Vorarlberg, 2003 – 2005
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- Law Clerk, Vienna Commercial Court, 2002 – 2003
- Assistant Professor, Institute of Tax Law, University of Vienna, 1998 – 2000
- Associate, Europa Treuhand Ernst & Young, 1996 – 1998
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- Austrian Chamber of Certified Public Accountants
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- International Tax Planning Association (I.T.P.A.)
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- Corporate, Commercial & M&A
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SPECIALISATION

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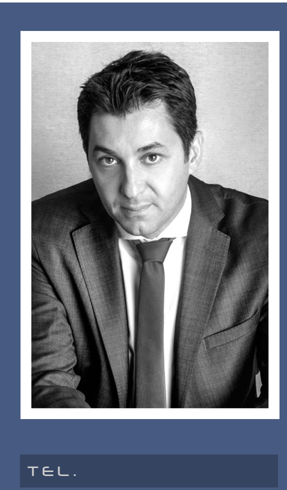

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His articles, commentaries and interviews have been published in various Greek and foreign law reports, periodicals and media. His publications include: Getting the Deal Through - Tax on Inbound Investment 2008-2014; Global E-Commerce Law and Taxation - Oxford University Press; and Greek Law Digest. Mr. Skouzos is the national reporter of the IBA Tax Committee for Greece (2014-2015)

PROFESSIONAL HIGHLIGHTS

- Managing Partner of Iason Skouzos & Partners Law Firm
- Reporter of the IBA Taxes Committee
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- Article author for Getting the Deal Through - Tax on Inbound Investment 2008-2014;
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She specializes in Tax law and her practice area focuses on tax litigation and alternative dispute resolution. Before joining our firm in 2017, she practiced tax law in other domestic law firms.

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