

## **Enclosure 1**

### **Real estate investments / Tax matters in the US**

One key consideration when assessing the investment strategy for real estate will be to protect the Bank's balance sheet and the Government Pension Fund – Global from potential liabilities beyond invested capital and other costs, including potential tax costs.

The starting point for the Bank and the Fund is that, when investing in listed equities and bonds, we are subject to special tax rules as government entities, and no tax is paid on dividends or capital gains in many markets (including the US).

When investing in real estate in the US, there are two particular factors that need to be taken into account. First, we must ensure that the expansion of the investment universe to include real estate does not mean that the Bank or the Government Pension Fund – Global loses its favourable tax status for other investments. Second, the tax costs for investments in unlisted real estate companies need to be weighed against the tax costs for other types of real estate investment.

Based on advice obtained from our legal advisers in the US, there will be a risk of unlisted investments in real estate companies having an undesirable “tax contagion effect” on our other investments in the US (listed equities and bonds). NBIM is currently working on obtaining an advance ruling on this issue from the Internal Revenue Service (IRS). If the IRS does issue such a ruling, the process will take around six to nine months. Without such a ruling, there may be a high tax risk for the Fund as a whole, which could rule out a number of investments in unlisted real estate companies in the US.

When it comes to tax costs for actual real estate investments, unlisted real estate investments may come under the rules for “commercial activities”, resulting in significant tax costs compared to investments in listed equities and bonds. If we are subject to full taxation (35 per cent of dividends and capital gains), the expected return after tax on real estate investments will not be attractive.

One solution may be to invest in listed real estate investment trusts (REITs) or other listed partnerships. The challenge here is partly that the market for REITs is not large enough for our anticipated real estate investments in the US, and partly that the

maximum holding in other partnerships and unlisted funds to avoid a tax liability is 5 per cent. In addition, the Ministry has proposed a limit of 30 per cent for listed investments in the draft rules.

These factors mean that real estate investments in the US are a challenge which still needs to be considered carefully, and the diversification requirements imposed by the Ministry in the section of the rules on real estate may prove impossible to implement. Norges Bank therefore believes that these requirements should not be laid down at this time, but be postponed until the tax situation has been clarified.

NBIM aims to begin making unlisted real estate investments in the markets where the tax status of these investments is sufficiently clear. One such market is the UK, and this may be a natural starting point for a real estate portfolio.