

Buying Property in France or Spain

Owning a property overseas is no longer a prerogative of the rich. Low prices on the continent are attracting many UK investors. Sometimes the purchase is simply to generate an income from letting but in many cases it is to provide a semi-permanent base in the other country. That may become permanent if people choose to retire there or decide that the opportunities for business or employment are better (and the climate is a considerable improvement on the UK).

Initial considerations

There are many issues to take into consideration in deciding to make such a purchase and most of those will be nothing to do with tax. Indeed it is arguable that the decision to make a purchase like this is not one that should be driven in any way by tax. However, there are some important tax issues which do need to be taken into account and a failure to give them some consideration could cause a shadow to fall over the pleasures of owning a place in the sun.

The key tax issues which need to be considered are:

- The impact the purchase and subsequent living arrangements may have on residence for tax purposes both in the UK and in the country where property is located
- The impact of local tax issues
- The impact on UK tax liability

This factsheet provides an outline of those issues and focuses briefly on two countries— France and Spain – which are the most popular choices for property investment. Similar considerations will be needed for any other country as well.

Importance of local advice

As with the purchase of property in the UK, there are many legal issues to consider and it is vital that local legal advice should always be taken. The same applies to local taxation advice; there are often issues arising of which the outsider, even with reasonable working knowledge of the tax system, will be unaware. There will always be other expatriates with plenty to say in the local bar or at the 19th hole on the golf course. Such advice should be politely listened to but there can be no substitute for good, local, independent professional advice. A few hundred euros spent on that advice could save many euros and many tears later.

Local inheritance laws

Within the UK, the individual has freedom to decide how to distribute their estate on death (assuming they make a Will). That is not the case in many other countries and certainly not in France or Spain. This is an important area on which to seek advice before a purchase is made, otherwise property may not pass on in the desired way.

For example in France it is the location of the property, not the residence of the owner, which determines how the property passes. French inheritance law divides the property in a strict order as follows:

- Children (or, if they are deceased, their children)
- Parents and privileged collateral heirs (siblings or, if deceased, nephews and nieces)
- Grandparents
- Surviving spouse
- Other collateral heirs (uncles, aunts, cousins etc)

The position of the spouse is clearly not advantageous, although it is possible to improve that by making an election for the French universal matrimonial regime to apply or to ensure that a French Will is made. This is a very important area on which local legal advice should always be taken.

Spanish inheritance law is more generous to the spouse. It requires 2/3rds of the estate to go to the closest heirs and the remaining 1/3rd can be distributed freely. From the 2/3rds, 1/3rd must be for the spouse for life. It is important to take local professional advice and to ensure you have a Spanish Will.

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Impact on residence and domicile

UK situation

If you continue to live in the UK, you are unlikely to alter your basic position of being resident (and ordinarily resident) here. There is nothing that would allow HM Revenue and Customs to view you as becoming non-resident. Similarly, if you have a UK domicile (ie this is your 'permanent home') that too would continue.

If your UK property is sold and the move abroad takes on a permanent hue, then HM Revenue and Customs will probably accept that you have become not resident (and not ordinarily resident) for UK tax purposes. Domicile remains difficult to change and you will need to demonstrate a fundamental change in your lifestyle and an intention to make the overseas country your home on an indefinite basis. In any case you will remain domiciled in the UK for inheritance tax (IHT) purposes for up to three tax years after your departure.

It will be situations in between these two extremes where there could be issues. If you spend an increasing amount of time in your overseas property, you may be able to establish non-UK resident status provided your visits back here do not exceed 91 days a year on average. This may require careful management of time and should be carefully documented so that any arguments can be supported. You may also be able to claim not ordinarily resident status but you will be unlikely to be able to argue that you have shed a UK domicile.

France

A person who lives in France or has their principle abode in France (assuming they have another home elsewhere) will usually be treated as resident in France. This would certainly be the case if you spent more than six months in the country. A period of less than six months might still be sufficient if the time spent in France was greater than the time spent in any other country.

If you intend to work or run a business in France it is important to note that residency can also be established by performing the principle professional activity in France or by France being the centre of economic interests.

Spain

The starting point for Spanish tax residency is spending 183 days in Spain in a calendar year. Temporary absences will not reduce the 183 day rule unless you can show that you are still resident in the UK.

The Spanish Tax Agency may use the place of principle economic interest or professional activity as indicators of residence. They are also able to consider the location of a permanent home in Spain if the family live there on a habitual basis.

Remaining UK resident

The majority of UK investors buying property in France or Spain will, at least initially, remain resident in the UK for tax purposes. We consider the main tax consequences of this below.

France

Any rental income from the property is taxable in France and you will need to complete a French tax return. On sale of the property you may be liable to French CGT at a rate of up to 33%. You will however, pay less tax the longer you have owned the property.

There is an annual wealth tax but for those not resident in France it only applies to French assets. The tax starts on total wealth of 720,000 euros (about £500,000) and has a top rate of 1.8%. An individual with a modest French property should not be unduly concerned about this particular tax.

You would also be liable on an annual basis to a 'taxe d'habitation' and 'taxe fonciere' which are similar to our council tax.

French IHT is a progressive tax with a top rate of 40% on an estate of around £1 million. Where you are not domiciled in France it is only French assets that are caught.

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Spain

Non residents are required to file a Spanish tax return if they receive income from Spain or own assets in Spain. There is an annual income tax charge on the notional value of property owned in Spain. On a £500,000 home this would be about £1,875. Where a property is rented out, Spanish tax is charged on the gross rental income at a flat rate of 25%.

A transfer of property located in Spain is subject to CGT (at a rate of 35%) where the vendor is not resident in Spain. The purchaser is required to deduct 5% of the agreed price and pay this over to the Spanish Revenue as a payment on account of the vendor's overall liability.

A wealth tax payable annually on Spanish assets at rates starting at 0.2% up to 2.5% on 10 million euros.

There is also a local property tax to pay. The rate varies from area to area but somewhere between 0.5% and 1% of the value of your property.

Spanish inheritance and Gift Tax is an acquisition tax and is payable by the recipients and not by the estate. Rates are progressive from 7.65% up to 34% on around 800,000 euros. If the recipients are Spanish resident they are liable on receipt of assets wherever in the world the assets are located. If the recipients are not Spanish residents then the liability only extends to the receipt of assets located in Spain.

Becoming a resident in France or Spain

If your circumstances are such that you will become resident in France or Spain then the tax consequences are different. What follows is a very brief outline of some rules. There is no substitute for local professional advice.

UK

If you are non-UK resident, any rental income arising from property overseas is generally not taxable in the UK.

If you cease to be resident in the UK but actually stay out of the country for less than five complete tax years you can remain chargeable to CGT. This could mean that any gain made on the disposal of an overseas property would be potentially chargeable to UK CGT. Your IHT position will, as stated above, depend on your domicile rather than residence position.

France

If you become resident in France you will be taxable there on your worldwide income and gains, subject to the double tax provisions.

The annual wealth tax is charged on a worldwide basis for French residents. The French equivalent of council tax would be due.

French IHT would continue to be charged on French assets only, unless you became domiciled there.

Spain

If you become resident in Spain you would be taxable there on your worldwide income and gains, subject once again to double tax provisions. The annual wealth tax would also be applied to worldwide assets.

Spanish inheritance and Gifts Tax applies as described above.

Checklist

In summary the key tax issues to identify are as follows.

1. What are the local inheritance laws?
2. Will my residence status in the UK change?
3. Will I become tax resident in the country where I buy a property?
4. What continuing UK tax liabilities will I have?
5. What will be my liable to income tax and CGT in the country in which I buy property?
6. Will I be affected by local inheritance or gift tax?
7. Is there a local wealth tax?

Sort out all these issues and then, as you sit watching the sun glint on the blue waters of the Med, there will be no dark TAX clouds building up behind you to cast a shadow over your new found idyll!

How we can help

We will be more than happy to provide you with assistance or any additional information required.

For further information about James Cowper and how we may be able to assist you, visit www.jamescowper.co.uk

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