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Building Blocks

Structuring European property investments

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This is a guide to the key tax considerations for investors wishing to invest in property in the European jurisdictions of France, Germany and the United Kingdom.

It is not comprehensive and is intended as a general guide only. It should not be relied upon as tax advice in your particular circumstances.

This guide is based on law and practice as applicable at 1 October 2023, which may in principle change at any time.

Contents

Investing in property in France

France and, in particular, Paris and its regions comprise one of the most important economic hubs in the world. Paris contributes 31% of the overall Gross Domestic Product (GDP) of France and 5% of the overall GDP in Europe.

Paris is also the second most popular destination in Europe for international real estate investment, representing approximately 35% of all investment carried out by foreign investors in France.

As a prestigious world city, Paris is currently subject to a vast infrastructure project that aims to maintain and enhance the city's international stature. The 'Grand Paris' project covers several themes.

Those likely to influence the real estate market in the coming years involve the development of business districts around Paris (which could impact commercial property in Paris) and the creation of a new transport masterplan that will connect important transport hubs with the new districts around the city.

Ownership of French property

Non-residents are free to acquire real estate in France either directly or through other vehicles. It is common for French property to be acquired through a special purpose vehicle called a Société Civile Immobilière (SCI).

More complex ownership structures may be introduced by overseas investors, including the holding of French property through a French vehicle which is itself owned by companies established in another jurisdiction.

France draws a distinction between commercial and residential real estate for tax purposes and the rules differ substantially between the two types of property interest. It also distinguishes, for some tax purposes, between the tax which is applicable to individual holders of French property and that applicable to corporate entities holding French property. In contrast with the UK, France does not distinguish between properties which are used for trading and those used for investment purposes. However, the acquisition of properties for resale on a habitual basis may result in the characterisation of rental income and capital gains as trading income for tax purposes, under the real estate dealer status (Marchand de biens).

Property funds

France also offers a special tax regime for French property companies, such as the Organisme de placement collectif immobilier (OPCI). The OPCI is an unlisted real estate investment vehicle that is subject to the approval of the French financial market authorities, Autorité des Marchés Financiers (AMF), which could either take the form of:

- a real estate fund (joint ownership of real estate assets) without legal personality, Fonds de placement immobilier (FPI), or
- a limited liability real estate company under the form of a Société Anonyme (SA) or Société par Actions Simplifiée (SAS) with a variable capital, société de placement à prépondérance immobilière à capital variable (SPPICAV).

SPPICAVs are more often used by investors. Indeed, a SPPICAV benefits from a corporate tax exemption on all its income/profits, subject to distribution requirements as follows:

- 85% of the distributable income from the previous financial year resulting from the leasing of properties held directly or indirectly through a partnership (société de personnes).
- 50% of the net capital gain from the sale of real estate assets carried out directly or indirectly during the financial year or the previous financial year through a partnership.
- 100% of dividends paid by subsidiaries exempt from corporate income tax on their real estate activities (ie subsidiaries benefiting from the sociétés d'investissements immobiliers cotées (SIIC) regime).

France also has a specific tax regime applicable to property funds listed on a recognised stock exchange, the real estate investment trust called SIIC. Broadly, a SIIC is exempt from French tax on capital gains and rental income if a number of conditions are satisfied, in particular, distribution obligations. SIICs are less often used than SPPICAVs, notably because of:

- the distribution obligations being higher than that applicable to SPPICAV
- the required diversity of the SIIC shareholders (a single shareholder or a group of shareholders acting together cannot hold more than 60% of the share capital or voting rights). There is no equivalent rule for SPPICAV.

Tax on acquiring French property

The purchase of real estate in France can be subject to registration duties, at a minimum rate of 5.09%, or to value added tax (VAT) at a rate of 20%, depending upon the status of the seller and the characteristics and use of the property. VAT is not applicable to the acquisition of residential properties from non-professional sellers.

Registration duties for acquiring commercial and residential property

The amount of registration duties depends upon whether it is the French property or a company holding the French property that is acquired.

The acquisition of property that was constructed more than five years before the date the property was acquired will be subject to the following taxes and duties, which can amount to up to 7% of the purchase price:

- A registration duty of 5.09%, although most French 'départements', including Paris, apply a 5.81% rate.
- Additional tax (Contribution de Sécurité Immobilière) equal to 0.1% of the value of the property.
- Notary fees of 0.799% (plus VAT) of the value of the property (although fees can be negotiated if they exceed a certain amount).

Since 1 January 2016, an additional 0.6% tax has been levied on the sale of offices, commercial and storage premises in Ile-de-France (Paris area).

Real estate dealers can benefit from a reduced rate of registration duty of 0.715%. In broad terms, a real estate dealer is a company or individual (subject to VAT) who undertakes to rebuild or to resell the building within a specific time period. Investors acquiring a property which was constructed less than five years before the date of acquisition may also benefit from this reduced rate.

Registration duties for acquiring shares in predominant real estate company

Registration duties will apply to the

acquisition of a predominant real estate company - ie a privately held company whose assets mainly consist of French real estate properties and/or certain shares (such as shares in SCIs). The registration duties in this case will be imposed at the rate of 5% of the purchase price.

Given the lower registration duty for a share acquisition (as compared with a direct acquisition of the property), investors may prefer to acquire shares in a real estate company. However, the acquisition of a company's shares implies that the purchaser acquires all of the company's history and its liabilities and it would not be possible to amortise the acquisition value of the property for tax purposes.

VAT on acquisition of commercial properties

A seller must charge VAT on the sale of certain commercial real estate assets if he or she qualifies as a taxable person acting as such (that is, holding the property for the purposes of a business in its business capacity). Otherwise, the sale is exempt from VAT. Whether the sale of such property by a taxable person will be subject to VAT will depend on the qualification of the property as 'new' or 'old' for VAT purposes.

The seller will be required to charge a purchaser VAT on their acquisition of a 'new' property (that is, property supplied or sold within five years of completion or significant redevelopment). Conversely, the transfer of an 'old' property (that is, any property not regarded as new) will be exempt from VAT unless the seller has elected, under certain conditions, to charge VAT.

If the purchaser is required to pay VAT to the seller, the VAT is normally recoverable by the purchaser where the purchaser undertakes an activity subject to VAT (for example, the building is used for the business activities of the purchaser or the building is leased by the purchaser to tenants who are charged VAT). The application of VAT to such transactions also has an impact on the registration duty regime and specific VAT rules (with lower registration duties) apply to disposals of building land (terrain à bâtir).

VAT at the rate of 20% is applied to the purchase price and any other consideration provided to the seller. Unless the parties agree otherwise, VAT is payable by the purchaser.

As a matter of principle, there is no French VAT applicable on the acquisition of shares in a property holding company.

Tax on holding French property – individuals

Taxation of rental income

Individuals (whether or not resident in France) who hold a French property which is rented out to third parties will be subject to French income tax on the rental income they derive, unless otherwise provided by a tax treaty.

The income subject to French taxation will comprise the rental income (and any expenses paid by the tenant which should have been borne by the landlord) after deducting expenses clearly relating to the French property (including costs of repairs, maintenance and improvements, employee costs, local taxes, managing agent's fees, insurance premiums and interest on a loan to finance the purchase and/or refurbishment of the French property). Registration duty paid on the acquisition of the French property is not deductible from the rental income, although it is taken into account in determining any taxable capital gain on the sale of the property.

Taxable rental income will be subject to income tax at progressive rates up to 45%, as well as social security contributions of 17.2%. From 1 January 2018, non-French tax residents may not be taxed at an effective rate below 30% on their French sourced taxable income (for the portion of income exceeding €27,478). As an exception, however, non-French tax residents may benefit from a more favourable effective tax rate (ie below 30%) where they can show that, if their French and foreign sourced income were to be taxed in France, the applicable effective French tax rate would be below 30%.

As a matter of principle, non-French tax residents are also liable to social security contributions on their taxable rental income (ie 9.2% of

General Social Security Contribution (CSG) + 0.5% of Social Security Debt Repayment Contribution (CRDS) + 7.5% of solidarity levy = total of 17.2% of social security contributions).

However, non-French tax residents who are affiliated to a compulsory social security system, other than the French one, within an EEA country (EU, Iceland, Norway, Liechtenstein) or Switzerland, are exempt from the CSG (9.2%) and the CRDS (0.5%). Please note that although the United Kingdom left the European Union on 1 January 2021, British residents continue to benefit from this exemption.

Nevertheless, the solidarity levy (7.5%) will still be applied to this income.

Where the rental activity results in a loss, the losses may be offset against other taxable income of the individual owner (up to a limit of €10,700) and any excess can be carried forward for ten years and offset against future rental income.

VAT on rental income

In principle, the letting of French property falls within the scope of VAT. However, there are many exceptions which apply. Broadly, the letting of:

- furnished property (activity of a commercial nature) is always subject to VAT
- unfurnished property (activity of a civil nature) is exempt from VAT but the seller can elect to apply VAT
- residential property is exempt from VAT and the seller cannot elect to charge VAT.

Note that, where the French building is over 15 years old and the landlord is a legal person, a rental tax at the rate of 2.5% levied on the annual rental income (contribution sur les revenus locatifs) is charged to the landlord.

Wealth tax

Non-French tax residents who directly or indirectly own French real estate assets are liable to French real estate wealth tax (impôt sur la fortune immobilière (IFI)), provided that the global net value of all their French real estate assets exceeds €1,300,000 on 1 January of a given year.

The application of wealth tax will, however, depend on any applicable tax treaty between France and the country in which that person is resident. It is noted, however, that not all French tax treaties deal with wealth tax and, in the absence of specific treaty provisions to the contrary, French domestic tax rules will apply.

The IFI will be assessed on the net value of real estate assets held by the individual, either directly or indirectly through one or several entities. Where real estate assets are held through one or several entities, only the portion of the value of the shares directly owned by the individual representing the value of the underlying real estate assets will be subject to the wealth tax.

Debts contracted by the individual for the acquisition, refurbishment, maintenance, construction or expansion of real estate assets subject to the IFI will be deductible for the computation of the net value, subject to some restrictions: bullet loan repayable at maturity (ie 'in fine loan') will be subject to a deemed straight-line amortisation; exclusion of interfamilial loans; general limitation for debts exceeding 60% of real estate assets with an aggregate value exceeding €5m.

The applicable progressive rate for wealth tax ranges from 0% to 1.5%:

Net value of the French real estate assets	**2023 rates**
Up to €800,000	0%
Between €800,001 and €1,300,000	0.5%
Between €1,300,001 and €2,570,000	0.7%
Between €2,570,001 and €5,000,000	1%
Between €5,000,001 and €10,000,000	1.25%
Above €10,000,000	1.5%

Inheritance and gift tax

Unless otherwise provided for in a double tax treaty, under French domestic tax rules, the transfer of a real estate property located in France by a non-French tax resident either by way of an inheritance or a gift is subject to French inheritance or gift tax. The applicable tax rates will vary according to the kinship existing between the deceased (or donor) and the beneficiary as well as the amount of the inheritance/gift. The rates of tax range from 5% to 60%.

The inheritance and gift tax will be levied on the value of the property if it is held directly by the individual or on the value of the shares if the French real estate is owned by the individual through a corporate entity.

Tax on holding French property – companies

Taxation of rental income

Companies renting out real estate in France are subject to corporate income tax on the profits from such activity. The taxable income is equal to the accrued gross rental income less accrued deductible expenses provided that they clearly relate to the French rental activity.

Taxable income is subject to corporate income tax at the standard tax rate (ie 25% as of 1 January 2022) and most tax treaties signed by France do not prevent France from taxing such income.

Expenses deductible against rental income include employee costs, local taxes (such as local real estate taxes), registration duty on the acquisition of the property (which can either be fully deducted as an expense for the financial year in which the acquisition was made or depreciated over the useful life of the property), other general expenses such as management fees and insurance premiums, and interest on a loan to purchase and/or refurbish the French property (subject to limitations for related party loans).

For non-French companies purchasing French property through a partnership (which is itself not subject to French corporate income tax), the taxable income will be determined at the level of the French partnership but taxed in the hands of the corporate partner.

VAT on rental income

The letting of furnished premises (activity of a commercial nature) is liable to French VAT at the standard rate of 20%, which must be added to the rent charged to the tenant by the landlord of the premises.

The letting of unfurnished premises (activity of a civil nature) is, in principle, exempt from VAT and instead (provided the building was completed more than 15 years ago) subject to a 2.5% rental tax. However, the landlord can elect for VAT to apply after the beginning of the rental activity, in which case, there is no rental tax payable, but VAT is applicable.

A VAT election (which is applicable only to the relevant building) is valid until it is revoked. A VAT election can be made where the tenant is itself liable to VAT and uses the building for its commercial activities. The VAT election can also be made where the tenant is not subject to VAT but in that case, the VAT election must be expressly provided for in the lease contract.

Territorial economic contribution (CET)

The CET is levied on resident and non-resident companies operating a French business. The CET comprises the following two taxes:

- **Cotisation foncière des entreprises (CFE)** which is assessed on the rental value of the French property used by the entity and subject to land tax (taxe foncière). The tax rate is set annually by local authorities.
- **Contribution sur la valeur ajoutée des entreprises (CVAE)** which is payable by companies with a turnover of at least €500,000 (excluding VAT) and assessed on the added value of the companies (broadly equal to the difference between the turnover and the production costs). The rate of the CVAE is progressive and depends on turnover (0.25% for companies with a turnover between €500,000 and €3,000,000, up to 0.75% for companies with a turnover exceeding €50,000,000).

The amount of CFE and CVAE is capped at 2% of the added value generated during the fiscal year.

The CET applies to entities which conduct a professional activity subject to French corporate income tax, which includes non-resident companies with a French permanent establishment. However, foreign companies that rent out real estate in France (other than unfurnished residential properties) will be subject to the territorial economic contribution even if they do not have a permanent establishment in France.

Where a non-French resident company only undertakes an activity of letting out French property, that company will be treated as carrying on a professional activity if it rents out a furnished residential or commercial property (irrespective of the rental income), or it rents out unfurnished commercial property and the rental income exceeds €100,000 per year.

Repatriating profits to non-resident investors

Non-resident investors in French real estate do not incur any further tax consequences, other than those referred to herein, upon the repatriation of their rental income or capital gains, when the French property is held through a partnership.

However, when the property is held through a non-transparent corporate vehicle (that is, a company subject to corporation tax) tax is withheld from the profits repatriated to non-resident investors, at the following rates:

- 12.8% on dividends and assimilated distributions paid to individuals.
- 25% on dividends and assimilated distributions paid to legal entities.
- 75% on income paid to an individual or legal entity domiciled in a non-cooperative country or territory.

Most double tax treaties apply a lower withholding tax rate or often prevent the application of the French withholding tax.

There is no withholding tax on dividends paid by a French subsidiary to a parent company which holds a 10% minimum participation (or 5% in certain circumstances) for at least two years where the parent company is resident in an EEA Member State.

Ownership through a trust

The ownership of French properties (directly or indirectly) through a trust gives rise to the following consequences:

Status of people concerned	Tax obligations
Settlor/Deemed settlor[1]	French wealth tax filing requirements and payment[2]
Beneficiaries	French inheritance tax following the death of the settlor
Trustee	Specific filing requirements requiring disclosure of the existence of the trust and any specific event occurring within the trust. Failure to comply with this gives rise to a €20,000 penalty.

1 On the death of the settlor, the beneficiaries are deemed to be the new settlors of the trust and they are so-called deemed settlors.
2 Otherwise the settlor/deemed settlor may be obliged to pay a tax of 1.5%.

Ancillary taxes

The ownership of a French property also requires the payment of certain ancillary taxes.

The two main local taxes are the dwelling tax (taxe d'habitation), payable by an individual who uses the furnished residential property as a secondary residence (ie the occupant), it being specified that the dwelling tax has been repealed for main residences as from 1 January 2023; and the real estate tax (taxe foncière), payable by the landlord. Both taxes are based on the cadastral rental value of the property (which is lower than its rental value) and the tax rates are fixed on a yearly basis by the local authorities.

Moreover, there is a specific tax on the ownership of office premises, commercial premises and warehouses in the Paris area which is due annually from the owner of the building. Depending on the nature of the premises (office, commercial or warehouse), the amount of tax will vary.

Annual tax of 3% on French properties

All French and foreign legal entities (including trusts and investment funds) which directly or indirectly own real estate in France are subject to an annual tax equal to 3% of the fair market value of the property (as determined on 1 January each year) unless one of the exemptions applies.

Exemptions

The 3% tax does not apply to:

- Sovereign states, public bodies and those entities with or without legal personality whose shares or ownership interest are held (as to more than 50%) by a sovereign state or a public body.
- Entities that directly (or indirectly) own real estate in France where the fair market value of the real estate is less than 50% of the total value of the French assets which are held directly or indirectly by the entity. French properties which are allocated to or used for a professional activity (for instance, hotels used in the hotel business) by the entity (or a related party)

are not included for the purposes of computing the 50% ratio.

- Entities (and their wholly owned subsidiaries) whose stocks are (i) admitted to listing on a regulated market and (ii) regularly and significantly traded.
- Certain entities that have their registered office in France, in an EU Member State or in a country that has concluded a double tax treaty with France that includes an administrative assistance or non-discrimination clause. This extends to some pension funds, non-listed open ended real estate funds and equivalent foreign funds. This exemption also applies to entities owning directly (or indirectly) French properties, and whose portion of the French properties does not exceed either €100,000 or 5% of the fair market value of those French properties. Moreover, in many cases the 3% annual tax can also be avoided if the entity discloses to the tax authorities the names of its shareholders.

Consequently, entities located in tax haven countries, or which cannot benefit from tax treaty benefits (or, in some circumstances, which do not disclose details of their shareholders) would be subject to the annual 3% tax charge.

The purpose of this tax is to compel companies to disclose details of their shareholders so that the French tax authorities can identify the individual shareholders who ultimately own the relevant property to ensure that those individuals have properly reported the property in their French wealth tax returns.

Tax on disposal of French property

As outlined above, the sale of real estate and/or shares of predominant real estate companies will be subject to VAT or to registration duty computed on the price (or the value of the shares, if higher).

Non-French residents are liable to a French withholding tax on any capital gains arising from the sale of either a real estate property in France or the sale of shares of a real estate company whose assets mainly consist of French properties. This withholding tax will not apply if the non-French resident seller carries out a business in France and has used the property for the purpose of their business. Whilst most tax treaties provide France with the right to tax gains from the sale of real property, this is not necessarily the case with respect to the sale of shares of real estate companies.

Tax on sale of French property (or shares in predominant real estate companies) by individuals

Taxable capital gains on a sale of real estate are calculated as the difference between the sale price for the property and the price paid by the seller to acquire or improve the property (including expenses such as works improvement).

Capital gains arising from the sale of French real estate - either directly or indirectly - (for instance, through the sale of shares in a company holding the property or through the sale of a partnership interest in a partnership holding French real estate), are taxed at a flat 19% rate regardless of whether the seller is resident in France or elsewhere. If the seller is a French tax resident, social security contributions at 17.2% are also due. If the seller is a non-French tax resident, please refer to our comments under the 'Taxation of rental income' section, relating to the application of French social security contributions on rental income realised by non-French tax residents.

In summary, the following tax rates are applicable to taxable capital gains:

	French tax resident	EEA tax resident (and also UK)	Non-EEA tax resident (including NCST)
Income tax rate	19%	19%	19%
Exceptional tax on high income	Up to 4%	Up to 4%	Up to 4%
Surtax on real estate	Up to 6%	Up to 6%	Up to 6%
Social charges	17.2%	7.5%	17.2%
Total	46.2%	36.5%	46.2%

Individuals and transparent entities may also be liable to a surtax applicable to capital gains on a sale of property involving real estate assets or rights when the taxable amount (determined by applying an allowance for the holding period) exceeds €50,000. Tax paid on the sale of such taxable assets is increased by 2% (if the capital gain exceeds €50,000) or 6% (if the capital gain exceeds €260,000). This surtax applies to the full amount of the capital gain.

It is noted, however, that taxable gains are reduced in proportion to the length of ownership of the property if the property has been held for more than five years. The reduction is equal to 6% of the gain for each year of ownership between the sixth and the 21st year and the reduction is equal to 4% for the 22nd (or final) year. Accordingly, the sale of a property held for more than 22 years is exempt from income tax.

The gain computed for the social security contributions is also reduced by 1.65% for each year between the sixth and the 21st years, and then reduced by 1.60% for the 22nd year and 9% per year after 22 years. Total exemption from social security contributions will apply for property held for more than 30 years.

Tax on sale of property by companies

Capital gains realised by both French resident and non-French resident corporate entities on the sale of French real estate and the sale of shares in predominantly French real estate companies are generally taxed at the standard corporate income tax rate, unless otherwise provided for by a tax treaty.

The computation of the capital gain will depend on where the seller company is resident for tax purposes:

- If the seller company is a French tax resident, the capital gain is calculated as the difference between the fair market value of the building at the time of disposal and the net book value of the building. The gain will be subject to French tax at the standard corporate income tax rate (25%) together with additional charges.
- If the seller company is not a French tax resident, then broadly the capital gain will also be calculated as the difference between the fair market value of the building at the time of disposal and its net book value (although some specific rules are applicable to companies resident in a state situated outside the EEA). The gain will be subject to tax at the standard corporate income tax rate (25%) together with additional charges.

Tax on sale of shares of a predominant real estate company by companies

Capital gains on the sale of shares in a predominant French real estate company by:

- A French resident seller company will give rise to French corporate income tax at the standard rate (25%). In addition, if the company's corporate income tax amount exceeds €763,000, a social contribution equal to 3.3% of the tax due will be applicable (ie an effective tax rate of 25.83%). However, capital gains from the sale of shares in listed companies whose assets mainly comprise French immovable real estate will be taxed at a reduced corporate tax rate of 19%.

- A non-French resident seller company will typically give rise to French corporate income tax at the standard rate. Most French tax treaties provide France with the right to tax capital gains arising from the disposal of shares of a predominant French real estate company. Unless otherwise provided by a tax treaty, capital gains derived by a non-French resident corporate seller from the sale of shares in a quoted predominant French real estate company will be subject to a withholding tax at a reduced corporate tax rate of 19%.

Conclusions

Investing in French property can give rise to a number of tax issues and early identification and planning for such issues is key to managing the holding of French property in an efficient manner. Financing of French property through loans can also be taken into account in calculating French tax liabilities and should be considered at an early stage.

Investing in property in Germany

The German property investment market remains strong. Investments have spread from the 'big five' cities of Berlin, Dusseldorf, Frankfurt, Hamburg and Munich to secondary locations, with office space being the dominant use of properties, followed by retail and logistics.

Whilst demand is still focused on core real estate assets, the German market is experiencing an increase in investors willing to take risks.

In particular, foreign investors are prepared to invest in forward commitments and joint ventures with German project developers.

Ownership of German property

There are several ways to invest in real estate in Germany. An individual can purchase a property directly or the investment can be made indirectly using a German corporation or partnership. Alternatively, German property can be acquired using a non-German corporation or partnership.

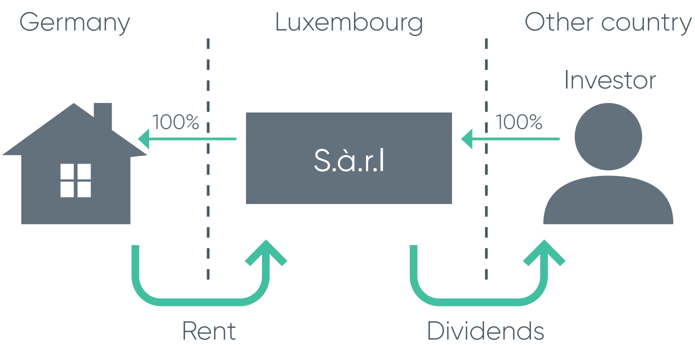
Investment in German property often takes the form of indirect investment via single corporations or partnerships that acquire the German property (with the investor(s) holding shares or interests in that entity), or by using a holding company that is the shareholder in one or more subsidiaries, each of which may own one or several properties. Furthermore, such investment vehicles can be domiciled either in Germany or in a foreign country.

For many transactions involving investment into German real estate from overseas investors, the investor establishes a new company outside Germany (but within the EU) to serve as the property owning company (Propco). The purpose of the Propco will be the holding, managing and renting of real estate assets. Such structures are aimed at limiting the German taxation to corporate income tax (CIT) of 15% (plus solidarity surcharge), being 5.5% of the CIT and to exclude further taxation in the form of German trade tax or German withholding taxes.

A typical legal form used for such types of transaction is a limited liability company established under Luxembourg laws as a Société à responsabilité limitée (S.à.r.l). Depending on the relevant double tax treaty, other countries can also provide similar tax structuring options.

However, such structures may lead to practical business limitations, as they typically require the Propco to avoid the creation of a permanent establishment in Germany.

Overseas investors will also need to consider German anti-avoidance and double tax treaty overriding regulations. Investors must ensure that they have established appropriate German and/or foreign corporate structures, which will require detailed analysis and review before implementation of an appropriate structure.



Tax on acquiring German property

The purchase of real estate in Germany (whether in the form of commercial or residential real estate) is typically subject to real estate transfer tax (RETT) and can also be subject to value added tax (VAT) at a standard rate of 19%, depending upon the characteristics and use of the property.

RETT rates have significantly increased in the past few years and RETT now has an enormous economic impact. The purchaser and the seller are both liable to pay RETT, however, in practice, the purchaser is usually required to pay the full RETT liability to the German tax authorities.

The RETT rates depend on the current tax rates applicable and where the real estate is located within Germany. RETT currently ranges between 3.5%-6.5% of the purchase price of the property.

Tax on acquiring shares in company holding German property

In a share purchase transaction, where the company or partnership holds German property, German RETT can also be due.

Under the current rules, RETT can be triggered if a 90% or more (economic) participation is acquired in a company holding German real estate, regardless of its legal form. This is particularly the case if, within a period of ten (in some cases 15) years:

- a total of at least 90% of the shares in a corporation or interests in a partnership holding German real estate are transferred directly or indirectly to new shareholders/ partners, or
- at least 90% of the shares in a corporation or interests in a partnership holding German real estate are directly or indirectly unified (legally or economically) by a shareholder/partner or its affiliate(s).

Accordingly, the application of German RETT in a share purchase transaction involving a German property holding company must be carefully considered and depends on the facts of the case. In addition, acquisition structures need to be bespoke, taking into account in particular the holding and transfer periods of ten to 15 years and the percentage of shares/interests to be transferred.

From 1 January 2024 onwards, it is very likely that the RETT exemptions rules for partnerships will not be applicable anymore. Thus, a new fundamental change of the German RETT concept in particular for the RETT exemption rules is being discussed and a first draft of the new law has been issued recently. The basic idea of the new RETT concept is that RETT exemption rules shall be the same regardless of the legal form of the German property holding entity (eg corporation or partnership). However, the draft is still subject to discussion and, as the Federal Council (Bundesrat) has to give consent to the new rules, it is unclear whether the new rules will be effective from 1 January 2024.

VAT on acquisition of German property

The sale of German real estate is, in principle, exempted from VAT.

However, an option to apply German VAT can be made by the seller if the purchaser qualifies as an entrepreneur for VAT purposes. The purchaser would then be liable to pay VAT on the purchase price and can in turn deduct input VAT. However, input VAT recovery is only available to the extent that the German property is used to earn income which is not exempt from VAT (such as rental income arising from property which has been ‘opted to tax’).

If the real estate is let at the time of sale, the sale of the property may qualify as a transfer of a business as a going concern, if various other conditions are met, this would result in the sale not being subject to German VAT (and therefore an 'option to tax' is not possible in this case).

The structure of any transaction involving the transfer of shares in a German property holding company must be reviewed to determine whether German VAT would apply, as such a transfer can be treated as a non-VATable transfer of a business as a going concern, or it can be treated as a VATable (but tax exempt) transaction.

Tax on holding German property – individuals

Taxation of real estate income

Individuals are generally subject to German income tax in respect of their real estate income (such as rental income).

Most double tax treaties agreed by Germany enable the jurisdiction in which the property is located to tax the real estate income from that property. Consequently, even those individuals having neither their domicile nor their habitual abode in Germany will generally be subject to German income tax in respect of their rental income from German real estate.

Real estate income may also be subject to German trade tax if such income is attributable to a permanent establishment located in Germany. The applicable trade tax rate depends on the location of the real estate, but generally ranges from 14% to 21%. However, the individual may make use of a trade tax exemption, provided their business consists only of the holding and management of real estate. Furthermore, in certain circumstances the individual may be eligible to apply for income tax relief, which could offset most of the trade tax burden, if any.

Inheritance and gift tax

German inheritance and gift tax may apply if German real estate is received on the occurrence of death or by way of donation. The tax is essentially assessed on the fair value of the real estate. Certain tax exemptions are applicable. The applicable tax rate depends on the precise circumstances and ranges between 7% and 50% for individuals benefitting from the German real estate and between 30% and 50% for corporations.

Tax on holding German property – companies

Corporate income tax

A German company will be subject to CIT on its worldwide income (including income derived from the holding of German property).

A non-German resident Propco will be subject to CIT on its income from sources in Germany. This means that the income from the real estate asset (such as rent) is taxable in Germany.

Income which is subject to German taxation is reduced by allowable deductions, including interest expense in relation to financing. However, the German interest deduction barrier (Zinsschranke) rules limit the deductibility of interest expense over interest income (net interest expense) to 30% of an entity's earnings before interest, taxes, depreciation and amortisation (EBITDA).

Interest includes all interest payments, receipts and/or accruals, whether to or from a shareholder, a related party or a third party (such as the financing bank). There is an annual threshold of net interest expense of the entity of up to €3m where, below this threshold, the interest deduction barrier rule does not apply. Therefore, the interest deduction barrier basically plays no role provided the overall net interest expenses of the Propco are below the threshold of €3m.

From 1 January 2024 onwards, it is likely that the interest deduction barrier rules will be tightened. However, the draft is still subject to discussion and it is unclear whether the new rules will be effective from 1 January 2024.

The income (less allowable deductions for certain expenses) will be subject to CIT at the standard rate of 15% plus a solidarity surcharge of 5.5% of the CIT, which results in an effective tax rate of 15.825%. An income tax return must be filed once a year.

Furthermore, German real estate income is subject to trade tax if the property qualifies as a business asset and is allocated to a German permanent establishment.

German real estate will qualify as a business asset if it is:

- used in connection with business activities (such as trading)
- held by a business partnership (rather than by a pure asset managing partnership), or
- held by a corporation (directly or indirectly via a partnership).

The applicable trade tax rate will depend on the location of the German real estate (although the rate generally ranges from 14% to 21%). Propco may be eligible to benefit from a trade tax exemption, provided its business consists only of holding and management of real estate. However, various requirements must be met in order to take advantage of this exemption, and tax structuring must be carefully implemented. Alternatively, trade tax can be avoided by an inbound investment structure which avoids the creation of a permanent establishment.

VAT on rental income

Rental income is usually exempted from VAT, but where certain conditions are satisfied, an 'option to tax' can be made in respect of commercial property only.

Input VAT recovery (or deduction against VAT payable to the German authorities) can then be obtained. Input VAT would include VAT payable in respect of the purchase price of the property, as well as VAT on construction and other costs. However, input VAT recovery is only available to the extent that the German property is used to earn income which is not exempt from VAT (such as rental income arising from property which has been 'opted to tax').

Repatriating profits to non-resident investors

If the entity holding the German property is a company incorporated in Germany or effectively managed in Germany, the repatriation of profits to non-resident investors can trigger German withholding taxes on dividends paid to such investors. The German withholding tax of 25% plus solidarity surcharge, resulting in an overall tax rate of 26.375%, can be eliminated under the EU Parent-Subsidiary Directive if the investor is a parent company located in the EU or can be reduced or eliminated under applicable German double tax treaties.

Provided that a Propco incorporated outside Germany does not have its effective place of management in Germany (ie it is not resident in Germany for tax purposes), repatriating profits to non-resident investors by way of dividends should not result in a German withholding tax obligation at the level of Propco.

Tax on disposal of German property

Tax on sale of German property by individuals

Capital gains from the sale of German real estate are only subject to German income tax if:

- The property qualifies as a business asset (such as in the case of short term trading), or
- The property was held for ten years or less.

Where the capital gains are taxable, individuals are subject to a progressive income tax rate of up to 45%, plus a solidarity surcharge, resulting in an aggregate maximum tax rate of 47.475%.

Most double tax treaties agreed by Germany provide for the jurisdiction in which the real estate is located to be able to tax the gains relating to the sale of real estate in that jurisdiction. Consequently, even those individuals having neither their domicile nor their habitual abode in Germany are generally subject to German income tax in respect of gains arising from the sale of German real estate.

Furthermore, capital gains from the disposal of real estate may be subject to German trade tax if such capital gains are attributable to a permanent establishment located in Germany. The applicable trade tax rate depends on the location of the real estate, but generally ranges from 14% to 21%. However, the individual may make use of a trade tax exemption, provided their business consists only of the holding and management of real estate. Furthermore, in certain circumstances, the individual may be eligible to apply for income tax relief, which could offset most of the trade tax liability, if any.

Tax on sale of German property by corporations

Profits resulting from a sale of German real estate by a German corporation or Propco are subject to CIT at a rate of 15%, plus a 5.5% solidarity surcharge, ie the aggregate tax burden is 15.825%.

German trade tax may only arise to a German corporation selling German real estate or to a non-German Propco that has a permanent establishment in Germany (such as a fixed place of business). Capital gains from the disposal of real estate may be subject to German trade tax if the property qualifies as a business asset and is allocated to a German permanent establishment. The applicable tax rate depends on the location of the German real estate (but generally ranges from 14% to 21%). However, Propco may make use of a trade tax exemption, provided its business consists only of the holding and management of real estate. Various requirements must be met to take advantage of this exemption and careful implementation of tax structuring is required. Alternatively trade tax can be avoided by an inbound investment structure which avoids the creation of a permanent establishment.

Conclusions

Investing in German real estate can give rise to numerous tax issues and early identification and correct planning and structuring of the transaction is necessary to ensure that the property is acquired and held in an efficient manner.

Where financing of the property results in net interest expense in excess of €3m, consideration should be given to the German interest deduction barrier rules which can limit the availability of tax relief for financing costs. Also, the possible change of the interest barrier rules needs to be followed closely.

In addition, planned share deals need to be closely monitored given the expected change in the RETT regime.

Investing in property in the United Kingdom

The UK real estate market has historically been very attractive to non-UK resident investors, with consistent financial performance and steady demand for the introduction of foreign capital supported by a stable political and legal system and a broadly supportive taxation regime for such investment.

London remains a key financial centre and a hub for international investment, and the UK as a whole offers many advantages for inward investment in terms of geographic location, language, academic centres of excellence and access to talent and infrastructure. Recent years have seen considerable expansion in specialist areas of the real estate development and investment market, including student accommodation, build-to-rent and 'big box' storage facilities.

Many of these factors remain present, notwithstanding continued uncertainty in political, social and economic terms caused by the economic impact of the war in Ukraine and the adjustments following Brexit, with the UK's long term treatment of the remaining EU laws still on its statute books following departure from the trading bloc highly uncertain.

However, property investors typically take a longer term view of a market and continue to put their faith in the UK economy despite current headwinds.

Against this backdrop, the UK taxation regime for property has been similarly turbulent in recent years, with what has seemed to be an annual targeting of residential property investment both in terms of new taxes and an extension of existing taxes (the annual tax on enveloped dwellings, non-resident capital gains tax on residential property and stamp duty land tax increases) joined by legislation aimed at ensuring UK tax applies to all profits of property development, including those made by non-residents and finally the introduction of non-resident CGT to all direct and indirect interests in UK land. However, reforms to the Real Estate Investment Trust (REIT) rules have made it more accessible and widened the types of investors who can benefit from this tax-efficient investment vehicle.

Ownership of UK property

Non-residents are free to acquire real estate in the UK either directly or through other vehicles. It is common for UK property (particularly commercial property) to be acquired through non-UK resident corporate entities.

More complex ownership structures may be introduced by overseas investors, including separating ownership of the property from any underlying business using the property (a so-called 'Propco/ Opco' structure) and the holding of UK property through partnership structures or unit trusts (which can sometimes benefit from more favourable tax treatment). These structures can also provide flexibility for the owner.

These structures are also heavily influenced by the different tax treatments which are applied to UK real estate depending on whether the property acquired will be used for the purposes of a trade or held as an investment.

Key distinctions drawn for UK tax

The UK distinguishes between the acquiring and holding of property for medium to long term returns in the form of rental income and capital growth (typically termed 'investment') and the acquiring of property for onward sale or development/ redevelopment of property for onward sale (typically referred to as 'trading').

The UK also draws a distinction between commercial and residential real estate for UK tax purposes and the rules differ substantially between the two types of property interest, generally resulting in considerably higher tax charges for owners of residential property. Prior to 6 April 2019, the rules also distinguished between UK residents and non-UK residents in respect of the application of some taxes relating to property, but gains made by non-UK residents on non-residential UK property are now also within the scope of UK tax.

Tax on acquiring UK property

The purchase of real estate in the UK is typically subject to stamp duty land tax (SDLT) and can also be subject to VAT at a rate of 20%, depending upon the characteristics and use of the property.

SDLT for commercial properties

The UK charges a transfer tax, SDLT, on the purchase of property interests in England and Northern Ireland. SDLT was originally UK-wide but has now been replaced by Land and Buildings Transaction Tax in Scotland and Land Transaction Tax in Wales. These systems are heavily based on the SDLT rules and often, but not always, mirror them. This guide only covers the SDLT rules.

SDLT is applied on a sliding scale depending on the price paid, with different rates applicable to portions of the overall price (the 'slice' system).

For commercial and mixed-use properties, no SDLT is paid for the first £150,000 of the price, with 2% applicable on the price between £150,000 and £250,000 and the rate of 5% applicable in respect of the price over £250,000.

SDLT for residential properties

For residential properties, SDLT is also applied on a sliding scale depending on the price paid for the property under the same 'slice' system as above, but at the rates set out in the table below.

Individuals acquiring residential properties

For UK and non-UK resident individuals holding only one residential property or acquiring the property to replace their main residence, the SDLT applicable should represent the usual rate (referred to in the second column of the table below).

Where the purchaser is a non-UK resident, a further 2% surcharge will apply for transactions which take place on or after 1 April 2021.

However, where UK and non-UK resident individuals already hold one or more residential properties (whether in the UK or elsewhere) and acquire a further English or Northern Irish property for more than £40,000, the SDLT applicable to the acquisition will represent the higher SDLT rate set out in the third column below, with a 3% 'second home surcharge' applying. This can apply in addition to the 2% non-resident surcharge detailed above.

In either case, SDLT is charged at the applicable rate on so much of the price as falls within each band (eg a property acquired for £1m by an individual who is not eligible for any reliefs or surcharges will attract SDLT of £41,250).

Purchase price of property	Usual rate of SDLT	Higher SDLT rate (additional dwellings rate)
Up to £250,000	0%	3%
Over £250,000 to £925,000	5%	8%
Over £925,000 to £1.5m	10%	13%
Over £1.5m	12%	15%

An exemption is available for first-time buyers, with the zero-rate threshold expanded to £425,000 (although only properties being purchased for under £625,000 are eligible for the relief).

Corporate and other entities acquiring property

Where residential property is acquired by a purchaser other than an individual, the higher rates in the third column of the table above apply, regardless of whether the purchaser holds any existing residential property.

However, where residential property is acquired for a purchase price exceeding £500,000 by a company, a partnership including a corporate member, or a collective investment scheme, a flat 15% rate of SDLT on the full purchase price is applicable instead, unless certain exemptions apply. Broadly, this penal SDLT rate of 15% is designed to dissuade ownership of residential property for personal occupation through corporate or other vehicles.

Acquisitions of residential property which are made for certain business purposes (such as for the purposes of development with a view to resale of the property or for letting to third-party tenants unrelated to the owner of the property) will not trigger this penal rate.

As with individual purchasers of residential property, where a corporate purchaser is a non-UK resident, a further 2% surcharge will apply for transactions which take place on or after 1 April 2021. This can apply on top of the 15% rate, creating an SDLT liability of 17% of the entire purchase price.

There are also specific rules which apply in relation to trusts.

For purchases of multiple residential interests, an alternative multiple dwellings relief (MDR) may be available, which broadly applies by considering the average price of the dwellings in the overall transaction and applying the SDLT bands to that average price for each dwelling in turn. This enables the purchaser to pay lower rates of SDLT on the chargeable consideration than if it was taxed as a single transaction.

Investors and developers may be able to take advantage of a portfolio relief that applies the much lower commercial rates of SDLT to purchases of six or more residential properties in a single transaction. Note that a purchaser of six or more dwellings can choose whether to apply the commercial rates, or claim MDR, but cannot do both.

Stamp duty on acquisition of shares in real estate company

No SDLT will generally arise when a purchaser acquires shares in a company that itself holds UK property. However, if the property holding company has been incorporated in the UK, then stamp duty will be due on the acquisition of shares in that UK company calculated at 0.5% of the consideration paid for the purchase of the shares.

If, however, the company holding the property has been incorporated outside the UK, the purchase of such shares does not generally give rise to any charge to UK stamp duty or stamp duty reserve tax.

As a result, there may be a tax benefit in acquiring and disposing of UK property via a company, particularly in relation to commercial property and where that company is incorporated in a jurisdiction that does not impose any transfer tax on dealings in shares.

Types of vehicle that can offer efficiency include companies and non-UK resident (typically Jersey) unit trusts. Types of structure that can also offer transfer tax savings include ‘forward sale/purchase’ arrangements where the land purchase is independent of any cost of construction of a property (which is particularly of interest to developers).

VAT on acquisition of commercial properties

Subject to certain exceptions, sales of commercial property will generally be exempt from VAT. Certain sales of freehold interests in new or partially completed commercial property may be subject to VAT. Nevertheless, commercial property owners have the ability to ‘opt to tax’ their property which would result in the sale and letting of that property being subject to VAT (currently at the rate of 20%).

Broadly, if a purchaser is required to pay VAT to a seller on the purchase of the property (typically because the seller has ‘opted to tax’ the property), the purchaser will be able to claim credit for or recover such VAT from the

UK tax authorities provided that the purchaser has also 'opted to tax' the property and is using the property to make supplies (such as leasing the property) which are subject to VAT.

Where the purchaser is required to pay VAT to a seller, the purchaser will have to pay SDLT on the purchase price for the property, including this amount of VAT. It is therefore important to structure a property purchase carefully to ensure that, wherever possible, no VAT is charged by a seller in addition to the purchase price. This is generally possible where a commercial property which is fully or partially let is acquired by the purchaser, under the so-called 'transfer of a going concern' (TOGC) rules. Due diligence will be required to determine the likely VAT treatment of a property purchase and specific drafting in the sale contract is often necessary to ensure that no VAT arises.

UK VAT is not applicable to the acquisition of shares in a company.

VAT on acquisition of residential properties

Unlike commercial property, most dealings in residential property are exempt from VAT as the 'option to tax' does not apply. This can be disadvantageous to investors as they will be unable to recover VAT on their own expenses (such as management and advisory costs) because they will be carrying on a VAT-exempt business.

However, the construction of residential property or the conversion of non-residential property to residential use may permit VAT to be recovered by a developer without that developer having to charge VAT to the ultimate purchasers of the property. The rules in this area are complex, and specialist advice should always be sought.

Tax on holding UK property

Taxation of rental income for UK residents

UK resident individuals owning UK property which is rented out to third parties will be subject to UK income tax on the rental income they derive. Taxable rental income will be subject to income tax at progressive income tax rates of up to 45%.

UK resident corporate entities holding property will be subject to UK corporation tax on rental income derived. The corporation tax rate on taxable rental income is currently 25% (with a lower rate tapering from 19% for small businesses).

The income subject to UK taxation will comprise the rental income after deducting allowable expenses generally including costs of repairs and maintenance, service fees, managing agent's fees, insurance premiums and deductions for financing costs (subject to certain restrictions outlined below).

Taxation of rental income for non-UK residents

Taxable rental income from investment property owned by a non-UK resident individual is subject to income tax at progressive rates of up to 45%.

Prior to April 2020, taxable rental income from investment property owned by a non-UK resident company was subject only to the basic rate of UK income tax (currently 20%). However, in April 2020 the scope of corporation tax was further extended to the income of non-UK tax resident companies carrying on a UK property business, meaning that corporation tax is now payable rather than income tax.

In the case of an investor that is a corporate entity incorporated outside the UK, it is necessary to ensure that the company is also managed and controlled outside of the UK to ensure that it is non-UK resident for UK tax purposes.

Withholding tax should be deducted from the rent by the tenant and paid to the UK tax authorities unless an appropriate application is made to the UK tax authorities under the 'Non-resident Landlord Scheme'.

Taxable rental income is determined in the same way for non-residents as it is for UK residents.

Deductions for financing costs

Deductions for interest payable on loans to finance the purchase and/or refurbishment of UK property are generally also available, subject to certain restrictions provided by:

- 'Transfer pricing' rules - these broadly operate to limit the tax deduction for interest and financing costs to interest and costs that are consistent with arm's length borrowing arrangements. It is possible to reduce taxable rental profits through careful acquisition structuring, including through the use of appropriate levels of bank and related party financing.
- Specific rules restricting tax relief for financing costs of residential property held by individuals for the purposes of letting to third parties so that all financing costs incurred by a landlord will be given a basic rate tax deduction.
- Rules that apply to limit corporation tax relief for interest to 30% of the company's (or the company's group's) UK earnings before interest, tax, depreciation and amortisation (EBITDA), subject to a group ratio rule if this is more favourable for the group. The restriction on tax relief for interest will not apply where net UK interest expense is £2m or less.

Where the rental activity results in a loss for income taxpayers, the losses cannot be set off against non-property related income but can be carried forward indefinitely and used against future rental income. For UK corporation tax payers, losses from a UK property business may be set against non-property related income and also carried forward and set against other income.

VAT on rental income

VAT is only applicable to rental income on commercial property where the owner of the property has 'opted to tax' the property.

Repatriating profits to non-resident investors

If the property is held by a non-UK resident company, it should be possible to return profits (including profits made on the sale of the property) to investors without any further UK taxation consequences. Typical routes include payment of dividends by the corporate entity or repayment of investor debt. However, any interest paid by the non-UK resident company to an investor may be subject to UK withholding taxes at the rate of 20%, although the withholding taxes can often be eliminated or reduced under an applicable double tax treaty or with appropriate planning.

Inheritance tax (IHT)

If UK property (residential or commercial) is owned by an individual, regardless of where that individual is resident or domiciled for tax purposes, that property will be subject to UK IHT. The value of that property will form part of the individual's estate on death and will be subject to IHT at 40% (subject to any available exemptions or reliefs). Certain lifetime gifts of UK property held directly (such as gifts to a trust) may also give rise to a charge to IHT at 20% of the value of the gift.

Previously non-UK companies and trusts were often used in structuring UK property ownership so that an individual did not hold UK property directly; holding UK property through a non-UK company could avoid the value of the property being subject to IHT. However, since 6 April 2017, using such structures has not prevented a charge to IHT on the value of any UK residential property held in the structure. To the extent that the value of shares in non-UK companies or other similar entities is derived from interests in UK residential property (including in certain circumstances loans relating to UK residential property), those shares are now subject to IHT. Additional IHT implications also arise where UK residential property is held in a non-UK resident trust (whether directly by the trustees or via underlying non-UK companies). These rules only apply to residential property; UK commercial property owned via non-UK companies or other opaque entities remains outside the scope of IHT where the company is owned by a non-UK domiciled (and not deemed domiciled) individual, or a trust set up by such an individual.

Annual tax on enveloped dwellings (ATED) on residential property

In 2013, the UK introduced an annual tax on high-value (ie worth over £500,000) UK residential properties held within companies or other vehicles (whether UK resident or non-UK resident) known as ATED. This charge is not applicable to commercial properties.

The charge is generally based on the market value of individual dwellings as at 1 April 2012 (or the purchase price of the dwelling if purchased after 1 April 2012). Revaluation is required broadly every five years (so the relevant revaluation date is 1 April 2022, for chargeable periods beginning on or after 1 April 2022). The ATED is levied each year in accordance with bands in the table below:

Chargeable amounts for 1 April 2023 to 31 March 2024

Property value	Annual charge
More than £500,000 up to £1m	£4,150
More than £1m up to £2m	£8,450
More than £2m up to £5m	£28,650
More than £5m up to £10m	£67,050
More than £10m up to £20m	£134,550
More than £20m	£269,450

In principle, the ATED increases in line with inflation, based on the consumer prices index (CPI).

The ATED does not generally apply where the residential property is owned by an individual or via trusts. There are also exemptions for ownership of residential properties for business purposes (including where a property is acquired and rented to third parties, is acquired for development and resale, or is acquired and held for use by business employees). Consequently, there are planning opportunities available for ownership of such UK residential property to mitigate ATED liabilities, including 'de-enveloping' to remove the residential property from existing company ownership.

Tax on disposal of UK property

Tax on sale of UK property by seller 'trading' in property

A UK resident individual will be subject to income tax (currently with tax rates up to a maximum of 45%) on the profit derived by the individual from the sale of the 'trading' property, while a UK resident corporation will be subject to UK corporation tax (currently at 25% with a tapering rate from 19% for small businesses) on the profit derived from the trade.

A non-UK resident is subject to UK tax when trading in property (whether residential or commercial) under legislation which took effect on 5 July 2016.

The legislation provides that income and profits of non-UK residents will be subject to corporation tax or income tax (as appropriate) where the trade comprises trading in UK land or developing UK land with a view to disposing of it, regardless of where the trade is carried on and regardless of whether or not the trade is carried on through a permanent establishment in the UK or elsewhere.

Tax on sale of UK property by non-resident seller 'investing' in property

From 6 April 2019, the scope of non-residents' capital gains tax has been extended so that all disposals of investments in UK property interests fall within corporation tax (currently 25% with a tapering rate from 19% for small businesses) for non-resident companies or capital gains tax (currently 20% for higher and additional rate taxpayers, subject to residential rates as set out below) for non-resident individuals, even if the taxpayer was not previously subject to UK tax.

Both direct and indirect disposals fall within the charge to tax. Indirect disposals relate to those where gains are made on certain 'property rich' entities which are 'closely held'.

A 'property rich' vehicle is one that ultimately derives at least 75% or more of its gross asset value from UK land. A 'closely held' interest is one where the seller holds at least a 25%

interest in the entity being disposed of at some point in the two years preceding the disposal, subject to the Collective Investment Vehicles (CIV) rules detailed below.

For both direct and indirect disposals, historic gains are protected and any taxable gain is limited to the increase in value arising from April 2019. This is determined by either a market value rebasing or an election to retain an historical cost (unless it would give rise to a loss).

Tax on sale of UK property by seller 'investing' in commercial property through a CIV

CIVs include collective investment schemes (CISs), alternative investment funds (AIFs), UK real estate investment trusts (REITs) and the foreign equivalent of UK REITs.

From 6 April 2019, the default position for non-resident CIVs is that they are deemed to be companies for capital gains purposes.

The default position can be superseded by CIVs which are 'property rich' (ie where 75% of their gross asset value derives from UK land) by two possible elections: the 'transparency election' or the 'exemption election'.

Non-UK resident CIVs which are 'transparent' for tax purposes in respect of income (most obviously a Jersey Property Unit Trust (JPUT)) may elect to be treated as a partnership for tax purposes, thereby ensuring that any capital gains are deemed to accrue to investors in the CIV. The transparent treatment will apply for all investors in the fund, both UK and non-resident.

Alternatively, certain non-UK resident CIVs (namely CISs or the foreign equivalent of UK REITs) that meet extensive qualifying criteria (including the requirement that the fund is widely marketed or otherwise not closely held) can elect to be treated as companies and exempt from corporation tax.

The exemption election covers direct or indirect disposals so that the CIV and any entities in which it has 40% or more investment will not suffer tax on the proportion of any gains attributable to the holding of the CIV in the asset (with the investors remaining liable to tax on their gains on disposals of interests in the CIV).

Capital gains tax for UK residents selling residential property

Capital gains (calculated as the difference between the price received on sale of the property and the price paid for the property and any improvements) which arise to UK resident individuals on the sale of residential property will generally be subject to a rate of 18% if the individual is a basic rate taxpayer, or 28% if they are a higher or additional rate taxpayer. Exemption from capital gains tax is available where the residential property is the individual's principal place of residence and no capital gains tax is levied if the individual's capital gains for the year do not exceed the annual exempt amount (currently £6,000 and expected to reduce to £3,000 from April 2024).

UK resident corporations selling residential property will be subject to UK corporation tax in respect of any gain derived from the sale of the property, with the gain determined after taking account of indexation allowance if the property was held prior to December 2017.

Property funds

The UK's tax regime can also offer benefits for private and public property funds and portfolio companies where UK commercial property investments can be held in separate offshore special purpose vehicles (SPVs) to offer the ability to sell the SPV without SDLT for a purchaser (although please see above for a discussion on the changes to the tax treatment of CIVs).

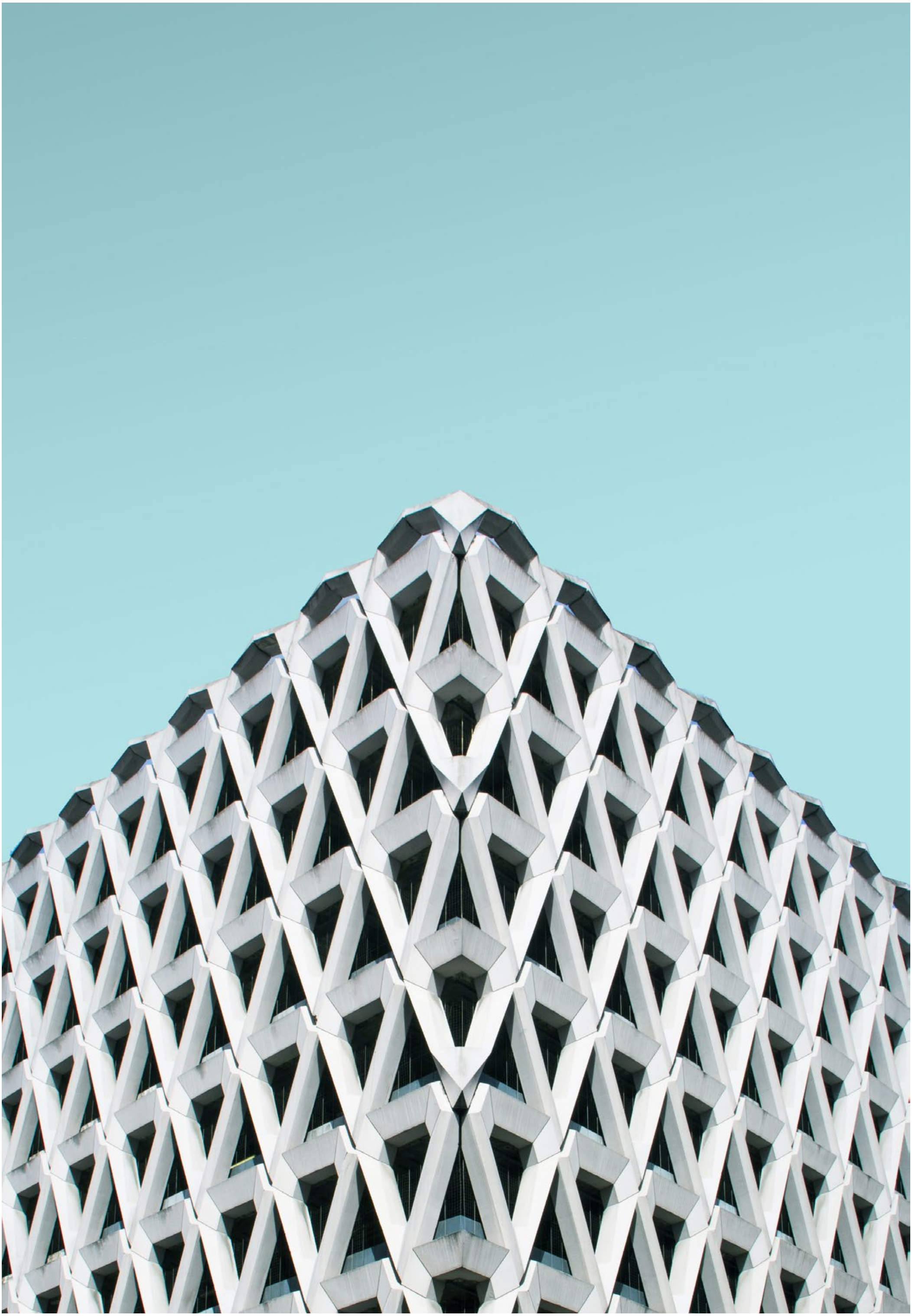
The UK also offers a special tax regime for REITs. Broadly, a REIT is exempt from UK tax on capital gains and rental income – despite the fact that the company is incorporated and tax resident in the UK. Instead, distributions from the REIT to shareholders are treated as if they were payments of rental income and generally subject to UK withholding tax (currently 20%).

Recent changes, taking effect from 1 April 2022, have made REIT status easier to qualify for - particularly when funded by institutional investors. Among other reforms, REITs no longer have to have their shares listed on a recognised stock exchange if they are substantially owned by institutional investors. Further changes were introduced from 1 April 2023, including relaxing the requirement for a REIT to hold a minimum of three properties where it holds a single commercial property worth £20m or more. Further changes which will also benefit institutional investors are planned in the Finance Bill 2024, for example the rule requiring a REIT to be a non-close company or only close because of an institutional investor will be amended to confirm that it can be satisfied by indirect ownership by institutional investors.

Islamic finance and UK real estate

This is a highly specialised area where careful tax structuring is required to achieve a 'level playing field' for finance arrangements undertaken in a form which is compliant with Shari'a law principles as compared with more conventional funding.

Examples of such structures include the Ijara lease, under which rental payments provide returns on finance, and Sukuk Al-Ijara, suitable for raising finance from a bond issue to the markets.



Summary for commercial property

Acquisition of commercial property

	France
Typical structure	Acquiring property through French corporate entity.
Transaction tax on acquisition of property	Registration duties – up to 7% of property value.
VAT on acquisition price	Applicable at the rate of 20% to 'new' buildings. Not applicable to 'old' buildings, unless the seller has 'opted to tax'.
Transaction tax on acquisition of property holding company	Registration duties – 5% of price if predominant French real estate company shares acquired.

	Germany	United Kingdom
	Acquiring property though non-German corporate entity.	Acquiring property through non-UK corporate entity.
	RETT – 3.5% to 6.5%.	SDLT – sliding scale up to 5% on price above £250,000.
	Applicable at the rate of 19% if seller has 'opted to tax' the property (unless 'transfer of a going concern' treatment applies).	Applicable at the rate of 20% if seller has 'opted to tax' the property (unless "transfer of a going concern" treatment applies).
	3.5% to 6.5% only if 90% or more of the shares/interests are legally or economically acquired/unified by (a) purchaser(s).	Stamp duty – 0.5% if shares are in a UK incorporated company; otherwise no stamp duty.

Summary for commercial property (continued)

Holding of commercial property

	France
Tax on rental income – individuals	French individual residents – progressive rates up to 45% and 17.2% social security and ancillary taxes (effective tax rate ("ETR") – up to 66.2%). Non-French resident individuals – tax at a minimum of 30%, unless average rate applicable to worldwide income under French rules is lower. Exempt from CSG and CRDS if affiliated to a compulsory social security system, other than the French one, within an EEA country (still subject to 7.5% solidarity levy).
Tax on rental income – companies	French corporates – standard tax rate of 25%. Non-resident corporates – tax rate of 25%.
VAT on rental income	20% if furnished premises or holder has 'opted to tax' (unfurnished premises subject to 2.5% rental tax instead).
Annual real estate wealth tax	Applicable to individuals where net value of French real estate assets exceeds €1.3m at progressive rates up to 1.5% of net value of French real estate assets.

	Germany	United Kingdom
	Progressive income tax rate up to 45% plus solidarity surcharge, resulting in an aggregate maximum tax rate of 47.475%.	Progressive income tax ("IT") rates up to 45%.
	CIT of 15% plus solidarity surcharge, resulting in an aggregate tax rate of 15.825% (no trade tax, assuming no German permanent establishment).	Corporation tax (CT) of 25% (unless small company rates apply) for UK resident and non-UK resident corporates.
	19% if holder has 'opted to tax'.	20% if holder has 'opted to tax'.
	Real estate tax (Grundsteuer) – tax rate depends on both local settings and characteristics of real estate.	Not applicable.

Summary for commercial property (continued)

Holding of commercial property

	France
Inheritance and gift tax	For individuals only – varying depending on relationship between donor and beneficiary – 5% to 60% (subject to exemptions under any relevant treaty).
Other annual taxes	For companies carrying on professional activities – Territorial Economic Contribution – variable rates capped at 3% of added value during the year. For companies – annual tax of 3% of fair market value of the property, although exemption generally applies unless company in tax haven or does not disclose shareholders. Certain ancillary taxes by local authorities.

	Germany	United Kingdom
	Assuming investment property located in Germany has been transferred on death or by way of donation – 7% to 50% for individuals and 30% to 50% for corporations; precise tax rate depends on individual circumstances.	Inheritance tax ("IHT") at 40% on death of individual – unless business property relief or spouse exemption is available. Non-resident individuals only liable to IHT on directly held UK commercial property.
	Not applicable.	Not applicable.

Summary for commercial property (continued)

Disposal of commercial property

	France
Tax on sale of property – individuals	Capital gains tax ("CGT") (19%) plus surtax (up to 6%) and social charges and ancillary taxes (ETR – c46.2%). Taxable gain reduced for years of ownership after five years and tax exempt where ownership is more than 22 years.
Tax on sale of shares (in predominant property holding company) – individuals	CGT (19%) plus surtax (up to 6%) and social charges and ancillary taxes (ETR – c46.2%). Taxable gain reduced for years of ownership after five years and tax exempt where ownership is more than 22 years.

	Germany	United Kingdom
	If property is held by individuals and sale is taxable (holding period is less than 10 years) – tax up to 45% plus solidarity surcharge, resulting in an aggregate maximum tax rate of 47.475%.	If property is held by individual for trading purposes – progressive income tax rates up to 45%. If property held as investment by UK resident individual – 20% CGT (if higher or additional rate taxpayer). If property held as investment by non-resident individual – subject to CGT from April 2019 (currently 20% for higher and additional rate taxpayers).
	If German resident individual holding at least 1% of the shares – up to 45% plus solidarity surcharge, resulting in an aggregate maximum tax rate of 47.475% on 60% of the profits. If German resident individual holding below 1% of the shares – 25% income tax plus solidarity surcharge, resulting in an aggregate maximum tax rate of 26.375%. If non-German resident individual – no German tax on capital gains from disposal of shares in foreign Propco.	If UK resident individual selling shares – 20% CGT (if higher or additional rate taxpayer). If non-UK resident individual selling shares – subject to CGT if gain is made on disposal of shares in offshore 'property rich' entities.

Summary for commercial property (continued)

Tax on sale of property – companies	Corporate tax – a minimum rate of 25% (unless overseas company can benefit from tax treaty). The rate can increase to 25.83% (if taxable income exceeds €763,000).
Tax on sale of shares (in predominant property holding company) – companies	Corporate tax – 25% (unless tax treaty prevents French tax). The rate can increase to 25.83% (if taxable income exceeds €763,000).

	15% CIT plus solidarity surcharge, resulting in an aggregate tax rate of 15.825%. Furthermore, trade tax may occur depending on the individual circumstances (eg permanent establishment in Germany).	If UK resident company selling property – CT of 25% on gain. If non-UK resident company holding 'investment property' – subject to CT of 25% on gain. If non-UK resident company 'trading' in property – CT of 25% on gain.
	If German resident company selling shares – 0.75% CIT plus solidarity surcharge, resulting in an aggregate tax rate of approximately 0.8%. For non-German resident company selling shares – generally no German tax on capital gain (subject to special Double Tax Treaty regulations).	If UK resident company selling shares – generally 25% CT on gain. If non-UK resident company selling shares – subject to CT of 25% if gain is made on disposal of shares in offshore 'property rich' entities.

Summary for residential property

Acquisition of residential property

	France
Typical structure	Acquiring property through French SCI.
Transaction tax on acquisition of property	Registration duties – up to 7% of property value.
VAT on acquisition price	None.
Transaction tax on acquisition of property holding company	Registration duties – 5% of price applicable if predominant French real estate company shares acquired.

	Germany	United Kingdom
	Acquiring property through offshore Propco.	Acquiring property by individuals directly or non-UK corporate entity.
	RETT – 3.5% to 6.5%.	SDLT – variable rates depending on acquirer. Can be up to 12% for individuals where value exceeds £1.5m and 15% for companies where value exceeds £500,000. Higher rates (adding additional 3% to standard SDLT rates) if purchaser already owns a residential property or is a body corporate. Additional 2% surcharge if purchaser is a non-UK tax resident.
	Depends on whether seller 'opts to tax'.	None.
	RETT – 3.5% to 6.5% only if 90% or more of the shares/interests are legally or economically acquired/ unified by (a) purchaser(s).	Stamp duty – 0.5% if shares are in a UK incorporated company; otherwise no stamp duty.

Summary for residential property (continued)

Holding of residential property

	France
Tax on rental income – individuals	French individual residents – progressive rates up to 45% and 17.2% social security (ETR – up to 66.2%). Non-French resident individuals – tax at a minimum of 30%, unless average rate applicable to worldwide income under French rules is lower. Exempt from CSG and CRDS if affiliated to a compulsory social security system, other than the French one, within an EEA country (still subject to 7.5% solidarity levy).
Tax on rental income – companies	French corporates – standard tax rate of 25%. Non-resident corporates – tax rate of 25%.
VAT on rental income	None.
Annual real estate wealth tax	Applicable to individuals where net value of French real estate assets exceeds €1.3m at progressive rates up to 1.5% of net value of French real estate assets.

	Germany	United Kingdom
	Progressive income tax rate up to 45% plus solidarity surcharge, resulting in an aggregate maximum tax rate of 47.475%.	Progressive income tax rates up to 45%.
	German corporates – standard tax rate of 15% plus solidarity surcharge, resulting in an aggregate tax rate of 15.825%. Furthermore, trade tax of approximately 15% may occur, depending on the individual circumstances. Non-resident corporates – CIT of 15% plus solidarity surcharge, resulting in an aggregate tax rate of 15.825% (assuming no German permanent establishment).	UK resident and non-resident corporates – CT of 25%.
	Depends on whether landlord 'opts to tax'.	None.
	Real estate tax (Grundsteuer) – tax rate depends on both local settings and characteristics of real estate.	Not applicable.

Summary for residential property (continued)

Inheritance and gift tax	For individuals only – varying depending on relationship between donor and beneficiary – 5% to 60% (subject to exemptions under any relevant treaty).
Other annual taxes	For companies – annual tax of 3% of fair market value of the property, although exemption generally applies unless company in tax haven or does not disclose shareholders. Certain ancillary taxes by local authorities.

Assuming investment property located in Germany has been transferred on death or by way of donation – 7% to 50% for individuals and 30% to 50% for corporations; precise tax rate depends on individual circumstances.	IHT at 40% on death of individual, shareholder of non-UK company or settlor who is also a beneficiary of a non-UK resident trust in the absence of any available exemptions. Additional IHT liabilities for non-UK resident trusts holding UK residential property interests directly or via non-UK entities.
Not applicable.	For corporates and similar vehicles only – ATED is variable annual levy depending on market value of residence; ranging from £4,150 per annum for properties over £500,000 to £269,450 per annum for properties valued over £20m.

Summary for residential property (continued)

Disposal of residential property

	France
Tax on sale of property – individuals	Capital gains tax (19%) plus surtax (up to 6%) and social charges and ancillary taxes (ETR – c46.2%). Taxable gain reduced for years of ownership after six years and tax exempt where ownership is more than 22 years.
Tax on sale of shares (in predominant property holding company) – individuals	Capital gains tax (19%) plus surtax (up to 6%) and social charges and ancillary taxes (ETR – c46.2%). Taxable gain reduced for years of ownership after six years and tax exempt where ownership is more than 22 years.

	Germany	United Kingdom
	If property is held by individuals and sale is taxable (holding period is less than 10 years) – tax up to 45% plus solidarity surcharge, resulting in an aggregate maximum tax rate of 47.475%.	If property is held for trading purposes – progressive income tax rates up to 45%. If property held as investment by UK resident individual – 28% CGT (if higher or additional rate taxpayer). If property held as investment by non-resident individual – CGT of 28% on any gain arising on property above value of property on 1 April 2015 (or acquisition price if acquired after that date).
	If German resident individual holding at least 1% of the shares – up to 45% plus solidarity surcharge, resulting in an aggregate maximum tax rate of 47.475% on 60% of the profits. If German resident individual holding below 1% of the shares – 25% income tax plus solidarity surcharge, resulting in an aggregate maximum tax rate of 26.375%. If non-German resident individual – no German tax on capital gains from disposal of shares in foreign Propco.	If UK resident individual – 28% CGT (if higher or additional rate taxpayer). If non-UK resident individual – subject to CGT if gain is made on disposal of shares in offshore 'property rich' entities.

Summary for residential property (continued)

Tax on sale of property – companies	Corporate tax – 25% (unless overseas company can benefit from tax treaty). The rate can increase to 25.83% (if corporate income tax exceeds €763,000).
Tax on sale of shares (in predominant property holding company) – companies	Corporate tax – 25% (unless tax treaty prevents French tax). The rate can increase to 25.83% (if corporate income tax exceeds €763,000).

	15% CIT plus solidarity surcharge, resulting in an aggregate tax rate of 15.825%. Furthermore, trade tax may occur, depending on the individual circumstances (eg permanent establishment in Germany).	If UK resident – 25% CT on gain. If non-UK resident and seller 'trading' in property – UK CT of 25% on gain. If non-UK resident company holding 'investment property' – 20% CGT applicable to gain arising on property above value of property on 1 April 2015 (or acquisition date if later).
	If German resident company selling shares – 0.75% CIT plus solidarity surcharge, resulting in an aggregate tax rate of approximately 0.8%. For non-German resident company selling shares – generally no German tax on capital gain (subject to special Double Tax Treaty regulations).	If UK resident seller – 25% CT on gain. If non-UK resident seller company – subject to CT of 25% if gain is made on disposal of shares in offshore 'property rich' entities.

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