MOORE STEPHENS

Basic Principles of Taxation of Cross-Border Investment in Real Property

Contents

1. Germany

1. Acquisition of Real Property in Germany

a) Legal Framework

The acquisition of real property in Germany is possible only in accordance with German law. The most frequent real property transaction is the purchase of real property. Purchase agreements must be notarised.

Registration of the purchaser in the Real Property Register *(Grundbuch)* is required for a valid transfer of ownership. Natural persons as well as entities having either full or restricted legal capacity under German law *(OHG, KG, GmbH, AG)* can be entered in the Real Property Register. Foreign companies may also acquire real property in Germany and can be the registered owner.

b) Real Property Transfer Tax / Other Costs

The tax rules for real property also apply to single dwellings. Accordingly, these forms of real property will not be discussed separately.

A transfer tax *(Grunderwerbsteuer)* is imposed on the acquisition of real property in Germany. If German real property is included in the assets of a partnership or company, a direct or indirect transfer of 95% or more of the partnership interests or shares in the company, and (in certain circumstances) the consolidation of 95% or more of the interests or shares in the hands of a single acquirer, is also liable to real property transfer tax.

Transactions exempt from real property transfer tax include the acquisition of real property as a result of the death of the owner, an inter vivos gift of real property, a transfer between spouses and a company reorganisation. However, such transfers may be subject to gift or inheritance tax.

The charge to real property transfer tax is based on the value of the consideration given and thus on the purchase price. The tax rate is 3.5% in most *Bundesländer*; Berlin, Hamburg and Saxony-Anhalt have increased the rate to 4.5%.

In addition to real property transfer tax, a purchaser must bear in mind the cost of the notary and of registration in the Real Property Register. These together amount to approximately 1.5% to 2% of the purchase price. If an estate agent has been used, the agent's fee will be an additional cost for the purchaser.

c) Value Added Tax

The sale of real property in Germany is exempt from VAT. However, under certain conditions, the vendor has the option of subjecting the sale to VAT and thus waiving the exemption. This may be beneficial if the purchaser is entitled to an input tax deduction. A VAT rate of 19% is applicable to the sale of real property under this option.

d) Acquisition of Property Companies

In order to create an option either to sell real property itself or to sell interests in an entity, many investors acquire ownership by using either a company or a partnership. If at a later time the purchase of shares results in a consolidation of more than 95% of the company shares or partnership interests in the hands of one acquirer, this transaction is subject to real property transfer tax at the abovementioned rates. However, real property transfer tax is imposed only on the value of the real property. The tax base is not the purchase price of the shares, but rather a special value for tax purposes (the so-called Bedarfswert). As a rule, this value is below the market value of the real property. However, the Federal Financial Court (Bundesfinanzhof) considers this to be contrary to the constitution and intends to make a submission on this point to the Constitutional Court (*Bundesverfassungsgericht*).

Warning:
The transfer of shares in a foreign parent company holding a German property company can be a taxable event, even if the transfer is income-tax neutral.

2. Current Taxation

a) Income Tax

Natural persons who use their real property solely for private purposes or who allow third parties

to use it gratuitously have no rental income and thus, to this extent, are not subject to income tax. There is no deemed income from owner-occupation in Germany.

If the property is let, the income received under the lease is subject to taxation in Germany. This does not apply, however, if the letting activities are not designed to provide consistent future profits (e.g. mixed letting and private use of holiday homes).

Taxable rental income for natural persons and asset management partnerships is calculated by determining the excess of income over related expenses. Commercial partnerships and companies use a business-asset comparison *(profit)*. Deductible operating expenses include all expenses related to the real property. This includes the purchase and construction costs of the real property and borrowing costs for financing the acquisition.

However, purchase and construction costs cannot be expensed immediately. Instead, these costs are depreciated over time. The basis for determining depreciation is the purchase or construction cost of the building. The underlying real property itself is not depreciable.

Depending on the year of completion of the building, whether it belongs to private or commercial assets and on the purpose of any leases, the annual deductible depreciation is between 2% to 3% of the purchase and construction costs of the building.

In the case of major investments financed by borrowing, the 2008 Company Tax Reform introduced the so-called 'interest stripping rule', which provides that the interest expense of a business is deductible only to the extent of interest income or up to 30% of EBITDA (earnings before interest, taxes, depreciation and amortisation). Interest expense that cannot be deducted in the assessment period may be carried forward to the following assessment periods and increases interest expense for those periods. The Act provides an exception when interest expense, less interest income, is less than EUR 3 million in a financial year. The unused amount of the deduction (30% of EBITDA) is carried forward and can be used in the following five years. Real property investments, traditionally financed by borrowing, are particularly affected by the rule.

The interest stripping rule is not applicable to natural persons and asset management partnerships because these are not regarded as carrying on a business under tax law.

Foreign investors not operating via a corporate vehicle must file a non-resident income tax return in respect of their German real property income.

Tax rates in Germany are progressive. The highest income tax rate is 42% plus a 5.5% solidarity surcharge on the income tax. The highest income tax rate is further increased by 3% for taxable incomes over EUR 250 000. Rental losses from real property can be carried forward indefinitely. A limited loss carry-back to the prior year is possible.

The rental income of a company from real property is subject to corporate income tax rather than income tax. German companies determine profits using a business-asset comparison. The interest stripping rule also applies to corporate income tax. The rental profits of a company from real property are currently subject to a tax of 15% plus 5.5% solidarity surcharge on the corporate tax, for a total effective rate of 15.825%.

b) Property Tax

Real property including the underlying land and any buildings thereon are subject to a property tax *(Grundsteuer)*. Property tax is a local tax, levied by local authorities.

Property tax is charged on the so-called assessed value *(Einheitswert)* of the land, which is normally less than the market value. The tax rate varies according to the local authority concerned.

If the owner lets the property, he is entitled to transfer the liability for the tax in full to the tenants. This requires a corresponding provision in the lease agreement.

c) Value Added Tax

Letting or leasing of real property is not subject to VAT. An option to tax exists where the tenant is an enterprise and makes almost exclusively taxable supplies.

d) Other Taxes

The income of businesses is also liable to trade tax *(Gewerbesteuer)*. Private individuals and asset management partnerships holding real property otherwise than as an asset of the business and whose activities are not classified as dealing in real property are not considered to be carrying on a business and thus their income is not subject to trade tax.

Foreign companies are not subject to trade tax provided that they do not have business premises in Germany. Companies that exclusively manage and use their own real property or such property and their capital assets can apply to have their assessment for trade tax purposes reduced by the income attributable to the management and use of the real property (this is the so-called 'extended abatement' – *erweiterte Kürzung)*. Property companies that engage in long-term ownership of their real property are exempt from trade tax even if potentially liable to it because of their legal form (e.g. GmbH).

Warning:
If certain equipment or appliances (e.g. loading ramps) are rented out along with the property, the trade tax exemption may not apply.

Trade tax is based on profit as determined for income tax or corporate tax purposes, subject to some adjustments. The rate of trade tax varies according to the local authority concerned. Based on an average local multiplier *(Hebesatz)* of 400%, which varies from one local authority area to another, however, the trade tax burden amounts to 14% or so of taxable profits. Trade tax is no longer a deductible expense for the purposes of corporate income tax.

3. Transfer of Real Property

a) Disposal of Real Property

Profits from the disposal of domestic real property that forms part of the private assets of the vendor and which is sold within ten years of purchase is treated as income subject to limited taxation. The same applies to disposal of an interest in a property management partnership.

If real property or an interest in a property management partnership is sold after ten years, the profit is tax-free in Germany.

If the disposal of real property goes beyond the private management of assets and takes the form of dealing in land, the resulting profits are taxable as business income subject to limited taxation.

It is generally assumed that dealing in land takes place when more than three items of real property are sold within a five-year period. Legal precedent on commercial real property activities is complex and each case must be analysed individually.

In the event that dealing in land is established, all property for sale is classified as a current asset independent of the types of lease. Consequently, no depreciation may be taken. The capital gain from the disposal will be liable to income tax or corporate tax and to trade tax. In the case of foreign businesses, however, trade tax is charged only where there are business premises in Germany. It should be noted that real property as such does not usually qualify as business premises.

b) Disposal of Shares in Property Companies

The capital gain from the sale of shares in a company is, in accordance with the so-called 'partial income regime' *(Teileinkünftverfahren)*, liable to personal income tax to the extent of 60% only. The remaining 40% of the gain is tax-exempt. This applies in cases where the shares are held as private assets and the taxpayer has held at least 1% of the share capital directly or indirectly at any time in the previous five years.

Where the interest held is and was less than 1%, the so-called 'final withholding tax' is applied. The capital gain is subject to a flat tax of 25% plus solidarity surcharge, amounting to a total of 26.4%.

If an interest is sold in an asset management partnership owning real property, this is treated as a sale of real property. If the sale takes place within the ten-year period mentioned above, the capital gain is taxable (see paragraph 3(a) above).

c) Gift and Inheritance Tax

A gift and inheritance tax *(Erbschafts- und Schenkungssteuer)* applies on the acquisition of assets *mortis causa* (typically by way of inheritance) as well as on *inter vivos* gifts including the transfer of assets without consideration in anticipation of inheritance.

Even where all parties are non-resident, the transfer of domestic assets through gift or inheritance is subject to a limited gift and inheritance tax in Germany. Domestic assets include not only real property but also interests in asset management partnerships that hold domestic real property. The amended Inheritance Tax Act of 1 January 2009 altered the method of valuation of assets subject to gift or inheritance tax. The tax base for real property now approaches its market value.

A progressive tax rate is applied. Depending on the personal relationship of the transferee to the transferor (testator or donor) and the taxable amount, the tax rate can be as high as 50%. For persons within Class I, in particular children and spouses, the tax rate is limited to 30%. However, the highest tax rate is applied only upon the transfer of assets in excess of EUR 26 million. Lower tax rates are applied to transfers of smaller value. Under certain circumstances, family homes can be transferred tax free. Tax reliefs may in certain cases be applicable for residential property, but not for real property held as a business asset.

Where unlimited liability to inheritance tax applies (see below), all assets are subject to German inheritance tax. This is the case even where the assets are located in a different country. Unlimited liability to inheritance tax applies when either the transferor or the transferee is resident in Germany at the time of the transfer. Even the regular use of a holiday home over a period of time that exceeds the typical holiday may cause the individual concerned to acquire residence status in Germany and thus lead to unlimited taxation.

This may not necessarily be disadvantageous because significantly higher exemptions are available in cases of unlimited inheritance or gift tax. In cases where real property located in Germany is a significant part of the estate, especially in the case of smaller estates, it may be advantageous to establish residence in Germany.

4. Avoidance of Double Taxation

The tax legislation of countries involved in a cross-border investment is often similar, resulting in overlapping and double taxation. Double taxation is partially avoided through bilateral agreements between states and to some degree through the domestic law of the countries involved. Nevertheless, double taxation cannot be avoided in all cases.

a) Income Tax

In accordance with German double taxation treaties (DTTs), income from real property is subject to the *situs* principle, with the result that income is taxed in the country where the real property is situated. Thus Germany has the right of taxation for income derived from German real property. The same applies to income or gains from the disposal of German real property.

In contrast, capital gains from the sale of shares in companies holding German real property may be taxed only in the state of residence of the vendor, under the DTTs with Austria, France, Italy and Switzerland.

If Germany has the right of taxation for the abovementioned income, the country of residence has the duty to prevent double taxation. This is provided in accordance with the provisions of the DTT by an exemption (tax-free in the country of residence), or by crediting the tax paid in Germany against the tax liability in the country of residence.

b) Gift and Inheritance Tax

Germany has concluded very few DTTs for gift

and inheritance tax. Currently, there is a DTT in force with France, Denmark, Greece, Sweden, the United States and Switzerland only. In those treaties, the *situs* principle also applies to real property, meaning Germany has the right of taxation over real property located in Germany even where the taxpayer is resident in the other state. The state of residence of the transferor must, in response, credit the tax paid in Germany against its own gift or inheritance tax.

In the event that there is no DTT, a review is necessary to determine whether or not the law of the country of residence grants a credit for the German gift and inheritance tax against its own tax.

2. Austria

1. Acquisition of Real Property in Austria

a) Legal Framework

The acquisition of Austrian real property must be carried out strictly in accordance with Austrian law, and there is no possibility of doing so pursuant to the law of any other country. The most common real property transaction is the purchase of land, in respect of which the deed of sale must be authenticated by a notary public. The purchase of an Austrian property can be considered as taking place in two stages. Both title and procedure must be considered.

a) There must be a binding transfer of title (e.g. by deed of sale or deed of gift)

b) The acquisition of ownership occurs only once the procedure is carried out. In the case of real property, the procedure is entry in the land register *(Grundbuch)*

Registration as owner in the land register requires a document bearing the signatures of the contracting parties attested by a court or notary. It is not necessary for the deed of sale always to be drafted by a notary.

Deathbed gifts, gifts without a transfer and deeds of sale between spouses must be notarised.

Generally both natural persons and legal persons may be registered as owners of real property in Austria. A civil-law partnership *(Gesellschaft bürgerlichen Rechts)* is subject to special treatment. It cannot be registered under its own name; only the names of the partners can be entered in the land register.

A company incorporated under foreign law may purchase land in Austria and be registered as owner in the land register.

Under the Acquisition of Land by Foreign Nationals Act *(Ausländergrunderwerbsgesetz)*, a permit is needed for registration in the land register of foreign nationals and companies in which the majority shareholding is held by foreign nationals.

b) Real Property Transfer Tax / Other Acquisition Costs

In Austria acquisition of real property is subject to real property transfer tax *(Grunderwerbssteuer)*. Insofar as the real property belongs to a partnership or company as part of its assets, qualifying transfers of shares or partnership interests are also subject to real property transfer tax.

In the case of a partnership or company, direct or indirect consolidation of shares in the hands of a single party is likewise subject to real property transfer tax, as is the transfer of 100% of the shares to a new shareholder.

Furthermore, the contribution of real property to a company by way of subscription for shares is also subject to real property transfer tax.

Exemptions from liability to real property transfer tax exist in particular for acquisitions of agricultural and forestry land, and for acquisition of land *mortis causa* or by lifetime gift.

The concept of land for the purposes of real property transfer tax differs considerably from the definition of land in civil law. The term land in the sense of the real property transfer tax covers also heritable building rights, ownership and joint ownership of apartments, buildings on land belonging to another party and land-use rights.

The basis of assessment for real property transfer tax is essentially the value of the consideration paid, so that in addition to the purchase price all other expenditure such as surveying and development costs, land charges and assumption of estate agent's costs or of other liabilities of the vendor are also included.

The change of legal form of an entity is with a few exceptions exempt from real property transfer tax.

The tax rate is normally 3.5%. For acquisitions between close relatives the rate is 2%.

Persons liable to pay the tax are as a rule those who are party to the transaction. For transactions

by way of transfers of shares in companies, the company is liable to pay the real property transfer tax.

c) Value Added Tax

The sale of land, even by a business, is generally exempt from VAT in Austria.

However, the vendor has under certain conditions the opportunity to opt for taxation and to waive exemption. This will generally be the case where the vendor has within the ten years preceding the sale borne acquisition or construction costs that were subject to VAT on which he has claimed deduction of input tax, since otherwise he would be obliged partially to refund the input tax deducted.

The applicable VAT rate is currently 20%.

d) Acquisition of a Property Company

In order to have a choice in the case of a disposal between disposing of the real property itself and disposing instead of shares in a company holding the property, many investors interpose a company ('a property company') or a partnership between themselves and the real property. Where during the course of an acquisition, all the shares become consolidated into the hand of a single person, then real property transfer tax is payable. The tax is of course chargeable only on the value of the real property, and not on the purchase price of the shares.

2. Current taxation

a) Delimitation of Taxing Rights

Income earned from a property located in Austria is subject to tax in Austria.

Here it makes no difference whether an investor holds the land in his own name or through a property company. Regardless of this, in most countries the so-called 'worldwide income principle' applies to the investor, according to which income earned abroad is also taxable in the country of residence.

b) Income Tax

Income from letting real property derived by a natural person in his or her own name or as a partner in a partnership is subject to income tax in Austria. In the case of natural persons and asset management partnerships, taxable income is the excess of income over the associated costs.

Where a partnership that carries on a business is involved, rental income is included in income of the business and the taxable profit is determined by business-asset comparison. This applies also to all foreign investors irrespective of their legal form. Independent of the method of determination of profits, all operating costs such as loan interest are to be deducted from the gross rental income (rents plus operating costs).

Austria at present has no restriction on the deduction of interest expense.

Deductions for depreciation can also reduce taxable income. Since depreciation is allowed only in respect of buildings and not the underlying land, acquisition and construction costs must be apportioned between buildings and land. The tax authorities have not developed any standard methodology for this apportionment. The apportionment must therefore be carried out in the ratio of the market values. The reasonableness of this approach can be supported with an expert opinion.

For buildings that are part of operating assets and directly serve the purposes of the business, the annual depreciation can be up to 3%. For buildings intended for letting, without proof of actual period of expected useful life, annually 1.5% of the basis of assessment is taken as depreciation. For buildings constructed before 1915, a depreciation rate of 2% is also permitted without a valuation.

For buildings meant for residential purposes, maintenance expenses must be differentiated between those for maintenance and those for repairs. Maintenance expenses due every year may be written off immediately. Maintenance expenses not falling due every year can on request be spread over ten years.

Deductions for repairs must be spread over ten years.

All expenses incurred within three years of purchase of a building in neglected condition are considered to be part of the acquisition costs of the building and can be depreciated in combination with the acquisition costs. This does not apply to buildings the rent on which is protected.

Foreign investors have to file a tax return in respect of rental income of the previous calendar year, if that income has amounted to more than EUR 2000.

The tax rates are the same as those applicable to residents. Austria has a progressive income tax structure with four tax bands.

The marginal tax rates are zero for the first EUR 11 000; 36.5% on the next EUR 14 000; 43.21% on the next EUR 35 000, and 50% on the excess of income over EUR 60 000.

Losses from renting cannot be carried forward and there is no tax loss carry-back in Austria.

The rental income of a company is subject to corporation tax in Austria at a rate of 25%. The determination of profits is by business-asset comparison (equivalent to accruals basis accounting).

c) Property Tax

Landholdings, i.e. land and buildings together, are subject to real property tax *(Grundsteuer)* in Austria. Real property tax is imposed by local authorities.

Property tax is assessed on the 'unit value' *(Einheitswert)* of the land, which is generally lower than the market value. The rate of tax differs from one authority to another.

The owner of a property has the right to transfer the burden of property tax in full to the tenant provided the necessary clause is included in the rental contract.

d) Value Added Tax

Letting of property for residential purposes is subject to the reduced VAT rate of 10%. Letting for other purposes is basically tax-exempt, but landlords may opt to subject rents to the standard VAT rate of 20%, in order to avail of input-tax deductions.

Proceeds from disposal of land are tax-exempt. Again an option to waive exemption exists.

The option to waive exemption would be of interest where input-tax deductions for new buildings or extensive restorations can be availed of. Without this option the vendor would otherwise face a proportionate adjustment of the deducted input tax over a ten-year period.

3. Disposal of real property

a) Private Disposals

Capital gains from the disposal of domestic real property that is a private asset of the vendor and is sold within a period of 10 years after the conclusion of the notarised deed of sale (i.e. within 10 years of acquisition), are deemed to be 'speculative' profits and are subject to income tax as miscellaneous income. The taxable period extends to 15 years, if within 10 years of acquisition construction costs were deducted in instalments.

Speculative profits are exempt from tax, if the property is owner-occupied and has, since its acquisition (or gratis transfer between living persons) served for at least for two years as the vendor's main residence.

In the case of acquisition *mortis causa* the periods of ownership are counted together.

b) Dealing in Land

Insofar as the disposal of real property goes beyond the private management of assets, the profits earned from the disposal are taxed as income from property dealing.

Property dealing is considered to be present where the criteria of section 23 of the Income Tax Act *(Einkommensteuergesetz)* are satisfied. Austrian law has not adopted the German 'Three Object Test' as a criterion. In fact in Austria, the circumstances of each individual case must be considered separately. General statements on the required scope for the existence of property dealing are hard to find. Even the sale of only two pieces of land can under certain circumstances lead to property dealing.

If property dealing is confirmed, all objects intended for disposal become operating assets and thus current assets, regardless of whether they are let. Consequently, no depreciation can be claimed.

The profits from disposal of land are subject to income or corporation tax.

c) Commercial Disposals

There are no special rules regarding the taxation of profits from disposals of real property belonging to a business. Exemption for disposals after ten years of ownership, as in the case of natural persons, does not exist for businesses. The profits are regarded as income from commercial activities and are subject to income or corporation tax.

In Austria, in determining the income of natural persons, allocation of dormant reserves to a reserve fund is allowed. The land or building disposed of must, however, have belonged to the business for at least seven years as a fixed asset. In special cases, a 15-year period is in point.

d) Non-Resident Property Owners

Non-resident owners of real property located in Austria are liable to comprehensive tax liability in Austria on both their income from the property and on the proceeds of disposal.

According to most double taxation agreements that Austria has concluded, the capital gains from disposal of shares of companies holding Austrian real property are taxable in Austria.

4. Avoidance of Double Taxation

For avoidance of double taxation Austria has concluded bilateral double taxation agreements with numerous countries, under which the right to tax income from immovable property is exclusively assigned to the country in which the property is located. The country of residence generally reserves the right to take this foreign income into account when computing its own income tax. This rule conforms to the OECD Model Treaty and is used by most countries.

3. Switzerland

1. Acquisition of Real Property in Switzerland

a) Legal Framework

The direct acquisition of real property located in Switzerland may be carried out in accordance with Swiss law only. The most frequent form of transaction in real property is the purchase of land. The deed of sale must be certified by a notary.

For a valid transfer of title, registration of the acquirer in the Land Register *(Grundbuch)* is strictly necessary. In principle, natural persons, partnerships (general partnerships and limited partnerships) and legal persons (AGs, GmbHs and cooperatives) may all be registered as owners in the Land Register. A company incorporated under foreign law may also acquire real property in Switzerland and be registered in the Land Register.

Indirect acquisition of real property, i.e. the acquisition of shares in a company that owns real property in Switzerland, may also be carried out under a different legal mechanism. This also applies to the situation where the company has its legal seat *(Sitz)* in Switzerland. Under this mechanism, the purchaser acquires the real property only indirectly, whereas the formal owner does not change under this process.

b) Acquisition of Swiss Real Property by a Person Located Abroad

Acquisition by a person located abroad of real property in Switzerland is under certain circumstances subject to approval.

Nationals of EU Member States who are legally and actually resident in Switzerland are not regarded as persons located abroad and may acquire any kind of real property for their own or for third-party use. They have the same rights in this respect as Swiss citizens.

As far as acquisition of real property is concerned, nationals of EU Member States who do not have their main residence in Switzerland (including frontier workers, but only within their particular district) have (provided that they have Swiss residence permits) the same rights as Swiss citizens only as respects the acquisition of real property to serve as business premises. The acquisition by them of second homes or holiday homes requires approval. Such approval is as a rule given only very sparingly.

Further restrictions (partly also as regards the acquisition of shares in property companies) apply to foreigners who are not EU nationals. These restrictions depend on the purchaser's place of abode, the purpose to which the real property is to be put and the reason for the acquisition. In all cases, the legal status of the would-be acquirer must first be ascertained exactly before any acquisition of Swiss real property may take place.

c) Real Property Transfer Tax/ Other Costs of Acquisition

The acquisition of title to land in Switzerland is subject to tax on the transfer of ownership *(Handänderungssteuer)*. This is a tax not on the profit from land but on the change of ownership as such. In Switzerland, the tax is levied not by the Confederation (federal government) but by the cantons and/or communes. It is variously described in cantonal tax legislation as a 'tax' *(Steuer)*, 'duty' *(Abgabe)* or 'charge' *(Gebühr)*. In most cantons, however, it is charged in addition to a land registration charge (as a rule, as a few tenths of 1% of the purchase price). In the canton of Zürich, the tax has been completely abolished.

The tax is charged on the purchase price inclusive of all other acquisition costs. As a rule, it is borne by the purchaser. Rates differ widely between cantons, between 0.2% and 3.3% of the purchase price.

c) Value Added Tax

The purchase or sale of real property is in principle exempt from VAT in Switzerland. Under certain circumstances, however, the person disposing of the property may opt to tax the transaction and thereby waive exemption. In such cases, the rate of VAT is currently 7.6% of the purchase price.

d) Acquisition of a Property Company

The acquisition of shares in a company the assets of which predominantly consist of real property (a so-called 'property company') is subject to real property transfer tax (*Handänderungssteuer* – see above) only where a majority holding is acquired (a so-called economic transfer of ownership – *wirtschaftliche Handänderung*). The acquisition of a minority holding is not subject to the transfer tax, even where the acquirer thereby acquires a majority interest.

2. Current taxation

a) Income Tax / Profits Tax

Income from the letting or renting of real property is subject in Switzerland to income tax (in the case of natural persons) or profits tax (in the case of legal persons). Both the Confederation and the cantons apply the same rules. The income from property of natural or legal persons resident in Switzerland is taxed together with other income and gains. Property owners resident abroad must file a tax return as persons subject to limited tax liability in respect of their property income of the previous year.

Under Swiss tax legislation, the rental value *(Mietwert)* of the owner-occupied property (including holiday homes) of natural persons is a taxable object. As a rule, this rental value is computed by reference to the amount of rent that would be demanded from a third party by the landlord and be payable by the tenant (the so-called 'standard rent' – *Vergleichsmiete*).

Loan interest is generally deductible in full from both rent actually received and from rental value in the case of owner-occupiers, as are property costs (in part). Relevant property costs are treated differently depending on whether they are property maintenance costs or expenditure that increases the value of the property. Whereas expenditure that preserves the value of the property is fully deductible, expenditure that increases the value of the property is not deductible from taxable income. However, improvement expenditure can be taken into account on the disposal of the property. The dividing line between improvement expenditure and maintenance costs is not always clear in practice and often leads to 'discussions' between taxpayers and the tax authorities.

Depreciation is deductible from taxable profits in the case of legal persons but is deductible from the taxable income of natural persons only in the case of business property (where those persons carry on an independent business). The rate of depreciation recognised for tax purposes depends on the nature and use of the real property, e.g. 2% in the case of residential property as a business asset, and 8% in the case of factory premises.

Income tax is levied at progressive rates in all cantons and differs greatly in amount from canton to canton. Tax rates are applied to the worldwide income of the relevant person, as a result of which, therefore, rental income is taxable as part of total income.

Rates of income tax vary between 10% and 40%.

Tax rates for profits tax on legal persons and for wealth tax (natural persons) and capital duty (legal persons) are linear (flat) in most cantons. Where they are not, it is the world-wide income, worldwide wealth or worldwide capital that is taken into account when determining the appropriate rate of tax.

Profits tax rates vary between 16% and 33%.

Wealth tax rates vary between 0.15% and 0.85%; capital duty between 0.001% and 0.5%.

b) Property Taxes

A so-called 'land holdings tax' *(Liegenschaftssteuer)* is levied in addition to wealth tax and/or capital duty in about one-half of all cantons. The Confederation does not levy any land holdings taxes.

Land holdings tax is charged on the so-called 'tax value' *(Steuerwert)* of real property and varies between cantons in the range 0.05% and 0.3%.

Some cantons charge a minimum tax on the land

held by legal persons. This tax is charged only where it would exceed the normal profits tax and capital duty and in such a case is charged in place of these other taxes. Only businesses that earn no or minimal profits are likely to be subject to this tax.

The minimum tax varies from canton to canton subject to a maximum of 0.2% of the value of the land holding.

c) Value Added Tax

The renting and letting of real property is in principle exempt from VAT. An option to waive exemption is available where the landlord or lessor is a business and makes almost exclusively taxable supplies.

3. The Transfer of Real Property

a) Disposal of Real Property

aa) Land Profits Tax

In Switzerland, the disposal of real property is subject to land profits tax *(Grundstückgewinnsteuer)*.

The taxation of profits (gains) from real property is subject to considerably different rules in the Confederation and the 26 cantons. The Confederation does not charge a separate tax on profits or gains from real property but charges income tax or profits tax solely on gains from property forming part of business assets. Gains from private property are expressly exempt from direct federal tax.

The cantons also differentiate between business real property and private real property. Profits from business real property are subject in most cantons to normal income tax or profits tax. In certain cantons, gains from business real property are subject to a separate land profits tax. The same applies to gains from private real property in all cantons. Gains from real property are taxable in the commune or canton in which the real property is situated.

It is always the person making the disposal who is taxable. Where an economic transfer takes place, the person subject to tax is the person who transfers the power to dispose over real property for monetary consideration. Relief from tax on property gains is available in certain cases (e.g. acquisition of land by inheritance or by an *inter vivos* gift).

Tax is charged on every gain from the disposal of real property. It is the net gain realised on the transfer of ownership over real property that is taxable. The net gain is calculated by determining the difference between the original cost (the purchase price plus improvement expenditure) and the sale price.

To the extent that gains from real property are subject to taxation, these gains can be set off by losses from real property. Where gains from real property are subject to a separate tax, however, a set-off of losses is generally not available, as the land profits tax is in such cases a property tax. Some cantons do, however, allow losses from real property to be set off.

In most cantons, the rate of tax depends on two factors, namely the amount of the gain and the period of ownership. Rates may be either flat or progressive and may reach a maximum of 40%, depending on the particular canton. Mostly, short-term gains are subject to surcharges, whereas long-term gains are usually privileged.

bb) Dealing in Land

To the extent that disposals of land go beyond the mere management of private property, the gains so derived become taxable as income from an independent business of land dealing.

Dealing in land will be presumed where real property is traded continuously, in a concerted fashion and with a view to profit. It can arise from frequent purchases and sales of real property, and from reinvestment of the disposal proceeds in new real property. The fact that purchased property is altered or renovated before further disposal is also indicative of a business-like approach.

The characterisation of property sales as commercial dealing in land has the result

that gains also become subject to taxation at the federal level and liable to social security contributions.

b) Disposal of a Property Company

The transfer of share certificates in a company the assets of which consist predominantly of real property (a so-called 'property company') is subject to land profits tax only where a majority holding is disposed of (a so-called 'economic transfer of ownership' – *wirtschaftliche Handänderung*). The transfer of a minority holding is not subject to land profits tax, even where the acquirer of the minority holding thereby acquires a majority holding.

c) Gift and Inheritance Tax

Where real property is acquired by gift or by inheritance (*mortis causa*), the gain is exempt from tax, i.e. tax first becomes chargeable on the next transfer of ownership. The period of ownership for the purposes of the tax is computed without reference to the transfer of ownership by gift or inheritance.

In Switzerland, gift and inheritance taxes are levied solely at the cantonal level. Exceptions are Schwyz, which levies neither gift tax nor inheritance tax, and Lucerne, which does not levy gift tax.

The taxable event for gift and inheritance taxes is the acquisition *mortis causa* (usually by inheritance) or by *inter vivos* gift; as is, *inter alia*, a transfer of property without consideration by the potential beneficiary.

The transfer of real property located in Switzerland is also subject to inheritance or gift tax where all the parties involved are resident abroad, namely in the canton in which the real property is located.

The rate of tax is progressive in all cantons. Depending on the personal relationship between the transferee (heir or donee) and the transferor (testator or donor) and the taxable amount (transfer value – *Verkehrswert*), the rate can be as high as 50%.

Transfers between husband and wife (whether *mortis causa* or *inter vivos*) and to direct descendants are exempt in all cantons, as are transfers to parents in some cantons.

4. Avoidance of Double Taxation

a) Income Tax

Switzerland has concluded double tax treaties (DTTs) for the avoidance of double taxation with a great number of countries. In these DTTs, the taxing rights over income from immovable property, including rental and letting income, are conferred on the state in which the real property is located (the *situs* state). As a rule, the state of residence reserves to itself the right to take account of this foreign income in determining the rate of tax (so-called 'exemption with progression'). This method is in line with the OECD Model Treaty and is applied by most countries.

Gains from the sale of shares in companies with real property located in Switzerland are, under the DTTs with Germany, Austria and Italy, taxable solely in the state of residence of the disponer.

To the extent that Switzerland as the source state has taxing rights over the income referred to above (e.g. vis à vis France), the state of residence must prevent double taxation. According to the particular DTT, this is achieved either by exemption (no taxation of the relevant income in the state of residence) or by crediting the tax paid in Switzerland against the liability to tax in that state).

b) Gift and Inheritance Tax

To date, Switzerland has concluded double estate tax (gift and inheritance tax) treaties with Germany, Austria, Denmark, Finland, France, the United Kingdom, Norway, the Netherlands, Sweden and the United States. Under these DTTs, the *situs* principle applies likewise. That is to say, it is Switzerland that has the taxing rights over the Swiss real property of a taxpayer resident abroad. The testator's or donor's state of residence must set the tax paid in Switzerland against its own inheritance or gift tax.

Where in a particular case, there is no DTT, it must be determined whether the domestic law of the state of residence provides for a credit for the Swiss inheritance or gift tax against the taxes payable in that state.

4. Italy

1. Acquisition of Real Property in Italy

a) Legal Framework

The acquisition of Italian real property must be carried out strictly in accordance with Italian law, and there is no possibility of doing so pursuant to the law of any other country. The most common real property transaction is the purchase of land, in respect of which the deed of sale must be authenticated by a notary public.

In the Regions of Trentino-Alto Adige and Friuli-Venezia-Giulia a transfer of title must be recorded in the land register (*libro fondiario*) in order to be effective. In principle, all foreign natural persons and legal persons (even those having only partial legal capacity, such as partnerships) are entitled to apply for registration in the land register.

In all other Italian regions, by contrast, the transfer of title to real property is effected on conclusion of the deed of sale. Nevertheless, for the validity of such a transfer to be upheld against any third party, it is absolutely necessary for the name of the acquirer to be entered in the so-called Public Real Property Records Office (*conservatoria dei registri immobiliari*). In principle, all foreign natural persons and legal persons (even those having only partial legal capacity, such as partnerships) are entitled to be registered as owners.

b) Acquisition Costs

ba) Transfer Charges (Registration, Mortgage and Cadastral Duties)

In Italy, on an acquisition of real property, transfer duties (registration, mortgage and cadastral duties) and/or VAT fall due. Should VAT be applicable, than a fixed registration duty of EUR 168 will apply, whereas where the transaction is exempt from VAT, registration duty will be due on a proportional basis.

Where a building plot is acquired from a company as vendor, transfer duties of EUR 504 will apply; whereas where a building plot is purchased from a private individual, the transfer duties are 11% in total. Acquisitions of agricultural land are subject to transfer duties of 18% in all.

The acquisition of residential properties from a company as vendor is subject to transfer duties of EUR 504; whereas transfer duties of 10% in total would apply to an acquisition from a private individual. However, if the property is to be used as the purchaser's principal residence in Italy there is a measure of relief, in that the registration duty is reduced to 3% and the mortgage and cadastral duties to a fixed amount of EUR 336 in total. Where commercial property is the subject of the acquisition, there is generally a fixed registration duty of EUR 168 and mortgage and cadastral duties amounting to 4%.

The taxable base for the transfer duties (registration, mortgage and cadastral duties) in connection with the acquisition of real property is generally the purchase price agreed in the deed of sale. However, it should be noted that if the agreed purchase price of the property is lower than its market value (*valore venale*), it is the market value on which the duties will be based, unless the taxpayer is able to demonstrate that the purchase price agreed in the deed of sale is justified by objective criteria (e.g. location or condition of the property).

It is exclusively in the event of a sale of residential property to a private individual that the taxable base for the transfer charges is the cadastral value (i.e. a fictional transactional value of the property based on officially determined coefficients); this value is normally considerably lower than the market value of the property.

In addition to the transfer duties mentioned above, there are also notarial fees and costs related to making the appropriate entry in the land register, for an overall amount of approximately 1.5%-2% of the purchase price. If an estate agent is involved, there will also be the agent's fees.

bb) Value Added Tax

Where building land is purchased from a company, the transaction will be subject to VAT at the standard rate of 20%, whereas, where the

vendor is a private individual no VAT will apply. The sale of agricultural property is not subject to VAT.

The acquisition of residential property from a company is subject to a reduced rate of VAT of 10% (reduced further to 4% where the property is to be used by the purchaser as his or her main place of residence in Italy); where the vendor is a private individual no VAT will apply. The acquisition of business property is subject to VAT of 10% (repurchase) or 20% (in all other cases).

The taxable base for VAT is generally the price agreed in the deed of sale.

c) Acquisition of Property Companies

In principle, as an alternative to the direct purchase of real property, an indirect acquisition through the medium of a company or partnership is possible.

In the event that the purchase is effected by a newly incorporated company that subsequently acquires the property (a so-called 'asset deal') the same transfer duties (registration, mortgage and cadastral duties) would apply as in the case of a direct purchase. Where the real property is held as a business asset by a business or a branch of a business that is being acquired, the registration duty would be charged on the net value of all the purchased branch assets (i.e. value of the real property less the related liabilities).

In the event that the newly incorporated company receives the real property as a contribution in kind, the same transfer duties (registration, mortgage and cadastral duties) would apply as in the case of a direct purchase. Where the real property is held as a business asset by a business or a branch of a business that is being contributed, than a fixed amount of registration, mortgage and cadastral duties of EUR 168 would be applicable.

The purchase of shares in a company holding the real property (a so-called 'share deal') is subject only to a fixed registration duty of EUR 168; no mortgage or cadastral duties are due.

2. Current taxation

a) Income Tax

Rental income deriving from real property owned by private individuals is subject to income tax (IRPEF – *Imposta sul reddito delle persone fisiche*). It should be noted that income tax will be due where the property is not rented out (an owner-occupation charge exists).

Where the property is not let, income tax is charged on an imputed income equal to the cadastral rent (*rendita catastale*), which is a theoretical rental income determined on the basis of an officially established arbitrary value put on the use of the property. Where the property concerned is the main residence of the owner, no taxation at all will apply, because a deduction equal to the cadastral rent is granted.

Where the property is let, the taxable income is the greater of (a) the cadastral rent and (b) the actual rental income obtained, reduced by 15%. Normally, the actual rental income, even though reduced by 15%, exceeds the cadastral rent).

No other tax deduction for expenses in connection with the property, apart from the fixed 15% reduction, can be claimed. However, an exception is made where a mortgage loan has been obtained in order to finance the purchase of the property, in which case 19% of the interest paid is deductible as a credit from the income tax due, up to a maximum deductible amount of EUR 3615.20.

Rental income derived by an individual as a partner in a partnership is subject at the partnership level to IRAP (*Imposta regionale sulle attività produttive*), or the regional tax on production, whereas for income tax purposes the partnership is considered a 'flow-through' entity and therefore the lease income (or rather, the allocated partnership income) is liable to income tax (IRPEF).

IRPEF is levied at a progressive rate on the total income of each taxpayer. The progressive tax rate for private individuals starts at 23% (for taxable income up to EUR 15 000) and reaches 43% for that part of taxable income

in excess of EUR 75 000.

Rental income from real property held through a company is subject to corporate income tax (IRES – *Imposta sul reddito delle società*), as well as to IRAP. IRAP normally varies between a minimum of 2.98% and a maximum of 39%, and it should be noted that interest payable is not deductible for IRAP purposes. The rate of IRES is 27.5%.

The determination of the taxable income in partnerships and companies is generally performed in accordance with the normal rules concerning the determination of taxable income, namely by computing the difference between income (rents, recharged business costs etc) and deductible expenses (property management costs, maintenance costs, depreciation, interest expense etc).

Where the business of the company or partnership is property management, its taxable rental income is the greater of (a) the cadastral rent and (b) the rental income less actual documented expenses, subject nevertheless to a maximum 15% of rental income. No other cost (e.g. property management costs, depreciation, interest expense etc) may be deducted.

After the corporate tax reform of 2007, an interest-expense limitation exists for companies. As a consequence, interest expense exceeding interest income is deductible only to the extent that it does not exceed 30% of EBITDA (earnings before interest, taxes, depreciation and amortisation). Any excess may be carried forward to the next tax year and increases the amount of interest expense in such year.

It has, however, been clarified that the interest limitation rule does not apply in respect of interest payable on mortgage loans taken by property management companies on properties that are let. In such cases, interest expense is deductible without limitation.

The corporate tax reform of 2007 also tightened the regulations concerning so-called 'shell companies' (or rather, companies that are regarded as only apparently carrying on a commercial activity). Where such companies do not derive income greater than a certain percentage of turnover (basically, 4% in respect of dwellings, 5% on office premises and 6% in respect of all other types of properties), they are liable to tax on a lump-sum basis, regardless of the actual taxable profit (or loss).

b) Property Taxes

Agricultural properties, building land and buildings – regardless whether they are of commercial or residential nature – are subject to a property tax (ICI – *Imposta comunale sugli immobili*). Agricultural properties in mountainous areas are exempted.

The tax is charged on a formulaic market value of the property, determined by applying a multiplication factor to the cadastral rent. The tax rate varies according to the local authority area, from a minimum of 0.4% to a maximum of 0.7%.

c) Value Added Tax

The letting of real property is subject or to VAT or, alternatively, to registration duty.

The letting of building land is subject to VAT of 20% where the lessor is a business; in all other cases no VAT will be due. The letting of agricultural properties is never subject to VAT.

The letting of commercial or residential property is generally exempt from VAT, but in the case of commercial properties let by a company or partnership, the lessor may opt to waive exemption.

d) Other Taxes

The letting of building land is not subject to any registration duty where the lessor is a business, whereas in all other cases a registration duty of 2% will apply. On the lease of agricultural property a registration tax of 0.5% applies. The taxable base for the registration duty is the contractually agreed annual rent.

The letting of commercial or residential property is always subject to registration duty varying between 1% and 2%. Here also, the duty is charged on the contractually agreed rent.

3. Transfer of Real Property

a) Disposal of Real Property

Where Italian real property is directly held by a private individual, the capital gain from the disposal of building land (without exception) and from the disposal of buildings and agricultural property (if the property is sold before five full years of ownership) is classified as 'miscellaneous other income' and included in the taxpayer's total income subject to income tax. However, a private individual may instead opt for an alternative method of taxation, whereby a flat 20% tax is applied to the capital gain.

For property dealing companies, taxable income in Italy is generally computed under the rules generally applicable to taxable income, namely by finding the difference between income or gains and deductible expenses (personnel costs, administrative costs, other operating costs, interest expense etc).

For property dealing companies, all the property held for disposal has to be classified as current assets in the balance sheet. Consequently, on these no depreciation can be applied. Corporate income tax (IRES) and regional production tax (IRAP) will be due.

Income from an Italian property dealing partnership is included in the taxable income of the individual partner, as are dividends from a property dealing company in the case of an individual shareholder.

b) Disposal of Property Companies

Where a private individual holds real property through a participation in an Italian company, the capital gain from the sale of a participation in the company is taxed in Italy as follows:

- for non-qualifying shareholdings (voting rights below 20% or shareholdings below 25% in nonlisted companies or below 2% or 5% respectively in listed companies) there is a final withholding tax of 12.5% on the capital gain
- for qualifying shareholdings (where the above limits are exceeded), 49.72% of the capital gain is subject to income tax (partial participation exemption)

Where a participation in a property management company (no matter whether residential or business property is leased) in Italy is held via a company or partnership, the partial participation exemption does not apply. Consequently, if a company or partnership disposes of a participation in a property management company in Italy, the capital gain from the sale of the participation has to be taxed as ordinary income.

c) Gift and Inheritance Tax

Gift and inheritance tax is levied on transfers of assets *mortis causa* (in general by a will) or by lifetime gift.

For the application of the gift and inheritance tax in Italy, only the residence of the transferor is relevant, and not the residence of the transferee. If the transferor is resident in Italy at the time of the transfer, all assets involved in the transfer are taxable in Italy, no matter where they may be situated. If the transferor is non-resident, then only assets situated in Italy are taxable. As a note of caution, it should be borne in mind that merely the regular use of holiday homes in Italy for a period that is longer than a regular holiday, can lead to an assumption of residence for the purposes of gift and inheritance tax.

Tax is chargeable on the market value of the assets transferred, calculated as the difference between the current market value of the assets and the associated liabilities. However, the tax is cumulative, so all gifts received by the transferee from the same transferor during the latter's lifetime are included in the taxable value of the transfer.

In the case of real and personal property, the taxable value is the current market value of the property; nevertheless it is important to point out that the Italian tax authorities cannot reassess the taxable base, if at least the cadastral value of the property has been taxed. Consequently, in practice the cadastral value of the property is used as the taxable base as it is in general significantly lower than the current market value of the property.

Where transfers of participations in a company or partnership holding real property are concerned, the taxable base for gift and inheritance tax is the book value of the transferor's equity in the company or partnership. However, in the case of transfers of shares in listed companies, the taxable base is the current market value of the shares.

Where the transfer is made to a spouse or a direct descendant or forebear, the rate of tax is 4% on the amount exceeding EUR 1 million per transferee. For transfers to siblings, the rate is 6% on the amount exceeding EUR 100 000 per transferee. In the case of transfers to any other individual, the rate is 8%, without any personal allowance. For transfers of real property, there are also mortgage and cadastral duties of 4% in total (or, in the case of a main residence, a fixed amount of EUR 336).

4. Avoidance of Double Taxation

The tax legislation of countries involved in a crossborder investment is often similar, resulting in overlapping and double taxation. Double taxation is partially avoided through bilateral agreements between states and to some degree through the domestic law of the countries involved. Nevertheless, double taxation cannot be avoided in all cases.

a) Income Tax

In order to avoid double taxation Italy has signed double taxation treaties with various countries. Under these treaties, the taxation right over income from immovable property is exclusively assigned to the state where the property is situated (the *situs* principle). The state of residence generally reserves the right to include this foreign income in computing its own income tax. This rule conforms to the OECD model convention and is applied by most countries.

On the basis of the double taxation treaties concluded by Italy, capital gains from the disposal of shares in companies holding real property are in general taxable in the state of residence of the vendor. An exception to this rule appears in e.g. the treaty with France: in this case the capital gain from the sale of shares in companies holding real property is taxed in the country where the property is located, i.e. Italy.

b) Gift and Inheritance Tax

Thus far Italy has signed relatively few agreements to avoid double taxation on inheritances and gifts. Such treaties exist with France, Denmark, Greece, Sweden, the United Kingdom, Israel and the United States only. These treaties provide that in the case of real property, the right to tax generally remains with the country where the property is located. This means that for a property situated in Italy and owned by a non-resident, gift and inheritance tax will be chargeable in Italy. The tax paid in Italy must be credited against the gift and inheritance tax charged by the country of residence. The treaty with France provides that the same principle also applies for shares in companies holding real property in Italy.

For a specific situation where there is no double taxation treaty in place, it will be necessary in each case to verify whether a unilateral credit is available

5. France

France has always been a favourite location for foreign real property investment (e.g. purchase of an apartment in Paris, a holiday home in sunny Provence or investment in one of the numerous new building projects in all major French cities).

However, a large majority of those investors seem to have paid very little attention to the potential tax implication of their investments and the related financial risks. The mere ownership of real property in France, even for personal use and with no speculative intention, is likely to induce a variety of tax liabilities.

Liability to inheritance tax is also seldom in the foreground when a property is acquired, which, in extreme cases, could leave the heirs with no alternative but to sell the property to settle the inheritance tax bill.

1. Acquisition of Real Property in France

a) Property Transfer Taxes / Other Acquisition Costs

The purchase of real property in France would as a rule generate transfer taxes at the approximate rate of 5.1% payable by the purchaser via the notary upon the registration of the transaction in the land register. Although these taxes are in principle due by the purchaser, the vendor is jointly liable for the payment vis-à-vis the tax authorities.

Additional purchase fees and costs to be borne in mind are notarial fees, estate agent's commission etc.

b) Value Added Tax

The purchase of real property in France is in principle exempt from value added tax (VAT). However, for buildings completed less than five years prior to the transfer, the transaction would be subject to VAT at the standard rate of 19.6%. As the VAT would in most cases not be deductible by or refundable to private investors, it is of the utmost importance to review whether or not VAT may apply to the transaction when assessing the potential cost of the investment.

c) Purchase of Property Companies

French tax legislation tends to look through shares held in French companies more than 50% of whose assets consist of French real property and regard those shares as real property. The transfer of shares in such property companies is subject to a transfer tax of 5%. As those shares do not qualify as real property for civil law purposes, however, the deed of sale does not need to be notarised nor does the transaction have to be registered in the land register.

2. Current Taxation

a) Income Tax

A foreign investor owning French real property may be subject to French income tax based on the rental value of the property, even when such property is not rented out (i.e. there is deemed income from owner-occupation). This rule is, however, only applicable in the absence of a tax treaty between France and the country of the investor. Investors resident in countries with which France does not have a tax treaty, such as Liechtenstein, Jersey, Guernsey, Andorra etc, should therefore pay special attention to this rule.

In most cases where the investor is resident in the European Union or in a treaty-protected country, French income tax would apply when the French property is rented out, i.e. where there is actual income.

The annual income tax return is due between March and May. For the determination of the taxable rental income, costs such as interest, insurance premiums, administrative expenses, real property taxes, renovation and maintenance costs etc. are deductible from the rental receipts. Depreciation is as a rule not admitted for tax purposes.

Losses (where the costs exceed income) may be carried forward for ten years and set off against future rental income. Those losses may under certain conditions and subject to a maximum of EUR 10 700 per year be offset against other categories of income in the current year.

Income tax rates in France are progressive and the highest rate is 40%. Non-residents are subject to a minimum tax rate of 20%.

b) Value Added Tax

The letting of furnished or unfurnished real property for private use is in general not subject to VAT. An option to waive exemption, as in the case of letting as a business, is not available. Owing to the VAT exemption, any VAT paid for renewal or other expenses cannot be refunded.

c) Wealth Tax (impôt de solidarité sur la fortune)

Non-resident individuals may be liable to French wealth tax where the net market value of their French properties (including shares in property companies) exceeds a certain amount (EUR 790 000 in 2010). Given the boom in the French property market in the last 10 years, (recording an increase in prices of more than 80%), the number of individuals liable to French wealth tax has considerably increased. For political considerations, the French government has so far refused to exempt an individual's main residence from wealth tax.

French wealth tax is calculated on the net market value, i.e. after deduction of existing liabilities (taxes, mortgage etc) related to the property. For foreign investors, financing the purchase with debt (vs. cash equity) may thus offer some tax advantages.

The split of the ownership in the French property into usufruct (*usufruit*) and bare ownership *(nue propriété)* does not bring any tax savings, as the wealth tax burden is borne by the user of the property and is be calculated on the value of the full ownership. The bare owner is exempt from wealth tax.

For a real property investment of EUR 1.5 million financed with equity (with no financing loans or other deductible liabilities), the annual wealth tax burden may be as high as EUR 4000.

Foreign investors liable to French wealth tax must file an annual wealth tax return no later than 15 July for European and 31 August for other investors. Failure to file the tax return and pay the tax due on time results in the payment of a penalty of between 10% and 40% and interest at the rate of 4.8% p.a. The limitation period is extremely long. The tax administration may audit the wealth tax status of an investor over a period of six years retroactively.

d) Tax on French Real Property Owned by Legal Entities

Legal persons irrespective of their form (companies, trusts, foundations, associations etc, and in France also partnerships) are liable to an annual 3% tax based on the fair market value of their French property. Exemption is available in most cases subject to satisfying specific filing requirements and disclosure of the details of the members of the legal entity who are natural persons to the French tax authorities.

The purpose of the specific filing requirements is mainly to target foreign individuals sheltering behind legal entities so as to avoid French wealth tax.

e) Other Taxes

The ownership of a French property may incur a liability to various other taxes, such as local property and occupation taxes *(taxe foncière and taxe d'habitation)* levied by local authorities and due annually.

Owners of properties used as office space or for commercial purposes in Paris and its surroundings are liable to a specific tax on office premises.

3. Transfer of Real Property

Depending on the purpose of the investment (personal use or letting), the investor should from the outset bear in mind the potential tax implications of a future transfer of the property (through sale, gift or a transfer upon death) and take the necessary tax planning actions.

a) Disposal of the Property

Capital gains derived by foreign private investors

from the sale of French properties are in principle subject to withholding tax at the rate of 16% for individuals resident in another EU Member State or 33.33% for non-European investors. The capital gains tax is withheld from the purchase price and paid over by the notary to the French tax administration at the time the transaction is registered. The appointment of a tax representative is required where the value of the transaction exceeds EUR 150 000 and the property has been in the vendor's ownership for less than fifteen years.

The taxable gain corresponds to the excess of the sale price over the acquisition cost. The sale price may be reduced by certain expenses paid by the vendor (agent's commission, costs for the release of mortgage or other securities, etc.). The acquisition cost may be increased by the costs borne by the vendor on purchasing the property (transfer tax, inheritance or gift tax, notarial fees etc).

The acquisition cost can in addition be increased by any renovation or construction costs, provided those expenses are evidenced with relevant documents and invoices. Where no documentation is available, renovation costs may still be estimated as a percentage of the purchase price, where the property is sold more than five years after acquisition.

The taxable gain may normally be reduced by 10% for each year of ownership starting from the sixth year, leading to a total exemption when the property has been held over a period of 15 years. For instance, the sale in 2010 of a property purchased in 1995 would not generate any capital gains tax.

The sale by EU nationals of their French home may under certain conditions be exempt from capital gains tax, where the vendor can establish that he or she has, at any time prior to the disposal been resident for tax purposes in France over a consecutive period of at least two years and has the free disposal of the home on the date of the transaction.

b) Gift and Inheritance Tax

The French inheritance tax consequences are worth considering when investing in a French property, whether the investment is for personal use or for letting. The level of French inheritance taxes is currently so high that the heirs might be obliged to sell the property to settle the inheritance tax bill.

Tax planning possibilities should already be considered at the time of the investment. For example, splitting the ownership into usufruct kept by the parents (investors) for their lifetime and bare ownership transferred by gift to the children offers some tax advantages. The transfer of the usufruct to the children upon death would not generate any additional inheritance tax.

French inheritance tax rates are progressive and range from 5% to 40% (for an estate valued at above EUR 1.8 million) for transfers in the direct line. The allowance for inheritances or gifts in the direct line amounts to EUR 156 357 per child (2009). Transfers to the surviving spouse are totally exempt from inheritance tax.

French gift tax is levied at the same progressive rates as inheritance tax. However, the amount of gift tax may be considerably reduced depending on the age of the donor: the younger the donor, the lower the tax. Gift tax may under certain conditions be reduced by up to 30% when the donor is aged between 70 and 80 and by up to 50% if the donor is under 70. The gift of real property to children is therefore a convenient way to reduce gift tax liability.

4. Avoidance of double taxation

a) Income Tax

In most of France's DTTs, taxation rights over income are assigned under the source principle, so that in the case of income and gains from French real property, it is France that has the right to tax, as the country where the property is located. This rule applies to French properties held directly as well as to shares in French property companies.

b) Inheritance Tax

Generally speaking and under most DTTs that cover inheritance taxes, the French real property

of a non-resident is subject to inheritance tax in France. The same principle applies to shares in French or foreign property companies more than 50% of whose assets are comprised of French real property. However, for the purpose of determining the 50%, property that is an operating asset of the company is not taken into account.

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