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Global Tax Alert

Portugal approves new REIT regime

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Executive summary

The Portuguese Government published, on 28 January 2019, Decree-Law nr. 19/2019, introducing the legal framework for Real Estate Investment Trusts (REITs), effective as of 1 February 2019. This regime is aimed at providing investors with a new vehicle for real estate investment. Under this regime, exemptions (or reduced taxation) at the level of the REIT and its shareholders are available, thereby aligning the Portuguese tax regime with other international tax regimes.

The introduction of a REIT legal regime has been a long-discussed issue in Portugal and its approval has been under consideration since 2015, when the Portuguese Government was granted authorization by the Portuguese Parliament to introduce this regime.

In view of the prospects of a dynamic 2019, the introduction of the REIT legal regime was deemed a necessary step to provide investors with alternative tax-efficient investment structures, thereby bolstering the foreign direct investment and the potential of the Portuguese real estate market for future growth and expansion.

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Detailed discussion

Overview of the Portuguese REIT framework

Under the applicable legal regime, Portuguese REITs should take the legal form of full-fledged corporate entities named *Sociedades de Investimento e Gestão Imobiliária* (SIGIs) and are, therefore, legally regulated by both the aforementioned Decree-Law and the legal provisions applicable to public limited companies.

SIGIs are designed as listed companies whose purpose consists of attracting savings to be used in long-term investments in real estate properties available for leasing (renting) or other types of economic investment purposes. Listing should occur within one year from incorporation and at least 20% of the capital should be held by investors with less than a 2% stake.

In addition, and from a financial point of view, these companies must hold a minimum share capital of €5 million and maintain a maximum debt-to-total asset value ratio of 60%. The portfolio of assets held by SIGIs should be subject to further limitations whereas the entities themselves shall be subject to further regulatory requirements and procedures, depending on the specifics of their incorporation. For example, real estate assets and shareholdings should represent at least 80% of the SIGIs total assets, and the value of real estate assets should represent at least 75% of the SIGIs total assets, which should be maintained for a minimum period of three years.

Specifically, their activity is limited to:

- Acquiring property or equivalent real estate rights, with the objective of lease or other types of economic investment (which comprises the development of construction and rehabilitation projects, the use of stores or spaces in commercial malls or the use of office spaces).
- Acquisition of shareholdings of other SIGIs or companies with residence in another European Union (EU) Member State or country of the European Economic Area (EEA) subject to the exchange of information equivalent to the one established for EU, with and equivalent activity and complying with the requirements concerning the nature of the assets and respective thresholds as well as the distribution of profits.
- Acquiring shareholdings and participation units in undertaking for collective investments (UCI), adopting a profit distribution policy similar to the one foreseen for SIGIs.

With respect to the profit distribution, a SIGI's profits should be mandatorily distributed as dividends within nine months after the end of each year. As to the ratios, at least 90% of the profits derived in the previous year from dividends subsidiaries and distributions from UCIs should be distributed, whereas this ratio is decreased to 75% in regards to profits obtained from other sources. Finally, at least 75% of the net income derived from the disposal of assets held by SIGIs should be subject to reinvestment in other assets within three years.

Existing stock corporations, as well as UCIs adopting the legal form of a company, may convert into a SIGI provided they meet the required conditions.

Taxation of SIGIs

From a tax perspective, SIGIs will benefit from the Portuguese tax regime applicable to UCIs, which is based on an exit taxation method.

Under this regime, SIGIs will benefit from an exemption on qualifying income, namely, investment income (dividends, interest, etc.), rental income and capital gains.

SIGIs should be subject to corporate income tax (CIT) on their net profit (excluding the qualifying income mentioned above) at the standard 21% CIT rate. Although SIGIs will be subject to autonomous taxation on certain qualifying expenses and to most of the CIT compliance obligations, on the same terms foreseen for regular CIT taxpayers, they will not be subject to the municipal surcharge and state surcharge.

Losses computed by SIGIs may be carried forward for a five-year period (the 70% cap on the deductible taxable income also applies).

Finally, SIGIs are also subject to stamp duty at a rate of 0.0125% on their global net asset value, which is due on a quarterly basis.

Taxation of resident corporate investors

In case of resident corporate investors, any income derived from SIGIs (income distributed by SIGIs, capital gains from the disposal or income arising from the redemption of the shares) will be subject to CIT on the general terms (21% CIT plus municipal surcharge and state surcharge, whenever applicable), and no exemptions nor exclusions should apply. Furthermore, income distributions from the SIGI to a Portuguese resident corporate investor are subject to withholding tax (WHT) at a 25% rate, although this WHT is treated as a payment on account of the final tax due.

Taxation of nonresident corporate investors

In the case of nonresident investors, a definitive 10% WHT will be levied on any distributions made by the SIGI or upon redemption of shares. Further, capital gains derived from the disposal of shares will be subject to an autonomous tax of 10% and the beneficiary will have to file a CIT return to assess and pay the tax due.

If the nonresident investors are located in a tax haven or if the income is paid or made available in a bank account and the beneficial owner is not identified, the income will be subject to tax at a rate between 25% and 35%, depending on the nature of the income.

Finally, if the nonresident investor is held, directly or indirectly, 25% or more by Portuguese residents, the 10% WHT/CIT rate only applies if the invertor is located in the EU, the EEA or in a tax treaty country (otherwise, a 25% WHT/CIT rate should apply).

Implications

With the introduction of this new legal and tax framework, the Portuguese Government has responded to the market's demand and has encouraged new real estate investments in Portugal. This new regime to attract a new profile of nonresident investors (yield oriented) is expected to increase investment in the Portuguese real estate market.

When investing in Portugal through a REIT, legal and regulatory issues should be considered as these companies are subject to the supervision of the Portuguese Securities Market Commission.

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