

## Taxation on Offshore Property

- No. 175-

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More than 500.000 Germans own property abroad. Half of these properties may be found in Spain, followed by France and Italy. In principle, every German who either lives / works in Germany for more than 183 days per annum is liable to pay Income Tax in the place where such income was earned. However, the country in which the property is situated also levies taxes. This means that whether in the case of a sale or purchase, during ownership and in the event of inheritance or donation, both the domestic and foreign fiscal authorities are involved. Depending on the circumstances, the situation can be complicated as the tax law, even within the EU, has not yet been harmonised. To moderate the effects of double taxation, Germany has concluded treaties to avoid double taxation with regards to income tax and assets as well as to prevent tax evasion with many countries. Abbreviated, these treaties are called the "Double Taxation Agreements" or "DTA".

In France, Italy and Spain, the DTA apply to income and property tax. Double taxation is alleviated in accordance with the DTA and tax through two methods. The first method is one of exemption, with or without progression, and second method is one of apportionment.

Where the method of exemption applies, only the country where the income is generated is eligible to collect the tax. This is in accordance with DTA, exemption with or without progression. In the case of exemption with progression, the country of domicile calculates the national income as well as foreign earnings accruing and applies the corresponding tax rate thereto. This method has taxation benefits for persons who find themselves at a higher level of progression and are subject to tax. The burden of tax conferred by the exemption with progression is of course a lot lower than a full taxation.

This method only has tax advantages when the burden of tax in the respective foreign countries is less than in the country of domicile.

With this method of calculation, the taxes raised and paid abroad get deducted from the local tax, should there be no other reason for tax reductions abroad.

Indeed, not all types of foreign paid taxes are deductible. An example to show this would be the Capital Gains Tax which accrues in the case of inheritance in Canada in and the additional Estate Duty in Germany.

With regards to the others, the foreign tax may only be deducted from the apportioned German tax. This means that should a foreign inheritance tax be higher than the local one, the difference between the foreign and the proportional local inheritance tax amounts can only be cleared with the asset and not with a potential further asset to pay for the local inheritance tax.

The German Receiver of Revenue ( IRS ) hasn't experienced any losses on properties located in France, Italy or Spain. Profits made from private leasing and renting are not taxed in either France or Italy. In Germany, however, the profits are taxed at a high tax rate within the scope of the progression proviso. In Spain, private leasing, renting and even personal usage thereof form part of the Spanish Income Tax.

Under the topic of Estate Duty and Donations Tax, no DTA exists. It must be individually checked whether and in which scope the German tax laws ( e.g. Estate Duty ) regulates such matters. Inheriting or donating foreign property is less beneficial, in terms of tax, than inheriting German property. In calculating the German Estate Duty, there are no beneficial values to work from. The fair market value ( gemeiner Wert ) of the property is implemented, § 12 para. 6 of the Estate Duty Act, § 31 Valuations Act. The fair market value ( gemeiner

Wert ) is approximately equivalent to the market value. This means that it's a disadvantage in contrast to owning local property. This provision, under these circumstances, infringes the prohibition against discrimination of the EG – contract.

## France

The acquiring of a property in France entails paying Registration Tax ( *la taxe de publicité foncière* ) which is levied by the Province ( Département ), the municipality and under certain circumstances also the region. The tax rate in France is not uniform. It varies according to the type of property involved, the region it is located in and the length of time the seller was owner thereof. The rates are between 7 and 20,6 %. The relevant rate is based on the purchase price stated in the Purchase Agreement. The nationally permitted options of depreciation of a purchase are only conditional for non-resident taxpayers.

The municipality raises a "Residence Tax" ( *taxe d'habitation* ) against the property. Merely the right of use activates taxes, however no mention is made of the actual use thereof. In 1999, the tax was lowered to 4,3 %. Under certain financial conditions, this tax rate may be reduced even further.

It was planned to reform the Property Tax in Autumn 2002. The government is anxious to relieve Property Taxes. Due to the fact that there is a difference of opinion between the State President and the government, the planned reform has been postponed. To date, France has raised Property Taxes (*ISF*) of 4,7 million Francs ( 717.000 EUR ) per property owned by foreign individuals; the tax rate averages at 0,55 % on properties up to a value of 1,2 million EUR. Above that, the tax rate increases up to 1,8 % on the exceeding value of the property.

Income generated from leasing is subject to French Income Tax ( *revenus fonciers* ). Property which is personally used is not burdened with a notional income. Attained earnings can be debased by deductions, e.g. general flat-rate expenses, actual costs.

The Capital Gain at the sale of property ( plus-value ), also with private use or privately kept property is subject to Income Tax. In calculating the assessment basis, France permits a range of abatements and reductions ( e.g. incidental flat-

rate costs to acquisitions, reassessment of inflation ). In this way, Capital Gains can be annually reduced by 5%, starting from the 3<sup>rd</sup> year. The nett Capital Gains for foreigners with their principal residence abroad will then be taxed at a rate of 33,33% in France.

French Estate Duty is applicable to property situated in France, regardless of the testator's nationality. The difference from German law is firstly the contrast in which spouses are treated as well as the different formal requirements.

Inheritance and Donation are subject to Estate Duty in France ( *droits de mutations à titre gratuit* ) which averages between 5 and 60% according to degree of kinship of the receivers. For spouses and other close relatives there are tax exempt amounts. These however, are notably less than in Germany.

There are still legal options: to revoke the right to inherit in France and to transfer such right to rather inherit in Germany. Some reasons for doing this would include avoiding high Estate Duties and the fewer tax exemptions available. Specific individual advice and examination of the situation is always essential as not every option can be locally applied across the board.

The German fiscal system exempts property situated in France from Income Tax due to the DTA (and also under exemptions with progression). Under the topic of Estate Duty, no DTA exist. In such cases, Germany applies the method of apportionment ( § 21 Estate Duty Act).

## Italy

The Italian tax legislation is currently undergoing great changes. Therefore, only the current applicable tax situation can be described in this article.

Before purchasing property in Italy, the buyer must apply for a tax number ( *codice fiscale* ) at the local revenue authorities ( *ufficio d'imposte dirette* ). This number may be submitted no later than at the conclusion of the notarial deed.

The purchase of property sets off registration tax ( *imposta di registro* ) through the transfer activity. Tax on a mortgage, land registration taxes ( *imposta catastale* ) and VAT under certain circumstances.

The tax rate is dependant on the type of property being purchased and the purchaser. The Transfer Duty in total is between 4% for persons who are first-time residents and 20% for properties purchased for a business enterprise. The basis for assessment is the said purchase price referred to in the Purchase Agreement, with respect to where the value of the land registration might be higher.

The Increment Value Tax ( *IVT* ) was abolished with effect from 01.01.2002.

The Italian fiscal system also taxes property owned in Italy by non-residents with a Property Tax ( *PT* ). The tax rate lies between 4 – 7 %; the tax value is the yield from the land register, that which the regional municipality determines annually in accordance with specific principles. This value is clearly below market value.

Income generated from rentals is subject to Income Tax ( *IT* ). Privately used property is burdened with a notional income; achieved earnings can be reduced by private owners only by means of a general flat-rate expenses.

The Capital Gain at the sale of a property, whether privately used or privately kept property is also subject to Income Tax. The tax rate depends on the type of property and the total income subject to tax in Italy. Private persons cannot include either loss of value or inflation adjustments nor other reductions. The average tax rate for foreigners with their principal residence abroad is from 69.721,68 EUR. The taxable income is at a rate of 44%.

Persons liable for tax must take personal responsibility in Italy that the correct tax at the correct rate and at the right time is paid.

For owners in Italy, German Inheritance law as well as German Estate Duty applies to German purchasers.

Estate Duty and Donations Tax have been abolished as of October 2001 in Italy.

Unaffected by the above, Transfer Duty on properties transferred and received by either inheritance or donations has remained intact: Tax on a mortgage ( 2% ) and Land Registration Tax ( 1% ). Despite the allocated Estate Duty, in the case of succession a copy of the "Statement of Estate Duty" ( *dichiarazione di successione* ) is filed at the respective Master's Court ( Estate Duty Authorities ) within 6 months. The existence of a German

"certificate of inheritance" is insufficient as it is not generally recognised in Italy.

The German fiscal system exempts property situated in Italy from Income Tax on ground of the DTA (however subject to exemptions with progression). Since there is no longer an allowance for Estate Duty in Italy, the German Estate Duty still applies.

## Spain

The purchase of a property in Spain activates different taxes. Transfer Duty is payable upon purchase ( *Impuesto sobre Transmisiones Patrimoniales* ) and under certain circumstances, VAT is also chargeable. The tax rate varies according to the type of property involved, the region it finds itself in and the purchase. The rate is between 6 – 16 %. The basis of assessment is the purchase price stated in the certified notarial deed.

The property is annually taxed by the municipality with Property Tax ( *IBI* ) based on the registered land value of the property. On average, the registered land value is 1/3 of the actual value. The tax varies between 0,3 % - 1,7 %. The tax return must be handed in on the due date. In the event of a late submission, one may be fined up to 20%.

The Property Tax ( *Impuesto sobre Patrimonio* ) includes also persons who live for less than six months of the year in Spain (non-residents). The tax rate lies between 0,2 % - 2,5 % ( progressively increasing ). The tax basis is the registered land value or the purchase price, whichever is higher.

Income generated from leasing is subject to Income Tax ( *IRPF* ). Spain grants non-residents deductions for costs incurred only under certain circumstances ( 2 % deduction of the value per annum).

A notial value for the use obtained is attached to property which is personally used. 25 % of this calculated value is subject to Income Tax.

Also the private Captial Gain is subject to Income Tax. The Spanish fiscal system taxes the limited tax liability of non-residents at a 35 % flat-rate. Additionally, the municipality levies Increment Value Tax ( *Plus valia Municipal* ) on the sale thereof. The value gained on the property is taxed from the previous change of ownership. The rate

of taxation is dependant on the value of the property, the period of ownership and the number of inhabitants in the municipal area. The maximum tax rate is 30 %.

The taxation of Spanish property in Germany falls within the scope of Income Tax despite DTA complications. After the DTA, earnings generated from private leasing are subject to Income Tax in Germany. The Income Taxes paid abroad are deducted. The taxation of private Capital Gain is disputable: the revenue authorities believe the method of apportionment to be correct ( administrative direction of the OFD Münster dated 29.11.1999 ). For lack of a DTA for Estate Duty, Germany applies the method of apportionment according to § 21 Estate Duty Act.

In Spain, there are attempts to reduce Estate Duty and possibly to even abolish them as has been done in Italy. If and when this will be done is yet to be seen. To date, no bills have been proposed.

German law of succession, but Spanish Estate Duty applies to Germans who own property in Spain.

The difference to German law is the noticeably higher Estate Duty rates and tax exempt amounts. Succession and donation is subject to Estate Duty ( Donations Tax ) in Spain. The tax rate, depending on the degree of kinship and previous assets owned, lies between 7,6 – 81,6 % (the highest tax rate in the EU). The bench mark is the market value of the property. Only certain tax exemptions exist for relatives.

Additionally, the upon sale of the object, Capital Gains Tax is levied.

However, legal possibilities exist to revoke the right to inherit in Spain and to transfer such right to rather inherit in Germany. It is however always recommendable to seek individual advice and have the facts examined as every situation may be different.

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