

Real Estate Tax Newsletter

February 2007



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Introduction

REITs were the big story in real estate taxation in 2006 and will probably remain so in 2007 as the German, Italian and UK REIT regimes come on stream. The French model became more mature and continues to expand its scope with "SIIC 2", "SIIC 3" and "SIIC 4" enhancing and then limiting the initial SIIC legislation. In Asia, the taxation of REITs was made more favourable in Malaysia, and in India, REIT legislation is being considered too.

Thus, the smooth passage of real estate from private opportunistic vehicles down the risk reward curve to publicly quoted REIT-type vehicles is possible in more and more countries across the world. Ironically perhaps, while the public REIT is being widely promoted as the most effective vehicle for stable steady real estate cash flows, in the birthplace of the REIT, the largest leveraged buy-out of all times involves the taking private of a large REIT.

Increasing complexity of acquisition and disposal structures was matched by increasing volumes of anti-abuse legislation in Germany, the UK, Spain among others. Increasing focus on thin capitalization will be a constant challenging the standard business models of many financial investors.

In the year since the publication of the first version of this annual newsletter, Taxand has expanded its global reach to 34 jurisdictions, with firms joining from countries such as Russia, South Korea and the Netherlands. The Taxand Real Estate Team has broadened and now covers all major economies of importance to the Real Estate world.

In this annual publication of tax news of interest to the real estate industry, we have highlighted recent or future tax developments that can have particular importance to the real estate industry. In depth coverage of international tax developments more generally is available in various other Taxand publications: visit www.taxand.com for a closer look.

We hope you enjoy the newsletter prepared by Taxand real estate tax specialists and look forward to seeing all our

clients and friends whether it be in MIPIM or elsewhere. As always, comments and suggestions on the newsletter are welcome and can be addressed to me at the address below.

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1. Switzerland

1.1. Swiss real estate investment funds

In the Taxand Newsletter 2006 we reported on the taxation of Swiss real estate investment funds and their favorable taxation. Switzerland does not offer a Real Estate Investment Trust for real estate investments. However, the Swiss real estate investment fund (REIF), in many ways, is an attractive alternative to a REIT.

If the Swiss vehicle invests directly only (as opposed to investing in shares in real estate companies), it will be taxed on its Swiss real estate income at a rate of approximately 12 % only e.g. in the Cantons of Zurich, Basel-Stadt or Vaud (combined federal/ cantonal/ municipal tax rate, depending on real estate location, although higher taxes may apply on real estate capital gains). This tax rate is much more attractive than the one resulting for an investment in a Swiss real estate company or direct ownership in Swiss real estate.

Furthermore, the distribution of real estate income by the investment fund to the investor is not subject to any Swiss withholding tax, contrary to many REIT systems. The investor will end up with an overall tax rate of 12% on the real estate income if he is not taxed for the income in his home country.

1.2. New law on legal form of collective investment vehicles

On January 1, 2007 the new Swiss Federal Act on Collective Investment Vehicles came into force. The new law foresees various legal forms for collective investment vehicles under Swiss civil law. The investment vehicle may be an investment fund, a corporation (comparable to a Luxembourg SICAV "société d'investissement à capital variable" or a SICAF "société d'investissement à capital fixe") or a partnership (comparable to the Anglo-Saxon Limited Partnership). Hence, the new law creates a great flexibility with regard to legal form of the vehicle and the specific needs of the investors.

All these types of collective investment vehicles are taxed principally in the same way, i.e. they can all benefit from the tax-efficient scheme for Swiss REIFs (except for the SICAF type of corporation).

2. Spain

2.1. Changes in the taxation of non-resident individuals investing in Spanish real estate

The Spanish Congress approved on October 2006, Law 35/2006 that amends, inter alia, the taxation of non-resident investing in real estate. The objective is to bring the tax treatment of non-residents without a permanent establishment in Spain into line with that of residents, to which a new rate is applied. This follows the decision of the EU Commission to refer Spain to the European Court of Justice (ECJ) due to the incompatibility of certain Spanish tax provisions.

The previous regime was that non-residents were subject to a 35% tax on capital gains obtained on real estate.

The new Law includes a reduction of the tax on capital gains to 18%, effective as from January 1, 2007.

2.2. Taxation on the transfer of shares of a Spanish real estate company

In general, transfers of company shares are exempt from both value added tax (VAT) and transfer tax under the "transfers for consideration" heading (article 108 of Securities Market Law 24/1988).

Since 1986, the acquisitions of shares of a Spanish company owning mainly real state in which, as a result of the transfer, the acquirer of the securities obtains the control of the company, control being understood as the majority of the capital stock, were subject, in principle, to transfer tax (TPO) at the rate applied for transfers of real estate.

This provision has been criticized on the basis that the application of an indirect tax other than VAT to such transactions between entrepreneurs must be restricted to absolutely exceptional cases. The tax legislation can distort business decisions relating to the sale of real estate, by penalising a share deal (exempt from VAT and subject to TPO) compared with an asset deal (subject, in principle, to VAT and exempt from TPO, where the VAT exemption has been waived), since the tax cost of the transaction changes radically from one scenario to the other.

In this connection, a presumption of avoidance of TPO on the transfer of company shares is at least questionable where, had the real estate been transferred, the VAT exemption could have been waived and the application of TPO thus prevented.

As from January 1st, 2007, the law has been reformed with a view to clarifying and reinforced some of these issues and eliminating certain possibilities for avoidance. The new features include notably the following:

- Shareholdings increases

According to the new wording of Article 108, TPO shall also apply in those cases where the acquirer increases its shareholding in a company over which it has already control.

- Indirect control

The new Law provides that the acquisition of shares in an entity whose assets include a holding which allows it to exercise control over another entity of which more than 50% of the assets consist of real estate, shall be subject to TPO.

It also provides that, when calculating control, securities belonging to the same group of companies must also be counted.

- Calculation of the percentage of assets consisting of real estate:

- When the assets are to be “measured”

The new wording of the Law, having regard to the position taken by the Spanish authorities and courts, provides that the assets should be “measured” when the holdings are transferred, the taxpayer thus being obliged to submit to the authorities, at their request, an inventory of the assets on that date.

- Value at which to compute the real estate: book value vs. actual value

The position taken in the Law comes from the Article 46 of the Transfer Tax Law. The tax authorities are entitled to check the actual value of the assets and rights transferred. In principle, it would appear that this is the value that should be used. The net book value of the assets is to be replaced by the actual value on the date the shares are transferred.

- Assets included in the calculation of the amount of real estate assets

Under the new Law, the total assets to be computed as a denominator are reduced by the amount of external financing with a maturity of equal to or less than twelve months, provided that it had been obtained within the twelve months immediately prior to the transfer date.

- Redemption of treasury stock

According to the new wording of Article 108 of Securities Market Law 24/1988, where securities are transferred to the company owning the real estate for subsequent redemption by that company, the shareholder obtaining the control of the company will be treated as the taxpayer for TPO purposes.

- The Law increases the anti-abuse period between the contribution of real estate and the transfer of the shares received as consideration, from one to three years.
- Transfers of securities admitted to trading on an official secondary market

This special regime shall not apply to transfers of securities admitted to trading on an official secondary market, provided that the transfer takes place after a period of one year has elapsed since the securities were admitted to trading. For these purposes, any periods in which the trading of the securities has been suspended shall not be taken

into account when calculating the one-year period. So in those cases, transfers of securities shall be exempt from VAT and from TPO.

- Tax base

The tax rate (6% or 7%) is to be applied to the proportional part of the total current value of the assets that in application of this rule should be considered as real state. Nonetheless, where shares are transferred after a contribution of real estate, it is to be applied to the proportional part of the actual value of that real estate that relates to the shares transferred.

3. Malaysia

3.1. Changes in the taxation of REITs

Malaysia has extended the scope of the exemption applying to REITs. In the past, REITs were exempt from tax only on income distributed. As from 2007, where a REIT distributes at least 90% of its total income, the REIT will be exempt from tax. Where a REIT does not meet this 90% distribution test, then the exemption will not apply and the REIT will be taxable at the rate of 27%. In such situations, unit holders will be entitled to claim a refund of the tax suffered at source by the REIT against their respective tax liabilities.

The rental income of a REIT is treated as a business source of income. Therefore, all expenses incurred wholly and exclusively in the production of rental income are deductible for tax purposes. However, any expenditure exceeding the rental income of a REIT is disregarded. Similarly, capital allowances (tax depreciation) are claimed by a REIT on any qualifying capital expenditure incurred and used in the rental ‘business’. As with the treatment for losses, unutilized capital allowances also cannot be carried forward.

REITs are also given a tax deduction for consultancy, legal and valuation services incurred in the course of establishing the REIT.

3.2. Changes in the taxation of unitholder in a REIT

As from 2007, a withholding tax (WHT) regime will be introduced for distributions by REITs as follows:

| | WHT RATE |
|---|----------|
| Non-resident companies | 27% |
| Foreign institutional investors | 20% |
| Non-corporate investors (e.g. individuals including non-resident individuals) | 15% |

Resident companies will not be subject to WHT on distributions from REITs, but will be subject to tax at the prevailing corporate tax rate (currently 27%) on the distributions received.

4. Germany

A number of major changes have been planned or implemented in the last 12 months. These reflect an attempt to reduce rates while broadening the tax base. The changes can have major impact on the profitability of existing investments for financial investors and on future market pricing.

4.1. Tightened substance requirements

According to the 2007 draft bill, a foreign company may not claim withholding tax relief "insofar as its shareholders are persons who would not have been entitled to tax refund or exemption, if they had earned the income directly, and

1. Business or other good reasons for imposing the foreign company are lacking and the foreign company has no business activity of its own or
2. The foreign company does not derive more than 10 per cent of its total gross revenues of the relevant financial year from its own business activity or
3. The foreign company does not engage in general business activity with a business establishment being adequate for this purpose.

Only the circumstances of the foreign company itself are relevant; organizational, economic or other features of companies related to the foreign company are not taken into account. There is no own business activity if the foreign company derives its gross revenues from the administration of assets or transfers its substantial business activities to third parties. Sentences 1 to 3 do not apply, if the main share classes of the foreign company are materially and regularly traded at a recognized stock exchange or the foreign company is subject of the provisions of the Investment Tax Act. The requirement to receive at least 10% of own business income can be problematic for any holding company holding German property company shares. A decree in preparation may clarify to what extent a "management holding" company can consider income from its subsidiaries to be its own business income.

Having a substantial business establishment being appropriate to the business purpose is according to the commentary still essential to prove that a company is more than just a "letter box" company or a "base" company.

4.2. General subject to tax provision

The 2007 draft bill introduces a general subject-to-tax provision to limit tax treaty exemptions. A tax treaty exemption may not be granted if

- the other state (source state) applies the provisions of a treaty in a way that the income in this state is tax exempt or taxed at a reduced rate according to the treaty, or
- the income is not subject to tax in the other state because the recipient is a person which is not liable to tax, therein by reason of its domicile, residence, place of management, or any other similar criterion.

The latter provision is not applicable however to dividends which are tax exempt according to a tax treaty

if the dividend payment did not reduce the tax base of the paying entity.

4.3. Restriction on domestic/treaty exemption for dividends

The dividend exemption regime (50 % for individuals, 95 % for corporate taxpayers) will only be applicable on certain (constructive or deemed) dividends if the payment did not reduce the tax base of the corporation paying the dividends. This restriction shall also be applicable to dividends which are tax-exempt according to a tax treaty. As a consequence a treaty exemption with respect to dividends will only be applicable if the dividends are not tax deductible at the level of the distributing company.

A corresponding principle will apply for constructive contributions. The recipient corporation has to treat these as taxable income if the shareholder deducts the contribution as an expense. The same applies to non-arm's length transactions between related parties such as controlled subsidiaries, triangular cases.

4.4. Corporate Tax Reform 2008

A yet-to-be-drafted corporate tax reform in Germany for 2008 aims to cut the effective tax rate on income of corporations, from c. 39 %, to a maximum combined tax burden below 30 %, thus putting it on a par with the European average. The lower corporate and trade tax rate is to be financed by measures broadening the tax base, especially measures against the shifting of income abroad via debt financing or business restructuring/transfer of functions and risks within multinational groups. A task force comprising of members of the federal and state finance bodies examined several options and published its results on November 2, 2006. There is widespread concern in the real estate industry that a restriction on the deductibility of interest, on both related party and bank debt, could seriously impact many investment programs.

4.5. The G – REIT

The legislator intends to pass the G-REIT law in the first quarter of 2007, to take retroactive effect as of January 1st, 2007.

The following is an overview of the G – REIT legal framework.

| | |
|---------------------------------------|--|
| entry into force | 1 January 2007, likely retroactively |
| legal form | German corporation, AG |
| minimum share capital | € 15.000.000 |
| domicile/residence | registered seat/place of management in Germany |
| supervision | no |
| class of shares | single class of shares with voting rights |
| permitted activities | holding of domestic and foreign real estate, renting and leasing of real estate including any necessary auxiliary activities; holding of interests in real estate partnerships |
| prohibited activities | real estate for residential use built before January 1, 2007; trading in real estate; ancillary activities for third parties (only via wholly owned REIT service companies) |
| group REIT/subsidiaries | real estate holding partnerships undertaking permitted activities; wholly owned foreign corporations holding foreign real estate; wholly owned REIT service companies |
| listing | mandatory within 3 years after incorporation as a Pre-REIT at a stock exchange in the EU or EEA |
| Free float | at least 15 %; "free float" = interests of less than 3 % |
| ownership restrictions | no direct holding of 10 % or more; indirect holding of more than 10 % possible |
| investment assets | domestic and foreign real estate, no restriction |
| RE asset test | 75 % of assets |
| RE income test | 75 % of gross revenues (both calculated according to IFRS consolidated financial statements) |
| profit distribution obligation | at least 90 % of the profits within 12 months after the end of the financial year |
| leverage | maximum 60 % of all assets calculated according to IFRS consolidated financial statements |
| accounting | IFRS and German GAAP |
| depreciation | straight line depreciation of a maximum of 2 % |
| breach of conditions | penalties or loss of REIT status |

The tax treatment of the G-REIT can be summarized as follow:

Domestic REIT vehicles are:

- exempt from German corporate income tax and German trade tax on income;
- subject to a 25% (+5.5% solidarity surcharge) withholding tax.

When establishing a REIT vehicle:

- transfer tax of 3,5% on real estate;
- half taxation of gain on disposal of real estate held by the seller for more than 10 years to a REIT.

Domestic shareholders:

- full taxation on dividends and capital gains. The capital gains realized on individual shareholding ($\leq 1\%$) after a holding period of one year are not taxable;
- tax credit for withholding tax.

Foreign shareholders:

- full taxation on capital gains if they are subject to German limited taxation (shareholding $>1\%$);
- final withholding tax on dividends;
- treaties may relieve this taxation.

4.6. Taxation of German investors in foreign REIT

Domestic shareholders in foreign REITs are fully taxed on dividends and capital gains (individuals may exempt a gain on a $<1\%$ holding). REITs not domiciled in Germany have to meet certain prerequisites:

- gross asset $> 2/3$ real estate;
- gross revenues $> 2/3$ rental income/capital gains deriving from the sale of real estate;
- not subject to investment supervision;
- listed on a regular market;
- not subject to foreign tax comparable to German CIT.

There is a tax credit for withholding tax.

5. Belgium

5.1 VAT grouping introduced

On November 24, 2006, the Belgian Government has decided to implement a Royal Decree which will allow VAT consolidation between group companies. This VAT grouping system will apply as of April 1, 2007.

As a result of such VAT grouping, a group of connected companies will - for VAT purposes - be considered as a single VAT taxpayer. This VAT grouping enhances the cash flow position of the members of a group, as members no longer will be obliged to charge VAT on intra-group transactions. Also, VAT refunds to a group member may become immediately effective and will have a direct cash-flow effect since these refunds may be offset against VAT payments due by another group member. At present, VAT-refunds may take several months before being effectively repaid and often are subject to a preliminary VAT-inspection.

The precise conditions and details will have to be defined, but the VAT grouping most probably will be *optional*, leaving a choice to companies concerned, and will be limited to entities established in Belgium for VAT purposes. As a result of the latter rule, also permanent establishments of a foreign group may enter a VAT group with other Belgian subsidiary companies of that group.

A VAT group can – besides having a beneficial effect from a cash-flow point of view – also be beneficial to the VAT taxpayer's right to recover input VAT. Therefore, the choice to VAT group (or not), will have to be evaluated by reviewing the total amount of VAT recoverable by the group.

VAT grouping can have a major impact on real estate transactions in Belgium. Indeed, certain real estate transactions are subject to VAT and allow the recovery of input VAT (for instance, the construction and sale of new buildings by professional constructors) whilst other activities allow the recovering of input VAT depending on the terms of the contract: for instance, a normal lease does not allow the recovery of input VAT, whilst so-called "finance" leases qualify as taxable transactions with a right of refund of input VAT. If these various transactions are carried out within the same VAT-group, the total amount of VAT to be recovered may be significantly influenced by the new VAT-grouping system.

6. United Kingdom

6.1 The UK-REIT

Legislation was passed in the Finance Act 2006 that will enable companies to convert to Real Estate Investment Trusts ("REITs") in relation to their accounting periods commencing on or after 1 January 2007.

This comes as welcome news and a number of the UK's largest listed property companies are taking steps to reorganize their affairs to take advantage of the new regime.

There are six principal conditions that a company which carries on a property rental business must meet in order to obtain the benefits of the REIT regime. Three of these will need to be met *before* an application is tendered to H M Revenue & Customs ("HMRC") for REIT status. The remaining three conditions will need to be met throughout the accounting period in which REIT status is claimed.

The six principal conditions are supplemented by a further series of conditions in relation to asset allocations, distribution policy and interest cover:

- Corporate structure: A REIT will need to be established as a company that is, for tax purposes, resident in the UK and is not tax resident in any another jurisdiction. Dual resident companies will not be allowed.
- Open ended company restriction: It will not be possible for the REIT to be established as an Open-ended Investment Company ("OEIC") within the

definition of section 236 of the Financial Services and Markets Act 2000.

- Listed status: A REIT must be listed on a "Recognised Stock Exchange" that is accepted as such by HMRC and features on their published lists. The Government consider that listed status will allow for wider access, increased consistency in reporting results and enable a higher degree of market scrutiny.
- Closed company status: The REIT may not be a close company within the definition of Section 414 ICTA 1988. It will, however, be possible for the REIT to be a close company by virtue of having as a participator a limited partnership within the meaning of Section 235 of the Financial Services and Markets Act 2000.
- Share capital: The REIT may only have a single class of ordinary shares. It may, however, issue non-voting fixed-rate preference shares.
- Loan creditors: REITs may not enter into any financing arrangements that operate so that the interest charges arising on the debt are referenced to the operating results of the enterprise or the value of its assets.

6.2. Activity of the REIT

Conditions for the tax – exempt business of a REIT

There are four key conditions in relation to the tax-exempt business of the REIT in order for it to secure preferential tax status. It will be necessary for the REIT, throughout an accounting period, to:

- Have at least three properties in its property rental business.
- Ensure that no single property may represent 40% or more of the total value of the properties in the property rental business.
- The property rental business may not involve property that would be regarded under generally accepted accounting practice as being owner occupied.

Finally, it will be necessary for at least 90% of the profits to be distributed by way of dividend within 12 months of the end of the respective accounting period.

Conditions for the balance of the business of a REIT

There are two key conditions that will need to be satisfied in relation to the non tax-exempt business of the REIT:

- The profits arising from the tax-exempt business of the REIT must be equal to or exceed 75% of the total profits.
- At the beginning of the accounting period the value of the assets in the tax-exempt business must be equal to or exceed 75% of the total value of the assets of the company.

Other conditions

An entry charge of 2% of the market value of the assets in the tax-exempt business will be applied on entry to the REIT. A charge of 0.19% is added to represent the deemed interest charge in recognition for a deferred settlement of the liability.

No corporate shareholder in the company may, directly or indirectly, hold an interest of 10% or more in the REIT. This includes UK and overseas corporates as well as entities that are deemed to be corporates by HMRC.

I- Profit: financing-cost ratio

The level of the gearing that may be assumed by the REIT in respect of its tax-exempt business is fixed by reference to the following ratio:

$$\frac{P+F}{F} > 1.25$$

Where “P” represents the profits of the tax-exempt business before the offset of capital allowances and “F” the financing costs arising in the respective accounting period.

The imposition of a financing-cost ratio will impose a maximum level of gearing in the REIT, currently in the order of 65 to 75%.

II- Corporation tax

The profits arising in relation to the non-tax exempt business of the REIT will be subject to tax at the standard rate of tax of 30% and without reference to the starting or marginal rates of tax.

III- Distributions: Deduction of tax

Tax will be deducted from the distributions made at the basic rate of tax.

6.3. The UK-REIT: conclusion

REITs are principally aimed at UK individual investors and they will result in a reduction of the overall taxation liability for this class of investor. In relation to UK corporate investors and overseas investors the taxation benefits are less profound.

That said the introduction of the REIT regime has been eagerly awaited, the provisions as currently drafted are eminently workable and we look forward to the introduction of the regime with interest.

6.4. Stamp duty

6.4.1. Stamp Duty Land Tax anti-avoidance measures

- Anti avoidance measures were announced and come into effect from 2pm on 6 December 2006.
- The legislation introduces the concept of a 'notional land transaction' and constitutes a wholesale clampdown on SDLT avoidance. This may apply wherever a series of enacted transactions has resulted in a tax saving on the disposal of a chargeable interest from one party to

another, and the amount of the SDLT payable is less than the amount that would have been payable in the case of a single transaction. The transactions are disregarded and there is a notional land transaction.

6.4.2. Stamp Duty Land Tax

- Changes have been introduced in relation to the treatment of transfers to and from partnerships, and the transfer of an interest in a partnership.
- Where property is transferred to a partnership, a reduction of the full market value charge will now only be available to the extent that the vendor is a partner or where there are individual partners who are connected to the vendor. However, where partners are part of the same SDLT group as the vendor, group relief may be available from a proportion of the charge, to the extent of their partnership interests.
- Where property is transferred from a partnership, a reduction of the full market value charge will now only be available to the extent that the purchaser is a partner or where there are individual partners who are connected to the purchaser.
- Where an interest in a partnership is transferred between connected parties, to a person other than an individual, there is a charge on a proportion of the market value of the property regardless of whether consideration is given for the transfer.

7. France

7.1. Extension of “SIIC 3” and adoption of “SIIC 4”

The additional Finance Act for 2006 (voted at the end of 2006) contains several provisions on the legislation applicable to French listed real estate companies (so-called “SIIC”s) and also to newly created French real estate SICAVs, “SPPICAV”.

“These new provisions aim at introducing more constraints on SIIC companies in terms of control and holding by exempt shareholders.”

1. Introduction of a **majority ownership capped to 60% of the voting right and/or the beneficial ownership**. This threshold would be applicable as of **January 1st 2009** for the existing SIIC and as of **January 1st 2007** for the companies electing for the SIIC regime as from 2007. This condition would have to be complied with on a continuous basis.
2. Introduction of a **free float requirement of 15%**, where each shareholder should own less than 2% of the equity and voting rights of the SIIC. This condition should be fulfilled on the first day of the year for which the company elects for the SIIC regime. Only newly-listed companies, electing for the SIIC status as of January 1st, 2007 are concerned.
3. Introduction of a **withholding of 20%** applicable to distributions of dividends by a SIIC to any exempt entity or any entity that would be exempted or subject to a significantly limited income tax rate (equal or below 11% of effective tax rate), provided that such entity owns directly or indirectly at least 10% of the SIIC company

(beneficial ownership). This provision would not be applicable (a) to SIIC or SPPICAV companies receiving dividends from another SIIC company (so called "SIIC of SIIC") and also (b) to companies subject to a 100% distribution duty on dividends received from the SIIC. The withholding would be due by the SIIC and not offset against the dividends paid to the exempt shareholder. As a consequence, this may affect the value of SIICs on the stock market. These provisions are applicable for distributions carried out as from July 1st, 2007.

"However, French authorities remained sensitive to maintain the attractiveness of the regime and extend their favourable tax regime on acquisitions until 2009"

As far as the encouraging measures are concerned, the new law provides for an extension of the favourable tax regime of Article 210 E of the French tax code, so-called « SIIC 3 », until December 31, 2008 (the original regime was to be terminated on December 31 2007).

It is worth remembering that this tax regime allows a tax cut of the capital gains tax rate by 50% down to 16.5% for real estate owners selling or contributing real estate assets to SIICs (or to their subsidiaries subject to an identical tax regime) provided that the real estate assets be kept by these entities for at least 5 years.

SIIC companies have already been benefiting from this regime since January 1st, 2005. Nevertheless, SPPICAVs (the tax regime of which was provided by the modified Finance Act for 2005), which may only be incorporated as from the first semester of 2007 were in a rather delicate situation since they could only benefit from this regime over a quite short period of time.

The extension of the "SIIC 3" regime until December 31, 2008 will allow these new investment vehicles to become a genuine alternative to SIIC companies on the real estate market with respect to real estate asset spin-offs.

8. France – Luxembourg

8.1. Double Tax Treaty amendment

Luxembourg and France have initialed a side-letter amending the real estate income provisions of the double tax treaty concluded on April 1st, 1958.

The qualification of the income as real estate income will prevail over the provisions dealing with the taxation of business income connected to a permanent establishment.

The objective of the amendments to the Treaty is to avoid situations where income from immovable property was qualified differently by the Contracting States involved (real estate income versus business income), so that the income was finally considered as taxable in neither of the States:

- Luxembourg considered that income realised by a Luxembourg Company and arising from a French immovable property was to be regarded as taxable in France according to Article 3 of the Treaty;

- France considered that such income was business income taxable in France only to the extent it is connected to a French permanent establishment ("PE") of the Luxembourg Company (Article 4 of the Treaty). In absence of such PE, France considered that the income was not taxable in France.

In the end, the income was neither taxed in France nor in Luxembourg.

The side-letter does not contain any provision according to which capital gains realized upon the sale of shares of a company the assets of which mainly consist in real estate assets will be considered as real estate income. Structures involving a Luxembourg fully taxable company investing in French property via a French real estate company should therefore not be affected by the present amendments to the Treaty: the income realised upon the sale of the shares in the French real estate company should remain a capital gain which should be only taxable in Luxembourg.

The new provisions will enter into force on the first of January of the year following the completion by both countries of the ratification process. The Prime Minister who is also the Finance Minister, Mr. Jean-Claude Juncker, recently announced in a response to a Parliamentary Question that the Luxembourg Government plans to issue a draft law by the beginning of 2007 so that the amendment will enter into force at the earliest on January 1st, 2008.

9. India

The Indian real estate market, already witnessing an unprecedented growth, received a further fillip with the implementation of a new Special Economic Zones ("SEZ") policy in early 2006. The SEZ policy aims to provide an internationally competitive duty-free environment for exports, supported by world-class infrastructure. This policy offers a slew of fiscal incentives such as income tax holidays, duty rebates, etc to both, developers of SEZs as well as to units operating from such SEZs, coupled with procedural simplifications and single window clearance systems.

The policy has been received with great enthusiasm by the developer and investor community and over 400 proposals for the development of such SEZs have been received with over 200 of them receiving the formal approval from the Government of India resulting in a proposed investment of over US\$ 10 billion.

The SEZ policy has, however, also been a subject matter of an intensive political debate over the quantum of revenue loss as well as on fears of large scale acquisition of agricultural land for development of SEZs. Finally, owing to the intense pressure the Government has put an interim moratorium on approval of new SEZs till such time as some of the contentious issues are resolved. The Government is working at resolving these issues and it is expected that the SEZ policy will continue to be one of the key reasons for the momentum in the Indian Real Estate Market.

10. Italy

10.1 Introduction

The Budget Law for FY 2007 (Law 27 December 2006, n. 296, articles 1/119-1/141), has introduced a new tax regime for joint-stock companies listed on Italian capital markets mainly performing real estate activities ("*Società di investimento immobiliare quotate*" – SIIQ).

According to the new regime, SIIQs can benefit from a general income tax exemption, while the shareholders (other than companies) are subject to a definitive withholding tax equal to 20% of the dividend paid by the company (which cannot be lower than 85% of the net income accrued by the company in the financial year ("FY")).

SIIQs can elect for the new regime starting from the FY subsequent to the one running as of 30th June 2007 (i.e., for companies whose FY corresponds to the calendar year, the new regime will be applicable starting from January 1, 2008).

The option is made by filing with the Tax Authorities an application within the end of the FY preceding the one in which the company is willing to apply the regime (i.e. companies whose FY ends on 31st December 2007 must submit within 2007 the application for the new regime, which will be applicable from FY 2008).

10.2 Requirements for the admission to the SIIQ regime

In order to qualify as a SIIQ, a company needs to meet some conditions.

A SIIQ must be a joint-stock company:

- a. resident in Italy;
- b. mainly performing activities of rental of real estate properties;
- c. whose shares are listed in Italian financial markets;
- d. in which none of the shareholders owns directly or indirectly more than 51% of voting rights and more than 51% of the profit sharing rights;
- e. in which at least the 35% of the shares is held by shareholders which do not own, directly or indirectly, more than 1% of voting rights and 1% of profit sharing rights each.

In order to meet the requirement sub b):

- i. real estate properties must represent at least 80% of the assets of the company;
- ii. revenues from real estate rental activities must represent at least 80% of the whole company's turnover.

The company opting for the SIIQ regime must keep separate books for the rental activity and for other activities; moreover, the company has to describe in its financial statements the criteria used for the allocation of common costs to the rental activity and to the other activities.

10.3 Results of the application of the new regime

The SIIQ regime has several effects, the most relevant of which are the following.

- a. The option for the SIIQ regime causes a step-up in real estate values, up to the market value as of the closing date of the last FY in which the ordinary tax regime applies. The latent gains, net of any losses, will be subject to a 20% substitute tax.

b. The company is obliged to distribute, each year, at least 85% of the income from the rental activity ("rental income"); however, if the whole distributable net profit is lower than the profit from the leasing activity, the 85% applies to the whole distributable profit.

c. The company is exempt from corporate income taxes (National and Regional taxes), with reference to the rental income. Rental income is taxed in the hands of the shareholders, at a rate of 20%, to be withheld by the distributing company.

d. This withholding tax represents an advance withholding tax in case the shareholder acts in the sphere of a business concern (i.e. the shareholder is a company, a partnership, an individual business or a Permanent Establishment of foreign commercial entities).

e. In any other case, the withholding tax represents a definitive withholding tax.

f. Tax losses suffered in the FYs preceding those in which the new regime is applied can be utilised to offset the taxable base of the substitute tax due in relation to the asset step-up and income deriving from the activities other than the exempt rental activity.

10.4 Provisions related to the contribution of assets to SIIQ companies – direct taxation

Capital gains deriving from the contribution of immovable properties in exchange for shares into a company which has made the option (or is going to make it, within the FY in which the contribution takes place) for SIIQ regime, can be subject – at choice of the taxpayer – to the ordinary tax rules or to a substitute tax at a rate of 20%; however, in the latter case, the receiving company must hold the real estate contributed for at least three years.

10.5 Provisions related to the contribution of assets to SIIQ companies – indirect taxation

The contributions of a plurality of mainly rented properties to a company which has elected for the SIIQ are out of scope of VAT. These contributions are subject to Registration, Mortgage and Cadastral taxes at the fixed amounts of Euro 168 each.

For Mortgage and Cadastral tax purposes, contributions of assets other than those mentioned above are subject to a reduced 2% tax rate.

10.6 Further information

Non-listed companies can also benefit from the SIIQ regime on condition that:

1. they are resident in Italy,
2. they are mainly performing real estate renting activities,
3. they are controlled for at least 95% of voting rights (and 95% of profit sharing rights) by SIIQ companies listed on Italian capital markets.

In this case the option for the SIIQ regime must be jointly made by both the controlling and the controlled company, and the controlled company has to draw up Financial Statements according to the International Accounting Standards.

With a further Government Decree, the enforcement of the new SIIQ regime will be completed with technical dispositions governing several relevant aspects (assets step-

up values, carry-forward of the losses, M&A, offsetting of existing tax credits, etc.).

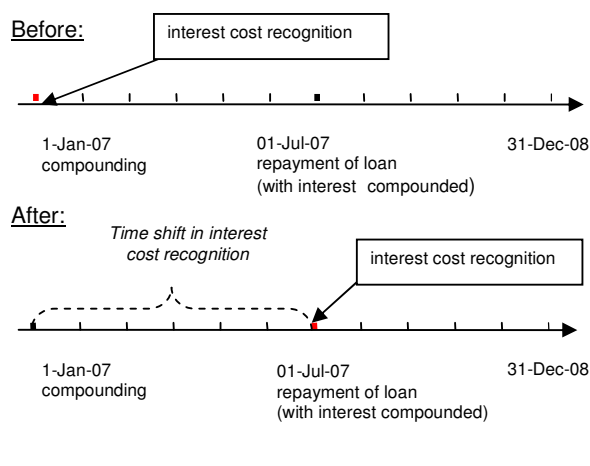
11. Poland

11.1. Elimination of step-up upon contribution in-kind of an enterprise

Under the previous law, an investor holding Polish real estate with a value lower than market price, through a Polish SPV could step up the tax value by contributing in-kind its enterprise to a new company. Tax savings due to higher depreciation write-offs could thus be achieved. As of January, 2007 an amendment to the Corporate Income Law eliminates the step-up upon contribution in-kind of an enterprise. This step up had been used by many real estate investors. It may still be available in exceptional circumstances.

11.2. Interest compounding

Before July 2006, the compounded interest was treated as tax deductible at the date of capitalisation. Based on this approach, compounding interest was used to recognize tax costs, without actual cash out-flows from the borrower. On 11th July, 2006 the District Administrative Court in Warsaw in one of its rulings challenged the established way of interpretation and ruled that compounded interest is deductible for CIT purposes only when the loan principal (containing interest compounded) is actually repaid.



The administrative courts case law should be monitored to establish if this –unfavourable– position is maintained in further rulings (in particular, issued by the Supreme Administrative Court of Poland). Other actions, such as requesting the binding ruling of a taxpayer's competent tax office, may also be considered on a case-by-case basis.

11.3. VAT rate on the delivery of residential apartments

Based on transitional rules granted to Poland upon entry to the EU, the delivery of residential property by

developers (for so called "first time occupancy") benefits from a reduced VAT rate of 7% till 31 December 2007.

In accordance with the provisions of the VI VAT Directive Poland may continue to apply the reduced rate of 7% (instead of standard 22%) even after that date upon introducing the specific provisions on "social housing". As of 1st January, 2008 the government will introduce the notion of "social housing". The definition is not yet agreed on; it is currently proposed to cover apartments of up to the useful space of 120 sq. meters and houses up to the total useful space of 200 sq. meters. In the parts exceeding such limits, residential property would be subject to standard 22% VAT rate.

12. Netherlands

12.1. Dutch Corporate Tax Reform 2007:

Changes for the Real Estate investment branch

Several significant amendments to the Netherlands holding regime entered into force on January 1, 2007. The principal amendments affecting corporations are summarised below:

- Reduction of the corporate tax (CT) rate to a maximum of 25.5% (for profits exceeding € 60,000, profits below € 25,000 will be taxed at 20% CT and profits between € 25,000 and € 60,000 are taxed at the CT rate of 23.5%);
- Significant amendments to the participation exemption regime, including the introduction of a credit system for "passive investment subsidiaries";
- Introduction of a group interest box, resulting in an effective rate of 5% on profits from inter-company finance activities;
- Introduction of a patent box regime, resulting in a tax rate of 10% for income from self-developed intellectual property, patented after January 1, 2007;
- Reduction of the dividend tax rate from 25% to 15%;
- Restriction on depreciation of assets (goodwill 10 years, other assets 5 years);
- Limitation of the depreciation on real estate (portfolio assets not lower than the value under the Real Estate Survey Act, real estate for own use not lower than 50% of said value);
- Restriction on loss relief (carry back to 1 year, carry forward to 9 years);
- Revision of the anti-base erosion measures (interest deduction and thin cap rules).

12.2. Participation exemption

Qualifying participations

A subsidiary qualifies for the participation exemption if the parent company holds at least 5% of the (nominal, paid up) capital. This 5%-criterion has been amended so that is now a strict rule without exceptions. Contrary to the position prior to January 1 2007, the exemption on income derived from a hybrid loan is no longer restricted to hybrid loans on which the interest paid by the foreign subsidiary is not deductible. This creates opportunities

for tax planning: if carefully drafted, the income on a hybrid loan from a Netherlands parent company to a foreign subsidiary may be exempt from corporate tax, even if the interest is deducted at the level of the subsidiary.

Passive investment subsidiaries and real estate participations

Under the new rules, a credit system instead of a participation exemption applies to so-called passive investment subsidiaries, which is substantially less attractive. These are participations that (1) keep portfolio investments for more than 50% of their assets and (2) are subject to an effective profit tax rate of less than 10% (according to Dutch principles). Real estate subsidiaries however are not considered passive investments. To qualify as a real estate subsidiary, the assets must consist in real estate for 90% or more.

12.3. Group interest relief

For inter-company financing activities, a special, optional regime has been introduced. In short, the (positive) balance of income from loans granted to group companies and the interest paid to group companies, is taxed at a rate of 5%. Capital gains and losses on inter-company loans do not fall within the scope of the group interest relief. Discussions are still ongoing with the commission in relation to compatibility with EU law.

12.4. Dividend tax

The dividend tax rate has been reduced from 25% to 15%. This reduction will only affect shareholders of Dutch companies that do not benefit from the EC Parent/Subsidiary Directive or double taxation treaties which mitigate the dividend tax burden. Furthermore, the threshold for the exemption to withhold dividend tax has been lowered to a shareholding of 5% for EU-resident parent companies.

12.5. Depreciation on real estate

Depreciation on property for tax purposes has been drastically reduced. A distinction is made between investment property and buildings for own use. For investment property, the bill states that depreciation may not drop below value under the Real Estate Survey Act (RESA) of the building (in other words, the "floor value"). Depreciation on buildings for own use may be 50% of the RESA value. As the RESA valuation will be adjusted regularly in line with the market situation, the 'floor value', specifically with respect to investment property, will be quickly reached. If the floor value becomes higher than the balance sheet valuation (after depreciation), this will not lead to a taxable revaluation.

12.6. Investing through silent partnerships: Important change

Investors in Dutch real estate often make use of the so-called silent partnership (in Dutch: commanditaire vennootschap, or 'CV'). Such a legal entity, where there is one operating partner and several silent partners, may be transparent for Dutch tax purposes. One of the main

criteria for transparency is that the 'shares' in such a partnership may not be transferred without the consent of all the other partners. In cases where there are many silent partners in the partnership, this causes administrative problems. The Dutch ministry of Finance has now published a decree which makes it easier to meet this condition. In short, when a new silent partner will join the partnership, or when a share is transferred, all silent partners should receive a request. If none of the silent partners objects to the transfer within a period of four weeks, all silent partners are considered to go along. Existing partnerships may make amendments to the partnership contract in order to comply with the new criterion.

12.7. Investing in Dutch real estate: expected changes in legislation

Apart from the reduction of the corporate income tax rate and the lowering of the dividend withholding tax rate, there are other developments that will make investing in Dutch real estate more attractive from a tax point of view. Several amendments to the Dutch zero rated investment institution ('fiscale beleggingsinstelling') are expected to enter into force later this year. These are corporations that benefit from a corporate tax rate of 0% under the condition that profits are distributed on a year by year basis. These amendments are:

- corporations constituted under foreign law may be eligible to qualify for the zero rate investment tax regime;
- a zero rate investment institution no longer has to be seated in the Netherlands in order to qualify;
- the restriction that no more than 25% of the shares may be owned by foreign corporations will be abolished;
- zero rated investment institutions may engage in project development.

This may create an attractive REIT-like environment for investment in Dutch real Estate.

13. Portugal

According to the Budget Law for 2007, closed-end Real Estate Investment Funds with private placement will no longer be exempt from Property Tax and Property Transfer Tax, although they will still benefit from a reduction of applicable rates by 50%.

A transitional rule has also been created according to which this new taxation regime will be applicable retroactively to funds created after November 1st, 2006 or that increased their capital after that date, and also to real-estate that was detained by these funds when all the participants, at that date, where non qualified investors or financial institutions acting on their behalf.

| Taxation of Real Estate Investment Funds | | |
|--|--|--------------------------------|
| Type of Fund | Property Tax and Property Transfer Tax | |
| | Until 2006 | 2007 |
| Closed-end Real Estate Investment Funds with private placement | Exempt | Taxable at 50% of normal rates |
| All other Real Estate Investment Funds | Exempt | Exempt |

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On the other hand, a new regime is to be created applicable to Forestry Investment Funds. General rule, the regime follows the one applicable to venture capital funds as long as 75% of the fund's capital is invested in forest resources.

| Taxation of Forestry Investment Funds | |
|---|---|
| Fund Income taxation | Exempt |
| Income from Fund Units/Shares | Non resident shareholders - Exempt |
| | Resident shareholders - 10% withholding tax |
| Income from the sale of the Fund Units/Shares (capital gains) | Non resident shareholders - Exempt |
| | Resident shareholders - 10% flat rate |
| Property Tax and Property Transfer Tax on real estate assets transference | Same as normal Real Estate Investment Funds |

Taxand News

MIPIM conference in Cannes

As in 2006, Taxand tax experts from 10 countries will be present at next MIPIM conference which will take place in Cannes between March 13th and March 16th, 2007.

You are most welcome to meet us at our stand in the Palais des Festivals.

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