

## April 2008 – Newsletter

Welcome back to our monthly look at Spanish tax and its potential implications for you as Spanish property owners.

If there are any issues that you would like us to address during 2008, then please drop us an email and we will try to cover your questions or subject areas in future editions.

## UK Tax Changes



Following on from our November newsletter, where we outlined the planned changes to **UK capital gains tax** and **inheritance tax**, and their potential implications in relation to your Spanish property, we can now confirm that the proposed changes are effective from 6<sup>th</sup> April 2008. As a **reminder**:

### Capital Gains Tax

There will now be a flat rate of **18%** ( by coincidence now in line with the Spanish CGT rate), which will mean that if you were to sell your Spanish property, you would be subject to 18% on the net gain, before applying your annual CGT allowance. To balance against this new rate, the previous relief for indexation has now been withdrawn.

The probable effect is that you will pay 18% in Spanish capital gains tax, and then on your UK tax return you will need to apply similar calculations, but then offset any Spanish tax already paid, which should mean that no additional tax will actually need to be paid in the UK.

### Invoices and Receipts

In preparation for the date of sale, can you please ensure that you keep all invoices and receipts relating to when you bought the property, any improvements that you have made and any costs relating to the property sale. If we have evidence of all these costs, then we can potentially use them to offset your eventual capital gain.

Although there will no doubt be people (i.e. builders!) who will want cash paid for any work (and therefore no invoice), please weigh up whether you are making a significant saving today by paying cash, as with no evidence of invoice, you will end up paying 18% of that amount in tax at a later date.

## Capital Gains Tax - Allowable Expenses

The costs that we should be able to recover include:

***Solicitors fees / Notary fees / IVA / Land registry / Stamp duty / Estate Agents commission / Advertising Costs / Air Conditioning / Gardens / Extensions / Pools / Kitchens/Bathrooms etc.***

This list is not an exhaustive, so if we can justify a relevant expense then we will claim for it, so please remember to **get receipts** wherever possible and **keep hold of them!**

## Inheritance Tax

In the Pre-Budget report, the Chancellor announced a measure aimed at helping those married couples and civil partnerships who have a combined estate which is more than the IHT nil-rate band (currently £300k each), but who are not truly “wealthy”. Prior to this report, the IHT nil-rate band was specific to an individual, and could not be carried forward on the death of the first spouse or civil partner.

However, now the unused percentage of the nil-rate band can be carried forward and added to the nil-rate band that is available to the second partner.

### Example:

John and Mary have a UK home worth **£500k** and a Spanish home worth **£150k**. On John's death he leaves everything to Mary, and so it escapes UK IHT because of the husband and wife exemption, so on John's death none of his nil-rate band is used.

When Mary dies, she owns the UK house (now worth **£600k**) and the Spanish house (now worth **£200k**), making a combined total of **£800k**. If the IHT nil-rate band at the time of Mary's death was £350k, the estate would pay no tax on 2 x £350k – so £700k tax-free – with 40% to pay on the excess of £100k, i.e. a total of **£40k**. This compares with a previous figure, under the old system, of **£180k**.

The new rule applies to all second deaths after 9<sup>th</sup> October 2007, and it is understood that it will apply regardless of the date of the first death, so that even if the first death was before 9<sup>th</sup> October 2007, the potential for doubling the nil-rate band still exists. The full details of these provisions will not be completely certain until the 2008 Finance Act.

Remember, in the latter scenario, Mary would have been subject to Spanish inheritance tax upon the death of John (in relation to the Spanish property only), and similarly, upon Mary's death her beneficiaries would again be subject to Spanish inheritance tax, upon receiving the Spanish property from Mary.

If you do have any questions regarding these changes and the implications on your position, then please let us know.

## Spanish Inheritance Tax Advice

Following on from the last point above, if we were to act as your fiscal representative then as part of our service to you, we can help you look at your potential Spanish inheritance tax liabilities. This tax can be very complex, and it is your beneficiaries who will be the ones taxed on the property gift they receive from you – so this could be your spouse, partner, children or grandchildren.

The potential tax amount will depend on several factors, and so if you haven't already done so, if you were to let us know your plans, we could then articulate what the potential tax amount could be, and identify, if possible, potential ways to minimise such tax.

Also, the Spanish Will writing process through Spanish solicitors generally does not include any such tax advice, so in most cases, they will merely take your instructions, i.e. do what you tell them to do, and this could be exposing you to a potentially high tax liability in future. So again, if you were planning to sort out a Spanish Will, you could give us a call beforehand, in order that we could then discuss the tax implications.

Remember, there is no extra charge for this, it is part of our service to all our clients, as we want you to be fully informed about the tax implications before you make any decisions in Spain.

***If you do wish us to act on your behalf, please check below as to what information we would first require.***

## Property Valuations



We have been involved in a recent case whereby there has been a death of an owner of a Spanish property, and their accountant has been trying to establish the correct property value to use for inheritance tax purposes in Spain – as you can imagine with Spain, this is not an easy task!

In order to be prudent, we will always assume the market value of your property, so if you have ever used our IHT calculator, this is the value that will have been used. We do this to make sure that the full potential liability is clear.

However, there are potentially 4 valuations of your Spanish property:

**Market Value** – the anticipated value of your property if it were to be sold on the open market – normally valued by an estate agent, based on current market conditions and sales of similar properties.

**Purchase Value** – the amount that you actually paid for the property, net of taxes, and the value that appears on your escritura/deeds.

**Rateable Value** (Catastral Value) – the value that your local council has assigned to your property, which is then used to calculate your annual rates and your annual income tax. This value will increase each year by a small percentage, and then every few years (depending on your council) they will increase all values by a significant amount, as they do a local re-valuation of all properties.

**Fiscal Value** – this is normally based on the catastral value of your property and then multiplied by a certain factor, for example a multiplier of 2.4.

In essence, market value will always depend on the market at the time, purchase value will never change, catastral value will increase over time and may overtake the purchase value if a property is kept for many years, and fiscal value will again always increase as it will move in line with the catastral value.

So, what value should we assume for inheritance tax?

For estimating purposes, we would always assume the market value, as in the majority of cases this will always be the higher end of your liability, but in reality, if you were ever in this unfortunate position, we, or your representative, should always try to justify as low a valuation as possible for tax purposes.

## Income Tax v Rental Income Tax

We are always hearing from property owners in Spain who believe that they do not need to pay tax in Spain because they do not rent out their property!

Therefore just to re-affirm to you the situation with regard to “**income**” tax in Spain.

### **Income Tax**

All property owners in Spain are subject, on an annual basis, to Income Tax – however, this is not based on a real level of income, but instead is based on a notional or “imaginary” level of income. Although this appears unfair, the Spanish tax authorities treat this as an imputed benefit you receive from having the property, and therefore tax you accordingly.

In essence, it is a **tax of ownership** as opposed to income, and the tax amount will, normally, be based on the rateable value of your property. This is why we will always ask you to provide your annual rates or IBI receipt.

So, along with wealth tax, this income tax is part of the 2 annual taxes that ALL property owners in Spain need to pay on an annual basis.

### **Rental Income Tax**

This tax is based on a “**real**” income, and for non-residents the tax is applied to the **gross income** amount you receive, and not the **profit** you receive. So if you received €1,000 in rental income, and you made a profit of €600, then, in Spain, you would pay tax on the €1,000 amount and not the €600.

The current tax rate is **24%**.

If you do generate income in this way, as tax residents in the UK, you also need to declare this income to the UK taxman. However, on your UK return, you will be taxed on the profit and not the income, and any tax paid in Spain can be offset against your UK tax liability, which will most probably mean that you will pay no further tax in the UK.

If you have any further issues or concerns over these taxes in Spain, then please let us know and we will try and answer your questions.

## **UK Tax Returns**

With the end of the 07/08 tax year upon us, and if you are generating rental income from your Spanish property, then you will need to declare this income, along with the related costs, on your return for 07/08. The link below takes you to the appropriate form that you will require off the Revenue & Customs website (simply copy the link into your browser). This is an additional form and should be completed as part of your overall UK self-assessment tax return.

[www.hmrc.gov.uk/forms/sa106.pdf](http://www.hmrc.gov.uk/forms/sa106.pdf)

## **Capital Gains Tax Recovery!**

You may have seen in the press this month about the potential claim that previous sellers of Spanish property may have in relation to overpaid capital gains tax.

The background is that during the period March 2004 to December 2006, there were 2 capital gains tax rates in Spain – 35% for non-residents and 15% for residents, and the European Commission has now ruled that Spain contravened European Union legislation by charging foreign non-residents a higher rate than Spanish nationals.

It is believed that this may have affected up to 4,500 British owners, and depending on the tax originally paid, they could now potentially reclaim a 17% rebate on the tax paid.

At the moment there have been around 70 claims made, but the result of these claims most probably will not be known for some time, so watch this space to see how effective this may be. Anyone who has claimed a capital gains tax rebate in the past will know that this process can take some time, and so no doubt the Spanish tax authorities will try to defend their position.

Remember, that from the 1<sup>st</sup> January 2007, Spain did equate the tax rates, so that an 18% rate is now applicable to both residents and non-residents.

If this situation could be applicable to you, there is a Spanish solicitors firm now providing a “no win/no fee” type service to potential claimants, with some initial setup costs to pay.

Numerological, however, are not providing such a service at this point, as we will wait and see what happens!

You can however find some more information at [www.spanishtaxreclaim.co.uk](http://www.spanishtaxreclaim.co.uk), and although we cannot validate the solicitors' claims and indeed have no connection with them, we are aware that they are offering such a service to potential claimants.

## Paying off your Spanish Mortgage

The question of whether to have a UK or a Spanish mortgage in order to pay for your Spanish property always causes buyers some concerns. And remember, although tax should not drive the funding option you choose you should be aware of the tax implications of your decisions.

For those of you with Spanish mortgages, the question you no doubt ask sometimes is whether you should be paying this off over time, either in full or some early repayments. Given the recent drop in the Euro, the cost of increased mortgage repayments may be starting to cause some concern.

So by way of an example, if you repaid a **€100k** off your Spanish mortgage, from a tax perspective, this would mean that your wealth tax would reduce by **€200** per annum; if you rented the property, then you would no longer be able to reclaim the mortgage interest as an expense against the income you have generated (on your UK tax return but not applicable in Spain); and finally, you would potentially increase the inheritance tax that your beneficiaries would need to pay upon your death by **€10k**

**So if repayment of your Spanish mortgage is a consideration for you, please give us a call to highlight any potential tax issues.**

## Euro Rate Watch

The Euro rate is still not showing any real signs of improvement, as the graph below shows – over the last month it has reached 1.28, but has also dropped to 1.23, so still remaining fairly volatile.



## 2007 Tax Returns

For those of you who own 1 Spanish property your 2007 returns will be due by the **31<sup>st</sup> December 2008**, and for those that own more than 1 property, your returns will be due by the **30<sup>th</sup> June 2008**.

Tax returns relating to the **2006 tax year** are now overdue however we can continue to submit them at any point, although, in theory, you may now be subject to an interest charge on the overdue tax amount.

Please remember that all property owners in Spain are obliged to complete annual tax returns, and this is not based on whether you rent the property out or not, they are effectively ownership taxes and not income taxes.

**Please let us know whether you wish us to act on your behalf, and if you have any further questions then please do not hesitate to contact us.**

## Change of Address

As you may already know, we have now moved to new offices in Warrington, so please make a note of our new contact details.

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