Advocate General Hogan concludes that the discriminatory treatment of closed-ended and open-ended real estate investment funds for the purposes of the 50% reduction of Italian mortgage and cadastral taxes on transfers of real estate could be compatible with the free movement of capital

Yesterday Advocate General Hogan (“AG”) issued his opinion in the joined cases C-478/19 and C-479/19, *UBS Real Estate* regarding the potential infringement of the EU fundamental freedoms of the incentive consisting in the reduction by 50% of Italian mortgage and cadastral taxes on transfers of commercial real estate assets made by or to closed-ended real estate investment funds (“REIFs”).

Transfers of Italian commercial real estate carried out by VAT taxable persons are generally subject to certain transfer taxes (mortgage tax and cadastral tax), which are computed on the value of the transaction. Italian law reduces such taxes by 50% (from 4% to 2%) if the buyer or the seller is a REIF set up as a “closed-ended fund” under Italian law. The applicant (UBS Real Estate) was the asset management company of two open-ended REIFs organized under German law. The applicant purchased commercial real estate in Italy on behalf of these funds and fully paid transfer taxes; it then asked the reimbursement of half of these taxes, but the refund was denied. Finally, the applicant started court litigation against the refund denial claiming that foreign REIFs, whether closed-ended or open-ended, should also be eligible for the favourable regime because otherwise Italian law would be in breach of the EU fundamental freedoms.

The AG examined the question from the perspective of free movement of capital and pointed out that the tax law of a Member State may infringe this freedom only if it discriminates investors in comparable situations. The AG identifies two conditions that a REIF should meet to benefit from the favourable transfer tax regime and that may be relevant in determining whether Italian law is discriminatory: (i) the fund must be established under Italian law; and (ii) the fund must be closed-ended. Although the referral from the Italian Supreme Court mainly focused on the second condition, the AG examined also whether the first condition may give rise to discrimination. Reading his conclusions, it transpires that if the first requirement were interpreted in a way that only funds governed by Italian law could qualify for the reduced transfer taxes, then Italian law would create a direct discrimination and would likely be in breach of the free movement of capital.

On the second requirement, the AG’s view is that making the favourable regime conditional on the REIF being a closed-ended fund could determine an indirect discrimination on the basis of nationality because under Italian law REIFs can only be established in the form of closed-ended funds. Therefore, by limiting the favourable regime to closed-ended REIFs, Italian law would only deny the reduced tax rates only to certain foreign REIFs (i.e. those that are open-ended). However, the AG concludes that this discrimination could be justified by the need to mitigate a potential systemic risk in the commercial real estate market ("snowball" effect). In particular, the AG mentions that the Italian referring court explained that "in the case of open-ended funds, if there were to be a market crisis following a drop in real estate prices, this could induce many investors to ask for the early repayment of part of the invested sums. This phenomenon could absorb the liquidity reserves of the funds, which in turn could then be forced to sell part of the real estate below its book value in order to satisfy the requests for repayment of the shares" (paragraph 90). According to the AG, (i) a similar risk is much lower for closed-ended REIFs in which the investors can only redeem their investments after a certain period of time, and (ii) the indirect discrimination at stake seems to comply with the principle of proportionality as it does not go beyond what is necessary to achieve its objective. Although the AG recognizes that the potential systemic risk is not likely to disappear just because open-ended funds are denied the transfer tax benefit, the indirect discrimination under review can be justified because the Italian measure should anyway at least reduce the systemic risk and would not infringe the principle of proportionality.

If the Court endorsed the AG's opinion and also addressed the first condition (nationality of the REIF), the judgment could support the view that Italian law is in breach of the free movement of capital at least to the extent that it excludes foreign closed-ended REIFs from the favourable tax regime. In this regard, some lower-tier Italian tax courts already held that the reduced transfer taxes should apply also to foreign closed-ended REIFs (see judgment of the Provincial Tax Court of Milan no. 5952 of 2018).

For further information: **Maisto e Associati**

Milan
Piazza F. Meda 5
20121
T: +39.02.776931

Rome
Piazza d'Aracoeli 1
00186
T: +39.06.45441410

London
2, Throgmorton Avenue
EC2N 2DG
T: +44.207.3740299