

# *Favourable changes in the regulation of Hungarian Real Estate Investment Trusts*

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## **In Brief**

Effective from 25 July 2018, the Hungarian Parliament has adopted further favourable changes to foster the establishment of Real Estate Investment Trusts (REITs). Rather than taxation related measures, the amendment to Act CII of 2011 on Real Estate Investment Trusts (REIT Act) aims to encourage REIT investment through the extension of allowable activities as well as introducing less burdensome profit distribution requirements.

## *Key characteristics of Hungarian REITs*

- Hungarian REITs are stock corporations (seated in Hungary or in any other state in the EEA), which are listed on a regulated market within the EU with at least 25% public ownership.
- Investors may include both small investors and institutional investors, but credit institutions and insurance companies should not directly hold more than 10% voting rights.
- REITs may own and operate their real estate portfolio directly, or alternatively, through their 100% owned companies ("Project Companies").
- At least 70% of the REITs total assets must consist of immovable property (at fair value), while the level of their debt financing may not exceed 65% of the real property value as shown in the financial statements.
- REITs may account either under Hungarian GAAP or under IFRS (even on standalone level).
- In terms of taxation, REITs (and Project Companies) are exempted from corporate income tax (which is otherwise 9% of the adjusted pre-tax profit) and local business tax (which otherwise may be levied up

to 2% of the adjusted net sales revenue by local municipalities).

- Additionally, a reduced transfer tax rate of 2% applies to the acquisition of real estate, property rights related to real estate and real estate rich entities by REITs (instead of the general 4%/2% regressive rate).
- Distributions by REITs to foreign or Hungarian entities are not subject to Hungarian withholding tax.
- Hungarian or foreign resident private individuals are subject to 15% personal income tax withheld at source on distributions made to them (in the latter case a reduced treaty rate may apply).
- Provided the REIT is listed on a recognised stock exchange, no Hungarian capital gains taxation shall arise on the disposal of the REIT's shares by foreign investors.

## *Changes to the Hungarian REIT regime*

### *Broader allowable activities*

To date, a REIT's activity may have comprised of several real estate related services such as trading, leasing and asset management, however, the development

of real estate fell outside of the Hungarian REIT regime (unless the development was undertaken for the purposes of the REIT operating the developed asset). However, taking into consideration the current market environment the law changes now eliminate this restriction by allowing that

- the activity of a REIT may include the coordination of real estate development projects, and at the same time
- REITs can invest in special purpose vehicles (SPVs) engaged in actual development of residential and non-residential real estate properties.

### *Profit distribution requirements*

Prior to the amendment of the REIT Act, REITs were obliged to distribute 90% of their distributable profits (unless the free cash and cash-equivalent sums were lower than such amount). However, going forward, the management of the REIT is obliged only to propose 90% profit distribution to the shareholders, with the actual decision on the distribution level being at the discretion of the shareholders.

### *Eliminating the restriction of share classes in issue*

Previously, REITs could issue ordinary shares and employee stocks only. However, effective from 26 July 2018, REITs may also issue preference shares (with the exception of preference in terms of dividends and preference shares securing veto rights).

### *Our view*

Since the introduction of REITs into Hungarian legislation in 2011, only a few investors have made use of the investment vehicle. However, with the constant investment friendly legislation changes, REITs now represent an attractive investment platform and as such, an increase in their uptake is expected.

## **Contact**

Uwe Stoschek

*Global Real Estate Tax Leader*

Phone: +49 30 2636-5286

[uwe.stoschek@de.pwc.com](mailto:uwe.stoschek@de.pwc.com)

Jeroen Elink Schuurman

*EMEA Real Estate Tax Leader*

Phone: +31 88 792-6428

[jeroen.elink.schuurman@nl.pwc.com](mailto:jeroen.elink.schuurman@nl.pwc.com)

## **Hungary**

Gergely Juhász

*National Real Estate Tax Leader*

Phone: +36 30 689-5487

[gergely.juhasz@hu.pwc.com](mailto:gergely.juhasz@hu.pwc.com)