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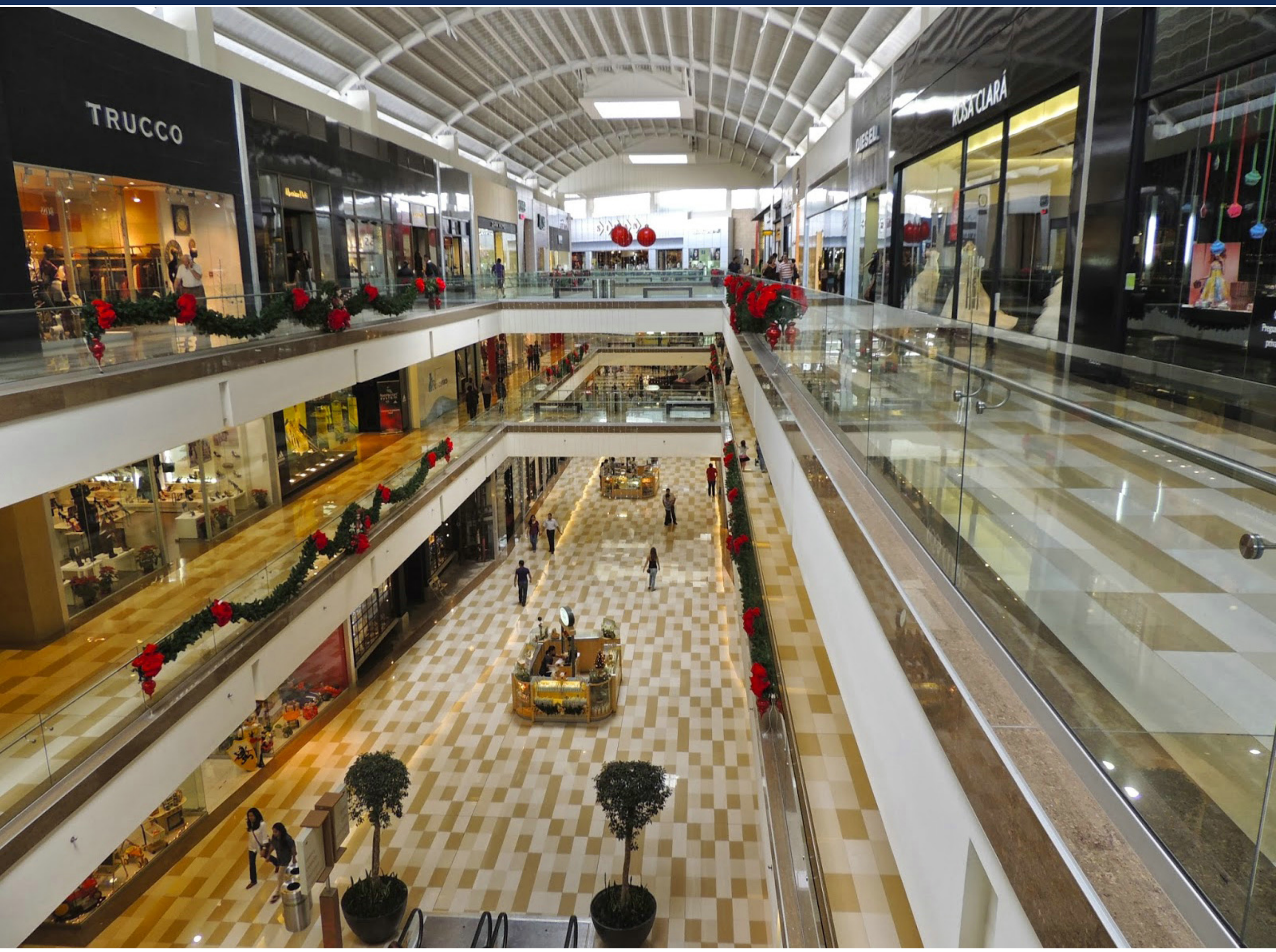
European Public Real Estate Association

Global REIT Survey 2016

AMERICAS

Costa Rica – REIF



A COMPARISON OF THE MAJOR REIT REGIMES AROUND THE WORLD

1 General introduction

	Enacted year	Citation	REIT type
REIF	1997 and 2009, respectively.	Securities Market Regulation Act (Num. 7732) and the General Regulations of Fund Management Companies and Investment Funds.	Fund type (Showing some characteristics of a REIT).

In general, investment funds are treated as independent estates owned by plural investors. Only authorised investment fund management companies (IFMC) can manage an investment fund. The participation units of the investors are represented by participation certificates (participations), issued with the same characteristics and under the same conditions for each investor. Only investment funds authorised by the National Securities Commission (*Superintendencia General de Valores* – SUGEVAL) may conduct a public offering of its participation units, or be quoted on a local securities exchange.

Costa Rican legislation establishes two types of REIFs: a) Real Estate Investment Funds (REIF) and b) Real Estate Development Investment Funds (REDIF). These investment funds differ by the type of assets in which they are allowed to invest.

REIFs should only be organised as closed-ended funds and can only assume risks related to real estate activity. These invest mainly in real estate for leasing and eventually, selling. The real estate must include facilities already built. The assets in which the REIF invest could be located within Costa Rica or abroad. In the former case, the minimum amount for participation is of USD 1,000 and when the investment is in real estate assets located abroad, the investment must be at least of USD 5,000. The minimum number of investors is of 50. For SUGEVAL to authorise a REIF it must have minimum net assets of USD 5 million and the diversification of assets is subject to the following rules: 80% annual average of monthly balances of the fund assets must be invested in real estate assets and 20% must be kept in cash in a current account to attend cash needs or in securities publicly traded, Participants or related entities or individuals, could not act as lessees of the assets of the fund. However, the IFMC or related entities could act as lessees of the fund, provided that the total monthly income these produced do not exceed 5% of the total monthly revenues of the fund. The assets must be assessed annually and could be sold only after three years of acquisition; exceptions under specific circumstances are allowed.

REDIFs should only be organised as closed-ended funds and its public trade is restricted. These must invest in real estate development projects which may be in different stages of development, whether these are in a design or in a construction stage. Once the construction is finished, the real estate must be sold or leased. Complementarily, REDIFs could purchase real estate to let it increase its value with time (*appreciation*) or for leasing. The assets could be located within Costa Rica or abroad. The minimum amount for participation is of USD 1,000. However, different from REIFs, the minimum investment for participant is of 50 participations for investor. For SUGEVAL to authorise a REDIF it must has minimum net assets of USD 5 million. The minimum number of investors is of 25. The IFMC or related entities could act as lessees of the fund, provided that the total monthly income these produced do not exceed 5% of the total monthly revenues of the fund.

The investment funds are governed by the Securities Market Regulation Act (Law Num. 7732 dated December 17, 1997 and published in La Gaceta No. 18 on January 22, 1998) and the General Regulations of Fund Management Companies and Investment Funds (issued by the Financial System Oversight National Board, on December 19, 2008 and published in La Gaceta No. 10 on January 15, 2009).

2 Requirements

2.1 Formalities / procedure

Key requirements
- Licence from the National Securities Commission (SUGEVAL) for the investment fund management company (IFMC). - Registration on the REIF list. - Fund must be authorised by SUGEVAL. - Approved prospectus by SUGEVAL.

The Investment Fund Management Company (IFMC) could be a local entity or a branch from a foreign entity, but their exclusive business purpose must be to act as investment fund management entity and as a complementary purpose these could have the trading of local or foreign investment funds. These must obtain authorisation to operate within the local market from the National Securities Commission (SUGEVAL). Among other requirements: the request must be filed by the person who will act as legal representative of the company, and a draft of the incorporation deed must be attached to the request, along with the shareholders, directors and legal representatives' résumé and a sworn statement indicating that none of the them has been convicted of a crime during the previous five years.

Other requirements include: (i) Capital stock must be paid and subscribed. (ii) A description of the Integrated Risk Management Unit which should be structured to comply with the regulations rules. (iii) Manual including policies and procedures of the IFMC. This manual should include selling and marketing rules.

The license to operate granted by SUGEVAL to an IFMC is conditioned to the filing of the original documents within a six month period after the authorisation date. Therefore, the IFMC has a six-month period to register the original documents of incorporation before the Mercantile Section of the Public Registry. The IFMC has a one year term to begin operations as of the date of communication that final requirements have been completed. If the IFMC fails to begin operating during that year, the licence will be cancelled. It is understood that an IFMC has began operations if it registers at least one Investment fund.

As per the investment funds, the authorisation process is performed on-line. Once the authorisation is obtained the original documentation should be filed within a three-month period.

After obtaining the authorisation the Investment Fund will be registered before the Securities and Intermediaries National Registry.

The requirements to register a fund include:

a. Request filed and signed by the legal representative of the IFMC before the SUGEVAL.
b. Board of directors agreement in which said Board agreed the organisation of the fund. This agreement should comply with the requirements specified by SUGEVAL.
c. Investment Fund Prospectus.
d. Code ISIN issued by the authorised codified entity.
e. Procedures Manual.
f. When the fund would be publicly traded it must comply with additional requirements established in the Securities Public Trade Regulations.

The prospectus should include the relevant information of the investment fund that would allow the investors to make an informed investment decision. Therefore, the Investment fund Prospectus should contain the following information:

a. Purpose of the fund.
b. Main characteristics of the fund (i.e. characteristics of the participation units and of the issuance and redemption of units procedures, term of the fund; mechanisms for estimating returns and distributions to investors; commissions payable to the IFMC; among others).
c. Terms of investment policy.
d. Description, policies and warnings in relation to the risks associated with the investment.
e. General description of the entity responsible for the management of the fund (IFMC).
f. Legal declarations indicating that all information is reliable.

Investment funds must start operations within a nine-month period following the notification from SUGEVAL that all requirements have been completed. This term may be extended upon request for an additional nine-month period. If they do not start operations during this time, the authorisation to operate the fund would become invalid. However, regarding REDIFs the term to start operations is extended to 18 months.

2.2 Legal form / minimum initial capital

Legal form	Minimum initial capital
- The IFMC must be a corporation or a branch of a foreign fund manager company.	- The IFMC must have a minimum share capital of CRC 131 Million[1] (approx. USD 235,370.21)[2], as of July 22,2015

Legal form

The fund management company could be a Costa Rican corporation or a branch of a foreign fund management entity, incorporated before the Mercantile Section of the Public Registry as established by the Commerce Code.

If a foreign management company is interested in trading a foreign REIF in Costa Rica, the Regulations allow the local trading of authorised REIF from the following countries: United States, Spain, Mexico, Colombia, Chile, Canada, Brazil, United Kingdom, France, The Netherlands, Australia, Germany, Ireland, Italy, Luxemburg, Switzerland, Portugal, Japan and Hong-Kong.

Minimum initial capital

The IFMC must have a minimum share capital of CRC 131,000,000 (approx. USD 235.370).[3] However, this amount is updated every year by a resolution from SUGEVAL.

REIFs and REDIFs: The real estate investment fund must have USD 5 million in net assets.

The participation value of REIFs that only invest in assets located in Costa Rica is a minimum of USD 1,000, and if the REIF invests in assets located outside of Costa Rica, the minimum amount of participation is USD 5,000.

2.3 Unit holder requirements / listing requirements

Unit holder requirements	Listing mandatory
Minimum 50 participants – REIF Minimum 25 participants – REDIF	Yes

[1] In accordance with the Financial Entities' Superintendent General's decree SGV-A-205, , in effect as of June 30th of 2016.

[2] US$ 1 = CR₡ 556.57 on August 18th of 2016 Source: Costa Rica Central Bank, Website: www.bccr.fi.cr,

Unit holder requirements

The minimum number of participants in a CR for REIFs is 50 and REDIFs is 25. However, the general rule for investment funds is 50. If the fund does not comply with the minimum investors' requirement for a period exceeding the six months, the fund would be deregistered.

Listing requirements

Closed-end investment funds are required by law to be registered for trading on an organised local exchange market.

If the investor decides to sell his/her participation interest, the participations could not be redeemed directly by the Fund except in the circumstances established by law. The latter include for example: when the investors execute their appraisal, which can be executed when they do not agree with the amendments made to the fund's investment policies.

Therefore, when selling a participation in a REIF, the participant would have to trade them in a stock exchange. The participation value will be determined both by the valuation of the assets and by its fair market value according to the stock exchange.

The IFMC must be registered before SUGEVAL. However, the IFMC is not a listed company on the Costa Rican Stock Exchange, only the fund is listed.

2.4 Asset level / activity test

Restrictions on activities / investments
- The main activity must be the acquisition and/or leasing of real estate. - 80% of property in real estate assets. - The remaining percentage could be invested in other financial investments such as publicly traded securities. - No more than 25% of the REIF's income can derive from one individual or corporation that belongs to the same economic unit. - There are some limitations regarding the sale of the REIF's asset.

At least 80% of the annual average remaining balance of assets must be invested in real estate. The remaining 20% must be kept in a checking account or invested in publicly traded securities. The 80/20 percentages apply to both CR funds investing in Costa Rican assets as well as CR funds investing in non-Costa Rican assets. However, these percentages should not apply to foreign funds registered with SUGEVAL, since foreign funds must comply with the regulations of their country of incorporation.

REIFs have three years to fulfil these investment percentage requirements.

No more than 25% of the REIF's income can be derived from one individual or corporation that belongs to the same economic unit.

Real estate assets may not be sold by the REIFs until three years after the acquisition and registration under the REIF's property.

Neither investors, individuals nor companies related to the fund, may lease real estate belonging to the fund. The IFMC manager, or companies integrated to its economic group may lease real estate from the fund as long as it does not represent more than 5% on the REIF's monthly income.

2.5 Leverage

Leverage
- Loans for IFMC are limited to a 20% of their assets. - Loans for REIFs and REDIFs are limited to 60% of their real estate property and 10% of any other securities owned by the fund (this 10% cap is the same that applies to financial funds).

Loans for IFMC are limited to 25% of their assets[4]. Loans for financial funds are limited to 10% of their assets. In exceptional cases, SUGEVAL may authorise a 30% limit on loans for financial funds, however, the investors' assembly must agree on this.

Non-financial investment funds may have a leverage of up to 60% on their assets. This cap applies to REIFs and REDIFs.

In general, with the exception of specific situations described above, an investment fund may not encumber or lien its assets to obtain debt.

2.6 Profit distribution obligations

Operative income	Capital gains	Timing
No requirement.	No requirement.	No requirement.

Operative income

The law does not establish a mandatory percentage to be distributed, or a specific timing. This will be established in the fund's prospectus. In practice, Costa Rican Funds substantially distribute all of their income to their investors.

Capital gains

The law does not establish a mandatory percentage to be distributed, or a specific timing. This will be established in the fund's prospectus.

2.7 Sanctions

Penalties / loss of status rules
Determined by SUGEVAL.

If the CR fund fails to comply with regulatory requirements, SUGEVAL could take control of the REIF or liquidate the fund.

In the case of closed-end funds, such as REIFs, SUGEVAL may call for an investors' assembly to determine if the fund must be liquidated or not. Also, the investors' assembly may decide to liquidate the fund and the Superintendent from SUGEVAL will ratify the decision.

[4] Amended by Art. 19 of the Regulations of Risk Management issued by the Financial System Oversight National Board, February 13, 2009 and published in La Gaceta No. 41 on February 27, 2009.

3 Tax treatment at the level of REIF

3.1 Corporate tax / withholding tax

Current income	Capital gains	Withholding tax
5% on gross income.	5% on net amount.	N/A

Investment Funds enjoy a preferential tax treatment. Therefore, REIFs and REDIFs benefit from this System. Article 100 of the Stock Market Regulatory Act (*Ley Reguladora del Mercado de Valores*, or its Spanish Acronym LRMV),[5] establishes that investment funds are subject to taxation under a special system.

Revenues received by investment funds are divided into three groups with a different tax treatment for each one:

- Income derived from bonds subject to withholding taxes or exempt from withholding taxes is not taxable in addition to the ordinary 8% withholding tax on interests generated from financial investments (with the exception of bonds issued in local currency by the Popular and Communal Development Bank). However, jurisprudence states that capital gains derived from the sale of such securities are subject to the fixed rate of 5% mentioned below.
- Income derived from other types of assets and not subject to withholding taxes (such as dividends, offshore investments, exchange currency differences, and leases received by real estate investment funds) is subject to a 5% tax rate on the gross amount.
- Capital gains are subject to a fixed tax rate of 5%. The tax base is the difference between the sale price and the value of the asset in the accounting records on the date of the transaction.

In Costa Rica, there is no registration duty or capital duty on the fund or transfer duty on the transfer of the investor’s interests on the fund.

Distributions of yields from a fund are not subject to withholding taxes. Yields, dividends and capital gains derived from the fund are not considered taxable income for the investor. Roll-up is in fact permitted without adverse tax consequences.

Investment funds are exempt from transfer taxes applicable to the acquisition or sale of assets.

Interest income, dividends, capital gains, and any other income derived from pension funds created and operating under the terms of the Law for the Protection of Workers, are exempt from the tax established under article 100 of the LRMV and are also exempt from income tax and the withholding tax on dividends and interests.

Other taxes

No other taxes apply.

Accounting rules

SUGEVAL has a series of regulations that REIFs must comply with for accounting purposes. Also REIFs have special rules for the appraisal of assets. Assets must be appraised at least once a year by a registered appraiser and by a financial professional. IFRS 40 is also applicable.

[5] Stock Market Regulatory Act, Num. 7732 dated December 17, 1997 and published in the Official Gazette Num. 28 of January 27, 1998.

3.2 Transition regulations

Conversion into REIT status
N/A

Not applicable under Costa Rican legislation.

3.3 Registration duties

Registration duties
Transfer tax exemption.

The transfer tax applicable upon the transfer of real estate is levied at 1.5%. However, according to the Securities Market Regulation Act, the sale of real estate from or to a fund will be exempt from the transfer tax. Stamp tax and registration fees of approximately 1% should apply.

4 Tax treatment at the unit holder's level

4.1 Domestic unit holder

Corporate unit holder	Individual unit holder	Withholding tax
Tax-exempt.	Tax-exempt.	N/A

Article 100 of the Securities Market Regulatory Act establishes that profits, dividends and capital gains generated by participations of investment funds will be exempt from any tax.

4.2 Foreign unit holder

Corporate unit holder	Individual unit holder	Withholding tax
Tax-exempt	Tax-exempt	N/A

Article 100 subsection (d) of the LRMV states that yields, dividends, and capital gains generated by investments in investment funds are exempt from all taxes. This exemption refers to investments made by the unit holders, not by the investment fund itself.

5 Treatment of foreign REITs and its domestic unit holder

Foreign REIT	Corporate unit holder	Individual unit holder
Taxed under normal Costa Rica tax rules whether as a non-domiciled taxpayer (subject to WHT) or as a PE subject to ordinary income tax.	Non-subject to tax	Non-subject to tax

Foreign REIT

Article 100 subsection (d) of the LRMV states that yields, dividends, and capital gains generated by investments in investment funds are exempt from all taxes. This exemption refers to investments made by the unit holders, not by the investment fund itself. As a result, the Fund will be subject to ordinary taxation in this country and if it is a foreign entity, it will be subject to a withholding tax. This means that if the foreign REIT is not registered in Costa Rica it does not enjoy the special treatment applicable to investment funds. Consequently, any Costa Rica source income it may obtain will be subject to an 8% WHT rate that is established under article 23, c) paragraph 1 of the Income Tax Law for all interests and yields generated in financial investments. Consequently, such investments of the fund will be subject to this particular rate, which according to the said provision is the final tax liability without distinguishing between local and foreign investors. However, any other Costa Rica source income will be levied with a WHT determined under article 59 of the Income Tax Law. According to this provision the rate may range from 5% to 30% depending on the characterization of the income.

However, if the REIT actually owns and rents or develops real estate within the country it should be considered a permanent establishment (PE) in Costa Rica. In effect, according to article 2 of the Income Tax Law there is a PE in the country if a foreign entity has a fixed place of business where it conducts for-profit activities. According to said article, a fixed place can be any factory, building or real-estate used for that purpose. A PE is considered an ordinary taxpayer that in the case of a legal entity is subject to a 30% corporate income tax rate computed on net income. Consequently, it would be required to prove the existence of deductible expenses by complying with a number of tax obligations, including bookkeeping, filing of tax returns, issuance of invoices, etc.

However, if a foreign REIF wants to be registered before SUGEVAL, it must comply with certain requirements established by SUGEVAL, such as being authorised by a regulatory entity that is member of IOSCO; the fund should at least have one year of operation behind it; it must have an equity of at least USD 20 million; the fund manager should have a minimum of three years experience, and should have an independent custodian entity, among others. However, only the commercialisation of real estate investment funds duly authorised in United States, Spain, Mexico, Colombia, Chile, Canada, Brazil, United Kingdom, France, The Netherlands, Australia, Germany, Ireland, Italy, Luxemburg, Switzerland, Portugal, Japan and Hong-Kong, is permitted.

Domestic corporate unit holder

A foreign REIT with assets in Costa Rica may be deemed to have a permanent establishment in Costa Rica, and therefore it will be subject to the 30% corporate income tax. Once the REIT transfers its profits out of Costa Rica, such distribution will be subject to a 15% withholding tax. Furthermore, the distribution of dividends from the foreign REIT to its corporate unit holders in Costa Rica should not be subject to taxation according to the territoriality principle, if they are also registered as income taxpayers.

Please note that Section 19 paragraph c) of the CR Income Tax Law establishes that 100% of the net income of permanent establishments, of non-domiciled entities, will be also subject to a 15% withholding tax over the amount credited or remitted to its parent company, Distribution of dividends to foreign unit holders will be subject to a 15% WHT disregarding if the beneficiary is a legal entity or an individual.

Domestic individual unit holder

As previously mentioned, a foreign REIT with assets in Costa Rica will be deemed to have a permanent establishment in Costa Rica, and therefore it will be subject to the 30% corporate income tax. Once the REIT transfers its profits out of Costa Rica, such distribution will be subject to a 15% withholding tax.

Please note that Section 19 paragraph c) of the CR Income Tax Law establishes that 100% of the net income of permanent establishments, of non-domiciled entities, will be subject to a 15% withholding tax over the amount credited or remitted to its parent company.

If the foreign REIT has only investments abroad, with no connection to Costa Rica other than the local domicile of the unit holders (individuals or legal entities), such income is not subject to taxation neither for the REIT nor for the unit holders. ▯

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