



Global tax considerations

As lodging players look to 2015, certain tax issues must be carefully evaluated as an integral part of a company's overall investment strategy. This year, several key tax considerations, including the continued growth and sophistication of cross-border hospitality investments, the acceleration of the use of Opco/Propco structures and spin-offs, escalating tax enforcement initiatives and an increasing number of indirect taxes, will remain top of mind for industry participants looking to invest in the hospitality sector globally.

During 2015, significant cross-border capital flows will continue to draw focus from a tax standpoint. The deployment of capital by sovereign wealth funds and other global institutional investors will require careful consideration of tax regimes and withholding requirements in traditional markets, as well as emerging ones. As new markets gain momentum, with new alliances and joint ventures formed, tax advisors can no longer focus on one tax regime when structuring hospitality investments and operations.

Instead, advisors must carefully consider the tax consequences of where the capital originates, where the investment vehicle is located and where the capital is deployed. Given the heightened tax scrutiny that investor groups are now subject to, they must also properly manage cross-border tax implications that could adversely affect profitability. In response, tax advisors are now called on to develop robust tax models that project capital flows and the related tax consequences throughout the life of the investment.

These models, which incorporate multi-jurisdictional tax analysis, are ongoing management tools that allow "what if" scenarios at any point in the investment cycle. As countries are regularly revising

and updating applicable tax laws to remain competitive in the global marketplace, tax advisors must continually review the investment structures being utilized, as structures that may have been optimal in the recent past may no longer be the most tax-efficient structure.

The strategic use of REIT structures to hold lodging assets across the globe will continue to gain investor attention in 2015. As observed over the past year, the wave of countries adopting REIT structures keeps growing, with more than 30 countries having now enacted some version of REIT-like structures. Global REITs will gain even more traction, fueling cross-border capital flows, whether through publicly held REITs traded on exchanges or through private REITs, sometimes referred to as baby REITs, which may own only a single property.

Another prominent trend that will remain important in the lodging sector in 2015 is the separation of operations and property ownership, commonly known as Opco/Propco structures. Opco/Propco structures involve the separation of the real estate into one company and operating assets into another company. The structure allows for organizations to identify and focus on one core business, whether it be owning lodging facilities, operating them or maximizing the values of brands and other



intellectual properties. The creation of an Opco/Propco structure is often accomplished through a spin-off of one company to the shareholders of the previously combined enterprise, initially creating “brother-sister” companies. Over time, the overlapping ownership subsides, as the Opcos and Propcos attract dedicated investors into one company or the other.

Before creating the Opco/Propco structure, advisors must evaluate if the spun-off entity qualifies for tax-free treatment, or whether the creation of the Opco/Propco structure qualifies as a taxable transaction for the company, and in turn, the shareholders. A thorough analysis of potential taxable gains, as well as analysis of indirect taxes, such as transfer and property taxes, is necessary to make an decision about whether to convert to an Opco/Propco structure. Many Opco/Propco structures utilize REITs to serve as the Propco; the Propco will then lease the property to the Opco, which operates the lodging asset. The lease structure of the Opco often includes both a fixed base component as well as a contingent or participating rent component based on the gross revenues of the Opco.

In addition to Opco/Propco separations, the lodging sector will continue to witness spin-offs among major industry players. Having gained considerable recognition in recent years, lodging companies are now using spin-offs to strategically segregate their portfolios. For instance, some hospitality players have segregated their limited-service properties into a separate entity from their portfolio of larger, full-service properties. This segregation can be accomplished via a spin-off, similar to the Opco/Propco separation. If properly structured, it may be possible to execute a tax-free spin-off to separate the property classes. However, even if a tax-free spin-off is not a viable option, lodging REITs may still consider taxable spin-offs in an effort to segregate their property types and gain efficiencies.

Global tax enforcement will go on evolving and expanding in 2015, causing hospitality companies to prioritize the tracking and monitoring of global tax compliance issues and related tax controversy matters. Many companies are turning to electronic platforms to not only identify and monitor global tax risks, but to also proactively manage them. For example, a leading practice among successful hospitality companies is to maintain a real-time dashboard that monitors global tax filings and alerts them to upcoming filing deadlines and other critical tax milestones. In addition, many lodging companies have increased their focus on transfer pricing, both globally and domestically. Companies must ensure that the “transfer pricing” of their intercompany transactions, as well as cost allocations, are at “arm’s length” and compliant with the relevant tax regimes.

Finally, in 2015, indirect taxes, such as transfer taxes, property taxes and value-added taxes (VAT), will be increasing burdens for hospitality companies, as governments across the globe carry on with introducing and expanding indirect tax obligations to raise revenue. While indirect taxes may not have been as much of a material burden for companies in the past, going forward indirect taxes will present a meaningful cost for the lodging sector. Tax advisors have sometimes found that even intercompany transactions may generate unexpected tax liabilities, and new indirect “change of control” transfer taxes – triggered when subtle ownership changes are made at the parent company level – can be a burden. Thus, investors will want to review applicable indirect tax implications before initiating new structures or activities.