Christian H. Kälin

International Real Estate Handbook

Acquisition, ownership and sale of real estate
Residence, tax and inheritance law

John Wiley & Sons, Ltd

"This invaluable reference source for professionals will undoubtedly prove every bit as indispensable to the individual. Anyone seriously considering buying or selling a home abroad would do well to follow its advice to avoid the many pitfalls of the property maze."

Jill Keene, Editor, International Homes magazine

"The International Real Estate Handbook *is a great reference book, summarising in a concise way the relevant information concerning the acquisition, sale and transfer of real estate in a number of important countries. It will be a very useful tool for the advisers of wealthy and internationally mobile individuals."*

PD Dr. Hans Rainer Künzle, Partner, KPMG private, Zurich

"This book provides you with all the information you need concerning investing in properties abroad: It not only reviews the whole real estate acquisition process, from the search to the financing, but also gives a lot of tips and checklists. A must buy if you are thinking about investing in real estate abroad."

Ángel Serrano – Manager International Clients – Deutsche Bank SAE

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Contents overview

About the editor

Christian H. Kälin is an international real estate, tax and estate-planning specialist and a partner at Henley & Partners, Zurich. He is also a member of the board of directors of the International Financial and Legal Network and one of the founding partners of Verica Trust & Capital Management, Zug, an investment advisory firm with a strong focus on real estate. After completing Zurich Business School and his training at a Swiss private bank, he lived and studied for many years in France, the USA, New Zealand and Switzerland. A holder of a cum laude law degree from the University of Zurich, he is a frequent writer and speaker on international tax-planning issues, on cross-border business relocation and private residence planning, and is regularly quoted in major international publications, most Swiss newspapers and Swiss television. He also specializes in real-estate structuring and real-estate investments and is a member of the panel of judges for the Bentley International Property Awards.

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About this book

This book presents general information on the most important questions concerning the acquisition, ownership and sale of private real estate, and also looks at selected countries which are particularly relevant to this sector in practice. It is designed as a guide for **lawyers, tax consultants, asset managers, private–client advisers** in banks, **family offices** and other advisers dealing with the acquisition, ownership and sale of privately used real estate in an international context. It is, of course, also addressed to **private individuals** who wish to acquire and own real estate abroad. The use of concise and precise language reflects its character as a handbook and reference source. In particular, the authors have endeavored to express the terms and concepts involved as transparently as possible in order to make them easily accessible even to those without a legal background. Footnotes are dispensed with for the sake of clarity.

The **addresses sections** have been carefully researched and list important contacts relevant to the acquisition and ownership of real estate. Although a mention in this publication certainly implies a recommendation, it would have been impossible to list all good lawyers, consultants, real estate brokers, banks and other institutions. Neither can the publishers, editor or authors guarantee the addresses listed in this publication, even though they have been selected with great care.

This book can in no way substitute legal advice. The publisher, editor and authors therefore unreservedly exclude any liability for losses or damages of any kind – be these direct, indirect or consequential – which may result from the use of this book or of the information it contains. Although all the authors have undertaken their research with great care, they obviously cannot guarantee their completeness and correctness any more than the editor or publisher.

Any **comments and suggestions, praise or criticism** will be gratefully received. If you, as the reader, feel that a particular topic or address should be removed from or added to this volume, please let us know.

By all means write to the editor via e-mail at christian.kalin@henleyglobal.com or by conventional mail to the following address: Christian H. Kälin, *Henley & Partners*, Kirchgasse 22, CH-8024 Zurich, Switzerland.

How to use this book

The book is divided up into a **general/international chapter and chapters on individual countries**. The general chapter covers all the criteria that should normally be considered by anyone wishing to acquire or own real estate. The chapters on individual countries explain the details of acquisition, forms of ownership, taxes and inheritance law up to residence and domicile that are specific to that country. The book also contains address lists, checklists and overview tables, making it an excellent **reference source**.

The book has a **systematic structure**, and the contents of the individual countries have an identical layout so that the same topics in each country can always be found under the same titles or subtitles. Thus the title 'Easements, charges, liens and mortgages' is always listed

under item **2.2**, and 'Restrictions under family law and matrimonial property regime' comes under **3.2.1** in each country.

The **comprehensive checklists** in the general chapter offers a systematic approach to the most important points to be considered when acquiring real estate. In addition, each individual country contains **country-specific checklists** that are designed to supplement the general checklists and contain only the most important points to be considered when acquiring real estate in the respective country.

Overview tables are inserted at various points. They make no claim to completeness and are designed to give the user an overview of key sectors and to facilitate comparisons.

The **addresses sections** give the user easy access to relevant addresses that are useful for the acquisition, ownership and sale of real estate. The addresses are arranged by country so that they appear under the relevant section of each specific country. An international addresses section is also attached to the general chapter.

A **bibliography**, i.e. a selection of more comprehensive and specialized publications, is attached at the end of each chapter. It is more or less extensive depending on the country and the available literature.

At the end of the volume, **comprehensive indexes** arranged by individual countries, allow a systematic search for terms.

Acknowledgments

This publication arose from the idea and need to produce a really first-rate, up-to-date and useful international handbook of residential real estate, simply because nothing of this kind had been available before. The original publishers, Orell Füssli of Switzerland, concurred with this idea, and so did the publishers of this present English edition, John Wiley & Sons. They and the editor are now pleased to present the result to interested readers. A great deal of specialist knowledge, work and effort has gone into this project, and it has certainly proved worth while. As an expression of its overall concept, this volume can unquestionably be seen as a pioneering achievement. The authors, editor and publisher hope that our readers share this viewpoint as well as their enthusiasm for the project.

At this point I would like to express my sincere thanks to all those who have contributed to the book. Special thanks are due to Yvonne Meinert, who was principally responsible for coordinating the authors and helped to rework the texts and tables, and to Mirjam Schnepf, who devoted herself particularly to the complex task of editing the addresses sections. Furthermore, I would also like to thank all the co-authors as well as Rachael Wilkie and her colleagues at John Wiley & Sons. Thanks to their professional support, they have also contributed significantly to the successful publication of this book.

Zurich, July 2004 Christian H. Kälin

General/ International Chapter

General/ International Chapter

International Real Estate: Key Aspects

by

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Contents: General/International Chapter

1 Introduction: Real estate abroad

Many people no longer limit the horizon of their activities and aims to the borders of their own country. New transport and communications media, the political stability and integration of *Europe*, cross-border activities, prolonged stays in foreign countries and the acquisition of real estate abroad are an expression of this trend. Especially the last of these – in the form of vacation homes, second homes or a new main domicile – is gaining in interest and importance within *Europe* and world wide. The ongoing integration of the *European Union*, in particular the free movement of persons and capital as well as the single European currency, has made its contribution to the growing trend for foreign nationals to acquire real estate abroad, above all in southern *Europe*. European countries such as *France, Spain, Italy* and *Portugal* are among those most favored by foreign buyers who seek a mild climate, a more relaxed lifestyle and recreational surroundings. But interest is increasingly extending to destinations such as *Croatia, Malta*, the *Caribbean*, the *Bahamas* and elsewhere, and even cooler regions such as *Canada, Sweden* and *Ireland* are popular.

The acquisition and ownership of real estate across borders raises legal and tax issues, and problems may occur whose full extent is often unsuspected by those concerned. Private acquisitions of real estate are not infrequently made without any accurate knowledge of the legal, tax and economic background. Even if **quality of life** and personal use are paramount motives for the purchase of noncommercial real estate, the acquisition of property is always a **capital investment**. As value maintenance and capital growth – as well as aspects of tax and inheritance law – will accordingly play a vital role, it is important to clarify these key framework conditions before acquiring real estate in order to be protected from unexpected legal and tax consequences. While this applies to real estate in general, it is particularly true for property located abroad.

Every purchase of real estate abroad must clearly be approached with **particular care** by buyers without sufficient legal and possibly linguistic knowledge, but this should not deter them from trying. Nevertheless, it is generally advisable to play it safe by calling in lawyers, tax experts, architects and trustworthy real estate agencies familiar with local conditions. The costs incurred will almost always be more than offset by the smooth and correct handling of the procedures involved.

Other countries have different habits – and different legal systems. This applies quite particularly to real estate and tax law, which may assume very different forms in various countries. So foreign acquirers of real estate cannot let themselves be guided by their native feeling for what is right, but must inform themselves in an unprejudiced way about the circumstances prevailing locally. Still, the acquisition of real estate is quite safe in most countries as long as certain **basic rules are observed**.

Ownership of real estate satisfies a basic human need. To acquire a piece of property in an attractive location is equivalent to gaining a certain quality of life, and in most cases sensible asset diversification. At the same time, it means acquiring an asset that almost always retains its value, and in most cases gains in value over a longer period of time. However, it is important to observe certain important principles here too.

2 Finding the right property

2.1 Brokers, dealers and developers

In every country, many players are involved in the real estate sector. A great deal of money can be earned and lost in this business, but few if any qualifications or other professional or personal preconditions are generally required to take part in it. Corresponding **care** must therefore be taken, as there will always be some among the many agents, brokers, general contractors and promoters whose business methods cannot be called respectable.

Real estate brokers

Real estate brokers (agents) are found throughout the world. Whereas it requires authorization in some countries to be a real estate broker/agent, others exercise no supervision at all, so that absolutely anyone can try to run an agency. The services offered by a broker may also vary greatly. In some countries, the broker or agent does practically everything for the buyer, including drawing up the contract, administrative work, completion of tax forms, etc. Often, however, the broker does no more than bring the buyer and seller together and, at most, accompanies the transaction as far as the notary or a selected lawyer. As a rule, brokers receive a **commission** only when a purchase actually takes place. If no sale results, they go away empty-handed. That's why brokers are interested in **rapid closure** and accordingly tend to urge prospective customers to buy. However, good brokers always have the overall consulting service for their client in mind and endeavor to praise the prospective property in relatively objective terms. Professional brokers also tend to have an extensive portfolio of real estate from which to select the most suitable for their client. However, the fact that the broker is commissioned by the seller and usually receives payment for his services from the latter tends, in practice, to produce a bias in favor of the seller's interests – although this is contrary to the rules of the profession and often also infringes the legal obligation to neutrality. As a buyer, therefore, one should always maintain a certain **distance** and **communicate** this reserve clearly.

The business of a real estate broker for privately used real estate normally has **a strong local orientation**. Brokers tend to limit their activities to a particular city, province or region. In some small countries, however, brokers may extend their activities over the whole country (for instance in *Malta* or the *Caribbean*). Larger real estate brokers may have an extensive network of branches and their activities can extend over several regions or even across the whole country. However, their individual offices obviously have a local orientation. Franchise companies are also expanding throughout the world, especially from the *USA*. They comprise a number of autonomously managed and independent real estate brokers who present a united brand vis-à-vis the outside and apply uniform standards for marketing, quality assurance, etc. Only in the luxury segment is a certain level of internationalization to be observed, although here too the leading brokers continue to be specialists with a strong local presence. Some companies with an international scope of operations thus offer luxury real estate world wide via exclusive networks of brokers.

Real estate dealers

In contrast to brokers, who essentially merely bring buyer and seller together and receive a commission for this service, **real estate dealers** act as buyers and sellers on their own

behalf. The buyer must be even more careful in this case, as a real estate dealer who wants to sell a property now acts completely in his or her own interest and tends to urge the buyer to make a quick closure. In addition, there is obviously a danger that the dealer may try to take advantage of an unsuspecting buyer, for instance by concealing important facts about the property. In this case it always makes good sense to call in an independent expert (such as a reputable agent, real estate expert or lawyer with experience in real estate).

Developers

The term ***developer*** refers to a kind of general contractor responsible for the overall realization of real estate projects. The *developer* is usually the owner of a piece of land which is ready for development and handles all the building work up to the marketing and final handover of the individual real estate. Buyers must exercise the greatest caution when buying real estate from a *developer* for various reasons. Firstly, the *developer* is obliged to complete specific project phases within certain periods of time, which may lead to the use of somewhat more aggressive sales methods. Moreover, the buyer may incur an extensive financial risk by buying the real estate on the basis of a mere plan, i.e. before any building work has been started or while this is still in progress. New or still unbuilt real estate should be acquired only from very well-established and reputable developers. Corresponding guarantees are indispensable.

2.2 How to recognize a reliable real estate professional

The reputability of a real estate professional cannot be determined on the basis of generally applicable paradigms. However, a number of **indications** may allow a conclusion to be drawn one way or the other. Although these seem obvious to many readers, experience shows that it is nevertheless important to make oneself aware of this time and again.

Reputable brokers, real estate dealers and developers will always be distinguished by a professional, **reserved** manner. **Professional associations**, whose members comprise real estate brokers, architects, surveyors, developers, etc., are found in all countries. Depending on the organization, the selection criteria for membership usually guarantee a certain quality standard. Moreover, it makes sense to find out how long the relevant broker, real estate dealer or developer has been established. Anyone who has already been in business for many years, possibly at the same address, would normally merit a positive valuation. You should also ask openly for references and not neglect to check them.

2.3 Key criteria to note when looking for real estate

Although common knowledge, it is nevertheless worth stressing that **location** is the most important factor in the selection of any piece of real estate. Quite apart from the present circumstances, special care must also be taken to check how the environment may change in the future. So it is not irrelevant if **projects for constructing** freeways, airfields, power lines, waste dumps or similar major developments are planned in the area. One should also know in which **construction zone** the building plot and its surrounding plots are situated (might a neighbor add another story to his house and in so doing obscure the marvelous lake view?). The best way to be quite sure about these factors is to buy existing real estate in surroundings which are already well developed and in which rezoning is unlikely.

If there are still many undeveloped plots of land around a property, it is difficult to estimate how the surroundings and perhaps the entire appearance of the locality may change. Many location factors must be considered, above all the **quality of the local municipality**. Thus the way in which this quality is likely to change in a positive way in the future is of critical importance for any gain in the value of the real estate. This will be explained in greater detail later. Also the quality of the **location within the municipality** where the real estate is situated is important. Is the house located on a quiet street in a quiet area? Where are the nearest shops, bank, post office, schools and kindergartens, high schools, location of evening classes, restaurants and sports facilities? Are there cultural facilities nearby? How easily can the real estate be reached by public transport? Where is the nearest national or international airport? Where is the nearest rail station? What are the connections like? How far is it to the nearest highway or freeway access? How close is the nearest healthcare facility, and where are the nearest major hospitals?

These questions concerning the **infrastructure** are of **central concern** to anyone interested in acquiring real estate and their answers have a corresponding effect on **price levels**. In general, real estate situated in largely rural localities with a modest infrastructure are much less in demand and are correspondingly more difficult to resell. In contrast, real estate in locations offering an extensive infrastructure immediately command higher prices. In the case of 'bargains', a poor infrastructure is often a major reason for the relatively low price. And although the same demands are not necessarily made on infrastructures around vacation residences – where a rural idyll away from the hustle and bustle of the city is often sought – considerations of this kind are nevertheless just as important as for a principal residence. The ideal for many people is likely to be real estate in a very quiet location in idyllic surroundings, but nevertheless close to a town and an international airport. And it is precisely real estate of this kind that represent the **ultimate luxury** and attract the relatively highest prices world wide.

If interest focuses on the **maintenance and value growth potential**, it should be noted that owner-occupied residential properties often tend to be a poor investment in real terms – i.e. when adjusted for inflation. At any rate, the return is not as good than is generally assumed, as real estate tends to be considered a very secure and above all an inflation-proof investment. However, the most important factor in maintaining and increasing the value of residential real estate is not its current location quality but potential positive changes, i.e. the **improvement of location quality**. Such improvements are often the result of expanding residential areas, especially in the periphery of larger cities, and of associated infrastructure improvements in transport links and shopping facilities. However, the expansion of the infrastructure can also have a negative impact on location quality, such as the construction of new freeways or the extension of airports with the associated changes in flight paths. The latter can have an impact up to dozens of kilometers distance from the actual location of the airport.

In making a possible estimate of the future potential growth in value of a real estate, it is always worth while clarifying the planned and future development of the residential area in which it is located as well as any changes in local infrastructure in advance of purchase.

Important aspects of the real estate itself are the **size and shape** of the plot, the **orientation** of the building and its **exposure to sunlight**, the **view** as well as the extent to which it is overlooked by neighbors. **Exposure to wind** plays a significant role in many areas (for

example, the *Mistral* in southern *France* or the *Bora* in *Dalmatia*). A secluded outside patio can be very attractive, but excessive exposure to wind can make conditions quite disagreeable outside the house – for instance, in the garden. Tranquility is also important, and **noise**, especially from busy roads and airports, should not be underestimated. **Intrusive odors** also represent an important factor (proximity to paper factories, pig farms, food-processing establishments, etc.). Furthermore, **exhaust emissions** must be considered. In view of the pollution from fumes, it is important to be sufficiently far away from filling stations, covered car parks and busy roads. Likewise, one should be sufficiently far away from **pylons/high-tension lines** and **mobile phone network antennas.** It is also necessary to be aware of possible **risks of accidents**. For instance, industrial or other installations may represent a considerable risk (chemical factory, nuclear power plant, liquid gas tanks, cyanide warehouse of a metal-processing plant, etc.). Given a choice, a prospective buyer would obviously opt for real estate located a sufficient **distance** from installations of this kind.

Where buildings are constructed on a slope, excessive water pressure and thus damp masonry may be a problem. Any danger of **natural hazards** must also be clarified. Landslides, avalanches, earthquakes, forest fires as well as flooding, tidal waves and hurricanes or tornadoes may present considerable risks in certain areas. The situation and construction of the property must be carefully considered to estimate the real risks.

Certain special features must be considered in the case of **rural/agricultural real estate** as well as of **historical real estate** and **real estate located by rivers, lakes and close to the sea**. These will be treated in separate chapters.

What about **access** and access authorization? Is there a public road leading to the property, or only a private road? Is snow clearance an issue in winter?

Security must not be neglected either. How frequent are burglaries in the area where the real estate is located? Is the house very isolated? Is there a need for a burglar alarm? Are there any neighbors and trustworthy persons who can keep an eye on the real estate when the owner is absent? Might there be a need for a private surveillance service?

The most varied criteria must then be considered as regards the property itself. They include the **size and configuration of the rooms** and ancillary premises, the number of bathrooms, potential for additional fittings and extensions (for instance, can the attic be extended?), **construction quality** of the buildings, **heating insulation**, energy consumption, heating system (also a necessity in a country like *Spain* if the real estate is to be used all year round). Penetration of **moisture** (e.g. in the case of old walls, damp subsoil, slope situation) can constitute a major problem which may not be easy, or indeed possible, to solve. The condition of the **roof** is a major consideration, and **pest** damage – not only in the attic – is by no means unusual in many areas. The technical equipment of the property and the various installations must also be carefully examined. What is the state of the electrical installations and the plumbing? Are there telephone, internet, ISDN/ADSL, cable TV connections, a satellite dish? What kind of water supply and waste-water disposal facilities are present? What kind of heating system is in place? In the case of oil heating, the potential environmental risk means that the oil tank must not be placed directly on or in the soil outside. It should be located in the cellar or other separate building and be equipped with a protective trough. One should also check whether the heating installation and the oil tank have been regularly maintained.

In the case of a **swimming pool**, it is also of interest to know whether it has been regularly maintained. What is the condition of the pool? Is there potential for extension? Would this require approval?

It is important to ensure sufficient **sound insulation**, including against **foot fall sound**, especially in apartments/condominiums and duplex villas. To check this out in practice, it is best to spend several days in the building or – more realistically – to have the sound insulation inspected by an expert who can measure it accurately.

Prestige elements such as a sauna, swimming pool, tennis court, parking facility or direct waterfront location naturally increase the value and thus the price of a real estate. The historical importance of the building, an absolutely exclusive location or the fact that it has been built by a celebrity architect can have a significant effect on the price of the real estate.

Properties that are not too large, in good to very good locations, particularly in a region with a promising future in terms of residential development, ideally close to a large city, with high-quality and well-maintained buildings with a practical interior design and appropriate fittings are almost always in demand. Such properties are correspondingly easier to resell and offer above-average potential for value growth.

When searching for real estate, one should ideally already apply those criteria that will be significant to future buyers when it comes to a **resale**.

2.4 The valuation of real estate

The value of real estate is affected very strongly by **subjective criteria.** This makes an objective valuation difficult, and there is never anything like a 'right' value, but only value bands, which may be justified on both objective and subjective grounds. The price for a specific real estate is fixed precisely only when the buyer and seller agree on it at the sale. However, this is merely a momentary value.

The **property announcements** in the local press and in specialized publications like real estate magazines give an initial overview of the **price level** of comparable local real estate. As brokers almost always represent the sellers, their price information and recommendations must be taken with all due caution. It is much better to be advised by an independent expert – for example, a chartered surveyor, a lawyer familiar with the relevant market, or a local architect.

In the case of larger, older or special real estate, such as historical buildings, it is wise to commission an **assessment** by an expert (surveyor, architect or civil engineer). The associated costs, depending on the detail of the assessment, the size and location of the real estate and the country, normally range between US$ 1,500 and US$ 20,000, and represent a sound investment in most cases. It may even be worth while obtaining a **second opinion**, especially if the initial appraisal was made by a potentially biased party.

It is very important to **find a suitable expert** who can appraise the real estate on objective criteria and analyze its market value as realistically as possible. A suitable expert should possess local building knowledge as well as experience in the type of real estate to be assessed. In the case of older properties, and especially of historical buildings, it is important that the condition of the building and any need for renovation be examined and realistically

assessed. Professional surveyors perform a valuable service here, as these questions cannot be answered by a buyer unfamiliar with local circumstances.

There are various **real estate valuation** methods. In **past-** or **cost-based** methods, the original building costs are extrapolated to their current value via a suitable index and annual hypothetical amortizations are concurrently calculated. The land value is also determined. In contrast, **future-oriented** methods are based on the revenue value or on discounting future revenues. However, **market or cross-comparison** methods are of particular relevance for private, owner-occupied real estate. The price of the real estate being assessed is then determined on the basis of the latest prices of comparable properties. This method is also used intuitively by a layman when comparing different properties.

3 Ownership of real estate

3.1 Possession and ownership

Non-lawyers often confuse the terms 'possession' and 'ownership'. So it is worth briefly clarifying what these two terms, which originate in property law, mean in most legal systems. **Possession entails the actual control** over a physical object (such as an automobile, a shovel or a house) with the intent to have and to exercise such control. A tenant who lawfully rents a house on the basis of a rental agreement from the owner, and therefore has real power to use it, is consequently the possessor of the house (for the duration of the rental). In contrast, **ownership means the fully comprehensive power of disposal and complete dominion** over a property, including the right to transfer it to others. Ownership is, of course, often associated with possession, and these two legal powers often coincide. However, it is important to distinguish between them, as such a distinction may be relevant in certain circumstances.

3.2 Different forms and types of ownership

Sole ownership of real estate is possible in all the legal systems of interest here. The (sole) owner has the most comprehensive power of disposal and legal control which is possible over a piece of real estate within the scope of the prevailing legal and factual limits. As a rule, **various forms of shared ownership** are also possible, especially joint and condominium ownership. The different forms and types of ownership existing in the various countries are explained in the respective country sections. Some jurisdictions additionally allow separate ownership rights to the land and the buildings standing on it, resulting in **splitting of ownership**. This is particularly the case for the right to build which exists in some jurisdictions.

3.3 Encumbrances, easements, charges, liens and mortgages

Ownership can be **encumbered** and **restricted** in various ways. In addition to contractual agreements, which apply only between the contractual parties, all jurisdictions allow various rights relating to real estate, which are generally applicable and can, in most cases, also be entered or noted in a land or ownership register or in the title deeds. In contrast to comprehensive ownership rights, these imply restricted control over rights to a property.

Restricted property rights limit ownership to the encumbered real estate and to this extent take precedence over comprehensive ownership rights.

There are essentially **four types of restrictions on property rights**, although several different designations for them are found in the various jurisdictions. Thus **personal easements** or **personal servitudes** depend on the entitled person and normally end at the death of natural persons whom they benefit, or in case of legal entities being beneficiaries after some period set by law. A classic example is the right of usufruct or life-estate existing in various forms. There are also various forms of **easements on real estate** or **real servitudes**. These involve a servient and an entitled property. The owner of the servient property must **tolerate** certain interventions by the respective owner of the entitled property (such as right of way or right of passage) or **restrict** the exercise of his ownership right in a certain way (e.g. not build higher than one story). **Charges on real estate** have been handed down from feudal times and still exist in some countries. They obligate the owner of the real estate not only to exercise tolerance, but to perform a certain action, for instance to supply a certain amount of grass or to pay an annual land rental. However, it is now usually possible to be released from a real estate charge by paying a redemption fee. To secure claims and to mobilize the value of a piece of real estate, almost all jurisdictions also include various forms of **liens and mortgages (real estate security interests)**.

So it is very important **to check before every acquisition** whether the real estate to be acquired is encumbered with any easements, charges, restrictive covenants, liens or mortgages. Such rights may be significant and may often greatly restrict the enjoyment or use of the real estate. The existence of such encumbrances may also have considerable effects on its value and future appreciation.

3.4 Protection of ownership, proof of ownership and registration

Private property is guaranteed in all the countries considered here by their respective laws and usually even at constitutional level. In countries such as *Switzerland* and *Germany*, a land register allows the exact ownership relationships and encumbrances of real estate to be determined at any time, and a relatively high legal security prevails, also because of the professional liability of the notaries or lawyers handling the transaction. In such countries as the *USA*, where there is no comparable land register, ownership proof is instead based on title documents and the notary's liability is essentially substituted by a **title insurance**. However, secure title to ownership cannot be quite so easily proved in some other countries, and one must be very careful to ensure that full and good title is acquired and appropriately protected. An overview of the real estate market in selected countries is presented in Table 1.

4 Purchase and sale of real estate

4.1 How to proceed with a purchase

The buyer generally bears the greater transaction risk, as is fittingly expressed by a principle of Roman law: *Periculum est emptoris*, or, in other words: *Caveat emptor*. That is why certain precautions and clarifications are needed prior to every purchase in order to minimize the risks. As a long-term investment, which usually ties up large amounts of capital, the acquisition of real estate should additionally be planned and carried out in a **careful** and

Table 1 Overview: Real-estate market in selected countries

	Types and forms of ownership	Usual financing by credit institutions	Usual rental duration for residential real estate	Rental payments	Security due from tenant for residential rental	Usual deposit at purchase
Austria	Sole ownership, co-ownership, joint ownership, apartment ownership, building right	Up to 80% of the estimated value, depending on financial soundness	Agreed by the contractual parties. Usually between 3 and 10 years. Residential rentals as per rental law: at least 3 years	Monthly in advance	Up to 3 months' rent or a bank guarantee for the same amount	5–30%
The Bahamas	Sole ownership, co-ownership, apartment ownership, timesharing, leasehold, trusts	Up to 75% of the market value	Residential rental usually 1 year. Leasing: longer term	Monthly	2 months' rent	10%
Canada	Sole ownership, co-ownership, joint ownership, condominium ownership, timesharing, leasehold, trusts	Up to 75% of the market value. For foreign nationals: 65%	According to use. One year and thereafter month to month	Payment due at beginning of each month	Leasehold: Rent for the first and last months	5%
Croatia	Sole ownership, co-ownership, joint ownership, apartment ownership, building right	Up to 75% of the market value	No specifications	Payment due at beginning of each month	Depends on the contractual relationship and the conditions	10%
France	Sole ownership, co-ownership, joint ownership with right of accrual, apartment ownership, joint tenancy, timesharing, building right	Up to 100% of the market value or the sale price. Foreign nationals: max. 70%	Residential rental at least 3 years	Monthly in advance or quarterly	Residential rental: 2 months rent or one quarter rent if quarterly payment	5–10%
Greece	Sole ownership, co-ownership, apartment ownership, timesharing	Up to 100% of the sale price	Residential rental at least 3 years. Leasing: 10 years with option to extend	As a rule, monthly in advance	2 months	10%

	Broker's commission [7]	Land register and notaries' fees	Purchase taxes	VAT on new buildings	Annual property and wealth taxes	Capital appreciation taxes as % of appreciation
Austria	Max. 3%, possibly from both buyer and seller, i.e. max, total of 6%	1% land register fee plus authentication costs; 1–3% lawyer's fee	Land transfer tax 3.5%	None (or 20% if chosen by seller)	Ca. 1% of assessed value, no wealth tax	Maximum 50% [3]
The Bahamas	6% for developed, 10% for undeveloped building plots	2.5% of the real-estate value (lawyer's fee)	2–10%	None	1–2% of the market value	None
Canada	3–6%	Notaries in Quebec, otherwise lawyers: either hourly fee or flat rate	Varies by province, mostly between 0.5 and 1.5%	7%	Land tax: varies greatly. [5] No wealth tax	Ca. 25% of the appreciation
Croatia	2–5%	Euro 35 land register registration fee, Euro 10 signature authentication by notary	5%	22%	Vacation home tax Euro 0.7–2 per square meter of usable area, depending on position and infrastructure. No wealth tax	None [1]
France	5–10%	7%	See land register and notary's fees	19.6%	Land tax and living space tax (varies from place to place); wealth tax, for property above Euro 720,000	No capital appreciation tax for main residence; non-residents 16–33%
Greece	2% from buyer and depending on situation plus 2% payable by seller	Ca. 1.5% at purchase, ca. 2% for donation	Conveyancing fee 7–11%; registration fees: ca. 0.5%	No VAT on property	Land tax: 0.3–8% for natural persons or 0.7% for legal persons, where land value exceeds Euro 243,600	In principle none. Possibly 35% for foreign legal persons

Table 1 (*continued*)

	Types and forms of ownership	Usual financing by credit institutions	Usual rental duration for residential real estate	Rental payments	Security due from tenant for residential rental	Usual deposit at purchase
Hungary	Sole ownership, co-ownership, apartment ownership, timesharing	60–70% of the financing value (which is ca. 80% of the market value)	Three to five years, often with an option to renew the contract	Monthly or quarterly in advance	Up to 6 months' rent	10%
Ireland	Sole ownership, co-ownership, apartment ownership, timesharing, leasehold, trusts	90% of the market value	Residential rentals 1–3 years. Leasing: 25 years are standard. The contract is renewable every 5 years. Leases of up to 999 years are possible	Quarterly in advance	Depends on the contractual relationship and the conditions	10%
Italy	Sole ownership, co-ownership, joint ownership, apartment ownership, timesharing, inherited building right	Up to 75% of the market value	Four years with automatic extension by another 4 years. Shorter-term contracts may be agreed	Monthly in advance. Other modes of payment may also be agreed	1–3 months' rent	10–30%
Malta	Sole ownership, co-ownership, joint ownership, apartment ownership, timesharing	75–90% of the market value, depending on the bank	Rentals before 1995: non-terminable. Rentals arranged after 1995: by free agreement	Quarterly	1 months' rent	10%
Monaco	Sole ownership, co-ownership, apartment ownership	50–70% of the market value	By free agreement, usually 1–3 years	Quarterly	3 months' rent	10%
Portugal	Sole ownership, co-ownership, joint ownership, apartment ownership, timesharing, building right	60–80% of the estimated value	Rentals before 1990 non-terminable. Rentals since 1990 terminable after a minimum period of 5 years. Leasing agreement terms 7–30 years	Monthly in advance	1–3 months' rent	10–40%

	Broker's commission [7]	Land register and notaries' fees	Purchase taxes	VAT on new buildings	Annual property and wealth taxes	Capital appreciation taxes as % of appreciation
Hungary	2–5%	As per scale of fees. Total ca. 1%	Conveyancing fee generally 10%, for residential real estate up to 6%	25% if sold by a company	Premises tax: max. 900 HUF per square meter of useful area. Land tax: max. 200 HUF per square meter of useful area	20% discounts if the property was in possession for longer than 6 years
Ireland	1.5–2.5%	Each party pays its own lawyers' fees as agreed, usually 1% of the property value	Conveyancing tax up to 9%; Statutory duties: 2%	13.5%, but included in the purchase price	None	20–40%
Italy	2–3% if only one intermediary, possibly 5% for an exclusive broker	Euro 2,500–10,000, varies greatly depending on real estate value and notary	3–10%	4–20%	Land tax: between 0.4 and 0.7%, referred to cadastral value. No wealth tax	None
Malta	5%	1%	Transfer duty 5% plus Euro 250 for authorizations	18% on building materials and work contracts	None	35% [2]
Monaco	Purchase: 8%. [6] Leasing: 10% of the first year	Registration and notaries' fees ca. 9%	Ca. 9%, 7.5% of which are registration fees and stamp duties, the rest the notaries' fees	19.6%	None	None
Portugal	2–6%	Notaries' and land register fees ca. Euro 300 minimum	Real estate transfer tax 6.5%; [9] stamp duty 0.8%	19% on building materials and works contracts	0.2–0.8%	25% for non-residents

Table 1 (*continued*)

	Types and forms of ownership	Usual financing by credit institutions	Usual rental duration for residential real estate	Rental payments	Security due from tenant for residential rental	Usual deposit at purchase
Spain	Sole ownership, co-ownership, apartment ownership, timesharing, building right	Up to 80% in normal cases, in individual cases up to 100% of the market value	As a rule, 3–5 years; minimum tenancy right 5 years for residential purposes	Rent and charges to be settled monthly in advance	One months' rent	10–15%
Sweden	Sole ownership, co-ownership, joint ownership, unlimited right of apartment use, timesharing, building right	Up to 90% of the market value	By mutual agreement of the contractual partners. Normally between 9 months and 10 years	By mutual agreement of the contractual partners. Otherwise monthly in advance	By agreement	10%
Switzer-land	Sole ownership, co-ownership, joint ownership, apartment ownership, building right	60–80% of the market value, 50% for investment property	Leasing: normally 5 years, with renewal option for another 5 years	Monthly or quarterly in advance	Bank guarantee or up to 3 months' rent	10–15%
United Kingdom	Sole ownership, co-ownership, joint ownership, tenancy in common leasehold, trusts	75–85% of the market value	Usually 1–3 years for residential rentals, otherwise anything between 5 and 999 years possible	For short rentals usually monthly, for longer rentals quarterly	For short rentals usually 3 months' rent	10%
United States/ Florida	Sole ownership, co-ownership, joint ownership, apartment ownership, timesharing, leasing, tenancy by the entireties, trusts	For local residents up to 90%, for non-residents up to 70% of the market value	Negotiable in line with the tenant's requirements. 30-year leasing contracts are regarded as purchase contracts	Monthly in advance	1–6 months' rent, depending on the credit-worthiness of the tenant; frequently waived	10% and more for residents; 30% and more for non-residents

Notes on the table:

[1] There are no capital gains taxes in the following cases:
– where the real estate was used as a residence for the owner's family
– where the real estate was sold again more than three years after its acquisition
– where the real estate was transferred between close relatives or divorced spouses.

[2] Tax-free, if used as a principal residence for more than two years.

[3] Always tax-free after 10 years.

	Broker's commission [7]	Land register and notaries' fees	Purchase taxes	VAT on new buildings	Annual property and wealth taxes	Capital appreciation taxes as % of appreciation
Spain	Usually 4–7%	Ancillary purchasing costs ca. 3%	Land acquisition tax 7% as a rule	7%	Land tax IBI 0.3–1.1%; wealth tax from 0.2% to 2.5%; as a rule both calculated on the cadastral value	Max. 3.7% of the cadastral value per year; max. 20 years. Must be distinguished from capital gains tax: max 35% for non-residents
Sweden	3–5%	None	Conveyancing fee: none; Statutory duties: 1.5% for acquisition by private persons, and 3% of purchase price for acquisition by a company	25%	Land tax: 0–1%; wealth tax: 1.5% of net wealth exceeding 1.5 million SKr	Private persons: 30% on 2/3 of the capital gained Companies: tax on 90% of capital gains; tax rate as for other income
Switzer-land	2–4%	0.01–0.7% depending on the canton	1–3% depending on the canton	7.6% on building work	Wealth taxes 0–0.7% depending on the canton, plus property taxes in ca. half the cantons of 0.005–0.02%	Between ca. 25 and 70% depending on the canton and duration of ownership
United Kingdom	2–3%	Max. £800 land register fees, plus lawyers' fees	Up to 4% stamp duty. Up to £150 for data searches at local authority	None (5–17.5% on reconstruc-tions and extensions)	None	40% [8]
United States/ Florida	6% developed; 10% undeveloped real estate	None	Documentary stamp taxes, lawyers' fees, title insurance: 2–5%	None	Land taxes depend on various factors. No approximation possible. No wealth tax	10–28% [4]

[4] Capital gains are taxed like regular income; with special exemptions depending on taxpayer.
[5] For a house in *Toronto* valued at US$ 500,000, for instance, this tax is about US$ 4,000 to 5,000.
[6] Comprising 3% for the 'buyer's broker' and 5% for the 'seller's broker'; this is however freely negotiable.
[7] Unless otherwise stated, the broker's commission is paid by the respective seller. Broker's commissions are subject to VAT in most countries.
[8] Only for persons domiciled in the *UK*.
[9] 0% up to Euro 80,000, then graduated between Euro 80,000 and Euro 500,000; 6% from Euro 500,000. This applies only to real estate which serves exclusively residential purposes.

rational manner. Because real estate designed for private use should above all bring subjective pleasure to its users and not only maintain and increase its value in objective terms, careful clarification of these factors is most important.

1 Start by renting

Before the step is made to buy, it is advisable first, to **rent** a comparable property in a similar location for a short period. Some time should also be spent in that area during the months when the climate is least pleasant.

2 Viewing and detailed inspection of the property

The best thing to do is to inspect the prospective property on several occasions at different times of the day and night (to observe noise, the way the sunlight falls, etc.) and if possible also at various times of the year. It is also worth while living nearby, in the same area or neighborhood, for some time before deciding to buy, if this is possible.

3 Consider the marketability of the real estate

Special-interest real estate is often hard to resell. This applies to old mills, castles, houses with an unusual architectural style, etc., as well as to very expensive and very large properties. The market for such properties is very limited. In contrast, high-quality real estate in good to very good locations on not excessively large plots in a region that is developing in terms of its future residential potential, ideally in the suburbs of a larger city, will almost always find buyers over the long term. Whoever lays value on marketability, i.e. on factors that will also be relevant at a later possible resale, will simultaneously take into account the factors important for preserving the value of the property.

4 Observe real estate price cycles

Real estate prices tend to follow cycles lasting several years. So it makes sense to examine general price trends in recent years in the region in which the prospective real estate is located. Hence, if the analysis shows that real estate prices have risen continuously over a decade, caution is called for, although an unbroken rise in prices does not necessarily mean that a slump will follow. And in the contrary case, we can generally assume that stabilization will follow several years of declining prices. However, it should be stressed that price trends can never be forecast, and only a rough assessment can ultimately be made.

5 Check the legal and tax situation

Before a sales agreement or even a preliminary agreement is signed, all important legal and tax aspects must be clarified in detail. The checklists contained in this handbook set out all the key points.

6 Purchase with the aid of one or several experts

Depending on the country, place and circumstances, it may make sense to consult one or several experts when making the purchase. These may include a competent broker, an

architect or engineer, a notary or a lawyer. In most cases, it is worth while for a buyer (or seller) unfamiliar with local circumstances to obtain advice from a competent source and have the purchase transaction checked. Further information on this point may be found in Section 4.8 below.

4.2 The sales agreement (sale and purchase agreement)

The way in which real estate can be sold is in some respects subject to different rules, laws and regulations in various countries. Whereas a house can be legally sold via a short simple contract in *Spain*, indeed even by verbal agreement (!), many countries require on notarized contract and an entry in the land register to make the purchase of real estate legally valid.

Despite differences in legal systems and practices around the world, the key points that should be covered in a sales contract can nevertheless be summarized as follows:

- A precise designation of the parties to the contract.
- A precise designation and description of the real estate to be purchased (description of the real estate, notes, charges, easements, liens, other encumbrances, covenants and mortgages).
- The purchase price, mode and schedule of payment.
- The time of transfer of ownership and right of occupancy.
- The time of transfer of rights and obligations, benefits and risks.
- The security and interest on deposits, balance payments and funds held in escrow.
- Payment of taxes due, especially of capital gains tax.
- Warranty questions regarding title and material defects.
- Settling existing contracts referring to the real estate (rental and tenancy agreements, insurance policies, etc.).
- Any penalty clauses, forfeits and similar clauses.
- Applicable law and jurisdiction.

These are the most important points, but every sales contract should generally be negotiated and drawn up **on an individual basis**. Nevertheless, **standard form contracts** are usual in some countries (e.g. the frequently used *FAR/Bar* standard contract in *Florida*). Although a preprinted agreement is not suitable for all transactions, the *FAR/Bar* contract is well suited for the great majority of transactions involving residential real estate and even for commercial transactions. The same applies in several other countries. However, it is always advisable to consult a lawyer familiar with local practices and the local legal situation to **at least review** the sales agreement.

4.3 Restrictions on the sale/conveyance

The seller's power of disposal may be restricted for various reasons. Such **restrictions may result from the matrimonial property regime**. If the seller is married, his or her disposal authorization is based on the matrimonial property regime that applies to him or her. It

must therefore be clarified to which matrimonial property regime the seller is subject and whether consent of the spouse is actually required. In many countries, the effects of the marriage, and thus any possible restrictions on the disposal of property, are based on the personal statute or *lex patriae* of the spouses, i.e. on the law of the country whose citizenship the spouses possess. The precise arrangements are a question of the international private law of the country in which the property is located. Many countries require the consent of the spouse for a valid agreement to be concluded if the sale refers to the **matrimonial home of the spouses**. In such a case, that spouse should be joined as a party to the contract and agree to the sale. To prevent possible fraud by the spouse who is the registered owner, the sales agreement should contain a confirmation that the other spouse has actually received separate legal advice before agreeing to the sale.

Furthermore, restrictions on minors and wards of court as well as contractual and legal **pre-emption rights** should be observed. A **contractual pre-emption right** or **right of first refusal** stipulates by contract that in the event of a sale a particular named person has the right to acquire the real estate under the same conditions and the same price that would be offered to any other prospective buyers. Various **legal pre-emption rights** usually also exist, e.g. **in favor of the municipality or the state**. This is often the case, particularly for historical buildings or those of particular cultural importance. Such rights may also exist in favor of lessees, neighbors, etc. Current **tenants** often also possess a pre-emption right and could thus prevent a sale to another party. If a prospective real estate is rented or leased, extreme care must be exercised in its acquisition. It must be precisely clarified whether legal or contractual pre-emption rights exist and whether the real estate had been offered to the tenant or lessee as prescribed. In this context, it is worth mentioning the case of a tenant who is aware of ongoing contractual negotiations between the owner and the prospective buyer. Although initially willing to leave the apartment voluntarily in return for compensation, the tenant may subsequently refuse to do so in violation of the agreement while attempting to obtain still higher compensation from the acquirer. As a rule, there is nothing that the seller or the buyer can do against such unethical behavior by the tenant. In the interest of both parties, a tenant who enjoys pre-emption rights should firstly be offered the real estate so that all those concerned know what their position is after the legal period of notice has elapsed.

Finally, **agricultural properties** are subject to special restrictions in many countries (on this point, see Section 12.3 below).

4.4 Restrictions on acquisition

Analogous to such sales restrictions, some countries also impose restrictions on acquisition. The most significant of these are restrictions on the acquisition of **real estate by foreign nationals**. Whereas there are almost no restrictions of this kind in many of the countries of interest here (such as in *France, Spain, Portugal, Great Britain, Canada* or the *USA*), they are imposed by some countries, and range from minor restrictions and the obligation to obtain a permit up to complete prohibition. More or less strict acquisition restrictions apply in a number of countries including *Switzerland, Austria, Greece* and *Croatia.* The laws in some of these countries even stipulate **draconian sanctions in the event of evasion**. For example in *Switzerland,* evasion of acquisition restrictions on foreign nationals leads to **nullity** of the relevant contracts, which may lead to a total loss of the foreign

buyer's investment. On the other hand, other countries make it easy for such restrictions on acquisition to be bypassed via legal structures. Thus in *Croatia*, the obligation for foreign buyers to obtain approval – and the associated lengthy process of authorization – can be simply and legally avoided by setting up a Croatian company with its own legal personality in whose name the real estate is then acquired without the need for obtaining approval.

It is in any case essential to assure oneself before buying real estate that no sales or acquisition restrictions exist. If they do exist, the prospective buyer must clarify whether approval may be obtained, what the relevant conditions are, and how the obligation to obtain approval may **impact a possible resale**. It can also be worth while to check whether the approval obligation may be lawfully bypassed by means of a suitable legal structure. It must then be clarified with great care whether such a device is also accepted by the relevant authorities and is not classed as a structure established specifically to evade the law.

4.5 Other important points to consider when acquiring real estate

The following key points must be considered when acquiring real estate. However, other legal obligations and requirements may also impair rights to real estate ownership, depending on the country in question.

4.5.1 Capacity to act and entitlement of the seller

The authorization of the seller to conclude contracts in general and the ownership transfer in particular follows from his/her **status as the owner of the real estate**. The person presenting as the seller must possess the unrestricted **ownership** of the real estate to be sold, and appropriate proof should be requested. The seller must be **legally capable** as well as **authorized** to dispose of the real estate. A seller is legally capable as long as he/she is not restricted in his/her legal capacity to act. Restriction of the seller's capacity to act may be due to that person not yet being of an age to perform the sale. In this case, authorization by a legal representative or a ruling by a judge of the guardianship court must be submitted to allow the legal business to be carried out. Moreover, there must be no temporary legal incapacity or disallowance of business activity due to a criminal conviction. If the seller is married, it may not be possible for him/her to legally sell the matrimonial home without the consent of the spouse, or other restrictions based on the applicable matrimonial property regime may require involvement of the spouse.

If the seller is a **legal entity** (such as a company, foundation, etc.), the legal capacity of its executive organ or the latter's representative must not be restricted. Ultimately, legal persons are always represented by natural persons, who sign contracts on their behalf. The same criteria naturally apply to these representatives as described above, i.e. they must possess full legal capacity. It must also be demonstrated that the legal person has **authorized** his/her legal representative to **perform the sale**, so that the sale can actually go through. If the purpose of the company does not expressly include the acquisition and sale of real estate, a decision by the owners (shareholders of a company) is required in most countries, i.e. a decision by the managing board does not suffice. A restriction of the capacity to act by legal persons may also result from other circumstances – for instance, if the company has gone into receivership. The authorization to perform legal business for the company then passes to the receivers. If a legal person is a contractual partner, **special care** must be taken with regard to the authorization or legal capacity of the persons acting on its behalf.

4.5.2 Third-party claims and unpaid taxes

Every buyer should acquire comprehensive clarity about the existence of any third-party claims which encumber the real estate. Various easements/servitudes, liens and other **encumbrances on real estate**, as well as **lease and tenancy agreements, mortgages** and **unpaid taxes** can have considerable effects on the possibility of acquisition, and on the value and resale possibility of the real estate. These risks can extend to everything that has any connection whatsoever with the real estate. The seller need not necessarily intend any malicious concealment, but may simply have forgotten or overlooked something. In many cases – especially in the case of rural real estate – the contracts in question will already have been concluded between the person owning the real estate before the current seller and the neighbors regarding matters such as rights of way and grazing rights. Even if such rights have not been recorded in a register, they may nevertheless be fully effective. For example, informal permission to let cattle graze on a particular meadow can over many years become a legally enforceable right of lease or even a restricted property right. It is consequently advisable in most cases, especially in the case of **rural real estate**, to talk to the neighbors, the local authorities (such as members of the communal council) and other persons familiar with local circumstances in order to avoid unpleasant surprises.

If the seller has failed to pay bills from building tradesmen and contractors, the creditors can have a special **building tradesmen's lien** or a lien entered in the land or ownership register in some countries. For the new owner, such liens mean that his/her real estate is liable for payment of any outstanding bills. This must be borne in mind, especially when acquiring a newly built apartment or house, and the seller must be requested to provide proof that no bills are outstanding.

The real estate may often also be liable for capital gains and other taxes and duties not paid by the seller. In some countries, the taxes encumbering real estate have the character of a lien, i.e. the relevant real estate is directly liable for any unpaid taxes. Appropriate security for the buyer is thus absolutely necessary and may be arranged by means of a bank guarantee or by having a corresponding sum retained by a notary or lawyer.

Encumbrances and third-party claims are **apparent first from the ownership or land register** (where such a register exists), but they may also exist **by law** (e.g. the tacit rights of use or outstanding tax demands mentioned above) without being recorded in a register. Accordingly, **the greatest care** must be exercised in these matters. All existing encumbrances on, and third-party claims to, the real estate must be included in the sales agreement without fail and there must be agreement on who bears or redeems which encumbrances and debts. Before every real estate acquisition, a current extract must be obtained from the respective ownership or land register, and it must be comprehensively clarified whether the real estate is liable to any encumbrances and third-party claims.

The lawyer called in to act as consultant in the acquisition of the real estate shall clarify all outstanding matters in order to determine the legally protected claims and rights of third parties that may apply to the prospective real estate, and to ascertain any entitlements that the owners of neighboring properties may have. It is also important to **view the real estate** to be acquired, as this is a way to reveal those entitlements that cannot be determined from documents. If, for example, a path crosses the property it may follow that the land is

encumbered with a legally protected footpath, despite the fact that this right was not fixed in any document. A talk with the neighbors often helps to clarify such situations.

4.5.3 Provisions for protecting the environment, nature and the cultural heritage

Environmental protection

Environmental protection is a sensitive issue in conjunction with real estate transactions and ownership, not least because environmental pollution in general must be cleaned up by the current owner of the real estate if those who caused the pollution are unknown or unable to pay. This principle, applicable today in most countries, gives rise to delicate legal questions.

Some countries require former waste-disposal sites, as well as other land polluted with noxious substances, to be cleaned up (often **at the costs of the current owner of the property concerned!**) if they represent a risk of causing damage or creating a nuisance. It makes sense to clarify the situation even in countries with no current legislation for cleaning up polluted land. This is because the possible presence of noxious substances, whether below ground or in the building structure, has an impact on the value and resale chances of the real estate, and may even render it **unsellable,** apart from making people sick. If relevant legislation exists, the authorities may demand that polluted land be cleaned **at any time** and not only within the scope of a building project. Environmental protection measures may have **considerable impact**, such as limitations of use, higher insurance costs, major additional expenditures as well as delays in building projects due to assessments, cleaning and waste-disposal measures. Possible claims by third parties, such as owners of neighboring properties polluted by hazardous substances, represent another problem. A few countries maintain registers of polluted land. However, a relevant check is often the only way of clarifying the exact condition of the land. As a rule, potential buyers are well **advised to refrain from** acquiring real estate polluted by hazardous substances, or otherwise representing an environmental problem, as the associated risks are very difficult to estimate and are usually too high.

Protection of nature and the cultural heritage

Although nature-conservation regulations generally have no impact on correctly zoned real estate, it is nevertheless wise to clarify the situation as appropriate. A more important factor is represented by **restrictions relating to historical buildings** subject to protection. In most countries, the government or local authorities invest in the preservation of historical buildings at local and national level and keep records of this cultural heritage. Restrictions are normally noted in public registers or in the land register and often take the form of mandatory official approval before any changes can be made. However, the authorities may also intervene in the case of a not (yet) classified building which may be deemed worthy of protection. Anyone acquiring historical real estate that may be worthy of preservation must include these eventualities in the clarification procedure. It may be worth while discussing any planned building projects in advance with the relevant authorities in order to avoid unpleasant surprises.

The other aspect of heritage preservation is that owners of protected properties may be eligible for **state subsidies** toward renovation and similar costs in certain circumstances.

4.5.4 Access to relevant records and documents

Today, most countries maintain some type of **ownership register** which records the existence and scope of private rights to real estate. These registers may be set out in diverse ways, and their legal status also varies greatly. However, the books of the relevant registering authority must always be viewed before making a final decision to buy on the basis of information supplied by the owner or seller of the prospective real estate. The result of viewing the relevant register is usually of decisive importance to the buyer. It allows the buyer to determine, firstly, whether the seller in question is the **lawful owner** of the prospective real estate, and, secondly, whether the real estate is **free of encumbrances** or, alternatively, the kinds of encumbrances that exist (easements, mortgages, etc.). Generally, a later objection in litigation that the purchaser was unaware of an entry in the register is normally invalid. It also makes sense to check various documents, especially the sales agreement that forms the basis of the seller's ownership, or agreements on easements, financing agreements, etc. Another important point is proof of complete payment or securing of all taxes and duties by the previous owner, as the respective property and/or its owner are liable for unpaid taxes and duties in many countries.

Whoever buys an apartment or house that implies membership in an **owners association** (e.g. relating to shared facilities of a residential property) must request copies of all relevant minutes and documents relating to the association, especially a copy of the minutes of the last general meeting, a list of expenditures, proof of the reserve fund and the name of the administrator. In particular, one should check whether the meeting has decided on any building works that have not yet been carried out, or other larger expenditures.

Before every acquisition, the following must be checked by consulting the relevant register extracts and documents:

- Proof of the seller's **lawful ownership** and **authorization to dispose** of the real estate
- Proof of all existing **encumbrances and claims** on the real estate
- Proof that all **taxes** and duties have been paid by the seller
- Proof of any existing **tenancy and lease agreements** or of any corresponding negative declarations by the seller
- Where an **owners association** exists: minutes of the most recent meetings as well as confirmation that the seller has honored all his/her financial commitments to the association

4.5.5 Division of costs

It can never be precisely forecast at the time of signing the sales agreement when the actual transfer and complete payment will take place. Also, certain costs accrue up to the day of the transfer at the expense of the seller. Sales agreements consequently often contain clauses which divide up such costs between the seller and the buyer on a time basis. As a rule, this cost division is not exactly set until the transfer date has been fixed. The most common examples of such cost divisions refer to land taxes, insurance premiums for third-party liability (the real estate must always be covered!), rental income, contributions to condominium or other owners associations and advance payments of maintenance costs.

It is also advisable for the buyer to ensure that all invoices for electricity, gas, water, telephone, TV license fees, etc., have been paid by the previous owner up to the transfer date, otherwise problems might arise when the property is re-registered.

4.6 Powers of attorney

It may be advantageous to use powers of attorney when dealing with a foreign notary, local authorities or lawyers, especially if the buyer is a foreign national and speaks the relevant language insufficiently or not at all.

The general rule is that the form, effect, changes and cancellation of powers of attorney which concern the disposal or administration of real estate are subject to the law of the country in which these properties are located. In other words: powers of attorney relating to transactions with real estate are subject to the law prevailing in the location of the relevant real estate, and a choice of law in this respect is usually excluded. Even if such powers of attorney do not require any particular form in some countries, those referring to real estate transactions usually require **to be notarized**. This also makes good sense quite generally for important business. Even if a choice of law were permitted (such as when the *lex patriae* of the grantor of the power of attorney were applicable), it is **advisable for the power of attorney to be based on the local law in every respect**. After all, the power of attorney must above all be recognized locally, where the real estate is located.

If the notarization is performed by a foreign notary, it will generally need to be legalized or **authenticated**. Most countries are party to the *Hague Convention of 5 October 1961, Abolishing the Requirement of Legalisation for Foreign Public Documents*, which requires the document bearing the signature and stamp of the notary to be provided with an *apostille* on which a higher government authority supervising notaries confirms that the notary really is authorized to exercise his/her function. This is required so that the document will be recognized in the foreign country in which it will be used.

Powers of attorney may be granted in the form of a **special or general power of attorney**, and either as a power of attorney limited in time or as an enduring power of attorney. In most cases, a special power of attorney restricted to the purchase transaction is required.

4.7 Acquiring real estate through a holding structure

The most varied factors will dictate whether real estate should be held via a company or other holding structure rather than directly. Certain features specific to various countries will be outlined here. Thus it is not uncommon in the *USA* to hold real estate via a limited liability corporation. In addition to any tax advantages, this is done especially for reasons of *asset protection*. In other countries, such as *Switzerland*, non-resident foreign nationals are prohibited from holding residential real estate via companies. The most varied regulations and reasons may exist in which a specific legal device may appear to be necessary, make sense, or not, as the case may be.

In general, **the more expensive the real estate** the more sense it will make to use a holding structure rather than buying directly in one's own name. It is debatable where to draw the line here, but in most cases a minimum value of US$ 500,000 can be taken as a basis. Depending on the country and situation, however, this threshold may also be

set significantly lower. This is the case in *France*, when using the popular *Société Civile Immobilière,* or in *Croatia*, where the only straightforward way of acquiring real estate may be to establish a local holding company.

The larger and more valuable the real estate, the more will not only **fiscal and succession-planning aspects**, but also questions of **asset protection** and **confidentiality**, play a role. It is often best to buy smaller properties directly in one's own name – or possibly under the name of one's children or other persons, depending on the inheritance-law situation. The legal consequences in the event of succession can then be influenced by means of a will or other suitable legal instrument. But also in the case of larger properties the question arises whether it is worth while setting up a suitable legal structure, such as a company, to hold the real estate, or whether the same end cannot equally be achieved by means of a will, transfers between living persons or other contractual arrangements.

4.7.1 When does it make sense to use a holding structure?

In some situations, the use of a holding structure such as a company makes good sense for legitimate reasons of fiscal and succession planning. In *France,* for example, it is certainly often a good idea to establish a French real estate company (*Société Civile Immobilière, SCI*) in order to achieve more flexibility with regard to the law applicable in the case of an inheritance. This is because exclusive application of French law is mandatory for directly owned real estate, whereas company shares are considered as movable assets and can accordingly be inherited with the testator's other movable assets. In the *United Kingdom*, it makes particular sense for a non-resident and/or non-domiciled owner to hold real estate via a (foreign) company rather than directly for tax reasons. For this purpose, companies are usually set up in countries where company taxes are nil or limited and annual maintenance costs are low. Such jurisdictions include *Jersey, Liechtenstein, Malta* and *Panama*, where companies can be set up and maintained at low cost and with no or only limited local tax consequences. However, tax consequences may have to be taken into account depending on the country of residence of the company owner. So it is essential to clarify all circumstances and tax consequences carefully – including in the country in which the company owner is resident.

It is also worth noting that corporate and other holding structures (such as private foundations and trusts) are not infrequently recommended and also implemented despite **failing to pass** a thorough scrutiny by the relevant tax authorities – where such scrutiny takes place. Many countries have now extended the relevant tax laws with very comprehensive **abuse regulations**. If more than 50% of a company's assets consist directly or indirectly of real estate, that company will often be taxed just like real estate. Thus the capital gains from the sale are also taxed on the same basis (and cannot simply accrue tax-free in a zero-tax country) when the responsible tax authorities discover the true nature of the transfer. Ultimately, many company structures are based on the transfer of company shares without notification being made to the tax authorities. Although it is often highly unlikely that the tax authorities ever find out about the transaction, it cannot form the basis of a legal arrangement. The list of ways used in the various countries to try to 'save' taxes, in some cases by means of complicated structures, could fill a whole volume. Only one thing is certain: in some countries and for larger real estate it is certainly possible and makes good sense to save taxes and increase legal flexibility by setting up suitable holding structures. However, to do

so requires **international know-how** and **relevant country-specific knowledge** as well as extensive experience in connection with holding structures for real estate to be held by foreign nationals.

In addition to tax and succession-planning aspects, it is also desirable in certain cases for reasons of **confidentiality** and **asset protection** to hold real estate via the intermediary of a company rather than directly. The effective owner, then, will not appear in the ownership or land register.

4.7.2 When is it better to acquire real estate directly?

In many countries, such as *Spain, France* and *Italy*, it does not usually make much sense to acquire privately used real estate via a company, for various reasons. Firstly – for example, in *France* – comprehensive regulations aim to prevent acquisition via the intermediary of companies and thus make such procedures more complicated – with the notable exception of the already mentioned domestic *SCI.* Secondly, this can even have tax disadvantages, as companies are often liable to higher capital gains tax than directly owned properties at a later resale. Furthermore, most companies (again perhaps with the exception of a French *SCI*) lead, to considerable administrative costs. In many countries it therefore makes more sense to acquire real estate in the lower to middle price range directly in one's own name. However, careful planning is of particular importance in this case, and includes drawing up a suitable will or possibly also acquiring the real estate in the names of one's children.

4.8 The execution of a real estate purchase

The procedure involved in acquiring real estate differs from country to country, and sometimes very greatly. Whereas it is generally unproblematic in a country such as *France*, the greatest care must be exercised in *Italy*, for example. As the various jurisdictions apply the most diverse regulations with regard to contractual requirements and ownership transfer, only the most essential points can be summarized at this juncture.

In any sales transaction, a distinction must always be made between a new property still at the planning stage, and an already completed or used property. In the case of **new or still incompletely built properties**, the purchase price is, as a rule, payable in advance in several installments according to the progress of the building work. The buyer may therefore incur a considerable **financial risk** in certain circumstances, depending on the project developer. This can and should be secured by a suitable **insurance policy** or **bank guarantee**. In some countries, this form of security or insurance is mandatory (although this requirement is not always observed in *Spain*, for example). Other countries have no legislation aimed at protecting the buyer, and due care must therefore be taken.

Although **preprinted standard form contracts** are easy to complete, they are usually designed to benefit the contractual partner who has designed them or suggests that they be used. On the other hand, balanced individual contracts are a frequent source of trouble. Insistence on an individually prepared contract may not only affect the mood of the contractual negotiations, but may also change the result decisively. Especially in the case of larger real estate, it is essential to prepare an **individual sales agreement** appropriate to the situation with the aid of a competent lawyer. Nevertheless, standard form contracts are usual

and can be used with no problems in some places, such as *Florida*. There, such contracts are designed and published by the bar association and are prepared in a correspondingly fair and comprehensive manner. It should be checked in each individual case whether standard form contracts are usual, who has published them and whether they seem to be appropriate in the individual case.

As the **transaction risk** involved in a purchase is usually greater for the buyer than for the seller, the buyer should – independently of the seller or any associated persons (such as the broker) – have the documents relevant to the sale checked by a lawyer. As in all important transactions, **trust is good, but security is better**. Before and during the sales procedure, it must always be clear what **guarantees are offered by the contractual partners** so that what has been promised and agreed in a contract can also be executed – if necessary by the agency of the courts. So it usually makes sense to conclude a **preliminary agreement** – assuming this is permitted by the relevant jurisdiction – in order to obligate the seller to conclude the sales agreement and, if necessary, also to enforce the seller's declaration of intent via a court.

The buyer should always take care to ensure the necessary security either by means of provisional registration (where possible) or an appropriate guarantee by the seller. Some countries allow a **provisional entry of the acquisition in the land or ownership register** in order to secure the buyer's rights vis-à-vis third parties. This is done to safeguard the interests of the buyer and is to be recommended if available. The same purpose is also served, alternatively or additionally, by requiring the seller to set up a **bank guarantee** in the amount of the purchase price. It must run until the ownership rights of the buyer have been definitively entered in the relevant ownership register or the title deeds have been issued.

In most countries, the sales agreement – which may be drawn up privately or by a notary – is entered in a **public register**, usually known as the **land** or **ownership register**, in order to ensure public access to proof of purchase. The buyer should always insist on immediate conclusion of a notarial sales agreement (where applicable) and on his/her name being entered as the owner in the relevant register.

For the safe conclusion of a real estate transaction, it is advisable to consult an expert, and not only in the event of difficult questions. The expert's fee will be a fraction of the damage that could result from improper or careless action.

4.9 Defects and warranty claims

All jurisdictions make a distinction between **legal** and **material defects**.

Legal defects are those that affect the ownership rights to the real estate. Thus a legal defect exists if the seller is not the real owner of the real estate, or if the real estate is encumbered with a mortgage or right of use unknown or undisclosed at the time the contract was concluded. Also, the buyer should be aware if other legal obligations exist for which the real estate is liable – easements and encumbrances of all kinds, or claims by someone with a stronger entitlement (e.g. in the case of a double sale by the former owner), etc. As a rule, the seller is liable vis-à-vis the buyer to ensure that the real estate is free of legal defects. Depending on the type and severity of the defect, the buyer can in general be entitled to a

reduction of the purchase price, to withdraw from the agreement or to claim compensation for damages.

Material defects are those present physically on the property, such as a leaky roof, peeling paint, etc. Material defects can be further distinguished in **patent defects**, which would involve a visible deterioration of the property, and **latent defects**, which only an expert may discover upon inspection. A **concealed defect**, on the other hand, would in most cases constitute a fraudulent misrepresentation and would normally give the buyer the right to claim that the contract is void.

In almost all jurisdictions, the seller is generally liable for both legal and material defects. However, relevant warranty claims always lapse after a certain time. A buyer should always try to safeguard against possible obligations associated with the real estate and any undiscovered defects such as environmental pollution. In contrast, the seller has an interest in limiting any warranty claims after conclusion of the contract. For used properties, any warranty by the seller is, as a rule, waived in the sales agreements. In most cases, therefore, only **maliciously undisclosed defects** can justify damage compensation claims.

4.10 Key points that a seller should consider

The seller is the contractual party who normally bears the **lower risk**. However, he/she should also observe a number of important points.

From the viewpoint of the seller, it is particularly important that the **purchase price** is **paid in full** or **secured** before or concurrently with the transfer of ownership. This may be done, for instance, by means of a promise to pay, transfer of a bank check or a deposit with a notary. A direct bank transfer is in general not recommended for practical reasons. To protect the interests of both parties, the purchase price should only be paid upon the signing of the notarial sales agreement. If the buyer has to sell his/her previous home to pay for the acquisition, special care must be taken, as it must be certain that he/she really can sell the real estate and thus secure the funds required for the acquisition of the new house. A definitive form of security, for instance by means of an irrevocable bank guarantee, is essential in this case. But, quite generally, the seller should also check whether the buyer has received financing approval from his/her bank before breaking off negotiations with other prospective buyers or making other arrangements in the assurance that the sales agreement will indeed be concluded.

In many jurisdictions, the **observance of contractual or statutory time limits** is an absolutely basic condition for the correct fulfillment of a contract. If one of the contractual parties (for instance, the seller) is delayed, the other party may, in certain circumstances, be released from his/her contractual obligations and may possibly also claim compensation for damages. So both parties are well advised to observe all agreed or legally stipulated time limits to the letter.

The seller must also ensure that he/she can produce all authorizations (e.g. consent of his/her spouse) needed for the purchase, as failure to do so would delay the transaction.

Moreover, in most countries the seller is obliged to inform the buyer of **any defects** and, as a rule, the seller must also inform the buyer of the existence of any **pre-emption rights**. Often, the seller is liable to a comprehensive **obligation for information and disclosure**

and bears corresponding liability vis-à-vis the buyer. So it is important to clearly indicate any defects in the sales agreement for purposes of later evidence. Accordingly, it is essential for the seller to settle all **questions of liability** in the agreement in detail. In general, it is recommended wherever possible to exclude all liability by the seller from the agreement (this is also usual for second-hand property in most countries). This liability exclusion should be comprehensive and expressly include liability for legal and material defects, error and damage compensation, as far as this is permissible on the basis of the local law. In any case, care must be taken to ensure that the sales agreement contains **no guarantees** which the seller is unable to satisfy. If the seller makes any representations and warranties, a carefully drafted sales agreement will limit the warranties and representations to the period of time the seller has owned the real estate and exclude the periods of ownership by previous owners.

The seller should also note who is responsible for which **fees, taxes and lawyers' or notaries' fees**. In many cases, notaries' fees and transfer taxes are divided on a 50/50 basis, but this division is ultimately a matter for negotiation. Lawyers' costs are usually borne by the party commissioning the lawyer. However, the seller is always responsible for **paying capital gains tax**.

If real estate is sold together with **furniture** (especially valuable furniture, for example, antiques that belong to a historic property), the purchase price may be split (property/furniture) and, as a consequence, the taxes may be somewhat reduced as most taxes are only calculated on the basis of the purchase price of the property, and not on the furniture.

In most cases, the seller is also liable to pay the **broker's commission**. This varies **between 2% and 10% of the sale price** in different countries and is usually subject to value added tax (where such a tax exists). It should be noted that only in justified exceptional cases it is in the seller's interest to conclude an exclusive agreement with a single broker, in particular for expensive properties where confidentiality is usually important. As a rule, however, it is more advantageous to commission several brokers with the sale in order to maximize the exposure of the real estate.

Further, the seller should from the outset find out precisely any **other costs** for which he/she is liable that may be involved in the sale, i.e. which will be deducted from the sale price, and what **tax consequences** the sale may have. The **real estate acquisition taxes**, which are levied everywhere, are as a rule borne by the buyer. However, if they cannot be collected from the buyer, they may in some countries be charged to the seller. This is particularly relevant when the seller remains resident in the same country.

When apartments or houses belonging to an **owners association** (e.g. concerning the shared amenities of a condominium) are sold, the amount of any reserve or renovation fund must be determined, as this can have an effect on the sale price.

4.11 Checklist: Acquisition of real estate

The following checklist offers a systematic approach to clarifying all essential factors ***('due diligence')*** which must be taken into account when acquiring real estate.

1 The location

Location is the first and most important factor to be considered when selecting a property. In addition to the current circumstances, it should be noted how the environment may change in future. A future positive change in the location quality is the most important factor for the potential growth in value of real estate.

- Location quality of the local municipality.
- Position within the municipality.
- Changes in location quality to be expected in the mid- to long-term.
- Orientation of the building (north/south, east/west).
- Sunlight exposure of the building, balconies, terraces, gardens – during all seasons.
- Climatic situation: Does the climatic zone meet expectations? Consult tables of average monthly temperatures, air humidity and rainfall.
- Wind exposure: How frequently and strongly do winds blow in this location? Possibly consult a relevant wind atlas. Winds (such as the *Bora* in *Dalmatia* or the *Mistral* in *France*) can considerably impair comfort in outside areas (such as during garden parties).
- If the house is on a slope: water pressure, danger of landslides, avalanches, etc.
- Level of groundwater table: relevant in particular with regard to basements and cellars, but also if it is desirable to have one's own well, for example, on a country estate.
- View: Is the view safe from obstruction by subsequent building?
- Privacy: Do neighbors have a view into/overlooking the property?
- Size and shape of the real estate.
- Access: Asphalted, concreted, gravel, dirt road?
- Is access possible in winter? Winter service? Who clears the snow?
- Waste-disposal service.
- Noise (roads, airports, rail lines, etc.).
- Smells (paper factories, pig farms, food industry, etc.).
- Sufficient distance from filling stations, covered car parks and heavily used roads (exhaust and noise emissions).
- Sufficient distance from pylons/high-tension lines and mobile phone network antennas.
- Shopping facilities, banks, post office.
- Schools and kindergartens, secondary and higher schools, evening-class venues.
- Sports facilities.
- Cultural facilities.

- Public transportation: How can the property be reached by public transportation? Where is the nearest national or international airport? Where is the nearest rail station? How good are the connections?
- Links to road and freeway network.
- Basic healthcare.
- Extended healthcare: Where are the nearest major hospitals?
- Existing or planned future projects for the construction of freeways, airports, high-voltage power lines, transmission equipment, power plants, waste disposal tips, factories or other major public or private projects?
- Existing or planned future projects for changing flight paths of nearby airports?
- In which construction zone is the real estate located? Existing or planned future projects for other buildings in the vicinity?
- Is the real estate located in a protected area?
- Major accident risks: Are there any industrial or other plants in the vicinity which may pose a risk (chemical plant, nuclear power plant, liquid gas tank, cyanide storage of a metal-processing factory, etc.)?

2 Building materials and building quality

- Size and distribution of main and ancillary rooms.
- Fitting and extension options.
- Architecture.
- Construction of the building (masonry, concrete, wood).
- Quality of the materials used.
- Windows (wood, plastic, aluminum).
- Energy consumption.
- Thermal insulation: Is a heat insulation certificate needed/available?
- Footfall sound/soundproofing (especially important for apartments).
- Penetration of moisture (e.g. old walls, sloping location).
- Condition of the roof.
- Pest damage (e.g. termites).
- Asbestos contamination (old tiles, insulation materials, etc.).
- Lead contamination (old, decaying paints, plumbing, etc.).

It is often advisable to call in a building expert familiar with the local building standards in order to correctly assess the condition of the real estate.

3 Interior design

- Standard and equipping of kitchen, bathroom, showers, toilets.
- Quality of the materials used.
- Design and interior architecture (e.g. color concept).
- Wheelchair access: Is the house also suitable for elderly or handicapped people?
- Special details.

4 Installations and household technology

If certain installations are absent or need renovating, what does an installation or renovation cost? How long will the work take? Are approvals required?

- Electrical installations.
- Sanitary installations; connection to the water supply.
- Heating: What heating system is used? In the case of oil heating, it is important to note if the oil tank is outside (= environmental risk).
- Have the heating system and oil tank been regularly serviced?
- Telephone connection: Internet/ISDN/ADSL?
- Television reception: Cable TV, satellite dish?
- Swimming pool: Has it been regularly serviced? What is the condition of the pool? Can it be extended? Does this need approval? Water usage restrictions?

5 Security

- Are burglaries frequent in the area?
- Alarm system.
- Is the property sufficiently illuminated?
- Are all outer doors sufficiently secured?
- Are all windows, day shafts and balcony doors, shutters and roof windows secured against intrusion?
- Is there a need for security doors or security windows?
- Are power and communication lines secure from sabotage?
- Are there any neighbors or trustworthy persons who can keep an eye on the real estate during your absence?
- Is there a need for a private surveillance service?
- Danger of natural hazards (forest fires, flooding, storms, avalanches, etc.)?

6 Legal questions concerning the real estate and its acquisition

- In what building zone are the real estate and its neighboring properties located?
- Can construction activity be expected on the neighboring properties? If so, how extensive will it be (e.g. building height)?
- Distances between the properties.

- Is there room for extensions, and would approval for an extension/rebuilding be issued?
- Might the real estate or parts of it have been built illegally? Possibly check the building permits.
- Is the seller really the lawful owner (land register extract, proof of ownership)?
- If a real estate holding company is acquired, it should be scrutinized in detail. It may be more secure for the buyer not to acquire company shares but to buy the real estate from the company.
- Is the seller married, or is he/she cohabiting? Is approval by the spouse or cohabiting partner required?
- What rights, easements, servitudes, etc., exist that benefit the real estate?
- Are there any easements, servitudes, liens, charges or other encumbrances that burden the real estate?
- Have all duties and taxes been paid in full by the previous owner?
- Inspection of the most recent and earlier tax statements for real estate taxes and other duties.
- Do contractual pre-emption rights exist?
- Do legal pre-emption rights exist (e.g. in favor of tenants, neighbors or the state)?
- Are there any restrictions concerning environmental, nature or heritage protection?
- Could pollution of the soil constitute a hazard? If so, the real estate should be checked accordingly. A check is in any case recommended for larger real estate.
- How will the real estate be used in future? Depending on its use (e.g. as a guest house), official approval may be required (does it already exist or is it available?).
- In which name or possibly company is the real estate to be purchased?
- The real estate purchase transaction should be handled only by a competent notary or lawyer. The functions of lawyers and notaries vary in different countries, and use of a notary may be mandatory.
- After the sales agreement has been concluded, the acquisition must be entered immediately in the land or ownership register.
- In the case of condominium or other ownership which involves membership in an owners association, it is important to request copies of the statutes and all regulations, the minutes of the most recent general meeting, the most recent annual accounts or list of expenditures, the key to expenditure distribution as well as the name of the administrator. In particular, a check must be made as to the rights and obligations incumbent on the individual owners as well as on the administration and whether the meeting of the owners association has decided on building work which has not yet been carried out.
- Also verbal assurances and apparently evident matters should be confirmed in writing by the contractual partner.

- In the event that a lower sale price than the actual price is specified on the sales agreement in order to reduce the tax burden, the risks should be assessed. Such action is illegal in all countries.

7 Legal questions on structuring real estate ownership

- Should the real estate be acquired under one's own name, or should a special purpose company be used as an intermediary?
- Are other, possibly more complex, holding structures possible and useful?
- Advantages and disadvantages of using a company as an intermediary in the country in which the real estate is located.
- Advantages and disadvantages of using a company as an intermediary in the country in which the buyer is resident.
- Acquisition in one's own name or jointly with one's spouse? Note that various kinds of joint ownership rights are possible in different countries.
- Acquisition in the children's names ('skipping' of one generation)?
- In the event of acquisition in the children's names, should a right of residence be retained?
- In the event of acquisition via a company, should a local, foreign or offshore company be used?

8 Renovations and building-law restrictions

- Is reconstruction and extension permitted?
- Heritage and landmark/monument-protection regulations.
- Requirements of the fire and police services.
- What does partial or complete renovation cost?
- Are good local construction companies and reliable tradesmen available?
- Is it possible to carry out the renovation work oneself or with foreign contractors without coming into conflict with local construction companies or the law?

9 Taxes

- One-time real estate acquisition taxes.
- Recurring real estate and income taxes regarding the real estate.
- With regard to income taxes on rental income, is it possible to offset borrowing interest and other expenses against rental income?
- Inheritance and gift taxes.
- Capital gains taxes on a future sale (possible different scenarios if real estate is held directly vs through a company).

- Have all previous taxes been paid by the seller?
- In the case of change of residence: Total tax burden? Is pre-immigration tax planning advisable?

10 Inheritance law aspects

- Which inheritance law applies? Is a choice of law possible?
- What impact does the matrimonial property regime have, and can this be used in inheritance tax planning?
- International estate planning (use of wills, gifts, trusts, foundations, etc.).
- Possible acquisition of the real estate in the children's names.

11 Various

- Home-contents' insurance, possibly buildings' insurance, additional insurance policies (see section 10.1, Checklist: Insurance).
- In case of own well/spring: Can this be used privately? Do communal charges exist?
- How are foreign nationals accepted in the area? Do many foreign nationals already live in this area?
- Think of resale. From the standpoint of potential value growth, properties in areas in which the location quality is likely to improve in the future are to be preferred.

5 New buildings and purchase from a developer

Planning and building one's own house can be an extraordinarily satisfying experience, but it can also end in great frustration and disappointment. This is even truer in a foreign country. Whoever hopes to build their own house abroad must be particularly aware that special rules apply in the construction trade – and those rules are different abroad.

In every country, it is possible to find an **architect** and to commission the necessary experts to build a new property according to plans prepared by oneself or the architect. However, this approach inevitably requires relevant legal and practical advice so that the various agreements can be drawn up and mutually coordinated. It should also be noted that deadlines and costs are often overrun even in the best professionally managed building projects, leading to greater or lesser frustration for the principal. Architects are normally paid for providing their services in a reasonably competent and diligent manner. Unless agreed otherwise, the principal normally has the responsibility to review the designs and report any errors or requirements for redesign unless the agreement with the architect or general contractor clearly stipulates that the architect or contractor guarantees for the design and proper execution or it was agreed to deliver a turn-key construction. It is therefore important that in any agreement the risk for inappropriate design or construction clearly lies with the architect or general contractor.

In view of complex building standards and the diversity of offers in the construction trade it is often wise to engage a highly experienced architect as well as an independent **adviser** who in fact represents the interests of the principal vis-à-vis both the architect and the

various building contractors. Such an adviser may also be called in on an ad-hoc basis, i.e. merely in the event of important decisions.

It is usually much easier to **buy a new building from a developer**. However, special rules must be noted here too. The buyer essentially acquires the land from the developer together with a building which is still to be constructed. Specific contractual conditions are then mandatory in some countries. There may even be special laws aiming principally to protect the buyer of the real estate. The latter must also note various particularities, especially as regards the manner in which the purchase price is paid, questions of warranty, release from encumbrances (such as the mortgage used to finance the development) and the risk involved in completing the buildings. Key factors include the building schedule and the **securing of the purchase-price payment**.

It is usual for the purchase price to be paid in accordance with the progress of the building work, for example as follows:

- 10% as a deposit
- 15% when the foundations have been laid
- 20% when the bearing walls have been built
- 15% when all the walls have been completed
- 20% when the roof has been completed and the windows and doors fitted
- 20% when all the work has been completed.

In some countries it is usual to retain 5% of the total price for warranty work. This is also a good idea in those places where it is not usual. Unfortunately, developers and general contractors are only rarely called to account by the courts for **overrunning deadlines**. So the risk of such delays, which may be very unpleasant for the principal, is correspondingly high.

It should also be noted that many developers, i.e. sellers of new real estate, are financially not very strong. So unless one deals with a reputable, financially sound and well-managed company the buyer may also incur a considerable financial risk from this standpoint. **If a developer becomes insolvent**, deposits may be lost and warranty claims may no longer be asserted. So here, too, it is essential to ascertain exactly what kinds of guarantees are offered, and to be aware of the worst-case scenario.

Local authorities almost everywhere have considerable freedom in **granting building permits** – this applies at least to all more or less densely populated areas. So a prospective builder will usually be bound by more or less **strict regulations**. It is obvious that building cannot begin until appropriate building approval has been granted; it makes sense, therefore, to start planning as early as possible and to submit the application for approval at an early stage. Prospective builders are also strongly advised to discuss their project in advance with the responsible authorities, as well as with any neighbors who may be affected, and to comply with their requests wherever possible. The applicable legal situation must also be considered. Some countries require the use of a qualified architect. In any case, it will be impossible to dispense with the services of an architect as well as other specialists in order to deal with all the questions and problems arising in connection with the project.

Successful claims for the correction of real estate defects and regarding warranties require accurate **documentation of the progress of the building work** as well as a comparison of the initial order with the successful completion of the work. Disputes often result from

insufficiently documented supplementary orders which had been awarded without any separate cost estimates and, in some cases, without being clearly drawn-up.

6 Reconstruction and renovation of old properties

Most buyers acquire used real estate. This may be in a good or very good condition and the new owners might be able to move in immediately. However, real estate with an old structure may need, or could benefit from, reconstruction or renovation before the new owners can reasonably be expected to live in it.

It is often possible to acquire a substantial old house with considerable land around it surprisingly cheaply. However, such properties have their price when it comes to renovating them and making them comfortably habitable again. In most cases, such renovation work not only takes up a lot of time but also a lot of money. The cost of retiling a large roof alone might easily amount to the entire initial purchase price of the real estate. Nor should the costs of laying a damp course, renovating the electrical installations and plumbing, assuring thermal insulation, renewing the windows, floors, etc., be underestimated.

So when buying an old property that needs renovation, it is absolutely necessary to call in a surveyor, architect or construction engineer to prepare a report assessing the condition of the building. Besides a general evaluation of the structure, walls, roof, etc., issues such as possible asbestos contamination in old tiles and insulation, or lead contamination due to decaying paints, plumbing, etc., should be carefully addressed. Often in older houses wooden structures such as the roof, beams, etc., are affected by xylophagous insects (e.g. termites). Although such checks cost money, it often saves unpleasant and expensive surprises.

The **availability of reliable tradespeople** and other specialists needed for a reconstruction or renovation job is often a major concern for a foreign real estate owner. In many countries, especially in the south of *Europe*, artisans are good and relatively inexpensive. There are also well-qualified and experienced architects and other specialists who may have to be called in for particular projects. Although tradespeople may also be available elsewhere, they can be relatively expensive (for instance in *Switzerland*), or very scarce (as in the *USA* or *Sweden*) and, consequently, owner-occupied properties tend to be maintained and renovated by their owners. Tradespeople everywhere are happy to do work without an invoice and get **paid in cash**. Especially in countries such as *Italy, Spain* or *Greece*, but elsewhere as well, a considerable proportion of privately commissioned artisan work is carried out without payment of VAT, which is usually considerable. Quite apart from the fact that this practice counts as tax evasion, it also involves disadvantages for the customer. If no invoice is issued, the expenditures cannot be accounted to the value of the real estate in the event of a later resale and the capital gains tax works out correspondingly higher. This is obviously unimportant in the case of maintenance work and smaller renovations but could well be relevant for larger rebuilding projects.

7 Rental and tenancy

For a prospective buyer, it is a very good idea to rent a similar property in a comparable location for a period before purchasing. Local and internationally specialized agencies offer

a broad range of vacation apartments and houses which may be rented on a daily, weekly or monthly basis.

Many second homes are rarely used and remain empty for many months of the year. So for an owner of a second home it is obvious to ask whether it might not make sense to rent out such real estate, at least for limited periods. The answer has to be a firm negative. **Temporary rental is not worth while in most cases.** Firstly, because the time and costs involved are relatively large (administration, cleaning, wear and tear of furniture by careless tenants, etc.), and, secondly, because the revenue obtained usually compares poorly with the outlay and is subject to substantial tax in most countries, *The Bahamas, St Kitts & Nevis* and *Croatia* being notable exceptions.

Whereas some countries have almost no relevant **tenants' protection legislation**, and a tenant can be evicted from a rented real estate at any time (for example, in *Florida*), other countries have tenants' protection laws which may be very rigorous. In some circumstances, they may offer tenants a **position almost as secure as that of owners** (e.g. in *Sweden, France, Spain* and some other European countries). So it is wise to check carefully before renting how extensive the local tenants' protection laws are. In many cases, this alone may be a good reason not to pursue a rental option. On the other hand, rental agreements not designed for permanent residence, especially those relating to **vacation homes**, usually come under the category of general conditions of rentals and are not subject to rigorous tenants' protection regulations for normal residential real estate. Before deciding to rent, it is in any case wise to find out exactly what legal stipulations would apply to the tenancy and, especially from a practical standpoint, what ways exist of terminating the lease against the tenants' wishes and of evicting the tenants from the rented property.

Standard form contracts are often used to conclude rental agreements, and specific forms are sometimes mandatory for giving notice. Payment of rental security amounting to between one and six months' rent is usual and also makes a lot of sense from the landlord's standpoint. The security sum is often paid to the landlord or into a special rental security account at a bank.

7.1 Checklist: Rental and leasing agreements

The following list sets out the key points and clauses which should form part of every rental agreement:

- A precise description of the real estate, its location plan, including all buildings, parking spaces, interior fittings, living area, etc. Separate plans may also be annexed to the rental agreement.
- Prepare house rules when renting out residential real estate.
- Key data (signature date, start of rental, start of payment, expiry date).
- Time of handover of possession.
- The agreed rent and an itemized list of all costs, such as taxes, to be borne by the tenant.
- Regulation of insurance policies and insurance costs.
- Regulation of cases of damage (deferment of rental payments; obligation to carry out repairs).

- Tenant's liability.
- Repairs and maintenance.
- Regulations concerning subletting.
- Provision of security by the tenant.
- Contract extension/options.
- Possible formula for calculating the rent.
- Notifications (method, addresses).
- Lawyers' costs (in favor of the prevailing party in litigation – this is particularly important in the *USA*, where the prevailing parties normally have to bear their lawyers' fees themselves).

8 Succession and gifts

The ownership of real estate abroad also involves questions of international law and taxes relating to inheritances and gifts. Depending on the country in which the assets are located, different rules concerning inheritance and various taxation laws will apply. In earlier times, a foreigner's estate fell automatically to the state in some countries (such as in *France* up to 1819). This is obviously no longer the case. Nevertheless, cross-border inheritance and gifts are often relatively complicated matters, and international inheritance law is one of the trickier legal domains. Thus French inheritance law continues to make life difficult for foreign owners of real estate because real estate located in *France* is subject exclusively to French inheritance law. There is no possibility of choice of law. This means, among other things, that inheritance contracts are recognized only to a limited degree if at all, and that a surviving spouse may be considerably disadvantaged. However, such a disadvantage may be mitigated or even avoided by suitable legal instruments such as a **will,** a **gift** or other arrangements **during the testator's lifetime**. In contrast, other countries such as *Italy* and *Spain* permit real estate located there to be inherited on the basis of the laws of the testator's country of citizenship *(lex patriae)*, i.e. according to, for example, English law if the deceased was an English subject.

The applicable rules will depend on the country concerned. Before acquiring real estate abroad, a prospective buyer is well advised to check a number of points: exactly which law is applicable, whether a choice of law is permitted, what taxes are payable in the case of inheritance and whether there are any ways of reducing or even avoiding inheritance taxes by means of suitable legal instruments or holding structures. By being aware of these questions even before the purchase, one can take appropriate steps to make favorable arrangements in terms of inheritance law and possibly save considerable taxes and costs. A detailed check of the relevant circumstances is always worth while. Two **central questions** arise in such cases:

1. **Applicable law** What inheritance law is applicable to the foreign real estate – can the applicable law be determined by a choice of law or by the intermediary of a suitable holding structure?

2. **Inheritance taxes** Where and to what extent is inheritance tax payable in the event of a testator's death – can this tax be reduced or even avoided by suitable measures?

8.1 International inheritance law

In the case of cross-border real estate ownership, i.e. when the owner lives in a different country from that in which the real estate is located, the laws of both countries must be considered. This applies especially to inheritance law. The interplay and delimitation between various national inheritance laws is the province of international inheritance law. Two questions are of primary importance: **which authorities or courts are responsible** for handling an inheritance case, and **which law is to be applied?** The question also arises as to which law should apply to the form of a testamentary disposition. In order to answer these questions, the relevant national laws that regulate national and international private law must be consulted. But **international conventions** must also be considered, especially the *Hague Convention of 5 October 1961 on the Conflicts of Laws Relating to the Form of Testamentary Dispositions.* This stipulates that a testamentary disposition shall be valid **as regards its form** when it has been drawn up to comply either with the law of the testator's home country, of the place where it is drawn up, or, in the case of real estate, of the place where the real estate is located. Other conventions which may be relevant are the *Convention of 2 October 1973 concerning the International Administration of the Estates of Deceased Persons*, the *Convention of 1 July 1985 on the Law Applicable to Trusts and their Recognition* as well as the *Convention of 1 August 1989 on the Law Applicable to Succession to the Estates of Deceased Persons.* For more information about these conventions, see the homepage of the *Hague Conference on Private International Law* at www.hcch.net.

The inheritance law of many countries is based on the principle that an estate cannot be divided **(principle of unity of the estate),** i.e. if the testator is a foreign national and owned local real estate, then foreign inheritance law applies. However, some legal systems make the application of local law mandatory to real estate located in their national territory (e.g. in *France*, where French law applies exclusively and necessarily to all immovable property located in *France,* and a choice of law is excluded). This may lead to a **division of the estate,** i.e. the estate being divided or split in different ways according to the applicable national laws. This **principle of scission** is followed by most common law as well some civil law jurisdictions. One part of the estate (movable property) is then subject to the law of one country, and the other part (immovable property, e.g. the house in *France*) to that of another. Where one owns real estate in a state that applies the principle of scission, separate wills should be made for the different parts of property. In many cases, however, the problem may be bypassed by setting up a suitable company structure. If a property is held through a company, the company shares count as **movable property** (just like cash, bank accounts, jewelry, etc.), and are subject to the law of the testator's last domicile.

In some circumstances, **a choice of law is possible** (e.g. in *Spain*). In many countries (e.g. in *Italy*), however, the *lex patriae* of the testator generally applies, i.e. the law of the country whose citizenship the deceased possessed. So, if an Australian decedent leaves a property in *Italy*, Australian inheritance law will also apply to it. If a **will** exists, its contents will take precedence: if no testamentary disposition exists, the inheritors to be designated on the basis of Australian inheritance law will inherit. For the transfer of ownership of real estate abroad, however, legal procedures require the application of the foreign law, and

relevant responsibility rests with the foreign authorities and courts. The foreign authorities may consequently be confused by unfamiliar documents. In general, land-registry officials, notaries and even judges are sometimes bewildered if they are suddenly confronted in the course of their daily work with the law of another country and foreign documents. So it is often advisable to draw up a suitable will for the foreign real estate which satisfies the legal requirements of the country in which it is located. **Intestate succession** applies if the testator has left no, or an invalid, testamentary disposition, the entire estate was not divided up in the will, or if the testamentary inheritor has predeceased the testator, has renounced his/her inheritance or is deemed unworthy of receiving it. It is always advisable, therefore, to make a testamentary disposition. As already mentioned, its specific form will depend on the requirements of the relevant legal system.

Inclusion of the property or parts of it in a property-holding company, a **trust** or a **family foundation** may in certain circumstances offer a suitable means of efficient succession planning. In any event, expert advice should be sought in these matters to avoid costly complications in case of an international inheritance situation.

8.2 Matrimonial property regime and inheritance law

Questions of inheritance law may also involve issues of matrimonial property law and in particular questions as to which matrimonial property regime applies. The matrimonial property regime that the spouses selected when they got married or at their first matrimonial domicile is recognized in most countries. This has a corresponding effect on the situation of married testators with respect to inheritance law. As the spouses are subject to a specific property regime according to their national law, the law applicable at the time of the marriage or the law of their first matrimonial domicile, this property regime is given priority in case of an inheritance. This means that the assets that are actually to be included in the estate will depend on the relevant matrimonial property regime. It follows that a careful selection of a suitable matrimonial property regime may allow succession planning in favor of the surviving spouse, which might not have been possible purely from the standpoint of the applicable inheritance law.

8.3 Forced heirship provisions

Whereas on the civil-law dominated **European continent** the testamentary capacity of the testator tends to be more or less restricted by forced heirship rules which provide for reserved portions of close relatives (generally children), testators in the common-law **Anglo-American legal sphere** are largely free to order their estate as they wish, having regard, however, to the rights of surviving spouses. However, foreign real estate located in a country with no forced heirship can be inherited with exclusion of the forced heirship of the testator's home country – which remains valid – only under certain preconditions. This is particularly the case when the **main residence** has been moved abroad specifically for this purpose. In many cases, an international change of domicile is the only way of bypassing forced heirship provisions in a legally effective way. The same end may in some cases be achieved with the aid of suitable structures, such as **private foundations** or **trusts.** However, this involves a very sophisticated area of international estate planning. It should be approached only by suitably qualified and experienced specialists, as all too often structures are set up in this context which cannot hold up against challenges in a court.

8.4 Gifts

Real estate may also be transferred as a gift, and here too corresponding formalities must be observed (the written form being the minimum requirement in most cases). However, higher transfer taxes (gift taxes) often apply for transfers as gifts. So where this is allowed it may make more sense to arrange a transfer between living persons as a sale rather than a gift. In this context it should be noted, however, that a purchase at an intentionally low purchase price is known as a mixed gift, which may have tax consequences. If the purchase price is purely symbolic, the contract is normally considered as a pure gift and taxed that way (see Table 2).

9 Taxes and charges

The principle that **real estate is taxed where it is located** applies on an international level. However, the asset value or any income from real estate may additionally be taxed at the owner's domicile. In the worst case, **double taxation** may be incurred. This may mean that, for example, wealth taxes are charged on the real estate in country A where it is located, and that the real estate is included – instead of being exempted – in the calculation of the net wealth of the owner resident in country B, where he/she is being taxed on the total worldwide wealth, including the real estate located in country A.

9.1 One-time taxes and charges on purchase

The purchase of real estate generally involves considerable **transfer taxes** (in the form of land or document transfer taxes, stamp duties, etc.) which may well exceed 5% of the purchase price and in some countries even more (for instance up to 11% in *Greece*). The purchase of new real estate normally incurs no transfer tax, but is subject to a sales tax or **value added tax** *(VAT)* in many countries. *VAT* rates are usually higher, around 20% in most European countries, but lower *VAT* rates often apply for new buildings.

In general, land transfer taxes are charged only on the price of the land and buildings, i.e. exclusive of any movable property. If a furnished house is sold, it is in most cases permissible to list the price of the furniture separately in the contract so that only the part of the purchase price relating to the land and buildings is specified in the taxable property sale. This often allows the total purchase price and the associated land transfer taxes (as well as other fees depending on the purchase price, such as notary fees) to be legally reduced to some extent.

As a rule, in civil law jurisdictions **notary and registry fees** are also payable. However, both their structure and amount vary greatly in different countries. Whereas registry fees, and often notary fees too, are specified by the law, in some countries notaries have considerable discretion in setting their fees. Consequently, notary fees for real estate of a particular value may vary greatly. By **requesting a cost estimate from the notary**, the prospective buyer can obtain a clear idea of the costs involved and avoid unpleasant surprises later. If a lawyer is also called in, **lawyers' fees** will also be due. Here too it makes good sense to obtain an estimate in advance. In some countries, lawyers work strictly on the basis of hourly fees plus out-of-pocket expenses. However, in many cases a one-off fee can also be arranged, which usually comprises a certain percentage (as a rule 1% to 3%) of the transaction value. In most common-law countries (such as in the *USA, The Bahamas* and *England*), real estate

Table 2 Succession laws and inheritance taxes in selected countries

Country	Uniform inheritance law[3]	Divided inheritance law[3]	Applicable inheritance law based principally on		
			Actual domicile	Nationality	Legal domicile
Austria	x			x	
Bahamas	x		x		
Canada		x	x		
Croatia	x			x	
France		x	x		
Germany	x			x	
Greece	x			x	
Hungary	x			x	
Ireland		x			x
Italy	x			x	
Malta	x		x		
Monaco		x		x	
Portugal	x			x	
Spain	x			x	
Sweden	x			x	
Switzerland	x		x	x[7]	
UK/England		x			x
USA/Florida	x		x		

Notes on the table:

[1] Renvoi: The applicable law makes provision for remission to the referring law or further remission to a different foreign law.
[2] Relatively broad terms are used for the sake of legibility. As a rule, however, it can be assumed that the term 'nearest relatives' refers to children and spouse and the term 'other relatives' to parents and siblings.
[3] Uniform inheritance law = the same law applies to movables and real estate; divided inheritance law = different laws apply to movables and real estate.
[4] Children, spouse, direct descendants or forebears, adopted children and parents.
[5] In the case of both tax-free inheritance and the donation of real estate, certain taxes are payable for the transfer from testator to inheritors or from donator to donees as recorded in the land register. If this does not involve the main residence, these mortgage and land-register taxes do not exceed 3%.

transactions are handled exclusively by lawyers and almost no notary costs are involved. However, the lawyers' costs are then correspondingly higher.

9.2 Annually recurring taxes and charges

In addition to unavoidable annual **real estate taxes**, which are levied in some form or other in most countries (except, for example, in *Malta* or *Monaco*, which have no annual charges of any kind on real estate), any **revenue** is also regularly taxed as income if the real estate is rented. As a rule, however, maintenance and similar costs can then be set off against the taxable income. Some countries levy income tax on what is known as an **imputed rental value**, i.e. an income is calculated which would be obtainable in the event of rental, and this fictitious income is then taxed. Some countries additionally levy **wealth taxes**, which can constitute up to 1.5% and more of the value of the real estate. In *Spain*, for instance, the maximum tax rate on larger assets is 2.5%, which is very high in an international comparison. In contrast, many countries have no general wealth tax, but merely charge such taxes on property in the form of land or real estate taxes.

Need a renvoi be considered? [1]	Is there a forced heirship?	Maximum tax rates in % on inheritance for [2]			Country
		Spouses and closest relatives	Other close relatives	Unrelated persons	
Yes	Yes	15	50	60	Austria
No	No	0	0	0	Bahamas
No	No	0	0	0	Canada
Yes	Yes	– [4]	5	5	Croatia
Yes	Yes	40 [4]	45	60	France
Yes	Yes	30	40	50	Germany
No	Yes	20	30	40	Greece
No	Yes	21	30	40	Hungary
Yes	Yes	20	20	20	Ireland
Yes	Yes	0 [5]	0 [5]	0 [5]	Italy
Yes	Yes	5 [6]	5 [5]	5 [5]	Malta
Yes	Yes	0 [4]	8	16	Monaco
Yes	Yes	0	10	10	Portugal
No	Yes	40.8 [11]	64.8 [11]	81.6 [11]	Spain
No	Yes	30	30	30	Sweden
Yes	Yes	0 [8]–11 [9]	0 [10]–23.1 [8]	0 [9]–54.6 [8]	Switzerland
No [14]	No	40	40	40	UK/England
Yes [12]	Yes	55 [13]	55 [12]	55 [12]	USA/Florida

[6] Only on real estate. Movables are not taxed.
[7] If the foreign national domiciled in *Switzerland* expressly stipulates application of the law of his/her home country.
[8] Most cantons, including the canton of *Schwyz*.
[9] Canton of *Geneva*.
[10] Canton of *Schwyz*.
[11] These are progressive rates (starting at 7.65%) depending on the size of the inheritance (here over Euro 797,555.08) and of the inheritor's prior assets in Spain (here a max. of Euro 4,020,770) and the multiplier referred to them.
[12] Florida law allows renvoi to be legally excluded.
[13] Tax-free allowances of up to US$ 1,000,000 for spouses of US residents.
[14] The *UK* does, however, have legislation providing for dependants who have not been adequately provided for.

9.3 Capital gains tax

In most countries, the owner of real estate is liable to pay taxes on any **value increase** or **capital gains** resulting from the sale. These **capital gains taxes** often decline in proportion to the time during which the real estate is held. Sometimes different tax rates are applied depending on whether the real estate is held or sold by a private person or a company. This will have to be considered where holding structures are set up.

It is advisable to carefully retain all invoices and receipts for costs incurred during the period of ownership for renovation and maintenance work, as any expenditures for value-increasing investments can usually be deducted in calculating the capital appreciation.

9.4 Inheritance and gift taxes

Whereas US real estate is taxed at a rate of up to 55% at transfer to the inheritors, countries such as *The Bahamas, Italy* and the canton of *Schwyz* in *Switzerland* charge no **inheritance taxes** at all. Except for *Italy,* which has abolished inheritance taxes altogether, rates of inheritance tax can be very high in the *EU*. Even if the inheritance takes place between spouses and close relatives, if the testator is the direct owner of the property, inheritance

taxes can quickly rise to 20 or 30% of its market value. In the event of inheritance to unrelated persons, they can easily reach 60% (*France*) and in extreme cases even over 80% (in *Spain,* for example, where the highest tax rate for inheritance to wealthy unrelated persons is 81.6%). The higher the value of the estate and the more distant the kinship, the higher is the inheritance tax. *Spain* also has the interesting peculiarity of taking into account not only the value of the estate and the degree of relationship, but also the wealth of the inheritor. This may in certain circumstances lead to the enormous maximum tax rate of 81.6%. So it should always be determined before buying who is to be the legal owner of the foreign real estate. Depending on the circumstances, various options are available before a purchase, such as setting up a holding structure or direct acquisition of the real estate in the names of the children.

Even for real estate in the medium price range, it already makes sense to make suitable legal arrangements to reduce or avoid foreign inheritance taxes within the framework of **international estate planning**. This can often be done, and it is worth while carefully checking out each case individually.

9.5 Other taxes and charges

In most countries, various **lesser taxes and duties** are payable at acquisition, but also annually. They include smaller stamp duties for documents, sewage connection charges (which can be considerable, for instance in *Switzerland*), garbage removal charges, and connection charges for cable TV which, in some countries, can also have a tax-like character.

Other charges may include costs for fire or building's insurance. These are not mandatory in many countries, so taking out such a policy or not is at the discretion of the owner. In other countries, however, every real estate owner is obliged to conclude such an insurance policy.

If the activities of a private real estate investor exceed the limits of 'normality', in many countries there is a risk of being considered as a **real estate dealer** for tax purposes. In such a case, all revenues from the real estate inclusive of sales profits count as earned income and are liable to the usual income tax, which may be very high. In addition, there may also be value added tax implications. However, this will obviously not apply to a one-time purchase of a privately used real estate.

9.6 Incorrect (lower) statement of sale price on the sales agreement

The basis for calculating real estate transfer taxes and capital gains taxes is normally the **purchase price documented in the purchase deed** (such as a sales agreement authenticated by a notary). This offers a tempting way of 'saving' taxes by stating a lower sale price on the sales agreement. However, such action constitutes tax fraud and can lead to considerable sanctions, depending on the country concerned. Nevertheless, it continues to be common practice in countries such as *Spain* and *Italy* and in some cases the other party to the agreement will even insist on it.

This practice not only evades part of the real estate transfer tax usually payable by the purchaser, but the seller also 'saves' taxes on the appreciated value of the real estate. In addition, the difference to the real purchase price not declared in the sales agreement is often paid in untaxed money, which represents another motive for this practice.

Sometimes – for instance in *Spain* and *Italy* – it may even be quite impossible to acquire certain real estate without such illicit payment, as the seller is only willing to sell to someone who is prepared to pay part of the purchase price illicitly. This preference on the part of the seller may also be linked to the fact that he/she had also paid part of the price illicitly and would now have to pay considerably higher capital gains tax if the true sales price were put on the agreement.

Quite apart from the fact this practice is illegal and may lead not only to fiscal but also in some cases to considerable criminal sanction, depending on the country concerned, it in any case involves **more disadvantages than advantages, above all for the buyer.**

A particular problem, which should not be underestimated, concerns the handover and **time of transfer of the cash**. Should the money be transferred when the preliminary contract is signed, at the notarial authentication of the main agreement or only when the property changes hands? If the sales agreement is not fulfilled, any illegal subsidiary arrangements can be unfortunate for both buyer and seller. A purchase in which the declared price does not correspond to that actually paid is generally considered a **fictitious transaction**, which is invalid in most countries, and leads to corresponding complications if any contractual claims are asserted. Thus, if the buyer should wish to pursue litigation against the seller, either for building defects or in connection with the title, the responsible court will, as a rule, at most sentence the seller to reimburse the documented and registered purchase price. Normally no evidence is admitted which shows the purchase price to be any other than the official one. The buyer should also note that an officially lower purchase price leads to a **higher capital gain** at a later resale and thus to correspondingly higher capital gains tax – unless the seller finds another prospective buyer who is willing to pay part of the sale price illicitly.

In the case of **acquisition from a legal entity, such as a company**, this illegal practice can also be risky in the event of the latter's bankruptcy. In most countries, if the purchase price specified in the official sales agreement differs significantly from the market value of the real estate, the receiver can contest the sales contract and possibly even reclaim the real estate. In the worst case, the buyer would have to register his/her bankruptcy claim at the price specified in the official sales agreement, or alternatively consider the option of notifying the tax authorities of his/her own tax evasion, because the buyer actually paid a higher purchase price.

9.7 International taxation and avoidance of double taxation

Any tax liability is always based on the **tax law of individual countries**, i.e. a specific country will always assert its **right to impose tax** with respect to a particular matter (such as property, income, license earnings, etc.) within its borders. As long as the person concerned does not cross the borders of a particular country and maintains no tax-relevant relationships beyond its borders, only the tax laws of that country are applied.

However, by crossing national borders – for instance, by acquiring real estate in another country – a buyer also becomes liable, at least in part, on the basis of the fiscal laws of the other country. The question then immediately arises of the **delimitation of the rights to impose tax** between these two countries, and double taxation then becomes a threat. The buyer can be taxed firstly by the tax authorities of the country of his/her residence,

which in most countries means unlimited tax liability based on global income and (in some countries) value of net assets. But he/she can also be taxed by the country in which the real estate is located on the basis of the limited tax liability that comes with ownership of real estate. So it often happens that parts of the assets (such as the real estate in the other country), or of the income, will in principle be taxed by two countries, i.e. the same part of the assets or income is subject to double taxation unless limits are imposed. This can be done on the basis of national law (by means of **provisions in the law limiting tax liability**). For instance, although *Switzerland* basically taxes the global income and assets of persons who have their tax residence in *Switzerland*, real estate assets located abroad are exempt from Swiss taxation. However, such national regulations are relatively rare, and to avoid double taxation in an international context as far as possible, double taxation agreements (known as DTAs) have been concluded between many countries.

Double taxation agreements

Double taxation agreements are bilateral treaties that delimit the tax-imposition rights between two countries and take precedence over national legislation. The aim of such treaties is to **avoid double taxation** by preventing incomes, assets and, in some treaties, also inheritances and gifts from being taxed twice. An extensive worldwide network of agreements exists regarding income and wealth taxes. In contrast, relatively few agreements concern inheritance and gift taxes.

For real estate, DTAs generally apply the following **taxation principle**: real estate is taxed as an asset and any revenue deriving from it is taxed as income in the country in which the real estate is located. The other contracting state (in this case the country of residence of the real estate owner who is liable to unrestricted taxation there) must either exempt the real estate from its own taxation or credit the taxpayer with the taxes imposed by the other country.

Imputation method/tax credits

The DTAs of relevance here often apply the imputation method. The real estate located abroad is then subject to taxation in both countries, i.e. in the state of residence and the state in which the real estate is located, although the former credits the taxpayer with the tax already collected in the latter. This means that the taxpayer will **always be liable to the higher tax rates** applicable. For example: a person resident in state A who is liable to unlimited tax owns real estate in state B which he/she lets. The net revenue from the rental is 100, which is taxed in state B at 25%. State A levies a tax of 35% on the same income of 100, but credits the 25 already paid, so that only the additional 10 of the income derived from the rental revenue is taxed in state A. The taxpayer is consequently not taxed twice on the same income, but ultimately pays the higher tax rate of state A. However, if the tax rate in state A was also 25%, then state A would impose no further tax on the relevant income.

Exemption method

In the exemption method, the taxation right is assigned exclusively to the state in which the property is located and the residence state must exempt the corresponding income or assets from taxation. However, in most cases a saving clause as to tax progression **(exemption**

with progression) is applied. This means that in the overall taxation of the taxpayer, the residence state may apply the tax rate that would be applicable to the taxpayer's income or assets if his/her income or assets located in the treaty state were to be added to these. This saving clause thus affects only those taxpayers whose taxable income or assets are not already subject to the highest progression bracket of income or wealth tax. It is irrelevant to those who already pay at the top tax rate.

Debts and debt interest attribution

The DTAs do not deal with the question of attribution or **splitting the debts and debt interest encumbering a real estate** between states. Almost all states accept debts and debt interest on the basis that the mortgage and debt interest encumbering a particular real estate are subtracted from the corresponding market value or revenues and only the respective net asset value or net income is taxed. *Switzerland* is an exception to this rule, as it applies a quota-based exclusion of global debts and debt interest (as a ratio of Swiss to global assets), so that double deductions or deduction gaps can naturally result with respect to *Switzerland*.

Combating tax evasion

In addition to avoiding double taxation, DTAs increasingly also serve to **combat tax evasion**. The contracting states thus agree on extensive exchange-of-information clauses. It is worth noting that some of the countries that interest us here have introduced special taxes or reporting requirements on foreign companies that hold local real estate (e.g. *France, Spain*). Exemption is usually possible only if the foreign company is domiciled in a country that has concluded a DTA containing extensive information-exchange clauses with the country in which the real estate is located.

The *Organization for Economic Cooperation and Development (OECD)* has published a **model double taxation agreement** which acts as a reference for most DTAs applicable between contracting states. After various partial revisions between 1992 and 2000, the *OECD Steering Committee* has now ratified a further update of this agreement. A significant and relevant change is that *Article 13* now includes a stipulation about the sale of shares of a **company whose main asset(s) is real estate**. Also, *Article 27* was added; it concerns mutual help between states in collecting tax.

The new stipulation in *Article 13(4)* is as follows: *'Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other state.'*

This new stipulation will be considered in future double-taxation agreements or in renegotiations of existing agreements and should accordingly be borne in mind. If real estate is acquired abroad via a company, it is certainly advisable to consult the domestic law both of the country in which the real estate is located and of the owner's country of residence, and in particular any relevant double taxation agreements. These agreements may diverge from the *OECD* model agreement in significant points concerning these issues. An overview of personal taxation in selected countries is presented in Table 3.

Table 3 Overview of personal taxation in selected countries

Country	Maximum tax rates in %				Number of double taxation agreements concluded	Assessment [1]
	Income	Capital gains	Wealth	Inheritance/ gifts [2]		
Australia	47	47 [34]	0	0	42	***
Austria	50	50 [23]	0	15–60	61	**
Bahamas	0	0	0	0	–	*****
Belgium	54.55 [3]	33 [4]	0	30–90 [5]	81	**
Canada	46.41 [16]	23.20 [17]	0	0 [18]	55	***
Cayman Islands	0	0	0	0	–	*****
Croatia	45	0 [19]	0	0–5	33	****
Cyprus	5 [30]–30	20	0	0	37	****
Finland	56	28	0.8	16–48	64	*
France	49.6	26 [8]	1.8	40–60	108	*
Germany	44.31 [6]	51.17 [7]	0	30–50	76	*
Greece	40	0	0.8 [9]	40	35	***
Hong Kong	17.5	0	0	15/0	1	****
Hungary	38	20	0	21–40	54	***
Ireland	42	20	0	20	42	****
Italy	12.5 [11]–45	27	0	0 [12]/15 [13]	71	***
Japan	50 [14]	52 [15]	2.1	70	45	*
Jersey	20	0	0	0	1	*****
Malta	35 [20]	35	0	0 [21]	34	*****
Mexico	34	34	0	0	27	***
Monaco	0	0	0	16 [22]	1 [32]	*****
Netherlands	52	0	0	27–68	79	*
New Zealand	39	0	0	0/25	27 [33]	***
Portugal	40	20	0	0–10	33	**
Singapore	22	0	10	10/0	47	****
Spain	45	15 [28]	0.2–2.5%	40.8–81.6	41	*
Sweden	60	30	1.5	30 [35]	83	*
Switzerland	23.5 [24]–45.5 [25]	0	0.4–0.7 [26]	0–54.6 [27]	52	****
UK	40 [10]	40	0	40	118 [31]	****
USA	39.6	20 [29]	0	55	64	**

Notes on the table:

[1] Assessment of the total tax burden on foreign nationals taking up residence, including all tax planning options: * = Tax desert, ***** = Tax paradise.

[2] The first number designates the maximum tax rate for spouses and children, the second number the maximum tax rate for unrelated persons. If different tax rates apply for inheritances and gifts, the figures before the slash refer to inheritance, after it to gifts.

[3] Plus additional taxes at municipal level from 0 to 9.1%.

[4] Certain private capital gains are tax free.

[5] Depending on the region; for close relatives, the maximum tax rate is 30%.

[6] Maximum tax basis for 2005 is 42%; however, a 5.5% solidarity supplement is additionally imposed on income tax.

[7] Only 50% of capital gains from share sales by natural persons are taxed; capital gains from the sale of real estate are tax free after 10 or more years.

[8] Various rates apply depending on the situation. Tax rates of up to 50% apply to certain capital gains from the sale of options.

[9] Only on real estate assets.

[10] For foreign nationals under certain conditions only on UK income.

[11] On interest earnings from foreign bonds.

[12] In the case of tax-free inheritance or donation of real estate, certain taxes are payable for entry of the transfer in the land register from the testator to the inheritor, or from the donator to the donee. If this is not the testator's main residence, these mortgage and land register taxes total 3%.

[13] Gifts between spouses and relatives of up to fourth degree (cousins) are tax free.

[14] Total of national, regional and municipal taxes.

[15] If the real estate is resold five years after acquisition.

[16] *Ontario*.

[17] Capital gain: 50% of appreciation according to tax progression or 21.46% for non-residents.

[18] There is no inheritance tax, but capital gains tax is charged as per the day of death.

10 Insurance

Incidents involving new and reconstructed buildings can lead to considerable liabilities for the principal. The latter is normally liable for any damages that may be caused by his/her building project – that is, even if there is no fault. If the principal wishes to shift liability to the causal agent, he/she will first have to find the latter and then prove negligent conduct. The **principal's liability risk** must consequently be covered by a suitable insurance policy. It is also advisable to consider cover for unpredictable damage during the building phase, as unfinished buildings are at particular risk. Damage to the building itself is covered by the **builders' liability insurance**. In addition, cover can be arranged for existing buildings and movables as well as for costs for clearance, inspection for damage and reconstruction.

Upon completion of the building work or acquisition of a completed building, **building damages insurance** is absolutely necessary and is even mandatory in many countries. Suitable cover must also be arranged for the **owner's liability** associated with the real estate. It must furthermore be ensured that the **household effects** contained within the building are sufficiently insured – against damage by fire, water, etc., as well as burglary. Normal household effects' insurance does not cover rare or expensive objects such as jewelry or works of art sufficiently, if at all. Special valuables or art cover should therefore be arranged for them. Finally, the risk arising from financial obligations should not be neglected either. Life or loss-of-earnings insurance may also be advisable to provide security in the event of **death** or **disability**.

10.1 Checklist: Insurance

The following risks should be checked and suitably insured:

- Liability consequences of the principal: principal's liability insurance.
- Damage by the elements to the still incomplete building: buildings' insurance and builders' liability insurance.
- Damage by fire, water, etc., to the completed building: building damages insurance.
- Liability of real estate owner: homeowner's insurance.

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[19] If the real estate was used as the domicile of the owner or his/her family, or was sold three years after its acquisition. If more than three properties of the same type were sold within a period of five years, this is seen as a business activity and is thus liable to standard income tax.
[20] For foreign nationals with permanent residence permits: taxation limited to 15% of income transferred to *Malta*.
[21] However, 5% stamp duty is charged on real estate and 2% on shares (except shares listed on the Maltese stock exchange) at donation or death.
[22] Only on assets in *Monaco*.
[23] Tax free after the real estates have been held for 10 or 15 years.
[24] Cantons of *Zug* and *Schwyz*.
[25] Canton of *Geneva*.
[26] Wealth taxes vary between the cantons.
[27] Canton of *Geneva* (unrelated persons).
[28] Applicable to capital gains over more than a year.
[29] On short-term capital gains 39.6%.
[30] Option for foreign pensions, special tax rate of 5% on income exceeding CYP 2,000.
[31] Some countries have more than one DTA with the *UK*, 118 represents the number of countries that have any form of DTA with the *UK*.
[32] One agreement with *France*.
[33] Three agreements not yet in force.
[34] Individuals will usually only be taxed on 50% of the capital gains, with no indexation of the cost base of the capital asset.
[35] It is proposed that taxation of gifts and inheritances is abolished as per 1 January 2005.

- Household effects contained in the building: household effects' insurance.
- Particularly expensive objects, jewelry, objets d'art: valuables or art insurance.
- Financial obligations of the owner (especially with regard to bank loans): whole or term life insurance, loss-of-earnings/income replacement insurance.

11 Financing

Real estate is generally considered as an asset retaining its value over the long term, so that building societies, banks and other financial institutions usually grant **mortgages** of up to 80% of the current market value, in some countries even up to 100%, against corresponding collateral. As a rule, however, this applies only to real estate buyers or owners living in the same country who can demonstrate sufficient income. Foreign buyers of real estate often find that opportunities for local financing are severely restricted. Depending on the country concerned, few lenders are willing to grant foreign real estate owners corresponding loans. On the other hand, banks in some countries (for example in *Spain*) grant relatively generous mortgages to foreign owners too. However, banks in the buyer's home country tend to be even less willing to finance real estate located abroad.

Property can also be financed by means of **leasing**. However, this is far more usual for commercial properties such as office buildings, industrial premises, etc., than for private houses and apartments. In a leasing transaction, the owner of the real estate acts as the lessor who lets the lessee have the use of the real estate in return for remuneration. The latter may obtain 100% financing for this purpose. As a rule, leasing agreements can be concluded with a buy option.

Regarding vacation homes it should be pointed out that they should be seen essentially as consumer goods and should consequently be largely financed from one's own funds wherever possible. On the other hand, financial planning and tax aspects may often make some degree of borrowing advisable.

11.1 Checklist: External financing

- Amount, currency and specific conditions.
- Amount of own funds required.
- Interest rate: The interest rate can be arranged to be either fixed or variable, and multi-currency. Various interest-stage and interest-plateau models are also available.
- Bank charges and other ancillary costs.
- Term, amortization and other conditions. In some countries it can make sense from a tax viewpoint to maintain a high mortgage and amortize it indirectly.
- To secure the loan, there are usually several different ways of setting up a suitable lien or mortgage on the property which acts as collateral.
- Some countries (such as the *USA*) require title insurance.
- In some countries, the payout of loans is taxable.
- Currency risk.

12 Special real estate

12.1 Timeshares (timesharing)

Instead of acquiring a vacation home as a sole owner, and then letting it stand empty much of the year, it can make good sense to share the property with other interested parties. Although this is basically a good idea, many providers of timesharing services have acquired a bad reputation, and not without reason. In most cases, this is because they offer **over-priced projects** and often market them by using **aggressive sales methods**. Acquirers of timeshares are frequently swindled out of their money as a result of false information about the possible utilization to be expected and excessive maintenance fees. They may even lose their entire investment if a vacation resort remains unfinished. It is frequently suggested that timesharing rights are a kind of capital investment which appreciates in value and can be resold. And yet no entry is often made in the land or ownership register, in which case the buyer has no security in the event of bankruptcy, and in most cases no real resale market exists. Great care must accordingly be taken by prospective acquirers.

For this reason, various countries – in the *USA,* the state of *Florida* is exemplary in this respect – have introduced regulations aimed at preventing such exploitation of the timesharing concept. Thus providers of timeshares in *Florida* are liable to extensive **disclosure requirements**, so that the risks of a purchase must be made apparent and the buyer is clearly informed that he/she has a 10-day right of withdrawal from the contract. The *American Resort Development Association* (*ARDA*) has also published a *code of ethics* for the *USA.* In *Europe,* an **EU timesharing directive** has been in existence since 1994, but has not been implemented in all countries. It stipulates that sellers must provide comprehensive information and make provision for withdrawal rights for the buyer as well as for additional protective regulations.

Forms of timesharing

There are several different forms of timesharing. In most cases, a share is acquired in an ownership association in conjunction with a temporary utilization/occupancy right which is entered in the land or ownership register. This may also be called **deeded** or **real timesharing**. In some timesharing agreements, however, no such utilization right is entered in the ownership register but a right to a timeshare is secured merely by contract. This is known as **non-deeded** or **contractual timesharing** and is in reality closer to a long-term rental or accommodation contract with full prepayment of the rent. In a number of countries (for example in *Switzerland*) real timesharing is not possible because the law does not actually allow real estate ownership to be divided up into various periods of use calculated over the year. However, arrangements to this effect in contract and company law are usually permitted. This leads to another form of timeshare that consists of the acquisition of company shares or participation rights in a similar legal entity which, in turn, permits utilization of real estate held by that legal entity. This form of timesharing is often called **cooperative timesharing**, vacation club or incorporated timesharing. The companies can, for example, be organized as stock corporations whose shareholders acquire shares or other participation units for which residential-rights points are distributed. Also worth mentioning are the **trust structures** not infrequently set up as a complement to real timesharing arrangements. Trusts play an important role above all in the English-speaking world which

generally knows various forms of trusts. In trust structures the acquirer is a trust beneficiary and not a holder of real estate ownership.

The costs of timesharing

Even if a provider is operating legitimately, the question must be asked whether timesharing is really worth while, as it almost always works out to be much more expensive than a hotel stay or package tour. Equally, it fails to offer the comfort of one's own four walls assured by full ownership or the option of using the property at any time.

A utilization right in a timeshare is usually acquired by paying a certain **initial purchase price**. Its amount depends on the most diverse factors, such as the location and facilities of the property and the season for which the utilization right applies. It has no upper limit but usually costs up to some US$ 25,000 per week. However, regular annual **maintenance fees** must be paid in addition to this. These can be quite considerable, depending of course on the real estate. It should also be noted that such fees are regularly increased in line with cost-of-living criteria. If services such as final cleaning are retained, **service charges** are also incurred. If a client does not wish to take his/her vacation in the same place every year, he/she should consider membership of an exchange network. There are two main providers in this market, both based in the *USA*: *Interval International* and *RCI.* In most cases, membership is acquired right at the start with the rest of the package and is also used as a sales argument. However, exchange-pool membership also incurs annual **membership fees** which must be added to the running costs.

The best way of obtaining a timeshare under relatively attractive conditions is via the **second-hand timeshare market**. Agents specializing in this business can be found especially in the *USA*, but also for example on the Caribbean island of *St Martin*. Elsewhere, especially in *Europe*, there is almost no real market for second-hand timeshares. Shares of incorporated timeshare companies that distribute dividends in the form of residence-rights points for vacation properties can also be acquired second-hand rather than new. Such shares are even offered via newspaper advertisements. As a rule, the price obtainable on the open market is well below the initial sales price, which is also a clear indication that timesharing tends to be over-priced.

12.2 Historical real estate

A chateau in *France*, a historical country estate in *Andalusia* or an apartment in the old center of *Venice* is the ultimate dream of many. And residential properties with a long history are indeed something special, with their own charm and romanticism. Old walls, wooden beams and floors of natural materials often hold great appeal for many prospective buyers.

However, **old masonry** in particular can give rise to considerable problems and costs. Dampness, poor insulation, rotten attic timbers, a leaking roof, antiquated electrical and sanitary installations and much else can mean expensive renovation and maintenance work.

In an extreme case, a house may be beyond repair because of insalubrious conditions – such as excessive decay and mold or asbestos contamination – and should really be pulled down. However, this need not be the case, and solidly built dwellings, such as all-wood chalets in the Alps, are often exemplary in terms of **building quality** and **biological factors**.

In any case, historical properties should never be bought until they have been examined by a specialized architect or construction engineer. Surprises lurking in the attic, cellar, or even behind a newly painted wall, may be just too major and unpleasant. The fee charged by the architect for an assessment (usually between US$ 2,500 and US$ 15,000 depending on the real estate) is very reasonable in comparison.

In most countries that are of interest here, historical real estate is protected in some way, and **preservation regulations** may even encumber the real estate with major restrictions. Every item of renovation or alteration work, no matter how minor, may require approval from the relevant authorities. This can be a very laborious procedure in some countries. However, that need not be the case. For example, hundreds of historical buildings in *France* are not protected. Before acquiring historical real estate, however, it is important to check exactly what restrictions apply. On the other hand, the owner may well be able to claim state subsidies for (usually very expensive) renovation work. In any case, the legal framework conditions and restrictions should always be examined carefully and should be completely clear to the prospective buyer **before buying**.

12.3 Rural and agricultural real estate

Rural real estate such as a farm or an olive grove usually suffer from the same problems as historical ones in terms of masonry, preservation orders and similar factors. However, prospective buyers of such real estate should be aware of many other points. They include the question of their earlier **use**. Thus buildings that were formerly used as animal stalls or as shelters for shepherds or farm laborers, and are sold today as *rustici*, were never designed for residential purposes. **Access** is often difficult and maintenance of a track leading across rough ground may be troublesome and expensive. Other points to consider are a supply of **fresh water** and a means of **removing sewage**, as remote properties are rarely connected to the public water supply and sewage systems. It can also be difficult to obtain a **telephone line** and **electricity supply**. Real estate located in agricultural zones is practically always subject to relatively extensive **building prohibitions or restrictions**, and any utilization rights by neighbors and other questions of **neighbors' rights** must be additionally clarified before a purchase is made. Nor should **safety aspects** be neglected in the case of remote real estate. Poorly secured properties that are not under surveillance in the absence of their owners are preferred targets for burglars. Finally, it should not be forgotten that agricultural land must be suitably tended. This may be done by the neighbors in many cases, but such arrangements must be organized and usually have to be supervised.

Although the acquisition of agricultural real estate – such as *olive groves* in *Andalusia*, a *vineyard* in *Piedmont* or a country estate in *England* – is essentially comparable to the purchase of any other real estate, special care must be taken due to the peculiarities of **agricultural use**. In political terms, agricultural land has long been treated as a special case in almost all countries, but especially in *Europe,* and this largely continues to apply. Laws passed in favor of farmers frequently encroach upon the rights of residential and commercial tenants. A buyer of agricultural real estate must take this particularly into account. Long-standing rights of neighbors, such as grazing rights, are often in place. They may not be recorded in any register but nevertheless have full validity and can be enforced if necessary. Special tax allowances or state subsidies are often available for farmed land. Not infrequently, restrictions on acquisition by foreign nationals continue to apply.

The purchase and sale of agricultural real estate may involve contact with **unfamiliar stipulations of the local laws**, often with deep roots in the history of the country. Agricultural real estate may also be subject to various regulations, such as hunting and fishing rights, which may be important in a particular case. Accordingly, the purchase and sale of such real estate usually takes much more time than other real estate, and such transactions often require special knowledge and experience.

Moreover, particularly larger agricultural estates may be regarded as enterprises and there are often employees that permanently work and sometimes live on the estate. The buyer would then need to consider **employment law aspects** and may have to assume an employer's liability to continued wage payment, pension contributions, insurance payments and the like. He/she would then have to decide whether to keep employees on after the acquisition and may even have an obligation to do so under local employment law. Such cases must be examined on the basis of the relevant legal stipulations as well as concrete employment contracts and agreements so that the obligations passing to the buyer can be evaluated from a legal standpoint.

12.4 Vineyard properties

As a special form of agricultural real estate, vineyards require particular knowledge in viticulture and oenology. Accordingly, at least for the purchase of larger vineyard properties, vineyard experts, oenologists, specialized architects and surveyors, nursery gardeners and vineyard planners should be involved.

Regarding the vineyard in general, in a number of countries, **permits** are required for vineyards above certain acreage. Classification of origin is available in countries such as *France, Spain* and *Italy* and may be of interest for the prospective buyer. For example in *France*, the *INAO (Institut National des Appellations d'Origine)* issues certificates which will confirm the *AOC* (*Appellation d'Origine Controllée*) classification of wines.

A land survey controls the exact planted surface area before the sale. The resulting computerized document is also used for the day-to-day running of the vineyard (for example, spraying). The sanitary condition of the vineyard is checked to detect possible diseases and problems, and the **climatic risks** (in particular, hail, frost and flooding) are estimated via empirical data and maps identifying sensitive areas.

Regarding the **buildings and installations** on the property, such as vinification plants, cellars, offices, shops or houses, there are normally specific regulations in most countries. Regulations include provisions regarding asbestos and other pollutants, surface area of the building and possibility to enlarge existing facilities, the water quality of wells in case the property is not connected to the public water supply, termites and other xylophagous insects, etc. When the buildings are large, it is important for a surveyor to carry out a check of the main structures.

Regarding the **vinification plant** in particular, attention must be given to the conformity of the installations to local regulations, especially concerning work safety and electrical installations. Appropriate conformity certificates and reports must be attached to the sales agreement. Also the constantly changing regulations concerning the treatment of effluents and the growing problem of chloroanisoles must be verified. A comprehensive **list of**

equipment mentions its condition as well as the possible securities, guarantees, leasing agreements, etc.

Where the vineyard produces significant quantities of marketable wine, in other words in those cases where the vineyard is operated as a real business, the **goodwill of the business** is the most delicate factor to measure in the estimation of the overall value of the real estate. Very often, the quality and reliability of the business will depend on the owner. Therefore no guarantee can be made on the value of the business. It is nevertheless essential to check the sound protection of the trademarks sold, in this case the trademark of the estate or the château.

As wine is a living product, a complete **qualitative control** (wine-tasting coupled with laboratory analysis and maturing tests) is essential in all transactions. Although a contradictory evaluation does not free the seller completely, it increases the security and clarifies the operation. In addition to the stock, the standing crops correspond to the expenses engaged by the seller with a view to the future harvest which will be to the benefit of the buyer.

Unless there is a special agreement, the takeover of the estate usually implies the takeover of all existing staff. On the day of the sale, the legal situation of the employees must be up to date (remuneration, bonuses, sick leave and paid holidays) and any risk of litigation clearly announced to the buyer.

Often, when an estate contracting to a cooperative cellar is sold, the buyer may not wish to carry on this contract. In this case, the buyer's position must be clearly and precisely stipulated in writing before the sale at the risk of having to pay cancellation fees in conformity with the regulations of the cooperative cellar. A written agreement before the sale enables the minimization of financial consequences.

Because of comprehensive tenant protection regulations in many countries, a **leased estate with a tenant** is normally difficult to sell. In the case of a sale, the owner must pay attention to the deadlines and the form of the notification for the ending of the lease in order to be disengaged from his/her tenant farmer without financial consequences (compensation for the tenant farmer) because, in the case of a sale, in many countries a considerable amount (for example in *France*, up to 30% of the value of the real estate) can be allocated to the tenant farmer as an indemnity for termination. The calculation is determined by the quantity and nature of the investments carried out by the tenant farmer on the estate.

With the purchase and sale of a vineyard, the **purchase price calculation** and the allocation of the prices between the various assets sold, the interests of the seller are usually very different from those of the buyer. For example, the buyer will want to optimize the redeemable values (equipment, plantation) whereas the seller will want to reduce them as these assets are often already depreciated. On the other hand, the seller may aim to maximize the value of his/her main residence, whereas the buyer may prefer to minimize it.

A vineyard purchase transaction, from the provisional sales agreement to the signature of the final contract, usually takes four to six months. The transaction must be formalized by experts qualified in their respective fields of competence. Lawyers, accountants and bankers must verify and validate, among other things, the title deeds, the release of mortgage and other encumbrances, the notifications to neighbors and organizations benefiting from a pre-emption right (government, commune, etc.), easements, the annual accounts and balance

sheets of the vineyard operation, the guarantees of assets and liabilities (when there is sale of company shares) and the execution of contingency clauses.

12.5 Real estate located near water

A location close to or with a view of water is often preferred for vacation homes, which may also be required to directly adjoin the sea, a lake or river. However, properties located close to water are liable to particular problems. Especially in the case of stagnant waters such as lakes, considerable nuisance from **gnats and midges** must be expected in the summer months or in warmer climate zones throughout the year, and the vicinity of such waters generally encourages pests. A pleasant summer's evening lounging about in the garden can be considerably disturbed. Certainly there are various mechanical and chemical ways of limiting this nuisance, but their use is not always pleasant. Water can also be a **danger** from various standpoints. Rivers and lakes can burst their banks during **floods**, and **coastal flooding** as well as **hurricanes** in certain subtropical and tropical regions can be a serious hazard to buildings and people. The possibility of sudden devastating **waves** caused by earthquakes must also be considered. In some countries, such as *New Zealand*, the danger of *tsunamis* is very real and is taken seriously. In many parts of the world there were good reasons not to build directly next to the water in the past, but rather to seek out more elevated locations further inland.

In areas **close to the sea** it should also be noted that salt air tends to ravage building materials. Metal parts in particular **corrode** very quickly. Window fittings which function perfectly when a new owner moves in can be defective after only a short time. Prospective builders of a property in the vicinity of the sea should ensure that appropriate materials are used. In most cases, certain types of wood should be preferred, special paints are required and the appropriate architecture is also important. It is essential to call in an expert familiar with local building traditions, irrespective of whether a new house is being built or an existing one acquired.

13 Private islands

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The thought of a private island conjures up dreams and wonderful fantasies: your own untouched piece of land completely surrounded by water where you can enjoy the isolation and beauty of nature. In earlier centuries islands were perceived as hostile isolated places, utilized as sites for prisons or remote locations of exile and banishment. The only other 'positive' purpose they served was to save shipwrecked sailors from drowning.

Then with the paintings of Paul Gauguin which captured the enchantment of distant tropical islands and with Stevenson's book *Treasure Island*, islands signified places of freedom, exoticism and secret desires. Today for people under modern-day stress, islands symbolize a further desire: a longing for peace and fulfillment and a retreat to pure nature and the rhythm of the simple life without all the worries of modern-day life. In today's civilized world, the desire for a private island is becoming very popular.

Due to technological progress, islands are no longer cut off from civilization. On the contrary, islands are becoming much more accessible. Through development of technology such as

solar energy, prefabricated homes, desalination systems as well as mobile phone networks and the internet, the advantage of mainland property as opposed to island real estate has almost disappeared.

Many celebrities have taken the initiative and have secured their own oasis of tranquility: for example, the shipping magnate Aristoteles Onassis with his island *Scorpios* in the *Ionian Sea* in *Greece*, John Rockefeller with island groups in the *Caribbean*, which he then devoted to nature conservation, actors such as Nicolas Cage *(The Bahamas*) or Tony Curtis *(Canada),* artists such as Diana Ross *(Pacific Ocean)* or entrepreneur Richard Branson who offers his *Necker Island* in the *British Virgin Islands* for rent.

Although some private islands for sale, for example in the *Caribbean*, have been developed into luxury refuges (and have corresponding price tags), not all private islands represent extreme wealth. The sales of most private islands take place in the region of US$ 150,000 to US$ 350,000. Despite different budgets, all island buyers have two characteristics in common: they are individualists and lovers of nature.

Irrespective of the fact that certain countries such as the *Philippines, India* or the *Seychelles* restrict or forbid the purchase of private islands by foreigners, the following criteria have proven to be important when considering the purchase of a private island.

13.1 Key criteria to note when buying a private island

Infrastructure on the mainland

The distance to the mainland or to another inhabited island should not be too far, for example, 1 km to a maximum of 5 km. The mainland should offer the necessary infrastructure such as roads, parking areas, access to a grocery store, services, and road connections to the next airport, electricity and telephone connection possibilities. For some islands the journey by boat from the island to the mainland is often easier than that on land from a remote ranch or forest property to the next village. The owner of a private island should be aware that good infrastructure on the nearby mainland is an essential prerequisite.

Absolute ownership essential

The investment in a private island is a capital investment for which maximum security is imperative. The private island owner must ensure that he/she receives the documentation in his/her own name from the property registry or registry of deeds and that the ownership title is free and clear. Only good ownership titles are insurable and give the potential to earn profit through possible appreciation. This does not apply to leasehold titles.

Construction possibilities on the island

Islands, as most other real estate, have value only if they can be used. Potential owners should avoid islands designated as conservation area for birds or any other nature reserve. Instead, the island must have a planning and building permission. It is therefore important before signing an agreement to buy the island that the buyer is assured that a building permit is readily available or that a building permit is attainable before the conclusion of the purchase and sale transaction. The buyer should request for this to be one of the conditions

for purchase outlined in the agreement. Local legal experts can provide advice on applying for, and obtaining, a building permit.

Appearance of the island

Of course the island must have natural appeal and offer such features as woodlands, beaches, cliffs, and several coves, one of which should be protected and of suitable depth to anchor a boat. Drinking water must be available on the island and a healthy flower, plant and tree vegetation must also be apparent so that the overall appearance is positive.

Geographical location

A private island should be bought only in areas which are politically stable, in countries where a safe legal system and reliable judiciary is in place. Also a pleasant climate is important. These criteria help to narrow down the choice and also determine the price.

13.2 The cost of a private island

For US$ 12,000,000 you can buy 1.4 square kilometers of a tropical island in the *Caribbean* with an airstrip for your private jet, a large luxurious villa and staff accommodation. For approximately US$ 7,500,000 you could acquire an island in the *Mediterranean* near *Monaco* with a large harbour for your yacht and a medieval tower. US$ 5,000,000 will buy a large, 22 square kilometer island in *New Zealand*, somewhat isolated but with a sheep farm and lodge with magnificent views. For US$ 700,000 you could purchase an undeveloped island in the *Caribbean* off the coast of *Belize* in one of the best diving areas in the world. For US$ 350,000 you could savor the views from the terrace of your own island home on the famous castle of *Gripsholm* in *Sweden*. For US$ 200,000, one of the prettiest islands off the east coast of *Canada*, only a few minutes by boat from a popular tourist resort, can be acquired. And for US$ 20,000 a small private island with a summer cabin, also off the east coast of *Canada*, could be yours.

13.3 After the purchase

There is more to the purchase of an island than just a carefully thought out transaction. Like every other real estate, an island must also be managed and properly maintained in the future. In this respect one can retain a property management company or one can manage the real estate oneself. The annual costs that need to be considered depend on such factors as taxes, insurance, and the costs of a caretaker. However, in the case of most privately owned islands, the employment of a caretaker who would reside on the island is not necessary. In most cases, a manager can be found on the nearby mainland. One can often employ a fisherman who sails by the island daily and can keep an eye on the real estate for a reasonable monthly salary. Additionally, an hourly wage is paid for actual work done. Such a person normally also acts as the local contact person.

If an island is uninhabited and is held solely as an investment for future development or resale, then almost no other expenses are incurred. In such cases, nature is the best and most convenient manager.

In the case of a construction, one must ensure that a valid **building permit** is granted, in which case the availability of electricity must be determined. This is possible either via underwater cable, generator or by solar or wind-generated power on the island itself. A careful cost analysis prior to implementation is normally advisable.

In many areas prefabricated houses are also available. Often, prefabricated houses on an island are only 10% more expensive than those on the mainland. They have the advantage of being structurally approved, and the parts are delivered and, circumstances permitting, helicopters can also help to transport them. The costs of prefabricated homes are less than one may think, often around US$ 1,000 per square meter.

Drinking water is an important issue. In most cases, there is rainwater underneath the surface of an island, i.e. groundwater which has seeped through and floats on top of the lower-lying salt water. If this amount of water is not sufficient – for example, because more than one home or even a hotel requires a supply – then one must purchase a desalination system. For the smallest desalination system one would need to spend approximately US$ 50,000.

In addition, one should definitely include in one's budget a **boat**, a **car or small truck on the mainland** and a **small site on the mainland** with a boat house, storage and garage.

14 Citizenship through real estate acquisition – St Kitts & Nevis

By Vernon S. Veira, Henley & Partners, Basseterre

St Kitts & Nevis, also known in the country's constitution as *Saint Christopher and Nevis,* has been independent since 1983 and forms part of the group of islands known as the *Lesser Antilles*, located some 2,000 km to the southeast of *Miami.* The Federation comprises two islands: *Nevis* with an area of some 93.2 km^2 and *St Kitts* with 168.4 km^2. The official and business language is English. The Federation is a member of the *United Nations (UN)*, of the *Organization of American States* (*OAS*) and of the *British Commonwealth.* The *Eastern Caribbean Central Bank* has its headquarters on *St Kitts*. It maintains the stability of the *Eastern Caribbean dollar* (*EC$*), the national currency of most eastern Caribbean countries, which is tied to the *US dollar*. The head of state is the Queen of the *United Kingdom*. *St Kitts & Nevis* is a well-functioning democracy based on the British parliamentary system.

Although tourism plays a smaller role than on some other *Caribbean* islands, the twin island Federation offers very fine beaches and an outstandingly attractive mountainous landscape. The climate is tropical and close to perfect. Differences in altitude and corresponding differences in soil types make it a paradise for tropical plants. *St Kitts* has a very well designed championship golf course laid out between the *Caribbean Sea* and the *Atlantic Ocean*, with a second golf course presently being constructed in *Sandy Point* some 10 miles from *Basseterre*, the capital. There is also a very attractive golf course on *Nevis*. The truly appropriate motto of the local tourism authority is: *Two islands – one paradise.*

14.1 Acquiring real estate on St Kitts & Nevis

A foreign national who wishes to acquire real estate on *St Kitts & Nevis* will need an **authorization** known as an *alien land holding license* as stipulated by the *Alien Land*

Holding Regulation Act, Cap. 102. However, the acquisition of real estate with the aim of obtaining citizenship is in any case limited to developments which possess a corresponding special authorization issued by the government.

St Kitts & Nevis has **two different systems of transferring and showing proof of ownership** to real estate. Under the British **deed system** inherited from the colonial period, title to property can be transferred with a *deed* in accordance with the *Conveyancing and Law of Property Act*, which requires a search at the *Registry of Deeds* for upwards of 35 years. A second option is to acquire property by means of a *Certificate of Title* based on land surveying plans and subsequent entry in a title register on the basis of the *Title by Registration Act.* The acquisition of title to property via a *deed* is less secure because the *deed* applies only to the seller and buyer and does not preclude a third party from asserting a better title. A valid property title can be acquired only if the basis of the current property title can be demonstrated to go back 35 years by submitting proof of an unbroken ownership chain. A *Certificate of Title* is preferable to a *deed*. A title certificate gives the buyer a government guarantee and a right *in rem* or **title insurance**, and such a title is valid with respect to everyone. A title certificate also displays all encumbrances, such as mortgages, on the property. If real estate is acquired by means of a *deed*, the buyer or owner may subsequently request registration under the *Title by Registration Act* at any time by applying to the *Registrar of Titles. St Kitts & Nevis* is a small country in which lawsuits concerning disputes of ownership title to real estate are very rare. Before every acquisition, a lawyer will naturally check whether the ownership title is correct and unencumbered, and any problems will always come to light in the course of these enquiries and can be cleared up in advance.

Various **acquisition costs** are payable when buying real estate. Thus the government levies stamp duty of 6% of the purchase price, and another 0.5% contribution must be made to the national *Assurance Fund*. These are contributions to a title assurance which is a legal requirement on *St Kitts & Nevis*. The preparation of plans costs about another US$ 300 and the mandatory lawyer will charge a conveyance fee of about 2.5% of the purchase price. Accordingly, the total real estate acquisition costs amount to approximately 9% of the purchase price.

The *Comptroller of Inland Revenue* assesses the annual rental value of the property and a 5% **land tax** is levied annually on this rental value. No other running taxes are due. If the real estate is rented, any **rental income is tax-free** for the owner. In the event of a sale, there is no capital gains tax to pay. The tax system on *St Kitts & Nevis* is also financially interesting to those who wish to become resident there. This is because **income is not taxed** and there are **no wealth taxes**. So also from a tax viewpoint, one can live very well on *St Kitts & Nevis*.

14.2 Acquisition of citizenship

Since 1984, the *St Kitts & Nevis Constitution* and *Citizenship Act* has allowed foreign investors to acquire citizenship. This makes it the oldest existing *citizenship-by-investment program.* Other countries too, such as *Grenada, Ireland, Dominica, Austria* and *Belize*, have, or had, similar investment programs which permit suitably qualified investors to acquire citizenship. However, the *citizenship-by-investment program* of *St Kitts & Nevis* is currently the only one in the world, apart from that of *Austria* and *Dominica*, to permit the acquisition of citizenship

and consequently the right to carry a passport without a prior need to take up residence in the country.

In order to apply for citizenship, one must **invest a minimum** of US$ 250,000 in real estate. A house or condominium unit must be acquired from a developer who holds a suitable authorization issued by the government. However, almost all projects relevant to foreign investors have this authorization, and in addition only a few projects appear to be really attractive and make a corresponding investment advisable. All furniture and fittings can additionally be imported **duty-free**. One must expect to spend at least around US$ 300,000 for quality-built property in a well-tended residential estate. And some US$ 400,000 already buys a substantial villa with its own swimming pool on *St Kitts* – in contrast to the real estate prices on most other comparable Caribbean islands, which can be very high. Like everywhere, prices have no upper limit, and if one is prepared to spend several million US dollars, a luxury property containing all conceivable comforts and conveniences may be acquired next to a golf course.

Apart from this real estate investment, **various formalities** still have to be satisfied. In addition to comprehensive application forms, the most varied documents such as birth certificates, authenticated copies of identity papers, bank references and other letters of recommendation as well as a clean police record (extract from the register of criminal convictions) of one's home country and country of residence must be submitted. In addition, **government fees** of US$ 35,000 are payable for the main applicant as well as US$ 15,000 for the spouse and each child under 18 included in the application. For children over the age of 18 but still living in the same household, the fee is US$ 35,000. The documents of all applicants are scrutinized carefully – a procedure known as ***due diligence***, the cost of which is US$ 2,500 for each adult. In addition to some minor charges (such as for issuing the passport), there is also a **fee** for preparing, submitting and processing the citizenship application. The **costs associated with acquiring the real estate**, which total about 9% of the purchase price, must also be considered.

The whole procedure from submitting the application up to its conclusion, i.e. the issue of the *Citizenship Certificate* and a passport, takes usually about **three months**. The applicant does not need to travel to *St Kitts & Nevis* for this purpose. He/she is subsequently issued with a **passport** like any other citizen, permitting entry to about a hundred countries without the requirement of a visa.

14.3 Advantages of alternative citizenship

Dual citizenship and thus a second passport offer various advantages, particularly in terms of **personal freedom, security** and **flexibility**. As a citizen of two different countries, one has a 'second homeland' to which one can 'return' at any time. Citizens of *St Kitts & Nevis* can of course travel, work and settle there whenever they wish. *St Kitts & Nevis* are among the most beautiful islands of the *Caribbean*. They are politically and economically stable and practically free of crime – thus offering an ideal environment for a second residence. Citizenship secures the right to move to one's second home at any time and set up one's main residence there. This is open to every citizen at any time, without the need for a visa or residence permit, by right of settlement.

A citizen of *St Kitts & Nevis* belongs to a *Commonwealth* country, a fact which still offers certain advantages in some other *Commonwealth* countries, including the *United Kingdom*.

A *St Kitts & Nevis* passport allows one to travel **without a visa** to around a hundred countries, including the *United Kingdom, Ireland, Canada, Switzerland* and many others. It may well be asked why a holder of a US or EU passport, which allows visa-free entry to many countries around the world, should additionally acquire a passport of *St Kitts & Nevis*. There are several answers to this question. In the first place, geopolitical constellations repeatedly arise which may make it difficult or impossible for a US or EU citizen to obtain a visa for a particular country. Increased terrorist activities also imply the danger of attacks and kidnappings, especially of tourists who are citizens of certain EU countries, the *USA* and some other countries. So holding a second citizenship and a passport of a small country which is insignificant in terms of world politics may even save one's life. Barriers to entry and leaving, aircraft hijackings, armed conflicts and terrorism are all situations in which a second passport can be extremely useful if not vital. Dual nationality is a kind of **insurance**. One hopes that it will never be needed, but if the insured event occurs, the insurance must already have been concluded, as it would be too late to take it out after the event. It may also happen that one's passport is unavailable, perhaps because it has been submitted for extension, has been lost or had to be sent off to a consulate for a visa application. If one wants or needs to travel urgently to another country in such a situation, this would be impossible without a second passport.

For good reasons, many wealthy individuals, important personalities and international business people who are active world wide have opted for a second citizenship and passport. In an unsettling, ever-changing world, acquiring an alternative citizenship is a wise decision and an investment for the future. Making an active decision with regard to citizenship and residence options gives more personal freedom, privacy and security. It also returns countless other benefits for life.

15 International change of residence

Owners of real estate abroad sooner or later consider the option not only of using it occasionally as a vacation home or second residence, but of possibly setting it up as their **principal residence**. Anyone thinking seriously about moving their main residence abroad faces a series of questions which are not always easy to answer. At the outset, it should be clarified whether it makes fundamental sense in view of one's **personal situation** to transfer one's residence, i.e. the center of one's activities, to another country. In view of the **oppressive fiscal and increasingly burdensome regulatory environment** in some high-tax countries such as the *USA, Canada, Germany, France,* the *Netherlands,* the *UK* and others, a move of domicile to a country with a milder tax regime appears to be an interesting option for many people. It often offers the only alternative to reducing their tax burden significantly in a legal manner. However, one is well advised not to move abroad for tax reasons alone.

15.1 Immigration law and tax residence

With some exceptions, such as *Switzerland* or *Croatia*, many countries (including *France, Spain, Canada,* the *UK,* the *USA,* etc.) allow foreign nationals to acquire real estate with no restrictions or special formalities. However, the acquisition of real estate in most countries does not imply a right of residence or permanent settlement. In fact, such investments have

little if any relevance to immigration requirements. Thus any foreign national may easily acquire real estate in the *USA* and anyone with sufficient funds and of good character may enter the *USA* (with or without a visa depending on their citizenship). However, anyone wishing to live and settle there must first obtain a **residence permit**. Unlike most countries, the *USA* does not allow financially independent persons who wish to simply spend their retirement in, say, *Florida,* to obtain such a permit on this basis. The alternative is to seek out other ways, in particular via a business visa, which is more or less difficult to obtain depending on the situation.

However, it is relatively easy for financially independent persons who do not need to work, but live from their investments or a pension, to obtain a residence or settlement permit in most countries. For example the *Bahamas, Malta, Monaco*, but also *Australia, Croatia, Panama, Switzerland* and *Cyprus* grant financially independent foreign nationals a **residence permit as non-employed persons**. They merely need to demonstrate that they have sufficient funds – ranging from around US$ 25,000 in *Panama* or *Croatia* up to US$ 500,000 and more in countries such as *Bermuda* or *Switzerland* – and of course that they have no criminal record. To prove the latter, they must submit a police certificate of good conduct or an extract from a central criminal register confirming that they are not recorded in it. Some countries also insist on proof of suitable accommodation before they issue a residence permit, whereas this is not important in others, as it can be arranged after the permit has been issued.

EU citizens have the freedom to settle anywhere **within the *European Union*** with no restrictions. So anyone who holds EU citizenship and consequently an EU passport can move within the *EU* – for instance, from the *United Kingdom* to a country such as *Portugal, Spain* or *Ireland* without any immigration restrictions. Since June 1, 2002, the same also applies to financially independent EU citizens who wish to reside in *Switzerland* (see the explanations in the country chapter on *Switzerland*) and vice-versa.

Americans (and Canadians, Australians, etc.) in most cases have traceable ancestry in *Europe*. If the ancestry is not too far back, it may be possible for them to reacquire the citizenship of their ancestors. For example, an Irish-born grandparent, or a grandparent from *Poland* or *Lithuania*, may be the basis for a successful claim to Irish, Polish or Lithuanian citizenship and – as a result – to an EU passport. In *Croatia*, to reclaim citizenship it is even sufficient to have any kind of Croatian ancestry. Although *Croatia* is not yet an EU country, it is expected to join the *EU* in only a few years from now and therefore will certainly also be of interest. And, as was pointed out above (see section 14.3), dual or multiple citizenship in any case offers numerous benefits beyond the possibility to take up residence in the country of citizenship (and in case of citizenship of an EU country, to take up residence throughout the *EU*).

15.2 Change of residence under tax law

Tax residence

The location of a main or secondary residence can have considerable effects, particularly in the sphere of fiscal and inheritance law. This question will not concern those who use their real estate in the south only for a few weeks during the year. But anyone who wishes to live regularly for half a year in another country must look seriously into questions of legal domicile and especially of **tax residence**. For those who do not need to work for a living and

have sufficient funds, the right of residence presents no problem in most countries, as already pointed out. But whoever spends more than three months in a particular country without working should at least be aware of the question of tax residence. Whoever regularly spends more than six months of the year in their second home will practically always be considered as tax domiciled there and will thus normally be **liable to pay tax on an unlimited basis**, which in most countries means taxation of worldwide income. By choosing a country with a mild tax climate for a main residence, a taxpayer can considerably reduce his/her burden quite legally and effectively without the need for complex tax planning. *Monaco, Panama,* the *Bahamas*, but also *Malta, Switzerland, the United Kingdom, Ireland* or *Croatia* are attractive destinations in this respect. So a change of residence may well be worth while not only for climatic reasons but also from the standpoint of taxation.

Exit taxes and extended income taxes

The main problem with moving one's tax domicile to another country, especially one with low taxation, is that some high-tax countries have taken steps to discourage such moves, namely by introducing a form of **exit tax** such as in *France,* or an **extended income tax regime**, or a combination thereof. *Germany* is an interesting example. Its *Foreign Transactions Tax Act (Aussensteuergesetz)* lays down special tax rules to make moves abroad fiscally less attractive. Thus significant (>1%!) participations in companies held by German citizens are almost inevitably taxed upon emigration, and unrestricted German tax liability may continue to apply despite a move abroad, although the taxes payable in the country of domicile (if any) are then credited. The result is that, besides the payment of an 'exit tax', the higher German tax level is ultimately retained, at least during a certain period (usually between five and 10 years). Many other high-tax countries impose similar conditions. It is possible to mitigate – or in some cases even completely bypass – such taxation by appropriate structuring before, during and after a move abroad. However, this almost always requires the taxpayer to make a clean break with the former country of residence and to strictly avoid any links with it, such as maintaining a second home there, making frequent visits or longer stays on its territory, etc. These conditions can be tough for many expatriates and should be carefully weighed against the tax advantages such a radical change in one's life will bring.

In this context it should be noted that on March 11, 2004, the *European Court of Justice* rendered an interesting and potentially very significant judgment concerning the exit tax that is imposed in *France* on holders of substantial participations who give up their residence and move abroad. The court ruled that these French tax provisions restrict the freedom of movement (*Art. 43* of the *EC Treaty*). Given this decision regarding *France*, it is foreseeable that, for example, *Germany*'s even stricter exit tax rules will also be qualified by the *EU* as contrary to the principle of freedom of movement. This decision – together with other recent and pending decisions by the *European Court of Justice* – will in all likelihood have a significant impact on the continued existence of exit taxes provided for in the legislation of many other EU countries, and opens a new perspective with regard to emigration from European high-tax countries to lower-tax countries within the *EU*.

Double taxation agreements

It was already noted in the context of international tax law with regard to real estate that bilateral agreements to avoid double taxation of persons resident in contractual states

exist between many countries. These agreements are particularly relevant to a taxpayer who moves abroad, as they concern the determination of his/her tax residence. Whereas ownership of real estate abroad usually implies limited tax liability as a result of ownership of this real estate in the foreign country, a move abroad always affects **tax residence** and has considerable consequences on tax liabilities. Inheritance and gift taxes, which depend primarily on the testator's last residence, may also be relevant. If a taxpayer who moves abroad has considerable income and assets, experience shows that the tax authorities concerned are particularly interested in where he/she is tax resident, as this leads in most countries to unrestricted tax liability.

It may happen that two countries – according to their respective tax laws – simultaneously consider a particular taxpayer as fiscally resident and unrestrictedly tax liable. This could result in the taxpayer being taxed on his/her global income and possibly also on his/her assets by both countries on the basis of their domestic tax regimes. But if a double taxation agreement exists between the two countries, it will decide where the taxpayer is fiscally resident and thus liable to unrestricted taxation, and which country is to merely apply restricted taxation – namely on any assets or income located within its territory.

Residence in one of the two contractual states is the precondition for the application of the relevant double taxation agreement and all claims on its protection. The agreement lays down precise rules to determine in which of the two contractual countries a taxpayer is deemed to be fiscally resident. They are known as *tie-breaker rules* and in the majority of double taxation treaties they follow the *OECD Model Convention*. Accordingly, most double taxation agreements define the country of fiscal residence as the place where the taxpayer has his/her **permanent home**. If the taxpayer has homes in both countries, the crucial point is where **that person's personal and/or economic activities are centered**. The taxpayer's **habitual place of sojourn** is then in third place, and **citizenship** is considered only in fourth place. If the tax residence cannot be determined on the basis of these criteria, it is decided by **mutual agreement** between the countries concerned.

Double taxation agreements can also be useful in terminating tax residence in the country of emigration more quickly. So if someone no longer wishes to count as a UK tax resident – for instance, to avoid paying capital gains tax – UK domestic law stipulates that certain taxes apply up to five years even after moving abroad. But if the person moves the tax residence to a country that has a suitable double taxation agreement with the *UK*, such as *Belgium*, he/she can bypass such domestic tax regulations and reduce the period during which certain UK taxes still apply after a change of residence.

However, in the absence of a double taxation agreement between the previous and the new country of residence (such as when moving, for example, from the *Netherlands* to *Monaco*), only the respective domestic fiscal regulations apply. These are as a rule stricter – at least for high-tax countries – i.e. it is more difficult to terminate one's former fiscal residence. In order to avoid continuing to pay tax on one's global income and possibly assets there too, often all links to one's former country of fiscal residence must be severed, and even then sometimes certain extended taxation applies for some time after emigration.

15.3 Inheritance law and inheritance taxes

Moving permanently to another country can also have considerable effects on the **applicable law** regarding inheritance, and on **inheritance taxes**. Depending on the country in which

one sets up one's new residence, this can bring either advantages and tax savings or disadvantages and a higher tax burden. Other jurisdictions permit different asset dispositions in the event of succession to the estates of deceased persons (e.g. no forced heirship, greater testamentary freedom, but in other cases stricter forced heirship regulations, etc.). As inheritance taxes are in many countries only charged if the **decedent had his/her last or primary residence (domicile)** there, a change of residence of a person expecting to bequeath substantial wealth may lead to considerable tax savings for the heirs. Other countries, however, charge inheritance taxes if the inheritors are residents, and some countries, for example *Germany*, combine both systems. Thus German regulations consider not only the decedent's last place of residence; it is sufficient if the heir lives in *Germany*. So any inheritors living in *Germany* and wishing to avoid paying tax on the inheritance they receive would also have to consider moving their own residence to somewhere offering more favorable tax conditions. A similarly difficult situation exists for US citizens, who are subject to inheritance (estate) taxes on the basis of their citizenship regardless of their place of residence; in other words, even if a US citizen moves his/her residence abroad, this does not change anything with regard to his/her US inheritance tax liability. Moreover, a US citizen is subject to gift taxes on gifts of assets made during his/her life in excess of the applicable lifetime and annual exemptions. For a US citizen, the only possibility to escape US Federal estate and gift tax liability is to relinquish US citizenship. Finally, it should be noted that, as a principle of international tax law, real estate is generally subject to inheritance tax where the real estate is located. Therefore, if one's wealth primarily consists of real estate located in countries that have high inheritance tax rates, a change of residence may have little or no effect on the inheritance tax due.

15.4 International health insurance

International health cover is an **extremely important topic** for anyone thinking of moving abroad, and yet it is scarcely considered by many people and in particular hardly mentioned at all by advisers. Admittedly, it is not the job of a lawyer specializing in international inheritance law or an international tax adviser to know all about insurance as well – and especially about international health insurance. Consequently, relatively little specialist competence in this sector is available to private clients. Most advisers and insurance brokers world wide with such expertise merely represent a single insurer. Only very few offer more than a small number of products and are able to provide really comprehensive advice.

Trying to find ideal health cover is no easy task even without moving abroad, but it is of particular importance when moving to another country or even staying there for a limited period. The risks of sickness and accident must be covered comprehensively in an international context in order to avoid unpleasant surprises. A few important points must be considered in view of the wide choice of diverse solutions and different insurance products.

Anyone who lives or works abroad, runs a company or retires there should arrange insurance cover that is as extensive as possible and applicable around the world. Health insurance in particular should allow the patient to choose his/her preferred doctor and hospital with as few restrictions as possible, and ideally none at all.

A question of residence

In the event of a temporary stay abroad with no change of residence, basic state insurance usually assures at least minimum cover within *Europe* in emergencies. In addition, almost

all local health insurers offer the option of comprehensive cover for sickness and accident via private supplementary policies, even for temporary stays abroad. Before moving abroad definitely, however, it is useful to check out the insurance options in detail, from free choice of doctor and hospital to medication cover. Previous health policies normally terminate with a move abroad, and continuing insurance cover must be assured during the actual process of moving.

Comprehensive cover with a **free choice of doctor and hospital world wide** is strongly recommended in most cases. This is because even in many developed countries the public healthcare system satisfies only minimum requirements and it is essential to seek out private hospitals to ensure competent medical treatment. And there is no alternative to comprehensive insurance cover for anyone thinking of moving to, say, the *USA* or the *Bahamas*, or to a developing country. Many countries have good local private health insurers, and some of them also offer international cover and a free choice of doctor and hospital. Although such a local insurer usually represents the least expensive solution, it is rarely the best one. It should be stressed that almost all insurers with a local or national scope of activity in the relevant country will only accept policyholders who are actually resident in the country. Anyone who **leaves the country again will normally lose his/her insurance cover**, which can become an insoluble problem with increasing age. It is also difficult to obtain a truly international and unrestricted free choice of doctor and hospital in many places. So the ideal insurance policy will be independent of residence and duration of stay and will also guarantee fully comprehensive cover as far as possible. Most local insurers offer only unsatisfactory solutions if at all, and very few offer private health insurance that can be concluded or retained even when the policyholder lives abroad. So it is vital to check these important aspects, and in most cases it is worth while consulting an independent insurance adviser specializing in international health insurance.

Free choice of doctor and hospital, worldwide cover

Although an extensive choice of private health insurance schemes with an international scope is available world wide, only very few can really be recommended. When comparing the various offers, it is important not merely to look at a specific insurance product but also at the financial soundness and reputation of the insurer as well as the latter's experience in international health insurance. The insurance product that best satisfies the individual requirements must then be considered.

Private health insurers are not obliged to accept everyone. So anyone who is already over 55 years of age and/or is not perfectly healthy has little chance of obtaining private health insurance and still less comprehensive insurance with international cover. For this reason in particular, it is advisable to check out the insurance situation in detail before moving abroad. It may make sense to change over to an international health insurance scheme several years before a planned or possible move abroad in order to be assured of the necessary flexibility later on. Even if no transfer of residence is planned, but one wishes to be optimally insured against sickness and accident, a detailed check of all options is worth while. It may even be of benefit to take out international health insurance in this case.

Anyone staying abroad frequently or planning to move abroad permanently should arrange insurance cover **independently of residence and sojourn** – i.e. inclusive of any subsequent moves abroad or even a return home at a later stage. Such cover will ideally permit an unrestricted choice of doctor and hospital world wide.

15.4.1 Checklist: International health insurance

In selecting suitable health insurance, care should be taken to consider the following points:

- Worldwide cover at attractive premiums. It is also important to consider premiums in higher age brackets.
- Free choice of physician and hospital world wide without restrictions.
- No restrictions on the policyholder's residence and duration of stay, even in the event of a later permanent return to the home country.
- Guaranteed lifelong policy renewal, even in the event of a later change of residence, or illness of longer duration, etc.
- Efficient processing in the event of a claim.
- Multilingual emergency telephone service manned around the clock throughout the year.
- Choose an insurance company that is well known and has a good reputation as well as broad experience in the domain of international health insurance.

15.5 Other types of insurance

Many of the factors that apply to health insurance are also relevant to other kinds of insurance. However, they are less critical for the latter because property, personal liability and similar cover can be arranged or modified at almost any time irrespective of the age and state of health of the policyholder, i.e. also at a later stage. And in complete contrast to health insurance, it is often best to conclude this kind of insurance policy directly with a local insurer. However, it makes sense to clarify certain issues before actually moving in this case too.

For every insurance policy, it is important to check whether the cover continues to apply indefinitely after a move, only for a short time or expires immediately. It should also be checked whether any kind of restrictions apply, for instance in a geographical sense (motor vehicle insurance!). It is always advisable to **clarify these matters in writing** via letters to the respective insurers. Then, in the event of damage claims later on, the insurer's comments or commitment can be demonstrated without a question. An individual confirmation on the insurer's letterhead is also better than mere reference to the insurance conditions, as these may change and will always offer scope for discretionary interpretation. A policyholder is best assured by an unequivocal inquiry addressed to the insurer and an unequivocal reply which can be insisted on.

As already mentioned, it usually makes sense or may even be mandatory to conclude insurance policies for items such as household effects, motor vehicles, private liability, jewelry or objets d'art locally in the new country of residence. In some cases, however, such as for vacation homes, art collections or jewelry it may also be wise to arrange insurance in one's home country or via an international insurer. Special insurers with worldwide operations are particularly relevant for items such as larger and expensive furnishings or objets d'art.

15.6 Financial and estate planning

Anyone transferring their residence abroad will find that various parameters of their personal financial and estate planning will also change. Having previously been oriented to the legal and fiscal situation and general framework conditions prevailing in the home country, these must now be extended to cover conditions abroad.

So whoever moves to a part of the world dominated by the Euro should be aware that this is now the local **reference currency** rather than the US dollar, Sterling, Australian dollar, etc., and vice-versa. But it may still make good sense to retain investments in other currencies. As a rule, however, a move of a person's regular activities to a new currency area will also lead to different weighting of the currencies in their personal investment portfolio and will require a rethink of their financial planning and asset management arrangements. It may well be wise to consult a specialized investment adviser familiar with questions of clients with cross-border issues.

A move abroad also offers the opportunity for more flexible **pension planning**, as capital tied to government-regulated pension funds can often be released. Previous retirement provisions may have to be reorganized, liquidated or taken out prematurely (e.g. life insurance policies, pension claims, tied-up assurance funds, etc.). It is particularly important to consider **withholding taxes** when receiving payouts from pension institutions and any tax concessions when drawing any benefits in the form of pensions or capital payouts. As a rule, different costs of living also change the provision requirement and usually make it necessary to adapt one's **cash planning strategy**.

A move will also require careful examination of previous **estate planning or succession structures** (partnerships, foundations, trusts, family holding companies and the like). Here, too, considerable scope may be available for optimization depending on one's destination. Thus anyone moving for example to *Malta*, the *United Kingdom, Ireland, St Kitts & Nevis* or the *Bahamas*, can structure their assets by means of suitable succession structures so that they – or lifetime enjoyment thereof – are transferred without restrictions and in many cases also in tax-neutral form to freely designated heirs. The situation will be quite different when moving to a country such as *France* or *Spain*, although here, too, various opportunities for optimization usually exist. In any case, existing estate-planning strategies should be checked and their adaptation to the new conditions and opportunities examined. Professional support is usually indispensable in this domain too.

It is also important to include the aspect of **asset protection**, especially in the *USA*. In view of the peculiarities of the American legal system, which is characterized by a relatively low threshold of civil litigation, suitable measures to avoid excessive exposure of one's personal assets are indispensable. But when moving to other countries too, it may make sense to structure at least part of one's assets – perhaps including real estate – so that they are safe from seizure. Suitably designed **asset protection trusts** as well as specially structured **Swiss annuities** and **life insurance policies** are available for this purpose.

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Useful Websites

The CIA World Factbook
Country information from the US Central Intelligence Agency
www.odci.gov/cia/publications/factbook

The Economist Intelligence Unit
Political, economic, business analysis/forecasts for 180 countries
www.eiu.com

CountryWatch
Up-to-date information and news on the countries of the world
www.countrywatch.com

US State Department
Information on visas requirements, consular information, etc.
www.travel.state.gov

Map directory
Excellent maps available online
www.mapquest.com

Internet Portal of the European Union
www.europa.eu.int

Worldwide Chamber of Commerce Guide
www.chamberfind.com

Law.Com
A leading international legal directory
www.law.com

Hieros Gamos
International law and legal research center
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Tax-News.Com
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International Real Estate Digest
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Contents: Austria

1 Introduction

Located in the southern part of central Europe, Austria has a total area of 83,858 square kilometers and is composed of nine, independent federal states. The total population of Austria in the year 2003 was 8,159 million with 1.6 million people living in Vienna, Austria's largest city and capital. Austria is a well-developed country with a generally strong economy and one of the highest standards of living in Europe. Major industries in Austria include tourism, construction, vehicles and automotive parts, food, chemicals, timber and wood processing.

The main statutes in relation to real estate transactions are (i) the *General Civil Code*, (ii) the *Land Register Act*, (iii) the *Laws on the Acquisition of Land by Foreigners of the nine federal states*, (iv) the *Tenancy Act* and (v) the *Act on Brokers*.

The acquisition of specific types of land, such as agricultural and forestry land, and the acquisition of real estate by foreigners is restricted by the *Laws on the Acquisition of Land by Foreigners* (*Ausländergrundverkehrsgesetze*) of the nine federal states.

Regulations for investment funds have existed in Austria since 1963. However, these rules apply only to mere investment funds in securities. To establish regulations for investment funds investing in real estate, the Austrian Parliament enacted the *Real Estate Investment Fund Act* (*Immobilien-Investmentfondsgesetz*) in July 2003 (effective as of September 1, 2003), which regulates *inter alia* in which assets the real estate fund may invest, which entities are entitled to administer a real estate investment fund, the appraisal of assets, prospectus, supervision and tax treatment, etc.

2 Real estate ownership

2.1 Different forms and types of ownership

General

Generally the *General Civil Code* (*ABGB*) follows the principle '*superficies solo cedit*'. This means that the proprietor of land also owns buildings erected and located thereon, which are solidly connected with the ground (exceptions: building rights and superedifices).

Furthermore, acquisition of real estate requires both **title** (e.g. purchase contract) and **modus** by registration with the *Land Register* (*Grundbuch*).

Sole ownership – co-ownership

Besides **sole ownership** (*Alleineigentum*) entitling the owner to make use of the substance of and the proceeds from a property, Austrian law recognizes **co-ownership** of two or more persons (*Miteigentum*), which can be created, *inter alia*, by agreement. Not the real estate itself but fractions of the ownership right are divided among the co-owners. Accordingly, each co-owner can dispose of the ownership right to the extent of his/her portion thereof at his/her own discretion (e.g. pledge, sale). Each co-owner has the right to participate in the earnings of the jointly owned real estate and the obligation to bear costs and expenses in proportion to his/her ownership interests.

Condominium

The **condominium** (*Wohnungseigentum*) is regulated by the *Condominium Act* (*Wohnungseigentumsgesetz 2002 – WEG*) and grants a co-owner of a real estate the exclusive right to use a certain unit, such as an apartment, business premises or parking space, in a building located thereon. The creation of condominium is based, *inter alia*, on a written agreement by all co-owners, a judgment decision or a division of marital savings. The unit connected with a condominium can be transferred and inherited.

Right to build

A **right to build** (*Baurecht*) is the transferable and inheritable right of one or more persons to construct (permanent) buildings on or beneath the surface of a certain piece of land. Rights to build are regulated in the *Building Right Act* (*Baurechtsgesetz*) and may be granted for a period of not less than 10 and not more than 100 years. The holder of the building right is owner of the erected building, but not of the land on which such building is located. The building right can be transferred, encumbered, and divided. The building right is deemed to be **immovable property** and is registered separately (own lot number) in the *Land Register*.

Superedifice

A **superedifice** (*Superädifikat*) is a non-permanent construction built on another person's property with the intention that it should not always remain there. Accordingly, the ownership of the building, on the one hand, and the ownership of the land on the other hand are assigned to different persons. Thus, the constructor of the building has to obtain from the owner of the relevant land the right of use before starting to erect the building. Superedifices are deemed **movable property** even if constructed in a solid manner. Therefore, transfer of title and other rights regarding a superedifice do not require registration with the *Land Register*, but the proprietorship in superedifices is transferred by depositing the relevant contract with the *Document Deposit Register* (*Urkundenhinterlegungsregister*) at the competent district court.

Timesharing

According to the *Directive 94/47/EC*, which was implemented by way of the *Time-Sharing Act* (*Teilzeitnutzungsgesetz – TNG*), **timesharing** is the right to use a real estate, usually a vacation home, on a recurring basis during a specified period. Timesharing can have **different forms**, such as co-ownership or usufruct. Another possibility is the acquisition of shares of a company owning real estate.

2.2 Easements, charges, liens and mortgages

Easements in general

Easements are regulated by the *General Civil Code* and are limited rights *in rem*, which grant a property right of use in favor of another real estate (*Grunddienstbarkeit*) or a person (*persönliche Dienstbarkeit*). The right to use a property is granted by the owner of such property. As beneficiary *in rem*, the holder of an easement has an absolutely protected legal position, which may be asserted vis-à-vis any other party as soon as the easement has been enrolled in the *Land Register*.

Scope and term of an easement

The scope of an easement depends on the content of the underlying title (e.g. easement contract), in particular the **foreseeable purpose** of the easement. To become a right *in rem*, easements must be registered in the *Land Register*. The beneficiary is responsible for the establishment and the maintenance of the subject-matter of easement.

An easement expires *inter alia* by destruction of the servant real estate, by lapse of time (if the easement is limited with respect to time), by abandonment or confiscation. In addition, easements may expire after 30 years of non-use, or after 3 years if the use is physically impeded.

Real easements – personal easements – explicit easements

Real easements must be distinguished from **personal easements**. In the case of real easements, the easement belongs to the owner of a specified real estate, the 'dominant real estate'. Personal easements are the right of usufruct or the right of abode and are connected to a person. According to the *Austrian Supreme Court*, the acquirer of real estate (where a third party obtains easement rights) also assumes any non-registered easements, if they were **explicit** or the existence of an easement may be assumed, in particular by visible construction or other mechanisms.

Charges on land

Charges on land (*Reallasten*) are encumbrances of real estate obligating the owner of the real estate to perform recurrent services, e.g. payment of annuities, etc.

Restraint on alienation and encumbrance

Austrian law recognizes statutory, jurisdictional and contractual **restraints on alienation and encumbrance** of real estate (*Veräußerungs- und Belastungsverbote*). Statutory restraints may apply where construction or refurbishment of real estate is totally or partly financed by public funds. In such case, the disposal of the property is generally subject to prior approval by the relevant authority. Contractual restraints on alienation and encumbrance are only binding among the contracting parties, except in case the restriction was agreed to operate in favor of close relatives and is registered with the *Land Register*.

Lease

Leases under Austrian law must be distinguished from leases *in rem*, as they are known in Anglo-Saxon law. In *Austria*, leases are classified under the law of contracts and not under the law of real estate. They do not constitute an encumbrance on real estate, but constitute a mere contractual relationship between lessor and lessee. As a matter of principle, a lease will not be terminated by the sale of the real estate.

A lease contract **can be registered** as an encumbrance in the C-folio of the relevant *Land Register* entry if concluded for a specific period of time or with a waiver of the termination right for a certain period. In case of a transfer of the real estate, the new owner is then obliged to take over the lease contract as concluded with the prior owner. According to the registration of the lease the payments of the lessee made in advance are secured vis-à-vis the new owner.

Liens and mortgages

A **mortgage** (*Hypothek*) is a pledge of real estate. The creation of a mortgage is subject to a **mortgage agreement** (*Pfandbestellungsvertrag*), which has to be drawn up in writing. The signatures of the parties to the contract have to be duly notarized by a notary or a court to allow an entry in the *Land Register*.

The mortgage agreement may be made in the form of a notarial deed and may contain a clause, which certifies that the mortgage agreement establishes an executory right, thereby the bank is enabled to enforce the mortgage immediately in enforcement proceedings without the necessity of prior court proceedings in order to obtain a valid title for enforcement proceedings.

Mortgages have to be registered in the *Land Register* in order to become fully effective; particularly, with regard to third parties. As long as a legal transaction involving real estate is not registered, the party to the contract has only a contractual claim for performance against the other contracting party.

It is possible and common practice to register more than one mortgage in respect of one parcel of real estate. The ranking is established in general in the order of the date of filing of the application for registration of the mortgage with the competent *Land Register*. Changes in ranking are possible upon duly notarized approval by all parties involved. The proceeds of a sale of an encumbered real estate are distributed among the secured creditors in the order of their priority.

2.3 Protection of ownership, proof of ownership and registration

Land Register

The ***Land Register*** (*Grundbuch*) covers the real estate of a district and is kept by the district court of the district where the real estate is situated. It is processed by an electronic database that is **publicly accessible**, e.g. to notary publics, attorneys and banks. Legalized excerpts can be obtained from any district court, excerpts in electronic form, from any other institution having access.

The *Land Register* consists of the general register (*Hauptbuch*) and archives (*Urkundensammlung*). The general register contains a *Land Register* enclosure (*Grundbuchseinlage*) for each existing surface area, which also includes an enclosure's lot number (*Einlagezahl, EZ*).

The individual enclosure contains three parts (folios):

- the **A-folio** (*Gutbestandsblatt*), which covers two departments, in the first department (the A1-folio), **properties** are registered with their respective lot number and **disposition of use** and **size**; the second department (the A2-folio) contains the rights and encumbrances (e.g. clearance areas) connected with the real estate (e.g. easements on the entitled property, write-offs, public restrictions and burdens);
- the **B-folio** (*Eigentumsblatt*), which contains details about the **proprietorship structures**; and
- the **C-folio** (*Lastenblatt*), which shows **encumbrances** on the real estate, in particular mortgages, easements, real burdens, prohibitions of sale or encumbrance, etc.

Principle of registration

Under Austrian law any grant, transfer or limitation of rights pertaining to real property generally has to be registered in the relevant *Land Register* in order to become effective vis-à-vis third parties. Therefore, a proprietorship in real estate may – except in the case of adverse possession, inheritance, merger and demerger (universal succession) – only be transferred on grounds relating to a legal title (e.g. purchase contract) by registration in the *Land Register* (*Einverleibung*). As long as a legal transaction involving real estate is not registered, the party to the contract has only a contractual claim for performance against the other contracting party.

Principle of good faith

Every person may fully rely on the correctness and relevance of *Land Register* entries. As in other jurisdictions, any person relying in good faith on information contained in the *Land Register* is protected against third-party claims, even if the registered information turns out to be inaccurate or incomplete.

Principle of predecessor in title

Title to real estate may only be acquired from the registered predecessor. By way of exception, acquisition of title from a non-registered person is possible if the chain of transfer of title is proven from the last registered owner to the ultimate buyer.

Principle of priority

According to the principle of priority, the ranking order of multiple registrations for a certain property is determined by the date of filing of each application with the competent *Land Register* court ('first come, first served'). This principle is particularly significant for the registration of mortgages and other encumbrances.

Registration procedure

The beneficiary of a registration must file an **application for registration** (*Grundbuchsgesuch*) with the competent district court. Depending on the nature of registration, specific documents supporting the granting, transfer or limitation of rights to be registered must be attached (e.g. contract regarding title). Certain real estate transactions require the form of a notarial deed. In all cases, however, the signatures of the parties involved must be duly notarized. Furthermore, where real estate is purchased by foreigners, the application must be accompanied by a certificate or notification of the land transfer authority approving the registration and, in case of transfer of ownership, a confirmation of the tax authority must be submitted to the *Land Register*, verifying the payment of any taxes due.

3 Purchase and sale of real estate

3.1 The sales agreement

General

According to the principle of private autonomy, parties may establish their contractual relationship at their free discretion within the framework of *bonos mores* (*Gute Sitten*).

A contract is concluded by the expression of the mutual consent of the parties, either simultaneously by both parties or by the acceptance (*Annahme*) of a prior offer (*Angebot*).

A **preliminary agreement** (*Vorvertrag*) under Austrian law is an agreement that provides for exclusively the obligation to enter into a particular agreement at a later date. Each party may only demand the conclusion but not a specific performance of the main contract.

An **option**, granting one party the right to enforce a determined agreement in content, is similar to a preliminary agreement. Due to the fact that contractual obligations are directly created upon exercising the option, the other party may demand specific performance.

A '***Punktation***' is an agreement that contains only the essential provisions of a contract. Although a '*Punktation*' is more of a framework than a complete contract, it is considered binding, and the parties may claim specific performance of the contract.

Material requirements of a sales agreement

The conclusion of a sales agreement is preceded by the consent of the parties with regard to the essential parts of the agreement. Therefore, the sales agreement has to designate the parties, the real estate and the purchase price or the method of its calculation.

Furthermore, the seller has to formally approve the registration of the buyer in the *Land Register*. The seller usually grants this consent (*Aufsandungserklärung*) in the sales agreement, although it may also be expressed in a separate document. The agreement to register has to be made in writing and must be certified by a district court or a notary public. These formal requirements do not affect the validity of the agreement, but are required for the registration in the *Land Register*. Therefore, oral agreements or side agreements are valid and binding upon the parties.

Other terms customary for real estate purchase contracts are representations and warranties (relating, for example, to encumbrances and third-party rights, to the dedication of the real estate according to zoning ordinances and building regulations, environmental issues, administrative and corporate approvals, taxes, etc.), the agreement concerning the acceptance of encumbrances, the appointment of an escrow agent, and the obligation to register priority notices. In many cases, the prospective buyer obliges the seller to deliver to him/her (or to the trustee under the agreement) a **ranking order of the intended sale** (*Rangordnung der beabsichtigten Veräußerung*), a decree executed in only one counterpart safeguarding that no entry in the register effected by the potential seller may precede the purchase by the buyer. Such a decree is valid for one year.

Governing law and jurisdiction

The parties are free to choose the law governing the contract and the court shall have jurisdiction over any disputes relating to the contract. As far as rights *in rem* concerning real estate located in *Austria* are concerned, Austrian law is, however, mandatory. Further, any disputes concerning such rights *in rem* mandatorily fall within the jurisdiction of the Austrian courts.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

According to the *Act on International Private Law* (*Internationales Privatrechtsgesetz*), questions of matrimonial property law are in principle to be regulated according to the legal order that was expressly chosen by the spouses (party autonomy). If the spouses have not chosen any legal order, the matrimonial property issues are to be regulated according to the statute that was applicable for the legal effects of marriage at the time of the wedding. If the parties are nationals of Austria and of another state, then Austrian citizenship will be relevant.

As far as matrimonial property is concerned, the law regulates two types of matrimonial property regimes, namely the **separation of property** (*Gütertrennung*) and the **community of property** (*Gütergemeinschaft*).

Austrian law prefers the regime of separation; therefore, if the spouses did not provide for any agreement on their matrimonial property, the regime of separation will be applicable. According to the separation of property regime, each spouse retains sole ownership to the property that he/she brought into the marriage and will be the sole owner of what he/she will acquire or inherit during marriage.

If a marriage is dissolved by either divorce or invalidation, the property that has been acquired by the spouses during their marriage is divided according to the rules of the *Matrimonial Act* (*Ehegesetz*) without regard to ownership.

A **marriage contract** (*Ehepakt*) is a contract in the form of a notarial deed on the regulation of the matrimonial property regime between the spouses. It replaces or modifies the legal matrimonial property regime of separation of property.

3.2.2 Options and pre-emption rights

If a real estate is subject to a **pre-emption right** (*Vorkaufsrecht*), the owner of the real estate has to offer the real estate first to the beneficiary of the right of pre-emption at the terms and conditions agreed with a potential buyer. The pre-emptor may exercise his/her right within 30 days otherwise it expires. Provided that pre-emptive rights are registered with the *Land Register*, a transfer of the real estate in violation thereof is null and void. Generally the right of pre-emption is not transferable and not inheritable.

Another subsidiary agreement to the purchase contract is the agreement on a **repurchase-right** (*Wiederkaufsrecht*). If a real estate is subject to a repurchase, the seller of the real estate has the right to repurchase the real estate according to the terms and conditions agreed in the former purchase contract. The right can only be granted when a property is sold and can neither be transferred nor bequeathed. Furthermore, it cannot be subject to execution.

By registration in the *Land Register*, the repurchase right can be executed against the buyer as well as against third parties subsequently acquiring the real estate from the buyer.

Additionally, parties to the sales agreement can agree to **resell** (*Rückverkaufsrecht*) the real estate. In this case, the buyer has the right to request the seller to purchase the real estate for a specific sum of money. This right is neither transferable nor inheritable.

3.2.3 Agricultural real estate

The land transfer laws of the federal states restrict the purchase of specific types of land, such as **agricultural and forestry** land, in various ways. These laws mainly envisage the maintenance of agricultural areas in certain regions. Under said Acts, the acquisition of certain rights, such as ownership, right of usage (usus fructus; *Fruchtgenuss*), building right or long-term leases with respect to real estate used for agricultural and forestry purposes, requires **prior approval** by or, in certain cases, **notification** to, the competent **land transfer authority** (*Grundverkehrsbehörde*) for Austrian as well as for foreign buyers.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

The acquisition of real estate by foreigners is restricted by the *Laws on the Acquisition of Land by Foreigners* (*Ausländergrundverkehrsgesetze*) of the federal states. This – depending on the respective state – is also true for the acquisition of certain rights like 'usufruct' (*Fruchtgenuss*), building rights or long-term leases. However, in almost every federal state of *Austria* foreigners are required to obtain a **permit** (prior approval) from the **land transfer authority** in order to purchase land. This also applies for companies where a foreigner is a majority shareholder.

Under many *Land Transfer Acts*, the acquisition of shares or the increase of shareholdings in an Austrian limited liability company or partnership is subject to the prior approval of the land transfer authority if this company or partnership owns real estate located in the relevant states. Some states do not apply restrictions to companies whose majority shareholder is an Austrian company controlled by a foreigner. Therefore, a foreign investor may avoid having to obtain a permit by setting up two companies, one of which is the majority shareholder of the company purchasing the real estate.

Under all *Land Transfer Acts*, ***EEA/EU* citizens** and companies are treated like Austrian citizens/companies. However, a certificate confirming the *EEA/EU* citizenship/corporate seat must be obtained from the land transfer authority in order to be registered in the *Land Register*.

Furthermore, in certain municipalities which the law qualifies as **preserved regions** (*Vorbehaltsgemeinden*), an approval by the land transfer authority must be obtained even by Austrian citizens acquiring real estate for the purpose of establishing a second domicile. Various restrictions are also set forth in the *Federal Act on Urban Modernization* (*Stadterneuerungsgesetz*). The acquisition of land, which is located in what are known as '**clearance areas**' (*Assanierungsgebiete*) designated by states or municipalities, is restricted thereunder. The municipality is granted a pre-emptive right in regard of such land.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

Minors (persons under 18) are especially protected by law. Real estate belonging to a minor may only be sold if this is necessary or if the advantages prevail. Further, such transactions require a **tutelage court approval**.

3.3.2 Third-party claims and unpaid taxes

Encumbrances on the real estate, in particular mortgages, easements, charges on land, prohibitions of sale or encumbrances, etc., should be checked before purchase by obtaining a register excerpt and visiting the premises to be purchased. Furthermore, an agreement concerning the assumption and deletion respectively of encumbrances should be inserted in the purchase contract. An inspection in the *Land Register* is therefore absolutely essential.

For special public encumbrances (such as the annual real estate tax), Austrian law recognizes **legal mortgages** that take absolute priority over all other registered encumbrances.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Several sources of environmental law, which encompasses, more or less, public law as well as private environmental regulations have to be observed. In Austria, there are a number of environmental laws, e.g.

- *Water Act* (*Wasserrechtsgesetz*)
- *Waste Management Act* (*Abfallwirtschaftsgesetz*)
- *Contaminated Sites Act (Altlastensanierungsgesetz*)
- *General Civil Code* (*Allgemeines Bürgerliches Gesetzbuch*)
- *Trade Code* (*Gewerbeordnung*) and its implementing ordinances.

In general, the legislation follows the '**polluter-pays-principle**', which maintains that the person who caused the contamination is primarily responsible for repairing the damage or at least paying for the decontamination. However, real estate owners who have not caused any contamination can also be held liable in certain circumstances.

The *Contaminated Sites Act* (*Altlastensanierungsgesetz*) provides that **contaminated properties** must be listed in a *Register of Potentially Contaminated Sites*. The Governors of the states are obliged to inform the *Federal Ministry for Environmental Affairs* about potentially contaminated sites that have been detected within their states. However, this information is listed in the aforementioned register for information purposes only and has no significant legal relevance. Moreover, absence from the list may in no circumstances provide proof that environmental burdens do not exist on a particular piece of land.

Acquisition of real estate that is protected as **historic buildings and monuments** may be restricted under Austrian law. Protected historic buildings and monuments in *Austria* are listed in a special register kept by the national monument authority at the *Federal Ministry of the Interior*. Furthermore, they are shown in the *Land Register*. Therefore, an inquiry with the monument authority is recommended.

3.3.4 Access to relevant records and documents

According to the principle of good faith, which may be of great consequence in legal proceedings, and to obtain general information about the real estate, it is advisable to search the publicly accessible ***Land Register***, especially its general ledger and archives. It is advisable to inspect the real estate itself in order to identify obvious defects. The exact

topographical location of the real estate is shown in the **cadastral map** as well as in the **site plan**.

Information about corporations, partnerships and sole proprietorships may be obtained from the ***Commercial Register*** (*Firmenbuch*). In general, any person may rely on the accuracy of the information in the commercial register, unless proven otherwise. The commercial register is accessible online. An excerpt from the commercial register can be obtained also from the courts as well as from public notaries and attorneys.

3.4 Key points that a seller should consider

Under the sales agreement, the seller is obliged to sell and transfer title to the designated real estate to the potential buyer. In this connection, it is necessary to describe the real estate as well as the fittings and furniture as detailed as possible.

Provisions relating to **warranties** are significant for both contracting parties.

The **costs** arising in connection with the execution of the sales agreement and the registration of the agreement and all **taxes, stamp duties**, and other charges imposed in connection with the execution and registration in the *Land Register* are usually borne by buyer. This should be mentioned in the sales agreement. Both seller and buyer are liable to pay **land transfer tax** to the tax authorities.

The purchase price is usually withheld by the buyer or by a trustee in whole or in part, until registration in the *Land Register*. In some cases, a bank guarantee is issued in order to secure the transfer of title. Depending on the structure of the deal, parts of the purchase price are withheld or secured by bank guarantees for possible guarantee claims.

According to the *Insurance Contract Act* (*Versicherungsvertragsgesetz*), by passing title to the object of purchase, the rights and duties under an **insurance contract** will vest in the seller as long as the seller holds title, and they will pass to the buyer upon registration. Both seller and buyer are liable to pay premiums for the current premium period. As long as the insurer has not been notified of a change of title, it may still release the insured sum to the seller without having any additional obligation toward the buyer. The buyer may terminate the policy within one month after the title has been registered in the *Land Register*, notwithstanding any contractual provisions to the contrary.

3.5 The execution of a real estate purchase transaction

The execution of a real estate purchase transaction involves the following steps:

- inspection of real estate to identify obvious defects, possibly with a building engineer or architect;
- search of the *Land Register* and of the building authority files;
- drafting and execution of the sales agreement by an attorney or a notary public;
- negotiating with banks in case of debt financing;
- conclusion of the contract and certification of the signatures by a district court or a notary public;

- registration of ownership (and mortgage) with the *Land Register* – transfer of title to the new owner.

The attorney/notary public acting as **escrow agent** has to inform the buyer about the escrow provisions of the relevant Notary or Bar Association of the federal state, especially with regard to the deposit of the purchase price on the escrow account. It is common practice that the purchase price is transferred to the seller once the buyer is registered in the *Land Register*.

Legal fees are governed by the *Attorneys' Tariff* (*Rechtsanwaltstarif*) and the *Autonomous Guidelines for Attorneys' Fees* (*autonome Honorarrichtlinien*) issued by the *Austrian Bar Association*. However, with a few exceptions, attorneys may freely negotiate their fees with their clients, with the *Attorneys' Tariff* and the *Autonomous Guidelines* serving only as a guideline. Thus, for ongoing consultation, client and attorney may agree on an hourly rate or a flat fee. However, it is generally prohibited to take over a case on a pure contingency fee basis.

According to the *Act on Brokers* (*Maklergesetz*), real estate agents are entitled to a commission upon execution of the contract as follows:

- Purchase or sale of real estate or condominium: up to 3% of the purchase price, provided that the purchase price is above Euro 36,336.42. If the purchase price falls short of this amount, the commission rate increases to 4%.
- Residential and commercial lease agreements: Commission of up to three months' rent.

3.6 Powers of attorney

Both seller and buyer may issue a power of attorney to other persons, vesting them with authority to conclude a sales agreement. In this case, the power of attorney must be established with regard to the actual sales agreement and certified by court or a notary public. If foreigners are involved, the signature of the notary public must be superlegalized in most countries by affixing an Apostille pursuant to *'The Hague Convention'*.

3.7 Financing

Acquisition of real estate is often bank-financed, whereby a mortgage is granted in favor of the bank. Depending on the lender's credit standing, banks insist on the registration of the mortgage with the *Land Register*. In certain circumstances, the bank may enforce the mortgage without the necessity of prior court proceedings in order to obtain a valid title for enforcement proceedings.

3.8 Purchase through a company

Real estate can also be purchased, possessed and leased by legal entities, such as stock companies and limited liability companies or by partnerships, such as general partnerships or limited partnerships, as well as by private foundations.

The costs for the formation of the company must be considered, whereby the minimum share capital of, for example, a limited liability company is Euro 35,000.00. At least one-half

of the share capital must be paid up in cash, and the remainder may be raised in assets (contribution in kind).

Similarly, foreign legal entities and partnerships with their corporate seat outside of *Austria* or legal entities that have their corporate seat in *Austria* but are controlled by foreigners, are able to purchase real estate as long as it is not restricted by the *Laws on the Acquisition of Land by Foreigners* of the federal states.

3.9 Defects and warranty claims

Sales contracts on real estate frequently contain warranties relating to possible statutory liabilities of the buyer and/or defective or faulty performance of the seller.

The statutory warranty period for real estate is **three years**, which can be extended or abbreviated by mutual agreement. Real estate contracts often provide for different warranty periods, depending on the issue warranted. The buyer must notify the seller of defects or defective performance within the relevant warranty period. If the seller does not accept the defect, the buyer has to sue in order to prevent the claim from becoming statute-barred. The buyer always bears the proof of burden that the defect has existed when possession was transferred. Furthermore, the buyer may claim damages in the case of negligent or willful breach of contract.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

Building law, regional planning law and zoning regulations are subject to legislation of the federal states of *Austria*. The laws of the federal states vary in detail, but follow the same basic principles.

Zoning plan and building regulations

The building laws of the federal states provide for the basic material and procedural rules for regional development and building constructions. Based on these rules, each municipality enacts a **zoning plan** (*Flächenwidmungsplan*) and **building regulations** (*Bebauungsbestimmungen*) governing the development of certain areas of the municipality (e.g. building areas, recreation areas, industrial areas, etc.), providing for maximum measures of construction to be respected in these areas.

Building permit

Prior to the construction of a new building, it is generally necessary to obtain a **building permit** (*Baubewilligung*). Building Acts list the cases when a building permit has to be obtained exhaustively. Construction work may not be carried out before the permit has been granted and has become effective. Furthermore, a building permit is **appurtenant** to the property. Thus, the building permit is also effective vis-à-vis the successive owner of a property, even if it was granted to his predecessor. Such a building permit grants the right to carry out the building project underlying the application.

Neighbors whose parcel of land directly adjoins the land on which the construction takes place are parties to the administrative proceedings; they may raise objections against the entire construction or parts thereof. If they have raised objections in the proceedings, they are entitled to appeal against the building permit.

4.2 Architect's and building contracts

Architect's contracts should be concluded in writing, with detailed information about the construction work and fees, liability for infringement of copyright, terms for the implementation of the construction, etc. Moreover, it is recommended that proof of existing pecuniary damage liability insurance should be obtained.

The responsibilities usually assigned to an architect are:

- basic evaluation and drafting
- planning for the purpose of the building permit
- approval and planning the implementation of the project
- obtaining, verifying and assessing offers
- local building supervision to control the realization of the project
- ascertaining deficiencies, listing of the warranty periods.

4.3 Completion of construction and formalities

Notification of completion

The completion of a construction project must be declared by a certified civil engineer (*Fertigstellungsanzeige*) or by the municipal authority, which will grant a **permit to use** the premises (*Benützungsbewilligung*) after completion of the procedure to ensure the compliance of the building with the building permit.

Operating permit

According to the *Trade Code* (*Gewerbeordnung*), a localized plant that is operated for commercial reasons requires an **operating permit** from the local trade authorities. Especially environmental protection, as well as the protection of neighbors from external influence such as noise and dirt, shall be prevented. The *Trade Authority* issuing the permit usually imposes a number of conditions in order to protect the environment or neighbors, which the owner of the plant or the factory must fulfill during operation. The operating permit is **appurtenant** to the plant. Therefore, such decrees authorize and oblige not only the current operator of the plant but also his legal successors.

4.4 Deficiencies and warranty claims regarding new construction

The conclusion of a wide-ranging building contract should be the basis for the successful assertion of defects or deficiencies in construction and warranty claims. *Austrian Standards*

(*Ö-Normen, e.g. Ö-NORM B2110*) have been established, which contain appropriate contract-templates, whereas the parties are free whether or not to agree upon these templates.

For the successful assertion of defects or deficiencies in construction and warranty claims, a detailed documentation of the progress of construction work must be prepared. Furthermore, the work as ordered and work results must be compared. In the majority of cases, a lack of documentation of additional orders will result in disputes.

Development Contract Act

Building development contracts are contracts on the acquisition of property or leasing rights to buildings, condominium apartments and office space which are not yet built or which will be subject to rigorous renovation. The *Building Development Contract Act* (*Bauträgervertragsgesetz*) protects the buyer *vis-à-vis* the developer, and provides *inter alia* for a withdrawal of the buyer's offer, provision of security against losses, and appointment of an escrow agent.

Building development contracts must be made in writing and contain certain minimum information relating *inter alia* to the subject-matter of the contract, the consideration and the date on which the consideration is payable, the latest date of delivery, encumbrances, if any, assumed by the buyer, designation of a security for the buyer's payments to the developer (if any) and nomination of an escrow agent (if any).

The developer must designate a security for all repayment claims the buyer may have under the building development contract. The security may be an *in personam* security (guarantee, surety, insurance), a lien on the real estate, a security arrangement with a credit institution, securities provided by public entities or a payment schedule, which follows the progress of the construction of the building. If no *in personam* security is provided, an attorney-at-law or a notary public must be appointed as escrow agent.

5 Rental and tenancy

5.1 Rental and lease agreements

Austrian laws regarding leases are highly restrictive. Lease agreements for residential and business purposes are mainly governed by the *Tenancy Act* (*Mietrechtsgesetz*). The *Tenancy Act* does not apply to real estate leased in connection with the tourist industry, parking houses, the operation of transportation companies and airports, warehouses, employee housing, business premises leases for a definite period not exceeding six months, apartments used for recreation, and houses consisting of two possible objects of lease. In case the demised premises are part of a building established without public funds after June 30, 1953, or established after May 8, 1945, with condominium established, or are top floor apartments erected on grounds of a building permit after December 31, 2001, only parts of the Tenancy Act including the termination limitations will be applicable.

5.2 Regulations on protection of tenants and rent control

The *Tenancy Act* mainly intends to protect the lessee's interests. Therefore, also court decisions under the *Tenancy Act* are restrictive, especially with regard to regulated rent for specified types of leases, the conclusion of leases for a limited period of time and notice of termination given by the lessor. The provisions of the *Tenancy Act* are mandatory

and, with a few exceptions, cannot be waived or otherwise modified to the disadvantage of the lessee. The *Tenancy Act* deals, *inter alia*, with the duties of lessor and lessee, the limitation of **lease payments** (*Mietzins*), the limitation of operating costs (*Betriebskosten*) and maintenance contributions (*Erhaltungsbeiträge*), the **termination of contracts** (*Kündigung*), compensation (*Entschädigung*), administrative procedure to determine the lease owed (*Mietzinsfestsetzung*), procedures to settle disputes, etc.

Contracts which fall under the *Tenancy Act* are only in part subject to some of the Act's regulations, such as regulations on the termination of contracts.

Term and termination

In general, lease contracts entered into for an indefinite period may only be terminated by the lessor for the **specific reasons** listed in the *Tenancy Act*. The lessor may only terminate an agreement for good cause, such as the lessee's default of payments despite a reminder, a substantially detrimental use of the demised premises by the lessee, etc. Other reasons for termination except those mentioned above may only be validly agreed if the agreed reasons are comparable to the ones provided for by law, otherwise they are void and unenforceable. On the other hand, the lessee may terminate the agreement at any time without cause. Jurisdiction in most cases tends to be in favor of the lessee. Therefore, lease contracts on commercial and residential space are frequently entered into for a definite term, on apartments at least for three years, to prevent the termination provisions clearly favouring the lessee. In this case, the lessor can only terminate because of detrimental use by the lessee, non-payment of rent and in case the building has to be reerected, the lessee can only terminate because of the condition of the object. Lease contracts regarding apartments can be terminated after one year without any further condition which has to be fulfilled.

Lease payments

Generally, the parties are also free under the *Tenancy Act* to agree on the amount of rent payable, provided that, as of the day the parties enter into the lease agreement, the lease payment is 'adequate' for the relevant category (type, condition, location, maintenance) and the size of the leased object. Apartments are subject to a complex system of rent control. Typically, lease payments are adjusted from time to time, usually according to the *Austrian Consumer Price Index*. It is common practice upon conclusion of the lease agreement for the lessee to provide a security for future lease payments in one or the other form (e.g. payment bonds by a bank).

According to the *Tenancy Act*, the lessee of business premises has to notify the lessor of any **substantial changes** in the lessee's enterprise or ownership structure. Such substantial changes do not constitute good cause for the lessor to terminate the agreement. However, the lessor may increase the rent to market prices.

Stamp duties

In *Austria*, a written lease agreement is subject to **stamp duty** payable to the Austrian tax authorities at a rate of 1% of all rental payments (including service charge, operating costs and VAT) payable by the lessee to the lessor during the term of the lease. In case of indefinite contracts, stamp duty is calculated on the basis of three annual rental payments. In case of fixed-term contracts, stamp duty is calculated on the basis of the rental payments for the whole term, however, a maximum of 18 years applies. The signed contract must be submitted

to the tax authority on the 15th of the second month following the month of signing at the latest, or the lessor has to calculate the stamp duty and transfer the amount directly to the tax authority within the same period of time. Typically, stamp duty is borne by the lessee, but the parties are free to agree otherwise. However, parties are jointly liable toward the authority.

6 Succession and gifts

6.1 Applicable law and jurisdiction

The legal consequences of a succession *mortis causa* depends on the personal statute (nationality) of the testator at the time of his/her death. If probate proceedings take place in *Austria*, the transfer of the heir and liability for debts of the estate must be considered and determined according to Austrian law. Probate proceedings concerning properties located in *Austria* must be conducted before an Austrian court.

6.2 Fundamentals of the succession and gift/donation laws of Austria

Succession is determined by the will of the testator, an inheritance contract or by legal succession in case no testamentary disposition was made. **Wills** are valid in *Austria* if they are written by hand and provide for the appointment of an heir (without witnesses) or are made orally in the presence of three witnesses at the same time. These witnesses have to affirm the disposition of the testator under oath if requested to do so, and in view of potential difficulties of evidence they should make written records on the testator's oral disposition. Wills in the handwriting of another person or in typing are also valid. They require the presence of three witnesses to the will, of which only two have to be present at the same time and confirm (only) the identity of the testator with their signatures.

Intestate heirs are spouses and, in the 1st line, children and their descendants, in the 2nd line parents, siblings and their descendants, in the 3rd line grandparents, parents' siblings and their descendants, and, finally, in the 4th line, the first great-grandparents. If there are children and further descendants a spouse is entitled to inherit one-third of the estate; a spouse is entitled to two-thirds if there are parents and their descendants, or if there are grandparents. Children and the spouse are forced heirs who are entitled to a **mandatory share**, which consists of half of the statutory share in the inheritance for each of these persons. If there are no children, the testator's parents are entitled to this mandatory share; their claim is only one-third of the statutory share in the inheritance.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

Most transactions for the purchase of domestic pieces of land *inter vivos* by purchase or other agreements, such as exchange deals which create a claim for a transfer of title (obligation *ex contractu*), trigger land transfer tax under the *Land Transfer Tax Act 1987 (Grunderwerbsteuergesetz 1987)*. This is also true for the acquisition of property for example by expropriation, forced sale or adverse possession. Exemptions exist *inter alia* in case of donations or acquisitions by way of succession which trigger inheritance and gift tax. Land transfer tax is also levied where 100% of the shares of a corporation owning real property are

transferred, or where unification in one hand (of either an individual or legal entity) of 100% of the shares of a corporation occurs.

The **tax base** is generally the **value of the compensation** such as the purchase price, exchange performance, highest bid in forced sales, indemnification for expropriation, but also other performances accepted by the buyer, such as payments or outstanding mortgage. If there is no compensation, or if the compensation cannot be determined, the tax base is assessed at three times the **standard value** (*Einheitswert*), an assessed value for tax purposes, which is calculated in accordance with the *Valuation Law* (*Bewertungsgesetz*). The standard value of real estate is quite often considerably lower than its actual value, known as the market value.

Land transfer tax amounts generally to **3.5% of the tax base**, or **2%** if purchased by the spouse or 1st degree relatives of the ascending line and up to the 2nd degree of the descending line. Tax arises with the creation of the obligatory claim to transfer the title. The persons involved in the acquisition are liable as joint and several debtors. Therefore, it is advisable that the purchase agreement defines the party bearing the tax, which is normally the buyer. The tax return must be filed with the *Tax Office for Stamp Duties (Finanzamt für Gebühren und Verkehrssteuern)* by the 15th day of the second month following the calendar month in which the tax liability was incurred. Generally, the tax is due one month after service of the assessment notice.

A buyer may only be registered as owner in the *Land Register* if his request contains a so-called **tax clearance certificate** (*Unbedenklichkeitsbescheinigung*) issued by the tax office, a confirmation which is issued by the tax office that either the land transfer tax or the succession and gift tax has been paid, **or a statement of self-assessment** of a representative. Attorneys-at-law and notaries may, as party representatives of the person liable to tax, calculate the land transfer tax for acquisitions and issue a statement of self-assessment.

7.1.2 Sales tax (value added tax)

Sales proceeds on pieces of land within the meaning of the *Property Tax Act* are exempt from value added tax. Entrepreneurs may treat (opting-in) transactions concerning land as taxable whereby the general VAT tax rate of 20% would apply. If so, input taxes are deductible.

Currently, the rate of statutory **value added tax** in *Austria* amounts to **20%** and is due also on rent and operating expenses for business premises and offices. Only for residential property is the special tax rate 10% of the rent and operating expenses.

7.1.3 Real estate registration and notary charges

The actual registration of the transfer of ownership triggers a **registry charge of 1%** whereby the tax base corresponds to the same amount on which land transfer tax or an inheritance or gift tax would be assessed. The creation of a mortgage agreement triggers stamp duty at a rate of 1%. Mortgages that secure loan agreements, which are subject to 0.8% stamp duty, do not trigger additional stamp duty. Upon registration of a mortgage in the *Land Register*, a registration fee at a rate of 1.2% of the secured amount has to be paid by the applicant. Further, according to the *Act on Court Fees and Judicial*

Administration Taxes 1984 (*Gerichts- und Justizverwaltungsgebührengesetz 1984)*, a **lump sum fee** of currently Euro 39 is payable on all filings for registration with the *Land Register*.

In general clients may agree with the attorneys on the fee whereby *inter alia* lump sum fees or hourly fees are admissible. If there are no prior arrangements, attorneys bill their clients for real estate transactions according to the Act on *Attorneys' Tariffs* (*Rechtsanwaltstarifgesetz*). However, they may also choose to calculate their fees according to the *Act on Notaries' Fees* (*Notariatstarifgesetz*), whereby the fee is mostly calculated as a percentage of the purchase price total (plus VAT and cash expenses), and is negotiable between 1% and 3%, depending on the expected work load. The **costs for drawing up an agreement** are usually **borne by the buyer**.

Only notaries and district courts are authorized to perform the simple procedure of certifying signatures along with the verification of the undersigned's identity; this involves minor costs.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

Land, including agricultural and forestry assets, real estate and business premises, is subject to land tax (*Grundsteuer*) calculated on the basis of the standard value. The rates vary among the municipalities, which have the right to tax.

Parcels of land without buildings or constructions are subject to a federal duty on land value (*Bodenwertabgabe*) at a rate of 2% of the standard value per year. No such tax accrues where the standard value does not exceed the amount of Euro 14,600.

7.2.2 Income tax

Individuals are subject to personal income tax whereby legal entities are subject to corporate income tax. The income concept and the profit concept, developed for purposes of assessment of the personal income tax, apply to corporate income taxation as well. Therefore, with some exemptions, profits are computed in the same way for purposes of personal income tax and corporate income tax.

The *Income Tax Act* (*Einkommenssteuergesetz*) distinguishes seven categories of income, one of which is income from rental and commercial leasing. The overall concept of rentals and leasing is not strictly defined but includes both rental and leasing of immovable assets as well as for example earnings from the use of an entirety of movables. The taxable income is generally computed on the basis of the receipts less expenses. Special rules apply for expenditures made for repair to a building in any particular year. Whereas expenses for ongoing repairs are tax deductible immediately, expenses for repairs leading to an increase in the building's value are deductible only over a period of 10 to 67 years rather than in the year the expenses have been incurred. Certain expenditures for (re)building are tax deductible only over a period of 15 years. Finally, as far as income generated in the category of rental and commercial leasing relates to income from agriculture, industry and commerce or an independent profession, it is added to the relevant category of income when computing income from these sources.

Annual personal income tax is:

Up to	EUR 10.000,–	0.0%
Up to	EUR 25.000,–	23.0%
Up to	EUR 51.000,–	33.5%
For any further income		50.0%

Personal use of premises is considered as own consumption. Premises that are used personally, for example apartment houses, are reduced by fictitious rental proceeds corresponding to the personally used surface, which must fulfill the criteria for arm's length dealings. This personal use also means that the depreciation rates are reduced by analogy. Although the owner-occupier does not actually have to pay him/herself rent, the fictitious receipt thereof is subject to tax. It is in any case advisable to consult a tax adviser.

Companies and other legal entities are subject to corporate income tax (*Körperschaftsteuer*). The income tax rate for corporations is 34% (25% from 2005). The minimum corporate income tax for Austrian limited liability companies amounts to Euro 1,750 per year. Corporate income tax law does not distinguish seven different kinds of income.

7.2.3 Net wealth tax

Net wealth tax was entirely abolished in Austria as of December 31, 1993.

7.3 Capital gains tax

Sales transactions concerning pieces of land and other rights where the period between acquisition and sale is less than **10 years** are speculative ventures and thus subject to **income tax**. In case of pieces of land for which production costs were deducted in installments within 10 years, this period is extended to **15 years**. For periods longer than 10 and 15 years respectively, gains are currently not subject to tax.

Any increase in value from the sale of real estate will increase the general annual income. Income taxes accruing on the capital appreciation therefore depend on other income of the selling real estate owner and are capped at 50% under current laws.

The 10-year speculation blocking period is only relevant if the selling individual holds the real estate as a private investment. If the real estate is part of a business unit, the capital gain resulting from sale is in most cases taxable regardless of a 10-year period. Also in the case of a corporation the sale of real estate always triggers capital gains tax regardless of the 10-year period.

Foreign nationals selling their real estate in *Austria*, even if the person is not a resident or does not have his habitual place of abode in *Austria*, have to declare capital appreciation revenue and pay tax in *Austria* as they are subject to limited tax liability. Existing tax treaties may apply.

7.4 Inheritance and gift taxes

The *Inheritance and Gift Tax Act 1955* (*Erbschafts- und Schenkungssteuergesetz 1955*) applies to any acquisition *mortis causa* (inheritances, bequests, asserted claims to forced heirship,

donationes mortis causa, claims under contracts of inheritance) and to gifts *inter vivos*. The rate of inheritance and gift tax varies from 2% to 60% depending both upon the value of the inheritance or the gift and upon the relationship of the beneficiary to the deceased or the donor. These rates are increased by 2% or 3.5% depending on the relationship of the beneficiary to the deceased or the donor in case of transfer of real property. In such a case, tax is calculated on the basis of the triple standard value of the real estate. This mark-up replaces the land transfer tax, which does not apply to inheritance or gifts.

In the case of gifts *inter vivos* between spouses, an amount of Euro 7,300 is tax exempt in addition to the absolute tax-exempt amount of Euro 2,200.

The tax is imposed on total assets transferred if either the deceased at the time of his/her death or the devisee, the legatee, heir at law or donor, at the time of the taxable event, is a resident of *Austria*. The tax is only imposed if the estate consists of Austrian domestic agricultural or forestry land or domestic enterprises or domestic real estate.

7.5 Other taxes and charges

Certain documentary stamp duties are levied on various legal transactions concluded in written form. These stamp duties may, in certain circumstances, cause a substantial tax burden, such as in case of debt financing which may be subject to **stamp duties at a rate of 0.8%**.

7.6 Incorrect (lower) statement of sale price on the sales agreement

Incorrect (lower) statement of sale price on the sale agreement is uncommon in *Austria.* One reason for that fact may be the – compared to other jurisdictions – relatively low land transfer tax of 3.5% or 2% of the consideration. When real estate is purchased together with movables, the purchase price should be divided to prevent the amount for movables being added to the taxable base.

Tax offences are punishable according to the provisions of the *Fiscal Crimes and Penalties Act (Finanzstrafgesetz)* and may be subject to imprisonment, fines, forfeiture or compensation for lost value.

7.7 International taxation

Although the more recent double-taxation treaties that *Austria* has concluded follow the *OECD-Model Convention*, deviations exist, and the relevant treaty must be consulted in any event. Generally, income from immovable real estate, including income from leasing of real estate, may be taxed in the state where the real estate is located. Income from the alienation of real estate may be taxed in the state in which such real estate is located. Income from the alienation of any other real estate is generally taxed only in the contracting state where the seller is a resident.

According to tax treaties that also cover inheritance tax, inheritance taxes are assessed by the state where the real estate is located. The industrial and commercial real estate of a permanent establishment is taxed by the state where this establishment is located. Other real estate is taxed by the state where the deceased had his/her residence on the day of

his/her death whereby this state is entitled to apply a tax rate that would be applicable to the total amount of inheritance.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

There are no border controls when entering Austria overland from a Schengen-Country. Border-crossing documents are only required at EU external borders respectively borders of countries which are not party of the Schengen treaty and on airports. EU nationals may reside and establish themselves for an unlimited period in *Austria*. The *Foreign Nationals Act* (*Fremdengesetz*) provides that other nationals have to obtain a **residence permit** from the authorities and, under certain conditions, also a work permit.

8.2 Tax residence

Unlimited tax liability applies to those natural persons whose residence or habitual place of abode is in *Austria*. Unlimited tax liability includes all domestic and foreign income. **Residence** within the meaning of Austrian tax laws is where someone has a home, suggesting that he/she will keep and use the home. Tax law therefore refers to objective circumstances. Objectively noticeable circumstances, suggesting that there is an intention to keep and use the home, are required; a subjective intention alone is not sufficient. The **habitual place of abode** is where someone resides and the circumstances indicate that he/she does not just temporarily stay at this place or in this country. Unlimited tax liability applies to any actual residence in Austria that lasts for more than six months. In this case, also the first six months are taxable. As a result, a person may have multiple residences, but only one habitual place of abode at any given time.

Limited tax liability for natural persons who have neither a residence nor a habitual place of abode in *Austria* includes, *inter alia*, income from agriculture and forestry operated in *Austria* and income from rental and commercial leases if the real estate is located in *Austria* or registered in a public ledger or register or is exploited within the scope of a domestic permanent establishment. These persons are also liable to tax on income from speculative transactions involving domestic pieces of land subject to the provisions of civil law regarding pieces of land and on capital assets obtained from domestic real estate ownership.

8.3 International taxation for residents of Austria

Austria has entered into double taxation treaties with more than 40 countries, among others with *Australia, Canada*, the *United States* and the *United Kingdom*. These tax treaties, which are generally closely modeled after the *OECD-Model Convention*, apply either the exemption or the tax credit method. Some apply a mixed method for avoiding double taxation. In the meantime, there are also a number of EU Directives on double taxation, which must be observed.

Nationals of Member States of the *European Union*, or a state to which the *Treaty on the European Economic Area* applies and who have neither a residence nor their habitual place

of abode in *Austria*, are treated as taxpayers with unlimited tax liability upon request if and to the extent they have special income subject to limited tax liability. This applies only if at least 90% of their income for the calendar year is subject to Austrian income tax or if their income not subject to Austrian income tax is less than Euro 6,975. Domestic income, which may only be taxed up to a certain limit under a tax treaty, is not considered as not being subject to Austrian income tax in this context. The amount of income not subject to Austrian income tax must be proven by submission of a certificate from the relative foreign tax office.

9 Checklist: Real estate acquisition in Austria

- Search of the Land Register as to registered encumbrances.
- Inspection of real estate as to obvious defects and obvious encumbrances.
- Review of zoning ordinances (dedication of land), building regulations, excerpt of the cadastral map, monument preservation and urban development matters.
- Identification of restrictions on transferability and (non-)registered encumbrances.
- Existence of construction permits and permits to use.
- Examination of material contracts to be adopted or terminated, such as lease agreements, agreements with abutters, utility agreements (gas, electricity, heating), property management contracts, agreements on refurbishment, etc.
- Financial and tax matters (e.g. unpaid taxes; prevention of land transfer tax, if possible; etc.).
- Environmental considerations (contamination and other environmental issues – asbestos, oil residues, storage).
- Insurance.
- Litigation (third-party claims, restitution claims of former owners, etc.).
- Drafting and execution of the sales agreement by an attorney or a notary public.
- Conclusion of the contract and certification of the signatures by a district court or a notary public.
- Negotiating debt financing with banks.
- Deletion of encumbrances, if any.
- Registration of ownership with the Land Register.

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Contents: Bahamas

1 Introduction

In 1492 when *Columbus* landed in the 'new world' at the Bahamian island called *Guanahani* (later renamed *San Salvador*), he discovered a world already inhabited by Lukku-Cairi or island people. The Lucayans, who were Amerindians, are understood to be the original Bahamians who came to the Americas by way of the land bridge that once joined *Alaska* with *Siberia*. Artefacts from burial sites have been retrieved giving testimony to the existence of early Lucayan communities throughout ***The Bahamas***. In 1647, after periods of occupation by Spanish and French settlers, English settlers from *Bermuda* seeking religious freedom would populate *The Bahamas* and claim them for *Great Britain*.

The Bahamas archipelago spans 100,000 square miles, extending southeast from *Florida* in the *United States of America* to northern *Hispaniola*.

The Bahamas is noted for being one of the oldest parliamentary democracies in the western hemisphere enjoying peaceful and stable governance for close to 300 years. Accordingly it is one of the safest and most stable international locations for investments. During 1972, the Bahamian people intimated their desire to become independent from *Britain* and on July 10, 1973, under the leadership of *Lynden Oscar Pindling* and the *Progressive Liberal Party (PLP)* full independence as *the Commonwealth of The Bahamas* was achieved. The *PLP* remained in power for the next 25 years until its defeat in 1992 by the *Free National Movement (FNM) party* led by *Hubert A. Ingraham*. In 2002 The *PLP* was returned to power under the leadership of *Perry G. Christie*. Today ***The Bahamas*** remains a member of the *Commonwealth of Nations.*

The legal system in *The Bahamas* is based upon the English legal system with the notable exception that *The Bahamas* has a written constitution. The constitution of *The Bahamas* provides for an independent Bahamian judiciary. Generally the judicial system in *The Bahamas* follows the English common law. Additionally, there is a large body of local statutes, which together with the common law constitute the laws of *The Bahamas*. There are three levels of courts in *The Bahamas*: the *Magistrates Court*, which determines small claims; the *Supreme Court*, which has unlimited jurisdiction in civil and criminal matters; and *The Bahamas Court of Appeal*, which is the highest court sitting in *The Bahamas* and hears appeals from the *Supreme Court*. The *Privy Council* in *London* is the final court of appeal. Judges in *The Bahamas* are appointed by the *Governor General*.

The legal currency of *The Bahamas* is the Bahamian dollar. The US dollar is however widely accepted and treated by merchants on par with the Bahamian dollar. Within the banking system conversion of foreign currency including US dollars to Bahamian and the reverse are subject to an official rate of exchange, which is however almost at par with the US dollar (as of February 2004 the exchange rate on conversion from US dollars to Bahamian dollars was 0.9950).

2 Real estate ownership

2.1 Different forms and types of ownership

The primary forms of real estate ownership in *The Bahamas* include **fee simple, leasehold**, life estates, co-ownership, joint tenancy, tenancy in common, **condominium**, future interests and **time-sharing**.

2.2 Easements, charges, liens and mortgages

Easements

Easements in *The Bahamas* generally take the form of **rights of way** or **easements of support** in connection with multiunit buildings with common support walls. *Section 6* of the *Conveyancing and Law of Property Act, 1909, Chapter 138*[1] has the effect of passing to the transferee of land the benefit of existing liberties, privileges, easements, rights and advantages which appertain to the land conveyed, or are reputed to appertain to it, or which are at the date of the conveyance enjoyed with the land.

Licenses

Grants of licenses to allow another party to utilize or pass over land in circumstances which would typically amount to trespass in Bahamian law are not uncommon. These can normally be found where a beach front real estate owner wishes to allow a neighboring real estate owner access to the beach but does not wish to burden his real estate with a legal easement.

Restrictive covenants

Restrictive covenants generally arise in the context of subdivision developments and condominiums and are generally imposed to regulate land use. In Bahamian law the burden of restrictive covenants bind succeeding owners of the real estate and is considered as running with the land.

Liens

The primary liens and charges affecting real estate ownership in *The Bahamas* are as follows:

Regarding real estate taxes: see section 7.2.1 below.

Judgments: Under *section 63* of the *Supreme Court Act 1996, Chapter 53*, every judgment entered up in the *Supreme Court of The Bahamas* against any person shall operate as an equitable charge upon every estate or interest (whether legal or equitable) in all land to or over which the judgment debtor at the date of entry or at any time thereafter is or becomes beneficially entitled or entitled to exercise a power of disposition for his own benefit without the assent of any other person. A charge imposed by *section 63* of the *Supreme Court Act* shall take priority over all other mortgages or charges affecting the land other than any mortgage or charge registered under the provisions of the *Registration of Records Act 1928* prior to the date of the entering up of the judgment or any further advance made under the security of a charge or mortgage registered prior to the judgment provided that the security allows for the mortgagee or chargee to make further advances.

Condominium contributions (common expenses): Any unpaid contribution due from the owner of any condominium unit under the provision of the *Law of Property and Conveyancing (Condominium) Act 1965, Chapter 139*, shall constitute a charge upon the unit in priority to all other encumbrances on the unit except a charge under *section 25(1)* of the *Real Property Tax Act 1969* (see section 7.2.1 below).

[1] All references to 'Chapter' with regard to Bahamian statute law are to chapters of the *Statute Laws of the Bahamas, Revised Edition 2000.*

Mortgages

Mortgages (both legal and equitable) duly recorded in the *Registry of Records (Registrar General's Department)* pursuant to the *Registration of Records Act 1928, Chapter 187*, are afforded priority over subsequently recorded documents dealing with the same security (*section 10* of the said Act). A security created under a mortgage is subject to the overriding charge created under *section 25(1)* of the *Real Property Tax Act 1969*.

2.3 Protection of ownership, proof of ownership and registration

Title to land and registration

The transfer of a legal title in land in *The Bahamas* is effected by the valid execution of a deed (document under seal) by the grantor. At present there is no mandatory system of land registration in *The Bahamas*. The *Registration of Records Act 1928* provides for the voluntary registration of documents and names of parties to a transaction and is not a system of land registration. All instruments recorded in the *Registry of Records* pursuant to the provisions of the Act are however afforded priority over subsequent instruments purporting to deal with the same interest except in the case of fraud. Additionally, the effect of recording the instrument is to create a permanent record of the transfer in the event the original title deeds are lost or destroyed.

Title search

In order to ensure that a clear title to the subject real estate is being acquired a purchaser should have the title to the subject real estate researched and certified by a local attorney. Additionally title insurance may be purchased from a local title insurance company. Under the present conveyancing practice it is not customary for the seller to produce an abstract of title although it is open for the parties to stipulate otherwise in the Agreement for Sale. Unless otherwise agreed, the seller is only obligated to show **a good and marketable title commencing with a good root of title at least 30 years old** (*section 3(4)* of the *Conveyancing and Law of Property Act*). All real estate taxes should be paid up to date and all required permits or validating permits (if necessary) should be obtained prior to completion (see section 3.2.4 below).

3 Purchase and sale of real estate

3.1 The sales agreement

Under the *Statute of Frauds*, *Chapter 154*, any contract or agreement dealing with the sale or other disposition of an interest in land must be in writing. Consequently it is not possible under Bahamian law to enter into a verbal agreement for the sale of land as this contract would not be specifically enforceable. A properly entered into agreement for the sale of land has the effect of transferring the equitable estate in the real estate to the buyer with the seller retaining the legal estate until completion. It is advisable that where a completion of the transaction is considerably delayed the **Sales Agreement should be registered under the *Registration of Records Act*.**

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

Previously under Bahamian law a wife acquired a right to dower in all real estate of her husband. Consequently on any onward sale of real estate it was necessary for the wife to renounce her right to dower before an onward sale of any land owned by her husband. A failure to obtain a renunciation of dower meant that clear title could not be passed to the buyer. In 2000 the Bahamian Parliament sought to replace the wife's right to dower with a spousal right of occupation in the matrimonial home under the *Inheritance Act 2000*. However, doubts have arisen as to whether or not the right to dower has been effectively abolished and at the moment a degree of uncertainty has crept into Bahamian law on this issue.

3.2.2 Options and pre-emption rights

Under Bahamian law a seller can, by a written agreement, grant to an intended buyer a right of pre-emption. This is a right to call upon the seller at a particular point and time to contract to sell the subject property to the owner of the pre-emptive right. This is based entirely in common law.

3.2.3 Agricultural real estate

There are no discernable agriculture estates in *The Bahamas*.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

In 1993 the Government passed the *International Persons Landholding Act, Chapter 140 ('the IPLA')*, which was designed to encourage non-Bahamians to acquire real estate in *The Bahamas*. The enactment effectively removed past onerous restrictions placed on the international investor with a more investor friendly outlook. Under *section 2* of the *IPLA* a foreigner who purchases or acquires an interest in a condominium, or real estate, vacant or otherwise, to be used by him as a single family dwelling can acquire real estate in *The Bahamas* as of right subject only to an obligation to register the purchase or acquisition with the *Bahamas Investments Board (BIA)*. Where the buyer's acquisition has not been registered, any attempt to record the conveyance in respect of the transaction will be null and void. In all other circumstances, unless the foreigner is a permanent resident of *The Bahamas,* it is necessary for the foreigner to obtain a permit from the Board in order to make the acquisition (i.e. for purposes other than a single family dwelling or where the acquisition is in respect of more than five contiguous acres).

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

As a general rule under Bahamian law in order to enter into a binding contract both parties to the contract must be over the age of 18 and mentally competent. Issues of capacity would apply to minors and mentally disordered persons.

In *The Bahamas* the age of majority and by extension of capacity is 18 years of age. Consequently the only contracts which would bind a person under that age would be contracts for necessaries. All other contracts are voidable at the option of the minor.

As in the case of minors, contracts for necessaries are binding on mentally disordered persons. All other contracts are voidable provided the mentally disordered person can show that owing to his/her mental condition at the time of the contract he/she did not understand what he/she was doing and further that the other party was aware of his/her incapacity.

All legally incorporated entities are competent to hold land in *The Bahamas*. Under *section 27* of the *Companies Act of the Bahamas, Chapter 308*, where a company has been removed from the register all its property immediately vests in the *Treasurer of The Bahamas*. Consequently, a company which has been struck off the register would have no capacity to enter into an agreement for the sale of any land titled in its name in *The Bahamas*. It is always necessary in these circumstances to **ensure that a selling company is in good standing** with the *Bahamian Companies Registry*.

3.3.2 Third-party claims and unpaid taxes

The primary third-party claim affecting the ability of a seller to sell real estate would be the claim by a judgment creditor (see section 2.2 above). To protect against such a claim a cause list search should be conducted at the *Bahamian Supreme Court Registry* to ascertain if there are any judgments on record affecting the seller. Additionally, in the case of any other actions revealed by the cause list search these should be examined to ensure that the real estate being sold is not the subject of any proprietary claim by any third parties. Where there is outstanding real estate tax due (see section 7.2.1 below) the new owner would not be able to pass clear title to any subsequent buyer unless and until the unpaid taxes have been satisfied. To prevent such an eventuality prior to closing on a purchase it is imperative for the buyer's attorney to **insist on the seller's attorney obtaining an assessment from the real estate tax office which indicates that there are no outstanding real estate taxes due**.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

The primary legislation enacted for the protection of the environment includes *The Bahamas National Trust Act*, the *Conservation and Protection of the Physical Landscape of The Bahamas Act*, and the *Coast Protection Act*. There is currently no legislation specifically directed at the preservation of Bahamian cultural heritage. However, some provisions of the above listed Acts do touch on aspects of Bahamian cultural heritage.

In *The Bahamas, The Bahamas Environment Science and Technology (BEST) Commission* is charged with the responsibility of ensuring that there is a coordinated and concerted effort to protect, conserve and manage the environmental resources in *The Bahamas*. It is generally a precondition of any large-scale real estate development in *The Bahamas* that a favourable environmental report is obtained. See also section 4.1 below.

3.3.4 Access to relevant records and documents

The Bahamas does not have a system of land registration. Consequently **it is necessary for all title deeds in the chain of title to be carefully vetted by the buyer's attorney**.

Additionally a search of the records registry should be undertaken to ensure that there are no other conveyances or transactions recorded in respect of the real estate to be purchased. Further, the *Department of Physical Planning* should be consulted to ensure that, where the real estate is situated in *New Providence*, the real estate is in an approved subdivision.

3.4 Key points that a seller should consider

In effecting a sale of real estate a seller should always ensure that it is clearly stated in the offer price whether the price is a net or gross price. A net price refers to the price that the seller expects to receive in his/her hand after payment of all closing costs. A professional appraisal should be obtained so as to ensure that the sale price accurately reflects the market value of the real estate. In *The Bahamas* it is **the obligation of the buyer to ensure that the real estate is fit for its intended use**, however a seller cannot materially misrepresent the features of the property to the buyer. The seller should also check to make sure that real property tax payment (see section 7.2.1 below) is current as any outstanding amounts will have to be paid prior to closing.

3.5 The execution of a real estate purchase transaction

The first step that a potential seller or buyer should take is to retain the services of a licensed real estate broker. Under the provisions of *section 4* of the *Real Estate (Brokers and Salesmen) Act*, *Chapter 171*, no person may engage in the practice of real estate business without a license. Therefore it is important to ensure that any real estate broker retained is properly licensed under the Act. Secondly, once a purchaser or potential property is identified the sales agreement will have to be prepared. Most licensed brokers have standard form real estate contracts at their disposal but it is still preferable that a lawyer is retained either to draft or review the contract. See section 7.5 below for customary professional charges on real estate transactions.

3.6 Powers of attorney

In *The Bahamas* the law applicable to powers of attorney is found in the *Powers of Attorney Act 1992, Chapter 81*. Powers of attorney must be signed and sealed by the donor of the power and provision is made under the Act for the recording of the power with the *Registrar*. There is also a provision creating enduring powers of attorney, which would survive any subsequent mental incapacity of the donor. All contracts executed pursuant to a valid power of attorney would be binding on the donor of the power; this would include any contracts dealing with the sale of land.

3.7 Financing

The primary sources of obtaining real estate financing in *The Bahamas* is from banks and insurance companies. *Credit Unions* also provide some limited financing options but these are usually limited to members. Banks generally would call for the following documents in order to process a loan application: employment letter, executed agreement for sale, appraisal report on the subject real estate and, where the applicant is a foreigner, proof of residency status. Additionally, in the case of non-Bahamians the bank will also have to be provided with an approval to borrow from the *Central Bank*.

3.8 Purchase through a company

In *The Bahamas* there are two distinct forms of corporate entities, companies formed under the *Companies Act* (see section 3.3.1 above) and those formed under the *International Business Companies Act, Chapter 309 ('IBC Act')*. *IBC Act* companies are specifically designed for the international investor. Real estate can be held by either type of company but in each case it will be necessary for a non-Bahamian to obtain approval from the *Central Bank*. Forming a company in *The Bahamas* is a relatively simple and uncomplicated exercise. All that is required is the proposed name of the company and the required fee, usually ranging from US$ 1,500 to US$ 2,000. The incorporator will have to be vetted in accordance with the appropriate 'know your customer' rules.

3.9 Defects and warranty claims

In *The Bahamas* warranty claims generally refer to breaches of contract which would not result in a repudiation or termination of the contract. In contracts for the sale of land there is no implied warranty covering defects of quality, the governing rule being ***caveat emptor*** *(buyer beware)*. A seller is not bound to call a buyer's attention to patent defects to the real estate although he/she must deliver real estate corresponding to the description in the contract. However, an express warranty that a real estate is free from defects would found an action for breach of contract in the event that the real estate is not free of defects. A seller may not, however, conceal patent defects from a buyer; this would be regarded as fraudulent.

As to legal defects of title, there is an implied obligation on a seller to deliver a marketable title to the real estate sold. This implied obligation only applies to legal defects and not to physical defects. A legal defect is a defect which affects the seller's ability to pass a good title to the real estate sold.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

Given the peculiar characteristics of the islands of *The Bahamas*, it will be readily appreciated that the practice of zoning is not as one would be accustomed to in larger cosmopolitan areas. In *The Bahamas* the zoning of any particular section or area of *New Providence Island* is governed by the *Town Planning Act*. *Section 5* of that Act empowers the Minister responsible for the *Department of Physical Planning* to prescribe areas, by order, in which new buildings may be constructed. Since the enactment of the *Town Planning Act* the Minister has issued several orders that have resulted in the creation of the zones listed below. Given the wide parameters of the zoning definitions, it should be noted that every application for construction, rebuilding and or renovation must be approved by the Minister and all other relevant authorities as set out in the *Building Code* (paragraph 2-01).[2]

[2] It must be noted here that *The Bahamas Building Code* is undergoing a revision and updating process. The revised Code is due for publication mid-2004. Subsequently much of the information relied on in this section, for which the code was a major source, may be revised.

The *Town Planning Act* may, by Order of the Minister, be extended to any particular area of one or more of the archipelagic family of islands by virtue of *section 14* (see also the *Town Planning (Extension to the Out Islands) Order*). However, with the recently enacted *Local Government Act 1996*, town and district councils in the relevant islands have assumed responsibility of the central *Town Planning Council* for their towns and districts. The one exception to this is in relation to construction applications from non-Bahamians. **Persons who are not residents or citizens of *The Bahamas* must make their applications to the central authority in *Nassau*** (see the *Local Government Act, section 14(1)(a)(ii)*). In that regard it should be noted that investment into the Bahamas is facilitated by the ***Bahamas Investment Authority (BIA)***. The *BIA* coordinates all requirements and regulations under the various statutes, and foreign investors are guided through the various processes with the BIA's assistance.

The primary construction zones may be identified as residential areas, the downtown area, main *Bay Street* thoroughfare, farming areas, protected preserved and reserved areas, developmental or industrial areas.

Residential areas

In areas delineated as 'residential' permitted buildings may include single family dwelling houses, apartments, buildings for religious or educational purposes, hotels, retail stores and filling stations, community centres, banks and other connected uses.

The down town area

This area may be properly identified as a commercial area and within its boundaries permitted buildings include retail stores, businesses, office buildings, restaurants, hotels and their connected uses. The architectural designs of buildings constructed in this area are regulated, as a result of the historical importance of many buildings located in this area, and must be approved prior to construction and or renovation.

Farming areas

Allowable construction in this area includes buildings and facilities connected with animal husbandry, poultry farms, and produce farms.

Protected, preserved, reserved areas

These areas are designated as public parks, public beaches, national parks, naturally preserved cays and areas. The construction of any building and the type of any allowable construction projects on particular cays, or in particular areas, are also regulated in this category.

Industrial areas

In this category construction of buildings connected with manufacturing, shipping, cargo-handling and storage facilities are allowed. There are also areas the Minister by Order[3] may designate as approved for mining, quarrying and excavation operations.

[3] Pursuant to the *Conservation and Protection of the Physical Landscape of The Bahamas Act 1997*.

Construction requirements

In each of the above classifications the minimum distances allowable between neighboring buildings, as well as building restrictions and requirements, are greatly dependent on the nature of the building materials used for constructing the building, its location and the purpose of the building. The various requirements and restrictions based on the material and purpose of the proposed buildings are set out in *The Bahamas Building Code*. The *Code* also provides guidance for the calculation of the allowable height and distances of buildings.

Substantial alterations to historical buildings and sites will often not be approved by the *Town Planning Council*, or the responsible Minister. In situations where work is contemplated on an historical site that will alter its composition, *The Bahamas National Trust*, who has a mandate to preserve such sites (see *The Bahamas National Trust Act*), will often be asked to give its opinion of such works. Often only necessary renovation work to preserve such historical buildings will be approved.

Also the construction of any building in areas designated as national parks and or natural preserves will often be strictly forbidden. Real estate in such areas will often not be eligible for sale.

Environmental protection

Environmental protection in *The Bahamas* is primarily governed by the *Conservation and Protection of the Physical Landscape of The Bahamas Act 1997*. Under the Act, where any construction works have the potential to impact the physical landscape of *The Bahamas*, approval of the Minister must first be obtained. Where such prior approval is not acquired, the offending party is liable to be fined in amounts ranging from B$ 5,000 to B$ 10,000 and above in instances of repeat offenders. Additionally, the Act allows for the imprisonment of an offender for three to six months. The Act considers impacts to the physical landscape to include filling up wetlands, areas commonly known as 'natural ponds', 'drainage basins' and 'blue holes', excavation and landfill operations, the removal of sand, dunes or stones from beaches and coastlands. It should be noted that this list is not exhaustive and the Act and accompanying Regulations should be carefully consulted.

With regard to the construction industry, the Act applies to excavations for large-scale luxury residential developments, the development of tourist attractions and facilities as well as the excavation for canals or other purposes connected therewith. However, the restrictions under the Act do not apply to excavations related to small, individual construction projects. Such projects include excavations for swimming pools, septic tanks, rainwater tanks, trenching for building foundations or other building operations approved under the *Buildings Regulation Act*.

4.2 Architect's and building contracts

Professional architects in *The Bahamas* primarily use the ***American Institute of Architects*** standard form contracts for building projects. This standard form contract makes provision for the commencement and completion of building projects, periodical payment of the contract sum, and general conditions regarding the supply of materials, subcontracting of works and the general administration of the project.

4.3 Completion of construction and formalities

On completion of any building works the *Ministry of Public Works* must conduct a final inspection of the works and issue an occupancy certificate. Such inspection is undertaken by the *Buildings Control Officer*. However, during the course of the works, at several set stages, an inspection must be undertaken by the *Buildings Control Officer* who either approves the works or requires the builder to redo the works, bringing it into conformity with the requirements under the *Code*. The requirements to comply with the set stages for inspection are the same for new construction projects, renovations, alterations and extensions to existing buildings (see *paragraphs 301* and *304* of the *Building Code*).

Building projects are required to undergo:

- foundation inspection
- piling inspection
- column inspection
- structural column inspection
- tie-beam inspection
- structural beam and slab inspection
- structural framework inspection
- roof inspection
- plumbing inspection
- special inspection relative to the particular works being undertaken
- electrical inspection, and
- any other inspections the *Buildings Control Officer* may deem necessary.

The timing of each inspection is designated in the *Building Code*. The builder must give the *Buildings Control Officer* at least 48 hours' notice.

4.4 Deficiencies and warranty claims regarding new construction

There are no statutory stipulations regarding deficiencies and warranty claims in connection with building works. Defects and deficiencies are left to the parties to the contract to address in their contract. The great majority of Bahamian building contracts contain a clause which requires the contractor to rectify all defects that may appear during a fixed period. Where the contract makes no provision for defects, the law of negligence and or common law principles apply. Similarly certain warranties are also normally included as provisions of the contract. These normally relate to warranties as to quality of material and workmanship.

5 Rental and tenancy

5.1 Rental and lease agreements

A tenancy in *The Bahamas* may be classified as fixed term tenancy, a periodic tenancy, a tenancy at will or a tenancy at sufferance. A tenancy may be created orally and there is no

legal requirement that a lease be in writing. The law relative to tenancies in *The Bahamas* is contained under the *Landlord and Tenant Act*, the *Landlord and Tenant (No.2) Act*, the *Conveyancing and Law of Property Act*, the *Distress for Rent Act*, the *Distress for Rent (No. 2) Act*, and the *Rent Control Act*. Subject to express agreement, the intending lessee is not entitled to call for any deduction of the freehold or leasehold estate under a contract to grant or assign a term of years. Acquisition of leasehold interest by foreigners is subject to the provisions of the *IPLA*.

5.2 Regulations on protection of tenants and rent control

Protection of tenants

There is no general statutory regime established to protect tenants. Such protection as exists is afforded to a tenant by virtue of the common law. Examples of the protections granted to tenants under the common law include the covenant for quiet enjoyment and for notice to be given where the tenant is required to vacate. There are a few exceptions, however, where statutes reinforce common law principles created for the protection of tenants. An example can be found in *section 24* of the *Rent Control Act*. There landlords are mandated to maintain the rented or tenanted premises in good repair, and adequate for occupation.

Rent control

Legislation affords some protection to tenants with regard to the amount of rent they may lawfully be charged. The *Rent Control Act* protects tenants who reside in premises with a value of B$ 25,000 or less. Where the value of the premises exceeds the above-mentioned amount the Act is inapplicable. Under the *Rent Control Act* a landlord may not charge more than the prescribed percentage for premises covered by the Act. The prescribed percentage currently stands at 15% (see the *Chargeable Rent Order 1980*).

6 Succession and gifts

6.1 Applicable law and jurisdiction

Where a foreign national who is resident in *The Bahamas* dies in *The Bahamas* without having made provisions for the disposition of his/her estate either in *The Bahamas* or elsewhere, the estate may be distributed in accordance with the guidelines established in *section 4* of the *Inheritance Act.*

6.2 Fundamentals of the succession and gift/donation laws of The Bahamas

Fundamentals of succession

In *The Bahamas* the law of succession was extensively revised in 2002. The revision abolished colonially inherited practices including tenancy by the curtsey, dower, and all other then existing modes, rules and canons of descent and of devolution by special occupancy or

otherwise of real or personal estate. In place thereof, three associated statutes were created to govern the law of succession in *The Bahamas*. The assembly of statutes were the *Inheritance Act*, the *Wills Act*, and the *Administration of Estates Act*. The *Inheritance Act* provides an alternating system of succession when a person dies intestate. The *Wills Act* governs the creation of wills in *The Bahamas*, the necessary formality requirements, and the recognition of wills created outside *The Bahamas*. It should also here be noted that a **subsequent marriage after the creation of a Bahamian will invalidates the earlier will**. In such circumstances, it would be advisable for the will to be reaffirmed or restated. The third Act, the *Administration of Estates*, deals with situations where an administrator must be appointed over a deceased's estate.

Intestate succession

As noted above, the *Inheritance Act* sets out the general guidelines regarding intestate succession. Where an intestate dies leaving a spouse and no children, that spouse inherits the entire estate; where one child and a spouse remain, the estate is shared equally between them. If a person dies leaving several children and a spouse, one-half of the estate is given to the spouse and the children share equally in the remaining half. Where only children remain, the estate is shared equally among them. Where only grandchildren survive the estate is shared equally among them. If there are no children, grandchildren or spouse remaining, the law directs its attention to the parents of the intestate or alternatively to the siblings, nieces and nephews, grandparents, or aunts and uncles of the intestate in that order. Where no such person exists of any of the above descriptions, the estate will devolve upon the next of kin.

Intestate succession also applies in circumstances where a person 'leaves a will but dies intestate as to some beneficial interest in his real or personal estate' (*section 2* of the *Inheritance Act 2002*).

Creation of a Bahamian will

Under the *Bahamian Wills Act 2002*, an individual's freedom to choose to create a will is not affected. Although it would be advisable for a foreigner to create a Bahamian will dealing specifically with any property in *The Bahamas*. It should be noted, however, that each situation is dependent on its particular circumstances and the desires of the testator. *Part 4* of the Act makes provisions for wills executed outside *The Bahamas*. Consequently, once the will currently subsisting complies with all necessary formalities of the territory where the testator was either a national, domiciled or resident at the time of its creation, or complies with the formalities of the territory in which it was executed, it is likely that *The Bahamian* courts will give effect to its provisions. One provision should be given special note, however. **Where the will purports to deal with immovable property, the devise ought to conform to the law of the territory where the real estate is located**. The Act makes provision for such circumstances where the testator, not domiciled in *The Bahamas*, wishes for the devise to be subject to Bahamian law (see *section 7* of the *Wills Act 2002*).

Under the *Inheritance Act*, irrespective of any other law, provision is made to prevent a surviving spouse from being evicted from the matrimonial home. *Section 24* expressly entitles a spouse, not otherwise entitled by virtue of a testamentary devise, to remain in the matrimonial home he/she was residing in at the time of the spouse's death. However, this

benefit extends only during the surviving spouse's lifetime or until terminated by marriage. *Section 25* extends this right of occupation to the minor children of the marriage, insuring that they are housed on the death of the parent. Apart from the above provisions, **there are no forced heirship rules** dictating who may receive testamentary bequests.

Donations

The law does not regulate donations in *The Bahamas*. Subsequently persons and private corporations are free to make such charitable gifts and donations they may be inclined to make.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

There are no real estate transfer taxes in *The Bahamas*.

7.1.2 Sales tax (value added tax)

There is no sales tax (value added tax) in *The Bahamas*.

7.1.3 Real estate registration and notary charges

Under the provisions of the *Stamp Act 1925, Chapter 370*, stamp duty is payable on *inter alia* the instruments listed in Table 1.

Notary fees

There are no standardized rates for notary services. Generally notary fees will be based upon the nature and number of documents to be notarized with a premium being charged for travelling expenses if applicable.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

Under the provisions of the *Real Property Tax Act*, real estate tax is payable annually on all real property specified in the Act (subject to certain exceptions). All outstanding taxes levied pursuant to *section 25(1)* of the Act, shall constitute a first charge upon the real estate for which the tax is unpaid for as long as the tax remains payable. **The rate of tax is dependent on the assessed market value of the real estate** (see Table 2).

No real estate taxes are levied in the port area of *Grand Bahama*.

Table 1 Instruments and stamp duty

Instrument	Stamp duty
1. Every deed of Conveyance, assignment or transfer of realty or personality where the amount or the value of the consideration:	
– does not exceed B$ 20,000	2% of the amount or value of the consideration
– Exceeds B$ 20,000 and does not exceed B$ 50,000	4% of the amount or value of the consideration
– Exceeds B$ 50,000 and does not exceed B$ 100,000	6% of the amount or value of the consideration
– Exceeds B$ 100,000 and does not exceed B$ 250,000	8% of the amount or value of the consideration
– Exceeds B$ 250,000	10% of the amount or value of the consideration
2. Every deed of exchange or realty or personality shall be liable to stamp duty on the amount or value of the consideration	See scale rate in section 5 above
3. Every lease:	
– where the lease is for a term not exceeding 7 years	1% of the annual rent reserved
– where the term of the lease exceeds 7 years but is less than 35 years	2% of the annual rent reserved
– where the term of the lease exceeds 35 years but is less than 100 years	5% of the annual rent reserved
– where the term of the lease exceeds 100 years	12% of the annual rent reserved
4. Every mortgage or transfer of mortgage or realty or personality or both, for every B$ 100 or fraction thereof	B$ 1.00
5. Every reconveyance or realty or personality or both to a borrower or mortgagor only, for every B$ 100 or fraction thereof	B$ 0.10

7.2.2 Income tax

There is no income tax payable in connection with income from real estate in *The Bahamas*. Indeed, there are no direct income taxes at all.

7.2.3 Net wealth tax

There is no net wealth tax in *The Bahamas*.

7.3 Capital gains tax

There is no capital gains tax in *The Bahamas*.

7.4 Inheritance and gift taxes

There are no inheritance and gift taxes in *The Bahamas*.

7.5 Other taxes and charges

Real estate sales commission

Depending on the terms of the sales agreement a real estate sales commission may be payable where a real estate agent is involved in the transaction. Sales commissions of real estate agents range upwards from 10% for undeveloped land and 6% for developed land.

Table 2 Tax on real estate

Description of real estate	Bahamian owner	Non-Bahamian owner
	Owner-occupied real estate	
1. Owner-occupied real estate where the market value exceeds B$ 100,000 but does not exceed B$ 500,000	1% of the market value of the real estate per annum	1% of the market value of the real estate per annum
2. Owner-occupied real estate where the market value exceeds B$ 500,000	1.5% of the market value of the real estate per annum	1.5% of the market value of the real estate per annum
	Unimproved real estate	
3. Unimproved real estate where the market value does not exceed B$ 3,000	N/A	B$ 30 per annum
4. Unimproved real estate where the market value exceeds B$ 3,000 but does not exceed B$ 100,000	N/A	1% of the market value of the real estate per annum
5. Unimproved real estate where the market value exceeds B$ 100,000	N/A	1.5% of the market value of the real estate per annum
NOTE: In some circumstances non-Bahamian ownership will attract a penalty if the land remains unimproved for a period exceeding two (2) years.		
	Other real estate	
6. Any other real estate where the market value does not exceed B$ 500,000	1% of the market value of the real estate per annum	1% of the market value of the real estate per annum
7. Any other real estate where the market value exceeds B$ 500,000	2% of the market value of the real estate per annum	2% of the market value of the real estate per annum
	Exemptions (not a complete list)	
8. Public places used exclusively for the purpose of religious worship		
9. Real estate of any foreign state used exclusively for the purposes of a consular office of a residence of a consular officer or consular employee		
10. Real estate used for commercial farming		
11. Real estate used exclusively for the purpose of charitable or public service from which no profit is derived		

Legal fees

The general fee scale used by attorneys in *The Bahamas* in connection with conveyancing transactions is as follows:

- 2.5% of the consideration for the first B$ 500,000

- 2% of the consideration for the next B$ 500,000, and
- 1% of the consideration for transactions over B$ 1,000,000 up to B$ 3,000,000.

7.6 Incorrect (lower) statement of sale price on the sales agreement

The effect of intentionally quoting an incorrect/lower statement of the sales price on the sales agreement is to commit a fraudulent act which deprives the Bahamian Government of stamp duty which the parties are obligated to pay pursuant to the provision of the *Stamp Act*. **It is required that the full purchase price be quoted in the transaction documentation** (*section 22* of the *Stamp Act 1925*). Where the provisions of the *Stamp Act* are not complied with may result in the imposition of fines ranging between B$ 50 to 200 Alternatively, penalties under the Act include imprisonment.

7.7 International taxation

Due to the absence of direct income taxes, there are no operative principles of international double taxation in *The Bahamas*.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Generally *The Bahamas* welcomes persons desiring to be resident in the islands. The primary statute governing this area is the *Immigration Act*. The Act categorizes persons entitled to enter into *The Bahamas* into six main groups. These include Bahamian citizens, permanent residents, members of the diplomatic corps, persons employed by the Bahamian government, spouses and children of persons in the previous categories, and persons immigration officials are authorized to treat as so entitled. With particular reference to residential status, persons are categorized as either

- permanent residents; or
- spousal residents; or
- resident cardholders; or
- holders of work permits.

Applicants for permanent residency should normally be over 18 years old, of good character, in good health, mentally and physically. The applicant should also state his/her intention to reside permanently in *The Bahamas*. Also, given that permanent resident status may be granted with the condition that the applicant not engage in gainful employment, such applicant must also satisfy the *Immigration Board* that he/she is able to maintain him/herself in *The Bahamas* as well as any accompanying dependants. Finally, an application for residency may not be approved if the applicant is not perceived as offering or adding some benefit or enrichment to Bahamian society. Once granted, residency status continues for the duration for the applicant's lifetime unless revoked.

The Act also envisions situations where an applicant for residency is married. In those circumstances an endorsement may be made on the permanent resident's certificate. Alternatively the Act appears to provide for the submission of a resident spouse permit (*Regulation 3, Immigration Regulations*). Such permit allows for the spouse of a person, resident in *The Bahamas*, to be granted the equivalent status.

Pursuant to *section 11* of the *International Persons Landholding Act*, **non-Bahamians who own a home in the islands are entitled to apply to the *Director of Immigration* for an *Annual Home Owner Resident Card***. This permit allows the applicant, his/her spouse and minor children to enter into and remain in *The Bahamas* for the duration of the card unless otherwise prohibited. Under this provision the applicant does not become a resident, but is given leeway to enjoy what may be a second home without having to relocate permanently.

The provisions of the *Immigration Act* do not distinguish between skilled and unskilled employees. *Section 30* of the Act allows for the grant of a work permit to persons already possessing resident status in *The Bahamas*. A work permit may also be granted to persons, allowing their admittance into *The Bahamas* to undertake a particular job. The work permit as issued may specify the occupation the holder is authorized to perform. Where persons who have been admitted to perform a specific function are no longer employed by that company, the work permit is revoked, removing authorization to remain in the jurisdiction.

8.2 Tax residence

The Bahamas is primarily a 'tax-free' jurisdiction. **In that regard there are no income taxes, whether personal or corporate, no sales taxes, no gift taxes and no inheritance taxes**. Subsequently permanent residents need not comply with any rules or prerequisites to be resident for tax purposes.

The system of taxation in *The Bahamas* is such that an estimated 60% of the government's revenue is generated through custom import duties. Additionally stamp duties are payable on certain instruments and transactions, including the sale of real estate. Another means of revenue is by virtue of an annual real estate tax, which is subject to certain exemptions, and is based on the assessed value of the real estate. A nominal departure tax of B$ 15 is payable at every port, via air or sea, as persons leave the jurisdiction. Various transactional and filing fees are also a means of revenue for the government. Examples of such fees include business license fees, and annual corporate registration fees. Both Bahamian and non-Bahamian residents are required to pay the applicable taxes and fees.

8.3 International taxation for residents of The Bahamas

In the wake of the **OECD initiatives of recent times, *The Bahamas* has entered into the *Tax Information Exchange Agreement (TIEA)* with the *United States of America***. This agreement was approved by the *Bahamian House of Assembly* on December 15, 2003. It was enacted as law on December 22, 2003, and certain of its provisions came into effect January 1, 2004. The effective provisions are for the exchange of information in criminal matters. The provisions relative to civil matters will be effective January 1, 2006. Neither the criminal provisions nor the civil provisions, when they become effective, are retroactive.

There have been no similar agreements with other nations at the time of writing.

9 Checklist: Real estate acquisition in The Bahamas

- Real estate acquisition by foreigners requires *Investment Board* approval or registration, and *Central Bank* approval for the purpose of bringing money into the country for purchase and to repatriate sale proceeds on any future sale ('investor status').
- Purchase has to be registered or a permit obtained in advance of purchase under the *International Persons Landholding Act.*
- Purchaser has to undergo verification procedures under the Know Your Customer guidelines.
- A title search should be carried out by a lawyer.
- Title insurance is recommended.
- Stamp duties upon purchase can be considerable, therefore it is sensible to calculate in advance the amount payable.
- If required, apply for an *Annual Home Owner Resident Card.* The card guarantees that its holder may enter and stay in *The Bahamas.*

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Contents: Canada

1 Introduction

In 1930, *Ontario* passed legislation that provided for persons engaged in the **trade in real estate** to register as a real estate broker. Today, it is not possible to act as a real estate broker/agent in *Canada* without meeting provincial or territorial statutory requirements, including the registration of the real estate broker and salesperson/agent, the disclosure of the agency relationship, and also the agent's right to sue for commission or other remuneration for services rendered as an agent in connection with a trade in real estate. Historically, the relationship between a salesperson (the **agent**) and an owner (the **principal**) was based on the agent offering assistance to the owner to sell the owner's real estate. However, we now find across *Canada* a highly regulated and pervasive system of **listing agents** who list real estate for sale with the local Real Estate Board's **multiple listing system** (MLS) and **buying agents** working with the listing agents to conclude an agreement for the purchase and sale of **real estate** (land or property) between a **buyer** (purchaser) and a **seller** (vendor).

The **listing agreement** is usually a standard form prepared by the local Real Estate Board and is based on the *common law* principle that an agent is authorized by the principal to provide certain services on his/her behalf, but must also include certain information that is prescribed by provincial and territorial statutes. One of the most significant aspects of this system of cooperative open listing information (which is not directly accessible to the general public) is that, in most instances, the buyer agrees that the broker is to be compensated through the listing broker as provided for on the MLS.

This arrangement has led to a very effective system based on professional conduct and mutual respect among real estate brokers/agents, and has made it possible for listing brokers to charge an average of a 6% **commission** of the sale price for the purchase and sale of residential properties, and more or less in the range between 2% to 10% depending on whether the real estate is a rural property, such as a cottage or farm (not more than 10%), or an industrial or commercial property (not less than 2%).

In *Canada*, real estate brokers generally try to cooperate with **lawyers**. It is the responsibility of a lawyer to **close** the real estate transaction and ensure that the monetary arrangements have been fulfilled and that each party has completed the covenants in the agreement of purchase and sale, including the transfer of title to the property. Lawyers in *Canada* provide to their clients a formal opinion with respect to the conveyance of the title of the real estate and a report on other conveyance services performed by the lawyer on behalf of his/her client. Only in *Quebec* are **notaries** involved in the closing of real estate transactions. In the rest of *Canada*, notaries have a limited role as commissioners of affidavits or providing authentication of documents.

Lawyers are retained by their clients pursuant to a **retainer agreement** which will outline the legal services to be performed by the lawyer and will confirm the fee arrangement, which may be a fixed fee based on a percentage of the purchase price or may be based on a time spent basis, with the lawyer setting out his/her hourly rate plus disbursements, which generally include photocopy charges, long-distance charges, courier charges, search fees, plus *Goods and Services Tax* (*GST*), and fees charged by title searchers, government registration fees and, recently, title insurance fees.

2 Real estate ownership

When *England* divided the colony of *Quebec* into *Upper Canada* and *Lower Canada*, the *Constitutional Act 1791* stated that all future land **grants from the Crown** in *Upper Canada* were to be in free and common soccage. Even today all land is owned, in theory, by the *Crown* in the right of the applicable province/territory, and individuals do not hold absolute private ownership in land. It is necessary to review the original *Crown* patent which may contain conditions and **reservations** such as the rights to minerals, timber and road and shoreline allowances as well as the bed of navigable water or streams running on the land.

2.1 Different forms and types of ownership

The owner's interest in land is documented in his/her legal title to land and may be separated into two basic categories: (1) that of an estate in fee simple or **freehold** title; and (2) that of a leasehold estate or **leasehold title**. Furthermore, whereas an **estate in fee simple** is an absolute grant in perpetuity, a **life estate** is a disposition of real estate designed to provide for a succession of persons, such as the present and future members of a family. The life estate comes to an end upon the death of the life tenant, and exclusive possession reverts back to the original grantor or passes to another person. Similarly, leasehold title estates provide that a tenant or lessee has the exclusive right of possession subject to certain contractual terms and conditions, and may run from year to year or month to month or for a fixed term.

The fee simple interest is the legal estate and includes certain equitable rights, and whereas a legal estate is a right *in rem* (enforceable against the whole world), an equitable estate is a right *in personam* (enforceable only against a limited number of persons). **Equitable interests in land** may be enforced against the owners of legal title and include such interests as easements, encumbrances, statutory charges and liens, options and rights of first refusal, restrictive covenants, and rights of way. This multitude of interests in real estate allows for the creation of various structures in ownership that generally may be determined by agreement among various parties, but also are regulated by law.

Whereas land may be owned in 'sole ownership', or 'in trust' for a beneficiary, or 'to uses', land may also be owned concurrently by multiple parties in the form of a 'joint tenancy', a 'tenancy in common', or a cooperative ownership or a partnership ownership, or also more regulated forms of ownership such as a condominium or timesharing, or even in the form of a more recent investment structure known as a real estate investment trust (REIT).

During his/her lifetime, an owner of real estate may transfer his/her ownership either by agreement of purchase and sale or by way of an *inter vivos* gift and, upon the individual's death, either intestate or by testamentary grant. Title may also be transferred by possession, operation of law or court order.

A **condominium** combines both individual ownership and shared ownership. The concept of a condominium is well known and was introduced in *Ontario* in 1967. Today almost 40% of new construction in *Toronto* is in the form of condominium development. *Ontario* introduced a significantly revised *Statute* governing condominiums in December 1998. All provinces and territories in *Canada* have their own specific condominium legislation; however, they generally follow the principles set out in the *Ontario* legislation. A buyer of a condominium

unit in effect owns a fee simple estate in the unit as well as a fee simple estate as a joint tenant of such common areas as parking or recreational facilities, lobbies and hallways, elevators, foundations, common walls and roofs as well as a share in a condominium corporation that manages the condominium development. Most of the changes introduced by the *Ontario* legislation deal with expanded possibilities for condominium structures and improve the disclosure requirements enhancing consumer protection.

Upon entering into an agreement of purchase and sale, a buyer of a condominium is entitled to receive a 'current disclosure statement'. This **disclosure statement** will contain specified information including: a table of contents; details regarding the legal structure and organization of the condominium; a statement as to whether the proposed units and common elements are to be registered in the *Ontario New Home Warranties Plan Act*; a budget statement; a statement setting out the fees or charges, if any, that the condominium corporation is required to pay to the declarant or any other person; and other prescribed information. A buyer having received the disclosure statement has a period of 10 days to review the material and decide whether he/she wants to proceed with the purchase.

2.2 Easements, charges, liens and mortgages

Potential claims that may form a **charge** against the ownership of real estate are commonly known as liens, but other encumbrances may arise, for example, upon bankruptcy or by way of a writ of execution filed with the sheriff.

In some jurisdictions in *Canada*, an interest in real estate may be acquired by way of **adverse possession**. Adverse possessory rights may be claimed by an adjoining owner, if he/she can demonstrate that for a 10-year period he/she has occupied the land and this was not disturbed or challenged during this time by the owner of the land. A permanent **easement**, in turn, may be acquired if, for a period of 20 years, without consent, an adjoining landowner makes use of certain interest in land; for example, a right to drain water across a neighbor's land or a right to have a roof extended over the neighbor's property. Easements may also be created by agreement; for example, an owner of real estate may grant his/her neighbor a right of way over his/her land.

Whereas easements are frequently used to regulate such common uses as mutual driveways, common party walls, access to lake frontage, or utility easements that may provide for hydro lines or gas pipes, underground sewer or water lines, **restrictive covenants** are frequently used in land development agreements.

Another form of encumbrance of the interests of an owner in real estate are **security interests**, either in the form of a **charge/mortgage** registered against the title of the real estate or a security interest in certain personal real estate which may be registered pursuant to a provincial personal property security registry system.

2.3 Protection of ownership, proof of ownership and registration

The first registry system in *Canada* was created in 1795 by the parliament of *Upper Canada*. Today, this system of municipal public land registry offices is still in place; however, with the development of microfilm technology and the internet, it is now possible in certain jurisdictions to access the applicable land registry system electronically rather than

physically attending at the land registry office. If an instrument that did not necessarily relate to a particular piece of land was deposited, this would be registered in the general register which contained a power of attorney index, a wills index and a general deposit index.

The **registry system** requires that a 40-year search of past registrations in relation to a particular piece of land must be conducted each time before real estate is transferred. In 1885, *Ontario* introduced the land titles system which, rather than producing an inventory of instruments affecting title, is a system whereby the local land titles municipal office issues a statement as to the title registered in connection with a certain parcel of land.

With the introduction of the land titles system, which is based on the ***Torrens system*** developed in the 1850s in *Australia* and is also used in most western provinces of *Canada*, a government guarantee of title provided easy access and certainty with respect to identifying ownership and any other rights that may affect the title to the real estate. The **land titles system** maintains a general register wherein all dealings affecting a parcel of land are recorded, as well as a leasehold register, a highway register, the *Trans Canada Pipeline* register, a powers of attorney register, the execution book and a register under the *Condominium Act*.

Although the land registry systems are maintained by local government offices, they still require that legal instruments be prepared and registered by the public. This process is generally described as **conveyance** and is conducted by lawyers, with the assistance of paralegals and conveyancers. However, before an interest in real estate is conveyed by a seller to a buyer, the parties must have reached an agreement to do so. Usually, a contract for the sale of real estate precedes the conveyance of the legal title to the buyer. There are in effect two distinct stages involved in a transfer of an interest in real estate: first, the agreement between the parties that determines the interests that are to be transferred; and, second, the conveyance of that interest by way of registration in the local registry office.

3 Purchase and sale of real estate

3.1 The sales agreement

The *common law* of contract is the basis for a transaction involving an interest in real estate. An offer/agreement of purchase and sale is usually negotiated until one party's offer is accepted by the other. Only when an offer has been accepted without changes will an agreement or contract have been formed. A contract does not exist until there has been a definite offer and an **unconditional acceptance** of the offer communicated to the offeror. Before a court will find that an agreement is enforceable, it will require that the parties have concluded their negotiations and settled not just the price but all terms of their agreement.

Another essential element of the formation of the agreement is that it must be **in writing**. All provinces and territories have re-enacted the *English Statute of Frauds* legislation except *Manitoba*, which has repealed the *Statute*, and *British Columbia*, which has its own legislative scheme. The British Columbia legislation recognizes the possibility of part performance and demands less in terms of an agreement reduced to written form. There are no formal requirements with respect to **execution** other than the requirement that signatures of individuals must be witnessed. It is accepted practice that offers and the acceptance thereof may be sent by facsimile or other electronic means.

There is no legal requirement that a seller and buyer deal directly with each other. Agreements, in the *common law* jurisdictions, are not concluded before a notary. Instead, the process of presenting offers, especially for residential properties, is managed by real estate agents but before a seller and buyer conclude the agreement they also involve their respective lawyers.

3.2 Restrictions on sale and acquisition

All standard form agreements deal with certain statutory restrictions that limit a seller's ability to sell his/her real estate, which include family law issues, control of subdivision provisions and the residency status of a seller.

3.2.1 Restrictions under family law and matrimonial property regime

In *Ontario* and the other provinces and territories in *Canada* there are certain family law requirements with which spouses must comply before they can transfer or encumber an interest in a matrimonial home. The *Family Law Act (Ontario)* provides that each spouse has an equal right of possession in the **matrimonial home**, irrespective of registered or beneficial ownership. Furthermore, a spouse has a special possessory right in the matrimonial home which is triggered on marriage breakdown or on the death of one of the spouses.

3.2.2 Options and pre-emption rights

Section 14 of the standard form agreement of purchase and sale used in *Ontario* contains a further statutory limitation regarding the disposition of real estate. *Ontario* introduced the *Planning Act* in 1946, providing that local planning boards (now committees of adjustment or land division committees) were to decide upon applications to sever existing lots of land, particularly in rural areas; whereas municipal councils were given the power to enact **zoning by-laws** to regulate the use of land within developed areas. Effectively, in the event that an owner wishes to convey a parcel that is not within the prescribed conveyances of the *Planning Act*, it will be necessary to obtain a consent or **severance**. Similar restrictions were also introduced in the other provinces of *Canada*.

Aside from the above-noted statutory restrictions on the disposition of an interest in real estate, it is possible that the granting of an option to purchase or a right of first refusal or a right of repurchase may also operate as a restraint on the alienation of real estate. In effect, upon the buyer electing to exercise the option, the option agreement becomes an agreement of purchase and sale.

Rights of first refusal differ from **options** as the seller is not obligated at any point to offer the real estate and, if the real estate is offered, the buyer is not obligated to accept the offer. Therefore, first rights of refusal are contractual, but do not create an interest in land, although they may be regarded as having similar attributes to an interest in land. Only upon the triggering event which gives rise to the right does a first right of refusal convert to an option, and it is at that time that an equitable interest in land is created.

3.2.3 Agricultural real estate

Many rural properties in *Canada* are not connected to a municipal water system, and it is therefore necessary to determine whether well water meets certain minimum requirements: regarding the quality of the water or its potability; the pressure of the water flow; the capacity of the well; and the overall operational efficiency of the well. Local health authorities will provide testing facilities to determine potability, and it is possible to inquire whether the local health authority has issued any orders regarding a well.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

Five out of the 10 *Canadian* provinces do not have any restrictions with respect to filing requirements or ownership of real estate by foreigners. *British Columbia* and *Prince Edward Island* have filing requirements. The western provinces, *Manitoba, Saskatchewan* and *Alberta* have filing and ownership restrictions. For example, in *Manitoba* only a *Canadian* citizen or permanent resident, or a qualified immigrant who intends to become an eligible individual within two years after acquiring farmland, is permitted to purchase an interest in farmland; in *Saskatchewan*, non-residents cannot own or acquire aggregate farm lands with an assessed value for municipal tax greater than Can$ 15,000, excluding any assessment for buildings and similar improvements; and in *Alberta*, the registrar can refuse to register a land transfer if it is not accompanied by a statutory declaration containing prescribed information.

In addition, *Crown land* may not be sold to non-*Canadian* citizens or non-*Canadian* corporations.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

Generally, in *Canada*, lawyers get involved in real estate transactions at an early stage and commonly assist sellers in the negotiation and conclusion of listing agreements and provide legal advice to the seller and buyer in connection with the offer/agreement of purchase and sale. The **seller's lawyer** has certain responsibilities such as preparing the transfer, statement of adjustments, direction regarding the payment of funds, responding to requisitions submitted by the **buyer's lawyer** and receiving payment of the purchase price on closing from the buyer in consideration for giving the transfer of the real estate to the buyer's lawyer so that he/she can attend to the registration on the title to the real estate. Lawyers have a duty to act in the best interest of their clients. Therefore, a lawyer acting for a buyer will not only search and give an opinion as to the title of the real estate, but will also conduct extensive due diligence on behalf of the buyer.

Having completed the **title search**, reviewed the adjoining lands, obtained an execution certificate and searched for any personal property security registrations, a buyer's lawyer must also be satisfied as to the corporate authority of a corporation selling property as well as the authority of an **attorney** acting under a power of attorney. Most standard form agreements of purchase and sale provide for the execution of the agreement to be **signed,**

sealed and delivered in the presence of a witness. The requirement of a seal stems from the *common law* requirement that a corporation executed a document not only by the authorized signing officer providing his/her signature but also by affixing the corporation's seal to the document. This old *English common law* rule has been changed in *Canada*. All business corporations legislation in *Canada* provides that a corporation need not execute an agreement by affixing its corporate seal. Pursuant to the **indoor management rule**, a corporation cannot deny a contract if it was signed by an officer or otherwise-authorized person in the ordinary course of the corporation's business.

The phrase **authorized signing officer** is only descriptive and does not confirm that the person has authority to sign for the corporation. The statement **I have authority to bind the corporation** together with the individual's title is sufficient.

Contrary to the practice in continental *Europe*, the **execution** of legal documents in *Canada* (except *Quebec*) is not conducted before a notary. Lawyers may upon application also become notaries. In the *common law* jurisdictions in *Canada*, notaries, when having an affidavit sworn before them, are required to administer an oath and satisfy themselves as to the genuineness of the signature of the deponent.

In *Ontario*, a buyer is required to file with the transfer an **affidavit of residence and value of consideration** Form 1 – *Land Transfer Tax Act*. A seller is required to deliver certain statutory declarations in connection with the possession of the real estate or other matters. A buyer's lawyer may be authorized to sign on behalf of the buyer the land transfer tax affidavit. If, however, closing documents are sent to persons residing in *Europe* the documents may be sworn as follows: (1) before an officer of any of the *Canadian* diplomatic or consular services who must impress the stamp of the office held on the document; or (2) a notary who must impress the official stamp on the document.

The *Ontario* form of affidavit is unique, and the usual statement of a notary confirming that he/she knows or has identified the party and saw the party sign the document is not acceptable for registration purposes. The notary should sign as 'witness', and the stamp of the notary should be placed underneath his/her signature.

A trustee who holds real estate may disclose the fact of the trust by using the word 'trustee' or 'in trust' after his/her name; however, it is possible that the trust relationship will not be disclosed in order to conceal the identity of the beneficial owner or to avoid the real estate vesting in a minor.

An extra-provincial license is required for a corporation incorporated in a foreign jurisdiction to carry on business including the ownership of real estate in *Ontario*.

3.3.2 Third-party claims and unpaid taxes

All municipalities in *Canada* assess and tax owners of real estate. Arrears in realty taxes take priority over any other encumbrances registered on title to real estate and if, after more than three years, an owner of real estate in *Ontario* has not paid the **real estate taxes**, the local municipality may proceed by public auction to sell the real estate. It is, therefore, standard conveyancing practice that, before a transaction involving real estate is completed, a search letter is sent to the treasurer of the municipality asking for a **tax clearance certificate**.

The buyer's lawyer must ensure that the outstanding arrears in real estate taxes and penalties to the date of closing are paid by the seller, or he must obtain an undertaking of the seller's lawyer to pay any taxes owing, pursuant to which the seller's lawyer will undertake to deduct the taxes owing from the balance of the purchase price due on closing and remit payment to the treasurer of the municipality. Real estate taxes are a **significant cost of ownership** of real estate. In *Toronto*, for example, the assessment of realty taxes was changed from a historical valuation to a fair market valuation which significantly increased the realty taxes payable by owners of real estate located in areas of the city that were developed some time ago.

Another important statutory **lien** and charge upon the interest of land of an owner or occupant/tenant is the charge for **services** such as water, gas and in some jurisdictions hydroelectricity supplied for the use on such land by a public utility. A lien for **public utilities** has the same priority as municipal taxes. Furthermore, the *Corporations Tax Act* provides for a lien for arrears of *Ontario* corporation taxes which may be enforced in the same manner as a writ of execution.

There are other statutory liens and charges that may effect the title to real estate, such as a contractor's right to register a lien, and a buyer is well advised to consult with his/her lawyer to obtain a complete understanding of the statutory liens that may arise with respect to his/her particular transaction.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Another area of concern to a buyer is the statutory obligations that may arise as a result of **the condition of the real estate.** In particular, the *Environmental Protection Act* provides that no person shall discharge into the natural environment any contaminant, and no person responsible for a source of contaminant shall permit the discharge into the natural environment of any contaminant from the source of contaminant, in an amount, concentration or level in excess of that prescribed in the regulations.

Although the potential liability arising out of environmental contamination is limited in residential or farm areas, it is of great concern in dealings with commercial real estate. Most provincial statutes dealing with environmental protection provide that the test for liability may be not just limited to the owner but may also extend to the person who has or has had charge, management or control of a substance. The *Environmental Protection Act* defines the **responsible person** as the owner, or the person in occupation or having the charge, management or control of a source of contaminant. The potential for liability that may arise in the case of environmental contamination is therefore not restricted to legal ownership but, in the case of a corporation, can be extended to parent companies being responsible for their subsidiaries on the basis that the parent company controls the actions of the subsidiary. Furthermore, the statutory provisions provide a potential for **liability for directors and officers** who authorize, acquiesce or participate in an environmental offence.

3.3.4 Access to relevant records and documents

The agreement of purchase and sale obligates a seller to convey ownership or title to the real estate sold to the buyer. The buyer will want to ensure that **title is good and marketable**. It is a matter of **disclosure and negotiation** as to what encumbrances, if any, a buyer will accept in connection with the seller's title.

Ontario prides itself on being the first jurisdiction in the world that has a land registry system in place that functions entirely by way of a **paperless electronic registry** called *Teraview Electronic System* (also known as *E-Reg*). The foundations for *E-Reg* were put in place in 1970 with the introduction of the Land Registry Information System also known as *Polaris*. The objective of *Polaris* was to provide for a province-wide system of electronic registration using a property identification number (PIN) to locate a particular parcel of land that may be accessed over the counter or from the internet through the *Teraview* website. *E-Reg* is the final stage of the conversion process from the registry system to the land titles system.

A buyer of real estate in *Ontario* may seek compensation as a result of a defective title as follows: (a) on the basis of a lawyer's professional negligence under the *Lawyers Professional Indemnity Fund*; (b) on the basis of an error or omission on the title registry under the *Land Titles Assurance Fund*; or (c) on a contractual basis pursuant to a title insurance policy.

E-Reg is a paperless system where documents are created, submitted and maintained as well as registered online electronically. In order to facilitate a closing electronically, lawyers are licensed to have access to *Teraview*, and are entitled to make the necessary statements of law in a document and, upon completeness, the document is released for registration by the respective lawyers. The process is structured in the form of the escrow closing, the terms of which describe a specific protocol and process pursuant to which the respective lawyers will proceed with the closing of the transaction.

3.4 Key points that a seller should consider

All standard form agreements of purchase and sale expressly provide that **time is of the essence**, entitling the parties to performance of the terms and conditions of the agreement within a specified time. As a result, a failure to comply with an obligation within the time provided is a fundamental breach entitling the other party to treat the agreement as at an end. If both parties agree that the specified time cannot be met, some standard forms authorize the seller and buyer or their respective lawyers to agree in writing to an extension. In the event no such agreement is forthcoming, the non-defaulting party that wishes to pursue an equitable remedy of specific performance must demonstrate that, as of the specified time, it was ready, willing and able to complete the transaction in accordance with the terms and provisions of the agreement of purchase and sale. A **tender** is not necessary if there is clear evidence that the defaulting party is not in a position to close the transaction. The alternative to a claim for specific performance is a claim for liquidated damages or a forfeiture of the deposit.

3.5 The execution of a real estate purchase transaction

It is recommended that a buyer avail him/herself of the right to inspect the real estate before closing. Lawyers will conduct the closing and prepare in anticipation of the closing a closing memorandum. Before the *E-Reg* system, lawyers or their respective conveyancers were required to meet in the land registry office on the date of the closing. The purpose of the personal attendance was to exchange all documents; for the seller's lawyer to receive the balance due on closing; and the buyer's lawyer to receive keys and to attend to the registration of the transfer and any mortgage documentation. The delivery of payment of the balance due on closing in the form of certified cheque or bank draft against keys would be subject to a short **escrow** pending confirmation of the registration numbers of the documents registered.

Provided the lawyers have exchanged the appropriate closing documentation, the closing can proceed subject to confirmation as to the receipt of the closing funds. The *Canadian* **banking** system does not facilitate the transfer of funds on an immediate confirmed basis, and therefore funds are usually sent by the buyer to the buyer's lawyer in trust, enabling the buyer's lawyer to forward the funds to the seller's lawyer's trust account in time for confirmation of receipt by the seller's lawyer on the date of closing. The terms of the escrow are summarized in an **Acknowledgment and Direction** which is signed by the client, authorizing the lawyer to complete the transaction and register the same electronically.

Prior to closing, the seller's lawyer will prepare a **statement of adjustments** identifying the purchase price and deposit as well as adjustments in relation to realty taxes, utilities and any other items such as rental deposits or financing. The seller will also provide a direction regarding the balance due on closing which will be forwarded by the seller's lawyer to the buyer's lawyer to issue the closing funds. The buyer's lawyer will advise the client of the **balance due on closing** as well as the payment of the land transfer tax and his/her fee and disbursements. After closing, the seller's lawyer will provide his/her client with a trust ledger statement identifying the receipt and disbursements of trust funds.

3.6 Powers of attorney

If a seller wishes to authorize the execution of a document to be registered in a land registry office, then he/she may execute a power of attorney appointing another person as his/her 'attorney' to execute documents on his/her behalf. Powers of attorney may be drafted to remain effective even if the grantor becomes incapable of acting on his/her own behalf. A power of attorney in *Ontario* must be executed by the grantor and witnessed by at least two witnesses and include a statement confirming that they are not the attorney, the spouse of the attorney or the grantor or a child of the grantor. Other provincial statutes provide for similar statutory forms of powers of attorney. Powers of attorney may be registered in the local land registry office general register. Powers of attorney do not survive the grantor's death, as the attorney has no more power or capacity to act than does the grantor. A power of attorney must include **specific language** to enable the attorney to offer and accept or negotiate an agreement of purchase and sale or otherwise deal in real estate in order to be effective in connection with real estate transactions. 'General' powers of attorney are not acceptable.

3.7 Financing

Most buyers of real estate finance the purchase by way of arranging financing either with a private or institutional lender. Canadian banks will provide a loan of generally up to 75% of the value of the residential real estate provided it is occupied by the owner as his/her ordinary residence and the owner can show sufficient income to service the **mortgage payments**. A person who intends to borrow money will submit an application for an approval of a loan to a lender. The lender will issue approval of the loan in the form of a commitment letter which will set out the contractual relationship between the borrower and the lender and provide for confirmation of the principal amount of the loan, the negotiated interest rate, the monthly payments, the period over which the loan is amortized, the maturity date at which time the amount of the principal outstanding must be repaid and fees charged in connection with the

loan. A loan may be drawn for a specific period of time or may be **open**. Furthermore, a loan to an individual that does not contain a prepayment privilege is repayable any time after five years provided the lender pays three months' interest.

A buyer of real estate who does not have sufficient income or is not resident in *Canada* may find it difficult if not impossible to obtain financing from a *Canadian* institutional lender.

Commercial properties are generally financed up to 60% of the value of the property providing the income of the real estate is sufficient to cover the mortgage payments. Personal guarantees from non-resident borrowers are generally not required as *Canadian* institutional lenders look primarily to the real estate located in *Canada* as security for the loan.

A lender will not issue a **loan commitment** to a borrower without having obtained its own independent appraisal of the real estate.

In *Ontario*, with the introduction of the *Land Registration Reform Act*, a registration of a charge/mortgage is an encumbrance on the legal estate of the chargor/mortgagor.

A lender who secures his/her loan by way of registration of a charge/mortgage against the title of the real estate of the borrower has certain **mortgage remedies**. The rights and obligations of a lender (chargee/mortgagee) and that of a land owner (chargor/mortgagor) are best discussed with a qualified lawyer. Generally, a mortgagee has the right to enforce his/her security either by way of a power of sale proceeding which would obligate the mortgagee to provide an accounting to the mortgagor and obtain the best price on the market or to proceed by way of foreclosure which would entitle the mortgagee to realize on the equity of redemption ultimately becoming the owner of the real estate.

3.8 Purchase through a company

Non-residents of *Canada* are subject to Canadian tax only in respect of their income from employment in *Canada*, business carried on in *Canada*, disposition of taxable Canadian property (capital gain) and certain types of income of a passive nature (interest or rental income).

For Canadian tax purposes, a limited partnership is not a taxable entity. The income or loss of the limited partnership is determined at the level of the limited partnership in accordance with Canadian tax rules, as if it were a separate person, but the income for tax purposes is allocated to the limited partner at the year end of the limited partnership and taxed in the hands of the non-resident earning Canadian income from real estate located in *Canada*.

The general partner of a limited partnership, being an *Ontario* corporation, is subject to Canadian tax on its worldwide income. However, the general partner may not have any income and may not be allocated any profits. It will be required to file at the very least a 'nil' corporate tax return.

Therefore, investing directly or as a limited partner(s) may be more preferable than through a corporation because direct ownership or the limited partnership structure permits Canadian rental income to be taxed only once in the hands of the individual or limited partner(s), whereas where an *Ontario* corporation is incorporated, a second level of tax arises on distributions by the corporation to its shareholders (i.e. first the tax payable by the corporation and, secondly, the withholding tax on the dividends paid to the non-resident shareholder).

However, an investor must also consider the consequences arising upon the disposition (including the deemed disposition upon death or a gift) of an investment in real estate in *Canada*. Therefore, before an overseas investor invests in Canadian real estate, he/she should consider not only limiting personal liability, the taxation of income and capital gains, but also estate planning issues.

Subject to the registration requirements, if the investor is a foreign corporation, this may provide additional tax or estate planning advantages.

3.9 Defects and warranty claims

Standard form agreements of purchase and sale will not only set out certain conditions that are fundamental to the completion of the agreement but will also provide for certain representations and warranties.

Representations are statements of fact that are important information that may have induced the buyer into entering into the agreement. Standard representations relate, for example, to the condition of the building on the land or the availability of a permit with respect to a dock or boathouse in connection with the purchase of a cottage.

A **fraudulent misrepresentation** will entitle the defrauded party to damages and/or a rescission of the agreement. A negligent misrepresentation made outside the written contract will not succeed unless there are special circumstances where a material false statement was made carelessly and there was a significant reliance by the other party on the statement which resulted in a loss.

A **warranty** is a covenant that would entitle a buyer to damages only and not to rescind the agreement. For example, most standard form agreements provide for a warranty with respect to whether a building has been insulated with insulation containing urea formaldehyde, which warranty survives and does not merge on the completion of the purchase transaction. A carefully written agreement of purchase and sale will limit the warranty to the period of time the seller has owned the property and exclude the ownership of the building by previous owners.

Buyers will try to protect against potential liabilities, for example, with respect to any environmental contamination, which may not be discovered during the **due diligence period**, whereas sellers seek to limit any post-closing obligations. Similarly, a buyer will request an unqualified representation and warranty with respect to regulatory issues such as compliance with rent control legislation or tax assessments, whereas a seller will try to limit his/her representations and warranties to limited statements within his/her personal knowledge.

Whereas in commercial real estate transactions lawyers would insist on representations and warranties regarding the seller's identity or corporate status, only with the introduction of the *E-Reg* system is there now a required warranty in *Ontario* as to the identity of the seller/mortgagor.

A buyer may also wish to be protected against the existence of a **patent defect** which would involve a visible deterioration of the structure of the building or roof as well as defective windows or doors. The *common law* doctrine of ***caveat emptor*** would be successfully argued if a visible inspection by a reasonably competent person would have revealed the

defect. **Latent defects**, which are problems only an expert may discover upon inspection, may also prove problematic for a buyer to raise in order to rescind an agreement. A **concealed defect**, however, does give the buyer the right to claim that the contract is void.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

In *Ontario*, as in most other provinces, land is subdivided by way of a registered plan of subdivision. When a municipality enters into a development agreement with a developer/builder, the municipality will impose certain conditions on the approval of the plan of subdivision. Generally, developers/builders will pay the charges in connection with the installation of services such as water mains, sewers, streetlights and sidewalks, as well as services to the building itself.

4.2 Architect's and building contracts

In *Canada* the services of both a professional design consultant and a general contractor are recommended to ensure proper completion of the construction of a new building. The relationship between the owner, the design consultant and the general contractor may be negotiated and agreed upon in the form of a simple letter agreement or set out in detail using a standard form contract. Architects and engineers are professional service providers subject to a professional code of ethics, and educational and licensing requirements administered by provincial self-governing associations.

An owner may enter into separate agreements with an architect or engineer respectively. The process of the construction of a building starts with the initial design phase, during which the design consultant prepares preliminary drawings which are used for the purposes of the selection of a contractor. Thereafter, the design consultant will prepare complete design and construction specifications and administer the progress and completion of the construction work including periodic inspection of the work, certification of progress payments and substantial performance of the work.

However, the services of the design consultant and the work performed by a general contractor are not always easy to determine. In effect, design professionals do not have to guarantee their services and are merely required to exercise reasonable judgment, competence and diligence. For example, the responsibility to review the design documents and report any errors or requirements for redesign may rest with the owner unless the contract with the contractor clearly stipulates that the contractor assumes a design risk or guarantees the work to be performed within a turnkey/build to suit contract. It is, therefore, important that the contract with the contractor clearly allocates the risk for inappropriate design or construction methods to the contractor and should also provide for a unit price for any additional work that may be required.

Architects and engineers carry **professional liability insurance** providing coverage for circumstances where they failed to exercise reasonable care in providing such services as: preparation of drawings and specifications; acting as payment certifier; interpreting

requirements of the construction contract and judging performance thereunder; and acting as decision maker in disputes. However, architects and engineers generally do not carry the complete control of the construction work and have therefore limited their responsibilities to a limited supervision and inspection of the contractor's work.

4.3 Completion of construction and formalities

In *Ontario*, as well as the other provinces of *Canada*, general contractors as well as any other supplier of materials or services to a construction project are able to enforce payment of any outstanding amounts by registering a lien against the title to the real estate. *Ontario* introduced its *Construction Lien Act* in 1983 providing for a statutory regime setting rules designed to protect persons who supplied services and materials to construction projects. A person who performed any work or services or furnished materials for a construction project will be entitled to register a lien within a period of 45 days once a certificate of substantial completion issued by an architect or engineer or the owner personally confirming substantial performance/completion of the project has been published.

A lien claimant is required to commence an action within a 90-day period after the work has been substantially completed in order for the lien to remain on title, and if after two years no other action has been taken, an owner may apply for the vacation of the certificate of action and a discharge of the lien. Therefore, in order to protect his/her interest in the land, an owner should insist that no payments be made to a general contractor while liens are registered against the real estate. The cost of the removal of any liens should also be the responsibility of the general contractor.

A further requirement provided for by the *Construction Lien Act* is the requirement that a certificate for payment of holdback monies be issued. The holdback amount is 10% of the amount owing until all liens have expired (i.e. 45 days after publication of the **certificate of substantial performance**). If a lien has been registered, the owner must retain sufficient funds to cover the lien and any costs associated therewith. The standard form construction contract provides that **holdback** monies be placed in a joint account which obviously creates certain difficulty for the owner, if he/she wishes to set off any holdback funds from claims he/she may have against the general contractor.

The construction of new buildings is regulated pursuant to a building code which sets minimum construction standards. These standards provide for efficiency in construction and the safety of a building. Prior to the construction of a new building or any changes to an existing building, the owner of the property must obtain a building permit from the building department of the local municipality. Building officials will inspect the construction of a building prior to occupancy and may issue work orders should there be outstanding work to be completed. Once the work is completed, notice must be given to the chief building official and, following an inspection, an occupancy certificate is issued enabling the owner to take possession of a new or renovated part of a building. Prior to purchasing real estate the purchaser should obtain a building clearance certificate to ensure that there are no outstanding work orders.

4.4 Deficiencies and warranty claims regarding new construction

A buyer of a new house will require the general contractor to fulfill the obligations of an owner under the *Construction Lien Act* and also act as the **constructor** under the *Occupational*

Health and Safety Act, as well as qualify under the *Ontario New Home Warranty Program*. In *Ontario* all builders/general contractors/developers must register under the program. The *Ontario* legislation requires each seller of a new house to warrant that the house: (a) is constructed in a good and workmanlike manner, free from defects in material; (b) is fit for habitation and is constructed in accordance with the *Ontario Building Code*; and (c) is free from major structural defects as defined by the regulations, and 'such other warranties as are prescribed by the regulations'. Under the *Ontario New Home Warranty Program*; a certificate of completion and possession will be issued to the buyer, which will form the basis of a warranty claim.

5 Rental and tenancy

All provinces and territories in *Canada* have passed legislation providing for comprehensive regimes governing the relationship between **landlord (lessor) and tenant (lessee)** both in the residential and, to a lesser degree, commercial context.

5.1 Rental and lease agreements

Whereas the terms of a residential tenancy are subject to the comprehensive regime set out in *Ontario* in the *Tenant Protection Act* (with similar legislation also passed in the other provinces and territories of *Canada*), the rights and obligations of commercial landlords and tenants are mainly a matter of contract (*common law*). Most agreements of purchase and sale involving the purchase of residential, commercial, industrial or retail property containing leased premises will set out numerous representations by the seller which must be reviewed by the buyer (and/or his/her lawyer) during the due diligence process in order to satisfy him/herself that the assignment of a lease is completed with the parties having a comprehensive understanding of the rights and obligations between landlord and tenant. The most common form of confirmation of the basic terms of a lease is by way of an **estoppel certificate**. The buyer will rely on the representations provided by the tenant in the estoppel certificate to determine that there is no dispute between the landlord and tenant with respect to the terms and conditions of the lease.

In *Ontario*, the *Commercial Tenancies Act* provides for certain minimum rights and obligations between a commercial tenant and landlord (many may be over-written by agreement between tenant and landlord). For example, a landlord may terminate a commercial tenancy for non-payment of rent on the sixteenth day after the day rent was due. In the alternative, a landlord may seize a tenant's property contained within the rented premises and may dispose of the seized property within five days without advance notice if not otherwise provided for in the lease.

Most residential or commercial leases are negotiated by way of **offers to lease** which contain the most important terms and conditions of the lease. A more formal lease is completed upon occupancy of the leased premises by the tenant. The offer to lease will focus on the following essential matters: a definition of the leased premises; the identification of the parties; the determination of the rent; the term of the lease; the commencement date; and such other material terms that may be particular to the relationship between the landlord and tenant (for example, leasehold improvements).

5.2 Regulations on protection of tenants and rent control

Ontario introduced its first rent control legislation in the mid-1960s. Until the *Tenant Protection Act* was introduced in 1997, landlords were not in a position to increase rent beyond a prescribed rate. The current legislation in *Ontario* regarding the security of tenure to residential tenants provides for two basic alternatives: either during the term of the tenancy, on the basis of termination for a cause, or at the end of the term, for 'no fault' reasons. An immediate termination of a tenancy is possible, for example, for **non-payment of rent**, illegal activity, disturbance, overcrowding or substantial interference with the rights of the landlord or other tenants.

A tenancy may only be terminated at the end of the term on 'no fault' grounds if the landlord requires possession of the premises for his/her own use. In the event that a tenancy is not renewed by an agreement between the landlord and the tenant, the tenancy continues on a month to month basis.

In 1998, with the passing of the *Tenant Protection Act*, *Ontario* liberalized its previously restrictive rent control legislation by moving from a rent based on the rental history of the residential premises to a system allowing for market forces to determine the rent, and only if a tenant continued to occupy the residential unit would he/she be entitled to the protection of the ***Rental Increase Guidelines*** which set an annual maximum of 4%. The maximum rent increase for 2004 is 2.9%. However, landlords are entitled to increase rents above the guideline in the event they can justify such increase as a result of major renovations or repairs or other improvements to the rental premises. If a tenant leaves the premises, then the rent that was negotiated no longer applies and a landlord is free to charge market rent. Rent increases are only possible after the expiry of a 12-month period and must be delivered by 90 days prior written notice to the tenant.

Any dispute between a landlord and a tenant is determined before the *Ontario Rental Housing Tribunal* which has the power to either mediate or adjudicate disputes between landlords and tenants.

6 Succession and gifts

6.1 Applicable law and jurisdiction

Private international law provides that succession to movable property is governed by the law of the last domicile of the deceased. Succession to immovable property is governed by the law of the place where the real estate is situated.

All provinces and territories in *Canada* have passed legislation dealing with the conflict of laws and provide for the **recognition of foreign wills**. However, only *Ontario, Manitoba* and *Newfoundland* have extended recognition of wills made in the foreign jurisdiction to include not only the disposition of movable property but also real estate.

All provinces and territories in *Canada*, including *Quebec*, have passed legislation dealing with the **formal requirements** of making a last will and testament ('will'). The English requirement that a will be in writing and must be executed by the testator and two witnesses has been uniformly adopted by the Canadian provinces and territories.

Any person who is mentally competent and at least 18 years old may act as a witness to a will. However, beneficiaries or spouses of beneficiaries should not act as witnesses. The executor (**estate trustee** or liquidator) is competent to witness a will provided he/she is not a beneficiary. It is not necessary that the testator and witnesses initial each page of the will. It is, however, necessary that the testator sign at the end of the will in the presence of the two witnesses and the two witnesses both sign after the testator in the presence of each other. Standard practice is for the testator to initial each page of the will.

It is also possible to enter into an **international will**. However, not all Canadian provinces have passed into law the *Uniform Law on the Form of International Will* as adopted by the 1973 Diplomatic Conferences on Wills in *Washington, DC*. Only *Alberta*, *Manitoba*, *Newfoundland*, *Ontario* and *Saskatchewan* recognize international wills. In order to meet the requirements of formal validity, an international will must be in writing and the testator must sign the will in the presence of two witnesses and at least one witness must attest to the execution of the will.

A **holograph will**, written in the testator's own handwriting and dated and signed by the testator, does not require a witness and is recognized in most of *Canada*.

In *Canada*, court offices have a **system of safe keeping** of original wills. However, this service is not widely used and a more likely location for the safe keeping of an original will is with a lawyer, with a copy being kept by the client in a safety deposit box. An executor may be informed by a testator of his/her appointment and may also be given a copy of the testator's will.

6.2 Fundamentals of the succession and gift/donation laws of Canada

Canadian laws, as they relate to estate matters, are very different from the laws of continental *Europe*, and this may lead to some unforeseen complications, especially if real estate is part of the estate of the deceased. Therefore, any buyer/owner of real estate in *Canada* is well-advised to become familiar with some of the more common forms of estate planning, including a disposition of real estate either by *inter vivos* gift, declaration of trust, an assignment to a joint tenant or a last will and testament.

A **gift** is an irrevocable transfer of real estate by a donor to a donee for no consideration with the intention that the donee own the real estate. Although there is no required form, a written deed of gift should identify the donor making the gift, the donee accepting the gift and provide for the irrevocable transfer of the real estate for no consideration.

A donor may gift real estate during his/her lifetime not only for **estate freezing** or **income splitting** purposes but also to minimize or avoid estate administration requirements, including probate court fees. The donee, in effect, acquires the real estate at the same cost as the donor's proceeds which are deemed to be equal to the fair market value of the real estate.

Trusts are most commonly created by a written declaration of trust which provides that a **settlor** (the owner of the real estate) transfers the real estate to a **trustee** to hold the real estate for the benefit of a **beneficiary** (the *cestui que trust*). The trustee may therefore hold the legal title to the real estate for the benefit of an undisclosed beneficiary. The trustee has the duty, enforced by courts of equity, to use his/her nominal ownership and control of the trust property for the benefit of the *cestui que trust*.

A **joint tenancy** involves the registration of the ownership of real estate in the names of two or more persons as joint tenants. Jointly held real estate has the benefit of not forming part of the estate of a deceased person; instead, the surviving joint tenant becomes the sole owner by reason of survivorship.

The *Civil Code of Quebec* to some extent follows the continental *European* statutory codes by providing that every successor may accept a succession and become an heir inheriting all the rights and obligations of the deceased. The successor has six months in which to decide to accept all the assets and debts of the deceased. *Quebec* follows the civil law principle that the opening of a succession is the legal principle pursuant to which property is transmitted to the deceased heirs which coincides with his/her date of death. The role of the liquidator is to liquidate the succession, and in the event there is no will, the selection of the liquidator is done by the heirs. The liquidator will determine the content of the succession and pay the debts of the deceased.

The other provinces, which are *common law* jurisdictions, follow a different regime. For example, in *Ontario*, the *Estates Administration Act* provides that when a person dies in *Ontario*, all his/her property **vests** in the person's personal representative (also referred to as an executor, administrator or estate trustee) to pay debts and distribute the remaining estate to the beneficiaries. All real estate situated in *Ontario*, whether owned by a person resident in *Ontario*, domiciled in *Ontario* or not, must be **administered** in accordance with the *Ontario* statutory regime.

In *Ontario* it is necessary to obtain **probate** (i.e. a certificate confirming the appointment of an estate trustee), if the value of the real estate is more than Can$ 50,000, if the real estate is registered in the land titles system, or if there is intestacy.

In order to obtain probate, the will must have been executed in the manner and form required by the will statute of the province. In the case of where a person dies without leaving a will, upon application by an interested person to the court, an administrator will be appointed to perform the duties and responsibilities of the estate trustee. The estate trustee must pay all debts and distribute the property of the deceased in accordance with the provincial succession laws.

Canadian succession laws do not recognize a minimum entitlement, i.e. there are no forced heirship provisions. However, if a person dies intestate and only his/her spouse survives leaving no issue, then the surviving spouse is entitled to the entire estate. Where a person dies intestate and leaves a spouse and one child, the spouse is entitled to a preferential share of Can$ 200,000 (in *Ontario*) and to one-half of the remaining property with the child taking the other half; where there is more than one child the spouse is entitled to one-third of the remaining property and the children share the other two-thirds with the issue of a predeceased child taking the child's share per stipes.

In *Canada,* spouses are protected by a statutory community of property regime which is subject only to the terms of a domestic agreement. In effect, the rights of a testator to provide for the distribution of his estate is unlimited (in most provinces) and the special rights of the surviving spouse or those of dependants who require support are limitations on the **testator's freedom of testamentary disposition**.

The surviving spouse must decide within six months of the death of the deceased spouse, to elect an equalization share pursuant to the *Family Law Act* or accept the dispositions in the

will of the deceased spouse or accept his/her entitlement on an intestacy. The conveyance of the real estate as provided for in the will or pursuant to an intestacy would be carried out by the estate trustee and the surviving spouse would be entitled to a cash equalization payment if he/she elected his/her share of the net family property and this was more than had been provided for in the will or intestacy. Only if both spouses maintain a common habitual residence outside of *Ontario* do the provisions of the *Family Law Act* not apply.

The other statutory limit on the distribution of an estate in *Ontario* (and other provinces) is that if the deceased does not provide adequately for the support of his/her dependants, the court in *Ontario* has broad power to order that provisions be made out of the estate of the deceased for such support.

A **certificate of appointment of estate trustee** does not contain a complete detailed list of the value of the estate of the deceased. In order to obtain a complete inventory of a deceased's estate and confirmation regarding the receipts and disbursements of capital and revenue, it is possible for a beneficiary to obtain an order for a statement of assets or further particulars. An estate trustee may be required 'to render a just and full account' before the *Ontario* court which will confirm: the allocation of receipts and disbursements of capital and revenue; the original assets of the estate at the time of death and any investments made by the estate trustee; and any fees, compensation and taxes paid and the distribution of the capital and revenue of the deceased's estate. In the event that the estate trustee does not provide a complete and satisfactory accounting, beneficiaries may force the **passing of the accounts** of an estate.

Upon making an application for a certificate of appointment of estate trustee, the estate of the deceased will be required to pay not only the fees of the estate trustee and professional fees but also an estate administration tax (**probate court fees**). In *Ontario*, the tax is based on the gross value of the deceased's assets: the amount of tax payable under the issuance of an estate certificate for which application is made after June 7, 1992, is (a) Can$ 5 for each Can$ 1,000 or part thereof of the first Can$ 50,000 of the value of the estate; and (b) Can$ 15 for each Can$ 1,000 or part thereof by which the value of the estate exceeds Can$ 50,000.

A non-resident who owns real estate in *Ontario* that is registered in the land titles registry system may make a will dealing specifically with a testamentary disposition of a real estate in *Ontario* and thereby limit the estate administration tax that will be payable on the application to the court for a certificate of appointment of estate trustee to be based on the net value of the real estate situated in *Ontario*. Therefore, if, for example, the value of the real estate is Can$ 1,000,000, the estate administration tax that must be paid to the *Minister of Finance* of *Ontario* at the time of the issuance of the certificate by the court is Can$ 14,500.

The probate court fees in other provinces of *Canada* are also calculated pursuant to the value of the estate and vary from province to province with *Quebec* being the most attractive at a flat rate of Can$ 45 regardless of the value of the estate. The fees on an estate of Can$ 1,000,000 in the other provinces are as follows: *British Columbia*, Can$ 13,658; *Alberta*, Can$ 4,000; *Saskatchewan*, Can$ 7,000; *Manitoba*, Can$ 5,990; *New Brunswick*, Can$ 5,000; *Nova Scotia*, Can$ 12,645; *Prince Edward Island*, Can$ 4,015; *Newfoundland*, Can$ 5,075.

In *Ontario*, a trustee is entitled to 'such fee and reasonable allowance' for the care, pains, and trouble, and the time expended in and about the estate as may be allowed by a judge of *Superior Court of Justice*. The *Ontario* rates of **compensation for an estate trustee** as

set by the *Ontario* court are equal to 5% of the gross value of the estate; based on 2.5% of the revenue and capital receipts and 2.5% of the revenue and capital disbursements. Where there are ongoing trusts the compensation for 'care and management' is based on a fee of two-fifths of 1% (0.4%) per annum allocated on the basis of two-thirds to the capital account and one-third to the revenue account. It is not unusual for professional estate trustees to negotiate higher compensation.

An estate trustee may be required to retain the services of various professional advisers including the **assistance of a lawyer**. The estate trustee has the overall responsibility for the administration of the estate. A lawyer may be required to assist the estate trustee in almost all aspects of the administration of the estate, including the filing of court documents and transfer documents in the land registry/titles system.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

Both the federal government and the provincial governments impose taxes that may be applicable at the time that a transfer of real estate is registered.

7.1.1 Real estate transfer taxes

In *Ontario*, the *Land Transfer Tax Act* provides that the prescribed rate of tax is payable on a 'disposition of the beneficial interest in land'. Not included is a vesting of land in a trustee pursuant to a will or a transfer of beneficial interest arising from the death of the registered owner. In order to determine the value of the consideration for purposes of calculating the **land transfer tax**, a buyer must file with the transfer an 'Affidavit of Residence and of Value of the Consideration'. The prescribed rate of tax for the disposition of land except single family residential properties is 0.5% of the first Can$ 55,000, 1% of the next Can$ 195,000 and 1.5% of the balance of the value of the consideration over Can$ 250,000. The tax payable for a single family residence with a value of consideration of Can$ 500,000 is Can$ 6,475 (i.e. $500{,}000 \times 0.02 - \text{Can\$ } 3525 = \text{Can\$ } 6{,}475$; rate applies to values over Can$ 400,000).

7.1.2 Sales tax (value added tax)

On January 1, 1991, the federal government introduced the *Goods and Services Tax (GST)* which applies to goods and services provided in *Canada*. The *GST* is calculated at a rate of 7% of the value of the goods and services and is also applicable to the sale of real estate situated in *Canada* subject to certain **exempt supplies** of real estate. For example, the sale of used residential real estate is exempt.

7.1.3 Real estate registration and notary charges

Lawyers' fees in *Canada* are determined on a *quantum merit* basis, taking into consideration the time and effort required and spent, special skill and services provided, and may also take into consideration the value of the real estate, the results obtained and any other special circumstances. Most lawyers in *Ontario* will charge an hourly rate for general real estate

services. For the transfer of real estate, lawyers (or notaries in *Quebec*) may enter into a fixed fee arrangement. Upon registration, local land registry offices charge minimal document registration fees, for example, less than Can$ 100 per document in *Ontario*.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

In January 1998 *Ontario* changed its **realty tax assessment** to a system based on the current market value of the real estate. The Municipal Property Assessment Corporation is a municipal corporation that works with the local municipalities to establish the municipal realty taxes payable by owners of real estate located in *Ontario*. For example, the owner of a residence valued at Can$ 500,000 will be required to pay in mid-*Toronto* approximately Can$ 5,000 (which includes approximately Can$ 1,750 educational tax) in annual realty tax. Similar municipal realty tax assessments are applicable throughout *Canada*.

7.2.2 Income tax

Canada taxes individual's resident and corporations incorporated in or controlled and managed from *Canada* on their worldwide income. Non-residents are taxed only on *Canadian* sourced income. The *Income Tax Act* does not contain a definition of **residence**. An individual will be deemed to be a resident in *Canada* for the entire year, if the individual 'sojourns' in *Canada* for 183 days or more in a year. *Part 1, Division E*, of the *Income Tax Act* sets out the computation of the marginal rates payable by individuals. The provincial income tax rates are determined separately and are added to the federal rates to arrive at various combined marginal rates as shown in Table 1.

If a non-resident decides to acquire an indirect interest in *Canadian* real estate through a *Canadian* corporation, the income of the non-resident controlled corporation will be taxed as shown in Table 2.

Table 1 Current Combined Federal and Provincial Personal Top Marginal Tax Rates

Jurisdiction	**Regular income/(%) over Can$ 113,804**
Alberta	39.00%
British Columbia	43.70%
Nova Scotia	47.34%
Ontario	46.41%
Quebec	48.22%
Non-resident	42.92%

2004 Federal/*Ontario* personal tax brackets

Taxable income	**Federal tax**	**Add *Ontario* tax**
Can$ 35,000 or less	16%	6.05% on first Can$ 33,375
Can$ 35,001 to 70,000	22%	Plus 9.15% on next Can$ 33,377
Can$ 70,001 to 113,804	26%	Plus 11.16% on over Can$ 66,752
Can$ 113,804 or more	29%	Total combined max. 46.41%

Table 2 2004 Non-*Canadian* controlled corporate income tax rates

Jurisdiction	Investment income/ Combined rate
Basic federal	24.12%
Alberta	34.62%
British Columbia	35.62%
Ontario	36.62%
Nova Scotia	38.12%
Quebec	38.37%

7.2.3 Net wealth tax

Neither Canada nor the provinces and territories impose a **wealth tax** on individuals.

Some *Canadian* provinces and also the federal government levy a capital tax on large corporations. In 2004, the federal capital tax is applied at the rate of 0.175% on capital in excess of Can$ 50 million. The calculation of the taxable capital differs from province to province.

7.3 Capital gains tax

A non-resident person who disposes of 'taxable *Canadian* property' as defined in the *Income Tax Act* is required to file a *Canadian* tax return to report the disposition of the real estate and pay tax on any resulting **taxable capital gain**. The capital gain is calculated using the value of consideration on the sale less the original purchase price (adjusted cost base) and any expenses. In October 2000, the inclusion rate of a capital gain was reduced from 66% to 50% so that currently only **50% of the capital gain is included in the taxable income**. A non-resident who disposes of real estate in *Canada* will be subject to tax on the taxable gain on the same basis as a resident of *Canada*.

Any capital gain arising on the disposition of a principal residence by a resident individual taxpayer is exempt from tax under the *Income Tax Act*. Interest payments and other expenses, including improvements, are not deductible from the taxpayer's income.

When a non-resident person disposes of taxable *Canadian* real estate which includes real estate situated in *Canada* as well as shares in a corporation (subject to public corporation exemptions), *section 116(1)* of the *Income Tax Act* requires the non-resident person to give notice of the disposition to the *Canadian Customs and Revenue Agency (CCRA)* and to obtain a certificate which the *Minister of National Revenue* issues to the non-resident seller. In order to receive the certificate, the non-resident seller must remit with the notice of disposition 25% of the amount, if any, by which the proceeds of the disposition of the property exceed the adjusted cost base to the non-resident person of the real estate immediately before the disposition. Expenses of disposition, such as legal fees or real estate commissions, cannot be used to reduce the portion of the gain which is subject to the withholding tax calculation. If the *Minister of National Revenue* does not issue a certificate, then the buyer is personally liable for payment of 25% of the purchase price which must be remitted to the *Minister of National Revenue* within 30 days after the end of the month in which the real estate was acquired.

The cost base of real estate excluding the land may be depreciated at a rate of 4% per annum and any depreciation claimed in connection with the income producing real estate is subject to recapture on the sale of the real estate.

The deceased taxpayer is deemed to have immediately disposed of the real estate before death and any accrued capital gains on such real estate are subject to tax to be reported in the final tax return.

7.4 Inheritance and gift taxes

The *Canadian* income tax regime taxes income and the capital gain on a disposition of real estate. There is no tax based on a person's wealth or a gift or inheritance. The transfer of real estate to a close person for proceeds less than the fair market value, or the transfer of real estate to any person by way of gift, or the transmission of real estate as a result of an inheritance are all transactions that are deemed to occur at fair market value. Therefore, **a gift of real estate is subject to capital gains tax** based on a deemed disposition at fair market value. Similarly, a transmission of real estate as a result of death does not trigger any **gift** or **estate tax**; instead, there is a deemed disposition at fair market value resulting in a **capital gains** tax payable by the estate of the deceased.

7.5 Other taxes and charges

All applicable taxes and charges have been discussed above.

7.6 Incorrect (lower) statement of sale price on the sales agreement

If a person transfers real estate at less than fair market value, then the *Income Tax Act* deems the transferor to have received proceeds of disposition equal to the fair market value of the real estate at the time of transfer. There is no corresponding adjustment to the cost base of the transferee. In the case of a gift or inheritance, the tax will be payable by the donor or the donor's estate on any capital gain and the donee has the benefit of the increased cost base. This requirement for transactions to occur at fair market value leaves no opportunity for transactions to be structured to reduce or avoid capital gains taxation.

7.7 International taxation

Canada has entered into reciprocal tax treaties providing for the avoidance of double taxation with many countries. Information regarding the various tax treaties may be obtained at the *Canada Department of Finance* website www.fin.gc.ca. Canada entered into these tax treaties with the main objective to avoid double taxation either by providing for tax credits or exemptions. The scope of the tax treaties is based on the *OECD Model Treaty* of 1977 which provided that the application of a tax treaty is determined by **residence** and not by nationality. The taxes covered are both taxes on income and on capital. The tax treaties provide for a more or less uniform treatment of non-resident investors in real estate situated in *Canada*.

Pursuant to the tax treaties, if a non-resident person derives **rental income** from a rental operation, the net rental income will be taxed 'in the State where immovable property is

located' at the applicable progressive rate of tax. A different federal and provincial tax rate is applicable depending on whether the non-resident entity is an individual, corporation or trust and on the amount of the income. A non-resident person who receives income from the rental of real estate that is located in *Canada* is subject to withholding tax under Part XIII of the *Income Tax Act* at the rate of 25% of the gross rents received. The *Canadian* resident payer has an obligation to withhold and remit the tax.

Under Canadian tax law, a non-resident receiving rental income may reduce the **withholding tax** of 25% on the gross rental income by making an election and providing an undertaking to file an income tax return and pay tax under *Part I* of the *Income Tax Act*. The non-resident, in effect, is entitled to pay the applicable tax on the net rental income as if he/she were resident in *Canada*.

Income in the form of interest and dividends received by a non-resident is subject to *Canadian* withholding tax and relief from double taxation under the tax treaties.

Subject to certain exemptions, interest income paid by a *Canadian* borrower to a non-resident lender is subject to a 25% withholding tax. The *Canadian* borrower is subject to personal liability as well as interest and penalties for failure to remit to the *Canada Customs and Revenue Agency* the withholding tax. The tax treaties provide relief from double taxation by reducing the basic withholding tax rate of 25% on interest income up to 10%.

Withholding taxes in the basic amount of 25% on **dividends** paid by a *Canadian* corporation to a non-resident shareholder may be reduced by a tax treaty to 5%. In order to qualify for the reduced withholding tax rate of 5% the non-resident corporate shareholder must control at least 10% of the voting shares of the *Canadian* corporation paying the dividends.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Canada's immigration policies and procedures have been designed with the following objectives in mind: (1) to attain the country's demographic goals; and (2) to enrich and strengthen the multicultural fabric of its society. Every year the *Minister of Immigration* issues immigrant targets based on the three main immigration categories: (i) economic immigration; (ii) family reunification; and (iii) refugees totaling 245,000 persons.

Temporary visitors to *Canada* from certain specified countries are required to obtain a temporary resident visa. Citizens of other countries, including European Union members and *Switzerland*, are exempt from the temporary resident visa requirement. The foreign national will be entitled to remain in *Canada* as a visitor for a period of up to **six months** unless an immigration officer indicates a shorter period in the person's passport.

Foreign nationals who seek to engage in international business activities in *Canada* without directly entering the Canadian labor market do not need to obtain a work permit. The *Immigration and Refugee Protection Regulations* specifically identify the following persons as business visitors: (a) a person purchasing Canadian goods or services for a foreign business or receiving training in respect of such goods or services; (b) a person receiving or giving training within a *Canadian* parent or subsidiary of the corporation that employs

them outside of *Canada* if any production of goods or services that results from the training is incidental; and (c) a person representing a foreign business for the purposes of selling goods for that business if the person is not engaged in making sales to the general public in *Canada*.

Prior to employing a foreign national, a Canadian employer normally must obtain a positive labor market opinion from a local *Human Resource Canada Center* (HRCC).

Senior executives or managers or persons with specialized knowledge qualify as **intra-company transferees** if they are transferred to *Canada* by a foreign parent or subsidiary corporation. In order to qualify, the individual must have at least one year of work experience in the previous three-year period with the foreign corporation transferring the worker to *Canada* and must satisfy the criteria for the senior management or specialized knowledge.

Subject to special provisions for the protected person's category, all immigrants are assessed under a **six-factor selection system**. Both family class immigrants and qualified business immigrant applicants receive bonus points and, therefore, the six-factor selection point system is of particular relevance not only to **skilled workers**, or what is generally called the **independents**, but for all immigrants. As a result of the changes introduced by the *Immigration and Refugee Protection Act* on June 28, 2002, an immigrant visa would not have been issued to an applicant in the independent category, unless he/she was in possession of a validated employment offer or was qualified to pursue certain listed occupations and was proficient in English or French. Due to the Minister's announcement on September 18, 2003, the **pass mark** for independents was reduced from 75 to 67 out of a total of 100.

There are three classes of **business immigrants**: entrepreneurs, investors, and self-employed. All require at least 35 points taking into consideration the following criteria: age, education, language, experience and adaptability.

The **entrepreneur** is an experienced business person who wishes to buy or start a business in which he/she will have an active management role. The business must create jobs for one or more Canadians and must make a significant contribution to *Canada*'s economy. This category is mainly designed for applicants who have successfully managed small and medium-sized enterprises in their homeland. Most entrepreneurial applicants will receive conditional landed status only. Entrepreneurs, generally, have to make a qualifying investment within two years of landing in *Canada*. This allows an applicant and his family to first come and live in *Canada* and consider possible investment opportunities offered to the entrepreneur even after landing rather than deciding on an investment activity before coming to *Canada*.

The **investor** class was first introduced in 1986 and the old *Immigration Act* provided a means for admitting to *Canada* people who had business skills and experience and who were prepared: (a) to make a passive investment in a business in *Canada* that the provinces considered important to their economic development; and (b) to rely on others to oversee their investment. After several changes to the program the new *Immigration and Refugee Protection Act* now requires that the investor must have accumulated through his/her own endeavours a net worth of at least Can$ 800,000 and specifies that the minimum investment of Can$ 400,000 must be in a provincially sponsored and fully guaranteed investment fund for a period of five years.

A **self-employed** applicant immigrant used to be someone who intended and had the ability to establish or purchase a business in *Canada* that will create an employment opportunity for him/herself alone. This has now been changed, and the class of self-employed persons is now restricted to foreigners who can not only create an employment opportunity but can make a significant contribution to cultural activities or athletics, or are involved in the management of a farm in *Canada*.

For convenience of illustration, set out below is a **step-by-step description** of the sequence of events which would or should take place from the day that a qualified business immigrant applicant developed a keen interest in *Canada* to the day when the immigrant and his/her family obtain permanent residence: (1) exploratory visit to *Canada* by the intending immigrant; (2) visit with government authorities in province of destination; (3) seek advice on Canadian tax law, family law and business law; (4) lodging of application for permanent residence at Canadian visa post abroad; (5) interview by Canadian visa officials; (6) if approved provisionally, medical examinations for the applicant and family; (7) background clearance (police/criminal record); (8) issuance of immigrant visa, valid for 12 months from the time of medical examination; (9) implement pre-landing tax planning measures including, if applicable, the setting up of non-resident trust, making arrangements to accelerate payment of retirement bonus, or golden handshakes, etc.; (10) prepare a list (in duplicate) of all personal effects to be brought into *Canada*, including those brought in at the time of landing and those which are to follow at a later date; (11) arrival at port of entry to have landing effected; (*12) visit to local *Canada* immigration center regarding conditional visa process; (*13) satisfaction of conditions; and (*14) second visit to *Canada* immigration center to have conditions removed from record of landing. (*Not applicable if visa is unconditional.)

On arrival at the *Canadian* **port of entry** and presentation of the permanent resident papers, the immigrant and his/her family used to be issued a *Canadian Immigration Record and Visa* or *Record of Landing*. This has been changed, and instead permanent residents are issued a secure photo identification permanent resident card called the *Maple Leaf Card*. Existing permanent residents must replace the *Record of Landing* and were required to apply for the *Maple Leaf Card* before December 31, 2003.

Once the immigrant has landed and obtained a **permanent resident card** he/she is eligible: (i) to work in *Canada*; (ii) to apply for a social insurance number which may be obtained by mailing an application to *Social Insurance Registration*; (iii) to register with the Provincial Hospitalization Insurance Program; and may be required (iv) to exchange in his/her driver's license.

As of June 28, 2002 and subject to certain exceptions, such as a permanent resident spouse accompanying a Canadian citizen abroad or a permanent resident working abroad for a Canadian business, **a permanent resident** complies with the newly imposed residency obligations if he/she is **physically present** in *Canada* for a period of at least 730 days during a five-year period. All *Maple Leaf Cards* are only valid for five years, and on renewal the permanent resident must demonstrate that he/she was physically present in *Canada* at least two years during the previous five years.

8.2 Tax residence

There are potentially three bodies of law that a person coming to *Canada* as a permanent resident will have to consider: (1) the income tax rules of the person's country of origin;

(2) the Canadian tax rules; and (3) any applicable international tax treaty between *Canada* and the person's country of previous residence/citizenship.

The timing of becoming a resident of *Canada* for purposes of Canadian tax laws is a question of fact. A person may be deemed to be a Canadian resident and consequently taxable on his/her worldwide income, if he/she **sojourns** in *Canada* for more than 183 days. In order to determine residency, other factors such as the location of the permanent home, the social and economic ties, the residency of a spouse and dependants as well as the time spent in *Canada* must be taken into consideration. The citizenship of the person and the fact that the person entered *Canada* as a permanent resident are not relevant with respect to determining residency under Canadian tax law. Upon becoming a Canadian resident, a person will be deemed to acquire all of his/her capital real estate at a cost equal to the fair market value of the real estate. Therefore, the immigrant is well advised to obtain valuations with respect to his/her capital property (other than taxable Canadian real estate) held at the time of becoming a Canadian resident.

Canada taxes individual resident and corporations incorporated in or controlled and managed from *Canada* on their worldwide income. Non-residents are taxed only on *Canadian* sourced income. The *Income Tax Act* does not contain a definition of **residence**. An individual will be deemed to be a resident in *Canada* for the entire year, if the individual 'sojourns' in *Canada* for 183 days or more in a year. *Part 1, Division E*, of the *Income Tax Act* sets out the computation of the marginal rates payable by individuals. The provincial income tax rates are added to arrive at combined marginal rates.

8.3 International taxation for residents of Canada

Upon entering *Canada* as a permanent resident, a person may choose to transfer income-producing assets to a foreign trust and thereby not be required to pay Canadian tax on the income of those assets for a period of up to five years. Generally, a trust is considered to be resident in the country of residence of the majority of trustees who exercise management and control of the trust's assets. *Canada* will impose a tax on a non-resident trust as though it were resident on its worldwide income at the maximum personal income tax rate if the following conditions apply: (1) there is at least one beneficiary who is a Canadian resident; and (2) the contributor of the property (settlor) to the non-resident trust is resident in *Canada* for more than 60 months by the end of a particular taxation year.

Therefore, a foreign trust that was funded by a non-resident settlor will remain a non-resident trust for a period of the first 60 months of residence of the immigrant settlor. At the end of the 60-month period, the immigration trust would either be terminated and its assets distributed or, if the **immigration trust** continues, it will be considered a Canadian resident taxpayer required to pay tax on its worldwide income.

9 Checklist: Real estate acquisition in Canada

- Most purchases of residential real estate in *Canada* begin with the assistance of a real estate broker/agent who is a licensed member of a local real estate board. The broker will expect for his/her services a **commission** of the total purchase price. Generally the listing agent will split a 6% commission (sale of residential real estate) on a 50/50 basis with the other agent.
- Lawyers will not only also assist with respect to the negotiation of agreements of purchase and sale but once the agreement has been accepted in writing (this may be done by fax) the purchase and sale transaction will be subject to certain **due diligence** and once the conditions have been waived will be **closed by lawyers** (or notaries in *Quebec*).
- Prior to the closing, the buyer's lawyer will **search** for all forms of possible **encumbrances** on the title, including realty taxes, unregistered liens, easements and utility charges.
- On the **closing date**, upon payment of the closing funds, the ownership and any third-party interests in the real estate will be registered by the buyer's lawyer in the public registry system administered by local land registry offices.
- When registering a transfer of real estate, for example in *Ontario*, the buyer is required to pay **real estate transfer tax** in the amount of approximately 1.5% of the purchase price.
- There are no estate or gift taxes in *Canada*. Instead a transfer (disposition) of real estate is regarded as a taxable event and if the seller's (donor's) cost base exceeds the fair market value of the real estate, then 50% of the capital gain (deemed capital gain in the case of a gift or inheritance) is subject to tax.
- *Canada* does tax **capital gains** and a non-resident must provide on closing a '*section 116 certificate*' or the buyer must hold back 25% of the purchase price and remit same to CCRA.

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www.canada.gc.ca

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Study in Canada
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Language Studies International – Canada
www.lsi-canada.com

International Language Schools of Canada
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Contents: Croatia

1 Introduction

The Republic of Croatia is the second largest country which originated from the former *Yugoslavia*. The declaration of independence in 1991 resulted in a four-year war with *Serbia*. Although most of *Croatia* did not suffer any war damage, there are still some people who wrongly believe that this remains an area of conflict. Sometimes this draws the attention away from its clear sea, over 1,000 islands, romantic fishermen's villages, stunning beaches, vineyards, Roman edifices, medieval towns and tourist-friendly people.

Today, *Croatia* is an independent state, member of *UN, WTO, NATO's Partnership for Peace Program* and a state member of the *EU Stabilization and Association Agreement*. *Croatia* is expected to join the *EU* by 2010. *Croatia* is a country of parliamentary democracy, with a legal system similar to the civil law of other continental-European countries, such as *Germany, Austria* and *Switzerland*. The official language is Croatian; however, English, German and Italian are widely spoken, especially along the Adriatic coast.

The population of *Croatia* is about 4.5 million. The capital *Zagreb* is the largest city with a population of 800,000, followed by *Split* (200,000) and *Rijeka* (150,000). *Croatia* is somewhat larger than *Switzerland* and has 5,835 km of spectacular coastline on the Adriatic Sea – 1,777 km on the mainland coast and 4,058 km of island coast. Of the 1,185 islands, only 66 are inhabited. This coast is considered to be the most beautiful in *Europe* with innumerable bays, inlets, coves and beaches. Most islands receive more than 2,600 hours of sunshine per year. As well as a beautiful coast and countryside, *Croatia* has a very rich culture and there are many historical places such as *Pula, Split, Korčula, Trogir, Hvar* or *Dubrovnik*. There are five UNESCO World Heritage sites on the Adriatic coast alone.

Croatia is a country with generally high taxes, but it offers unique opportunities to people with certain types of income, e.g. foreign pensions, bank interests and capital gains. In addition to the charming, well-preserved nature and rich historic heritage, these fiscal advantages make *Croatia* one of the most attractive European locations for residence and retirement.

2 Real estate ownership

Ownership of real estate is provided for in the *Ownership and Other Property Rights Act* and the *Land Registers Act*.

Special laws may limit and remove ownership rights (subject to recovering their market value) in order to protect national interests and safety, to protect nature or the environment and health, and may limit ownership rights with regard to the use and exploitation of goods of particular national interest (e.g. objects of particular cultural, historical or economical importance). Such special laws are the *Defense Act*, the *Environment Protection Act*, the *Nature Protection Act*, the *Agricultural Land Act*, the *Waters Act*, the *Forests Act* and the *Expropriation Act* which provide for the removal of ownership rights when this is a matter of national interest. As well as the above, ownership rights are also limited by stipulations of the *Ownership Act* which provide for neighbor's rights.

2.1 Different forms and types of ownership

Co-ownership

Unlike individual ownership, co-ownership is ownership by several owners over a single piece of real estate in its relative (ideal) parts. Each co-owner may freely dispose of his/her part, in other words, he/she may alienate, encumber, etc., at any time. When a co-owner sells his/her part of a real estate, the remaining co-owners have **no right of first refusal** (right of pre-emption) unless it is agreed otherwise. Each co-owner may demand the dissolution of co-ownership at any time; he/she may not waive his/her right to dissolution in advance, but may validly contract limitations to the right to dissolution. The means of dissolution is usually a matter of agreement, however, if co-owners cannot agree, the dissolution is ruled upon by a court of law in a non-contentious procedure.

Joint ownership (joint tenancy)

Joint tenancy is the ownership by several persons of a single piece of real estate though shares that are not relatively (ideally) determinable; but are determinable nevertheless. Unlike co-owners, joint owners may not dispose of their shares by a legal transaction *inter vivos*, and may only transfer it to another joint owner. Property that is jointly owned by several persons may be subject to material-law disposal only if all of the joint owners agree (unanimously). Joint ownership frequently exists in hereditary communities.

Condominium

Condominium is the ownership over a particular part (flat, business premises, garage or parking lot) of co-owned real estate, which consists of land with a building on it or the right to build a building. Ownership over a particular part of real estate is indivisibly connected with the appropriate (ideal) part of the real estate to which it refers.

Ownership over a particular part of a real estate is established by the written consent of all of the co-owners and afterwards by the entry in the land register as a right connected to a particular co-owned part of the real estate. Condominiums may also be established in the procedure of partition (dissolution) of a co-ownership, in which the co-owners agree to limit their co-ownership rights by connecting a certain ideal part of the real estate with ownership over a particular part of the co-owned real estate.

Timesharing

Timesharing is very rare in *Croatia*. Nevertheless, it is possible to make appropriate agreements and such contracts should be notarized.

Right to build

The right to build is a **property covenant** referring to another person's land, authorizing its holder to build his/her own building on such land and the land owner is obliged to allow this. The holder/owner of the right to build is also the owner of the building that was constructed on the basis of the right to build. Once established, the right to build is transferable by

legal transactions like any other real estate, and the ownership over the building is also transferred with it. It is recorded by a double entry in the land register, both as a property covenant, and as a particular land-register entity in a new file.

2.2 Easements, charges, liens and mortgages

Personal easements

Personal easements are special rights over somebody else's real estate, on which basis a certain person is entitled to the use of the real estate in a certain way. These are (a) the usufruct, (b) the right to use, and (c) the right of residence. Unlike material easements, personal easements are normally divisible rights (e.g. a co-owner may establish a personal servitude over his ideal part). Personal easements are **non-transferable** (they are bound to the beneficiary) and non-inheritable (they expire with the death of the holder, unless they are established to the benefit of heirs as well). In this case we can only consider the non-transferability of rights, and not the non-transferability of performing the content of the personal easements rights (e.g. beneficiary of a personal easement may lease the real estate). The personal easement right is established only by a legal transaction (contract, testament).

Usufruct

The purpose of usufruct is to enable particular persons to commercially utilize things without them becoming their property. The usufructuary right may exist related to assets, real estate and also to properties that are creating a profit. A common form of this right is the lifetime usufruct (e.g. father leaves real estate to his children, and the wife has the lifelong right of using the real estate).

The usufructuary right is **strictly** a **personal right** and cannot be transferred by inheritance. However, the implementation of the contents of this right can be transferred to third persons. For instance, a real estate that is subjected to this right may be rented to a third person. If the usufructuary right expires, then the right to implementation of this right by a third person also expires. The right of usufruct does not end with the sale of the real estate if it is registered in the land register in favor of the entitled person. The entry in the land register is the condition for establishing the right of usufruct. Without the entry this right does not exist.

Right of residence (*habitatio*)

The right of residence is another non-transferable personal easement, which gives the entitled person a right to live in someone else's building or to use a part of it for living purposes. If the object of this right (e.g. an apartment) is sold, then the right of residence remains if it was registered in the land register. This principle applies to all personal easements.

Real servitude

Real servitude is a special right of the owner of a real estate (dominant property) to use the real estate of another owner (servient property) for the need of his/her real estate. The owners of

dominant and serving properties must be different persons, and it must always relate to two different properties. A real servitude is registered to the favor of the respective owner of the dominant property and charged to the respective owner of the serving property, and is always connected to the real estate, whoever its owner may be. The real servitude can be established by a legal transaction (contract, testament), by a court decision (inheritance, probate procedure, in the procedure of division of the co-ownership), by national authority (expropriation procedure) or directly by law (adverse possession and inheritance). When acquired by a legal transaction, the contract must be in writing, and the signatures must be notarized, because only in this way can the entry of the servitude be registered in the land register.

Real servitudes can be divided into land servitudes (the road servitude, the water servitude, the pasture servitude) and city and home servitudes (such as the right to lean the weight of the building in question upon another), the right for a window in another's wall, the right to have part of your own building or device upon another's property (balconies, signboards, antennas, electrical installations, etc.), the right to take waste-water over another's land (servient property), etc.

Charges

A charge is the right over another's real estate, authorizing the beneficiary to demand that the owner of certain real estate perform certain periodic actions (giving and acting, in contrast to easements where the acting consists exclusively of suffering and omission). The responsibility for the execution of these actions lies with the **respective real estate owner** to the maximum value of the real estate, as well as with the person who owned the real estate at the time of the establishment of the charge to the maximum value of his entire personal assets. The charge is a **personal right** and expires with the death of the beneficiary. The right is transferred to the holder's heirs only if this is explicitly contracted.

Liens and mortgages

Liens encumber real estate for payment of a debt, claim or obligation. Objects of a lien can be movable or immovable property as well as rights which are usable and/or have monetary value. The lien is the **security for a debt or an obligation**. To secure a debt or obligation, a lien can be established over a property and over property rights; this can be done voluntarily by contract or in the form of a court record; in the form of an agreement made before a notary public; by court order; or by law (statutory).

If a lien is statutory or in the case of voluntary and court-enforced liens, the creditor, before enforcing his/her claim, must obtain a court order (enforcement order). Litigation can be avoided in cases of voluntary court and voluntary notary liens, where the document (court record, notarized agreement) of establishing such a lien is itself an enforceable document.

A lien over real estate can be established only as a **mortgage** on an individual property, on an ideal part of property or on several properties together. A claim secured by a mortgage can only be enforced in court.

Fiduciary transfer of ownership

Besides the lien, another important institute is the securing of a claim by fiduciary transfer of ownership which is exercised on the basis of an agreement (contract) between the owner

of the real estate and the creditor. Here where the title to the property is conveyed to the creditor, with the intention of securing a certain creditor's claim against the previous owner or a third person. The contract must be made in the form of a court record, a notarized document, or as a solemnized private document made before a notary public.

Unless otherwise agreed, the debtor is authorized to use the real estate whose title is transferred to the creditor, while the creditor is not authorized to sell or encumber the real estate. If the creditor sells or encumbers the real estate contrary to the contract on securing the claim, such a sale or burdening is legally valid but the creditor is responsible to the debtor for damages.

A contract which would allow the creditor to keep the real estate if the claim is not settled when due cannot be made in advance. When a claim becomes due, the creditor and the debtor may agree that the creditor is to receive alternative settlement. If the creditor does not agree to the alternative settlement, he/she is authorized to sell the real estate to settle his/her claim, and this can be done either in court or out of court through a notary public or an authorized sales agent. If the creditor does not settle his/her claim from the proceeds of the property sale, he/she may settle it by selling other assets or rights owned by the debtor.

It is important to point out that the transfer of title for security and for the return of real estate following settlement of the claim, is not subject to payment of real estate transfer tax.

2.3 Protection of ownership, proof of ownership and registration

Real estate can be acquired by a legal transaction, by inheritance, by court order and by force of law. When the acquisition is made **by a legal transaction** (which must be done in writing before a notary public), ownership is acquired by registration in the **land register**. Ownership of real estate that is not registered in the land register is acquired **by deposit of a certified document**, which is suitable for entering the title in the land register. An heir acquires ownership over an **inherited property** at the moment of exercising the succession, that is, at the moment of death of the legal predecessor. However, in order to obtain the entry of his right in the land register, the heir must wait until probate has been completed and the inheritance order becomes legally valid. With the acquisition **by a court order** or by order of another responsible authority (administrative authority) the title is acquired at the moment when the court order or other document becomes legally valid. Ownership **by force of law** is acquired when all of the legal conditions are fulfilled. The most common cases of acquisition of real estate by force of law are: adverse possession and building on another's land.

The procedure for registering real estate ownership is regulated by the ***Land Register Act***. The land register is deemed to show both the actual and the legal status of real estate. Therefore whoever proceeded in good faith and with trust of the land register, not knowing that they are incomplete or different to the true status of the real estate, is protected by law. In the case of a multiple sale of a property by the owner, the ownership will be acquired by the person who was the first to request the entry into the land register. Therefore it is in the best interest of each acquirer of real estate to apply for registration as soon as possible after conclusion of the sales agreement and to take advantage of the rules over the protection of trust in the correctness and completeness of the land registers.

3 Purchase and sale of real estate

3.1 The sales agreement

The sales agreement is to be made in writing. The signature of the party whose rights are to be transferred, charged, removed or limited (which is usually the seller) is to be authenticated by a notary public. If the agreement imposes certain liabilities upon the buyer as well, his/her signature is to be authenticated also (e.g. if the buyer's rights are to be limited by stipulating the seller's right of first refusal).

In order to acquire title after the conclusion of the sales agreement, the buyer must place a request for entry of the title with the district court that has jurisdiction over the real estate. The delivery of the real estate into the possession of the buyer is not a condition for the acquisition of the title.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

Spouses may have their personal and marital property. **Personal property** is property that a spouse had at the moment of contracting the marriage as well as all of the property acquired during the marriage on another basis (inheritances, gifts, etc.). **Marital property** is property acquired by the spouses during their marriage. Spouses are co-owners of their marital property in equal parts. However, if only one spouse is entered in the land register, the third party will rely on the entry in the land register. Therefore it is strongly recommended to register marital property under both names after the acquisition.

In case of marriages where one spouse is a foreign national, foreign laws may be applied to their marital issues since it is a marriage with international characteristics. Such a marriage is subject to whichever foreign law the spouses select. However, this does not apply if the spouses married in *Croatia* and have a joint residence in *Croatia*, particularly since, in such a case, the law relevant to their personal and marital issues, i.e. the *Family Act of the Republic of Croatia*, excludes the application of foreign laws in such a situation. The same applies to real estate issues of common-law marriage partners.

3.2.2 Options and pre-emption rights

The right of pre-emption is the right of a certain person to whom the owner of real estate must offer this real estate first in case of a (re)sale. The right of pre-emption may be on the basis of law or a contract. The pre-emption right may be entered in the land register.

A contractual right of pre-emption exists when the buyer makes a commitment, by a special regulation in a contract, that he/she will offer the bought real estate first to the seller under the same conditions and at the same price in the case of the eventual resale. The contractual right of pre-emption can be agreed upon with a **maximum duration of five years** starting from the day of the conclusion of the contract. In case of violation of the right of pre-emption, cancellation of the legal transaction can be demanded with a subjective period of six months and an objective period of five years, under certain conditions.

A legal right of pre-emption is, for example, shown in the *Law on Protecting and Preserving Cultural Properties*. The seller of any cultural real estate (as well as a mediator in such a sale) is to advise the buyer that the object of the sale is a protected cultural real estate, and that it shall be first offered to the authorities (i.e. *The Republic of Croatia*, Municipality, City and County). Only if they decline to exercise their pre-emption right may the real estate be sold to another person. The owner is obligated to inform all of these institutions of his/her intention to sell. If no reply is received within 60 days, the owner can sell the cultural real estate to another person. This means that before conclusion of the sales agreement, the buyer has to check whether the owner informed all of the pre-emption right holders, otherwise he/she is exposed to the risk of possible contract annulment. The buyer can also be a foreign person; however, in this case it also requires consent of the *Ministry of Foreign Affairs*. **The duration of the legal right of pre-emption is unlimited**. There are no other forms of pre-emption rights.

An **option to buy** has to be made in writing either in the form of a pre-agreement without deposit, or in a form of non-refundable deposit (*kapara*) agreement.

3.2.3 Agricultural real estate

Agricultural real estate is of national interest and enjoys special protection. Agricultural real estate is used, protected and administered in the way that is determined by the *Agricultural Land Act*. Fields, gardens, meadows, pastures, orchards, olive groves, vineyards, fish ponds, reeds and marshlands are considered as agricultural real estate, as is any other land that can be used for agricultural production. Foreign legal and physical persons cannot acquire agricultural real estate, unless otherwise stated by an international treaty.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

When acquiring real estate in *Croatia*, foreign nationals must fulfill the following prerequisites: with the acquisition of real estate by inheritance, **mutual reciprocity** is presumed; with the acquisition of real estate by a legal transaction, mutual reciprocity is required as well as a resolution of a court or an administrative authority and the consent of the *Minister of Foreign Affairs*. A foreigner can thus become a real estate owner in *Croatia*, if the laws of the country of his citizenship permit Croatian citizens such a possibility under the same conditions. The reciprocity of acquiring real estate without special restrictions for its citizens exists within the following countries: *Australia, Austria, Belgium, Canada, Denmark, Egypt, Finland, France, Germany, Great Britain, Hungary, Ireland, Luxembourg, the Netherlands, Poland, the Russian Federation, Spain, Sweden, Ukraine, USA* and *Venezuela*. Citizens of *Switzerland* and *Italy* can become direct owners of real estate only if they have permanent residence in *Croatia*. However, there is still the possibility of acquiring real estate **indirectly through a Croatian company** (further information is give in section 3.8 below).

By signing the *EU Stabilization and Association Agreement*, *Croatia* has committed itself to gradually harmonize its legislation related to the acquisition of real estate, with intention to equalize EU citizens with Croatian citizens. The procedure for obtaining the consent of the *Minister of Foreign Affairs* can take up to 10 months. Upon definite permission only a relatively small deposit should be paid, usually 10% of the purchase price.

Even if there is reciprocity and consent, foreign legal and physical persons cannot acquire agricultural land (*Agricultural Land Act*), real estate in protected nature areas (*Nature Protection Act*) or forests and forest land (*Law on Forests*). In the case that a foreign person should inherit those excluded areas, that person would not acquire the title, but would be entitled to indemnification as if the real estate had been expropriated.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

A physical person becomes legally competent at the age of 18 and can make legal transactions independently. **People with limited legal competence** are only those adults, whose legal capacity to act have been partially taken away by a court order after their coming of age. **Persons with no legal competence** are minors (i.e. younger than 18) as well as adults whose legal competency was taken away by a court order (e.g. because of a mental disorder); However, a minor older than 16 becomes legally competent by marriage or by becoming a parent.

All legal transactions related to the real estate of people with limited competence and persons with no legal competence must be in the form of a notarized document and must be approved by the *Social Welfare Center* (the public institution for family legal protection). The fact that the person has no legal competence must be registered in the land register (if such a person is the owner of real estate) and must be made public. Whoever buys real estate from such a person (notwithstanding such a note in the land register) is exposed to the risk of having such a legal transaction annulled. If no such note is registered, rules of trust in the truthfulness and completeness of the land registers apply.

If the seller is a company, the sales agreement must be signed by the director or other authorized person. Accordingly, it is very important to check whether the person(s) signing for the company are actually authorized to do so and may legally bind the company. For a Croatian company, this may be verified by obtaining an up-to-date extract from the commercial register.

3.3.2 Third-party claims and unpaid taxes

A buyer is still entitled to the real estate if the land register was trusted in good faith but failed to show the existence of any third-party rights, charges or restrictions. Exceptionally, the person acquiring the real estate does not enjoy the protection of trust in the completeness of the land registers regarding those rights, charges and restrictions which exist in law (statutory), and which do not need to be registered in land registers.

Unpaid taxes do not represent an obstacle to registering the title into the land register and therefore the land register office is obligated to permit the execution of the entry even if the taxes were not paid, provided that all of the other conditions for title registration are fulfilled.

However, in the case where taxes are not paid within the required period, the tax authority may enforce collection by seizing funds, selling company shares, assets or real estate, etc. As a condition for a delay of tax payment, the revenue office can also ask for collateral, e.g. a bank guarantee, movable property lien, mortgage, etc. However, after the title is

transferred, the new owner of the real estate is not responsible for the unpaid tax liabilities of the previous owner.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

The coastline is classified as general property (public domain) and, therefore, cannot be subject to ownership regardless of whether it concerns native or foreign persons. Real estate of particular cultural, historical or economic importance is under special national protection. Their acquisition is equally complicated for nationals and foreigners.

3.3.4 Access to relevant records and documents

The land register is public and documents the existence and legal status of real estate. Land registers are maintained by those municipal courts that have special land registry offices. Land registers and their transcripts enjoy **public trust** and have the **power of evidence** of public documents. A land register consists of land register sheets. Only one real estate is registered on each sheet (a land register object). A land register sheet consists of three listings: A (List of Properties), B (Ownership listing) and C (Encumbrances). A single land register is maintained for each cadastral district. However, the land register data often does not correspond to the cadastral data or to the actual ownership or possession rights.

Land registers are open to the public. Anyone can demand inspection of a land register and receive excerpts and copies of it. For an extract from a land register, the average waiting time is about 8 days; however, in some courts it is available on the same day. A person requesting an extract from a land register must bring 20 Kuna in duty stamps. The party must know the number of the land register sheet in which the real estate is registered, or, if not knowing this, must know the number of property or the building as well as the name of the cadastral district in which the real estate is registered. The number of a plot and/or other relevant data can be checked in the Cadastral Office.

An extract from a land register can be obtained to show the status of the whole land register object (general excerpt) or for the part of the land register object (special excerpt). For instance, if the real estate is co-owned by several persons, the general excerpt from the land register would show all of the co-owners, while a special excerpt would only refer to the information on the portion owned by one of the co-owners. An extract could also display all registries' entries prior to the actually registered ownership (history excerpt).

Requirements for restitution and outdated land registers

The reason for the condition of Croatian land registers and requirements for restitution not being updated goes back to the previous political system, when expropriations were made and when a privately owned house could be built on community owned land, which in turn resulted in separation of the land from the building. The situation is made complicated by the fact that many owners acquired real estate either by inheritance or other statutory means and became owners but never registered their real estate in the land register. Thus, it is often the case that a person registered in the land register passed away a long time ago or has already sold the real estate in question. In those cases, the new owners simply

failed to register the transfer of title in the land register. The situation is complicated even further by the fact that, in certain cases, registration in the land register can take up to a few years. However, this long period can be overcome by administrative measures which enable the full utilization and disposal of real estate within a reasonable time. Therefore, as the new regulations require the computerization of land registers, **improvements are already under way.**

The **restitution** of real estate that has been expropriated under the former political system is enabled by a law of January 1, 1997, which regulates the return of real estate to those original owners who were expropriated by nationalization, confiscation or by other measures under the earlier system. However, Croatian citizens had to submit the request by June 30, 1997, and foreigners by January 5, 2003, otherwise they lost their right for restitution.

Due to the possible problems regarding requirements for restitution and outdated land registers, the title should be checked and an excerpt from the land register requested to ascertain whether a clean title can be acquired prior to the purchase of any real estate in *Croatia*. If this is not the case, the acquisition of real estate is not recommended.

3.4 Key points that a seller should consider

Above all, it is essential for the seller to know that the payment is guaranteed. All payments should be made through the bank or office of a lawyer or notary, which can be done in a relatively simple manner.

Broker commissions are usually paid by the seller and are normally between 2 and 3% of the sale price. However, a broker commission can also be required from the buyer in cases where a real estate search order was requested. Broker commissions can be freely negotiated by the parties concerned.

3.5 The execution of a real estate purchase transaction

After signing and certifying the sales contract and obtaining consent from the *Ministry of Foreign Affairs*, for foreign nationals the real estate purchase procedure can be completed. It is customary that at the moment of entering the agreement and before obtaining the Ministry's consent, the buyer pays a deposit directly to the seller or, preferably, to an attorney or notary in escrow. After receiving permission from the Ministry, the buyer has to pay the remainder of the agreed purchase price as well as the transfer tax under the tax authority decree and then he/she may apply for registration of the title in the land register. The acquisition of real estate takes place when the new owner is entered in the land register.

Most real estate agencies also offer advice in this area; however, it is strongly recommended that the entire purchase procedure be executed with assistance of a reputable attorney and a professional tax adviser.

3.6 Powers of attorney

The real estate sales agreement can also be signed by an authorized person. The signature of the seller and authorized person must be **authenticated by a notary public**. The signature of the buyer and authorized person must only be authenticated if the agreement imposes some liabilities on the buyer.

A special power of attorney is valid until revoked or until the buyer's title is registered. A general power of attorney may not be more than 12 months old at the time of title registration application.

A power of attorney that has been issued abroad must be legalized. The land register office will also permit the entry of private and public documents if they are authenticated in the way prescribed by international treaties or laws. *The Croatian Act on Legalization of Documents in International Traffic* prescribes that public documents issued abroad can be used in *Croatia* only if they were authenticated by the *Croatian Ministry of Foreign Affairs* or a Croatian diplomatic or consular mission abroad.

If a document originates from a state which is a co-signatory of the relevant Hague convention, legalization with an Apostille is sufficient. If a document comes from a state with which *Croatia* entered a treaty on document acknowledgment, it is necessary that such document is authenticated in accordance with the regulations of the signatory state. Further authentication is not necessary. The same rules also apply if Croatian documents are to be used abroad.

3.7 Financing

The most frequent way of financing is a mortgage loan obtained from a local bank. However, this kind of financing is generally only available to Croatian nationals, and it is very difficult for foreigners to obtain local mortgage financing unless they have permanent residence or employment in *Croatia*.

3.8 Purchase through a company

A legal entity, Croatian or foreign, can also be a real estate owner. However, the same restrictions apply to foreign companies as to foreign individuals; therefore it is generally not advisable to use a foreign company for the purchase of real estate in *Croatia*. It is usually much better to transact the **acquisition through a Croatian company** which may, however, be fully owned and controlled by foreign persons. This procedure **eliminates the obligation to request consent for the purchase** from the *Ministry of Foreign Affairs*, so the acquisition of real estate can be realized much more quickly. In addition, by using a domestic company it is also possible legally to avoid payment of transfer tax upon the acquisition and with each subsequent resale of the real estate.

In *Croatia* there are no CFC (controlled foreign corporation) or anti-avoidance regulations; therefore adequate structures can be used relatively easily for personal tax planning and financial privacy protection purposes.

The two **most commonly used company forms** in *Croatia* are the limited liability company (LLC, *društvo s ograničenom odgovornošću – d.o.o.*) and the corporation (*dioničko društvo – d.d.*). The members of an LLC and the shareholders of a corporation can be foreign or Croatian legal and physical persons. Only physical persons, either Croatian or foreign, can be managing directors. The minimum share capital required for the establishment of an LLC company is approximately Euro 2,600, while the capital required for the establishment of a corporation is approximately Euro 26,000.

3.9 Defects and warranty claims

In the case where the seller has sold the same real estate several times, the title will be acquired by the buyer who, in good faith, was the first to request their entry in the land register. However, the buyer who was not the first to apply for title registration but was the first to obtain possession of the real estate may, in exceptional circumstances, demand the deletion of the entry of the buyer who was the first to apply for registration if this buyer knew that ownership of the same real estate had already been transferred to someone else, or if this buyer did not act in good faith. In such situations, the damaged party (if he/she cannot arrange entry in his/her name or his/her entry is deleted, although he/she acted by trusting the land register) is entitled to **dissolution of the contract and compensation** from the seller who sold the real estate several times.

In general, all contracts should be kept safe in case there is a reason for legal dissolution or if the contract should in any way be proven invalid. The buyer of a real estate is also entitled to demand dissolution of the contract and payment of damages if, for example, the actual surface area of the acquired real estate is smaller than the amount registered in the land register.

For used real estate, any warranties regarding physical defects are normally relinquished by the seller in the sales agreement. The seller is, however, responsible for any hidden defects for a period of six months if the buyer was not aware of these defects. This period can be longer but must be agreed in the sales agreement.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

Zoning and building permits are regulated by **the *Regional Planning Act*** and ***the Construction Act***. Each intervention in the area (construction, rebuilding, and renovation) is to be performed in line with regional planning documents, special regulations and based on a zone permission. The **zone permission** is an administration act that is given on the basis of regional planning documents which comprise the *Strategy and Regional Planning Program of the Republic of Croatia* and regional plans (county regional plan, regional plan for special areas, city and municipal plan, general and detailed town planning). The responsible administration is obligated to issue a zone permit within 30 days from the date on which the correct application was filed and the required documents from other administrative authorities (consents, etc.) were obtained. Zone permission is valid for **two years** from the date of issue if an application for a **building permit** is placed within that time, or if construction work has begun, for which (in accordance with the special directions) no building permit is required. The validity of the zone permission can be extended for two more years provided that there is no change to the regional planning documents on which the original issue was based.

Construction work can be commenced only with a final **building permit**, or with final zone permission for those structures that do not require a building permit. This applies to simple structures (garages, storage rooms, tool houses, etc.). The authority responsible for issuing the building permit is obligated to issue the permit within 30 days after receipt of the correct

application. A building permit will cease unless the work is started within **two years** from the date of issue. Exceptionally, this period can be extended for two more years.

Owners of neighboring lands are also parties in the zone or building permit issuing procedure. This means that they have the right to lodge an appeal after the issuance of the permits; therefore the **building program can be considerably delayed**. In such a case, the investor to whom a zone or a building permit was issued must wait until the administrative authority of the second instance (the responsible ministry) decides over the objection; that is, until the zone or the building permit becomes final.

4.2 Architect's and building contracts

It is common practice that a building contract is made with the building contractor while a building supervision and control contract is made with a certified person. The **building contract** is a contract whereby the contractor commits to erect a certain building or to carry out certain work on an already existing object, and the investor commits to pay the contractual price. The making of such a contract is always preceded by the so-called preliminary actions (producing the project documentation, obtaining the building permit, etc.).

The project documentation (preliminary plans, main plans and working plans) is to be made by a duly authorized person – an architect, who is usually also commissioned to supervise and inspect the construction works and to obtain the building permit along with all of the required approvals. Relations with the architect are set by a contract, and his/her fees are contracted in line with the **official rate** of the *Croatian Chamber of Architects and Building Engineers*.

The building price can be contracted as a unit price (e.g. per m^2) or as a total price (single amount for the entire structure). The law allows changes to the price even when it is contracted as fixed. If the parties do not contract the price as variable, the law allows the contractor to increase the price if the prices of elements on which the contracted price is based increase (e.g. building material price increase) between the start and the fulfillment of the contract. The building contract may also contain a 'turnkey' clause, meaning that the contractor is to furnish all works independently and to deliver the finished object to the investor. In this case, the contracted price also includes the sum of all unpredictable works. Where the price has significantly increased above the contracted price, the investor may terminate the contract.

4.3 Completion of construction and formalities

The completed building may be used after the responsible authority has delivered permission (***utilization permission***) for its use. The utilization permission is given after a technical examination. Furthermore, an acceptance protocol is to be prepared before moving in. The acceptance protocol is to be signed by both the buyer and the seller. With new condominiums, all owners must sign an agreement in regard to building maintenance which will regulate how high the monthly maintenance and reserve payments should be and who should be responsible for organizing the maintenance, etc.

4.4 Deficiencies and warranty claims regarding new construction

The contractor is obligated to guarantee to the investor permanent supervision over the work and inspection of the materials used. The contractor and the designer are responsible for rectifying any construction or quality defects, whereby the contractor is responsible for the execution and the designer for the building plans. The investor and his/her legal successor may claim against defects within **10 years** from the acceptance of the building. It makes no difference whether the claim concerns hidden or obvious defects. This time period can be neither waived nor limited in the contract.

5 Rental and tenancy

5.1 Rental and lease agreements

A lease agreement is to be made in **writing** and signed before a notary public. The person leasing the real estate is obligated to submit the lease agreement as well as all of the charges with respect to the rent details to the local authority and the responsible revenue office. The person leasing the real estate has a lawful lien on furniture and other movables belonging to the tenant and members of his/her household in case of overdue rent or damage compensation. The person leasing the real estate can retain these movables until the owed rent or compensation is paid.

The same rules also apply to land lease. Land rental is subject to the *Agricultural Land Act*, but only in cases where the State leases land that is in its ownership. Rental of private land is subject to general rental and lease regulations.

There are **no special regulations on the legal protection of tenants**. However, they are entitled to enter the lease agreement in the land register.

6 Succession and gifts

6.1 Applicable law and jurisdiction

As already mentioned, foreign citizens can acquire real estate in *Croatia* through inheritance and gifts under the assumption that **mutual reciprocity** exists.

The *Conflicts-of-Law Act* contains stipulations on applicable laws and court jurisdiction in the matters of succession in cases where this is not regulated by bilateral international treaties and conventions. Therefore, this Act rules that inheritance is subject to the laws of the state in which the testator was a citizen at the time of death and that the capacity for creating a testament is subjected to the law of the state in which the testator was a citizen at the time of making his will. However, the estate of a foreigner consisting of real estate located in *Croatia* is in the exclusive jurisdiction of the Croatian courts. When applying stipulations on applicable laws, it is important to point out that an authorized court in *Croatia* is obligated to establish the contents of any foreign material law that is to be applied. Also, parties in the court proceedings (heirs) can submit a public document which discloses the contents of the foreign law.

With regards to inheritance by foreigners, special restrictions regarding certain matters ruled by special laws (agricultural land, forests, etc.) are to be borne in mind. If such special

regulations rule that foreigners cannot have or cannot acquire title to real estate, this means that upon the death of a predecessor holding title to such real estate, the heirs cannot acquire title by succession, but would be entitled to the reimbursement of its market value.

6.2 Fundamentals of the succession and gift/donation laws of Croatia

Legal (statutory) succession

Statutory heirs are divided into the following orders: heirs of the **first order**, which include the decedent's descendants, the decedent's adopted children and their descendants as well as the decedent's spouse. They all inherit equal portions. Heirs of the **second order** include parents of the decedent, the spouse as well as the siblings and their descendants. Decedents without descendents are succeeded by their parents and spouse. Decedent's parents inherit together one-half of the estate (to be shared equally) while the spouse inherits the other half. If both parents die before the decedent, the spouse inherits the whole estate. If the decedent does not have a spouse or the spouse dies before him/her, the decedent's parents inherit the whole estate, shared in equal parts. If one of the decedent's parents die before the decedent, the part that would have been inherited by that parent is inherited by the surviving parent. The **third order of succession** consists of the decedent's grandparents while the **fourth order of succession consists** of the decedent's great-grandparents. Any decedent who did not leave behind any descendents, parent or a spouse is succeeded by his grandparents.

Succession by will

There are several types of last wills and testaments: personal testament, witnessed testament, judicial testament, and international testament. It must be noted that stipulations on international wills were added to the *Succession Act* and that *Croatia* is co-signatory to the *Hague Convention on the conflicts of laws relating to the form of testamentary dispositions*, concluded October 5, 1961, and that all co-signatory states recognize, with regard to this form, wills made in line with the Convention and the laws of the co-signatory states.

According to Croatian inheritance regulations, the testator is not completely free in managing his/her property in his/her last will and testament. In other words, there is a circle of people to whom the testator must leave part of his/her estate. These are the so-called **obligatory heirs**. Obligatory heirs are the testator's children, adopted children along with their descendents and the testator's spouse. The testator's parents, adoptive parents and other predecessors are only considered as obligatory heirs if they are permanently incapable of working or if they do not have sufficient means to survive.

Gifts

Gifts are subject to the provisions of the *General Civil Code*. A gift is a contract whereby the donor gives something to the beneficiary voluntarily and without compensation. Any transferable article or right can be a subject of a gift. A gift contract may be revoked, e.g. because of the donor's subsequent impoverishment, ingratitude of the beneficiary, breach of maintenance liability, etc.

A **gift contract** without simultaneous delivery of possession of the given thing (e.g. promise to donate or donation at the moment of death) must be in the form of a notarial document. In a

gift with simultaneous delivery of possession, no special contract form is required. However, if the object of the gift is a piece of real estate, the contract must be made in writing and the donor's signature must be notarized. The gift contract on real estate, depending on the content of obligations taken over by parties, has to be signed in a prescribed form.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

There are **two kinds of transfer taxes** which apply, depending upon the type of real estate and upon who the seller is. Generally, newly built structures are charged at 22% **value added tax** (see the following section), while other real estate is charged at 5% **real estate transfer tax**.

Type of real estate	*Status of previous owner*	*Tax*
Land	Not relevant	5%
Older structure (built before 31.12.1997)	Not relevant	5%
New structure	VAT exempt	5%
New structure	Not VAT exempt	22% and 5%

Every transfer of real estate in *Croatia* is subject to real estate transfer tax – whether by purchase, exchange, inheritance, gift, release of real estate from company assets, the acquisition of real estate in a procedure of winding-up or bankruptcy, the acquisition on the basis of a court order or by another authority, as well as all other kinds of real estate acquisition by other persons. All agricultural, building and other land is taxable; all business and other buildings built prior to December 31, 1997, acquired and taxed in accordance with the *Real Estate Transfer Tax Act*, regardless of who sells them; all used and newly built real estate disposed of by persons who are exempt from VAT (individuals, banks, insurance companies, etc.), as well as all further transfers of newly built real estate, initially acquired by persons exempt from VAT who, therefore, could not have reclaimed the paid VAT.

Real estate transfer tax is paid by the **acquirer of the real estate** – domestic or foreign individuals or legal entities. However, the seller of the real estate is responsible for the payment of transfer tax as well as the buyer in cases where he/she agreed to take over the obligation for the payment of the tax in the purchase agreement. The **assessment of the amount** of real estate transfer tax is based on the market value of the real estate at the time of its acquisition. The tax office is authorized to determine the **market value** of real estate.

Tax exemption occurs in some cases of **inheritance, donation and other acquisitions without payment**: persons acquiring certain parts of a real estate upon the termination of a co-ownership or upon the distribution of jointly owned real estate; acquisition by the decedent's or the donator's spouse, descendants, ancestors and adoptive children; persons acquiring real estate under a lifetime support agreement, and who are successors of the first degree related to the person disposing of the real estate; acquisition by former spouses when settling their real estate matters in divorce proceedings. Bringing real estate into a company as contribution in kind is not taxable.

Tax liability occurs at the moment of concluding a contract or other legal transaction by which real estate is acquired. The real estate acquirer is to declare the tax liability to the tax office holding jurisdiction over the real estate within 30 days of concluding the contract. The real estate acquirer must pay the due tax within 15 days from the receipt of the tax demand.

The real estate acquirer may reclaim the tax paid if the real estate title transfer is terminated with the agreement of both parties within 60 days from conclusion and before the new owner is registered in the land register, or if such contract is terminated or annulled by the court.

7.1.2 Sales tax (value added tax)

Value added tax (VAT) is regulated by the *Value Added Tax Act* and the *Value Added Tax Rules*. The regular VAT rate is **22%** and payable only on the value of a **newly built building**, or a used building for which the VAT was already paid if disposed of by a business VAT payer. When such buildings are bought by a non-business individual, VAT must be paid by the buyer at 22% of the building value plus the transfer tax to the amount of 5% of the land value. Each possible subsequent sale of such real estate is taxed at the 5% transfer tax only.

The rule is, therefore, that if real estate was charged with the 5% transfer tax when sold for the first time, it will remain within this tax regime for any subsequent transfers. This rule is not applicable with regards to VAT, because real estate taxed with 22% VAT remains in this taxation regime only when sold between businesses which are VAT registered. So, for instance, if real estate that was previously within the VAT regime is acquired by a non-business individual, then such real estate passes into the 5% taxation regime for each subsequent sale.

7.1.3 Real estate registration and notary charges

Upon concluding a real estate sales agreement, the seller's signature must be authenticated by a notary public. Registrations in the land register and the transfer tax payment procedures require six copies of the contract. The notary fee for signature authentication is Kuna 75 (approx. Euro 10). The fee for the land register entry is Kuna 250 (approx. Euro 35).

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

A special **holiday home tax** is payable by all legal and physical persons who own a holiday home. Every building or part thereof used occasionally or seasonally is considered to be a holiday home. Taxes on holiday homes are between Kuna 5 and 15 (approx. Euro 0.70 to 2) per annum per square meter of the effective area of the holiday house. Holiday home tax rates are set by the town or the municipality and will depend upon location, age and infrastructure. The persons responsible for the payment of the holiday home tax have to submit all data concerning their holiday homes to the responsible tax office by March 31 each tax year. Holiday home taxes are payable within 15 days of the receipt of the tax bill.

Apart from the holiday home tax, no other **land or real estate tax** is levied in *Croatia*.

7.2.2 Income tax

Physical persons residing in *Croatia* pay taxes on income obtained world wide. Persons who are not resident in *Croatia* only pay taxes on the income generated in *Croatia* (limited tax liability). Income tax is payable at the following rates:

- 15% on income from dividends (withholding tax)
- 15% on income from leasing or renting real estates or movable property
- 15% on income from insurances
- 35% on income from interest (withholding tax)

as well as on the all other income:

- 15% up to Kuna 3,000 (approx. Euro 400) per month
- 25% on any additional income between Kuna 3,000 and 6,750 (approx. Euro 400 and 900) per month
- 35% on any additional income between Kuna 6,750 and 21,000 (approx. Euro 900 and 2,800) per month
- 45% on any additional income which is more than Kuna 21,000 (approx. Euro 2,800) per month.

It is to be noted that with the taxation of real estate rental income, there is an allowance of 30% of the income, so the effective tax rate amounts to only 10.5%. When letting property to tourists, this allowed expense amounts to 50% and thus **the effective income tax rate for renting out holiday real estate is only 7.5%**.

Income tax is increased by a **municipal surtax**, with rates depending upon the place of residence. For example, the municipal surtax in the capital *Zagreb* is 18%, in *Split* 10%, in *Rijeka* 6.25%, in *Dubrovnik* 15% and on the island *Hvar* 0%.

The following income is tax exempt:

- the first Kuna 1,500 (approx. Euro 200) per month
- interests on savings deposits of domestic and foreign currency with banks, saving banks and saving and lending associations, interests on securities issued in line with the special law
- pensions received from abroad
- receipts resulting from insurances and liabilities, unless the premiums were tax-deductible expenses.

Corporate income tax is payable at **a unified rate of 20%**. There is a set of **fiscal privileges** for companies in certain areas, in free-trade zones as well as for foreign direct investments.

7.2.3 Net wealth tax

There is no net wealth tax in *Croatia*.

7.3 Capital gains tax

Capital gains tax is payable at the rate of 35% of the income received from real estate acquisition or takeover of ownership rights.

Capital gains tax is not payable on gains resulting from:

- **Disposal of financial assets** (such as shares, bonds, other securities, etc.), unless this is the business activity of the taxpayer.
- **Disposal of real estate** provided:
  - the real estate was used as the residence of the owner or his dependants; or
  - the real estate was sold at least three years after its acquisition; or
  - the disposal is exercised between spouses or first degree relatives and other close family members, or between divorced spouses.

The sale of more than three properties of the same kind within a five-year period is considered to be a business activity and is taxable by the usual income tax rates.

7.4 Inheritance and gift taxes

Inheritance and gift taxpayers are physical and legal persons who acquire taxable property on Croatian territory free of charge either by succession, as a gift or in another way. If an heir waives the inheritance or cedes it in the probation procedure, the inheritance and gift taxes are payable by the person who inherited or ceded such property.

Inheritance tax is payable at the rate of 5% on cash, receivables, securities and assets worth more than Kuna 50,000 (approx. Euro 6,750). The 5% real estate transfer tax is levied in the case of the inheritance of real estate.

Inheritance and gift taxes are not payable by spouses, blood relatives in direct line, and the decedent's or the donor's adoptive children and adopters.

7.5 Other taxes and charges

Taxes on vacant cultivable agricultural land are payable by owners or tenants if they do not cultivate the land for longer than one year. The tax for vacant real estate is paid annually and is between Kuna 250 and 1,000 (approx. Euro 35 and 135) per hectare.

Tax on unused industrial or commercial real estate is payable by owners of real estate where no business activity is conducted for longer than one year. The tax is between Kuna 5 and 15 (approx. Euro 0.70 and 2) annually per square meter of effective area of the real estate.

Taxes on vacant building land are payable by owners of unused building land. The tax is between Kuna 1 and 5 (approx. Euro 0.15 and 0.70) annually per square meter of vacant building land.

The above taxes can be collected by local authorities only; however, most of the local authorities have not yet started to collect them.

Visitor's tax is payable by owners of holiday homes or apartments in tourist areas and by all persons staying in that home or apartment from July 15 to September 15. Visitor's tax is between Kuna 2 and 7 (approx. Euro 0.3 and 1.0) per person/night, depending upon the season and the tourist resort category.

7.6 Incorrect (lower) statement of sale price in the sales agreement

Stating a price lower than the actual price in the sales agreement usually has no effect on tax liability. The responsible tax office will estimate the market value of the real estate at the time of the conclusion of the contract and calculate the tax based on such estimation.

The practice of stating a lower sales price than the actual price paid is illegal and not recommended, but it is sometimes used in order to lower the VAT when purchasing a new property. Besides this, the illegally lowered purchase price can result in a higher capital gains tax in some cases, e.g. if the real estate is sold within three years of acquisition.

7.7 International taxation

If income is received by foreign taxpayers domiciled or residing in a country with which *Croatia* has entered a double taxation agreement, the regulations of that agreement are used.

Croatia had entered into 35 agreements which avoid double taxation. The countries with which these agreements were signed include *Canada*, *Ireland*, *Switzerland* and the *United Kingdom*, among others.

If income from renting or sale of real estate is received by, for instance, British, Canadian, Irish or Swiss residents, such income is taxed exclusively in *Croatia*.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Foreigners can enter *Croatia* with a valid passport and an appropriate visa. Citizens of western European countries, as well as citizens of, for example, *Australia*, *Canada*, and *USA*, are also permitted to stay in *Croatia* without a visa for up to three months. For citizens of some western European countries, entry is also possible with an identity card. However, any person entering Croatian territory should within 24 hours report the stay to the police department unless he/she stays in a hotel or hospital or with a person providing accommodation services.

Foreigners wishing to stay in *Croatia* as tourists for longer than 90 days must apply for a temporary **residence permit**. A temporary residence permit is issued for periods of up to 12 months, upon presentation of evidence of accommodation, non-criminal record, medical insurance and necessary financial means. The procedure takes about four weeks. This residence permit is renewable annually.

Foreigners wishing to start a holiday home or room rental business should establish a company in *Croatia* and request a temporary residence permit, if they want to stay in *Croatia* for longer than 90 days. If they want to hold the position of managing director, they must

request a **business permit**. Business permits are issued for periods of up to 24 months upon presentation of incorporation documents. This procedure takes about four weeks.

Permanent residence can be granted to the following persons:

- a foreigner who has a temporary residence permit and who has been married for at least three years to a Croatian citizen or to another foreigner holding a permanent residence permit, or
- a foreigner who has stayed in *Croatia* with a temporary residence permit for a period of not less than five years continuously.

Croatian citizenship may be acquired by origin, by birth in the territory of the *Republic of Croatia* and by naturalization. While the naturalization conditions are generally rather restrictive, it is relatively easy to acquire Croatian citizenship for persons of Croatian origin.

8.2 Tax residence

A person is deemed to be a Croatian tax resident if he/she has accommodation at his/her disposal in *Croatia*, either owned or rented, continuously for at least 183 days in one or two calendar years. The actual **period of stay** in this accommodation is **not relevant**. This definition of fiscal residence in *Croatia* may be very attractive to foreigners having income that is not taxable (bank interests, capital gains, foreign pensions) or with an income that is taxable at low rates (gifts), and who wish to be Croatian residents, but do not wish to have to stay physically in *Croatia* for a given minimum number of days.

Alternatively a person is deemed to be a tax resident in *Croatia* if he/she stays in *Croatia* for at least 183 days in one or two calendar years, under the condition that he/she indicates that the stay is not temporary.

Persons with fiscal residence in *Croatia* are generally taxed on their **worldwide income** (unrestricted tax liability), **however, important exemptions** apply (bank interests, capital gains, foreign pensions), while persons residing abroad are taxed only for the income generated in the *Republic of Croatia* (limited tax liability).

8.3 International taxation for residents of Croatia

If a person comes from a country with which *Croatia* has signed an agreement on avoiding double taxation, e.g. *Canada*, *Ireland*, *Switzerland* or the *United Kingdom* (among others), his/her status is determined in the following way:

The person is deemed to be a resident of the country of his/her permanent residence, and if resident in both countries, he/she will be deemed to be a resident only of the country of closer personal and economic relations (center of vital interests). If the country of the center of vital interests cannot be determined, he/she will be deemed to be a resident of the country in which he/she stays for at least 183 days a year.

9 Checklist: Real estate acquisition in Croatia

- During the **selection of real estate**, usually with the help of a real estate broker or a real estate agency, a consultation with a tax adviser and a reputable attorney is highly recommended for **examination of the property documents** in the land registers and for providing a real estate sales contract, even if these services are offered by some real estate agencies.
- Special detailed care is to be taken due to the changes to the political system and expropriations in the past, the risk of an **unclear title** or possible demands and restitution claims from former owners are found in Croatia with many properties.
- After comprehensive examination, authentication **of the sales contract takes place** before a notary and prepayment of a **deposit** (10%) to the escrow account of the attorney or notary as well as payment of the **brokerage commission** (2 to 3%).
- The attorney applies to the *Ministry of Foreign Affairs* for purchase consent. After receiving the consent, the attorney transfers the deposited amount to the seller, and the buyer pays the remaining amount of the agreed purchase price. The attorney applies for **registration** of the real estate in the land register and the buyer receives proof of title. *Caution:* The passing of property title only takes place through entry in the land register.
- The seller of a **cultural property** (as well as a mediator in such a sale) is to advise the buyer that the object of the purchase is a cultural property and that it must be offered to the authorities first due to their right of pre-emption.

10 Bibliography

Appropriate literature in English on Croatian real estate law, tax law or immigration law does not yet exist.

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Contents: France

1 Introduction

France is a world-leader in attracting foreign investors in real estate. With more than 544,000 km^2 in its continental area alone, housing some 60 million people, the country offers a widely varied landscape of real estate opportunities. From city apartments and office buildings to hill-top village houses, from historical chateaux to holiday homes on golf course developments, the real estate industry is well organized to receive the foreigner. Real estate prices are as varied as types of real estate available, with relatively inexpensive investments still available in the rural regions not yet massively discovered outside of *France*.

The system of purchasing real estate is standardized throughout the country. Central to the system is the notary (*notaire*). The notarial profession has a monopoly on receiving and registering acts that transfer title to real estate. Notaries are trained in the law, and are specialized in real estate, gift and inheritance law. Their professional liability insurance insures a good title for each transaction in which they participate. All funds paid to them (and to French lawyers or *avocats*) are guaranteed.

French property law and taxation relating to real estate transactions (other than local real estate and habitation taxation) are standardized throughout the country. Zoning and land use issues will vary locally, however. So the foreigner purchasing in *France* should be well aware of the tax consequences of the transaction that is being contemplated, both as regards the land transfer and personal or corporate taxation. They should also be well aware of the use to which the land may be put, because non-respect of the zoning laws can be a criminal offense, and with increasing frequency French courts are ordering the demolition of constructions that do not respect the law or do not have proper building permits.

2 Real estate ownership

2.1 Different forms and types of ownership

Real estate in *France* may be owned in many forms. The most common are the equivalent of common law's fee simple or in **joint ownership** (*propriété indivise* or *indivision*), with or without a right of survivorship. Ownership rights may be divided between life estates (*usufruits*) and remainder interests (*nue propriété*). Long-term leasehold arrangements can be established. Multiple ownership in a common building, an apartment house for example, will most frequently be in the form of **condominium ownership** (*copropriété*).

Ownership of real estate entails the absolute right of use and disposal as stated at Article 544 of the *Civil Code*, subject of course to applicable laws and regulations regarding appropriate use and construction which will apply in any particular area. Thus, quite apart from the provisions of the *Civil Code* that may generally apply, reference should be made to the *Code de l'urbanisme*, *Code de la construction et de l'habitation*, the *Loi Littoral* applying to seaside-based buildings, the *Loi Montagne*, applying to buildings near the mountains, and to the zoning regulations adopted by the town having jurisdiction over the real estate concerned.

Joint-ownership (l'indivision)

The term *indivision* refers to real estate that is owned in its entirety by more than one person. The ownership documentation will refer to a percentage of ownership for each *propriétaire indivis*. Joint ownership in this manner will afford all owners the right to use the real estate and to benefit from its use (for example, the right to share rental income).

If the joint owners cannot agree on how the real estate is to be used, the matter can be referred for a judicial resolution. Unanimous consent is required for the administration or sale of the real estate. The joint owners may delegate the administration to one of the owners.

The essential principle is that **no joint owner can be forced to remain in a joint-ownership situation**. A division of the real estate and attribution to one or more of the various owners can be envisioned, and if there is no agreement or no possibility of such a *partage* then the real estate can be sold at auction (*vente par licitation*) and the proceeds divided.

Condominium ownership (la copropriété)

Ownership in condominium form is known as *copropriété*. The controlling statute is *Loi fixant le statut de la Copropriété des Immeubles Bâtis no. 65–557* of July 10, 1965, and the decree applying it of March 17, 1967, which set out how *copropriété*s must be organized and run.

A *copropriété* will have private areas and common areas. The *règlement de copropriété* or *cahier des charges* is equivalent to the by-laws of a property association. It will set out the lot numbers for each of the **privately owned areas** in a building and the **percentage of common areas** that are owned by each lot owner. The percentage of ownership, usually expressed in *tantièmes* or in a fraction the denominator (which will be multiples of 10,000) will determine the percentage of the common charges to be attributed to each owner. Where the *règlement* does not comment on ownership, generally access roads, the gardens, common equipment, roofs, corridors, and rights attached to them, are commonly owned.

A copy of the *règlement* will be turned over to each owner at purchase, and is binding on successive owners. It can be modified, but no modification resulting in an owner losing a property right or being assessed with additional charges beyond the percentage specified, can be passed unless there is unanimity of the condominium owners.

Management

The **property owner's association** (*le syndicat des copropriétaires*) will meet at least once every year to approve the prior year's accounts, approve the following year's budget, elect the **managing board** (*le conseil syndical*) of the building and select or confirm a **property manager** (*le syndic*). Normally in larger buildings this will be a professional property manager holding the appropriate license.

The **condominium**, represented by the *syndic*, is a legal entity, a person before the law. It alone can sue on behalf of the apartment owners, and has the responsibility for the maintenance of the building. It will be liable for damages caused to individual co-owners or third parties.

The *syndic* is responsible for applying the condominium by-laws and for regulating the use of the common areas. He/she will manage the building, receive payment of common charges and hold funds, pay suppliers, subscribe insurance coverage for the building and for third-party liability, account for funds received and, with the agreement of the assembly, pursue defaulting payers in the courts.

The 'Syndicat des copropriétaires'

The **managing agent** will convoke the annual assembly by registered mail. The documents sent will include the agenda of the meeting, the proposed budget and normally a **proxy**. While the law specifies that a proxy may be given to a third party who is not an owner in the building, some by-laws will specify that only owners may receive proxies.

Each co-owner has a number of votes equal to his/her proportion of the real estate, unless the co-owner has a majority in which case his/her votes will be reduced to the aggregate number of the other owners. Most decisions are taken by a **simple majority**. Decisions outside the scope of everyday management require a **greater majority**, and in certain circumstances **unanimity** will be required. Minutes are kept and sent to the co-owners, who have two months to contest the assembly's decisions.

The right of construction (le droit de superficie)

The right of construction or building right (*droit de superficie)* confers a right to build on land owned by another. The owner of the right (*le superficiaire*) has rights on the buildings only, and not on the land. He may therefore rebuild the building, or add additional floors.

The 'concession immobilière'

The *concession immobilière* is a contract by which the owner of real estate, built or unbuilt, confers its use to another person for a period of **no less than 20 years**, in return for an annual payment. Should the beneficiary build, then compensation is due to him/her at the end of the concession period.

Long-term lease (le bail emphytéotique)

The *emphytéose* is a long-term leasehold which confers a real estate right, and is signed before a notary. It can be mortgaged. The leasehold period can vary **from 18 to 99 years**. The tenant has the right to use the real estate during the period of leasehold. The system is generally used for construction and, unless specifically specified, termination of the leasehold will imply that the landlord will own the buildings constructed without indemnification to the tenant.

Construction leasehold (le bail à construction)

The construction leasehold will commit the tenant to build, which is not the case in the *emphytéose*. The duration of the lease is the same (**18 to 99 years**), although a periodic rental will be due. At the end of the lease, the real estate reverts to the landlord. However, the contract can stipulate that title to the underlying land will be transferred upon termination.

The survivorship clause (la clause d'accroissement/pacte tontinier)

Where two or more persons purchase real estate jointly (in *indivision*) they can stipulate that upon the death of the first, the survivor (or survivors) will become the owner of the decedent's undivided property right. The transfer will trigger **inheritance tax**, unless the entire real estate has a value of less than Euro 76,000. The transfer at death will also be effective against children or parents of the decedent who would otherwise have a reserved portion of the decedent's estate, and for this reason has been in the past used by foreigners not wishing to submit their French real estate to French inheritance rules. However, it is generally disfavored today because of possible negative inheritance tax consequences.

Purchase of a life or remainder interest (la vente en viager)

The *vente en viager* is an often-used method of purchasing property rights. The owner sells the real estate, receiving a part of the sale price as payment (*le bouquet*) at the time of signature and the remainder as an **annuity** during the seller's lifetime. The seller may or may not remain in the premises, and this will affect the value of the annuity and of the *bouquet*. There may be multiple sellers, and the annuity will then be due until the death of the last survivor. The annuity will be indexed for inflation, and will be registered as a lien on the real estate, so that non-payment will result in title to the real estate returning to the seller.

For the seller this is an effective form of estate planning, as the real estate will not be part of the estate at death, and thus will not be taxable. For the buyer, there is a reduced amount of capital due at closing. However, the final cost will depend on the longevity of the seller. Everyone in *France* remembers the story of *Jeanne Calment* who sold a studio apartment to her notary *en viager* when in her seventies, and survived the notary dying when she was past the age of 130 years.

Timesharing (la multipropriété)

Timeshare property ownership is regulated under the *Consumer Code* (*Code de la consommation, articles L. 121–60 and seq.*). The definition is the contract offered to a consumer by a professional which directly or indirectly confers on the beneficiary the residential use of real estate for determined or determinable periods, during a minimum period of **at least three years**. Shares of companies conferring such rights are also included in the scope of the law. All contracts corresponding to this definition must comply with the legal requirements: the offer must be in writing and include no less than 12 specific details provided by law. The acceptance must also be written and return by registered mail. The consumer has a **10-day 'cooling off' period** during which he/she may withdraw. No deposit may be received before the expiration of the 10-day period. Violation of the provisions may not only result in civil liability but also in criminal prosecution.

2.2 Easements, charges, liens and mortgages

Easements

Real estate may be encumbered by restrictions on its use in the form of *servitudes*. These most often provide for a **right of access** to a third party (usually a neighbor or a utility

company), but they can also **prevent construction** on all or a portion of a parcel of land or limit the height of any building. The servitude is a right freely negotiated with the beneficiary and will 'run with the land' – that is, created by a notarial deed registered at the **registry of deeds** (*Conservation des Hypothèques*) that will reflect that one plot is encumbered (*fonds servant*) and that another benefits (*fonds dominant*) from particular rights or restrictions.

Servitudes, and particularly rights of passage, may also be created by the open and notorious use of the land for a particular purpose for 30 years.

Servitudes may also exist by law, for example the requirement that no building be situated less than five meters from the boundary of the real estate or by the natural situation of the real estate (for example, to allow the evacuation of rain water).

Usufruct (l'usufruit)

The life estate is a right to use a piece of real estate during the life of one or more people. It terminates at the death of the last *usufruitier* or **life-estate holder**.

The **life tenant** can freely use the real estate, or rent it to third parties. If the real estate is commercial, a commercial rental requires the agreement of the owner of the remainder interest. The life tenant is responsible for maintaining the real estate.

Right to occupy (le droit d'habitation)

Under a recent modification of French inheritance law, a surviving spouse has the right to remain for the **first year gratuitously** in the matrimonial domicile. Following the first year, the surviving spouse may request to remain in the premises. If the domicile is a leased premise, the heirs must pay the rent for the first year. If the premises were owned by the decedent, the surviving spouse can now remain in residence for the remainder of his/her life, even where the children inherit. The survivor must maintain the premises and must inhabit them: they may not be rented to third parties, unless the survivor requires **institutionalization**, in which case, the premises may be rented to generate income to pay for the retirement home.

Mortgages (les hypothèques, privilèges et suretés)

The mortgage of real estate takes different forms in French law, depending on whether it is formed by contract (by notarial deed), or by order of a court (as a conservatory measure – or *hypothèque conservatoire*). It is in all cases a measure to secure repayment of a debt and confers **priority** in accordance with the **rank** of the mortgage holder when there is a sale or auction of the real estate. It will permit the mortgage holder to force a sale of the real estate at auction, but will not allow the mortgage holder to take title of the real estate directly. The mortgage is a *privilège du vendeur* when it benefits a seller to secure an unpaid portion of the sale price. It is a *privilège de prêteur de deniers* when it benefits the entity, usually a French bank that has loaned funds to allow the purchase. The *privilèges* are less expensive to register than the *hypothèques*. Current case law, however, does not allow a foreign bank to register a *privilège de prêteur de deniers* but only a conventional mortgage.

2.3 Protection of ownership, proof of ownership and registration

While from a legal point of view, a sale is 'perfect' when there is agreement on the **object** and the **price**, in fact sale of real estate will take place by a notarial deed, signed in a single original, before one or more notaries, and deposited in the notary's 'minutes'. The deed will be sent to the registry of deeds for the area (the *Bureau de la Conservation des Hypothèques*, a branch of the *Treasury Department*).

The notary will verify the registry's documents to determine whether any other transfer of title has been registered for the same real estate, indicating that the seller is no longer the owner, and whether there are liens, encumbrances, or servitudes on the real estate. If the registry lists other notarial acts as having been registered on the same land, the notary can request copies of them to analyze fully the ownership rights that exist.

The registry is a **public archive**, and any person may request information or copies of registered acts or deeds. But only notaries may register acts there, with some exceptions. Attorneys at law (*avocats*) may register judicial mortgages and sales at judicial auctions, and the administration may register sales of real estate in which the government is involved.

Registration in the registry is not definitive proof that the current owner has title. This proof may be established in any manner, through any written documents. Similarly, the holding of an *expédition* or certified copy of a title deed of the sale by which the current owner claims to have purchased will not be considered dispositive proof of current ownership. The registry serves, among other things, to give notice to third parties of the existence of an act concerning a property.

Proof of ownership is established by showing a **continuous unbroken ownership** of the real estate from preceding sellers to buyer **for at least 30 years**, the statutory period of limitation. The notary will relate in the deed or in its annex the ownership of the real estate in this manner, in order to provide the proof. The notary's professional liability policy insures good title. Thus there is no separate title insurance required in *France*.

3 Purchase and sale of real estate

3.1 The sales agreement

The *Civil Code* provides that a purchase in *France* is perfected when there is agreement on the object and the price, and thus even a non-written contract could be considered valid, although proof of the agreement may be difficult to provide. Such an agreement could form the basis for a request at law in specific performance. The existence of the lawsuit can be published at the registry of deeds, thereby preventing the sale of the real estate to a third party. For this reason, no undertaking to sell or purchase should be granted, without including conditions precedent (*conditions suspensives*).

In practice, an **offer to purchase** will be drafted either by a lawyer, a notary or real estate agent, and will be accepted by the seller. The offer will be **followed by a more formal preliminary contract** that will either take the form of a *compromis de vente* (also called *promesse synallagmatique de vente*) or sale under conditions precedent, or of a *promesse unilatérale de vente* which is similar to an option to purchase.

The *compromis de vente* or *promesse unilatérale de vente* may be signed before a notary as an authentic act or deed, but this is not a requirement for validity. It may be registered with the tax office, and in the case of a unilateral promise (see below) it must be registered with the tax office within 10 days to retain its validity.

Real estate agents will often propose preprinted standard forms of agreement. There are significant differences among these and both parties should be very cautious about the terms contained. It is recommended that these be reviewed by a lawyer or notary prior to signature.

Since June 2001, all prospective buyers have a **seven-day cooling off period** during which they may retract their offer to purchase. No deposit may be requested during the seven-day period (with the exception of reservation deposits for new constructions), which begins on the day the buyer receives and acknowledges the contract to be signed.

The unilateral promise (promesse unilatérale de vente) and the bilateral promise (promesse synallagmatique de vente)

The *promesse unilatérale de vente* is similar to an option to purchase. The seller grants the buyer the right to purchase against a deposit of a certain amount known as the *indemnité d'immobilisation*. The deposit is negotiable but in consumer transactions is customarily 10%. The buyer must exercise the option to purchase within a specified period of time, provided the conditions precedent are fulfilled. The customary **conditions precedent** are that there is proof the seller has **good title**, that there are **no easements or servitudes** burdening the property such as to reduce its value and that there are **no mortgages or other liens** greater than the purchase price. By law, the buyer is also entitled to withdraw if financing has not been obtained, unless the buyer has specifically waived that right in the preliminary contractual documents.

If the conditions precedent are fulfilled and the buyer does not purchase, he/she will lose the deposit and the seller is free to sell elsewhere. There can be no specific performance requested by the seller to force transfer of title. The buyer, however, can bind the seller to transfer the title if he/she exercises the option in a timely fashion.

The *promesse synallagmatique de vente* must be distinguished from the *promesse unilatérale de vente*. Technically, the *promesse synallagmatique de vente* is the equivalent of the *compromis* or sale. The binding force of the bilateral promise is stronger than the unilateral promise inasmuch as the *promesse synallagmatique de vente* can be enforced as an actual sale before the courts by way of specific performance.

The *promesse* whether unilateral or bilateral can be a private document (*sous seing privé*) or by notarial deed (*acte authentique*). The bilateral promise does not need to be registered to maintain its validity, whereas the unilateral promise must be registered at the tax office.

The sales deed (l'acte de vente)

The *acte de vente* will be **prepared by the notary**, who will have verified the situation of the real estate at the registry of deeds, and obtained information from any registered creditors as to the amounts required to discharge mortgages.

The *acte de vente* will recite the full identity of the parties, the price, the description of the real estate being sold, the legal warranties and specific conditions and the 30-year history of the real estate. It will be very thorough in describing the complexities of the transaction. It may stipulate a date that is different from the signature date for the right to occupy the premises.

Any pre-emptive rights existing in favor of the town or of the *SAFER* (a government organization having pre-emptive rights on agricultural land for the purpose of developing agriculture) will have to be purged. In certain circumstances, the seller is required to provide certificates as to the absence of asbestos, lead and termites in the buildings. A certified statement as to the surface area sold is required for certain apartments.

The notary will register the *acte de vente* at the registry which will put all third parties on notice that the transfer has taken place. Notaries have a monopoly for the registration of such *actes*. Thus while a transfer which is not by *acte authentique* can form the basis for a court decision to transfer the title to the real estate, no transactions on real estate in *France* can take place without a notarial *acte de vente* unless the government is selling the real estate or unless the real estate is acquired at auction. Third parties are put on notice of the prior claim to title by registration at the registry of deeds.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

Although the law of the place where property is situated generally controls the ownership of the real estate, the matrimonial law applicable to the person owning the property will have an effect on the ability to sell the property freely.

The French matrimonial regime, without a prenuptial contract, is the **community property regime restricted to property acquired after the marriage** (*communauté réduite aux acquêts*). Couples may choose the **separate property regime**, or a **universal community property regime**. In any event, however, one spouse will need the approval of the other to sell the matrimonial domicile.

France is party to the Hague Convention of March 14, 1978, on the Law Applicable to Matrimonial Property Regimes (see: www.hcch.net). This allows foreign couples to adopt any one of the French regimes to govern their French real estate, even after their marriage. Failing such a choice, the French jurisprudence on conflicts of law will look to the place where the marriage took place and where the first matrimonial domicile was established to determine the matrimonial regime that is *applicable*.

The 'Pacte Civil de Solidarité' or PACS

The *PACS* is a contractual arrangement for couples who wish to live maritally together, having some of the benefits of marriage with respect to taxes and laws on inheritance. It can also be entered into by same sex couples. Where property is purchased after the registration of a *PACS*, it will be presumed to be undividedly owned 50% by each partner, unless the deed stipulates differently.

3.2.2 Options and pre-emption rights

Contractual rights of pre-emption

A third party can receive a preferential right to purchase real estate (*pacte de préference*). This can be part of the *acte de vente*, but there is no requirement that it be registered at the registry of deeds. The beneficiary of the right of pre-emption may sue to have a transfer in violation of that right set aside where he/she can show that the third-party buyer had knowledge of the existence of the right of pre-emption and of the beneficiary's intention to exercise it, under current case law.

Statutory rights for tenants of leased premises

A residential tenant of unfurnished premises has a statutory right to purchase in the event of the owner refusing to renew his/her rental contract with the intention of allowing the owner to sell. The tenant must receive **formal notification** from the owner, either by registered letter or by service from a bailiff, which will include information regarding the prospected sale, the sales price and other conditions of sale. **The notice is equivalent to an offer to sell the apartment**. The tenant must be given six months' notice that the landlord intends not to renew the lease and to sell the premises. The tenant has a two-month period from the receipt of the notice to exercise his right to purchase – a period that is extended by an additional two months if the tenant must borrow to finance his purchase. If the tenant cannot complete at that time, the right of pre-emption is lost and the tenant must consider his/her lease terminated. If the landlord then decides to sell at more advantageous conditions than those notified to the tenant, these must be notified to the former tenant who has one month to accept and two months to complete.

Statutory right of pre-emption for governmental authorities

A municipality may have a right of pre-emption. The information in this respect can be obtained from the *Mairie* of the town covering the real estate concerned. If the pre-emptive right exists, notification of the intended sale (*déclaration d'intention d'aliéner*) must be given, and the municipality may exercise its right during a **two-month period**. The municipality may also offer a lower price, in which case the owner has a *droit de repentir* and may decide not to sell.

3.2.3 Agricultural real estate

There are no restrictions on foreigners seeking to purchase agricultural real estate. There is a statutory pre-emptive right in the *SAFER*, as mentioned above. Agricultural real estate can also be purchased from the *SAFER*, who will also undertake to manage the agricultural exploitation for the owner.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

Foreigners may freely buy real estate in *France*. There are no specific restrictions.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

The parties must be capable of acting in order for consent to be validly given, and for a sale to be valid. The presumption under the *Civil Code* is that a party is capable of acting. A party must be of the age of majority (18 years of age in *France*, but the nationality of the seller will determine his/her majority). For a minor to validly sell, both parents must consent as well as the judge responsible for guardianship (*juge des tutelles*). Adults who are placed under **guardianship** will be judged incompetent to act without the approval of their *tuteur* or guardian.

The representation of legal entities

A civil or commercial company becomes a 'legal person' (*personne morale*) under the law once it is **registered** in the registry of companies. Although the corporate by laws (*statuts*) may differ, in general the shareholders must consent for the sale of corporate real estate, particularly where these are the only corporate assets. Transactions of *SCI*s (*see 'The Société Civile Immobilière (SCI)',* section 3.8.1 below) are exclusively civil, and their associates are jointly and severally liable for the company's debts. Associations formed under the law of 1901, which are the French equivalent of not-for-profit corporations, can act once they are registered at the *Préfecture*. The general assembly must decide on real estate transactions. *SCI*s are the most common form of company used for holding real estate.

Seller's title

A seller by law guarantees good title in real estate, even if the contract of sale says that no guarantees are given and unless the buyer had knowledge of the defect in title.

3.3.2 Third-party claims and unpaid taxes

The search at the **registry of deeds** prior to completion will reveal whether there are outstanding mortgages, judicial liens or tax liens. The notary will ensure at closing that the mortgages and liens are discharged.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Environmental protection

The applicable environmental protection regulations must be respected in requesting planning permits. They are particularly relevant to developments, whether industrial or residential, rather than to the constructions of individual homes.

Protection of national monuments

Two types of protection exist for historic buildings. A site or building may be considered *inscrit* (or registered) on the list of historic monuments. It may also be *classé* as a historic

monument. Where the building is *inscrit* or registered the government may take measures to protect it from being altered or destroyed. Any modification or sale of the building must be notified. Where a building is *classé* as a historical monument then it has been determined that its preservation is in the national interest. In that case any modification or sale is closely controlled. The government may **subsidize** work on the buildings in both cases, and certain **tax relief** is applicable. A relatively small number of *châteaux, manoirs* or *maisons de maître* are classed as historical monuments, and sometimes only part of the buildings (for example, a chapel) will be classed while the remainder of the estate is not.

3.3.4 Access to relevant records and documents

The records of the registry of deeds are public. They may be consulted only in writing, by requesting information on the appropriate forms, specifying the cadastral lot numbers in question. The registry document (*extrait hypothécaire*) will list all purchases and sales involving the land or apartment, all mortgages, and any lawsuits filed whose existence has been communicated to the land registry. Where it is a multiple dwelling building, the existence of condominium by-laws will be noted.

Any of the documents mentioned on the registry document may be requested from the registry, so that it is possible to obtain a copy of the preceding acts of sale for example. The applicable zoning regulations and the existence of building permits can be verified at the **municipal town planning office** (*service de l'urbanisme*) or with the *Direction Départementale de l'Equipment* or *DDE*).

Prior to allowing the signature of an *acte de vente* a notary will also request a *note d'urbanisme* from an architect. This document, which will be appended to the *acte*, will explain the zoning situation, and whether there are any residual construction rights.

When an apartment is being purchased, additional documents requested will be the minutes of the meeting of the condominium association, and of the property manager, as well as of the budget. If the association has voted major works that remain to be carried out, this will be a financial charge on the members of the association. The new owner will often be required to pay any amounts due following notification of the sale to the managing agent, under legislation enacted in October 2004. In addition the new owner must reimburse the seller for the percentage paid into the buildings association financial reserves.

In all cases, it will be necessary to verify the amount of the *taxe d'habitation* (**local occupancy tax**) which is **applied to whomever occupies the residence on January 1** of any given year, and of the *taxe foncière* (local property tax). The *taxe d'habitation* is not adjusted at closing, while the *taxe foncière* will be shared by buyer and seller on a pro rata basis.

3.4 Key points that a seller should consider

The seller must inform the buyer of any **hidden defects** of which he is aware. The defects can be as to the buildings or land itself, and as to legal issues regarding real estate, for example, the absence of documents relating to building permits. The seller's liability in these respects will be more important if the seller is a professional in the real estate business. The deed should relate any **apparent defects** in the property so that the buyer cannot deny having been informed.

It has become more usual to subject a purchase to a satisfactory survey, although the tendency is that while the seller is free to undergo the expense of a survey, the buyer will not accept to be bound until the survey results are known.

3.5 The execution of a real estate purchase transaction

Once there is an agreement as to the purchase price and other conditions, subject to conditions precedent, the parties may instruct notaries to go directly to closing, or may sign the *promesse unilatérale de vente* or *compromis de vente* stipulating the latest date on which completion is to take place.

Completion will normally be six weeks to three months from the preliminary agreement. The time is required to allow the notary to obtain the necessary documentation (registry documents, certificates regarding zoning regulations, attestations regarding asbestos, etc.).

Notaries in *France* may act for both parties, without this being considered a conflict of interest. However, either party may always select his/her own notary, without the other party being entitled to refuse. The identity of the notary or notaries should be specified in every preliminary document signed, to avoid later misunderstandings. The presence of an additional notary in the transaction does not increase costs, because the notaries will divide the fees.

The cost of fees (notarial fees and registration costs) is by custom paid by the buyer. If the buyer specifies in his/her offer that the purchase is made *acte en main*, this indicates that the seller will pay the registration costs. Such **costs are approximately 7%**, unless the transaction is subject to value added tax, or made as a speculative purchase.

If a *compromis de vente* or *promesse unilatérale de vente* is signed, and the accompanying **deposit, normally 10%**, is paid, the seller may not again promise to sell to a third party. 'Gazumping' or the practice of holding a property out for a higher price, until completion, is not permitted in *France* once the parties have signed preliminary documentation. Among other reasons, the preliminary documentation may be registered at the registry of deeds, which will mean that the seller cannot effectively sell the real estate on. The buyer would bring an action to have the sale recognized as 'perfect' and have the title transferred, which, whatever its outcome, would prevent the seller from completing until all appeals were exhausted, effectively removing the real estate from the market.

The real estate agent (l'agent immobilier)

Any person habitually acting as a real estate intermediary and receiving commissions for doing so **must be licensed and insured**. The real estate agent must also have an account that is fully guaranteed to receive client's funds. The agent may not receive amounts in excess of his/her guarantee, which must be properly posted so that potential clients are made aware of it.

The real estate agent must have a **mandate** to show the real estate from a seller, but may work on a multiple listing basis, where one agent is properly mandated. If the buyer has instructed the agent, then a mandate to search for real estate is necessary. The agent may only claim a commission if the transaction completes.

The mandate may be **exclusive or non-exclusive**. It should list among other things the real estate, the selling price, the amount of commission, and whether or not it is exclusive. On standard mandates, a clause may often be included allowing an agent a commission even where completion does not take place, on the basis that an agreement exists on the 'object and the price'. Such a practice is controversial and need not be accepted by the client. If it is accepted, the client may be unable to undo a transaction that has somehow become derailed prior to closing without paying a commission to an agent, impeding an amicable settlement between the parties. The mandate must be **limited in time**, or it will be declared null.

The mandate will not authorize the real estate agent to oblige the client to sell or purchase, unless it says so. It must be of limited duration, and may, if non-exclusive, be cancelled unilaterally. Non-respect by an agent of the requirements may lead to prosecution or loss of license. The agent may not personally purchase the real estate while under mandate.

The agent is responsible for informing the client of a real estate's market value, particularly where the client is selling at a price considerably lower than normal for the area. The agent must also advise regarding defects in title, or material defects of which the agent should have been aware as a professional, unless these were non-apparent and it is proven that he/she did not have actual knowledge of them. The agent must also verify that the persons giving the mandate are entitled to act, and where the agent drafts preliminary documents of purchase, he/she is responsible for their effectiveness. In short, the agent has a *devoir de conseil*, an **obligation to advise** the principal for whom he/she is acting.

The agent's commission is freely negotiable. Seller's commission is rarely higher than 5% plus *VAT* at 19.6%. An agent may request a commission from the buyer, which will not exceed 3% normally but the agent must hold a mandate from whoever pays the commission.

The notary (le notaire)

There are approximately 7,600 notaries in *France*. The notary is a ministerial officer appointed by the government. Their fees are fixed and not ordinarily negotiable. The notary's participation is necessary for any transfer of title to real estate other than by the government or by auction. Only the notary may register the transfer documents at the registry of deeds, giving notice to third parties.

It will be the **notary's responsibility** to verify that the seller has good title and that any liens or mortgages can be discharged with the purchase price. The notary most commonly will receive and hold both the initial deposit and the purchase price in his client's account until such a discharge takes place, but the price can also be paid outside of his accounts although this is not recommended. Funds held by the notary are entirely guaranteed. Where separate notaries act for the buyer and seller, the fees will be divided between them and there will be no extra cost for the buyer (the seller then paying no fees other than any costs involved in discharging mortgages (*mainlevée*)).

If he/she is the sole notary, the notary owes the client and the parties, a **duty of confidentiality** and the **duty to advise** them of all the risks inherent in a transaction. He/she must verify the parties' identities and their capacity to act. The notary today must also make a **declaration to the appropriate financial intelligence unit** (*Tracfin* in *France*) whenever the origin of funds for any transaction appears to him/her to be suspicious. The notary must not advise the clients of his/her suspicions.

The notary will pay the registration taxes for each sale, and will therefore demand that the buyer pays, on top of the purchase price, the registration taxes and fees prior to completing the transaction. **As of January 1, 2004, the notary must also collect and pay over the capital gains tax due on a transaction.**

3.6 Powers of attorney

Notaries will generally require powers of attorney to be either notarized and apostilled, or signed before the French consul in a foreign jurisdiction. While the law does not strictly require it, it is customary, particularly where the power of attorney is being used to sell.

The power of attorney must be specific as to the property and may set limits as to the price ('not less than a certain amount' for example, without stipulating the actual sale price eventually agreed).

Where companies purchase real estate, the power of attorney granted as a result of a shareholder's meeting need not be notarized, nor do the minutes of the meeting authorizing the purchase or sale.

3.7 Financing

It is very common to obtain **bank financing** for a real estate transaction. In fact all sales to consumers are subject to obtaining financing, unless the buyer specifically states in his/her own handwriting in the preliminary contract that financing will not be required. French banks will loan to non-residents, and foreign banks may loan and obtain mortgages on French real estate. The preliminary purchase document will state that financing is to be obtained, the amount, the maximum interest rate acceptable to the buyer and the repayment period.

The loan will be secured by a *privilège* or *hypothèque* – a **mortgage**. Generally this will be for the amount loaned increased by 10 to 20% for the 'accessories', which are the costs of foreclosing and interest presumably due if there is foreclosure. However, since the registration cost of the mortgage will be a percentage of the entire amount secured, the accessories will increase the overall cost.

Banks may also request **independent guarantees** in the form of deposits pledged to cover a portion of the amount loaned. The lender may be satisfied, in rare cases, with a **promise to mortgage** rather than a mortgage itself, although a promise will not secure the bank, since other borrowers may then register a lien and have precedence.

Because the foreclosure procedure is cumbersome and requires a sale of the real estate at auction, lenders will not be satisfied to be secured with the value of the real estate alone, but will want to verify income stream to determine that the borrower will make mortgage payments. Ordinarily, income should be three to four times more than the monthly mortgage repayment.

Under the consumer law, the financial institution must make a clear offer in writing, which is to be valid for at least 30 days. **The offer may not be accepted in the first 10 days following receipt.** The offer must contain an indication of the *taux effectif global* (*TEG*), the actual interest and costs payable on the mortgage. Loans may have variable or fixed rates of interest, and where the interest is variable the *TEG* will be based on applicable rate at the

time of the making of the loan (for example, *Euribor*). Completion must take place within a four-month period from the acceptance of the loan offer.

3.8 Purchase through a company

Purchasing French real estate through a company presents certain advantages, but also certain risks. The real estate investor will want to evaluate these carefully to ensure that the advantages apply to his/her specific needs.

There are two main advantages for the foreign buyer. Ownership of shares of a property-owning company is not considered under French inheritance law as the equivalent to ownership of real estate. This means that when the owner of the shares dies, the shares will be considered **'movable' property** under French law and will be subject to the law of the domicile of the decedent at death (or the law of the nationality of the decedent) but not systematically to French law (unless the decedent has in the meantime become a French domicile). From a practical point of view, the effect is that the heirship provisions in favor of children or parents under civil law will not be applicable. It is important to note, however, that with a few exceptions resulting from specific tax treaties, the shares will be considered to be subject to French estate tax if more than 50% of the company assets are composed of French real estate.

The second advantage concerns the **wealth tax**. Shareholder advances made to companies owning real estate in *France* by non-residents are considered under current tax policy to be financial investments in *France*. They will therefore be exempt from wealth tax calculations, and lower the value of the shares, often taking them out of the range of wealth tax which is triggered at Euro 720,000 per family taxable unit.

There are several disadvantages to purchasing through a company, depending on the type of company involved. These will be discussed below.

The Société Civile Immobilière (SCI)

French law distinguishes between civil and commercial activity. 'Commercial' activity is basically trading activity. **Civil activity, in the context of real estate ownership, will include holding real estate for rental, or for the free use of the shareholders of a company.**

The *SCI* is the most common type of company used to hold real estate. It requires no less than two shareholders, who hold parts not shares. No share certificates are issued. There is no minimum capital, and no requirement to file accounts. The *SCI* is **fiscally transparent**, that is any income it makes is attributed to its shareholders. However **the *SCI* may opt to pay corporate tax**. **This option is irrevocable** and has a number of consequences, including on the calculation of capital gains tax liability on resale of the real estate. The *SCI* will be required to be registered at the company registry in order to be considered a **legal entity**. Once this is done and it has the *personnalité morale* (becomes a 'person' before the law) it can sue or be sued, and may own real estate in its own name.

The company will have *statuts* that govern how it is to be run. These are the equivalent of the by-laws and memorandum and articles of incorporation. They will specify the capital, the address of the company, the corporate purpose, the number of shares, the names of the

subscribing shareholders, the number of shares each will have, and the duration (normally 99 years). The company's corporate purpose clause should avoid a commercial connotation if the 'civil' nature of the company is to be preserved. Thus the purchase and management of real estate is a civil objective, but the purchase and sale of real estate is a commercial one.

The company is represented or managed by one or more managing directors (*gérants*) who are chosen by the shareholders either in the statutes or by a general assembly. The *gérant* can be a foreigner, and need not be domiciled in *France*. The *gérant* can be revoked at any time, unless the statutes specify otherwise. The management has the power to bind the company for any acts that come within the corporate purpose and are not *ultra vires*. Third parties will not be considered to have notice of restrictions to the *gérant*'s authority in the statutes or in the minutes of the meeting appointing them. However, most careful notaries will require the approval of the shareholders in order to allow a *gérant* to dispose of all or a significant portion of the company's assets or to mortgage the real estate. Limited liability companies may be shareholders of an *SCI*, but tax consequences will flow from such a choice.

Transfer of company shares Any transfer of shares of the company will be registered both with the tax office at a cost of 4.89%, and with the registry of companies, and will in addition trigger liability for capital gains tax. A failure to register will make the transfer available to third parties, including the tax office.

An *SCI* may be created without the participation of a notary. However, only a notary may act to contribute real estate to a company as part of its capital (*apport*). The transfer of shares of a registered SCI may take place without the intervention of a notary.

Annual costs The costs of incorporation and annual management of an *SCI* are low, seldom more than Euro 3,000. It is recommended that an *SCI* keeps annual accounts, and that an annual meeting of the shareholders be held to approve them, and to approve the management.

Unlimited liability The *SCI* is not a limited liability company. Each shareholder is liable for the company's debts, proportionally to his/her percentage of ownership of the company shares.

Tax obligations The *SCI* will be required to file a tax form every year (*Form 2072*) listing the names of the shareholders and the identity and value of its French real estate. If no changes have taken place, then an exemption to the annual filing can be obtained. Like all companies, foreign or French, owning real estate in *France*, the *SCI* must undertake to **disclose to the tax office the identity of its shareholders, failing which an annual tax equal to 3% of the fair market value of any real estate held will be applicable**.

Where the *SCI* is held by individuals and where it has not opted to pay corporate tax, the capital gains tax treatment of the sale of real estate will be the same as for individuals. This will not apply where the *SCI* is held by a corporation.

Commercial company ownership

Real estate may also be owned through a *société en nom collectif* (*SNC*) or through a limited liability company known as a *société à responsabilité limitée* (*SARL*) or *entreprise unipersonelle à responsabilité limitée* (*EURL*), *société anonyme* (*SA*) or *société par actions*

simplifiée (*SAS*). The latter two corporate forms are seldom used for individual real estate ownership as they are more adapted for larger businesses having commercial activities and are not included in the discussion below.

The *SNC, EURL* and *SARL* have a commercial activity and will be subject to annual corporate tax. The *gérants* of the *SNC, SARL* and *EURL* must either be citizens of a country that is a member of the *European Union* or have a *carte de commerçant* allowing them to do business in *France*. They need not be domiciled in *France*.

Transfers of shares of commercial companies other than *SA* and *SAS* will be subject to the same registration tax as for parts of an *SCI*. Capital gains tax treatment on resale will be less favorable than for individuals or an *SCI*.

Ownership through foreign companies

All companies owning real estate in *France* directly or indirectly must either undertake at purchase to reveal the names of their shareholders, or make an annual declaration doing so, depending on the type of tax treaty existing between the company's country of origin and *France*, in order to avoid the above-mentioned annual tax of 3%.

Companies incorporated or domiciled in countries not having a tax treaty with *France* will always be subject to the 3% annual tax, and may not be exonerated by declaring the names of the shareholders.

This is why all knowledgeable advisers in *France* will strongly discourage potential buyers from using any kind of offshore company when purchasing in *France*. If an *SCI* has an offshore company as a shareholder, then the percentage of ownership in the offshore company will be taxed at 3%. The 3% tax will not apply to companies when less than 50% of their French assets comprise French real estate, or when the shareholder is a public company quoted on a stock exchange. The tax applies to ownership on January 1 of every year.

A commercial company, whether French or foreign, owning real estate in *France* will be required to file annual accounts with certain exceptions provided by treaty. Unlike the *SCI*, granting gratuitous use of real estate held by a commercial property to a shareholder is considered an 'abnormal act of management', and will create imputed income to the company. This 'fictional' rental income must be declared in the annual corporate tax declaration.

The use of a foreign company to purchase real estate in *France* can only be recommended when the income or estate tax treaty between *France* and the country in which the company is resident presents particular benefits. Specialist advice is recommended to determine whether a foreign company may be used, on a case-by-case basis.

3.9 Defects and warranty claims

Warranty claims favoring the buyer

Every property transfer contains a **warranty of good title** (a guarantee that the new owner will not be evicted from the real estate). The property sold must be the same as that described

in the preliminary contract, free of any flaws in title or defects known as 'redhibitory defects' rendering the real estate unfit for use.

Where the property is an apartment, the buyer has a right to have the apartment measured for one year following the sale. If the **square meterage** is more than 5% smaller than the surface area indicated in the *acte de vente*, the buyer can claim a reduction in price.

The buyer is also protected against *troubles de fait* or *troubles de droit*: attacks against his/her ownership rights either in fact or at law, for example where it is discovered that a rental agreement exists for the property.

The seller will be liable for **hidden defects** preventing or reducing the possible use of the real estate, or making it unfit for its intended use. The buyer has an obligation to check for existing defects that could be discovered by an ordinarily attentive person. But where such a defect is discovered, the buyer may request either a reduction of price or a cancellation of the purchase. The petition for either should be filed within the shortest available time following discovery.

Warranty claims favoring the seller (la lésion)

Where the seller discovers that he/she has sold the property for a **price less than seven-twelfths of the market value**, the seller can ask that the sale be rescinded. The request must be presented within two years of the sale and proof of the market value must be presented by three experts named either by the parties or by the court. The buyer can choose to pay the remainder of the 'just' price or to return the real estate to the seller and receive the price paid in return.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

Regulations regarding construction of new buildings and modification of existing ones are codified in the *Code de l'urbanisme*. Local communes may enact zoning ordinances (*plan d'occupation des sols* or *POS* and *plan local d'urbanisme* or *PLU*) that will determine among other things the different zones for different types of development, thus whether land can be used for construction, and the size of buildings that may be constructed (what percentage of the land may be covered by construction).

Nearly all communes have enacted *POS* or *PLU*, but as these may also be modified it is important to verify current status in each commune. Different types of legislation will apply to construction other than zoning, for example, rules regarding sanitation, historical preservation and security. The rules are independent of each other, thus a permit to build will not necessarily satisfy other required authorizations. It is not, for example, automatically a permit to demolish an existing structure.

Building permit (permis de construire)

No building may be constructed, and no modification as to the use, volume, exterior aspect or number of floors of an existing building may be made, without obtaining a building

permit. Modification of the interior layout of a building does not require a permit unless it will modify the use to which the building is put, or modify the number of floors. A permit is also required for demolition. Certain works require only a **declaration** or *déclaration de travaux* – generally where no additional volume is being created or where the building does not create more than 20 square meters of additional volume on a property containing an existing building. Adding a swimming pool, whether covered or not, may, depending on the design for example, only require a declaration rather than a permit.

The permit request is filed with the town hall (*Mairie*) by the real estate owner or his/her representative. The use of an **architect** is not required where the construction being built for the owner is smaller than 170 square meters, as well as in certain cases regarding agricultural buildings.

The request will be posted in the *Mairie* within 15 days of its receipt and will remain posted while the file is being examined. The *Mairie* must reply within the same 15 days informing the owner whether the file is complete and giving the date on which a decision will be taken, normally within two months of the receipt of the file, but which can vary according to the size and importance of the project.

If the *Mairie*'s reply does not mention that additional information is required, or that failure to decide within the specified time does not constitute tacit agreement, then where no decision is taken at the expiration of the announced period, the permit may be considered to be tacitly granted, but it is recommended that the real estate owner requests written confirmation that no refusal has been decided. The *Mairie* will also require the approval of the *Direction Départementale de l'Equipment* (*DDE*) and of the *Architecte des Bâtiments de France* for various aspects of the permit.

If a permit is granted, work must begin within a two-year period, and must not be interrupted for more than one year. The permit must be posted on site for the duration of the works (and a bailiff should establish existence of the posting on site or *affichage*) and with the *Mairie* for a two-month period following issuance, to allow third parties to file oppositions to the legality of the permit with the administrative courts.

4.2 Architect's and building contracts

Insurance is obligatory for both the contractor and the owner of a building being constructed or rebuilt. The owner's insurance is known as the *dommages ouvrage* while the builder's and subcontractor's insurance covers civil responsibility during the *garantie décennale* or 10-year period of liability.

Where the owner is building for his/her own use, then the *dommages ouvrage* insurance is not obligatory but it will nonetheless be requested should a sale be made during the 10-year period following completion of the real estate because the buyer will prefer to rely on the seller's own insurance contract for any defects that may appear rather than search for the contractors and their insurers years after they have left the site.

The architect

A person may only practice as an architect if he/she is a member in good standing of the *Order of Architects*. Use of the title is otherwise a criminal offense. Any works requiring

a building permit must be based on a plan prepared by an architect (*projet architectural*) which defines the place of the constructions on the land, their volumes and layout, their colors and materials. The architect retains certain intellectual property rights in the plans and in the executed building.

The architectural contract is not a mandate from the owner to the architect. A specific power of attorney is required to carry out additional tasks such as signing building contracts on the owner's behalf or paying the contractors.

The architectural contract should be in writing, according to the rules of the *Order of Architects*, but the jurisprudence will allow its existence to be proven by elements other than a formal document. The contract should accurately describe the architect's mission in relation to the project: it may go from the conception of the building to its reception by the owner, covering all the steps in between. The architect is then the *maître d'oeuvre* for the owner, who is the *maître d'ouvrage*.

The architect has a permanent **obligation to advise** and assist his/her client. He/she may be charged with directing the works, and with supervising them. The architect's fees are freely negotiable, although the Order publishes a schedule of 'suggested fees'. The fees may be fixed (*forfait*) or may be based on a percentage of the cost of the works, or a mixture of both. For example, the development of plans and preparation and filing of a building permit may be billed at a fixed cost, and the construction fee at a percentage of the cost of construction. The range of percentages is often between 8% and 10% of the cost of the works, value added tax excluded. The architect must have professional liability insurance. Depending on the complexity of the work, the owner and architect may decide to employ a quantity surveyor (*économiste* or *métreur*).

The building contract

The building contract follows the general provisions of French contractual law. Standard contracts that describe the works and the cost are often used. These can be found at www.ogbtp.com or www.afnor.fr, for example.

It is important to specify a precise time for completion, although this may depend on the granting or filing of a building permit. The contract may be for a fixed sum (*forfaitaire*) or it may specify that the cost may vary by defined percentages or be indexed. With a fixed price contract, the builder will be held to the bid, unless under the jurisprudence some important extraneous and unforeseeable fact intervenes.

The contract for an individual home (contrat de construction de maison individuelle)

Precise consumer protection provisions apply to individual home contracts. These are codified in the *Code de la construction et de l'habitation*. Failure to include them in a contract makes the contract void and may result in criminal prosecution. The builder's responsibility will vary according to whether he/she has provided the building plans or not. They are applicable to any construction that will include up to two residential premises for the same owner.

The contract must be in writing, and the owner must receive it by registered letter, with all its annexes. The owner has a **seven-day cooling off period** during which he/she

may withdraw. The contract must include a complete description of the land on which the construction is to take place, and state that the owner may be assisted by a professional such as an architect. The contract must list the guarantee the builder provides that he/she will complete the works (through insurance or a bank guarantee – known as a *garantie de livraison*) or will reimburse funds received if the works are not completed (*garantie de remboursement*), and make reference to the *dommages ouvrage* insurance obtained by the owner.

Other obligatory information includes the reference to the building permit, a technical description of the construction, the date on which the work will begin, and late delivery penalties (which cannot be less than 1/3,000th of the price per day); the price and the stages of construction at which separate payments are to be made; and if there is bank financing, the amount the owner intends to obtain. If there are conditions precedent to the contract's validity (for example, obtention of the building permit or financing), the contract must stipulate a date by which they must be fulfilled.

Certain clauses are considered invalid and will be given no effect (*clauses abusives*). These include any clause that require the owner to give the builder a mandate to obtain financing or that require the owner to prove that he/she has requested financing of several institutions prior to returning the deposit. The owner is entitled to retain 5% of the price for a period of one year following reception of the building. This retention can be substituted by a bank guarantee.

The builder can request **payment during the works** but the **percentages are fixed by law**. He/she can ask for no more than 15% before the work begins, 25% when the foundations are completed, 40% when the walls are completed, 60% when the roof is done; 75% when the windows and doors are installed; and 95% at completion and reception.

Sale of building to be constructed (vente d'immeuble à construire)

In the *vente d'immeuble à construire* the seller undertakes to build a building on the real estate at a specified date. The contract can specify that the sale will be completed when the building is delivered (*vente à terme*) or it can transfer the title to the real estate immediately.

The *vente en l'état futur d'achèvement* or *VEFA*, is the real estate transfer by which the seller undertakes to build and deliver, or renovate (*vente en l'état futur de rénovation*), all or part of a building on the real estate whose title is being transferred. Construction may have begun prior to the sale. The *VEFA* is most used in subdivision developments and condominium sales. *VEFA* contracts must respect certain legal provisions, or will be considered void.

The reservation contract must specify the area in square meters, the number of rooms, bathrooms and other services, its position in the building (if an apartment), the standard quality, the price and a delivery date, as well as conditions relating to financing of the purchase. There must be at least three originals, and the buyer must receive one in order for the **seven-day cooling off period** to commence. The deposit requested at reservation cannot be more than 5% if the building is to be completed within a year, and 2% if completion is to take place within two years. No deposit may be requested if completion is not to take place within two years or more. Failure to respect these provisions can result in criminal sanctions. The deposit must be made to a notary or to a bank account in the buyer's name.

The notarial deed will require the buyer to pay the price of the real estate and to undertake the payment of the construction as it advances in amounts no greater than 35% when the foundations are completed, 75% when the roofing is done, and 95% upon delivery of the building. Completion of the construction is guaranteed either by an independent bank or by a showing of sufficient assets and real estate sale in the development program, as well as by significant advancement in the construction at the time of sale.

Upon completion of the construction, the building will be **formally accepted** (*réception*) by the owner. The insurance coverage is triggered by this reception of the construction. At the formal handing over, all reservations about the construction and appearance are preserved in a minute or *procès-verbal de réception* which is signed by the participants. The individual buyer is well advised to have an independent architect or expert present during this process.

4.3 Completion of construction and formalities

Work must be finished prior to the expiry of the validity of the building permit. The permit will automatically expire if works are suspended for more than a year. Completion must be declared to the municipality within 30 days (*déclaration d'achèvement des travaux*) and if an architect has been directing the construction he/she will file a declaration that the building conforms to the permit (*attestation de conformité*). The authorities are to visit the premises and deliver a *certificat de conformité* – a certificate that the building conforms to the permit – within three months of the delivery of the *déclaration*. If no certificate is issued, the authorities can be formally requested to make an inspection. If no inspection or observation takes place within one month of the formal request, there is a tacit *conformité* which can replace the official certificate.

The issuance of the certificate can be attacked by any third party having standing to sue. A tacit *certificat* cannot be withdrawn by the authorities, who otherwise can withdraw the certificate at any time. A partial certificate of conformity can be issued where there is a building development of which the individual home or apartment building forms only one part.

4.4 Deficiencies and warranty claims regarding new construction

Visible defects must be reported within **one month**. The structural integrity of the building is guaranteed for 10 years, and there will be independent insurance to cover that risk. The functioning of other elements of the construction and equipment, such as doors and windows, is guaranteed for two years from reception.

The 10-year guarantee (garantie décennale)

The law provides that contractors, the architect and their subagents in the construction are liable for 10 years following acceptance for any defect in the works that can affect the construction's solidity or any essential elements that would make the real estate unsuitable for its intended use. The warranty does not cover minor defects. The case law construes 'works' widely so that a swimming pool, a supporting wall and tennis court are included. Renovations will also be covered by the 10-year guarantee.

It is important to verify that the insurance actually covers the type of work done by the contractor. Thus a general policy does not necessarily cover work on swimming pools, for example. The insurance will continue its validity even when the contractor goes bankrupt or otherwise ceases to work, providing it was in force when the work commenced.

The two-year guarantee (garantie de bon fonctionnement)

The builder, architect, engineer and their subcontractors are liable for any defects in the equipment and fixtures (heaters, air-condition system, windows and doors, for example). Most of these elements will also be covered under the manufacturer's warranty.

The one-year guarantee (garantie de parfait achèvement)

The one-year guarantee allows the owner to require the builder to correct the defects that were noted in the *procès-verbal de réception*, or that have become apparent since that time. The 5% sum retained at the time of the reception serves to cover that guarantee.

5 Rental and tenancy

Landlord–tenant law is complex in *France*, and it is **particularly protective of the tenant** both in residential and in commercial leases. Expulsion of tenants is a lengthy and uncertain process, even in cases of non-payment, and government representatives may intervene to prevent the execution by the police of court orders to expel where they have determined it will create hardship.

Differences exist where a lease is made as a primary or secondary residence and when furnished or unfurnished. Commercial leases are automatically valid for nine years at the tenant's choosing, and failure to renew will require indemnification. Agricultural leases are governed by a separate Code (*Code des baux ruraux*) and have their own specific conditions.

5.1 Rental and lease agreements

The rental agreement for residential premises should be in writing, but if a real estate owner accepts occupancy and rental monies without having a written agreement, the landlord–tenant relationship will be considered to exist, under the codified law (*law no. 89 - 462 of July 6, 1989*) and conditions will be as specified in the law.

The law will consider illicit clauses in a written contract as non-existing (*clause réputée non écrite*) without necessarily invalidating the entire agreement. Such clauses would include imposing a particular insurance company or requiring the tenant to allow rent payments by automatic withdrawals from a bank account. Unfurnished residential leases must be for a period of at least three years, which is increased to six years if the owner is a company. The tenant may terminate the lease if there is a change in his/her situation (loss of employment, for example) by giving one month's notice and, at termination, with three month's notice. The landlord must give six months' notice of intent not to renew. He/she may not terminate the lease before the expiration, and may not refuse to renew the lease unless he/she is selling the real estate or intends to use it for him/herself and immediate family. The landlord

may refuse to renew for non-payment of rent or a serious breach of the terms of the lease. Where the tenant is more than 70 years of age and can prove he/she has a minimum amount of income, the landlord cannot refuse to renew the lease without offering similar living accommodation elsewhere at a similar price.

Furnished and seasonal rentals are **not subject to the law of 1989**, and the provisions can be more freely negotiated.

5.2 Regulations on protection of tenants and rent control

The tenant's deposit may not be more than two months' rent if the tenant is paying on a quarterly basis, and one month's rent if the tenant is paying monthly. The tenant may choose which of the two is to apply. A common if questionable practice is to request an independent bank guarantee for additional sums of money to ensure payment of rent during the period it is estimated an expulsion would require.

Increases in rent at the expiration of the lease are linked to an inflation index. The landlord can propose a new rent amount, on the basis that the original rent paid is no longer equal to those for similar apartments. Where the tenant does not agree, an arbitration procedure exists to determine the appropriate amount that can be charged.

The portions of the common charges that can be recovered from the tenant are determined by a decree. The tenant will be required to pay provisional common charges with his/her rental monies, and an accounting will be made at the end of the real estate owner's association fiscal year to determine whether sufficient common charges have been contributed by the tenant or whether, more rarely, a reimbursement is due. The tenant cannot be required, for example, to contribute toward the payment of construction works on the real estate.

The tenant whose lease is subject to the 1989 law has a pre-emptive right to purchase the real estate if the landlord decides to sell. He must receive notice of the terms and conditions of sale and be given an opportunity to match any conditions agreed.

In **commercial leases**, the tenant may choose not to renew the lease every three years. The landlord may not refuse to renew after the ninth year, without paying an indemnity equal to the value of the goodwill of the business (*fonds de commerce*). While the landlord continues to own the property (the walls or *murs*) the commercial tenant is considered to own the '**commercial property**' (*droit au bail*) which is an element taken into consideration for the evaluation of the business and which may be sold to third parties under certain conditions. An arbitration procedure exists for disputed rent increases in commercial leases.

6 Successions and gifts

6.1 Applicable law and jurisdiction

France applies the **law of the decedent's domicile** at time of death to his/her estate, with the exception of any real estate located in *France*, to which French succession laws will apply. The courts of the decedent's last domicile have primary jurisdiction, but French courts will accept jurisdiction in estates where French real estate is present, or where there

is a French national who is an heir that has reserved rights under the *Code civil* provisions (a child or parent of the decedent).

6.2 Fundamentals of the succession and gift/donation laws of France

The French system of inheritance provides for **forced heirship** and **reserved rights** to children of the decedent, in equal shares. If there are no children, parents have reserved rights, if one or both survive the child, of one-quarter of their child's estate. The surviving spouse's rights will depend on whether there were common children from the marriage, or children from a previous relationship of the decedent. If there are common children, the spouse has a right of his/her choice, in a life estate (*usufruit*), of all the assets in the estate or of the outright ownership of one-quarter of the assets. If there are children born from a relationship with a person other than the surviving spouse, then the spouse has a right to the ownership of one-quarter of the estate.

Where there are no children, but there are surviving parents, the spouse receives one-half of the estate, and if there are neither parents nor children, all of the estate. There is an exception where the decedent has inherited non-fungible property from his/her parents that remains in the estate. In that case, the decedent's siblings or the decedent's children will have a right to inherit one-half.

Any reserved heir and the surviving spouse may request that the *usufruit* be transformed into a guaranteed annuity under court order. The spouse, however, retains rights on the matrimonial domicile, which cannot be substituted by an annuity.

The surviving spouse has a right to remain in rented premises for one year, with the rents being reimbursed by the heirs. Unless the decedent has stipulated otherwise in a will, the surviving spouse has a right to remain in the principal matrimonial domicile, if this is owned by the decedent or jointly by the spouses, and retains the right to use the furniture for the remainder of his/her life.

A basic principle in French succession law is that any agreement on a future succession is null and void (*pacte sur succession future*). This means that reserved heirs cannot validly waive their rights in a person's estate before the person dies.

The statutory portion or reserved right of an estate is one-half if there is one child, two-thirds for two children, and three-quarters if there are three or more children. If there are no children, then each surviving parent has a reserved right of one-quarter of the estate. To the extent that there is any freely available portion of the estate (*quotité disponible*) after the reserved heirs' portions, then the testator is free to bequeath that as he/she chooses, by will or by donation prior to death.

French wills can be made in three forms: handwritten (holographic), authentic or mystic. The **holographic** will must be entirely handwritten, signed and dated by the testator. No other signatures may appear, and thus it must not be witnessed. The **authentic** will is dictated by the testator to a notary in the presence of witnesses. Although the procedure for the authentic will is cumbersome, particularly for foreign testators, the authentic will is less likely to be contested. The **mystic** will consists of delivering a sealed envelope containing testamentary dispositions to the notary in front of witnesses and declaring it to be the last will. Foreign wills are valid in *France* if they are executed in a form either that is valid in the

country of which the testator is a citizen, or is valid in the country where they were executed. If the will contains a provision that is contrary to French public policy (for example, if the will ignores the forced inheritance rules) the bequests that violate the French rules will be modified to conform to French public order, but the will is not considered *a priori* void. The holographic will should be deposited with a notary who will register its existence at the central registry of wills, but this is not a requirement for validity.

Heirs are vested in the real estate at the death of the decedent. The estate may be accepted, refused or accepted with the benefit of an inventory. The inventory allows a beneficiary to determine the assets and liabilities. The beneficiary is liable for inheritance taxes.

Gifts may be made by notarial deed, or by simply turning over the gift (*donation manuelle*). Gifts that reduced the value of a reserved heir's share of an estate may be called back through judicial procedures. However, gifts *inter vivos* made to reserved heirs will be taken into account to determine the reserved portion to which they are entitled.

The French succession laws will not apply to shares of companies that own real estate in *France*, if the decedent is not a French domicile. This is why the use of French *sociétés civiles immobilières* is an important aspect of French estate planning for persons owning French real estate.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

The accurate calculation of taxes and notarial fees due at closing is complex and contains many variants. Only the principal aspects are referred to in this section, and in general with approximate percentages. The notary is charged with collecting the fees and capital gains tax due at closing and paying them to the tax administration. An indication of the calculations is found at www.pap.fr/calculs/fn/saisie.asp.

7.1.1 Real estate transfer taxes

The general cost of a transfer of real estate for value (*mutation à titre onéreux*), including notary's fees, is 7%. This cost is by custom paid by the buyer unless the price is stated in the offer to be *acte en main*, in which case it is understood that the seller will pay. Registration of a security on the real estate to guarantee repayment of financing will add from 0.6% to 1.5% approximately, depending on the type of security – *privilège* or *hypothèque*.

Notary's fees are not negotiable generally, although on large transactions the fee portion of the 7% may be subject to negotiation.

7.1.2 Sales tax (value added tax)

If the real estate was **built less than five years prior to the transfer**, value added tax (*VAT, French TVA*) in the amount of **19.6%** will be due by the seller. The buyer will therefore pay reduced fees and registration costs in the order of 2.5%. The reduced registration taxes and *TVA* will also apply to the first resale within five years of completion of a building.

A complete renovation or restructuring of an existing building may make a resale of the real estate subject to *TVA*, and it is therefore important to verify with an expert prior to committing whether the sale is subject to *TVA* or to ordinary registration costs.

7.1.3 Real estate registration and notary charges

The breakdown of registration taxes due at transfer is as follows: on top of the 4.8% registration tax and stamp duty, there is a 0.1% fee due as the *salaire du conservateur* or payment to the director of the *Title Registration Office*. The notary's fees are determined by law and contain a fixed and a variable amount based on the sale price. From Euro 16,777 the variable is of 0.825% of the sale price, on which *TVA* at 19.6% is paid.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

Property tax (taxe foncière)

The property tax (*taxe foncière*) is due by all owners of real estate, whether completed or not. This is a local tax imposed by the municipality in which the real estate is situated and will therefore **vary in accordance with the commune's budgets**. The amount of the tax should be verified prior to completion. The tax is assessed on a percentage of rental value of the real estate. When real estate is transferred, the buyer will undertake to pay a proportion equal to the days of the current year in which he/she will own the real estate. The tax for the year is assessed in October, and it is not customary to request the seller, who will receive the tax bill for the current year in any event, to hold back the portion of the property tax that he/she will owe. Normally, the seller will pay the property tax and request the notary to have the buyer reimburse the **pro rata portion**.

Exemptions can be obtained for newly completed buildings, and for persons older than 65 with very reduced income. If the real estate is rented, the owner pays the property tax, and not the tenant.

Occupancy tax (taxe d'habitation)

Occupancy tax is levied on furnished residential properties. The tax is **due by whoever occupies the real estate on January 1** of any given year. Unlike property tax, no adjustment is made at the completion of a transfer of real estate. Tenants will be liable for the *taxe d'habitation*. Partial or total exemption is possible where the occupant qualifies by income or age.

7.2.2 Income tax (impôt sur le revenu)

For **non-residents**, and subject to applicable double taxation treaties, only income from a French source is taxed. Income tax declarations are due at the end of the month of February for **French residents** and at different times of the year for non-residents, depending on their location. For real estate owners, there exists an obligation to file an income tax return in the event of ownership of a secondary residence, because the French *Tax Code* applies the same obligation to residents even where there is no taxable income. The requirement is, however, seldom applied to non-residents who do not have income from a French source.

Residents in countries not having an appropriate tax treaty with *France* may be subject to taxation on imputed income equal to three times the fair market rental value of the real estate they have at their disposal in *France* (whether through ownership, tenancy or gratuitous use), unless they can show that they have paid a certain percentage of tax on their income in the country of residence.

France applies a **progressive income tax rate** that will vary according to the number of persons and dependants in the 'fiscal household' (*foyer familial*). A minimum tax of 25% may be applicable. More details may be obtained on the website of the Ministry of Finance (www.fisc.gouv.fr).

Schedule of income tax rates for 2003

Taxable income	*Tax rate*
Under Euro 4,191	0
Euro 4,191 to 8,242	7.5%
Euro 8,242 to 14,506	19.74%
Euro 14,506 to 23,489	29.14%
Euro 23,489 to 38,218	38.54%
Euro 38,218 to 47,131	43.94%
More than Euro 47,131	49.58%

Gratuitous use of real estate does not raise income tax issues for the individual. It will, however, create inferred income when a company owns the real estate (this is not the case with an *SCI*), and therefore if, for example, a shareholder has free use of a house there is an obligation to file corporate income tax returns based on the real estate's fair market rental value.

7.2.3 Net wealth tax (impôt de solidarité sur la fortune, ISF)

Wealth tax is assessed where a fiscal household has assets valued at more than Euro 720,000. For non-residents, and subject to double taxation treaties, the wealth tax is only applicable to French assets, and not to certain types of French financial investments and collectibles. Wealth tax is otherwise incurred on a resident's worldwide assets. It must be declared annually and must include a description of real estate and personal property, including automobiles and boats.

Schedule of wealth tax rates for 2003

Amount	*Tax rate*
Less than Euro 720,000	0
Euro 720,000 to 1,160,000	0.55%
Euro 1,160,000 to 2,300,000	0.75%
Euro 2,300,000 to 3,600,000	1%
Euro 3,600,000 to 6,900,000	1.3%
Euro 6,900,000 to 15,000,000	1.65%
More than Euro 15,000,000	1.8%

7.3 Capital gains tax

When real estate is sold, or when shares of a company holding for more than 50% of its French assets or French real estate are sold, capital gains tax is due (subject to the appropriate tax treaties).

For individual real estate owners and those owning through fiscally transparent companies such as an *SCI* that does not have any commercial activity and has not opted to pay corporate income tax, a simplified system was introduced on January 1, 2004.

All real estate held for more than 15 years is not subject to capital gains taxation. After the fifth year of ownership, a reduction of 10% of the net profit is applied in the calculation of capital gains. A lump sum of 15% of the price of acquisition is applied to take into account works on real estate, but if greater amounts have been spent, then the real amount can be applied as long as sufficient proof is provided (original estimates, invoices and proof of payment). **Capital gains tax is levied at 16% of the result, for residents of the *European Union*, and 33% for non-residents. The tax is paid at closing.**

For residents, the sale of a principal residence is excluded from capital gains taxation, provided it has been held for more than five years. Former residents can qualify for this exemption provided they can prove tax residence in *France* prior to completion.

Sales for amounts of less than Euro 15,000 are exempted from taxation. Amounts paid in gift or inheritance tax can be included for the calculation of capital gains. A standard Euro 1,000 deduction is applicable to all transactions.

For **sales by companies** subject to corporate income tax, whether French or foreign, the capital gains calculation will *not* include a reduction of 10% and exoneration after 15 years. On the contrary, the company will be considered to have benefited from a 2% per year depreciation deduction, whether or not the real estate has been rented, and therefore the tax basis will be reduced by that amount for every year of ownership, causing an **increase in tax liability**.

7.4 Inheritance and gift taxes

Inheritance and gift tax rates are identical. Rates vary in accordance with the relationship of the donor and beneficiary. Gifts and bequests between unrelated persons are taxed at 60%. Gifts and bequests between parents and children and between spouses benefit from exclusions and graduated rates. Gift taxes may be reduced by 50% depending on the donor's age.

The inheritance tax declaration is due within six months of death if the decedent was a French tax resident, and within one year if he/she was a tax resident elsewhere. The tax should be paid at the same time, or if it is difficult to value the estate, then a provisional payment should be made. Late payment can incur penalties of 40% and interest (at 0.75% per month).

The parent and child exclusion is of Euro 46,000, and between spouses there is an exclusion of Euro 76,000. These exclusions are applicable to gifts made over 10-year intervals.

Tax rates for inheritances and gifts

Between parents and children	*Tax rate*
Under Euro 7,600	5%
Euro 7,600 to 11,400	10%
Euro 11,400 to 15,000	15%
Euro 15,000 to 520,000	20%
Euro 520,000 to 850,000	30%
Euro 850,000 to 1,700,000	35%
More than Euro 1,700,000	40%
Between spouses	*Tax rate*
Under Euro 7,600	5%
Euro 7,600 to 15,000	10%
Euro 15,000 to 30,000	15%
Euro 30,000 to 520,000	20%
Euro 520,000 to 850,000	30%
Euro 850,000 to 1,700,000	35%
More than Euro 1,700,000	40%
Siblings	*Tax rate*
(exclusion of Euro 15,000 under certain conditions)	
Up to Euro 23,000	35%
More than Euro 23,000	45%
PACS partners	*Tax rate*
(exclusion of Euro 57,000)	
Up to Euro 15,000	40%
From Euro 15,000	50%
Family members up to nieces and nephews	55%
Other family members and unrelated persons	60%

Gifts and bequests of French property to charitable institutions will only be exempt if the charitable institution qualifies as a '*fondation d'utilité publique*' under French law, or if a tax treaty on gifts and estates exists and allows the exemption. It should not be assumed that, because the foreign charity is qualified as a not-for-profit charitable institution in its home country, the French tax authorities will exempt the charitable donation from 60% taxation.

7.5 Other taxes and charges

Taxes on vacant apartments (taxe sur les logements vacants)

A special tax *(taxe sur les logements vacants)* is due on apartments vacant for more than two years in towns that have more than 200,000 inhabitants, where the government has determined that there is an imbalance between a high demand for lodging and an insufficient supply. Cities include Paris, Lille, Bordeaux, Toulouse, Lyon, Montpellier, Cannes-Grasse-Antibes, Nice. The tax is paid by the owner.

7.6 Incorrect (lower) statement of sale price on the sales agreement

Declaring a lower price of a real estate transfer in a notarial transaction is a **criminal offence**. Sellers may sometimes request this in order to lower capital gains tax and wealth tax exposure, and buyers may be tempted to lower the registration costs of a transaction, although this will increase their capital gains tax exposure on resale. There are serious inherent risks quite apart from the method of making the undeclared payments. Penalties can be very substantial (interest at 0.75% per month on the undeclared portion and tax penalties of 50% and more).

The transfer deed will contain a declaration that the parties have not dissimulated the price. Notaries that knowingly accept an act containing an understated price may face serious criminal charges and imprisonment.

7.7 International taxation

Ownership of real estate in *France* will not *per se* subject a foreign resident individual to income taxation in *France*. However, ownership of property by a foreign company will, in most cases, entail the existence of a **permanent establishment** in *France* and the requirement to file accounts and corporate income tax returns (*impôts sur les sociétés*) beyond the annual declaration of the identity of the shareholders (Form 2746 due on May 15 every year).

Income from French real estate is generally subject to French taxation, and if the real estate is worth more than Euro 720,000 and is unencumbered by debt, it will subject the owner to wealth tax.

Capital gains will be taxed by the country in which the real estate is situated, and thus *France* will impose its capital gains taxation on sales, and where double taxation treaties exist, will give the taxpayer a credit for French tax paid on their own home country taxation.

Income from real estate ownership, whether rental income or capital gains income, is generally taxed by the country in which the property is situated. There are important exceptions and the applicability of the treaties should always be examined on a case-by-case basis.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Two types of residence permits exist in *France*, the *carte de séjour* (**short term**) and the *carte de résident* (**long term**). The basic principle is that any stay longer than three months requires a residence permit, unless a visa has been issued allowing stays up to six months. Citizens of the *European Union* and *the European Economic Area* do not need visas in order to obtain residence permits.

European Union and EEA citizens

Any European Union and EEA citizen wishing to reside more than three months in a member country must request a residence permit. The following documents will be required in *France*:

a valid identity card or passport, three photos, recent proof of a residential address (lease and utility contracts), work contracts or statement of means of support. European Union citizens who are employed in *France* and wish to transfer their residence there can obtain a 10-year residence permit (*carte de résident*) if their home country provides a reciprocal right to do so. No work permit is required. The same applies to Swiss citizens.

Non-European Union citizens

Citizens of countries that are not members of the *European Union* must apply for a visa to reside in *France* on a short- or long-term basis. The application is made, with certain exceptions, at the French consulate nearest the person's last place of residence. Once in *France*, application must be made for a short-term residence permit (*carte de séjour*). Application may be based on offered employment in *France*. A work permit will be required in order to accept employment.

The application for a *carte de séjour* is filed with the *Préfecture*. The documents required are similar to those required of European Union citizens, but a birth certificate, proof of recent residence and a medical certificate will also be requested.

The *carte de séjour* is valid for one year and can be renewed every year. Unlike the *carte de résident* it does not imply authorization to work in *France*. The *carte de résident* will be granted only to certain categories of individuals: spouses of French citizens, after one year of marriage, *carte de séjour* holders after three continuous years of residence. It is valid for 10 years and will be automatically renewed. A long-term residence permit allows the holder to work.

8.2 Tax residence

French tax laws do not make the distinction between residence and domicile as occurs in the *UK*, the *USA* and some other countries. The basic tax text is the *Code général des impôts* and its annexes, including the *Livre des procédures fiscales* which is a procedural text for the collection and verification of tax liability.

The *Code général des impôts* lists **three criteria for tax residence** in *France*. An individual will be considered a tax resident if he/she fulfills **any one** of the three following criteria:

- *France* is his/her principal home and place of sojourn, which means the family's **usual place of residence**. A person can have only one *foyer fiscal* and this means that if a man is living abroad but his wife and children live in *France*, and there is no decree of separation and divorce, he may be considered a French tax resident. The law does not specify a particular number of days that will trigger tax residence, although stays of **more than 183 days** per year will be a strong indication of evidence of residence. If the person cannot prove tax residence in another country, that will be a very strong indication of French tax residence regardless of the number of days spent on French soil.
- *France* is the place where an individual practices his/her **principal profession**.
- *France* is the **center of the person's economic interest** – that is, the main investments are made in *France* or the majority of income earned is from a French source.

If the French authorities consider an individual to be a French tax resident, **taxation will apply on worldwide income**. Wealth tax will apply on worldwide assets. Inheritance tax will apply on the worldwide assets at death. Even where double taxation treaties may exclude certain income from French taxation, it must be reported.

8.3 International taxation for residents of France

France has entered into many bilateral income tax treaties and a few estate and gift tax treaties. These will generally include **non-discrimination provisions**, and may apply to citizens or to residents of either country concerned. Taxation will vary in accordance with the nature and origin of the income concerned. Most **double taxation treaties** will eliminate the risk that a foreign real estate owner will be subject to the tax on imputed income equal to three times the fair market value of his/her real estate. Income from real estate ownership, whether rental income or capital gains income, is generally taxed by the country in which the real estate is situated. There are important exceptions and the applicability of the treaties should always be examined on a case-by-case basis.

9 Checklist: Real estate acquisition in France

- Selection of the type of real estate sought:
  - residential or commercial
  - urban, agricultural, holiday home
  - speculative purchase, investment purchase, own use.
- Determination of manner of purchase, whether through a company or in the individual's name.
- Selection of appropriate real estate agent in accordance with the general market serviced (high end, middle range, low end, agricultural, holiday home, or commercial).
- Visits to real estate.
- Selection of notary or lawyer.
- Offer to purchase accompanied by 10% deposit made to the name of a notary, lawyer or agent.
- Signature of a preliminary contract (*promesse* or *compromis*) binding the parties and formalizing the deposit.
- If an apartment or property is in a subdivision, review of the *règlement de copropriété* (Condominium Statutes) and annual running costs (*charges*) and works voted by the real estate owners that may be charged to new owners.
- If a company, same as above, but additional due diligence investigation of the company, the real estate and of its beneficial owners.
- If works are required on the real estate, determination if the works will be authorized by the managing agent of the building and the *Mairie* of the town, as well as the *Architecte des Bâtiments de France.*
- Conclusion of the transfer of ownership at the notary and payment of the purchase price, fees and registration costs as applicable, following verification by the notary of the power of the buyer and seller to act, and of clear title on the real estate.
- If real estate, registration of the transfer at the property registry (effected by the notary) and payment of registration fees within one month of signature.

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BTZ Hans Zumstein specializes in residential property in southern France (Provence and Languadoc-Roussillon). The consultation services are based on own experience and a network of quality-oriented construction enterprises and real estate agencies in the region. Selecting a reliable general contractor is often a difficult task for foreigners who are not familiar with the French language and the French attitudes, and that is where BTZ Hans Zumstein comes in.

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Guide to Property and Life in France:
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Contents: Greece

1 Introduction

The political stability of the past few years, the tourist infrastructure which is constantly increasing, the mild and sunny climate, as well as the, still, relatively profitable real estate values on land have acted as contributing factors to the purchase of real estate in Greece by a large number of foreigners, particularly foreigners of *EU* origin. To date, this trend is constantly moving upwards. Real estate buyers mainly favour the Greek islands, which have evolved to typical holiday resorts for a variety of foreign tourists over the past decades.

Greece or *Hellas* covers a total area of 131,957 km^2. Approximately 20% thereof belong to the approximately 2,000 Greek islands, of which 134 are inhabited. The country's population amounts to approximately 11 million people, of which approximately 2 million live in the country's capital, the prefecture of Athens.

According to the Greek Constitution, *Greece* is a Presidential Parliamentary Republic. The *Hellenic Republic* (Ελληνική Δημοκρατία) is a centralized state with a single-chamber Parliament. The country is divided into 51 prefectures (named 'nomoi'), and the autonomous region *Mount Athos*.

Hellas has been a member to the *European Union* since 1981 and today it is also a full member of the *UNO, NATO, OECD, OSZE* and *WEU*. On January 1, 2002, the *Euro* was introduced as the official currency of *Greece*, replacing one of the oldest currencies worldwide, the Greek *Drachma*.

Since ancient times, *Greece* has influenced the establishment of a European cultural identity in many ways throughout its history. It is a historically acknowledged fact that *Europe* owes vital elements of its historical and cultural background to ancient *Greece* and to the 'Hellenic spirit'.

Greek law in force today is of Byzantine–Roman origin and is qualified as a Civil Law Jurisdiction of Continental Europe (or as a Middle European Law System).

The legal transaction of purchasing a piece of land in *Greece* is in general very time-consuming and may – in certain circumstances – require an extraordinary period of time. The frequent changes of legal provisions on taxation and construction are common practice of the Greek real estate sector.

2 Real estate ownership

Approximately 80% of *Greek* people are real estate owners. The *Greek Constitution* explicitly provides for the protection of private real estate. The **freedom of ownership** is a fundamental right, warranted by the constitution and granted to every owner in *Greece*. In other words, the constitutional protection of real estate ownership applies as much to foreign owners of real estate as to domestic owners.

The *Greek Civil Code* of 1940 (hereinafter '*CC*'), which is the pertinent statutory instrument on real estate, contains in its 3rd book (*Articles 947–1345*) the legal provisions on property law, which among others govern the purchase of real estate in *Greece*. The said provisions of the *CC* are binding and applicable to the purchase of real estate by foreign and domestic

entities alike, regardless of the permanent residence of the parties involved (in *Greece* or any other country).

2.1 Different forms and types of ownership

Sole ownership and shared ownership

Being the most comprehensive form of real estate ownership, sole ownership is to be understood as a subjective property right, which belongs to one beneficiary only. The beneficiary may be a physical person or a legal entity, their nationality or residence (or place of establishment respectively) being of no importance.

Distinct fragments of a single real estate may belong to several beneficiaries; this constitutes the form of **shared ownership (or co-ownership)**, whereby the real estate belongs to two or more persons (co-owners), each being beneficiary of a certain ideal share of the real estate. Actual division of the real estate is not effected. An essential characteristic of shared ownership is the right of each co owner to dispose of his/her ideal share freely and independently, without the consent of the other co-owners. On the other hand, disposal of the real estate as a whole presupposes the consent of all co-owners.

Horizontal **ownership or condominium** and **timesharing** are further special forms of ownership.

Horizontal ownership (condominium)

Horizontal ownership or condominium constitutes a special form of ownership, by means of which the beneficiary is granted a **separate right of ownership** on one or more distinct parts of a building, as well as **co-ownership rights** on the building site and on common installations (e.g. the garden, the staircase, etc.). This concept is similar to the notion of **'condominium'** in US law. As a result of distinct ownership rights, the beneficiary may dispose freely of the real estate, without affecting or being affected by any of the co-owners of the building. Apart from the ground floor and the upper floors of the building, the basement is also considered a separate floor, thus, may constitute the object of horizontal ownership rights.

For the establishment of horizontal ownership, the owner of the overall building site has to participate in the legal transaction; the relevant deed must be drafted by a notary public and registered in the records of the *Land Registry*. In most cases, the notarial deed of **building regulations** (regulations concerning the use of the properties and the building) is executed simultaneously with the deed for division of horizontal ownership rights. These deeds contain regulations on the legal relations between the co-owners concerning the use of common installations, their respective rights of ownership, the 'organization' of apartment owners, the election of the apartment owners' representative (the 'Manager of the Building'), the amendment of building regulations, as well as the respective share of the co-owners on the common charges of the building site. Building Regulations are binding on all apartment owners, provided that they have been registered in the competent *Land Registry*. In practice, the Building Regulations form a vital part of the notarial deed of purchase for an apartment. With the execution of the notarial deed, the buyer of a holiday apartment, for example, accepts the direct effect of the existing Building Regulations and undertakes the obligations

contained therein. In case of non-compliance with Building Regulations, any co owner or the organization of the apartment owners as a body, represented by the Manager of the Building, may refer the matter to the competent civil court and apply for judicial measures against the defaulting party: The measures shall involve either the remedy of the default or the refrain from future offensive action.

Timesharing

Timesharing was introduced in *Greece* in 1986 by *Law No. 1652/86*. This law was elaborated (fine-tuned) with *Presidential Decree No. 18/99*. With these instruments *Greece* implemented the *EU-Directive on timesharing* in national law. According to the law the legitimate lessee acquires, through a notarial timesharing deed with the lessor of the real estate, the limited (time-wise) right to use, in return for payment, a holiday apartment or a hotel room in a holiday resort (**timesharing right**), and to take advantage of any services offered in relation to the leased premises. The notarial timesharing deed must be registered in the records of the *Land Registry*. All timesharing agreements for real estate located in Greek territory are governed by the relevant provisions of Greek substantial law.

So far, the institution of timesharing has caused very little interest in *Greece*, and only relatively few hotels and holiday resorts offer timesharing programmes at the present time.

Right to build

Greek law does not provide for rights to build or hereditable rights to build.

2.2 Easements, charges, liens and mortgages

All real estate may be encumbered with easements or liens. There are two distinct categories of easements: **easements on real estate** and **personal easements**. Real estate law qualifies easements as **real rights of use** of the real estate, whereas **liens** are considered as real rights of utilization. There are no provisions for restrictive covenants in Greek law.

The **creation of any easement** (whether personal or real) on real estate is subject to the same formalities as any other encumbrance on real estate and requires a legal transaction (notarial deed) between the parties, as well as the registration of the easement at the *Land Registry*. Greek law also provides for the subscription of easements through **usucaption** (after 10 years of possession of real estate in good faith and after 20 years in the case of possession in bad faith).

Real easements

Real easement means that the real estate is encumbered in favour of another owner, in a way such as to enable the latter to use the encumbered real estate for particular reasons; the easement may also consist in the prohibition of certain activities on the real estate at issue or in the exclusion of a certain right by the owner of the encumbered real estate. Here are some examples of easement: Right of passage or transit through the neighboring property, right of transmission of electricity or of water through a neighboring area, prohibitions or restrictions on construction, etc. The beneficiary of the easement is the owner of the benefiting real estate.

Usufruct (usufruct of use)

Usufruct means that a real estate is encumbered in a way such as to entitle the beneficiary to use and utilize or even to exploit the real estate of another owner. According to the above definition, the types of use granted to the beneficiary through usufruct include use and enjoyment of the real estate, of its **proceeds and benefits**, such as proceeds and benefits from leasing the real estate. The use of a real estate also includes possession rights. Therefore, the usufructuary of a real estate is entitled to possess it. The usufructuary may rent the real estate and sign the relevant lease agreement in his/her name. According to Greek law, usufruct is neither transferable nor hereditable unless it has been agreed otherwise. The usufruct is terminated with the death of the usufructuary, unless the parties agreed otherwise or the owner has notified the owner of renunciation unilaterally. This notification on the part of the usufructuary has to be certified by a notary public and registered at the *Land Registry*. The usufruct right is also considered terminated if the usufructuary acquires the ownership of the real estate.

Right of residence

Through the personal easement of the right of residence, the beneficiary is granted the exclusive right *in rem* to use the real estate as residence. The right of residence may usually be encountered in practice as usufruct of sustenance during the life of the beneficiary. Example: The parents donate a real estate to their offspring and at the same time they reserve their right of residence on the real estate for life, so as to ensure their accommodation until their time of death. Due to the particular nature of the right of residence, the beneficiary is allowed to lease or rent the real estate upon judicial permit only, which is granted for exceptionally material reasons. The right of residence is not transferable and its method of termination is the same as of the usufruct of use. Furthermore, the right of residence is governed by the same principles as the general rules concerning the usufruct of use of real estate.

Liens and mortgages

Greek law provides for liens of immovable property in the form of mortgage. According to the legal definition of mortgage, real estate is encumbered to secure payment of the beneficiary's claim. A mortgage may also be created to secure future or conditional claims. A mortgage may be set up on the basis of a hypothecary title, which is registered in the records of *Land Registry*. The beneficiary may be granted a hypothecary title **by Statute** (e.g. the treasury of the State may be granted a title as security against pending taxes of the real estate owner), **by court decision** (e.g. the beneficiary of a claim may be granted a title against his debtor because of the existence of another unappealable decision) or **by agreement** (e.g. by notarial deed).

2.3 Protection of ownership, proof of ownership and registration

In all cases, a condition precedent to the acquisition of real estate is the existence of a valid **title of ownership** and its **registration** in the records of the ***Land Registry*** (Γραφείο Μεταγραφών, Υποθηκοφυλακείο). In *Greece*, proof of ownership is provided by the issue of a **certificate of registration** of the title of ownership (e.g. sale and purchase agreement, donation agreement, certificate of inheritance, acceptance of inheritance, court

decision) in the records of the *Land Registry*. The certificate of ownership is issued by the competent *Land Registry*. **No acquisition of real estate** takes place **without registration** of the title of ownership in the records of the *Land Registry*, except for acquisition of real estate through usucaption, which has been recognized by a court decision.

All transactions concerning real estate are registered in one of the four books or registers, which are kept at the *Land Registry*. The title of ownership (contract, certificate of inheritance, court decision) is registered in the **transcription book**. The **registry of mortgages** contains all encumbrances on real estate (personal and real easements, as well as mortgages), while any given legal actions for restitution (vindication) of real estate are filed in the **vindication book**. Finally, the fourth book is called the **book of freezed real estate** and contains all kinds of seizure, which have been executed against the registered properties.

In 1995, by means of *Law No. 2308/95*, *Greece* introduced the **national *Register of Deeds***, which records all real property on *Greek* territory. The registration of real estate across the country has not been completed to date. Until completion of the *National Register of Deeds*, the **regional *Land Registries*** will continue to carry out the relevant functions; by law, all titles of ownership of immovable property, as well as all encumbrances on real estate have to be registered in the respective records of the *Land Registries*. Upon completion of the national *Register of Deeds*, Land Registries will be abolished and replaced by the national *Register of Deeds*. After their establishment, the national register of deeds will then issue titles of ownership for all immovable property.

Unlike other European countries, books or registers kept by the *Land Registries* in *Greece*, are not bestowed with any **good faith effect**, i.e. good faith of the real estate buyer concerning the legal status of the immovable property is not protected.

The potential real estate buyer of immovable property in *Greece* should first of all, before signing any agreement with the seller, instruct his lawyer to confirm that the ownership status, as well as the relevant proprietor relationships regarding the real estate at issue, are legally clear and do not present problems. This may only be achieved by a thorough investigation at the *Land Registry*. In most cases, such investigation provides reliable information on the proprietor, the legal effectiveness of the title of ownership, as well as on the existence of encumbrances on the real estate. Certification of unencumbered ownership of the real estate, as well as of registration of the respective title of ownership may be obtained upon request at the *Land Registries*.

The review of the records of the *Land Registry* is only possible if the **exact details of the real estate proprietor** are known, since all records on real estate are kept in alphabetical order, with regard to the proprietors' names. Said information enables the interested party to ensure that the real estate at issue belongs actually to the seller and that it is legally unencumbered.

According to the prevailing practice in *Greece*, the right of review in the records of *Land Registries* and the clarification of the ownership status of immovable property is reserved to **lawyers**.

3 Purchase and sale of real estate

3.1 The sales agreement

With the execution of a sales agreement (sale and purchase agreement), on the one hand the seller is obliged to transfer ownership of the real estate at sale to the buyer and to deliver

the real estate fit for purpose and free from any defects. On the other hand, the buyer is obliged to pay the purchase price to the seller. All **sales agreements** for real estate (both preliminary and final) have to be **notarized** in order to be valid.

The execution of the notarial sale and purchase agreement constitutes the **enforcing agreement**, which is binding on the parties for the execution of the agreed consideration. Nevertheless, the **actual transfer of ownership** or rather the acquisition of the real estate and the enforcement of the sales agreement take place with the **registration** of the concluded notarial sale and purchase agreement in the records of *Land Registry*. In most cases, the notarial sale and purchase agreement includes the **disposal** of the real estate, i.e. the real estate conveyed *in rem* between the parties; such disposal is based on a contractual *causa* concerning the transfer of ownership. Disposal does not require a particular legal form. Unlike the law of other European countries, according to Greek real estate law, the validity of the disposal depends on the effectiveness of the causational transaction (i.e. **the principle of the abstract nature of rights *in rem* does not apply**). In case the notarial sale and purchase agreement is subsequently found to be invalid due to any legal reason, such as fraud, legal incapacity of a party, breach of moral and business usage or breach of law, the relevant disposal shall be considered null and void and the agreed transfer of ownership does not take place. **Greek real estate law** of immovable property (unlike Greek law of movable property) **does not provide for contractual *bona fide* acquisition of real estate from a non-owner**.

Even in cases where the parties have agreed on the sale of the real estate, it is common practice that the potential buyer delays the final execution of the notarial deed, so as to carry out a thorough legal examination of the real estate at sale, and to get hold of the relevant official permit or certificates, if any. In such cases, the parties may consider executing a **notarial preliminary deed of sale**, which is usually accompanied by a **down payment** (earnest) in the range of **approximately 10%** of the purchase price by the buyer. If the final deed is not executed due to reasons attributable to the seller, the latter is usually obliged to return to the buyer double the amount of the down payment. If the final sale and purchase agreement is not executed due to the buyer's responsibility, the deposited down payment is lost.

Greek real estate law does not provide for prior notice of conveyance. Nevertheless, if the seller is unwilling to conclude the final sale and purchase agreement for any reason, the buyer may make a public deposit of the remaining purchase price and execute the deed of sale by means of self-contracting, which results in the conveyance of ownership to his benefit, according to the preliminary deed of sale.

Finally, if the delayed action is deemed to put the interest of the buyer at risk and if it is suspected that the seller shall dispose of the real estate to a third party, despite the parties' agreement, the buyer may make use of the mechanism provided in law for **judicial protection** and obtain a restraining order to avoid his/her alienation from the real estate, in the form of an interlocutory injunction (interim measures), provided that the buyer proves before the competent court that the foregoing risk is substantially plausible.

3.2 Restrictions on sale and acquisition

According to the *CC*, the owner has, in principle, absolute control over his/her real estate, provided that the law sets no restrictions on the exercise of this right. Legal restrictions

on conveyance are based on private or public law rules. The former include, for example, the restraint of alienation of confiscated real estate by the debtor, whereas the restraint of alienation of agricultural estates over 250,000 m^2 and the restraint of acquisition of real estate in 'border areas' by foreigners (see below) should be allocated to the second category. Further orders of substantial public law containing restrictions on conveyance may be found in the relevant legislation on forest areas, on construction and finally on agricultural real estate.

3.2.1 Restrictions under family law and matrimonial property regime

In essence, Greek matrimonial property law does not include restrictions on the disposal of real estate, with the exception of the case where the spouses agree on the status of joint marital property with the execution of notarial deed, either before or during their marriage. In general, the joint matrimonial property status is governed by the rules concerning co-ownership, whereby contrary to the general rules of community co-ownership, the spouses are deprived of their right to dispose of their share independently.

According to Greek Private International Law (PIL, also conflict of laws), the matrimonial property regime is governed by the law of the state of both spouses' nationality and, on subsidiary basis, by the law of the state of their last residence in the course of their marriage, or of the state with which the spouses maintain the closest relationship. Freedom of choice of applicable law regarding the status of matrimonial property does not exist in Greek Private International Law.

If matrimonial property is governed by foreign law, including restrictions on conveyance (e.g. an American married couple is co-owner to a holiday apartment each spouse by 50% and according to Greek PIL, their matrimonial property status is governed by US law), the relevant provisions of foreign matrimonial law are only effective with regard to contract disputes and do not constitute direct restriction of conveyance of real estate located in *Greece*. In other words, the owners are still entitled to dispose of their real estate without limitation.

Nevertheless, if, in the frame of a marital disagreement, the spouse has obtained a court decision in his or her home country containing restrictions on conveyance of matrimonial property located in the country of the spouses' residence and provided that such court decision has been recognized as valid by the Greek courts, the beneficiary may have recourse to proceedings for interim measures and obtain a judicial order restraining the disposal of the real estate; in this way, the spouse may also obtain an order restraining the disposal of the Greek asset.

3.2.2 Options and pre-emption rights

Conveyance bans may also be concluded contractually, their effect being in this case merely of limited nature and **binding only on the parties** to the agreement. If a real estate owner fails to comply with an agreed conveyance prohibition, he/she may be held responsible for breach of contract and be obliged to compensate the other party, unless the conveyance ban is considered null and void because of breach of moral usage, breach of credibility and good faith. In such cases it is necessary that the respective conveyance prohibition is recognized by a court as void.

In general, pre-emption or repurchase rights of real estate may be concluded on the basis of principles of freedom of contract and of autonomy of the parties to a contract, which govern the Greek law of contracts.

Rights of purchase concluded by contract may be found, for example, in financial **leases of immovable property**. The minimum duration of a real estate lease is 10 years. With such a contract, the lessee is granted the right (option) to purchase the property after expiry of the duration of the lease agreement.

Real estate, located in specific residential areas of particular interest, is encumbered with **legal rights of pre-emption (priority rights)** to the benefit of the State. Furthermore, the State is granted the right of pre-emption for specific private forest areas of a minimum surface of 50,000 m^2. In both cases, the owner of such real estate is under the obligation to inform the State of the identity of the potential buyer and the agreed purchase price, prior to concluding the relevant sale and purchase agreement. Thereafter, the State may either make use of its pre-emption right and acquire the real estate at sale (at the same price) or it may inform the owners that they are free to dispose of the real estate. In practice the State has rarely exercised its pre-emption right.

3.2.3 Agricultural real estate

The foregoing also applies to the acquisition of agricultural real estate. As already mentioned, in given circumstances, special construction permits may be required. Agricultural real estate is usually located outside city areas. Building possibilities of agricultural real estate are governed by special rules (e.g. it is a general rule that only real estate exceeding a surface of 4.000 m^2 may be built on).

3.2.4 Restrictions regarding acquisition of real estate by foreigners

In border areas of vital importance for military or security reasons, designated as such by law, acquisition of real estate by foreigners – as well as by Greeks – are subject to an **official permit**. Such permit may be obtained upon request to the competent prefecture or to the Greek *Ministry of Defence* in *Athens*. **Security border areas** include the prefectures of *Florina, Thesprotia, Kastoria, Xanthi, Rodopi, Evros, Samos, Chios, Lesbos* (*Mytilini*), the administrative regions of *Pogoniou* and *Konitsa* in the administrative district of *Ioannina*, the regions of *Almopia* and *Edessa* in the administrative district of *Pella*, the region of *Sintiki* in the administrative district of *Serres* and the region of *Nevrokopi* in the administrative district of *Drama, Dodekannes, Kilkis*, the isle of *Skyros* and the isle of *Thira* (*Santorini*), as well as the prefectures of the isle of *Crete, Chania, Rethymnon* and *Lasithion*. Furthermore, some earlier decrees had designated also the prefecture of *Halkidiki* and the isle of *Corfu* as border areas in this sense. The law explicitly prohibits all legal transactions *inter vivos*, by means of which a real estate at the above-mentioned border areas is encumbered with contractual or rights *in rem*. Where such a legal transaction, e.g. a notarial sale and purchase agreement, is concluded **without an official permit**, the agreement is considered to be absolutely **null and void**, ***ex tunc***. If this rule is breached, the parties to the relevant agreement, and the notary public, may face criminal charges, the latter facing disciplinary sanctions as well.

Greeks, Greek-Cypriots, as well as EU-nationals (physical persons as well as legal entities), who are keen on acquiring real estate in border areas, may request that the

acquisition ban is lifted. An applicant who is interested in acquiring real estate located in a border area has to submit his/her application to the competent prefecture of the place where the real estate is located, attaching the ownership title of the property at issue, as well as a detailed description of the real estate at sale. Furthermore, besides the exact cause of the acquisition, the application must also include detailed information concerning the identity of the prospective buyer. Such requirements are usually met by submitting certificates issued by the competent authorities of the applicant's home state with personal information, e.g. the applicant's criminal record, etc.

According to procedural rules for the issue of a permit, **foreign legal entities with their registered office in an EU country** are obliged to submit an officially certified copy of their company articles of association, their balance sheets of the last few years and several official certificates, in order to prove that the company was in operation at the time of the application and that it has not been declared bankrupt. The decision concerning the application for the permit lies with the competent committee of the prefecture where the application has been submitted. The duration of the procedure varies among the various prefectures and takes approximately one to three months commencing from the time of submission of the application; it is free of charge.

Non EU-nationals have to submit their application to the Greek *Ministry of Defence* in *Athens*. In addition to the documents mentioned above for Greeks and EU-nationals, the *Ministry of Defence* further requests a topographical diagram of the real estate and a topographical diagram of the real estates located in the wider area. It is usually possible to have both of the required diagrams drafted by a local civil engineer. The procedure at the *Ministry of Defence* (office of security at border areas) is **relatively time consuming** (it may take approximately three to six months) and is also free of charge. Since the application for a permit is accompanied by multiple certificates, and since the process is in itself extremely complex, it is advisable that foreign investors in real estate should consult a lawyer prior to submitting the application, in order to speed up the process, or rather to entrust a lawyer with the handling of the whole procedure.

According to previous experiences, applications for a permit by EU-nationals (whether physical persons or legal entities) for both processes described above – at the prefectures and at the *Ministry of Defence* – are **usually approved**. In most cases an official permit to acquire the real estate is granted, provided that the application and the supporting documents are submitted properly and the competent authority does not detect any considerable reasons for rejection in relation to the identity of the applicant (such as previous convictions in the applicant's home country), which would lead to the rejection of the application.

Acquisition **of private islands** is also subject to certain restrictions. For a foreigner to acquire an island, in addition to the permit by the *Ministry of Defence*, it is also necessary to obtain a permit from the *Ministry of Agriculture* and the *Ministry of Shipping*.

In case of inheritance, the above restrictions for the acquisition of real estate do not apply. A foreign heir may acquire real estate located in a border area without being obliged to go through the described authorization procedure. It is merely required that the certificate of inheritance, which was issued in the heir's home country or at his/her country of residence, is recognized in *Greece* as valid by a court order; or the heir may file an official declaration of acceptance of the inheritance with a Greek notary public. With the recognition of the certificate of inheritance or the declaration of acceptance and payment of

the inheritance tax at the competent tax office, the heir may be registered in the record of the competent *Land Registry* as the new owner of the real estate.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

According to Greek Private International Law, the power of the seller is governed by the law of his/her **home country**, provided that the seller is a foreign physical person or a foreign legal entity, the facts of the case having a connection to foreign law. Even if the seller is found not to be vested with the necessary powers due to provisions of the law of his/her home state, he/she may be held to possess the necessary powers according to Greek law. According to Greek law, all persons over 18 years of age are considered to dispose of the authority to execute a sale and purchase agreement unless they are mentally ill or intellectually handicapped and have been set under custody.

Minors, i.e. persons under 18 years of age, who own real estate, have to be represented in the sale and purchase agreement by their legal representative, i.e. usually the parents; parents have to obtain a judicial permit in order to conclude a valid sale and purchase agreement on behalf of their child. Execution of a sale and purchase agreement without such judicial permits renders the relevant transaction void. The child's parents, the child itself or its legal successors may claim the invalidity of the transaction. There is no deadline for raising a claim for invalidity of contract. The judicial permit authorizing the parents to dispose of their child's property is issued upon request by the child's legal representatives; the request is filed to the competent court, which decides in accordance with the procedural rules of voluntary jurisdiction (εκούσια δικαιοδοσία).

3.3.2 Third-party claims and unpaid taxes

The buyer of real estate should, in all cases, have ensured before proceeding with the purchase that the real estate is **free of encumbrances**. As mentioned above, possible encumbrances are real and personal **easements**, as well as real estate liens, i.e. **mortgages**. Furthermore, real estate located in *Greece* may have been frozen to the benefit of a third party (seizure). The freezing of real estate is based on a title of compulsory execution and is registered in the records of the *Land Registry*. Any creditor of the real estate owner, including the treasury of the State, is entitled to proceed with such seizure. The competent *Land Registry* issues certificates of any encumbrances of the real estate upon request.

Owners are obliged to allow **archaeological excavations** of the State in their real estate. In some areas of archaeological interest it is even prohibited to acquire real estate at all. Real estate owners, whose property has been classified as **historical monuments**, are obliged to carry out all necessary renovation and maintenance at their own expense.

Before purchasing any real estate, it is advisable to thoroughly investigate whether the real estate at issue falls in any of the categories of property protected under the foregoing legislation. In practice, in sale and purchase agreements, the lawyer representing the buyer is bestowed with the duty of clarifying all issues related to the legal status of the real estate. Upon request, the local 'forest authorities' issue certificates on whether the relevant real estate is located in a protected **forest**. The local 'archaeological authorities' are competent for

providing clarifications relating to the classification of a real estate as a historical monument or as property protected due to historical reasons.

A condition precedent to the execution of a notarial deed of sale, as well as of any other legal transaction, for the creation, termination or encumbrance of rights of real estate, such as donation agreements, mortgages, or real easements, is payment of the relevant taxes to the tax office. For example, on selling the real estate, the seller is obliged to prove to the notary public payment of the real estate transfer tax before the execution of the notarial deed of sale; in that respect, it suffices to produce a receipt of payment of transfer tax, issued by the tax office. Any notary public who notarizes a legal transaction for real estate without having first received proof of payment of the relevant taxes incurs disciplinary sanctions.

The competent tax office upon request sets the amount of payable taxes. If the payable tax has not been calculated properly by the tax office because of false statements of the seller or the buyer, the *Treasury of the State* is entitled by law **to create a mortgage on the real estate for the amount of the unpaid taxes**.

If there are unpaid taxes, the debtor is usually not entitled to dispose of his/her real estate, unless he/she has agreed with the tax office payment of the unpaid taxes in several installments or unless some statutory provision provides otherwise to the benefit of the debtor. Upon the taxpayer's request, the competent tax office issues certificates, which may be used as **evidence for the non-existence of tax debts. Obtaining such a certificate and submission of the same to the notary public is a condition precedent for the execution of any notarial deed on real property**.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Restrictions are introduced by law in order to protect the common good and general public interest. Some basic legal restrictions on ownership refer to environmental safety and to the protection of nature and of cultural heritage. Information on whether a real estate is subject to such protective restrictions cannot be obtained from the *Land Registry*, since the registration of such encumbrances, or rather restrictions of ownership, is not compulsory. Usually, no construction permits are issued for real estates located in forests, national parks or archaeological sites.

3.3.4 Access to relevant records and documents

Before making a definite decision, foreign real estate buyers should have their lawyer check the relevant records and documents, which are kept at the competent *Land Registry* of the real estate at issue. Such records are based on the personal data provided by the real estate owner or, rather, the seller of the real estate. The competent *Land Registry* is the regional office of the area in which the real estate is located.

In *Greece*, the results of an investigation in the relevant records are of vital importance for the execution of a real estate purchase transaction. It enables the buyer to investigate whether the alleged seller actually is the **legitimate** owner of the real estate at issue and whether the real estate itself is **free of any encumbrances**.

Since *Greek* real estate law **does not provide for the protection of *bona fide* acquisition of real estate from a non-owner**, potential real estate buyers are practically obliged to

ensure, when investigating the said records, that the seller of the real estate is also the legitimate owner. Only after this investigation may it be considered possible to duly consult the buyer on whether the intended real estate purchase is advisable from a legal perspective.

If the real estate on sale has already been built, the seller is obliged to hand over to the potential buyer a **copy of the existing construction permit**.

3.4 Key points that a seller should consider

It is of vital importance for the real estate seller to **secure payment of the purchase price**. As already pointed out above, the seller may receive an advance payment as earnest money from the buyer where a notarial preliminary deed of sale is executed between the parties. The seller may then request payment of the full purchase price or the remaining purchase price (in case an advance payment has already been made) from the buyer at the execution of the sale and purchase agreement before the notary public. In practice, payment is effected by delivering a banker's draft to the seller, details of which are recorded in the sale and purchase agreement. Due to practical reasons, wire transfer is not recommendable, since it usually is in the interests of the seller if **the purchase price is paid against the seller's consideration (delivery of the property)** on executing the notarial deed of sale.

The real estate agent's commission is usually paid by the buyer and, in most cases, amounts to 2% of the purchase price plus value added tax (VAT). The rate of the estate agent's commission is subject to negotiation and may be agreed freely by the parties. It is common practice, however, that **the seller also** pays commission to the real estate agent for the same property, provided that a valid agency agreement exists between the seller and the agent. In such cases, real estate agents are entitled to receive two commissions, one from the buyer and one from the seller.

3.5 The execution of a real estate purchase transaction

To maintain legal and transactional security, as well as to protect the interests of the parties involved, Greek law provides for the **mandatory representation of the parties by a lawyer for most real estate agreements before a notary public**; this is a peculiarity of Greek law.

A potential foreign real estate buyer may find a property in *Greece* either independently or with the help of a real estate agent. If the sale and purchase agreement is concluded through an agent, the **buyer** is obliged to pay commission to the agent in the area of 2%, unless agreed otherwise, on the agreed purchase price (exclusive of 18% VAT). As mentioned above, very often the seller is also obliged to pay a commission to the real estate agent, provided a respective agency agreement has been signed.

It is by all means advisable that the buyer executes an agency agreement in writing **with** the real estate agent and that the use of the agent for the purchase of real estate, as well as payment of the agent's commission, are explicitly mentioned in the notarial sale and purchase agreement.

The sale and purchase agreement before the notary public may be executed either by the parties in person or through an authorized representative. As already mentioned, all real estate transactions in *Greece* before a notary public require that the parties are represented

by a lawyer (provided that the purchase price exceeds the amount of approximately Euro 15,000).

There is no exclusive **jurisdiction of the notary public**. Any notary public established in *Greece* is entitled to provide valid notarization of sale and purchase agreements, regardless of where the real estate is located. Thus, it is possible that a notary public with a registered office on the island of *Spetses* certifies a sale and purchase agreement for real estate located on the island of *Tinos*.

If a foreign real estate investor decides to purchase certain property in *Greece*, and provided that both parties have agreed on the purchase price, the lawyer appointed by the buyer takes charge of all legal issues regarding the execution of the sale and purchase agreement. The legal representative of the buyer has to ensure that his/her client receives the real estate free from any real encumbrances and with a legitimate title of ownership; this is done by checking the registers of the competent *Land Registries* (see above) and clarifying the ownership status of the real estate at issue.

In practice, the seller initially hands over the relevant documents (title of ownership and topographical diagram) to the lawyer representing the buyer, who then carries out the necessary investigations at the competent *Land Registry*.

If the buyer's lawyer recommends proceeding with the purchase after completion of the relevant research, the buyer should file an **application for the issue of a tax registration number** (ΑΦΜ) with the competent tax authority where the real estate is located. The tax registration number is an absolute requirement in all transactions with the Greek tax authorities.

Furthermore, the parties have to file a joint application with the competent tax office for the assessment of the **real estate transfer tax**, which has to be paid before the execution of the deed of sale. The amount of this tax is calculated by the tax office on the basis of the description of the real estate that the parties prepare, as well as on the basis of the declared purchase price. In practice, the real estate transfer tax is paid by the buyer.

Since the real estate transfer tax (real estate acquisition tax) in *Greece* is, compared to other European countries, relatively high (7% to 11%, see below for details), the parties often, for tax reasons (**incorrect or lower statement of purchase price**), declare at the tax office a lower purchase price than the price that was actually agreed. As a result, in many cases the parties merely declare the official lower value (known as the so-called 'objective value') of the property at sale, so that the real estate transfer tax is calculated on the basis of this value.

The **'objective value'** of real estate in *Greece* is determined by the tax office; in practice, this value is usually about 30% to 60% lower than the average market price, depending on the area in which the real estate is located. The difference between the fiscal 'objective value' and the actual purchase price is evident in the notarial sale and purchase agreement, since the parties in many cases agree to invoke the lower 'objective value' in the notarial deed instead of the actual purchase price. The risks involved in this method – though very common in practice – should not be underestimated, especially as far as the legal position of the buyer is concerned, and should by all means be avoided. Such agreements may be

classified as fictitious agreement and can thus be very problematic in cases where the sale and purchase agreement is annulled due to legal reasons (e.g. due to warranty claims). In such case the buyer is entitled by law to claim return of the declared purchase price only, as this is the price referred to in the agreement instead of the actual purchase price.

Furthermore, the purchase of real estate requires submission of several documents and declarations by both the seller and the buyer; all of which are conditions precedent to the execution of the notarial deed of sale. Some of the most important documents that need to be produced are listed below.

Documents to be produced by the seller:

- A certificate from the tax office stating that the seller does not owe any taxes to the State.
- A solemn declaration stating that the seller has properly declared the property at sale to the tax authorities in the last two fiscal years, **or**
- A solemn declaration stating that the seller has not received any income from the property at sale in the last two fiscal years.
- A certificate from the tax office regarding payment of the tax duty on 'large immovable property'.
- If the title of ownership of the seller stems from inheritance or gift, a certificate from the competent tax office regarding payment of the respective inheritance or donation tax.
- A certificate from the local authorities (municipality) certifying that the owner does not owe duties to the municipality.
- In the case of built properties, the existing construction permit.
- An updated topographical diagram of the property at sale.
- A certificate that the purchase object is listed in the national *register of deeds*.
- In the case of horizontal ownership, the building regulations of the co-owners.

Documents to be produced by the buyer:

- Proof of payment of the real estate transfer tax (real estate acquisition tax) to the tax office.

3.6 Powers of attorney

If the sale and purchase agreement is not signed in person by either of the parties, his/her representative has to present to the notary public a **notarized** power of attorney executed by the seller or the buyer accordingly, in order to prove his/her authorization. A private, non-notarized power of attorney is not valid according to Greek law and has no legal authority.

With a properly notarized power of attorney the seller and/or the buyer may authorize his/her attorney-at-law or any other third party to execute the deed on his/her behalf. It is

essential that the authorization of the representative **explicitly refer to the property at sale**. Therefore, a detailed description of the property at sale is absolutely necessary for the validity of the representative's authorization before the notary public.

The power of attorney may be executed before any Greek notary public or any competent consular office or diplomatic agency of *Greece* at the state of residence of the authorizing person (or 'mandator'). Powers of attorney, **certified by a foreign notary public**, are also recognized in *Greece* as valid, as long as they are apostilled according to the *Hague Convention of 1961*.

If the mandator is a **foreign legal entity** (e.g. corporation), the power of attorney should be accompanied by the 'authorization documents' of the legal entity according to the law of its place of establishment. These documents should also state the bodies vested with the power to represent the entity.

Such proof may be provided, for example, by the company's articles of association; furthermore, by a decision of the board of directors concerning the purchase of the property at issue or the appointment of the authorized representative, as well as by a certificate confirming the existence and operation of the company at the time the power of attorney was granted.

The form and content of the power of attorney, which is drafted before a Greek notary public, are governed by Greek law, whereas the authority and the power to appoint a representative for the execution of legal transactions are governed by the law of the mandator's home state.

If a foreign legal entity is party to a real estate sale and purchase agreement, its authorization has to be proved by submitting to the notary public the above-mentioned documents. Furthermore, it is also worth mentioning that all certificates drawn up in a foreign language have to be translated into Greek. Among others, Greek lawyers are also entitled to provide official translations and certified copies of documents. Original drafts of foreign documents have to be apostilled in order to be recognized as valid in *Greece*.

3.7 Financing

The most common form of financing in *Greece* consists in entering into a bank loan agreement. Due to the considerable reduction of interest rates, the real estate business has flourished in the past few years and many real estate owners have taken advantage of bank loans to finance the purchase of real estate.

At the time being, interest rates in real estate financing range from approximately 4.9% to 7%. The duration of a loan agreement is usually between 10 and 20 years, depending on the parties' agreement. Employment of the borrower and his/her other assets are essential criteria for the grant of a bank loan, as they serve as indicators of the applicant's credibility. **As a matter of principle, foreigners without permanent residence in *Greece* are not granted loans**, except where the borrower is able to provide sufficient security in *Greece* (such as a satisfactory bank balance in the case of a collateral loan).

To ensure repayment, the bank usually requires the setting up of a **mortgage** on the real estate. The mortgage is always created on behalf of the creditor (bank) for a specific amount of money. In most cases, mortgages are created by virtue of a court decision, which officially documents the agreement of the parties on the creation of the mortgage on the property. Then, the court decision is registered in the *Land Registry*.

3.8 Purchase through a company

Domestic and foreign companies may also be parties to a real estate sale and purchase agreement. Due to practical, as well as fiscal reasons, it is in general **not advisable** for a foreign real estate buyer, who neither has a permanent residence in *Greece* nor pursues a business activity in Greece, to acquire real estate through a Greek company.

Nevertheless, acquisition of real estate through a **foreign company** is of considerable interest in many respects. On the one hand, in specific cases it may lead to a lower taxation of the property at sale in the buyer's home state or in his state of residence whichever State is responsible for his taxation. On the other hand, the acquisition of real estate through a company confers, to a considerable extent, **anonymity of the owner**, which is often in practice one of the most crucial requirements from the side of the buyer due to reasons of **asset protection**. Relevant statistics show that as per December 2002 approximately 2,700 foreign companies were registered with the Greek tax authorities, whose overall value of real estate assets in *Greece* exceeded Euro 800 million.

Acquisition of real estate at border areas (for details, see above) through a company is permitted according to the provisions of the applicable law, provided that the competent authorities grant the relevant authorization. The information provided above concerning the general conditions precedent to obtaining an official permit of real estate acquisition at border areas applies to foreign companies accordingly.

Regarding the formalities of real estate acquisition through a company and the requirements of authorization before a notary public in particular, please refer to the foregoing details on the execution of a valid power of attorney.

Since December 2002, all foreign companies owning real estate in *Greece* or enjoying the right of usufruct on real estate located on Greek territory are subject to an **annual real estate tax of 3%**. The amount of the real estate tax depends on the value of the real estate. This law primarily aims at introducing a general property tax or tax obligation for Greek real estate mainly owned by **offshore companies**. Among others, the law also provides for the exemption of Greek and EU companies (corporations, limited companies, as well as partnerships) from this tax, provided that these companies submit to the tax office detailed information concerning their current shareholders.

Companies with registered shares, whose original or current shareholders are physical persons, are also exempt from this tax obligation. The criteria set forth by law do not refer to the beneficial owner, but it is **imperative** that the applicant foreign company **discloses information regarding individual partners or shareholders**.

Companies, whose registered office is outside the *EU*, are only exempt from the above tax if the foreign state of the company's domicile has concluded an agreement for the control of tax evasion and fiscal fraud with *Greece*.

Companies, whose shares are listed on domestic or foreign stock exchanges, are generally exempt from tax. Also exempt from this tax obligation are companies whose income from business activities in *Greece* exceeds their income from the exploitation of real estate.

***Liechtenstein* establishments (Anstalten) or foundations** which are real estate owners (and this is common practice) are to be excluded *prima facie* from the scope of application

of the new law, since the wording of its provisions speaks of 'companies' in a narrow sense. It cannot be assessed, however, whether in the future the tax authorities will aim at a broader interpretation of the law, which will most probably have a negative effect on the above-mentioned legal entities.

3.9 Defects and warranty claims

Greek property law distinguishes **physical from legal warranties** or, in other words, **physical from legal defects of real estate**. Some provisions of Greek real estate law have been recently amended, implementing the *EU-directive 1999/44*.

In addition to the obligation to convey ownership, the obligations of the seller from the sale and purchase agreement include delivery of the real estate **free from physical defects** to the buyer. Furthermore, the seller is obliged to deliver the real estate with all the agreed characteristics and to transfer ownership free from any third-party rights, i.e. **without any deficiency in its title of ownership**.

The buyer's **warranty claims for physical defects** are subject to a **deadline of five years**, whereas warranty claims for **legal defects** expire after **20 years**. The seller is not liable for warranty claims where the buyer was aware of the existence of the defect at the time the agreement was concluded. Once liability of the seller for breach of warranty is established, the buyer may exercise any of the following rights: (1) to request the remedy of the defect, (2) to request the substitution of the property (which is hardly applicable in the case of real estate), (3) to request a **reduction in the purchase price** and (4) to **withdraw from the sale and purchase agreement**.

The risk of loss or deterioration of the purchased asset passes to the buyer from the time of its delivery or from the time of the registration of the sale and purchase in the *Land Registry* records, if the registration took place before the delivery. The parties may amend the rule on risk transfer by agreement, since it is not a *ius cogens* provision.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

From 1 January 2005 for every construction, exterior rebuilding or renovation of real estate the owner must obtain a construction permit. The competent authority for the issue of the construction permit is the **planning authority of the municipality** of the area in which the real estate is located. In practice, the real estate owner – in cooperation with a civil engineer, an architect and an electrical engineer, who act on the owner's instructions – submits an application, attaching a plan of the construction or rebuilding scheme.

It is virtually impossible to obtain a construction permit without employing a specialized **civil engineer** and an **architect**, since the building authorities require a series of documents (technical plans and reports) for the issue of the construction permit; these documents can only be issued by officially authorized engineers.

In most Greek cities the areas are divided into construction zones with corresponding **development plans**, which provide for the allowable number of floors and for the maximum

surface allowed to be built on each real estate, in accordance with applicable building regulations. These regulations are binding on every real estate owner, as well as on the planning authority, since they set the rules for essential issues, such as the admissible total area of a holiday apartment on an unbuilt real estate.

Specific building regulations apply to real estate located outside urban development plans. In principle, in such areas only properties exceeding a surface of 4,000 m^2 may be built.

As for properties on the seaside, all constructions (e.g. a holiday apartment or house) are to be built at a **minimum distance** from the shore. For the time being the above-mentioned minimum distance is set at 35 m, whereas a statutory amendment providing for a minimum distance of 100 m is currently under discussion. The beaches and **the seashore cannot be privately owned**, but belong to the State and may be used by all people without exception.

Before purchasing a plot of land, any buyer should consult a civil engineer or a lawyer on the building regulations in force at the time, especially in case of properties on the seaside. **Building regulations** in *Greece* are **amended very frequently** and hence foreign real estate investors should seek at all times professional advice on the possibility of realizing the construction they have in mind for the property chosen.

4.2 Architect's and building contracts

After deciding to realize a specific construction and after the issue of the construction permit by the competent building authority, the owner usually executes a contract with an architect and a contractor of his/her choice. The latter are obliged to finish the construction according to the agreement, the architect being responsible for the design of the arrangement of the exterior and the interior of the building.

It is recommended that the agreement between the owner and the contractor is concluded **in writing**, whereby the **total remuneration** and the overall **obligations** of the architect and the contractor are described and defined in detail. Should the contractor not commence with the construction works on time or should the execution of his/her obligations be delayed contrary to the terms of the agreement and with no fault from the side of the owner, thereby rendering the timely completion of the construction impossible, the owner may withdraw from the building contract before the delivery date. If, in the course of works, it is envisaged that the construction will have defects or that it will be contrary to the agreed terms of construction due to the contractor's responsibility, the owner may set a reasonable time limit, within which the contractor has to remedy the deficiencies or defects. Should this time limit lapse without any action from the side of the contractor, the owner is entitled to carry out the required remedial work at the expense of the contractor.

As soon as the agreed construction is completed, **the building is delivered** to the owner, whose approval is required for the validity of the transaction. The owner's approval releases the contractor from his liability for any physical defects of the construction, except for hidden defects, which are defects that cannot be detected even through orderly examination at the time of the delivery or which the contractor has deliberately tried to conceal. The contractor's remuneration as agreed between the parties is due upon delivery of the construction. If it has been agreed that the contractor will be paid in several installments against completion of parts of the construction, which is most common in practice, payment of the installment is due with the delivery of each agreed part of the construction. It is recommended that

upon delivery of the final construction, as well as for all payments made to the contractor, the latter issues a receipt in writing.

4.3 Completion of construction and formalities

There is no official delivery of the construction. Nevertheless, the planning authority may conduct inspections on the building site without previous notice, in order to confirm compliance of the construction with the construction permit. After completion of the construction, the civil engineer in charge confirms to the planning authority that the construction was carried out in accordance with the requirements of the construction permit. Then, the planning authority issues the permit required for the connection of the building to utility networks.

4.4 Deficiencies and warranty claims regarding new construction

If there are construction defects, which are not considerable, the owner may request their remedy within a reasonable time limit, provided the remedy is in itself not extremely onerous. Alternatively the owner may exercise the right to request a **reduction in the purchase price**.

According to the provisions that apply on building contracts, the owner is also entitled to **withdraw from the contract or to claim damages** from the contractor, in the event of physical defects of the construction, as well as in the case that the construction does not have the agreed characteristics or if the construction is useless to the owner in the form in which it is delivered. Warranty claims of the owner or the contractor may be raised within a time limit of **10 years**, starting from the date of delivery.

5 Rental and tenancy

5.1 Rental and lease agreements

In *Greece*, real estate leases are divided into two categories, residential and business leases. Besides the general provisions on leases, lease agreements are also governed by several law decrees. All in all, Greek law on leases is relatively complicated, since the provisions on protection from unwarranted termination and on damages in the event of unwarranted termination are amended very frequently, so that they are hardly understandable.

Leases for residences have a statutory term of **three years minimum in favor** of the lessee. Nevertheless, the parties may agree on a shorter duration.

The lessor may only terminate a residential lease agreement after the expiry of the three-year term of the lease. The lessee may terminate the lease prior to the expiry of the three-year duration, only if the parties have agreed on a shorter duration. In both cases, the termination of the lease is without compensation to the other party. Holiday apartments are excluded from this regulation; here the parties are free to agree on the term of the lease.

Lease agreements with a defined duration may not be terminated before the agreed date.

The rental of a residence or of an office space may be terminated due to the following reasons: 1) default of payment by the lessee, 2) breach of contract, either by the landlord

or by the tenant, 3) physical defects of the rented premises, 4) non-compliances with the agreed terms of delivery of the rented premises to the tenant, 5) own requirements of the landlord.

The principle that 'the sale beats the lease' is not valid in Greek law. Nevertheless, to avoid termination in the event that the leased premises are sold to a third party, it is required that the parties have concluded a lease agreement in writing and that this agreement does not give the new owner the right to terminate the lease.

It is advisable that foreign tenants execute a **lease agreement** with the lessor in writing before delivery and demise of use of the leased premises.

Greek law, in general, differentiates between lease of agricultural real estate and lease of other lucrative land areas. Such lease agreements are principally governed by the same provisions as ordinary lease agreements, provided that the law does not require otherwise.

The **minimum duration of the lease of lucrative land areas is four years**, even if there is an agreement for a shorter duration. In case of default of payment by the lessee, the lessor is entitled to terminate the lease after giving the lessee two months notice. If the use of the leased premises has been altered, the lessor is entitled to terminate the lease immediately.

5.2 Regulations on protection of tenants and rent control

Irrespective of the general provisions of the *Greek Code of Civil Procedure* on lease agreements, Greek legislation on leases may be found in various law decrees. These decrees aim mainly at the protection of the lessee and in most cases they include security provisions on the **statutory term** of the lease and on the **protection** of the lessee in case of **unwarranted termination**. As already mentioned, in case of termination, the lessor of an apartment, for example, is generally obliged to compensate the tenant, if he/she terminates the lease before the agreed date. **Holiday apartments** are **excluded** from the above protection against unwarranted termination; they are governed by the general notice of termination set forth in the *Greek Civil Code*, which varies between 15 days and 3 months, depending on the agreed duration of the lease.

6 Succession and gifts

6.1 Applicable law and jurisdiction

According to Greek Private International law, successions are governed by the **law of the deceased's home state**. The deceased's ordinary residence is irrelevant in this case. If the deceased is a Greek national or if he/she has dual nationality, including Greek nationality, succession is subject exclusively to the Greek law of succession.

Where the deceased at the time of death is of foreign nationality, e.g. US nationality, then succession is governed by foreign law, e.g. US law. Had the American testator owned property in *Greece*, he is inherited by his heirs; the immediate successor according to US law acquires *eo ipso* ownership of the real estate.

In practice, official conveyance of ownership to the new owner takes place through the **recognition of the foreign certificate of inheritance** in *Greece* by a Greek court as valid, pursuant to the procedure of voluntary jurisdiction (εκούσια δικαιοδοσία), or through a **declaration of acceptance of the inheritance** before a notary public. It may occur that the successor is asked to submit the certificate of inheritance to a bank, which is usually the case, if the deceased had also maintained a bank account in *Greece*), in order to prove his/her authorization or right of disposal. Thus, foreign successors should prefer using the certificate of inheritance of their home state together with the Greek **court decision of recognition** in all transactions with Greek authorities.

With the registration of ownership in the *Land Registry*, the successor becomes officially the new real estate owner, as soon as the relevant **inheritance tax** (see below for the amount of tax) has been paid to the tax office.

6.2 Fundamentals of the succession and gift/donation laws of Greece

Like the law of most European countries, Greek law of succession is based on the **principle of universal succession**, according to which the entire fortune of the deceased is transferred as a whole *ipso iure* to the heirs. Succession is determined by the last will of the testator (testamentary succession) and, if the deceased did not have a will, by the legal rules on succession (intestate succession). **Contracts of inheritance** are not valid according to Greek law.

In the event of **intestate succession**, successors are allocated in the following categories: **successors of first degree** (descendants of the deceased), **successors of second degree** (parents, brothers and sisters of the deceased), **successors of third degree** (grandparents of the deceased and their descendants), **successors of fourth degree** (great-grandparents of the deceased and their descendants), **successors of fifth degree** (the deceased's spouse, if there are no other intestate successors) and **successors of sixth degree** (the State, if there are no other intestate successors).

The **spouse**, who outlives the deceased, is entitled to one-fourth of the inheritance, should he or she rank with the relatives of the first degree, and to half of the inheritance, in case of ranking with relatives of the second, third or fourth degree.

Greek law of inheritance also has **forced heirship** rules. Persons entitled to a **compulsory portion** are the descendants of the deceased, his/her **parents** and the **spouse**. The compulsory portion is half of the intestate portion. Provisions regarding compulsory portions are *ius cogens* and cannot be circumvented.

A **donation** is defined as the asset giving from one person to another without consideration, provided that both parties agree on the transaction. The donation of real estate requires the **notarization of the agreement** between the parties in order to be valid. Donation *causa mortis* are also provided for in Greek law and are governed by the general provisions on agreements of donation, which apply pro rata.

It is a common practice that the parents donate real estate to their offspring in their lifetime; this is generally known as **parental donation**. The advantage of such donation lies in the beneficial circumstances, with which the children acquire the real estate and in the avoidance of inheritance tax at the time of succession. In such cases, the parents usually

keep an interest (e.g. right of residence) on the real estate for life, while their children acquire the right of ownership.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

Real estate buyers in *Greece* are obliged to pay a one-time acquisition tax (called **real estate transfer tax** or **conveyance tax**); they also have to bear the costs for the notarization of the sale and purchase agreement, the lawyer's fees, as well as the registration fees in the *Land Registry*.

As for **new constructions**, the owner is obliged of various payments before the issue of the construction permit, such as payments to the municipal authorities, social security contributions for civil engineers, and for construction workers. The total amount of payments depends on the construction project and on the market price of the construction zone, where the property is located or where the construction is to be effected.

7.1.1 Real estate transfer taxes

Real estate transfer taxes in *Greece* depend on the location of the property and vary between **7% and 11% of the value of property**, i.e. the purchase price; in practice these are borne by the buyer, of which approximately 3% is a duty to the municipality.

The amount of taxes is calculated by the tax office upon request of the parties concerned. The purchase price that the parties declare is the basis for the calculation of the real estate transfer tax; however the declared price may not be lower than the 'objective property value', which is determined by the tax authorities for most of the regions in *Greece*.

Greeks, as well as EU-nationals, who are permanent residents of *Greece*, may be **released** from the obligatory payment of real estate transfer taxes, at the time of acquisition of first residential property, if they have their tax residence in *Greece*.

7.1.2 Sales tax (value added tax)

The **value added tax** is currently **18%**. Real estate acquisition in *Greece* has been explicitly exempted from the value added tax. Furthermore, legal services rendered by lawyers and notary publics are also exempt from value added tax, whereas the services of real estate agents, architects, civil engineers and real estate developers are subject to value added tax at 18%.

7.1.3 Real estate registration and notary charges

The fees payable to the notary public depend on the value of the notarial transaction. The same applies to registration fees. The former are approximately 1.5% of the real estate value, while the total registration fees are approximately 0.5%.

Lawyer's fees for transactions of real estate are subject to negotiations between the lawyer and the client, but a minimum fee is in all cases obligatory. In general, every party is obliged to pay a minimum fee to the lawyer in charge, which varies between 0.5% and 1% of the purchase price, depending on the value of the purchased real estate. It is to be paid before signing the relevant contract at the bar association of the lawyer in charge. Proof of payment of this minimum lawyer's fee is necessary for the notary public to be able to proceed with the notarization of the relevant agreement.

In addition to the minimum fee, in practice, lawyers request additional payment on the basis of **time spent** (hourly rates vary between Euro 65 and 250) or a **fixed rate (**ca. 1% to 2.5% of the purchase price), which depends on the difficulty of the subject matter and the value of the real estate.

7.2 Annually recurring taxes and charges

Foreign real estate owners (whether physical persons or legal entities), whose permanent place of residence or legal domicile is located abroad, are obliged to submit an **annual tax statement** to the Greek tax office if they own a secondary residence in *Greece* of a minimum surface of 150 m^2 or have income of Euro 600 minimum per year through leasing real estate located in Greek territory.

Vacant properties in *Greece*, apartments or houses of a surface of less than 200 m^2 are exempt from annual taxation, provided the respective owners have their primary residence abroad and are not taxed in *Greece* due to any other reason.

Real estate owners, who – although living abroad – are obliged to file tax returns in *Greece*, have to appoint a **process agent** in *Greece*, for the receipt of the annual tax statement from the tax office and, consequently, for submission of the same to the local tax office on behalf of the taxpayer.

7.2.1 Real estate tax

Every real estate owner is subject to a **duty on 'immovable property'** (known as the *T.A.Π.*), which is a kind of land tax. The yearly charge ranges from 0.25 to 0.35% of the 'objective property value'. There is also another duty on real estate in the amount of 0.3%, which is paid to the municipal authorities.

Physical persons and legal entities owning real estate of a total value of at least Euro 243,600 (for married couples the relevant amount is set at Euro 487,200) are subject to payment of an annual land tax ranging from 0.3 to 0.8% (for physical persons) or to 0.7% (for legal entities) on the value in excess of the foregoing threshold (**land tax of 'large immovable property'**).

Real estate owners, whose real estate assets in *Greece* have a value higher than the foregoing thresholds, should submit a tax statement on 'large immovable property'. Legal entities are obliged to submit their statement on 'large immovable property' in any case, even if the overall property value is less than Euro 243,600.

7.2.2 Income tax

Persons domiciled in *Greece* are subject to individual income tax on their *worldwide income*. Persons domiciled abroad are subject to income tax on their Greek-source income only.

The occupation of owner-occupied real estate gives rise to imputed taxable income. The imputed income arising from the ownership up to 200 m^2 is exempt from income taxation.

If a real estate is to be taxed due to the reasons mentioned above (e.g. a UK national living in *London* who is owner of a holiday villa of more than 200 m^2 located on a *Greek* island) and such tax obligation in *Greece* stems exclusively from the ownership of real estate, the tax office considers the property's value in terms of monthly rent according to its fair market value.

In such a case, the State embarks on the presumption that the taxpayer receives an annual and taxable income from the real estate, even if in reality this is not the case (tax presumption).

Greek tax law defines this type of tax treatment as taxation on the basis of 'objective presumptions' with the application of 'objective criteria' referring to the living standards of the taxpayers. This method of taxation applies also in other certain assets (e.g. a car of more than 2,000 kW, over Euro 50,000 purchase price, a pleasure boat over 10 metres, a private plane, a swimming pool, etc.), which are owned by the taxpayer.

According to the case law of the *Council of the State*, the real estate of owners who live abroad, and import foreign currency funds for the purchase of real estate, are non-taxable in *Greece*; **as a result, the said fiscal presumption in the sense of the fictional lease value does not apply**.

7.2.3 Net wealth tax

A new kind of net wealth tax in the form of a **real estate tax levied on companies** owning real estate or enjoying usufruct rights on real estate in *Greece* was introduced in December 2002. The tax rate is 3% on the fiscal property value and is levied on all foreign companies, which are not engaged in any other business activity in *Greece*.

A general tax exemption is only granted if personal information of shareholders is disclosed to the *Greek* tax office or if the company's shares are registered or if the shareholders are all physical persons. In this sense, non-EU companies are only exempted from taxation if there is a bilateral agreement between *Greece* and the state of their establishment on the avoidance of tax evasion (for further information in this respect, see section 3.8 above).

Furthermore, **real estate taxes on 'large immovable property'**, which are levied on both physical persons and legal entities (see section 7.2.1 above) are also considered net wealth taxes.

7.3 Capital gains tax

Foreign legal entities (companies) are subject to payment of a capital gains tax in the amount of 35% of the net profit obtained from the sale of real estate, provided that such companies are non-resident and do not have other income in *Greece*. There is **no similar capital gain provision for physical persons**.

7.4 Inheritance and gift taxes

Since 2003, inheritance tax rates **range from 5% to 40%**, according to the family relationship between the deceased and the successor. **Spouses** (provided that the marriage lasted for

a minimum of five years) and **minor children** of the deceased are **exempted from the inheritance tax** for the first **Euro 300,000** of the inheritance value. Inheritance taxes are calculated on the basis of the 'objective inheritance value'. Other successors are also eligible for tax exemption, depending on the family relationship with the deceased; in this case tax exemption may apply for values ranging from Euro 5,000 to Euro 20,000.

The same tax rates (5% to 40%) are also applicable on donations ***inter vivos***; amounts ranging from Euro 5,000 to Euro 20,000 (depending on the family bond) are also exempt from taxation.

Donations from parent to child (known as parental donations) in the course of the parent's lifetime are subject to half of the payable gift tax, provided the value of the gift does not exceed Euro 90,000 per parent, or Euro 123,000 if one parent has deceased.

Theinheritance tax rates given below also apply on gifts, see Table 1.

Table 1 Overview on inheritance and gift taxes

Category	Inheritance value	Tax rate
A (Spouse of the deceased, descendants and parents of the deceased)	Euro 20,000	–
	Euro 40,000	5%
	Euro 160,000	10%
	Above Euro 160,000	20%
B (Descendants of 2nd and 3rd degree, siblings of the deceased, uncles, aunts, parents-in-law, brother-in-law, etc.)	Euro 15,000	–
	Euro 45,000	10%
	Euro 160,000	20%
	Above Euro 160,000	30%
C (Other relatives of the deceased and non-relatives)	Euro 5,000	–
	Euro 55,000	20%
	Euro 160,000	30%
	Above Euro 160,000	40%

7.5 Other taxes and charges

No other relevant taxes and charges apply.

7.6 Incorrect (lower) statement of sale price on the sales agreement

It is a common – yet illegal – practice that the parties to a real estate sales agreement agree to declare in the notarial deed the lower value, i.e. the 'objective property value' instead of the actually agreed purchase price, in order to reduce or evade the relatively high real estate transfer tax (i.e. 7% to 11%). This happens very often but it is not, of course, in conformity with the law, and the legal implications in the event of a subsequent disagreement between the parties should not be neglected. Considerable difficulties might occur in the event of price reduction claims or in the event of withdrawal of the buyer from the sale and purchase agreement due to legal or physical defects of the real estate. If the dispute is

brought before a court, the non-declared transaction (including the actual purchase price) might be **declared null and void on legal grounds** and the formal sale and purchase agreement (including the erroneous purchase price) might be declared void as a **fictitious transaction**. In both cases, the invalidity may be declared *ex tunc*, by a court decision, resulting in the annulment of the purchase, whereby the buyer carries the heavy burden to prove payment of the actual purchase price, in order to claim it from the seller due to unjust enrichment. Furthermore, the tax office might qualify the intentional incorrect statement of the sales price as **tax evasion**, which theoretically may trigger criminal charges for the parties involved. In addition, a monthly **pecuniary charge** in the range of 3%, calculated on the amount of the tax that the taxpayer intended to avoid, is imposed, if any income was intentionally misstated.

7.7 International taxation

Existing bilateral agreements for the avoidance of double taxation apply in all cases where a real estate owner is taxable in two jurisdictions for the same property or income, due to the tax legislation of his/her home state in parallel with the tax legislation of the country in which the real estate is located.

Greece has concluded agreements on double taxation with 35 countries, among others the *United Kingdom* and the *United States of America*. According to these agreements, income gained through real estate located in *Greece* is taxable in *Greece*, even if the respective owners (whether physical persons or legal entities) are permanent residents of the other country or if they are treated as taxpayers of that other country.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

As a matter of principle, entry of EU-nationals is unrestricted upon presentation of an ID-card. No residence permit is required for a short-term stay of up to three months. Foreigners, who wish to prolong their stay beyond the three-month period, may apply for an extension of another six months maximum at the local police department of their place of residence.

If an EU-national intends to move to *Greece* for a long period of time, he has to apply for a **residence permit**. The competent authorities are the **authorities for foreign nationals in the local district**, while applications may be filed at the municipality of the applicant's place of residence.

EU-nationals do not need a work permit to carry out business activities, whereas non-EU nationals have to go through the administrative procedure for acquiring a **work permit** at the competent authorities for foreign nationals. Entry of foreigners into *Greece*, police issues on residence and work permit procedures for foreigners are regulated mainly by *Law No. 2910/2001*.

In general, non-EU nationals need a 'visa' to enter *Greece*, with a limited duration of three months maximum. Visas are issued upon request, by the *Greek* diplomatic agencies of the country of the applicant's residence, before entering *Greece*. Some non-EU countries are exempt from the visa obligation, such as *Switzerland* or the *USA*, both of which have concluded a respective bilateral agreement with *Greece*.

If a non-EU national intends to apply for a residence permit in *Greece*, he/she has to file a relevant petition at the municipality of his/her place of residence in *Greece*. The general secretary of the district decides on the petition after the applicant's hearing before the **immigration committee**.

Basically all non-EU nationals can obtain a residence permit, provided they are able to prove that they have been granted a work permit by the prefecture for exercising freelance activities or for working as an employee in *Greece*.

Financially independent foreigners who do not plan to carry out income-earning activities, may obtain a residence permit if they are able to prove that they dispose of the financial means or assets allowing them to pay for their living in *Greece*, and that they have acquired such financial means in a legitimate way. Residence permits of unemployed in the above sense may be extended on a yearly basis. After 10 years of residence, foreigners may apply for an unlimited settlement (permanent residence) permit.

8.2 Tax residence

Tax residence is basically determined for the taxpayer's primary legal place of residence. Residence of a physical person is defined in the Greek *Civil Code*. The code defines residence as the place where a person decides to be established permanently. The term 'tax residence' may be also found in the above-mentioned agreements for the avoidance of double taxation. Anyone who resides permanently in *Greece* is taxed in *Greece* for his/her **total global income**, according to the applicable income tax legislation.

If EU-nationals or non-EU nationals decide to reside in *Greece* and earn income in *Greece* that exceeds Euro 3,000 per year, they are obliged to submit a tax statement, regardless of whether or not they own real estate in *Greece*. The tax rates for physical persons in force for 2004 range from 15% for taxable income of Euro 13,400 per year to 40% for taxable income beyond Euro 23,400 per year. Annual income of pensioners up to the amount of Euro 10,000 maximum is tax-free; so is the yearly income of employees and people working freelance, up to the amount of Euro 8,400. Taxpayers with children, who need financial support, enjoy the benefit of additional Euro 1,000 to the above tax-free amounts per child.

The place of establishment of **legal entities** is of decisive importance. According to Greek law, the place of the actual administration and management of the company is considered as the company's establishment and not its statutory seat. Consequently, if a foreign company, whose statutory seat is located abroad, is actually administrated and managed from *Greece*, it is then taxable in *Greece*, as if its registered office was located in *Greece*. Corporations, limited liability companies, branches of foreign companies, as well as joint ventures, which are taxable in *Greece*, are currently taxed with a standard tax rate of 35%, while the tax rate for the income of partnerships is 25%.

8.3 International taxation for residents of Greece

Greece has concluded agreements for the avoidance of double taxation with 35 countries. All these agreements are based on the taxpayer's place of residence or the company's place of management and control. Where the residence of a taxpayer is in *Greece*, for example, and the taxpayer earns taxable income (this includes: income from real estate, income from profit-earning activities, income from ships, dividends, royalties, income from employee-work or freelance) abroad, the taxpayer is granted a reduction on the Greek income tax.

9 Checklist: Real estate acquisition in Greece

- In general, **representation by a lawyer is mandatory** in *Greece* for **real estate matters**.
- Receive the **title of ownership** including a topographical diagram from the seller.
- Investigate the ownership status of the property at sale in the *Land Registry*.
- If the purchase is recommended by the lawyer in charge: executing a **preliminary deed of sale** or prepare the final sale and purchase agreement, if necessary by granting a notarial power of attorney to the representative.
- Obtaining a **tax registration number** is absolutely necessary.
- Apply for the calculation of the **real estate transfer tax**.
- Pay the corresponding tax and the minimum fee of the lawyer to the Bar of the lawyer's practice.
- Have the authorized lawyer draft and submit the sale and purchase agreement to the notary public **and then execute the sale and purchase agreement** before the notary public.
- Register the sales agreement in the *Land Registry*.

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Contents: Hungary

1 Introduction

Hungary is a central European country with a population of 10 million and an area of about 93,000 square kilometers. It is a *NATO* member and has joined the *European Union* under an *Accession Agreement* on May 1, 2004.

Hungary offers a stable political and economic climate for investors and is thus a safe place for foreigners to buy real estate. Real estate prices are expected to rise significantly after *EU* accession – they are currently far below those in the 'old' EU member states.

2 Real estate ownership

2.1 Different forms and types of ownership

Under Hungarian law, every person with legal capacity – including the state, natural persons, legal entities, and business organizations without legal personality – has the right to own real estate. Hungarian law regulates various different forms of real estate ownership – depending on whether the real estate is owned by one legal person, by more than one legal person, or by the state. The simplest case of ownership is that in which property has **one owner**. Obviously, this legal arrangement requires no regulations as to the internal ownership structure.

Co-ownership means that the same real estate is owned by several persons in specific proportions. The individual owners hold undivided portions of the entire real estate. With co-ownership, each owner has the right to own and use the real estate, but none of the co-owners can exercise this right to interfere with the others' rights and legal interests regarding the real estate. The co-owners are entitled to the benefits of the real estate in proportion to their ownership; and in the same proportion, they must bear the expenses related to its maintenance, as well as any other expenses connected to the real estate. They are also bound by the obligations that arise from co-ownership, and they are liable for any damages the real estate may sustain. Each co-owner has the right to dispose of his own interest in the real estate. In addition, every co-owner holds rights of pre-emption, pre-rental and pre-lease vis-à-vis the other co-owners.

A building may be co-owned by a number of proprietors, each holding his own specific part or unit of the building – i.e. an apartment or residential unit. This arrangement is known as **condominium ownership**. A condominium is established by virtue of an agreement or deed of foundation executed by the co-owners. A precondition for effectiveness is entry of the condominium ownership in the Property Register. Any of the co-owners may file a petition with the court to transform a co-owned and technically divisible building into a condominium, in which case the condominium is established by a ruling of the court. Condominiums represent a special form of co-ownership. The condominium itself (the owners' community) is not a legal entity but it has legal capacity. The community of proprietors can acquire rights, assume obligations, may sue and may be sued as a community, and it looks after its own affairs, i.e., any issues related to the maintenance, refurbishment and co-ownership of the building.

An alternative to the above is to establish a cooperative (development association) specifically for the purposes of building and maintaining apartments. There are two types of **cooperative**

housing. In the first case, the entire building – including the common areas and parts of the building, as well as the individual residential units – is jointly owned by members of the cooperative; while the second case is similar to a condominium in that the common areas and parts of the building are owned by members of the cooperative, but the individual residential units or apartments are owned separately. The co-owners, i.e. cooperative members, look after their ownership-related affairs – by taking part in the general meetings of the cooperative development association, in accordance with the cooperative's by-laws. Each residential unit is entitled to one vote in the general meeting.

Ownership encompasses everything that forms a permanent part of the real estate. A permanent part is a thing whose separation from the real estate would result in the destruction of either the real estate or the separate part, or would significantly reduce the value or use of the property (i.e. a permanent part is an integral component of the property). To avoid any doubt, ownership also includes any objects that are not components but are required for, or promote, the proper use or upkeep of the real estate (appurtenances).

The owner of the land normally holds title to the building. **In exceptional cases, however, title to the building may be held by the party building on the land** if this is set forth in either the law or a written agreement with the landowner. In such cases, the title to the building is separated from the title to the land. The landowner has a legal right of pre-emption vis-à-vis the building, and the owner of the building has a legal right of pre-emption vis-à-vis the land.

Another alternative for purchasing an apartment is a **buyers' club**. A buyers' club guarantees that every buyer will receive the key to his/her apartment over a specific period, but the actual sequence in which they do so is decided by raffle. The problem with this arrangement is that no appropriate legal basis exists for it in *Hungary*, so it is quite risky to join such a club.

Timesharing exists in *Hungary* but is not very common. Nowadays, such plans are offered primarily by major international companies that specialize in timeshare under terms and conditions that are familiar and have worked well in other countries. The underlying legal arrangements may take a number of forms. On the one hand, timesharing may refer to a compound jointly owned by a number of co-owners where the co-owners predefine the rules regarding exclusive use. On the other hand, timesharing may also mean that the entire real estate is owned by an independent company that sells its customers the right to use the premises in certain periods.

Timesharing is governed by the *Government Decree of 20/1999 (II.15) Kr.* The most important provisions in this regard are the following: According to a timesharing contract, the customer obtains a right from the seller – directly or indirectly – for a period of at least three years to use one or more properties for a definite period of time, for housing or holiday purposes. The customer can neither acquire title of ownership nor usufruct. The seller (provider of the timesharing services) can be only an economic organization or a branch office of a foreign firm in *Hungary.* Pursuing timesharing business activities requires the permission of the *Ministry of Economy and Transport.* A further permission is needed in respect of the objects to be part of the timesharing service. The Ministry also issues an ethical code.

A timesharing contract is valid only in written form. The written information material (prospectus) has to be attached to the offer, and it shall be part of the later contract. The

prospectus shall list all relevant data of the real estate, and shall draw the attention of the contracting party to the point that ownership of the object cannot be acquired. The most common problems of timesharing in *Hungary* are that the seller does not make the real estate suitable for use by the other party within the period of three years, which is a basic prerequisite of performing timesharing services, and that the object built does not meet the requirements pointed out in the prospectus.

2.2 Easements, charges, liens and mortgages

The following **rights of use (servitudes)** exist in *Hungary*:

Use of land

If the party building on the land acquires title to the building (by virtue of a court decision or an agreement), the owner of the building has the right to use the land (or a part of the land) as long as the building stands. This is known as divided ownership.

By virtue of his/her entitlement to servitude, the owner of the building has the right to use the land (or a part of the land) and collect its benefits, but is also under obligation to bear the burdens related to its maintenance. If a new owner acquires title to the building by succession or conveyance, the new owner has the right to use the land under the same terms and conditions.

Usufruct and use

By virtue of his usufruct, the person so entitled may possess, use, and collect the benefits of the real estate owned by another person. While the usufruct prevails, the owner can only exercise his/her right to possess, use and collect the benefits of the real estate to the extent that such rights are not exercised by the person entitled to usufruct. Usufruct remains even if the real estate changes hands. Usufruct is of a limited period – at most, it may last the lifetime of the person so entitled. Usufruct is established by virtue of an agreement and by entry in the Property Register.

The person entitled to usufruct is obliged to act with due care and caution in exercising his usufruct. This person so entitled must bear the burdens related to the maintenance of the real estate – except for extraordinary repairs and restorations – and is bound by the obligations connected to use of the real estate. He/she is also obliged to pay public contributions, i.e. taxes, fees and levies in relation to the real estate. The person entitled to usufruct may not transfer the usufruct, but may assign the right to exercise it. Also, he/she is obliged to return the real estate when the usufruct expires.

By virtue of servitude, the person so entitled has the right to use the real estate and collect its benefits to the limit of his own needs and that of his family. The servitude cannot be assigned to any third parties.

Explicit easement

By virtue of an explicit easement, the owner of a property can use another's property to a specified limit, or may demand that the owner of the real estate subject to the easement

refrain from some activity that his/her title would otherwise authorize him/her to perform. Explicit easements may be established in order to grant right-of-way across the property, to allow utilities – such as water or drainage pipes – to pass through, to allow for a cellar to be built, electric posts to be installed, a building to be erected, or for any other purpose that benefits the person so entitled. If a tract of land is not accessible by public road, the neighbors are obliged to grant the person so entitled right-of-way. An explicit easement is not marketable on its own. An easement ceases after 10 years if the person so entitled has not exercised his/her right – though he/she had the opportunity – or if he/she has tolerated being hindered in the exercise of his/her right.

Use in the public interest

By virtue of an administrative decision, easements or other servitudes may be established in the public interest on behalf of organizations entitled under the law – for such purposes and subject to such terms and conditions as set out by the law. A servitude may be established subject to compensation. For example, a power company may wish to install a power line through/over the property.

Liens and Mortgages

Real estate may be mortgaged by making the required arrangements. Establishing a mortgage requires a related agreement and entry in the Property Register. Any agreement is null and void if it stipulates that the mortgager acquires title to the real estate in the event of default before the fulfillment right opens vis-à-vis the property. When real estate is mortgaged, it remains the obliged person's real estate, and the owner has the right to use and utilize it in a proper way but is also obliged to keep it in good repair.

2.3 Protection of ownership, proof of ownership and registration

The land registration offices of the various communes maintain certified public records of real estate in *Hungary*. The **Property Register** includes information on all the real estate in the country by commune; it includes the owners of the real estate, any related rights and the persons entitled to those rights, as well as the key legal facts pertaining to the real estate.

Information regarding the individual real estate is listed on the Proprietorship Register of the property. The content of the Proprietorship Register is accessible to anyone without any restrictions: anyone may see the records, take notes or request an authentic copy.

The property register is an authentic source to consult for the rights and facts registered regarding the given real estate. If a right or fact is entered in the Property Register, no one may claim ignorance of its existence. In practice, this means that the ownership and the encumbrances of real estate can be checked by consulting the current Proprietorship Register of the real estate.

The land registration offices adjudicate the various applications submitted regarding the real estate on a first come, first served basis. The applications received are indicated as 'marginal notes' or (margin slips) on the Proprietorship Register until they are adjudicated. The ranking of entries is determined by the filing date of the application for their

registration. A registration request acquires a ranking when it is submitted with the attached underlying document.

3 Purchase and sale of real estate

3.1 The sales agreement

A valid sales transaction requires a written agreement. Transfer of title to the real estate requires a relevant agreement, as well as an entry in the Property Register of the change in ownership. Without such entry in the Property Register a change of ownership cannot be validly made. The law specifies that registration of the title to the real estate – and of other real estate-related contractual rights – requires a written agreement and is subject to additional requirements both in terms of format and content. The sales agreement must either be drafted and countersigned by an attorney as a private document or prepared by a notary as a public document.

The generally accepted practice in *Hungary* is for real estate sales agreements to be drafted and countersigned by an attorney, where the lawyer is granted power of attorney by the contracting parties to proceed with the land registration office and any other authorities – the latter is necessary, for instance, when a foreign buyer is involved – in order to have the title registered.

A private document drafted in *Hungary* can only serve as the basis for registration if it includes the place and date of execution, and if the contracting parties have signed the agreement in their own hand or via a proxy such that their signatures can be clearly identified. Where the agreement consists of multiple pages, each page must bear the signatures of the contracting parties, and the signature of the attorney drafting and countersigning it. Agreements drafted in other than the Hungarian language must include an attached authentic Hungarian translation.

If the private document is drafted abroad – unless otherwise provided by an international agreement or required otherwise by reciprocal practices – the signature of the person who signs the statement must be authenticated by the Hungarian mission, or the authentication of the office authorized in the other country to authenticate the signature must be certified by the Hungarian foreign mission (diplomatic authentication and over-authentication). In the absence of a Hungarian mission, the signature must be authenticated by the foreign mission of the state representing the interests of the Hungarian state. The existence of a different international agreement must be pointed out or referred to by the person who requests registration. Whether or not reciprocal practices exist between the two countries is determined by the *Ministry of Justice*.

Diplomatic authentication or over-authentication of the private document drafted abroad is not required if the document includes an authentication clause (Apostille). In addition to a transfer deed, title to a property may also be acquired through auctions, court decisions, adverse possession, and building on top of an existing property.

Real estate cannot be acquired directly by exercising a mortgage in the event of default on a loan. This is because any agreement is null and void if it stipulates that the mortgager acquires title to the mortgaged real estate in the event of default before the fulfillment right opens. A mortgage is exercised via court-ordained collection by foreclosing the real estate.

The rights entered in the Property Register on behalf of a *bona fide* buyer must be regarded as correct and complete even if they diverge from the actual situation. For purposes of property registration, a person is regarded as a *bona fide* buyer if he/she acquires title for a consideration, on the basis of the Property Register.

3.2 Restrictions on sale and acquisition

By virtue of his/her right of disposal, the owner has the right to assign ownership, use of the property or the collection of its benefits to another person. The owner also has the right to pledge or otherwise encumber the property, and to transfer title to it.

In the context of selling and buying real estate, **the restrictions on conveyance and encumbrance** represent major practical hurdles. These restrictions essentially mean that the title cannot be transferred nor the real estate pledged. If the restrictions on conveyance and encumbrance are recorded in the Property Register, any further rights may only be entered subject to the approval of the persons entitled to those restrictions.

Restrictions on conveyance and encumbrance must be set out in an agreement, and they can only be imposed when the title is transferred. It is therefore not valid to impose a restriction independently of the transfer of title (on a stand-alone basis), nor are restrictions valid if the purpose of the agreement is something other than to transfer title to the real estate. So, for instance, it is not possible to impose a restriction on conveyance and encumbrance to secure a loan agreement – unless the loan is connected to the sale of the real estate.

The restrictions may only serve to secure the rights vis-à-vis the real estate. Such rights – for instance, the mortgage on behalf of the bank that issues a loan toward the purchase price – must be indicated when the restrictions on conveyance and encumbrance are registered. The exercise of the right of disposal despite the restrictions on conveyance and encumbrance will result in annulment.

3.2.1 Restrictions under family law and matrimonial property regime

By virtue of the Hungarian law concerning private international law, the personal and property status of spouses – including the use and retention of names and prenuptial agreements regarding assets – is governed by the common private law applicable to the spouses at the time of adjudication. Unlike other contractual relationships, Hungarian law does not allow for choice of law in the case of prenuptial agreements.

If the spouses are subject to different private laws at the time of adjudication, the last common private law will apply – or in the absence of that, the law of the state in which the spouses last had their common residence. If the spouses had no common residence, the law that applies is the law of the court adjudicating the case or the law of the state of the other relevant authority.

Under Hungarian family law, the assets included in the community property can only be sold – and, generally, any disposal other than that related to the separate assets of the spouses can only be made – subject to the approval of the spouse while the community property exists or until the community assets are divided after the end of matrimonial community. Since co-ownership persists not only while the community property exists, but also until the community assets are divided, this restriction applies not only while the

community property exists, but also until the community assets of the spouses are divided. Obviously, approval of the spouse is also required for the undivided interests in community property (e.g. a spouse cannot donate his/her undivided 50% interest in a real estate even to a common child without the approval of the other spouse). As a legal consequence of the relative invalidity, it is primarily the (ex-)spouse in breach who is liable for the value of the injured person's interest in the real estate. If the claim cannot be enforced, the third party who acquired the real estate must suffer the compensation of the injured (ex-)spouse from the real estate.

The interests of a third party contracting with either of the spouses is safeguarded by the law via the provision that the onerous transaction executed by either spouse while the community property existed must be regarded as though it is executed with the approval of the other spouse, except where the party to the transaction knew or should reasonably have inferred from the circumstances that the other spouse did not approve the transaction.

3.2.2 Options and pre-emption rights

Options and **rights of pre-emption** restrict the owner's right of disposal in that the person entitled to the right of pre-emption may interfere with any subsequent sales agreement and supplant the buyer by a unilateral legal declaration when the real estate is sold. Prior to executing the agreement, the seller is obliged to communicate the offer received to the person entitled to the right of pre-emption.

The right of pre-emption may either be based on a provision of law or on an agreement. The contractual right of pre-emption can only be exercised in the event that the title to the real estate is transferred in a sale/purchase transaction, i.e. it cannot be used in transfers of any other kind (for instance, if the real estate is exchanged for another, donated, inherited, or transferred by virtue of a maintenance agreement, etc.). The right of pre-emption may be specified for a definite or indefinite duration, and entitlement may apply to more than one person. In this case the right is indivisible and can only be exercised jointly.

The right of pre-emption is restricted to a person and thus **cannot be transferred** (any transfer, including assignment, is null and void) **or inherited**. The exclusion of succession does not apply to the party obliged by the right of pre-emption, since the right is connected to the real estate itself. Therefore, if the real estate is restricted by a right of pre-emption, the heir inherits it together with that restriction.

Should the contractual right of pre-emption occur together with the legal right of pre-emption, the law states that the legal right of pre-emption prevails. The law also provides for the sequence in which more than one legal right of pre-emption can be exercised.

A **buyback right** represents the right to buy back a sold real estate at the purchase price, which the seller may exercise at any time via a unilateral declaration conveyed to the buyer. The buyback price equals the original purchase price, but the seller is entitled to claim any value added to the real estate through investment prior to the buyback date, and conversely, the buyer may deduct any value lost through deterioration. The buyback right must be specified and spelled out at the same time as the sales agreement is concluded. The buyback right can be specified for a maximum of five years.

A **call option** allows the person so entitled to purchase the real estate by a unilateral statement. The agreement regarding the call option must be stated in writing – specifying

the real estate and the purchase price. The call option can be specified for a maximum of five years, too. Any call option that is specified for an indefinite duration will cease to exist after six months.

The reader, however, should not conclude that the Hungarian international private law allows the application of rules contrary to the Hungarian substantial law. Regarding a real estate located in *Hungary*, only those provisions have effect that are not contrary to the Hungarian law on real estates. At this point reference shall be made to the strict rules of the Act on Land Registration that are crucial regarding the transfer of property rights (see above at section 3.1).

Exploiting a right concerning a real estate located in *Hungary* falls exclusively under the scope of the Hungarian jurisdiction. Hence, even if the personal law of the contracting parties allows the agreement of provisions under a foreign law, the agreement may be invalid and unenforceable if it is contrary to Hungarian substantial law.

3.2.3 Agricultural real estate

There are tight restrictions on the acquisition of agricultural land, by virtue of which – except in a few cases – **only Hungarian natural persons can acquire title to arable land**. Resident private individuals are also restricted in that they can only acquire agricultural estates up to an area of 300 hectares or a value of 6,000 gold crowns. The gold crown is an index number, which represents the fertility of an agricultural/arable estate. The better the quality of the agricultural land, the higher the gold crown value. The gold crown value is also entered in the Proprietorship Register.

Foreign private individuals, foreign legal entities, or Hungarian legal entities cannot acquire title to agricultural estates or land in nature reserves. Foreigners can only acquire **farms functioning as stand-alone real estate with land of up to 6,000 square meters**, in accordance with the rules applicable to other non-agricultural estates as explained below. The law defines a farm as the entirety of residential and farming buildings or a group of buildings built for agricultural production (crop production and animal breeding, and the processing and storage of related products) as well as land up to an area of 6,000 square meters belonging to the farm and having the same lot number.

When agricultural land or farms are sold, the law extends a right of pre-emption to a number of persons (such as family members, neighbors, and residents in the community).

3.2.4 Restrictions regarding acquisition of real estate by foreigners

By virtue of the restriction under law, foreign private individuals and legal entities cannot acquire title to agricultural estates or land in nature reserves, with the exception of farms functioning as stand-alone real estate with land of up to 6,000 square meters.

The acquisition of properties other than agricultural land and areas in nature reserves by foreign legal entities or natural persons – except by inheritance – **requires a permit**. The permit may be issued by the head of the relevant administrative office of the capital city or the county if the transaction does not run counter to the interests of the local government or other public interests.

The head of the office for public administration is obliged to permit the acquisition of real estate if the transaction does not run counter to the interests of the local government or other public interests, and

(a) if the foreigner was granted an immigration permit or

(b) if the foreigner's other real estate was expropriated or

(c) if the foreigner exchanges another domestic real estate for the real estate or

(d) the purpose of acquiring the real estate is to terminate co-ownership or

(e) the domestic real estate is donated to a foreigner within the confines of the law or

(f) the foreigner presents proof that he/she has lived continuously in *Hungary* for at least five years for the purposes of work.

Whether or not acquisition of the real estate runs counter to the interests of the local government is decided by a declaration of the mayor of the locality in which the real estate lies.

Resident persons can only donate domestic real estate to foreigners if the foreigners are the next of kin; and such transactions also require a permit. The request for a permit must be submitted to the head of the administrative office in whose area the real estate lies. The following must be attached to the application:

- The document certifying the foreigner's country of origin; in practice, this is an authentic copy of his/her passport.
- One original or authentic copy of the agreement regarding the acquisition of real estate.
- A copy of the proprietorship register extracted from the Property Register, not older than three months.
- A tax certificate and a certificate of value, not older than three months.
- In the case of a donation, a document certifying the relationship between the contracting parties.
- HUF 50,000 (Euro 203) in stamp duty (a tax in the form of actual gummed-paper stamps purchased at the post office) for processing.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

For purposes of the sale of real estate, the seller must be the person identified as owner in the Property Register. The capacity to act and entitlement of the seller must be examined in order to establish whether he/she is actually capable of legally executing the transaction.

Natural persons who are entitled and have capacity to act can sign the agreement regarding the transfer of title to the real estate in their own hand. The agreement can also be executed by proxy – for which the proxy requires a written power of attorney. If a power of attorney is signed outside Hungary, it has to take place at a notary public and must be legalized by the Hungarian consulate or an apostille has to be affixed according to the *Hague Convention.*

Another possibility is to sign the power of attorney directly at the Hungarian consulate. In this latter case, the notarization and apostille are not required.

Persons with limited capacity to act may make legal declarations subject to the prior or subsequent approval of their proxy, while legal declarations on behalf of persons without capacity to act can be issued by their proxy. Limited capacity to act applies to minors above 14 but below 18 years of age, and the persons placed under guardianship by a court order that limits their capacity to act. Incapacity to act applies to minors below 14 years of age, and the persons placed under guardianship by a court order that excludes their capacity to act.

Legal entities can conclude contracts through their directors. The directors may authorize other persons to execute the contract.

3.3.2 Third-party claims and unpaid taxes

Debt collection by court order

Third-party claims vis-à-vis the owner of the real estate can be enforced through a collection process by court order. The collection right encumbering the real estate may be registered for the entire real estate or for an entire stake in the real estate. After the collection right is registered, any further rights or facts can only be registered if they do not interfere with the right of the party requesting collection.

Debt collection by order of the tax administration

Any unpaid taxes and public debt regarding the real estate may also represent an encumbrance. The collection right must be exercised in accordance with the rules applicable to court-administered debt collection, except that collection in this case is ordered by the tax administration. Upon request by the tax administration, the debt collection right regarding the real estate is registered by the land registration office on the Proprietorship Register of the real estate.

Any debt in taxes, fees and levies, as well as statutory contributions to the central budget, the separate state fund, the *Pension Insurance Fund*, the *Health Insurance Fund* and the local government are to be collected like taxes.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

In certain real estate purchase transactions, the regulations protecting the environment and nature must also be taken into account.

Environmental protection rules are of special importance when purchasing industrial sites. It is recommended that a report be prepared by an environmental protection expert on the purchasing of an industrial estate to reflect its state at the time of delivery, since the liability for pollution of the environment – until proven otherwise – rests universally with the owner and holder of the real estate in which the activity is or was carried out. The owner is relieved of the universal liability if he/she proves beyond a doubt that he/she has no liability whatsoever. This claim can be duly proved by furnishing the environmental professional opinion which sets out precisely the environmental state of the real estate at the time of purchase.

Nature reserves are safeguarded by many restrictions. In a nature reserve, practically any activity, including especially the changing of the nature or use of the area, cutting down or planting of trees, etc., is subject to a license from the environmental protection authorities.

Cultural heritage sites, including areas of archeological interest, archeological finds and sites, the protective zones around them, historic monuments and relics, historic sites, and cultural assets also enjoy protection. The outcome of the process of listing a property in accordance with the regulations under law must be entered in the Property Register. Considerable legal restrictions apply to listed sites and buildings. The costs of maintaining historic monuments must be borne by their owners.

Foreigners cannot acquire ownership in agricultural land and land of natural reservation.

The Hungarian state has a right of pre-emption regarding certain cultural heritage sites and properties if this right is specified under the regulation to list them. If there are multiple rights of pre-emption regarding historic monuments, the state will have priority over the local government handling the real estate, and the local government handling the property has priority over the local government in whose area the real estate is situated.

3.3.4 Access to relevant records and documents

The registration of facts and rights regarding real estate is the responsibility of the land registration offices. The land registration office maintains a proprietorship register of each piece of real estate, which includes authentic records of the rights and facts pertaining to that real estate.

The content of the proprietorship register in the Property Register is accessible to anyone without any restrictions: anyone may see the records, take notes or request an authentic copy.

The following documents may only be accessed by those persons who have a right or obligation according to the Property Register as well as those persons who are granted permission to do so by such persons in an indisputable private document or in a notarized document.

(a) The private and public documents included in the archives and underlying the registration of entries on behalf of the entitled or obliged person, except where the content of such documents are referred to in the entry on the proprietorship register.

(b) The personal identification number of the person so entitled.

(c) The list of owners (directory of names).

The documents under (a) and (c) can also be made accessible if a relevant legal interest may be presumed.

The document underlying the rights, facts and data entries registered regarding a part of the real estate specified in kind can be accessed without restriction even when the entry on the Proprietorship Register does not refer to the fact that the in-kind portion is specified by the document.

3.4 Key points that a seller should consider

Of the two parties to the agreement regarding the sale of real estate, the buyer is normally more vulnerable, since the seller is usually in a stronger position to assert his/her rights in the agreement. The general practice is that the attorney to proceed in the transaction is designated by the buyer and that – unless the parties agree otherwise – the legal costs are also borne by the buyer. Obviously, both parties may retain their own attorney, in which case each party will bear the cost of his/her own attorney. If only one attorney is involved in the contracting procedure, he/she is obliged to act with the interests of both parties in mind.

Thus the attorney involved in the process is obliged to check the buyer's identity to protect the seller, and where legal entities or business organizations without legal personality are involved, the attorney is obliged to check whether the buyer actually exists and is registered, and whether the agreement is executed by the registered representative.

The generally established practice is that – if the agreement is executed at a different date from the date at which the purchase price is paid in full and the real estate title is transferred – the buyer pays the seller a 10% earnest money deposit or advance when signing the sales agreement. The seller may retain title to the real estate until the purchase price is paid in full, i.e. the buyer's title is only registered after the seller receives the full purchase price and provides his/her consent to the registration of the buyer's title. It is also general practice that the payment of the purchase price in full coincides with the transfer of title of the real estate.

In order to demonstrate the seriousness of his/her contractual intent and to ensure fulfillment, the buyer generally pays the seller 10% of the purchase price when the agreement is signed. This amount may be paid as an advance on the purchase price or as an earnest money deposit. Both must be counted toward the full purchase price, but where earnest money was paid, the person responsible for failure of the agreement loses the earnest money paid, or he must repay twice the earnest money received. By specifying an earnest money deposit, the seller can ensure – without litigation regarding fulfillment – that the buyer cannot unilaterally withdraw from the agreement unless he/she forfeits the earnest money, which is to compensate the seller for the time lost.

The law does not stipulate the amount of the down payment. However, it is generally 10% of the purchase price, which is also acknowledged by the judicial practice. Should the amount of the down payment be excessively high, it can be reduced by the court in case of a dispute. If the agreement requires the approval of the Head of the Administrative Office (a foreigner can only acquire ownership of real estate in *Hungary* if permission has been given by the Head of the competent Administrative Office), the amount paid as earnest money can be considered as earnest money by the law only if the Administrative Office has approved the agreement. If for any reason the approval fails, the money paid as down payment, shall be considered as deposit payment of the purchase price and shall be returned to the buyer irrespective of who caused the rejection of the approval.

3.5 The execution of a real estate purchase transaction

The classic purchase transaction is executed in the following steps: the seller and the buyer – having found each other through a real estate broker or by direct advertisement – agree on the key parameters of the purchase, after which they contact an attorney

who helps them to agree on the details. The attorney then consults the Proprietorship Register for the real estate and checks the relevant information. Following that, the attorney drafts the sales agreement to reflect the understanding between the parties. The parties sign the agreement in the presence of the attorney, who uses the opportunity to verify their respective identities. In the case of companies or other organizations, the attorney procures, prior to signature, a certificate issued by the competent court of registry or any other document to certify that the organization exists, and verifies the right of the person executing the agreement to represent the organization. A sales agreement must be countersigned by the attorney or notarized as a public document in order to be valid.

As outlined above, the signing of the sales agreement is separate from payment of the full purchase price and entry into possession/transfer of title. The buyer generally pays the seller a 10% earnest money deposit when signing the agreement, and entry into possession and payment of the full purchase price take place subsequently. The countersigning attorney – if entrusted by the parties – submits the executed agreement to the land registration office, which indicates the application received on the Proprietorship Register of the real estate in the form of a marginal note (margin slip) within 24 hours. It is extremely important that the marginal note be entered, because the land registration office is obliged to adjudicate applications in the order in which they are received and so the buyer can safeguard the rights obtained through his/her purchase by ensuring that his/her marginal note occupies the first spot.

The real estate is delivered and the full purchase price is paid at a later date as specified under the agreement, and, at the same time, the seller grants permission for the registration of the buyer's title. This process takes place through the parties jointly visiting the real estate where the buyer checks the state of the real estate and whether the seller has vacated it of all movables. The parties jointly draw up a protocol of the meter readings. Then the parties again see the attorney involved or – if payment is made by transfer – they visit the bank with the attorney. At the time of payment, the seller signs the declaration required for the registration of title, which the attorney countersigns.

The declaration required for registration of title must be submitted to the land registration office with reference to the original marginal note, after which the office proceeds to register the title.

There are two different types of registration: (1) registration of the fact that agreement has been executed, (2) registration of the new owner based on the sale transaction. Both applications will appear first as a marginal note in the registry, but the latter will be rejected without the above-mentioned permission of the seller

In practice the said declaration for the registration shall be part of the drafted agreement, i.e. the seller shall declare that he/she permits the registration of the change in the ownership of the real estate into the Land Registry. In lack of such a declaration, the claim for the registration will be rejected. If the seller gives his/her declaration separately – as pointed out above – it is usually due to the fact that at the time of the execution of the purchase agreement, the buyer does not pay the entire purchase price and of course the seller will not declare his/her permission for the registration of the new owner until the last installment is paid as stipulated in the agreement.

In such cases the submission of the applications to the Land Registry should be done as follows: First, the purchase agreement shall be submitted into the Land Registry and claimed

for the registration of the fact that a purchase agreement has been executed. In the purchase agreement reference should be made that the seller permits the registration of this fact. As a second step, if the purchase price has been entirely paid, the registration of the new owner shall be applied for upon the above-mentioned separate declaration of the seller.

3.6 Powers of attorney

A proxy may also be duly authorized by the person so entitled to sign the real estate sales agreement. If the document is signed by a proxy on behalf of the person issuing the declaration, the authorization – completed in accordance with the formal requirements explained in detail in section 3.1 above – must be attached to the agreement.

Since the transfer of real estate is governed by Hungarian law and since the Hungarian courts and authorities have exclusive jurisdiction in such cases, the proxies are also governed by Hungarian law.

Where foreigners are concerned, a special rule exists according to which if the foreigner states in the registration application that he/she has no residence in *Hungary,* the name and address of a person the buyer authorizes to receive notices on his behalf must be attached to the registration request, along with a statement to the effect that the authorized person accepts the authorization. The benefit of authorizing a person in Hungary to receive notices is that the authorities will send the official documents to this person at his/her address in *Hungary*, rather than to another country; in this way the document is considered to have been delivered and the legal implications related to delivery apply.

3.7 Financing

Through various real estate financing schemes, *Hungary* offers favorable plans for housing purchases. Private individuals can obtain loans through different forms of savings, contributions to savings and loans associations, and special life insurance plans. Obviously, the favorable loans subsidized by the state are accompanied by strict terms and conditions. A favorable loan can only be granted if at least one of the debtor partners is a resident of *Hungary*, and the value of the residential property does not exceed HUF 15 million (approx. Euro 61,000). Such loans are offered by commercial banks according to their specific terms and conditions. Therefore, the attorney drafting the agreement must always be informed of the bank that the parties intend to use for the loan before signing the agreement.

Entrepreneurs are eligible for similar favorable loans with state subsidies in only one case – if the entrepreneur builds **apartments for sale or rent**. The requirement is that he/she must sell the apartments to private individuals or rent them to private individuals for 20 years. Another requirement is that he/she must build apartments of lower value, i.e. the contractual purchase price of each apartment inclusive of sales tax but without the price of the land, or where the apartment is rented, must not exceed HUF 30 million (approx. Euro 122,000). The loan can be up to HUF 10 million (approx. Euro 41,000) per apartment, but it cannot exceed 70% of the construction cost. The interest rate – depending on the lending institution – is around 7 to 8%. The loan must generally be repaid no later than the expected selling date of the finished apartments, or 10 years for rental apartments.

The most general possibility to obtain a loan to finance the purchase of real estate is to take out a **mortgage loan**, which is available to enterprises at commercial interest rates (16 to 19%). These loans can be used freely, and loan applications are subject to a relatively simple evaluation process. The collateral is the real estate – which must be free of litigation, claims, and encumbrances and must cover the size of the loan. In contrast to western European practices, banks generally make loans of no more than 40 to 50% of the market value of the real estate, to be repaid within a period of three months to five years. Loans entail an application fee, which generally consists of a fixed part (HUF 30,000 to 40,000 (approx. Euro 122 to 163)) and a certain percentage of the loan (typically 1%).

The **financial leasing** of real estate is a relatively new form of financing in *Hungary*. In such cases the lessor does not rate the creditworthiness of the lessee. However, the title to the apartment is only transferred to the lessee when the lease contract has come to an end. Leasing companies generally require a deposit equaling six months' leasing fees with a financial institution they specify, and require insurance coverage for the potential destruction of the real estate. Financing periods are 1 to 10 years, and interest rates are around 16 to 17%, depending on the lending market.

Most of the attractive financing schemes that are mentioned in the first two paragraphs are, as a rule, only eligible for Hungarian citizens. Real estate financing schemes are governed by Government decree, and, according to that, foreigners may obtain state subsidy only on permission of the *Ministry of Economy and Transport*. If one of the spouses is a Hungarian citizen, the said permission is not required.

3.8 Purchase through a company

Business organizations may buy real estate without a permit in accordance with the general rules applicable to natural persons – except for agricultural estates and landscape protection areas. This rule also applies if the business organization is solely owned by foreigners and its representative is also a foreigner.

In *Hungary*, foreign and domestic legal entities and natural persons, as well as business organizations without legal personality, can establish general partnerships, limited partnerships, limited liability companies, and companies limited by shares for purposes of business operations. Foreigners can establish business organizations without any restriction, according to the same rules as Hungarians. The companies must be registered at the competent court of registry. A company can generally be established and registered within two to three months.

Therefore, there is nothing to prevent foreigners from establishing a company in *Hungary* and using it as a vehicle to buy real estate – or even as a vehicle to bypass the licensing procedure. This may especially make sense for citizens of countries with which there are no reciprocal arrangements regarding the purchase of real estate, because the head of the public administration office generally rejects permit applications when citizens of such countries are concerned. Reciprocal arrangements exist with European countries.

It may also make sense to use a company to purchase real estate if the duty (tax) payable – especially for industrial real estate of higher value – is so large that it exceeds the cost of acquiring a company. If the owner of the real estate is a company, there is nothing to prevent the buyer from acquiring that company, as opposed to buying the real estate directly. In this case there is no real estate acquisition fee or sales tax. However, there is the

cost of a financial and legal audit of the company, since in acquiring the company the buyer also takes on all its liabilities.

Purchase through a foreign company is subject to the same rules that apply to purchase by a foreign natural person.

3.9 Defects and warranty claims

There are two main types of warranty claim: an appurtenance warranty and a legal warranty.

An **appurtenance warranty** applies to the physical condition of the real estate. For instance, the heating does not work in an apartment that is purchased with central heating. By virtue of the appurtenance warranty, the obliged party is responsible for the existence of the features in the real estate upon delivery that are specified by law and under the agreement.

In the case of defects, the right holder may claim either repair or a corresponding rebate. If the person so entitled is no longer interested in fulfillment as a result of these defects, he/she may withdraw from the agreement. Withdrawal causes the agreement to terminate retroactively, so the original condition at the time the agreement was entered into must be restored.

The person so entitled may enforce his/her warranty rights within six months of fulfillment, or within three years in the event of long-term use. If the mandatory conformity period is longer than three years, the warranty period will be equal to this longer period. The law provides for warranty periods of 5 or 10 years for certain building elements (foundations, main walls, chimneys, roof, etc.). This means that if the warranty claim of the person so entitled is founded on structural defects in the building – for which the mandatory warranty period is 10 years – the claim can be made for a period of 10 years. The warranty right is lost on expiration of the warranty. In the case of **new residential properties**, the contractor is also bound by **a mandatory three-year warranty** as required by law. This statutory warranty is considered to be a part of the agreement even if the parties did not specifically agree on the issue. Any agreements that exclude the statutory warranty or reduce the warranty period are null and void.

Legal warranty means that the seller can only sell real estate to which no third party has any right, except if the real estate is sold expressly with some kind of encumbrance. If any third party has a right vis-à-vis the real estate sold which interferes with the buyer's acquisition of title, the buyer may withdraw from the agreement and claim compensation. However, before exercising this right, the buyer is obliged to provide the seller with an opportunity to clear any obstacles to the acquisition of title or to furnish collateral by a set deadline.

If the third party's right restricts the buyer's title, the buyer may set an appropriate deadline and demand that the real estate be relieved of any encumbrance and may decline to pay the related amount until such encumbrances are removed. When the deadline has passed without resolution, the buyer may remove the encumbrance at the seller's expense or may withdraw from the agreement and claim compensation.

The buyer cannot exercise these rights if he knew or should have known that he would be unable to acquire title to the real estate without restrictions. Unless otherwise agreed, it is the seller who is responsible for freeing the real estate of mortgage and is not exempt from doing so even if the buyer was aware of that mortgage.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

The main rule is that a permit is required from the construction authorities to establish a lot, or to construct, refurbish, restore, modernize, demolish, or relocate a building, part of a building or a group of buildings, and also to commission, retain, or alter their use. The construction authority of first instance is the clerk at the local government for the relevant locality, who may issue the permits in accordance with the general rules and the local construction regulations.

The local regulations include the construction zones in a given area and define the types of buildings that may be erected in a given area, in keeping with the requirements of the appropriate zone. Construction may be carried out, and the construction permit may be issued, on the basis of architectural and technical plans, which may be drawn up by persons licensed to engage in design activities. Construction work must be carried out in accordance with the valid and effective construction permit, the related design for approval and other documents – with the attached authorizing clause – as well as the technical implementation plans drawn up on that basis when required by regulations.

Any deviation from the approved plan – with the attached authorizing clause – is subject to prior approval from the construction authorities, except if the deviation alone does not represent construction work that is subject to a construction permit.

4.2 Architect's and building contracts

Contracts may be concluded for design, supervision, technical control, and contracting (i.e. with a principal or general contractor) for purposes of carrying out the construction work. The terms and conditions of these contracts are determined by agreement between the parties. If the parties do not agree specifically on a major issue, the relevant provision of the *Civil Code* will apply. With regard to serious hazards involved in construction work, the regulations prescribe the qualifications of the persons with whom the customer can contract.

Architectural and technical design work requires university or college qualifications in the relevant field, and the designer must be listed in the design directory. Contracting work that is subject to an (implementation) construction permit from the construction authorities can only be carried out if the technical work is supervised by a responsible technical manager with qualifications relevant to the nature of the construction work and experience as specified by the regulations.

The contractor is liable for (1) both the workmanship and the real estate or part of the real estate satisfying standards of intended use and safety standards and for (2) complying with the requirements of the valid construction permit made available to him by the customer as well as with those of the related design for approval.

The responsible engineer is liable for the appropriate construction of the real estate or part of the real estate, and workmanship in accordance with the valid and effective construction permit, the related design for approval, as well as the implementation designs specified by the regulations. He is also liable for compliance of the construction work with the professional, quality and safety requirements, and the professional performance of workmanship.

Construction materials, structures, and equipment can only be distributed, ordered, designed for inclusion in a building, and installed subject to a conformity declaration as specified by the regulations.

4.3 Completion of construction and formalities

When the construction work is completed, a commissioning permit must be acquired for the real estate; otherwise, the real estate cannot be used. During the process of issuing the commissioning permit, the construction authorities check whether the workmanship complies with the valid and effective construction permit and the related design for approval, and whether the real estate is fit for proper and safe use.

If the real estate was built in breach of the rules, the construction authorities may grant a retention permit in response to a request by the person so entitled if the legal requirements are met, and if the customer proves that he has the right to build. Whenever the construction authorities grant a retention permit, they also impose a construction fine. The construction fine is at least 20% of the value of the completed part of the real estate and may be up to 100%. Construction fines are regarded as a public debt and may be collected like taxes.

4.4 Deficiencies and warranty claims regarding new construction

If the contractor fails to satisfy the terms of the contract fully, he/she is in breach of contract. Deficiency is the most frequent case of breach of contract, which serves as the basis for warranty claims.

Deficiency means that the real estate lacks the features specified by law or under the contract at the time of delivery – in which case the person so entitled has the option to request either repair or an appropriate rebate. If repair is not possible for any reason, or if the person so entitled is no longer interested in fulfillment, he/she may eventually withdraw from the contract.

The law specifies a **mandatory warranty period of three years for residential buildings**, starting on the date when the apartment is delivered and accepted. The parties may also specify other remedies for deficiencies under the contract, such as liquidated damages.

5 Rental and tenancy

5.1 Rental and lease agreements

The specific rules regarding **rental** of apartments and premises are set out by a separate law known as the *Housing Act*. As far as apartments owned by the state and local governments are concerned, the rules are generally conclusive whereas they generally leave open questions regarding privately owned housing, meaning that the parties are free to agree on the terms and conditions of rental.

The rules under the *Housing Act* are mainly used for the rental of apartments owned by the local government, since private landlords are not disposed to use the very strict tenant protection measures afforded by the Act. In this context, it is extremely important to draft a detailed rental contract to reflect the parties' intentions; otherwise, the rules under the *Housing Act* will apply, which could possibly be very detrimental to private landlords.

Under a rental contract, the owner may contract with a person he/she selects for either a definite or indefinite period. The parties are free to determine the amount of the rent and the rate of increase using an automatic mechanism, such as keeping pace with the inflation rate.

The landlord who rents out an apartment is responsible for maintaining the real estate, for keeping the central equipment operational and in good repair at all times, and for repairing any faults that may occur in the common areas and equipment. Unless otherwise agreed by the parties, the tenant is obliged to maintain, renew, supplement, or replace the wall and floor coverings, doors, windows, and equipment in the apartment.

Pursuant to the provisions under the *Housing Act*, the landlord may terminate the contract in writing in the following cases:

- if the tenant fails to pay the rent by the specified due date;
- if the tenant fails to fulfill any of his commitments under the contract or any major obligation under law;
- if the tenant or the persons living with him/her behave in a socially impermissible manner, create disorder, or exhibit intolerable behavior vis-à-vis the landlord or the other tenants;
- if the tenant or the persons living with him damage or use the apartment or the common rooms or areas improperly;
- if the landlord offers the tenant an appropriate substitute apartment that is ready for occupancy.

A private landlord will obviously not want to restrict his/her termination rights with the obligation to provide a substitute apartment, so it is best to set out the terms of termination in detail in the rental contract, indicating deviation from the provisions under the Act – with regard to the interests of both parties.

There is a separate chapter in the *Housing Act* to provide for rental of non-residential premises, which spells out the following special rules in that context. The rental contract regarding such premises terminates if:

- the tenant who is a legal person – operating either as a company or in another organizational form – is liquidated without a legal successor;
- the entrepreneurial ID card required for the tenant to pursue his/her operations in the rented premises was revoked by the authorities or renounced by the tenant.

The landlord may terminate a contract signed for an indefinite duration without providing substitute premises – unless the parties agree otherwise.

Pursuant to an **operational lease contract**, the tenant has the right to use and collect the benefits of a specific agricultural estate or other beneficial property for a period of time and is obliged to pay rent in return. The rent is due in cash or in kind, depending on the agreement between the parties.

The leasing of agricultural land requires a written contract, and the law may specify that the authorities make a determination on the validity of the contract. Any sublease of agricultural land is null and void.

There is nothing to prevent foreigners – be they private individuals or legal entities – from acquiring the right to use arable land. In order to prevent the restrictions on real estate purchases from being side-stepped, the rules which apply to the leasing of agricultural estates are compulsory, with the parties permitted no deviation whatsoever.

The lease contract may be concluded for a maximum period of 10 years. The maximum tenure is five years for forests, and with regard to agricultural estates such as vineyards, orchards, or other plantations, the lease contract for purposes of planting the crops on such estates may be concluded up to the end of the year in which the vineyard, orchard, or plantation loses all its value (i.e. until the end of the depreciation period).

Foreign private individuals and legal entities can lease arable land up to an area of 300 hectares or a value of 6,000 gold crowns (see section 3.2.3 above). Foreigners – be they private individuals or legal entities – may also acquire other rights of use in the form of half-lease or partial cultivation. Such rights of use will be governed by the rules applicable to lease.

The leaseholder of agricultural land is obliged to cultivate the land in a proper manner and to preserve its fertility. The cost of refurbishment and repairs required for the maintenance of the real estate, as well as public taxes, are borne by the tenant. Agricultural lease contracts concluded for an indefinite duration can be terminated as of the end of the fiscal year with six months' notice. Upon termination of the agricultural lease, the land and the other properties leased must be returned, appropriately and immediately, in a condition that allows for continued production.

5.2 Regulations on protection of tenants and rent control

The tenant and the lessee are afforded property protection as the rightful occupants of the real estate – against any third party or even against the owner. Pursuant to the rules regarding the protection of real estate, the occupant may fend off any attacks against the real estate and may even use force in self-defense – to the extent required to protect the real estate.

Owners or occupants who are deprived of their real estate or disturbed in the occupation of their real estate can contact the local government clerk within a year and request that the original real estate conditions be restored or that the disturbance be eliminated. The clerk restores the original conditions of the real estate and forbids any violators to continue such conduct, except where it is obvious that the party requesting the protection of real estate is not entitled to occupy the real estate or was obliged to suffer disturbance of his occupation. Either party who disagrees with the clerk's decision can pursue legal action within 15 days of receipt of the decision and file with a court to review the decision. The occupant can go directly to court after one year and request to have the original conditions of the real estate restored or the disturbance eliminated.

The occupant can also go to court directly if his/her entitlement to occupy the real estate is in dispute. In property litigation, the court decides on grounds of entitlement to occupy the property with the understanding that the entitlement of the party disturbed in peaceful occupation must be assumed.

The tenant or lessee is protected against the owner of the real estate mainly by the strict rules regarding termination which – as mentioned above – are only mandatory for housing

owned by the state or local government, but not for private rental, so private parties may also agree otherwise. In such cases, however, the rules under the contract must be observed strictly in order for the termination to be valid.

In the event that the rental relationship is terminated in accordance with the rules, but the tenant does not leave the real estate, he/she can only be evicted by the enforcement of a court order. That is because the tenant of an apartment enjoys protection as the occupant of the real estate until the valid and effective decision to evict him is enforced. Therefore, the landlord must sue to evict a tenant and must also wait for the court to enforce the decision.

6 Succession and gifts

6.1 Applicable law and jurisdiction

Pursuant to the Hungarian regulations regarding private international law, succession relationships must be adjudicated under the law to which the testator was subject at the time of his/her demise.

The applicable law of natural persons is the law of the state of which he/she is a citizen. A change in citizenship does not affect one's earlier personal condition or the rights and obligations arising on that basis. If a person has more than one citizenship, one of which is Hungarian citizenship, the applicable law is Hungarian law. The private law of persons with multiple citizenships, but not Hungarian, and of persons without citizenship, is the law applicable to their place of residence. If they have residence in *Hungary*, Hungarian is the applicable law. The applicable law of persons with multiple residences is the law of the state with which they have the closest relationship. The applicable law of persons in whose case the above criteria cannot be used to determine their private law will be the law according to their usual place of residence. If one of the person's usual places of residence is in *Hungary*, the applicable law is Hungarian law.

As far as contracts regarding real estate are concerned, the applicable law is determined by the location of the real estate; thus the law applicable to gifts/donations of Hungarian real estate is Hungarian law. Hungarian courts or other authorities have exclusive jurisdiction to proceed in matters related to the enforcement of substantial rights concerning domestic real estate.

As for the inheritance of real estate in *Hungary* by persons whose the applicable law is the law of another state (and not *Hungary*), the Hungarian authorities (the relevant notary public entitled to proceed in inheritance matters) will apply that foreign law. In gift/donation cases, however, the Hungarian authorities have exclusive jurisdiction and will proceed according to Hungarian law.

6.2 Fundamentals of the succession and gift/donation laws of Hungary

If a proprietor dies with no testamentary disposition, his/her bequest is governed by the rules of succession law.

If the proprietor made testamentary dispositions, the applicable rules are determined by the content of the will. The only exception is that Hungarian laws provide for **forced heirship** for the testator's next of kin and spouse, which amounts to half of their inheritance under

the law. An heir who is disinherited by the testator will is not entitled to his forced heirship. Testamentary dispositions can take the form of a will (written or verbal), an inheritance contract or a deed of donation upon death.

The testator cannot dispose of any properties committed under an **inheritance contract**, nor can he/she donate them to any third parties while alive, or leave instructions to give them to any such persons upon his/her death. As far as real estate committed under an inheritance contract is concerned, the restrictions on conveyance and encumbrance must be registered in the Property Register on behalf of the party contracting with the testator.

Gifts/donations represent bilateral legal transactions in which one party gives the other party free property debited against his/her own assets. Donation contracts regarding real estate are only valid in writing and if they are in conformity with the formal requirements regarding sales agreements. The procedure outlined under sale/purchase transactions must also be followed when real estate is acquired as a donation, obviously, with the exception of rules for payment of the purchase price. As explained in section 3.2.5 above, Hungarian citizens can only donate real estate to their next of kin.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

The acquisition of title to or usufruct of real estate is subject to duty (tax). The duty rate varies depending on the type of transaction, i.e. succession, donation, or onerous transfer of real estate.

The **onerous acquisition of real estate** and the acquisition of real estate by virtue of an **inheritance contract** are subject to onerous real estate transfer duty. The onerous real estate transfer duty is **10%** and applies to the market value of the real estate, without deductions for encumbrances.

As for the **acquisition of an apartment**, the onerous real estate transfer duty is payable on the market value of the apartment. The duty rate is 2% up to a market value of HUF 4 million (approx. Euro 16,260) (per apartment) and 6% on the portion above that. Where part of the title to an apartment is acquired, the 2% duty rate applies to the pro rata part of the HUF 4 million (approx. Euro 16,260), and 6% is payable on the part above that portion.

When an apartment is purchased by a buyer who is a private individual and sells his/her other apartment within a year before or after the purchase, the duty is only payable on the difference between the market values – without deductions for the encumbrances – of the apartment sold and the apartment bought.

If the purchaser buys a lot and erects a new building on it, the duty is payable only on the lot purchased. The duty payable on the lot is the general rate, i.e. 10% of the market value, and no duty is payable on the building erected. The only charge is a small processing fee for the construction permit application process.

The Act includes additional favorable terms for the construction of housing. The acquisition of a lot suitable for the construction of residential property is exempted from the onerous

real estate transfer duty obligation, provided that the purchaser erects a residential building on the lot within four years of submitting the agreement to the land registration office, and certifies completion to the duties office by presenting the commissioning permit.

Another exemption from duty applies to the acquisition of new apartments with market values not exceeding HUF 30 million (approx. Euro 121,950), built and sold by a contractor entitled to build and sell real estate.

The real estate acquisition duty is payable by the buyer.

7.1.2 Sales tax (value added tax)

As of January 1, 2004, the sales tax (value added tax) rate in *Hungary* is 25%, except for some products that are subject to favorable sales tax rates of 5% or 15%.

The law provides for a **tax exemption** for the sale/purchase or utilization of real estate in the following cases:

- sale, rental, or lease of land, **except for first sale for business purposes**;
- sale of residential properties, except for sale before completing construction, and the first sale after completion;
- rental of residential properties – independently of the purpose of use – and utilization in any other way, except for use as private tourist accommodations.

Since it is only persons who are engaged in business operations under their own name that are subject to sales tax, private individuals can sell their own residential property and **land** without sales tax in all cases, i.e. even before completing construction or for the first time after completion.

7.1.3 Real estate registration and notary charges

In *Hungary*, the purchase of real estate is primarily arranged by attorneys. It is not compulsory to have agreements notarized, and this is rarely done.

Hungary has no mandatory fees for attorneys; the attorney's fee is, therefore, negotiable and is subject to agreement between the parties. A lawyer's fee generally amounts to 1 to 2% of the value of the real estate. Typically, the higher the value, the lower the percentage. This fee covers the procurement of the Proprietorship Register, the drafting and countersigning of the sales agreement, and the representation of the parties at the land registration office.

Notaries must charge according to a mandatory schedule of fees. The schedule is as follows: the notary's fee for transactions of over HUF 10 million (approx. Euro 40,650) is HUF 81,700 (approx. Euro 332) plus 0.25% of the value over HUF 10 million (approx. Euro 40,650). The fee is twice as high if the notary drafts the agreement in a foreign language. In addition to the fee, notaries may also charge for their expenses.

The processing fees at the land registration office are marginal; for instance, the fee for the registration of title or right of asset value to the real estate is HUF 2,000 (approx. Euro 8.13). Foreigners are required to pay a separate processing fee for the permit to acquire title to real estate, as explained in the relevant section.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

The lot and building taxes represent the local taxes in connection with the title to the real estate, and are payable by the owner of the real estate.

The local government may levy the building tax on buildings or parts of buildings for residential or non-residential purposes, and it may levy a lot tax on undeveloped lots within the residential zone of the locality. Within the confines of the law, the local government may determine its own rules regarding exemption and the tax rate. The typical arrangement is that no tax is payable on real estate for residential purposes.

Based on the local government's decision, the building tax is payable either on the useful floor space of the real estate calculated in square meters or on the adjusted market value of the real estate. The maximum rate of building tax under the law is HUF 900 (approx. Euro 3.66) per square meter or 3% of the adjusted market value.

The lot tax is also payable on the area of land in square meters or the adjusted market value of the lot. The maximum rate of lot tax under the law is HUF 200 (approx. Euro 0.81) per square meter or 3% of the adjusted market value.

7.2.2 Income tax

Personal income tax is payable on the income received by private individuals from real estate. Such income may be the proceeds from sale or utilization through rental.

The income from transfer of the real estate or the related rights of asset value is calculated by deducting from the proceeds of the sale (full selling price) the following certified expenses of the private seller, with the exception of costs which represent expenses that can be deducted from certain kinds of income (such as refurbishment costs deducted from rental proceeds):

- the amount of fees, charges spent to purchase the real estate and any other related expenses;
- investment to enhance the value of the real estate;
- the expenses related to the transfer, including any amounts paid under commitment to the state and certified in relation to the real estate.

The personal income tax payable is 20% on the income calculated as described above. If the transfer takes place more than five years after purchasing the real estate, the taxable base must be reduced by 10% each year from the sixth year onwards; thus, no tax is payable after the 15th year.

Private individuals may claim a refund on the tax paid on the part of the income from the transfer of title or rights of asset value to the real estate which the seller or the seller's next of kin spent to acquire housing, within 12 months before or within 60 months after the income was received. For purposes of the above rule, the purchase of a construction lot to build residential property is regarded as having been for the purposes of housing if the private individual erects a residential building on the lot within the specified period.

All the income received by private individuals by renting out arable land and other real estate is taxable and is subject to 20% tax.

The income generated by companies through the sale and utilization of real estate is part of the company's total income, on which the tax is payable according to the general rules. Currently, the corporation tax amounts to 16% in *Hungary*. Income that is not paid out by the company is not subject to any further taxation.

7.2.3 Net wealth tax

In addition to local taxes – described in section 7.2.1 above – there are no other taxes in *Hungary* on real estate holdings at the moment.

7.3 Capital gains tax

The conclusion from the rules described in sections 7.1.1 and 7.2.2 is that whenever real estate is sold, the seller must pay income tax and the buyer must pay duty (a distinct form of tax). Capital gains only become taxable upon sale (20% personal income tax). No tax is levied on the increased value of real estate as such – unless the real estate is sold.

7.4 Inheritance and gift taxes

The applicable succession and donation duty rates are set out in Table 1. The **succession or gift duty** payable is calculated by multiplying the net value of the legacy or donation per heir/recipient by the relevant rate.

The law provides for certain exemptions from the obligation to pay succession and gift/donation duties: such as if the real estate (or part of the real estate) inherited or donated is a lot suitable for the construction of residential property, in which case the heir or recipient is exempted from the payment of duty provided that he/she builds a residential building on the lot within four years of the valid and effective delivery of the legacy or the signing of the contract. Fifty percent of the normal succession duty applies to inheritance of agricultural land or related rights, and a mere 25% of the normal succession duty is payable if the heir is also a family farmer.

Inheritance and gifts are tax-exempt, except for the income received from the inherited estate, such as on royalties from intellectual property.

7.5 Other taxes and charges

There are no other taxes or charges in connection with the sale or utilization of real estate – except for maintenance-related costs.

7.6 Incorrect (lower) statement of sale price on the sales agreement

It was common in the past for the parties to state a lower-than-actual purchase price for the real estate in the agreement in order to reduce the duty payable. According to the Act on duties, the duties office has the right to increase the value relative to that stated in the agreement and thereby increase the taxable base if its own figures suggest that the

Table 1 Inheritance and gift tax rates

Group	General duty rate	Rate applicable to acquisition of housing
I. To be paid by the testator's children, spouse, parents, and any grandchildren raised in the household without their parents (adopted children, step-children and foster children are regarded in the same way as natural children, and adoptive parents, step-parents and foster parents are regarded in the same way as natural parents)	Succession: **11%** up to HUF 18 m (approx. Euro 72,200); **15%** on the portion between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **21%** on the portion above that	Succession: **2.5%** up to HUF 18 m (approx. Euro 72,200); **6%** on the portion between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **11%** on the portion above that
	Gifts: **11%** up to HUF 18 m (approx. Euro 72,200); **18%** on the portion between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **21%** on the portion above that	Gifts: **5%** up to HUF 18 m (approx. Euro 72,200); **8%** on the portion between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **12%** on the portion above that
II. To be paid by the testator's grandchildren, grandparents, brothers and sisters who do not belong in group I	Succession: **15%** up to HUF 18 m (approx. Euro 72,200); **21%** on the portion between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **30%** on the portion above that	Succession: **6%** up to HUF 18 m (approx. Euro 72,200); **8%** on the portion between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **15%** on the portion above that
	Gifts: **15%** up to HUF 18 m (approx. Euro 72,200); **21%** on the portion between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **30%** on the portion above that	Gifts: **8%** up to HUF 18 m (approx. Euro 72,200); **10%** on the portion between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **16%** on the portion above that
III. To be paid by any other heir	Succession: **21%** up to HUF 18 m (approx. Euro 72,200); **30%** on the part between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **40%** on the part above that	Succession: **8%** up to HUF 18 m (approx. Euro 72,200); **12%** on the part between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **21%** on the part above that
	Gifts: **21%** up to HUF 18 m (approx. Euro 72,200); **30%** on the part between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **40%** on the part above that	Gifts: **10%** up to HUF 18 m (approx. Euro 72,200); **21%** on the part between HUF 18 and 35 m (approx. Euro 72,200 and 142,300); **30%** on the part above that

stated value is not in line with local market values. The decision of the duties office may be appealed. Willful fraudulent contracts between the parties may also give rise to criminal prosecution, although in practice the authorities tend to use administrative sanctions.

In the case of tax arrears, a delinquency penalty and a tax fine must be paid. The delinquency penalty is calculated as twice the effective base rate of the central bank as of the date of calculation (currently the base rate is 12.5%) divided by 365 and multiplied by the number of calendar days in delinquency. The tax fine is 50% of the tax arrears.

Subsequent adjustment of the taxable base for purposes of real estate acquisition duty with the submission of a retroactive tax return is not considered tax arrears, provided that all the assets subject to taxation are duly reported.

7.7 International taxation

Pursuant to Hungarian regulations – and in line with the relevant provisions of the double taxation treaties – the income source for purposes of the income from ownership, use, collection of benefits, and exercise of the right of disposal over real estate (including especially the transfer, rental or lease of the property) is the state in which the real estate lies.

Hungary has concluded double taxation treaties with many countries worldwide and most European countries, including the *United Kingdom, Malta*, the *United States* and *Australia.* The double taxation treaties concluded with the *United Kingdom, Malta*, the *United States*, and *Australia* contain identical rules for income from real estate holdings. They state that tax on the income from real estate is payable in the state where the real estate lies. This rule applies to all kinds of income from direct use, rental, lease or any other use of the real estate. The same rule applies to the income generated by companies from their real estate holdings and from the use of real estate for operations that do not require a permit.

Therefore, if residents of the above states generate income from their real estate holdings in *Hungary*, such income is subject to taxation in *Hungary*, and is deducted from their taxable income in the other state. However, that other state may prescribe a higher tax bracket for the rest of the person's income, as though the income thus deducted were not exempt from tax.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Foreigners may cross the Hungarian border, enter, and stay in the country if they possess a valid passport and visa. Pursuant to international agreements, the citizens of certain countries may enter *Hungary* without a visa and may stay in the country for a period specified under the agreement, generally up to 90 days. Stays of more than 90 days require a residence visa prior to entry, or a residence permit must be procured before the visa expires. Stays of over 90 days up to one year for specific purposes require a residence visa (Type 'D' Visa).

Residence visas can be issued for official purposes (to delegations, media representatives, and members of international organizations), for work and self-employment, study, or medical treatment, or for purposes of visits and family unification. The visa application

must be submitted in person to the Hungarian mission in the country of permanent or usual residence.

If the visa is for income-generating activities – i.e. for gainful activities that are not subject to a work permit – this information must be provided in the application. If the gainful activity is subject to a work permit, a work visa must be applied for. In order to be issued with a work visa, the applicant must have a valid work permit.

If the length of stay exceeds the date specified in the visa, a residence permit must be applied for in *Hungary* 15 days prior to expiration. If the purpose of stay is work or some other gainful activity, the residence permit can be issued for a maximum of four years on the first occasion.

An immigration certificate (permanent residence permit) can be issued to foreigners who have lived lawfully and without interruption in *Hungary* for at least three years after entry, provided that they have a domicile and sufficient income to live on.

Citizens of the *European Economic Area (EEA)*, and their family members, can enter without a visa, with only a valid passport or valid ID card, and may stay in the *Hungary* for up to 90 days without any special permission. These citizens do not require a visa to stay in *Hungary* over 90 days since they enjoy the right to settle in the country.

Citizens of the *EEA* do not have to prove the reason for their stay. They must only demonstrate that they have the means to sustain themselves and that they have comprehensive health insurance. They are free to work in *Hungary* unless their country of citizenship applies restrictions on the employment of Hungarian citizens. The member states may apply employment restrictions for up to seven years following the accession date (May 1, 2004) and *Hungary* is not obliged to apply community rules to those member states in this context until the end of the derogation.

Of the member states, *Austria* and *Germany* are expected to maintain national restrictions during the transition period. On the other hand, many member states – including *Denmark, Sweden, the Netherlands, Ireland, Greece* and *Finland* – have already indicated that they do not expect to use the derogation and will open their labor markets to Hungarian workers as of the accession date.

8.2 Tax residence

The Act on personal income tax prescribes that resident private persons are subject to taxation in *Hungary* on all their income, and foreign private persons are subject to taxation on their Hungarian-source income.

Pursuant to the provisions of the law, private persons are to be regarded as resident if their permanent or usual residence is in *Hungary*. Permanent residence is the residence where the private person stays on a permanent basis. If none of the above is in *Hungary*, the tax residence is the person's residence in another state. If a private person has permanent residence in more than one state, his/her fiscal residence is in the state that represents the center of that person's essential interests. The center of the private person's essential interests is that state to which he/she is tied through the closest family and business relationships. If the private person has no permanent residence in any other state, his/her fiscal residence is his/her usual place of residence in another state. If none of the above

criteria helps to identify where the person's fiscal residence is, fiscal residence is determined on the grounds of the person's citizenship.

8.3 International taxation for residents of Hungary

The double taxation treaties regulate the issue of tax residence similarly to Hungarian law, i.e. they apply similar rules to determine the fiscal residence of a taxpayer. The double taxation treaties concluded with the *United Kingdom, Malta*, the *United States*, and *Australia* all state that, as a rule of thumb, a person's fiscal residence is the state in which he/she has a permanent residence. If he/she has a permanent residence in both states, his/her fiscal residence is the state in which the center of his/her essential interests lies. If it cannot be established in which of the Signatory States the center of the person's essential interests lies, or if the person does not have a permanent residence in either of the Signatory States, his/her fiscal residence is the Signatory State that is his/her usual place of residence.

Another rule under the treaty with *Malta*, the *United Kingdom*, and the *United States* is that if the person has a usual place of residence in both states, or does not have one in either, his/her fiscal residence is the state of which he/she is a citizen.

If the taxpayer's fiscal residence cannot be established on the basis of the above criteria, the states concerned will coordinate in order to settle the matter by mutual agreement.

It is important to clarify fiscal residence because a taxpayer must pay taxes primarily in the state of his/her fiscal residence, except for his/her income from the other state, for which the law on double taxation provides that the right to collect taxes belongs to the state of the source of income.

9 Checklist: Real estate acquisition in Hungary

If a foreigner wishes to purchase real estate in *Hungary*, the purchase process consists of the following steps:

- The right real estate is generally found through a real estate agent.
- The attorney (notary public) who is to help to draft the agreement is contacted.
- Preliminary discussions take place with the seller, the Proprietorship Register of the real estate is procured, and the legal status of the real estate is clarified.
- The sales agreement is concluded in the presence of an attorney or a notary public (this is compulsory).
- The agreement is submitted to the land registration office. The registration application is ensured priority when the marginal note is placed in the first spot.
- The permit application process is completed – representation by an attorney is recommended.
- The full purchase price is paid at the same time as the real estate is delivered. This is generally when the seller relinquishes his/her title.
- The permit and the seller's declaration required for registration of title are submitted to the land registration office.
- In most cases the land registration office registers title within a few months.

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Contents: Ireland

1 Introduction

The laws relating to real estate in *Ireland* have derived from the social and political upheavals during the 17th, 18th and 19th centuries, with constant tension existing between tenants and absentee English landlords, who had acquired substantial tracts of land in *Ireland* as a result of confiscations and resettlements. This resulted in legislation governing the relation of landlord and tenant, the effects of which are still felt in many areas of modern law and practice today.

A large section of the Irish *Constitution* of 1937 is devoted to the protection of property rights. The Irish courts have increasingly turned their attention to the protection afforded by the *Constitution* to private property rights in disputes of real estate.

Article 43.1.2 of the 1937 *Constitution* states: '*The State accordingly guarantees to pass no law attempting to abolish the right of private ownership or the general right to transfer, bequeath, and inherit property.*'

Irish property laws have been derived from the laws of the *United Kingdom*. The most significant difference is that the Irish *Republic* has a **written *Constitution***.

2 Real estate ownership

2.1 Different forms and types of ownership

There are several different interests which someone may hold in real estate. The two main types are **freehold** and **leasehold**. A freehold real estate is the premier form of land ownership in the *Anglo-Saxon* world as the ownership of the real estate is absolute. It is followed by leasehold real estate where the lease is for a set amount of time. A person may also have a future interest in real estate, through a gift or inheritance where they will not be in possession of the real estate until some point in the future. A **life interest** in a real estate is also possible where the person has a **right of residence** in a real estate for the duration of his/her life.

Real estate can belong to one or several people; it may also, however, be held jointly or in common with others. All questions in relation to such real estate are regulated by way of private contract between the owners. Where no agreement can be reached, an application can be made to the court for directions to resolve the dispute on the basis of the usual provisions. The contract will normally deal with questions such as the maintenance of the real estate, its insurance and liability issues. Where real estate is held jointly, on the death of one **joint owner**, the share of the deceased will go to the other owners. Where the real estate is owned by way of **tenancy in common**, on the death of one of the owners, his/her share will pass to his/her lawful successors.

The most usual form of real estate in *Ireland* is individual family homes, although in urban areas apartments and apartment blocks of one or more stories are also common. Apartments are usually owned by individuals who enjoy common rights in the common areas, such as the garden and corridors, together with the other owners in the block. These common areas are generally held by a limited liability company in which each apartment owner holds a share. Properties that are set up for single or multiple lettings are also commonplace. *Timesharing*

is very uncommon in *Ireland. EC Directive 94/47/EC* on the protection of buyers in respect of timeshare agreements has been adopted into Irish law by *Statutory Instrument No. 204 of 1997 (Contracts for Timesharing of Immovable Property)*. The contract must be in writing and like all contracts in *Ireland* must contain the names and addresses of the parties to the contract, the *completion date*, the names of the people to whom a withdrawal notice should be sent and the price to be paid. In addition the buyer is entitled to a cooling-off period of 10 days from the time he/she signs the contract.

Only the owner of a real estate or such persons permitted by that person can build upon it. In all cases the land and buildings remain one unit. The system of building rights and tenancies under a building lease in the continental European meaning of the terms do not exist in *Ireland*.

2.2 Easements, charges, liens and mortgages

There are many different types of *easements* affecting real estate in *Ireland* e.g. fishing rights, rights of way, shooting rights, mining and quarrying rights. These rights in *Ireland* are called '*incorporeal*' *hereditaments*. The person who possesses these rights usually has no right to the possession of the land over which the right is exercised. The exercise of these rights is covered in the absence of a 'contract' under the laws of landlord and tenancy. However *'incorporeal' hereditaments* can be registered in the Irish *Land Registry* or the *Registry of Deeds* (which are discussed in detail in the next section) thereby ensuring that a purchaser of lands in the State can be certain to what rights exist over lands he/she is acquiring.

The most commonly used method of raising money to buy a building or real estate is by arranging a loan from a bank or lending institution. This loan is secured by way of **mortgage** over the assets whereby the real estate is charged to the financial institution.

Under the *Registration of Title Act 1964*, *registered land* (*Land Registry* land) may be mortgaged only by the **registered owners** by means of a charge. Unlike a mortgage, a charge involves no transfer of ownership to the lender, ownership remains with the owner and the lender only acquires rights over the real estate.

With **unregistered land** (i.e. real estate registered in the *Registry of Deeds*) this is conveyed, leased or assigned by the borrower to the lending institution subject to the borrower's right to obtain the title back and have it vested in him/her once the loan is repaid.

Title formally passes under the mortgage from the borrower to the lending institution. Notwithstanding the foregoing it is common to see real estate being sold by borrowers even where the real estate is subject to an existing mortgage. Normally after the sale of the real estate the existing loan is repaid as soon as possible after closing from the proceeds of the sale. The seller's solicitor usually gives a written undertaking in favor of the lender and buyer to complete all matters and discharge the loan.

In general terms the mortgage document is simple. It recites the terms of the loan and that the owner has agreed to repay the loan. The document contains a number of **covenants** made by the mortgager. The most important is an acknowledgment of indebtedness. The **covenant** will always extend to repay the loan and any interest that accrues together with any costs associated with repossession of the real estate and the enforcement of any security.

In general, other **covenants** that one sees in Irish mortgages are:

- A covenant to the effect that the mortgaged real estate must be used solely by the borrower. The covenant usually confirms that the real estate will not be rented or sublet without the consent of the lending institution.
- A covenant to the effect that the borrower will not carry out any development whatsoever without obtaining all necessary *Planning Permission*s.
- A covenant by the borrower to keep the real estate insured at all times.

2.3 Protection of ownership, proof of ownership and registration

There are two systems of registration currently in operation in *Ireland*. The ***Registry of Deeds*** was introduced under the *Registration of Deeds (Ireland) Act 1707* and was established for the purpose of giving priority to registered deeds (generally the document which transfers ownership of the real estate) and for the prevention of fraud in dealing with the transfer of ownership of land. It is now more commonly used in dealing with titles in urban areas. It is important to note that the registration in the *Registry of Deeds* is not compulsory. Registration is not necessary to transfer the title. Documents other than the purchase deed can be registered in the registry such as a contract for sale or an option to buy land. The *Registry of Deeds* has no responsibility for the effectiveness of the deed or other documents being presented to it for registration. This remains the sole responsibility of the parties preparing the documents. Therefore the registry does not guarantee ownership or good title.

The second system of registration in *Ireland* is the ***Land Registry*** and this system is basically the alternative registration system to the *Registry of Deeds*. The present *Land Registry* system operates under the *Registration of Title Act 1964*, and this Act provides for compulsory registration in certain cases:

- Where real estate has been sold and conveyed under the *Land Purchase Acts*.
- Where real estate is acquired by a statutory authority.
- All real estate being conveyed or assigned in Counties *Meath, Carlow* or *Laois*.

The *Land Registry* system is based on the boundaries of the particular real estate in respect of which the title is registered being shown on an *Ordnance Survey* map. When the title is registered in the *Land Registry* a *Folio* is opened. The *Folio* is the actual register and is set out in three parts:

- Part 1 gives the details of the real estate and specifies the map reference. It also specifies the area of the real estate.
- Part 2 shows the title and ownership.
- Part 3 shows the *Burdens* on the real estate and nature of *Burdens* or mortgages, rights of way and easements registered.

The *Land Registry* will, on request, issue a ***Land Certificate*** and this document becomes an important document of title. The effect of registering a title in the *Land Registry* is that such

title falls out of the *Registry of Deeds* system. The title in the *Land Registry* carries with it a State guarantee that it is valid.

3 Purchase and sale of real estate

3.1 The sales agreement

The contract for the sale and purchase of real estate is prepared by the solicitors acting for the seller. The *Law Society* of *Ireland* has produced a standard ***Contract for Sale*** which is used by all solicitors in *Ireland*. The contract is drafted by the solicitor for the seller and contains a standard set of 51 *general conditions*, together with any applicable *special conditions* and additional details of the transaction which are set out below.

The first part of the agreement lists the parties, followed by an agreement between the parties setting out their names and addresses, the purchase price, the deposit (standard practice is that this is 10% of the purchase price), the closing date (being the date of completion of the transaction) and the interest rate payable in the event of a late closing. The parties to the contract sign this part when they are executing it. It also contains a provision for the spouse of the seller to provide his/her consent if it is a family home that is being sold.

The next part of the agreement deals with what is called '*particulars and tenure*'. Essentially this provides details of the real estate being sold; however, these details are taken from the title documents to the real estate and are not merely the postal address or a statement such as 'three bedroom detached house'. If the real estate is held as leasehold or freehold, it will be stated at this point.

A document schedule follows on from the particulars and tenure and identifies a list of documents that will be produced by the seller to show title to the real estate. Copies of these documents are generally forwarded with the contracts for sale to solicitors for the buyer and the originals are then handed over on closing.

The second section of the sales agreement deals with **special conditions** to the sale. The standard *Law Society* contract includes three *special conditions* dealing with definitions, amendments to the *general conditions* and VAT. *Special conditions* can also be included for any matter dealing with the transaction and could include a condition dealing with anything about the title to the real estate and any title documents, a condition saying that the contract is subject to the buyer obtaining loan approval, a condition stating that the real estate is subject to a mortgage and the seller will discharge the same prior to closing, or a condition stating all the items in the real estate that are included in the purchase price. There are dozens of different *special conditions* that can be included as every transaction will, of course, have differing requirements.

The final part of the agreement sets out the **general conditions** which, as stated above, are standard and included in every contract. The *general conditions* correspond with the usual procedures that are accepted throughout *Ireland* by solicitors and have been approved by the *Law Society* of *Ireland* in consultation with the *Construction Industry Federation*, as well as the *Royal Institute of Architects of Ireland.* If a seller wishes to exclude a general condition then a special condition must be included explaining this. The more important *general conditions* would include conditions relating to title and conditions which relate to

Planning Permission. ***Planning Permission*** is an authorization from the local authority in the relevant area to build on, or alter, a real estate (This is discussed in further detail at a later stage.) The conditions also place an obligation on the seller to provide warranties in respect of the title and any *Planning Permissions* applicable to the real estate.

While contracts do not have to be notarized, the signature of both the seller and the buyer must be witnessed when they are signing. The contracts are not binding until both parties have signed and one copy has been returned by the solicitor for the seller to the solicitor for the buyer.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

Since the introduction of the *Family Home Protection Act 1976* there have been significant restrictions on conveyancing transactions dealing with matrimonial property. The chief purpose of the Act was to protect one spouse's interest in the family home (at the time this was targeted mainly at protecting the interests of a wife). *Section 3(1)* of the Act provides that where a spouse, without the prior consent in writing of the other spouse, purports to convey any interest in the family home to any person except the other spouse, then subject to certain conditions stated in the Act the purported conveyance shall be void. This section was at a later time limited by the *Family Law Act 1995* to six years from the date of the conveyance. It effectively means that if the spouse of the seller does not provide written consent to the sale or transfer of the family home, then the transaction is void provided an objection is raised within six years of the date of execution of the deed of conveyance. Generally, in conveyancing transactions a statutory declaration evidencing the position with regard to the property signed and sworn by both spouses before a commissioner for oaths or practicing solicitor is produced at the closing. Even in the event that a seller is not married it is common practice for him/her to swear a declaration stating this. Even in the event that a couple have divorced and one of the spouses is now selling the real estate, it is standard practice for a statutory declaration to be obtained from the other spouse, stating that the real estate is not a family home.

3.2.2 Options and pre-emption rights

Option agreements in respect of real estate or interests in land are valid. In extremely rare circumstances a lease may contain a **covenant** where the buyer has to offer the real estate to a third party such as his landlord at the market value when the lease expires. Such leases are, however, very rarely found in practice. Legislation is also in place in *Ireland* which allows a local authority to compulsorily acquire real estate for a variety of purposes such as road widening, river drainage or the supply of utilities such as electricity. Compensation is payable by the local authority to the party whose real estate is compulsorily acquired.

In business real estate, where a lease is held for more than five years there is an existing **right to renew** the tenancy and to have the lease for an additional period of five years or more.

3.2.3 Agricultural real estate

The *Land Act 1965* imposes certain restrictions on transactions involving **agricultural real estate**. It deals with the acquisition of agricultural real estate and has no significance for

land in urban areas. Although there is no general limitation on the purchase and sale of agricultural real estate, it may be necessary to obtain the consent of a state agency formerly called the ***Land Commission***. *Section 12(1)* of the Act states that an agricultural holding shall not be let, sublet or subdivided without the consent in writing by the *Land Commission*, which may be either general or particular or subject to conditions. An agricultural holding is real estate that is substantially agricultural. An application for consent is made to the Irish *Government Minister for Agriculture and Food* who took control of the responsibility when the *Land Commission* was dissolved in 1992. It was formerly necessary, without reference to the date of the lease, to obtain the consent for all leases and subleases to which the Act is applicable. If the consent is not obtained then any transaction involving the letting, subletting or subdividing of agricultural real estate is null and void. The consent may, however, be obtained retrospectively. The application for consent is generally in the form of a letter setting out the nature of the application and enclosing the necessary title documents. These restrictions apply generally only to land outside of the larger cities.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

Again, the *Land Act 1965* places certain restrictions on the acquisition of real estate by foreigners. For the most part, it is land used for agricultural purposes that is affected by this rule and not real estate in cities or towns. *Section 45(2)* states that no interest in land to which this section applies shall become vested in a person who is not a qualified person except with the written consent of the *Land Commission*. This approval is almost always issued now. An interest in real estate was defined as including a leasehold interest or tenancy and an estate. The 'land to which this section applies' was real estate not situated within the certain areas listed in the Act. The meaning of a '**qualified person**' was listed in a set of categories and included an Irish citizen or a person who has been an ordinarily resident in *Ireland* continuously for seven years prior to the real estate transaction. However, in 1995 an amendment to the Act was published which changed the definition of 'qualified person' to include citizens of the *European Union* or countries in the *European Economic Area*. Since the mutual treaty between *Switzerland* and the *EU* of June 1, 2002, Swiss citizens are also within the meaning of 'qualified persons'.

Therefore, if the real estate is not within one of the exempt areas and the buyer is not a qualified person then, again, the consent of the *Minister for Agriculture and Food* must be obtained. There is a set form which is used for the application as opposed to the general letter for *Section 12* consent. The excluded areas are, for the most part, the large cities and most of the towns in *Ireland*. Generally it is only agricultural real estate outside the cities that are not excluded. A complete list of excluded areas is to be found in the *1965 Act*. Normally the boundaries for which the restricted and unrestricted areas are marked are outside of the large cities and are determined by the local authorities of the *County Council*.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

Property can only be disposed of by the **registered full owner** or the **beneficial owner**. The beneficial owner is the person entitled to be legally in possession of the real estate or entitled to obtain the benefit of the real estate. However, the instrument of transfer in all

cases must be completed by the legal owner. The legal owner is the person who is entitled to be registered as the full owner of a given real estate.

In the event of a death of the registered owner the beneficiaries of his/her estate are entitled to the value of the estate. However, an executor named under an Irish will is the person empowered to administer the estate and carry out the testator's wishes. It is the executor who would generally sell the real estate or transfer it to the beneficiaries in accordance with the terms of the testator's wishes.

Recent Irish legislation has placed increased obligations on the directors of companies in respect of filing accounts and compliance with the *Companies Acts 1963–2001*. In the event that they do not comply with Irish tax or *Companies Office* filing obligations, they may be deleted from the **Irish *Companies Office Register*** and thereby the capacity of the company to dispose of any assets would be extinguished and all its assets would be vested in the State.

In relation to persons of unsound mind an application may be made to the **High Court** to have the person made a **ward of court**. In the event that a person is made a ward of court his/her assets are then deemed to be vested in the person appointed by the court. This person then has the power of sale. A minor is a person under 18 years of age and does not have capacity to act. Minors cannot conclude binding contracts of purchase or sale of real estate and cannot conclude other dealings with real estate. As they cannot own real estate themselves, usually their parents or guardian will act as trustees in the administration of the real estate on behalf of their children until they reach the age of 18 or until the trust is dissolved. Trustees have a special duty of care for the trust real estate, the beneficiaries of the trust and for transfers of the real estate in trust. There is no statutory limitation period within which court proceedings for compensation must be commenced where fraud or breach of trust is alleged.

3.3.2 Third-party claims and unpaid taxes

Irish taxes fall into certain categories – income taxes, inheritance and gift taxes (including **capital acquisitions tax** as dealt with later) and **capital gains tax**. Capital acquisitions tax and capital gains tax are a charge on real estate if they are left unpaid, and a buyer therefore should seek a release of such charges prior to completing a purchase. This is generally in the form of a certificate from the *Revenue Commissioners*. In the event of taxes remaining unpaid the *Revenue Commissioners* can take out a **Judgment Mortgage** on the real estate in question by which the sale of the real estate will be restricted for as long as the Judgment Mortgage has not been satisfied. The tax authorities and other creditors can, in addition, arrange for the registration of an entry in the applicable *Folio* of the *Land Registry*, called a *lis pendens*, to the effect that any further transactions may not be processed without placing the person in whose favor the entry is made on notice. In this way the creditor can ensure that the owner of the real estate does not sell it to third parties without notice to the creditor.

Other encumbrances that may affect real estate usually take the effect of a mortgage where property is charged to a financial institution and the charge is registered in the *Land Registry* or *Registry of Deeds* and therefore the buyer will be on notice of these charges.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Irish law in relation to the protection of the environment was significantly changed by the implementation of the ***Environmental Impact Directive*** in 1989. The regulations which

implemented the directive, the *European Communities (Environmental Impact Assessment) Regulations 1989,* have been amended several times since and most recently in 2000. The *Environmental Protection Agency* was also introduced into Irish law in 1992. *The Environmental Protection Agency Act 1992* listed several types of development where an integrated pollution control license is required before the development can begin. This is not relevant for a private residence.

3.3.4 Access to relevant records and documents

Searches are generally carried out by agents for the solicitors for the buyer on the transfer of an interest in the real estate. In order for the buyer to be protected as a ***bona fide*** **buyer for value** it is a requirement that the solicitors carry out reasonable enquiries in advance of the transaction. Generally searches come in the form of a *Land Registry* or *Registry of Deeds* search on the title of the property. They will disclose details about the current *registered owner*, any charges on the real estate and whether the real estate is leasehold or freehold. Other searches include a **judgments search** against the seller, a ***Companies Office*** **search** if the seller is a limited company, a **bankruptcy search** if the seller is an individual and a **planning search** against the real estate that will disclose the planning history of the real estate. Generally, searches are carried out by a recognized firm of law searchers who have a certain level of indemnity insurance in the event of any errors being made. Searches are generally made by the buyer on the day of closing.

3.4 Key points that a seller should consider

The main items the seller needs to be aware of have been discussed above. However, in the purchase contract the seller needs to ensure that the price is stated correctly and there is no room for ambiguity. The date of payment of the deposit and the date that the sale is due to close should be clearly stated on the contract. Particulars of the real estate should be well defined in the contract and if possible a map should be drawn up by a surveyor with the dimensions of the real estate clearly marked. This is particularly important where a seller is retaining some of the real estate. The seller should also ensure that prior to selling the real estate he/she has all the necessary consents to effect disposal of the real estate within the time limits set out in the contract.

The seller or his solicitor needs to ensure that they have good title to the property so that it is the seller's to sell. In addition the seller has, of course, to keep in mind his/her obligations under the *Family Home Protection Act 1976* in relation to the consent of spouses and also the consents required under the *Land Act 1965*. **Tax clearance certificates** for capital gains tax or residential property tax may also have to be obtained by the seller before the sale can close. He should also ensure that any outstanding mortgage on the real estate is discharged as soon as possible after the closing of the sale.

3.5 The execution of a real estate purchase transaction

The buyer should always ensure that only a **booking deposit** is paid until the title to the property has been examined and verified. The fees payable to the various professionals involved are a matter of negotiation between the purchaser/seller and the professional.

The buyer should engage a suitably qualified **architect** or civil **engineer** to carry out a detailed survey of the real estate to measure up and ascertain the nature and extent of the boundaries. A full appraisal of the structural condition of the real estate, a full planning search to ensure that the real estate complies with current planning legislation and permissions are necessary. It should also be ascertained if there is to be any future interference from statutory road widening or other local government plans. With commercial property it should be ascertained that the building complies with all statutory requirements such as fire safety standards. The buyer should then rely on his/her solicitor to diligently carry out all of the necessary legal examinations of the title in order to complete the transaction. Permissions to build the house are obtained from the relevant local authority. The only permission which is essential for the building of a residential house is the *Planning Permission* to build. Every county in *Ireland* has its own local authority, whereas larger cities and places will have one or more local authorities.

3.6 Powers of attorney

A solicitor may, with the correct authorization, sign a contract for sale in trust for his/her client. This is commonplace where the client lives abroad and is not in a position to travel to *Ireland* to sign documentation. Written authorization must be provided by the client detailing any conditions under which the solicitor can sign the contract for the purchase, including the agreed sales price or sale of the real estate. The form of the Power of Attorney is usually determined by the lawyer for the buyer and the bank which is involved. If the client creates the Power of Attorney at his/her residence outside of *Ireland*, normally the Power will be drafted by an Irish solicitor in English and will be agreed as valid and sufficient if it is executed by the client in accordance with the laws of his own country in the presence of a local lawyer who witnesses the client's signature. Alternatively, the client can execute the documentation in the presence of a competent staff member of the Irish *Embassy*.

Under the *Enduring Powers of Attorney Act 1996* a person may also provide authorization as set out in the Act to his/her solicitor or some other trusted person which provides that person with authority to sign documents on his/her behalf and contract for the sale or purchase of real estate on his/her behalf. This is commonplace in the case of people who lack the mental capacity to conduct their own affairs.

3.7 Financing

Most buyers obtain finance for the acquisition of real estate by arranging a loan from a bank or lending institution and securing that loan by way of a mortgage over the real estate that is to be acquired. The standard procedure is that the buyer raises 10% of the purchase price as a deposit on the real estate. The lending institution may then provide the balance, subject, of course, to its own terms and conditions and to the buyer's status. The **loan** is released on the day the purchase is to be completed and the mortgage registered on the real estate along with the buyer's interest in the *Land Registry* or *Registry of Deeds*. Prospective buyers should also note that there are strict rules under the *Criminal Justice Act 1994* for opening bank accounts in *Ireland,* and these must be complied with.

3.8 Purchase through a company

Real estate can be purchased by companies based in *Ireland* or abroad without any restrictions. If the company is located outside of *Ireland* and acquires real estate in *Ireland*, the seller's solicitors will require proof that the execution of the contract by the company is in accordance with the law of the country in which the company is incorporated. This is usually achieved by way of a letter of confirmation from a lawyer of the country in which the company is located or incorporated.

If a buyer wishes to acquire real estate via the use of a company, be it a limited company, public company or a company limited by guarantee, the following considerations are important to note:

1. Stamp duty reliefs available to an individual as a first-time buyer are not available to a company.
2. There will be an annual cost in respect of filing accounts and completing all necessary forms particularly to satisfy Irish company law requirements.

The preferred form of incorporation in *Ireland* is a **private limited company** (Ltd). **Public limited companies** (plc) are less common.

If there will be several owners, or if personal liability is to be avoided, then a corporation or other legal person is the preferred structure.

3.9 Defects and warranty claims

Warranty claims are dealt with in detail in the section on new buildings. There is a time limit within which such claims can be brought and buyers or their lending institution may request a report by a bonded surveyor prior to completing the purchase of a second-hand property.

Because of the wide-scale independent guarantee scheme (the ***Home Bond Scheme***) for structural defects operative in *Ireland*, separate guarantees are seldom contracted or given. However, warranties are often sought in respect of commercial buildings which are not covered by the *Home Bond Scheme* and these are generally the same warranties that are used internationally. Claims under the *Home Bond Scheme* for major structural defects must be brought within 10 years of the scheme being put in place for the real estate in question and, if it is a minor defect, within two years of the scheme being put in place. Claims against a builder for breach of contract must be brought within six years of the date from which the defect in the real estate became apparent.

In a case where a seller should have a less favorable right in a property to that of a third party, but this is only discovered following the completion of the purchase, the matter must be decided by a court. Compensation could then be claimed as a remedy. The court must estimate the loss arising and determine the amount of damages and possibly vacate the registration of the new owner in favor of the third party.

4 New construction, rebuilding and renovation

The procedure involved in purchasing a new house in *Ireland* differs significantly from the purchase of a second-hand house. It may be necessary to agree on several contracts

between the parties, such as the agreement in relation to the transfer of the property, the sale agreement, the contract with the builder and possibly contracts with an architect and a solicitor. Generally it is normal for the buyer to enter into two agreements with the owner-builder; one an **agreement for the transfer of the site** and the other a **building agreement** whereby the buyer is in fact employing the builder to build a house on the site. Often the seller in transactions involving new buildings will be a limited company and this also has to be taken into consideration by prospective buyers and their legal advisers. There is a standard set of documents which are normally sent to solicitors for the buyer at the start of the transaction which cover the fact that it is a new building.

4.1 Zoning law and construction permits

Buyers of new buildings and their legal advisers need to be more aware of Irish planning law and *Building Regulations* than they would be if purchasing an older property. The chief planning legislation in *Ireland* is the *Local Government (Planning and Development) Act 1963*. All developments commenced after October 1, 1964, had to firstly obtain *Planning Permission,* unless they came within the definition of an 'exempted development'. A development is defined by the Act as *'the carrying out of any works on, in or under land or the making of any material change in the use of any structures or other lands'. Section 4* of the Act then lists a number of categories of developments which are exempt from the obligation to apply for *Planning Permission*. It is not proposed to go into detail on the list of exempted developments here; however, it would include developments that affect only the interior of a structure (e.g. putting up a partition wall) or works that do not materially affect the external appearance of the structure and would not make it inconsistent with the character to other buildings in the same neighborhood.

It is reasonable to expect that when buying a new development ***Planning Permission*** will have been obtained. A copy of the decision by the local authority to grant permission, a copy of the actual grant of permission and the grant of approval should be furnished to the buyer together with the contracts. Generally when a local authority is granting ***Planning Permission*** for a new development it will impose financial or other conditions on the builder which must be complied with. For example a certain amount of money may have to be paid by the builder as a bond or lodgment to the local authority before the roads and services in the development are taken into the charge of the local authority. Solicitors for the buyer will generally seek a letter from the local authority confirming that all financial conditions have been complied with. In the case of a new building the payments due to be made to the local authority may take some time and it is common practice for the local authority to state that all due payments have been made to date. The builder can then provide an indemnity to the buyer for any payments that remain owing.

The other chief legislation which affects new buildings in *Ireland* is the *Building Control Act 1990*. This Act was followed by a series of regulations made under it and the Act and regulations are commonly known as the *Building Regulations*. The *Building Regulations* were targeted at improving the regulation of building standards and took account of the various issues at the time each regulation was made, such as access for the disabled in recent years or energy conservation in the past. Essentially, the Regulations regulate building works and provide minimum standards for design, construction, workmanship and materials used in the construction. The Regulations are seen as a code of practice for building. Briefly they deal

with matters such as structure, fire, site preparation, materials, sound, ventilation, hygiene, drainage and waste disposal, items that produce heat, stairs/ramps, energy conservation and access for the disabled. Essentially all works for the erection of buildings or the structural changes or change of use to buildings which commenced after June 1, 1992, must comply with the *Building Control Act*. The date for compliance with the various Regulations made thereafter depends on the date the Regulation was made.

In keeping with the *Planning Acts* certain classes of development are of course exempt. Again it is not proposed to discuss these in detail. However, they include works commenced before June 1, 1992, alterations to buildings which do not affect structural or fire safety aspects and even buildings such as lighthouses. If a development is subject to the Regulations a commencement notice must be submitted to the building control authority not less than 14 days and not more than 28 days before commencement of the development. Again there are certain exemptions to this rule. The Regulations also provide for the need to apply for a fire safety certificate before work can commence on the erection of a building. It must be accompanied by a detailed plan showing compliance with the *Fire Regulations* and state what the building is to be used for. It is an offence for a developer to carry out works without first obtaining a fire certificate. It should be noted that a building which is to be used as a domestic dwelling is exempt. However, if the development consists of a block of apartments, then a fire safety certificate will be required.

There are strict penalties for developers who fail to comply with the *Building Regulations*. There is a five-year time limit from completion of the development after which no enforcement notice can be served.

4.2 Architect's and building contracts

In practice it is usual that the buyer of a new house will employ an architect to check compliance with all *Planning Permission* conditions which relate to the house, including future developments and projects in the area and that the structure of the house is to a standard satisfactory to the buyer. The architect will normally assume a supervisory function during the course of the building project and will prepare a ***snag list*** of works and repairs at the completion of the building. Usually the architects for the builder and the buyer will meet to ensure that the matter completes.

The builder will normally build the house according to the plans of the buyer's architect, or the buyer will purchase the house that has been built according to the drawings of the builder. The architect will enter into a contract with the buyer in a standard form approved by the ***Royal Institute of Architects in Ireland***.

The main two documents involved in the purchase of a new house are, as stated above, the contract of sale for the site and the building agreement. These will normally be executed at the same time at the start of the project. None of the contracts will be entered on any public register as this is a matter of private contract between the parties. The buyer will be one party to the contract and it will be necessary then to distinguish the seller of the real estate from the builder of the house. The builder will receive staged payments during the course of the building and the seller will be paid on completion of the house.

The contract for sale is in the form of the ***Law Society Standard Contract for Sale***. It contains information relating to the physical location of the real estate, measurements,

dimensions and boundaries and the title of the real estate. Normally this would include reference to a map drawn up by the site engineer or architect or a map approved by the *Land Registry* in *Ireland*. A documents schedule in the contract will normally list the documents from which the builder deduces title, i.e. it will show how he/she is owner of the land. The contract then contains a list of general and *special conditions* which differ somewhat from those used for a second-hand house.

The second document, the **building agreement**, is again a standard document drafted jointly by the *Law Society* of *Ireland* and the *Construction Industry Federation*. It is not used for second-hand houses and is therefore widely acknowledged as the most important document in transactions relating to new houses. Briefly the agreement contains a ***covenant*** by the builder to build and finish the house in question to a certain standard and in keeping with the plans and specifications furnished originally to the buyer. Generally buyers employ their own architect to ensure that the house is being built in accordance with the plans and specifications. The agreement normally also provides a time by which the building work is to be completed together with details of how payment is to be made. The standard practice in *Ireland* is for 10% of the purchase price to be paid on signing the contracts and the balance to be paid on completion. Normally buyers pay a booking deposit to the auctioneer and the balance of the 10% is then paid when signing the contract and building agreement. The agreement then contains a set of *general conditions* which include conditions as to liability for any defects. When purchasing a new house the buyer is also provided with a *booklet of title* which is an indexed book containing documents evidencing the builder's ownership of the real estate. This is usually furnished with the contracts. An average *booklet of title* will contain documents such as *Land Registry* or *Registry of Deeds* documents showing the *registered owner*, extracts from the memorandum and articles of association of the seller company which lists the powers of the company and, in this case, shows that they are authorized under their memorandum and articles of association to sell the company, a certificate of incorporation of the company, *Planning Permission* documentation which should show the approval from the local authority for the development, architect's certificates which show that the development complies with all relevant regulations (which are discussed below) and a letter from the local authority dealing with financial conditions which may be listed in the *Planning Permission*. The *booklet of title* will also contain various other documents such as the floor area certificate, as mentioned above, and an indemnity from the builder which states that he/she will construct the roads and footpaths in the development and maintain any services. A *document under seal* refers to a document which has the seal of a company on it. It would apply, for example, when a company is signing a *Deed of Transfer* for a new property to a buyer and the seal of the company is placed on the document.

In general it is now standard practice for buyers of a new real estate to seek a ***certificate of compliance*** with the Planning Acts and *Building Regulations*. This is generally provided by an architect, surveyor or engineer. It will generally specify the qualifications of the person providing the certificate, give details of the inspection of the real estate in question, confirm that the real estate is in compliance with Planning Acts and *Building Regulations* and be signed and dated personally by the person providing the certificate.

4.3 Completion of construction and formalities

On completion of the purchase of the newly constructed property there are a number of documents provided by the seller which might not be included if it were the sale

of a second-hand property. Most of these, such as the indemnity under seal in relation to financial conditions imposed by the *Planning Permission*, have been discussed above. The final documents include a structural defects guarantee under seal and a *Home Bond* agreement which deal with protection for the buyer in the event of any future problems. No confirmation from the local authority is necessary and the buyer will normally accept a certificate from an architect certifying that the new construction has been built in compliance with *Planning Permission* and *Building Regulations*.

4.4 Deficiencies and warranty claims regarding new construction

The first protection for the buyer is generally contained in the conditions attached to the sales agreement. ***General Condition 36(a)*** is a warranty that the *Planning Permission* in relation to the real estate is fully in order and states that where applicable *Planning Permission* and building by-law approval or building control approval have been obtained and all conditions have been complied with. Any planning irregularities must be disclosed in the *special conditions* of the contract. If any planning irregularities are not disclosed here it provides the buyer with a possible right of action against the seller for breach of warranty.

In the event of a buyer subsequently discovering structural defects in a property, a number of options may be taken to pursue an action against the builder. The buyer may take an action in common law against the builder, an action against the builder for breach of contract, and may go to the *National House Building Guarantee Company* pursuant to a *Home Bond* agreement.

Under common law the buyer of a new building would be entitled to have the building built in a proper workmanlike manner, using good and proper materials and the property should be fit for human habitation. Generally these rights are found in the building agreement signed at the start of the transaction. If the builder is found to be in breach of his obligations under the agreement the buyer may sue the builder at common law for negligence and breach of contract. There is a time limit of six years from the date the defect becomes apparent before which proceedings must be brought. In addition to an action under common law a buyer could also take an action for breach of contract against the builder as the builder failed to abide by the terms of the building agreement. The building agreement generally contains warranties to rectify any structural defects within a certain time limit. Obviously if this is not done then the warranty, and therefore the contract, is breached. In practice most such actions are actually a combination of both common law negligence and breach of contract claims.

Finally a buyer may also have a right of action by virtue of what is known as the *Home Bond* scheme. The majority of builders in *Ireland* register with a company called the *National House Building Guarantee Company Limited*. This company provides a scheme known as the *Home Bond Scheme* which provides a guarantee against major structural defects for a period of 10 years and against water and smoke penetration for the first two years of the warranty period. If there are any major structural defects in the real estate then the builder is obliged to remedy them.

In addition, buyers should be aware that there are financial limits on the amount recoverable under the scheme. There is a limit of Euro 38,000 in relation to any one dwelling and Euro 508,000 in relation to any one builder. Obviously these limits could fall far short of what would be necessary to repair major structural defects, particularly where a builder has a number of real estates with the same defects.

5 Rental and tenancy

5.1 Rental and lease agreements

Renting real estate has become increasingly popular in *Ireland* in recent years as the cost of real estate has spiraled. However tenancies and leasing property have been part of Irish law in some form since the plantations of parts of *Ireland* by the English in the 17th century. As the economy in *Ireland* was largely based on agriculture, at that point large estates were generally subdivided between tenant farmers who had very little remedy against the landlords in the event of any dispute. It was not until the latter half of the 19th century and the early 20th century that legislation such as the *Landlord and Tenant Law (Amendment) Act (Ireland) 1860* (known as ***Deasy's Act***) and the *Landlord and Tenant Act 1931*, were introduced to protect the position of the tenant.

Most tenancies in *Ireland* fall into two broad categories: a **tenancy for a fixed term** and a **tenancy for a periodic term or year to year**. *Section 4* of the ***Deasy's Act*** requires leases and tenancies to be in writing if they are to create a legal relationship of landlord and tenant. It is not uncommon in the Irish market to find leases that run for 999 years.

Residential tenancies can occur for either fixed terms or periodic terms, though they are more commonly for short periods of time, e.g. three years or one year. There is a standard form of letting agreement, approved by the *Law Society* of *Ireland*, which incorporates standard terms and any particular terms agreed between the parties. Generally residential letting agreements would contain the name and address of both parties, the term of the tenancy, the agreed amount of rent and details of exactly how it is to be paid, together with details of the value of the contents of the property.

5.2 Regulations on protection of tenants and rent control

In recent years the protection for tenants has grown, and this has been reflected in standard letting agreements. However *Section 12* of the *Housing (Private Rented Dwellings) Act 1982* states that the landlord is deemed responsible for any repairs for which the tenant is not liable. In addition the *Housing Act 1966* states that a condition can be implied in a lease to state that at the commencement of the lease the house is fit for human habitation and the landlord will keep it that way throughout the duration of the lease. The *Housing Miscellaneous Provisions Act 1992* contains provisions to state that it shall be the duty of the landlord of a house to ensure that the house complies with the requirements of any regulations made by the relevant Government department. If, for example, a law is passed which requires a particular standard for sanitary equipment in all rental accommodation, then it would be for the landlord to ensure that this regulation is complied with. Generally, residential letting agreements contain covenants by the landlord to maintain the property in good condition and repair. **Residential letting agreements** can only be terminated on agreement between the tenant and the landlord, at the end of the duration of the letting agreement or if the tenant is in breach of one of the covenants of the letting agreement.

The *Landlord and Tenant (Amendment) Act 1980* as amended by the *Landlord and Tenant (Amendment) Act 1994* also contains provisions to protect the tenant. The tenant has the right to compensation for improvements to the house and the Act specifically states that the tenant shall be compensated for every improvement by whomsoever made which adds to

the letting value of the property and is in keeping with its character. The tenant may serve an improvement notice on the landlord in advance of the work and attach a statement of the proposed works, an estimate by an architect or surveyor and a copy of any necessary *Planning Permission*.

6 Succession and gifts

6.1 Applicable law and jurisdiction

A will executed in *Ireland* can dispose of real estate abroad and, likewise, a foreign will can dispose of real estate in *Ireland*. The determination of the applicable law is dependent on the nature of the estate left by the deceased. Immovables (that is, land) are generally governed by the Irish rule of private international law that the applicable law is the law of the country in which the real estate is situate i.e. *lex situs*. This is a common rule of private international law. The construction of that part of a will dealing with movables (like money), is generally governed by the domicile of the deceased, i.e. *lex domicilii*.

When a person dies intestate outside of the *Republic of Ireland*, leaving movable property in *Ireland*, the applicable law is that of the domicile of the deceased. If the property is immovable, then Irish law applies. The Irish law is most complex in its definitions of 'domicile' and local advice should be obtained to ensure validity and enforceability.

6.2 Fundamentals of the succession and gift/donation laws of Ireland

Inheritance law in *Ireland* is governed principally by the *Succession Act 1965,* which also regulates gifts made by or to a person during his/her lifetime. These gifts are then taken into account by the **administrator** of the estate of the deceased person and by Irish tax law.

It is a comprehensive body of law and it is important to note that it sets out strict requirements of formality and capacity for the making of a will. If these requirements are not adhered to the will can be rendered invalid. It is important, therefore, that anyone purchasing real estate in *Ireland*, particularly if they are foreign nationals, should have a will drafted by an Irish lawyer. A person is considered to have died **testate** if he/she made a valid will and **intestate** if he/she did not make a will or made an invalid will.

The Act also provides a number of important legal rights such as the right of the surviving spouse to a share of the estate regardless of whether the deceased died testate or intestate. *Section 111* of the Act states that the surviving spouse of a deceased person with no children shall have a **legal right** to one-half of the deceased's estate or, in the event that the deceased person had children, the surviving spouse shall have a legal right to one-third of the estate. Significantly it **does not provide for any legal right share for children**. However under *Section 117* of the Act if a child feels that the parent did not fulfill his/her moral duty by making proper provision for that child in the will, he/she can make an application to the **High Court** to make such provision out of the deceased's estate as it sees fit. The court will take into account the circumstances of the child, the view that a prudent parent would take and the position of any other children in the family before reaching any decision on these matters.

Estates are normally administered by **executors** named in the will of the deceased or, in the case of intestacy, the next of kin. The court may act as executor if no one else is available. The estate is then administered subject to the approval of the Probate Court. Applications to the Probate Court for a **Grant of Probate** allowing administration of the estate are normally made by Irish solicitors.

Beneficiaries under a will have certain **tax-free thresholds**, as discussed below, within which no tax is payable. The administrator will normally collect details of gifts or inheritances received by the beneficiaries in the past, as the amount of these will be added to their current benefit when assessing whether the beneficiary has exceeded the applicable threshold. In addition an administrator will collect details of gifts made by the deceased person as these are also taken into account in the administration of the estate.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

There are a number of one-time charges in the case of acquisition or construction of a property. Again it must be pointed out that Irish tax laws can change on an annual basis and local legal advice should be sought. The position here applies as of January 2005. The main cost that arises for most buyers of real estate is that of **stamp duty**, which is payable to the Irish *Revenue Commissioner*. Stamp duty is, in essence, a tax on the legal documents used in the transfer of real estate. There are varying rates that can apply, depending on the type of real estate involved.

The first distinction which applies in relation to stamp duty is between **residential and non-residential real estate**. Residential real estate is defined as a building or part of a building which at the date the deed is signed is used or is suitable for use as a dwelling. If a buyer buys a site with no building on it then it is classified as non-residential real estate even if it is possible to build on that land and, at a later date, a house is built on it. The rates of stamp duty on non-residential real estate are significantly higher than those on residential real estate and are as follows:

Purchase price	*Rate of duty*
Up to Euro 10,000	Nil
Euro 10,001 to 20,000	1%
Euro 20,001 to 30,000	2%
Euro 30,001 to 40,000	3%
Euro 40,001 to 70,000	4%
Euro 70,001 to 80,000	5%
Euro 80,001 to 100,000	6%
Euro 100,001 to 120,000	7%
Euro 120,001 to 150,000	8%
Over Euro 150,000	9%

Once a real estate qualifies as residential real estate the applicable rate of stamp duty then depends on the status of the buyer. There are two categories of buyer for the purpose of calculating stamp duty: first-time buyer and owner-occupier. First-time buyers pay a significantly lower rate of stamp duty. A first-time buyer is defined as someone who has not on any previous occasion, whether individually or jointly, purchased or built a house either in *Ireland* or abroad. First-time buyers must also occupy the real estate as their principal place of residence and must not rent out the real estate for a period of five years from the date they purchase it.

The rates of stamp duty for residential real estate are as follows:

Purchase price	*First time Buyers**	*Other owner-occupiers**
Up to Euro 127,000	Nil	Nil
Euro 127,001 to 190,500	Nil	3%
Euro 190,501 to 254,000	Nil	4%
Euro 254,001 to 317,000	Nil	5%
Euro 317,501 to 381,000	3%	6%
Euro 381,001 to 635,000	6%	7.50%
Over Euro 635,000	9%	9%

Stamp duty is therefore a major consideration for any prospective buyer and should always be taken into account when considering a purchase price; e.g. a real estate purchased by a first-time buyer for Euro 381,000 will incur a stamp duty at a rate of 3%, i.e. Euro 11,430. However, if the price is raised to Euro 382,000, then the stamp duty payable will be at a rate of 6%, which is Euro 22,920.

It should also be noted that where real estate is purchased with the aid of a mortgage and the amount of the mortgage exceeds Euro 254,000, stamp duty is also chargeable on the mortgage. The stamp duty is charged at a rate of 0.1% subject to a maximum of Euro 630. Stamp duty is also chargeable on leases where the annual rent exceeds Euro 19,040 and the term of the lease exceeds 35 years. All stamp duties must be paid within 30 days of the execution of the deed and failure to pay on time can result in severe financial penalties.

There are a number of other exemptions in relation to stamp duty on the purchase of real estate such as the exemption for new construction under a certain size, as discussed previously. In addition, a transfer of real estate between spouses is exempt from stamp duty as are transfers between divorced couples which are made pursuant to a court order.

7.1.2 Sales tax (value added tax)

Value added tax (VAT) is charged at two rates in *Ireland*. The general rate is 21%, however in certain circumstances, e.g. for new houses, it is 13.5%. VAT is generally **included in the purchase price** quoted for a house, apartment or building unless a clause is set out in the *special conditions* to the contrary. It is not payable on second-hand houses or on a site only.

7.1.3 Real-estate registration and notary charges

There are, of course, other charges which buyers must be aware of when acquiring a new real estate. These include charges for the *Land Registry* and charges for the *Registry of*

Deeds. The difference between the *Land Registry* and *Registry of Deeds* has been discussed above and the costs between the two vary. Both offices have a set list of fees which are chargeable when documents are being registered. The fees chargeable in the *Land Registry* for registration of ownership of a second hand house are as follows:

Price	*Fee*
Euro 1 to 130	Euro 125
Euro 131 to 260	Euro 190
Euro 261 to 510	Euro 250
Euro 511 to 2550	Euro 375
Euro 2551 to 3850	Euro 500
Euro 3,851 and above	Euro 625

First-time registration of new property costs Euro 85 regardless of the price of the property. Registration of a mortgage on a property costs Euro 125. Registration of ownership of any real estate or a mortgage in the *Registry of Deeds* costs Euro 44. There are also of course solicitor's costs, which would generally be approximately 1% of the purchase price and fees for searches on the title of the real estate as discussed previously, which costs about Euro 70–100.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

Residential real estate tax was an annual tax chargeable on the market value of residential real estate owned and occupied on the valuation date of April 5 annually at the rate of 1.5% on the excess of the value over a certain threshold. This tax was abolished in 1997. However residential real estate tax clearance certificates may still be required from a seller if the value of the real estate exceeded the thresholds and he/she was in occupation of the property prior to 1997.

7.2.2 Income tax

Income tax is chargeable on all income arising in the State to individuals, partnerships and unincorporated bodies. In the case of individuals anyone who is resident, ordinarily resident or domiciled in *Ireland* is liable to income tax in respect of their total income wherever arising. An individual who is not resident in *Ireland* is normally liable to income tax in respect of income arising to him/her in *Ireland* only. The definitions of residency and domicile are discussed at a later stage. As of January 2005 the applicable rate of income tax for a single person is 20% on the first Euro 29,400 earned and 42% on the balance. Each person has a tax credit which, for a single person, is Euro 1,580 and this is deductible from the total amount of income tax payable per year. There are also a number of other exemptions and reliefs that may apply depending on individual circumstances.

In the case of real estate, income tax is only paid on any income deriving from the real estate and therefore if there is no income deriving from the real estate or if the real estate is used personally, then no tax is payable on it.

7.2.3 Net wealth tax

There is no net wealth tax in *Ireland*.

7.3 Capital gains tax

Capital gains tax is chargeable on the **gains arising on the disposal of assets** after April 6, 1974. A disposal of an asset includes a transfer by sale, exchange or gift. Again all persons who are resident or ordinarily resident in *Ireland* for a year of assessment are liable to the tax in respect of chargeable gains accrued in that year on the disposal of assets. This applies regardless of where the assets are situated. The tax is calculated on the chargeable gain which is the amount of the consideration reduced by what is called 'deductible expenditure', i.e. the cost of acquisition and any improvements to real estate. A system of indexation relief is used to adjust the deductible expenditure with the latest rates of inflation.

Once the chargeable gain is calculated the tax is charged at the rate of 20% for most disposals or 40% in certain situations. The 40% rate only applies in the case of gains on the disposal of foreign life assurance policies and/or an interest in certain offshore funds. Every other gain is chargeable at the rate of 20%. As with other Irish taxes, certain exemptions and reliefs apply. The first Euro 1,270 of any gain by an individual in a year of assessment is exempt and a gain on real estate which has been used as the individual's principal private real estate is also exempt.

Local advice should be sought for details of other exemptions or reliefs that may apply. Capital gains tax is payable by all persons whether they are resident in *Ireland* or not and whether they are Irish citizens or not. Those affected by capital gains tax should therefore look carefully at any double taxation issues that may arise.

7.4 Inheritance and gift taxes

Inheritances and gifts are taxable in *Ireland* by virtue of the *Capital Acquisitions Tax Act 1976*. *Section 4* of the Act charges gift tax on the taxable value of every taxable gift received on or after February 28, 1974, and *Section 10* of the Act charges inheritance tax on the taxable value of every taxable inheritance received by a successor where the date of the inheritance is on or after the April 1, 1975. It should be pointed out that Irish tax laws and rates change on an annual basis and the position reflected here is applicable up to June 2003.

The 1976 Act states that a person is deemed to have taken a gift or an inheritance where, under any disposition, he/she becomes beneficially entitled in possession either on a death (inheritance) or otherwise than on a death (gift) to any benefit otherwise than for full consideration in money or monies worth paid by that person. The taxable value of the disposition is arrived at by deducting from the market value of the real estate contained in the gift or inheritance, permissible debts and encumbrances and any consideration paid by the beneficiary. The market value is defined in *Section 15* of the 1976 Act as the price which, in the opinion of the *Revenue Commissioners*, the real estate would fetch if sold on the open market on the date on which it is to be valued in such a manner and subject to such conditions as might reasonably be calculated to obtain the best price for the seller.

The Act also goes on to provide definitions for a **taxable gift** and a **taxable inheritance**. A taxable gift is the entire real estate contained in the gift where, at the date of disposition,

the disponer is resident or ordinarily resident in *Ireland* or the beneficiary is resident or ordinarily resident in *Ireland* or the real estate contained in the gift/inheritance is situated in *Ireland*. The significance of this is that even if the gift consists of real estate outside of *Ireland* or partly real estate outside of *Ireland* and partly real estate in *Ireland*, the entire gift is still chargeable to gift tax if the criteria are fulfilled.

A taxable inheritance is also the entire inheritance where the disponer is resident or ordinarily resident in *Ireland* at the date of the disposition under which the successor (i.e. the person receiving the inheritance) takes the inheritance. The date of the disposition is the date of the death of the disponer.

Inheritance and gift tax are chargeable at the rate of 20% on the market value of the real estate comprised in the gift. It should be noted that deductions may be made by the recipient for any consideration paid by them or any debts that have to be paid off before they receive the gift or inheritance. In the case of an inheritance these might be debts owed by the deceased, funeral expenses or solicitor's fees. Before the tax is calculated, however, there are a number of exemptions and thresholds which should be considered.

There are **three tax-free thresholds** within which tax is not chargeable. The threshold that a recipient falls into depends on his/her relationship with the donor. Again it must be pointed out that Irish tax rates can be adjusted annually and the threshold amounts can change accordingly. At present the thresholds are as follows:

- *Class A: Euro 456,438*: This threshold applies to any gift or inheritance received where the beneficiary is a parent, a child or stepchild of the donor regardless of age. It also applies where the beneficiary is a grandchild of the donor and the parent of the said grandchild is deceased.
- *Class B: Euro 45,644*: This threshold applies to any gift or inheritance received where the beneficiary is a brother or sister, nephew or niece.
- *Class C: Euro 22,822*: This applies to any beneficiary who does not come under Class A or Class B.

New thresholds will be announced at the start of 2005, as the thresholds are index linked and increased with the inflation rate. These thresholds apply to all gifts or inheritances received by a recipient over a number of years and all gifts or inheritances received in that period are added together for the purposes of calculating the tax payable. It should also be noted that any gifts or inheritances between spouses are completely exempt from capital acquisitions tax. There are a number of **exemptions** of which all beneficiaries should be aware. Inheritances for public or charitable purposes, inheritances of a dwelling house taken after the December 1, 1999, provided that certain conditions are fulfilled, and inheritances of items that are of national, scientific or artistic interest are all exempt. There are also a number of exemptions from gift tax, including the first Euro 1,250 of all gifts taken by the donee in any calendar year taken after December 1, 1999; a gift of a dwelling house taken after December 1, 1999; in certain conditions, payments of support or maintenance, national lottery winnings and gifts for charitable or public purposes. No capital acquisition tax is payable where the beneficiary is a spouse of the donor.

There are also a number of reliefs that can apply in relation to agricultural or business real estate. *Section 19* of the *Capital Acquisitions Tax Act 1976* states that if a gift or

inheritance consists of agricultural real estate at the date of the gift or inheritance and at the later valuation date and is taken or inherited by someone who is, on the valuation date, a farmer, the market value of the agricultural real estate is replaced by the agricultural value in arriving at the taxable value of the benefit. In practice this reduces the value of the gift or inheritance by about 90% and leaves it with a taxable value of 10% of its market value.

The *Finance Act 1994* also introduced a relief in respect of business real estate comprised in a benefit taken by a beneficiary. Since the *Finance Act 1997* this has been a reduction of 90% in respect of a benefit taken on or after January 23, 1997. As distinct from agricultural relief, in business relief it is the taxable value of the relevant business real estate that obtains business relief. Business real estate is defined by the 1994 Act as property consisting of a business (this includes a partnership or sole trader). It should be noted that one single asset out of a business on its own would not qualify for the relief.

There are a number of other criteria that must be fulfilled in order to qualify for both agricultural and business relief, e.g. the real estate must be kept or, if sold, must be replaced by other agricultural/business real estate for a period of six years from the date of the gift/inheritance. There are also some smaller reliefs available to beneficiaries such as dwelling house relief (where the beneficiary occupied the dwelling house for three years prior to the gift/inheritance and does not have an interest in any other dwelling house). There are also a number of smaller inheritance taxes such as probate tax which is discussed in further detail in the next section.

7.5 Other taxes and charges

Probate tax, which was charged at 2% on the value of the estate of the deceased person, was abolished in December 2000. However, it still applies for deaths prior to December 2000. Miscellaneous outlays not listed above include the fees for having a document such as a sworn statutory declaration (generally Euro 10 for each document). A buyer may also have to pay for a **surveyor** to examine the real estate if requested by the financial institution providing the mortgage.

7.6 Incorrect (lower) statement of sale price on the sales agreement

The practice of stating one price on a contract and then actually paying a higher price is **illega**l in *Ireland* and constitutes a **revenue fraud**. Any such contract would be void and both parties could face legal proceedings for fraud.

7.7 International taxation

Ireland has a comprehensive system of **double taxation agreements** in place with over 40 countries and is currently in negotiation with several others to implement agreements. Agreements in place include agreements with the *USA, the UK, Canada, Australia, Japan, Germany, Austria* and *Switzerland*. The agreements generally cover income tax, corporation tax and capital gains tax. An agreement regarding capital gains tax is particularly important for foreign real estate owners who sell real estate in *Ireland* and may be liable to pay capital gains tax on the profit. Where a double taxation agreement is in place and a person is paying

tax in both countries, then that person has the facility to reclaim the tax paid in one country as a credit. Where a double taxation agreement does not exist with a particular country there are provisions within Irish tax laws which allow certain reliefs against Irish tax for tax that is paid in another country in respect of certain types of income.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Entry into *Ireland* is open to any individual with a valid passport and in certain cases with a valid Irish visa. A list of countries whose citizens do not require a visa to enter *Ireland* was set out in the *Aliens (Visas) Order 2002*. All countries within the *European Union* are included on the list, as are most other European countries. The Order also lists countries whose citizens must have a visa to enter *Ireland*. There is an agreement in place between the *EU* and *Switzerland* which states that since June 1, 2002, Swiss citizens have the same rights as EU citizens with regard to living and working in *Ireland*.

Citizens of a country in the *EU* can, of course, work and travel freely within the *EU*. All other persons, including citizens of non-EU states, whether they require a visa or not, may stay in *Ireland* for 90 days from arrival. Any persons wishing to stay longer than the 90 days must register with the **Alien Registration Office** and show that they fall into one of **three categories** – student, worker with a legal work permit or retired person. Irish citizenship is available through birth, marriage to an Irish citizen or naturalization where a person has lived in *Ireland* for more than five years.

A **work permit** must be obtained for citizens from outside the *European Union* and *European Economic Area* who wish to enter employment here. The countries within the *European Economic Area* are the countries of the *EU* together with *Norway, Iceland* and *Liechtenstein. Switzerland* has a separate agreement with *Ireland* whereby its citizens can work here without the need for a permit. Only an employer can apply for a work permit to employ a person from a country that is not in the *EU* or the *EEA* and the permit may last for up to one year. Therefore, people from an EEA or non-EU country must have an offer of employment in *Ireland* before they can obtain a work permit. Once they have a work permit it will then also be possible for them to obtain other work.

8.2 Tax residence

Residence for tax purposes is determined by the number of days an individual is present in *Ireland* during that tax year. Individuals will be deemed resident in *Ireland* for tax purposes if they spend **183** days or more in *Ireland* in one tax year. If they spend **280** days or more in *Ireland* in two consecutive tax years they will be deemed resident in *Ireland* for tax purposes only in the second year. A 'day' is counted when the individual is present in *Ireland* at midnight.

An individual may also choose to be deemed '**resident**' in *Ireland* for a tax year if he/she can show to the Irish *Revenue Commissioners* that he/she will be present in *Ireland* for the required 183 days in the next tax year. Once an individual is deemed resident in *Ireland*

then that individual is liable to pay tax on his/her worldwide income to the Irish *Revenue Commissioners* during that year, subject however to the exceptions outlined below.

The term '**ordinarily resident**' which has been used in previous sections refers to an individual who is resident in *Ireland* as described above for three consecutive years. He/she will then be deemed as 'ordinarily resident' in the fourth year. The individual must then be non-resident in *Ireland* for three years before he/she loses the classification of 'ordinarily resident'.

A person can be **resident but not domiciled** in *Ireland* for tax purposes if *Ireland* is not where he/she maintains a permanent home and if he/she is only in *Ireland* for a temporary period. Generally, foreign employees working on a contract in *Ireland* may be living in *Ireland* but will not be domiciled in *Ireland*. Irish income tax applies only to Irish source income, i.e. money earned from working in *Ireland*. Any other income that a person earns outside *Ireland* is on a remittance basis and must be constructively remitted to *Ireland* in order for Irish income tax to be charged on it.

8.3 International taxation for residents of Ireland

Ireland has a comprehensive network of double taxation agreements with over 40 countries. If an individual is tax resident in *Ireland* and also has income that is taxable in another country, then if a double taxation agreement is in force, the Irish tax authorities will agree with the other country to exempt the income from tax in one country or allow credit in the other country for the tax paid to be in *Ireland*. Any income earned by the individual prior to becoming tax resident in *Ireland* will not be liable to tax if it was earned prior to the beginning of that tax year.

9 Checklist: Real estate acquisition in Ireland

- Prospective buyers should look at all hidden costs of buying real estate before paying a booking deposit, e.g. what stamp duty is payable, solicitors' fees, registration fees, the cost of having a surveyor examine the real estate.
- Prospective sellers should look at any taxes they might have to pay, such as capital gains tax, if they have not been living in the real estate for sale.
- Auctioneer's fees should also be agreed by the seller with his/her auctioneer before placing the real estate on the market.
- The seller should also ensure that he/she will be able to pay the money owing on his/her mortgage from the sale price of the real estate. The seller's solicitor should get a statement of the figures owing from the mortgage company.
- Contracts and title documents to the real estate are inspected by the buyer's solicitors.
- The buyer signs the contracts and pays a deposit of 10% of the purchase price.
- Contracts and deposit check are forwarded to the solicitors for the seller.
- One part of the contract signed by both parties must be returned to solicitors for the buyer.
- A draft *Deed of Transfer* and *Objections and Requisitions on Title* (a long document raising a series of questions about the real estate) are sent to the solicitors for the seller.
- Replies to the *Objections and Requisitions* must be received and an appointment will then be made between the solicitors for both parties to close the transaction.
- Law searches must be ordered to ensure that there are no charges registered against the real estate and searches are also made against the seller.
- Any stamp duty payable must be discharged within 30 days of the date of execution of the deed.
- The buyer's interest in the real estate is registered by lodging the appropriate documents in the *Land Registry* or *Registry of Deeds*.

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11 Addresses

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Contents: Italy

1 Introduction

Italy is a country of important cultural and economic contrasts, if one takes into consideration, firstly, the northern regions, which belong to *Europe*'s richest areas, and then, on the other hand, southern *Italy* and *Sicily*, which belong to *Europe*'s least-developed areas. As different as the mentality is of the people from northern and southern *Italy*, so is the history that each one of the Italian regions had to go through. The northern Italian regions were seized by Austrian conquerors. *Naples* was temporarily occupied by the French, while the south of *Italy* and *Sicily* had to endure Spanish occupation for some time. *Italy* has only existed within its present borders since its reunification that started in 1848 and lasted until 1919, including the wars of independence. Relics from those times of occupation can still be seen today. The regions of *South Tyrol* and *Friaul-Julish-Venetia* adopted the land register system introduced by *Austria*, differing from the system of other regions, which followed the principle of the person-related connection to the real estate.

After the monarchy was abolished in 1946 by referendum and the constitution was introduced in 1947, *Italy* became a democracy, which transferred the legislative authority to the Parliament as well as the authorization of control, to the executive authority. In accordance with the Italian constitution, the national territory is divided into regions, provinces and communities. Altogether, there are 20 regions with each one having its own regulations. The majority of the population speaks Italian or one of its dialects. In some valleys of *Piedmont*, the population speaks French as a language on a par with Italian, and in *South Tyrol*, German is spoken as an equivalent language to Italian.

2 Real estate ownership

2.1 Different forms and types of ownership

Sole ownership

The Italian law provides for several forms of ownership concerning real estate. Firstly, there is the form of **sole property**, in which the owner disposes of the exclusive and comprehensive right to real estate that has been recorded exactly in the cadastral and land register. Sole ownership can be a **house, a plot of land or a condominium apartment**.

Jointly owned property

Secondly, the real estate may be **jointly owned property** where two persons become the **co-owners**, for example, through inheritance. In this case, neither of the owners exclusively possesses the sole real estate, and the rights of each individual person refer to the whole real estate. Each one of the co-owners may enjoy the whole real estate or even parts of it but the other co-owners enjoy the same rights. In cases of a jointly owned real estate, a proportional share is assigned to each of the co-owners, of which he/she can dispose.

Apartment property – condominium

Thirdly, a special form of jointly owned real estate in *Italy* is the *condominio*. Usually, this is a certain number of different apartment units in one complex, each single apartment being

the **sole property of its owner**. In addition to the sole ownership, the ownership comprises a **co-ownership in the areas outside the said real estate**. These areas can be the soil on which the building stands, exterior walls, roof, stairways, entrance door or entrance gate, courtyard, gatekeeper's office or apartment, and central heating; and can also be any kind of equipment that serves a common use (elevator, drain pipes, electricity, gas, water pipelines including the junctions into the separate apartment units). Thus, each co-owner can use the jointly owned real estate but cannot change its purpose. The common courtyard, for example, may not be used by a single co-owner to lay out a vegetable garden. In the administration of the jointly owned real estate the costs of it will be apportioned on a 'pro-rata' basis, referred to each share. This **apportionment is effected by thousandths.** As soon as there are more than 10 co-owners, the law stipulates that a *regolamento* (**condominium regime**) be established. That is why it is advisable when acquiring an apartment in an Italian *condominio*, to have a look at the *regolamento*. It will provide interesting information on the regulation of the common areas, restriction of usability, apportionment of costs, as well as the rights and duties of individual co-owners. It can be important to inspect the *regolamento* where, for example, one intends to transform into an office space an apartment which, at present, is listed in the land register as living space. If the *regolamento* explicitly prohibits this, the intended alteration of the purpose of the apartment can only be realized by means of changing the *regolamento*, and that will require the consent of all co-owners.

Right to build

The *diritto di superficie* (**right to build**) is of little importance in Italy. It concerns the right to construct a building on the soil of a third party, the building remaining the property of the builder. The real estate of the third party, i.e. the plot of land the building was constructed on, remains unaffected. This leads to a **severance of the real estate** of the ground and of the building constructed on it. The right to build is established by contract, which can either fix an exact period of time or provide that it will remain indefinitely.

Timesharing

There are still no specific regulations regarding timesharing in *Italy*. **Timesharing** is where a property owner gives a third party a right to a part of the real estate. This right gives the third party the possibility to use or to lease out that part of the real estate for a fixed period of time. The conveyance of timesharing is done by way of a notary deed.

2.2 Easements, charges, liens and mortgages

Under the Italian legal system, apart from property rights being established by law, no further additional property rights can be created. There exists a kind of *numerus clausus* of property rights. The property rights can be classified in terms of **usufructuary property rights**, including hereditary tenancy, real estate easements and usufruct, as well as a second group including the rights belonging to the **collateral property rights**, e.g. lien and mortgage. The effective creation of a property right requires **written form**, and the property rights must be registered in the land register to be asserted against any third parties.

With regards to easements, a connection between two different real estates is presupposed, whereas with usufructuary property rights, a direct connection between two legal entities

related to the same real estate is presupposed. All property rights expire after a statutory period, unless the use has been extended by another 20 years (this concerns the deadline of acquisition by adverse possession).

Usufruct

The usufructuary has the right to use the real estate of someone else, respecting, however, its economic purpose. As a rule, the usufruct is, unless otherwise defined, restricted to the **lifetime of the usufructuary**. The ownership of a right encumbered by usufruct limits the owner in such a way that he/she **cannot draw financial advantages** from the real estate until the usufruct becomes extinct. The owner only has the bare ownership of the real estate.

The usufruct can be acquired **by law** (e.g. usufruct of parents on goods of their minor children), **acquired by adverse possession** or by **declaration of intent**. The usufructuary can dispose of his/her right without ownership rights being affected. If a usufructuary leases the property on which he/she has usufruct to a third party, the tenancy contract **will continue in case of the usufructuary's death for the term of the lease, at most, however, for five years** from the death of the usufructuary.

Right of residence and utilization

The right of residence and utilization are **two special cases of usufruct**. **Utilization** is the right to use real estate and possibly enjoy the usufruct of it, whereas the **right to reside** is the right to use the real estate for **one's own needs and the needs of one's family**. The right to reside limits the holder to residing there, without changing the purpose of use. Neither the utilization nor the right to reside can be assigned or leased to another, since personal use is an essential element of them both and is expressly prohibited by law (see *article 1024 of the Codice Civile)*.

Easements

In an easement, a property (serving property) is burdened to the advantage of another property (dominating property). The following **principles** apply: the easement imposes only a **negative obligation on the owner of the serving property**. An easement can only be issued in the case of two different properties with two different owners. To create the easement, the properties **do not necessarily have to be neighboring,** but one property does draw an advantage from the other with regard to the object of the easement. The easement is created by legal transaction or acquired by adverse possession, by law or by court decision. If the owner of one property must by law grant an easement to the owner of the other property, the judgment of the court is required to create the property right. If the easement is based on a title establishing a right, the needs of the dominating property shall burden the serving property as little as possible. There are also **statutory easements** which are normally created to improve living conditions – for example, water pipes and electricity poles.

Liens on real property/mortgage

A mortgage can be justified **by law, by court order or by a legal transaction**. A **mortgage by law** is created in the following cases: in favor of the seller of a property, if the purchase

price was not paid in full at the time of the transfer of ownership (when the sales contract is concluded before the notary public, the parties expressly affirm having fully paid or received the purchase price); in favor of the heirs, the partners and other co-proprietors for the compensation payment for the real estates allocated to the co-proprietors; in favor of the **State for property of a convicted person,** pursuant to provisions of the penal code.

A **mortgage ordered by the court** is registered if a judgment regarding the payment of an amount has been made. This mortgage can still be registered even if the judgment is not yet final. Should the final judgment not confirm the preliminary judgment, the one in whose favor the mortgage was registered would have to agree to its cancellation and may be liable to pay damages.

A **voluntary mortgage** can be obtained either by way of a legal transaction or via a unilateral declaration of the person wanting to establish the mortgage. It will be registered at the property register of the town in which the real estate is located. One has to show the document which is the basis for the permission to register the mortgage. The **registration is valid for 20 years** and has to be **renewed after the term has expired**. After expiration of the said term, the creditor will have to re-register the mortgage. However the creditor may lose his/her original and perhaps advantageous rank.

The **deletion of a mortgage** will be effected if there are statutory reasons for deletion and, in any case, by the declaration of consent for the deletion by the mortgage holder. If the consent is refused, it can be obtained from the court.

2.3 Protection of ownership, proof of ownership and registration

The proof of ownership of real estate is obtainable from the **registers** of the Italian **land registry**, the *Conservatoria di Registri Immobiliari*. The legal system recognizes, with the exception of the provinces *South Tyrol* and *Friaul-Julish-Venetia*, a person-related connection when transferring real estate. Under this system, the land registers refer to persons involved in the transfer. Therefore, it only shows which transfers have taken place from one person to the other and not which transfers have taken place on a specific piece of real estate. Accordingly under the Italian system, the **chronological priority of the entry** and the **continuity of the ownership register** as well as its **declaratory character** are important. Because of the continuity of the ownership register and to ensure that one obtains real estate from the rightful owner, one would have to retrace all transfers of the past 20 years, since this would be the period for acquisition by adverse possession. The main **real estate registers** observing the **principle of public disclosure** are the following: general register of application, register of transfers, register of entries, and register of remarks.

3 Purchase and sale of real estate

3.1 The sales agreement

When purchasing real estate in *Italy*, as a rule **two contracts** must be concluded: the preliminary contract and the notarized sales contract.

The **preliminary contract** is a contract which binds both parties by law to effect the subsequent transfer of ownership on the terms and conditions negotiated in the contract.

In the preliminary contract, the contracting parties promise to observe and fulfill certain obligations, which have to be performed by the date of the **notarized contract**. An essential part of the preliminary contract is the stipulation of the purchase price and the terms of its payment. Another important aspect is the **down payment**, usually to be paid upon conclusion of the preliminary contract, which, depending on the contract, can have different legal effects especially where there is no notarized contract. In this case, the **confirming down payment**, known as *caparra* (*article 1385* of the *Codice Civile*), will be considered as a contractual penalty against the party breaching the contract. If the buyer prevents the transfer of ownership, he/she is prohibited from getting the *caparra* back. If the seller does not act in accordance with the terms of the contract, he/she will have to pay twice this amount to the purchaser – firstly, as reimbursement of the confirming payment and, secondly, as a penalty. The **preliminary contract** needs to be **in writing**. It is neither necessary nor usual to conclude this contract in the presence of a notary public. It is a private legal contract **binding both parties** and in which the actually paid purchase price is stipulated. The ownership is transferred upon the execution of the notarized contract. The notarized contract has priority over all other preceding contracts, including the preliminary contract, unless the preliminary contract contains a clause stating otherwise. The notarized contract can be effected as a **public document** or as a **private document before the notary public**.

To secure his/her rights, the buyer can **have the preliminary contract entered in the land register**. This ensures that the real estate cannot be sold twice. The registration of the preliminary contract provides protection for one year, if the parties have agreed on a deadline for the conclusion of the notarized contract. Otherwise, the protection will last for **up to three years**. However, private preliminary contracts can only be entered in the register if they are made by a notary public or if the parties' signatures have been certified by the notary public. The **registration makes public the purchase price** stated in the preliminary contract and so cannot be changed in the actual notarized contract. The disadvantage of this process is that it is costly. The registration itself causes a fixed tax of Euro 129.12 to be paid. If there was a *caparra* (confirming down payment) agreed upon, a tax of 0.5% is levied on this amount. If, however, an *acconto* (payment on account) was arranged, then a 3% tax is levied.

In *Italy*, it is still common for a lower amount than the actual purchasing price to be stated in the notarized contract of transfer of real estate (**under-recording**). This is done to lower the calculated real estate transfer taxes, as the notarized purchase price is the basis for the calculation of the taxes to be paid (see Section 7.6 below).

With the **signature on the notarized contract**, the **ownership passes from the seller to the buyer**. The effective transfer of ownership does not require entry in the Italian land registry. The **entry has a declaratory character** and is used to make public a change of ownership so as to assert it against third parties. Should, therefore, a third party who is not the owner of the real estate, be registered by mistake as the owner, he could effectively transfer the ownership rights to a **bona fide third party by notarized contract**. However, this will be practically impossible, since he/she cannot furnish the necessary documentation with regard to the real estate. The notary public of the bona fide third party must be satisfied as to the history of the real estate and as to the preceding transfers of ownership. Thus the notary public will notice that the **non-entitled third party** is not the owner of the real estate. It is different when the actual owner of the real estate sells it through a notarized contract,

but the buyer does not make public the transfer of ownership. In this case, the seller named in the register as owner of the real estate could still sell it to a third party. If the ownership is transferred to a third party, the third party will have obtained the ownership legitimately and cannot be asked to return the real estate. Therefore, the buyer who obtained ownership in the first place would have to ask for compensation from the seller.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

In general, in *Italy*, married couples are subject to the *comunione legale dei beni*, the system of **community of property**, which applies to the purchase of real estate. This means that both spouses obtain co-ownership of the real estate, even if the notarized contract is only signed by one of them. It is different if they declare in front of a notary public that the purchase is to be made **exclusively from the personal funds** of the purchasing spouse and that the other spouse waives his/her right to become a **co-owner**. If separation of the real estate was agreed upon marriage, only the purchasing spouse can obtain sole ownership. If community of property was optionally agreed upon marriage, the spouses will obtain ownership of the real estate in equal shares.

According to Italian law, it is not always necessary to have the consent of one's spouse when selling the real estate that is used as the **family's main place of residence**. However, consent is necessary when the real estate was purchased under the system of community of property and the spouse has become a co-owner under Italian law. Where there is a separation of the real estate, i.e. the **property used as main place of residence** is owned by one spouse only, the latter can generally dispose of it without restrictions. A problem could arise if during marital separation proceedings, a judge awards the real estate to the non-owning spouse as his/her residence.

If the buyer of the real estate is a foreigner, then the **law governing the personal relationship** between the spouses is applicable to questions of property rights. The couple can, however, stipulate that their property rights shall be regulated according to the law of the state of which at least one spouse is a citizen. The **choice of matrimonial property regime** will be valid if it is applicable to the law of the place chosen or pursuant to the law of the place where the agreement on the matrimonial property regime was concluded. The law also states that the personal relationship is governed by the law of the state of which both spouses are citizens. If they have **different citizenships** or more than one citizenship, their personal relationship is governed by the law of the state where the couple has their marital residence.

3.2.2 Options and pre-emption rights

The contractual right of pre-emption means that a person will have, in case of sale, the contractual right to buy the real estate on the same conditions and price as another buyer would do.

If the owner wants to sell real estate that is rented to a tenant, he/she has to consider the **tenant's right of pre-emption** to buy the said real estate. For example, if the owner wishes to sell an apartment, it has to be offered to the tenant at the same price as it would be offered

to third parties. Where the owner has offered it to the tenant and the tenant has refused to buy the apartment because the price is too high and the owner then sells it to a third party, the owner has to be careful that the official purchase price is not below that that was offered to the tenant. The owner has to have offered the apartment to the tenant at the same price as stated in the notarized contract. If the price in the notarized contract is below the price offered to the tenant, a **legal right of repurchase can be exercised by the tenant**. He can exercise this right of repurchase within one year from conclusion of the notarized contract. For commercial tenants, a compensation of 24 monthly rents is to be paid in addition to their moving out. This right is embodied in the law. If the **tenant exercises his/her right of repurchase,** the new **buyer will lose the real estate** just purchased. The buyer is **only entitled to the amount stated in the notarized contract**. If the buyer has paid more than the price stipulated in the notarized contract, he may not be reimbursed the full purchase price especially where the seller is not willing or not able to reimburse the difference.

In any case, the buyer of a real estate should ascertain whether such a **right of repurchase was offered** to the tenant and was refused by that person before moving out of the residence. The same applies, of course, if he is still living in the real estate. The buyer must, in particular, make sure that in the notarized contract, no purchase price is mentioned which is lower than that offered to the tenant.

It is possible that a tenant, who is informed about the ongoing negotiations between the owner and the potential buyer, agrees first of all to leave the real estate with compensation, and then, despite his agreement, does not move out and tries to get more compensation from the buyer. Neither the seller nor the buyer can do anything about this. In the interest of both parties, the **real estate should be offered to the tenant** so that all parties know where they stand after the term has expired. Where the tenant has not been formally informed about his/her right of pre-emption and is able to exercise it **within 30 days from service of the offer**, he/she could insist on his/her right of pre-emption. If he/she has not been formally offered the real estate or has not effectively waived his/her right, he could exercise his/her right of repurchase within one year after the conclusion of the notarized contract. The tenant cannot be forced out of the real estate if he/she relies on the right of pre-emption. If the buyer buys a rented real estate, it is the buyer's responsibility to get rid of the tenant. However, it should be mentioned that real estate with a tenant may be about **20% to 30% cheaper** than real estate without a tenant.

The **right of pre-emption by the government** may exist if the real estate to be sold is classified as particularly valuable for historical or cultural reasons. In this case, and **in order to prevent expropriation,** the authorities need to be informed of the owner's intention to sell. The government must be given the opportunity to decide whether or not to purchase the real estate. The decision must be made within two months.

3.2.3 Agricultural real estate

There is **no legal limitation or restrictions** with regard to the acquisition of agricultural real estate.

In cases where agricultural land is being sold, the adjacent neighbors or leaseholders (*azienda agricola* or *coltivatore diretto*) cultivating the areas to be sold have a **right of pre-emption**. In order to find out whether a neighbor is interested in exercising his/her

right of pre-emption, the preliminary contract must officially be sent to him/her and he/she must be given 30 days from the date the contract was received to exercise his/her right. If the neighbor is not interested in buying the agricultural land, the notarized contract can be concluded **after the 30-day term has expired, without running the risk of the right of repurchase**.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

According to the **principle of reciprocity**, foreigners can **in general acquire real estate in *Italy***, establish companies and manage them with the same rights that Italians would have in the foreigner's home country, unless any special legal restrictions exist or the principle of reciprocity would prohibit it. The principle of reciprocity means that the foreigner is only allowed the same rights in *Italy* as those of an Italian in the foreigner's home country. These rights are pursuant to civil law and are not of a political nature.

In cases of the purchase of real estate in *Italy* by members of EU countries, the **principle of reciprocity is given through the membership of the *European Union***. Due to *article 52* of the *Treaty of Rome*, the principle of reciprocity is no longer relevant. Therefore, there are no restrictions for European nationals and legal entities concerning the purchase of real estate.

The principle of reciprocity has to be taken into account when the purchasers of the real estate are **non-EU nationals**. It is different if a non-EU national takes residence (*residenza*) in *Italy* in the proper form. In this case, the foreign national has equal status with Italian nationals.

However, the real estate can only be resold or residence abandoned after a period of five years so as to prevent residence being established only as a way to obtain a tax-preferred status for the acquisition of the real estate and/or as an attempt to evade the principle of reciprocity.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

Pursuant to *article 2* of the *Codice Civile*, the capacity to act is the ability to conduct legal transactions. The **capacity to act** is reached when a person comes of age (**18 years**). Minors or persons whose business activities are restricted by court order do not possess such capacity to act and cannot fully conduct legal transactions.

The entitlement of the seller to conclude the contract results from his/her status as owner of the real estate. A seller is capable to act if he/she is **not restricted by legal competence**. The seller might be so restricted if he/she is not yet of age to perform the sale. In this case, the permission of a legal representative or an order of the judge of a guardianship court is needed. Another reason for not being able to sell a real estate would be the loss of legal competence through a penal conviction.

If, on the other hand, the seller is a **legal entity**, it needs to be shown that its **legal representative is authorized and entitled** to conduct the sale of the real estate. A legal representative may be restricted from acting on behalf of the company where the company

becomes bankrupt. Then, the ability to conduct legal transactions on behalf of the company may be transferred to the receiver.

3.3.2 Third-party claims and unpaid taxes

Risks due to **encumbrances with third-party rights** and **unpaid taxes** can be quite extensive. This will not always be because of malicious non-disclosure on the part of the seller. Quite often, it has simply been forgotten or overlooked by him/her as agreements have often been concluded by the previous owners and the neighbors. Such encumbrances can be, for example, **rights of way, pipelines, obligations not to build or restrictions on building,** etc. If the real estate is burdened by an encumbrance, it normally means a decrease in value of the real estate or even a restriction on the planned future use.

Unpaid taxes stay attached to the real estate. Therefore the new owner will have to deal with them. The legal basis for this is derived from the *TUIR* (*Testo Unico delle Imposte sul Reddito*). Taxes on real estate have material character, which means that they are not connected to persons, and accordingly stay with the real estate. In order for the buyer to be protected, a declaration needs to be put into the notarized contract that all taxes have been paid up to the date of transfer.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

To protect the environment and heritage of *Italy*, the Italian legislator has created a number of **legal restrictions** on building on real estate, for example: protection of forests, declaration that the real estate is in an area of land slides, which would make building on the real estate impossible, **regulations by authorities or local authorities** having allocated a certain area to a certain use (agricultural areas, green belts); restrictions on real estate near to roads or cemeteries, restrictions on real estate near to an airport; restrictions on real estate near to railroad tracks; and restrictions on real estate falling under the *bellezze naturali*, i.e. an area of outstanding natural beauty, which makes building on it impossible or extremely difficult.

The examples listed above are restrictions on the building on real estate situated in areas which are **protected in the public interest**. These restrictions are to prevent any interference with nature and the landscape, which could change their character irretrievably. An unrestricted building could have a detrimental effect on the environment and thus destroy the balance of nature – for example, if buildings are constructed too near to rivers, lakes or mountain slopes. The same restrictions apply to the **protection of historical monuments**. Constructions should not interfere with cultural monuments in such a way as to change or destroy their character. Examples are the buildings constructed without permission in the *Valley of the Temples* in *Sicily.*

3.3.4 Access to relevant records and documents

The timely inspection of relevant registers, mainly the **land register** (*Conservatoria dei Registri Immobiliari*) and the **land survey office** (*Catasto Terreni* for pieces of land and *Nuovo Catasto Edilizio Urbano, NCEU,* for buildings) should be done at an early stage in order to get an overall picture of the legal situation. The **land register** shows the **encumbrances**

and third-party rights mentioned above, as far as they have been registered. At the land survey office, one can verify whether the situation of the real estate according to the construction plans available reflects the real situation. If not, then the plans can be altered but as this could be very costly and time-consuming, the potential buyer needs be informed as soon as possible.

The registers of the Italian land registry and land survey office can be inspected by individuals, so the use of professionals is not compulsory. Nevertheless, it could prove to be difficult for a foreign individual to obtain the required information. Success depends on how the register is being kept, if it is up to date and if the person in charge is cooperative.

It could be useful to look at the **copy of the original notarized contract**, with which the seller at that time obtained the real estate. The identification of the plots of land to be purchased can be compared with the current entries in the land registry and land survey office.

3.4 Key points that a seller should consider

The seller is the contracting party carrying the smaller risk, if the real estate is being used in accordance with its specified purpose, under the regulations of construction law, and if taxes and other charges have been paid on time. Therefore, the **seller should not make any promises or accept conditions in the preliminary contract, which cannot be fulfilled in time before the conclusion of the notarized contract**. In this case, the seller would have to refund not only any down payments received from the buyer, but also pay double their amount. The buyer can also claim damages. The seller must also make sure that the real estate is free from third-party encumbrances, for example free from mortgages, unless otherwise agreed in the preliminary contract. After the actual sale has taken place, it is the duty of the seller to notify the change of ownership within 48 hours to the appropriate authority. Failure to do so will result in a financial penalty.

3.5 The execution of a real estate purchase transaction

The purchase of real estate according to Italian law can be described by three steps:

1. Usually, but not necessarily, the parties involved sign a preliminary agreement. The preliminary agreement constitutes an **obligatory commitment** between the parties. The parties commit themselves and promise each other to sign the subsequent purchase and sales agreement, with which the ownership of the real estate passes to the buyer. The **buyer promises to buy the real estate on the conditions agreed upon, and the seller promises to transfer ownership of the real estate**, free from encumbrances, according to the terms agreed upon, and to accept the agreed purchase price.
2. The **actual notarized agreement** (the *atto di compravendita* or *rogito*), which has to be signed before a notary public, with regard to the real estate is carried out at a time agreed upon by the parties. Until that date, the parties will do what is necessary so as to complete the notarized sales agreement. The **obligations mentioned in the preliminary agreement are to be performed prior to the appointment with the notary public**, since their realization is the basis of the conclusion of the notarized agreement. With the signature of both parties on the notarized agreement, the buyer will obtain **ownership** of the real estate.

3. As a third and final step of the purchase of real estate, the **notarized agreement will be entered into the different registers** to make the purchase public. The entry will protect the buyer from any purchase by third parties, who have also concluded a notarized agreement, but whose entry was made at a later date into the Italian land register.

3.6 Powers of attorney

In *Italy,* real estate can be purchased by power of attorney. The power of attorney can be executed in **simple form** by a notary public or can be a **public document**. It depends on how the purchase contract on which it is based is executed. It can be executed before a notary public as a private contract or as a public document.

The power of attorney for the execution before an Italian notary public may be an advantage if the **purchaser is a foreigner and does not speak the Italian language**. The notary public is bound by law to have a purchase contract executed in the form of a public document translated into the language of the other contracting party. Apart from the translated contract, the presence of an official interpreter and two witnesses is necessary, one of whom speaks Italian as well as the buyer's language. Since this will considerably prolong the procedure and also increase the costs, the contract can be executed before the notary public by power of attorney. The power of attorney has to be executed **in the same form as the sales agreement**. If the sales agreement is a public document, the power of attorney must also be a public document. If the sales agreement is only a private contract, concluded before a notary public, the power of attorney needs to fulfill this lesser requirement.

3.7 Financing

It is possible for a foreigner buying Italian real estate to obtain **financing through an Italian bank**, but in practice it is difficult to achieve. An Italian bank is not normally able to judge whether the documents submitted by the foreign customer with regard to income and financial status are correct. The Italian bank has to **ensure that the repayment of the loan is guaranteed.**

When financing is arranged through an Italian bank, the bank will have a mortgage entered as a security against the real estate, when the notarized contract is executed. Therefore, a bank representative will usually be present when the contract is executed before the notary public. Since the seller will get the purchase price upon transfer of ownership, the bank should at this moment hand over the amount to the seller. However, as a rule, the bank will hand over the financed part of the purchase price to the seller **only when it is certain that the mortgage has been entered**. This will take about 10 to 14 days. For **securing the bank's charge**, it is common in *Italy* that the **mortgage** entered is for at least double the loan amount. The bank tries to guarantee that in case of utilization of the real estate, for which an execution action of many years would be necessary, all its claims are covered. The seller will, therefore, in the case of the buyer's financing through a bank, usually receive the full purchase price, when the mortgage has been registered in favor of the bank. If there is no agreement in the preliminary contract stating that the seller will receive part of the purchase price at a later date, the seller could refuse to sign because the buyer, in breach of the contract, did not pay the purchase price at the moment of signing the notarized agreement.

3.8 Purchase through a company

The purchase of real estate through a company still to be established will be an advantage if tax benefits outweigh the costs connected with this process. The form of company offering this advantage is normally a **company with limited liability**, abbreviated under Italian law as *Srl* (*Società a responsabilità limitata*). The **minimum capital** for this form of company is Euro 10,000. The disadvantage is that the maintenance expenditure of such a company is quite high due to bureaucratic requirements. The services of an accountant are an absolute necessity. The *Srl*, like a **stock corporation**, is obliged to **officially hold a general meeting at least once a year**. The advantage of this form of company is the **limitation of liability.** Further, less formal ways to purchase through a company are, on the one hand, a *società in nome collettivo,* abbreviated to *snc* (general partnership), or a *società in accomandita semplice,* abbreviated to *sas* (limited partnership). Both forms are partnerships. In the first case, the individual partners are fully liable, whereas in the *sas,* there is limited liability of the partners. The *accomandatario* has full liability for the company's debts.

The purchase through a company can often be the only way to obtain ownership for a non-EU national who is limited by the principle of reciprocity. **Reciprocity exists when a *srl* is formed.** However, the problem of reciprocity still exists when there is a partnership under Italian law, and all partners are non-EU nationals and have their residence in a non-EU country.

International property-holding structures via foreign companies are no longer common in *Italy.*

3.9 Defects and warranty claims

Warranty clauses are seldom stipulated in the sales agreement with the consequence that **statutory regulations** apply. The rights of the buyer are set out in *article 1490* of the *Codice Civile*. According to this law, the seller warrants that the real estate is free of faults that would limit or prevent its use. According to *article 1495*, the buyer is obliged to declare any faults within eight days after they have been detected. All claims will expire one year after the transfer of the real estate. The warranty is also valid for **hidden faults**, which were not visible at the date of transfer. In addition, there is a **10-year warranty** for faults which cause complete or partial destruction due to poor soil or due to a deficiency of construction. These **claims will become statute-barred one year** after the faults have been detected.

Further warranties are stipulated by the law *No. 765* of *1967*, namely in cases where the seller is also the building contractor and did not obtain a **building permit** to construct the property, and the absence of which was not expressly mentioned in the contract. The law allows claims for damages against the seller/building contractor if, because of the unlawfulness of the building project, the buyer has lost tax benefits or other government benefits.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

The Italian legislator provides that every change from the point of view of urban development requires the prior approval by the community. Initially, the mayor of the community

concerned was responsible for granting such approval. This responsibility was transferred in 1997 to local administrative officers. The application for a **building permit** or a **permit to rebuild or to alter a building** can only be filed by the owner of the building.

The **procedure for granting a building permit** was completely revised in 1995. It stipulates that after a building permit has been applied for, the office responsible for it must inform the applicant who will be the person in charge of his/her application. The applications are examined in the order of their receipt. **Within 60 days after receipt** of the application, the person in charge has to give a decision on the application, taking into consideration the regulations for urban development and construction. This time period can only be extended once by the person in charge if the applicant is asked for further documents. In communities with more than 200,000 inhabitants, the time period is twice as long.

The decision of the person in charge has to be submitted to a building commission (*commissione edilizia*), who has to furnish their report also within a set time period. If they do not furnish a report, the person in charge will notify the mayor, giving the reasons why the period could not be kept. If the applicant does not receive his/her permit because the authority and responsible division failed to act, the applicant can contact the president of the competent regional council (*Giunta Regionale*) who can appoint a commissioner. The commissioner can order that the applicant receives a decision on application.

The land where in particular new buildings are allowed to be constructed depends on the zoning plan, the *piano regolatore*. This **allows certain kinds of buildings** to be constructed. It is up to the communes to determine, observing the general criteria specified by the regions, which of the building zones can be used for certain purposes.

The building permit (*concessione edilizia*) issued **normally carries a time limit.** This means that the building activity has to **be started and completed within a certain time span.** These time limits have to be indicated in the building permit. The time up to the start of the construction must not exceed **one year**. The time up to the completion (i.e. the time within which the property must be fit for human habitation) **must not exceed three years.** The latter term can only by extended by decree. Circumstances outside the control of the owner must have existed that made it impossible to carry out the work on schedule. In order not to let the building permit expire within a year, the owner must start constructing the building within one year. It is not sufficient to just raise a fence around the real estate and put up signs. The owner must be able to clearly show the start of the building activity externally. This start is important for the expiration of the term, since the building permit will expire after one year if the building activity has not actually been started. If the building activity has not started and the term has expired, the term cannot be extended. A new building permit will have to be applied for. However, the legislator expressly provides for the possibility of extending the term if the construction was started within the term specified, but not completed because of factors outside the control of the owner.

To summarize, the **building permit** can be characterized as follows. The building permit, once issued, is **in principle irrevocable**, except for expiry or annulment. The holder of the building permit can **assign it** through declaration of intent **to a third party**. In case of death, it can also be transferred to the heirs. The building permit can only be obtained through the payment of a **fee**, and it needs to be **published**. This means that once issued it will be put up publicly by the authorities. The building permit carries a **time limit**.

The building permit is an irrevocable decree, i.e. once granted, it cannot be rescinded by the authority who issued it. This does not, however, exclude the possibility of annulment of the building permit, if the latter should not have been issued in the first place. The **annulment** can be effected in four different ways: **annulment by the authority having issued the permit**; annulment by the higher regional authority; annulment by the government; and annulment by the court. In the first case, the power to annul is used to cancel the following: an illegally granted building permit or a building permit issued by an authority that was not competent to do it, or a building permit granted with too wide an ambit. The annulment is retroactive so that the **annulment will be effective as from the moment the permit was granted.** The annulment allows the state authorities to restore the statutory order that was violated.

The **building zones**, i.e. the areas where buildings are permitted to be constructed, are indicated in the *Piano Regolatore Generale (PRG* or the *piano urbanistico*, a type of **development plan** established by the commune and which defines the kind of buildings to be allowed to be constructed in the area in question (e.g. industrial area, residential area, mixed area). It is the purpose of the development plan to regulate the building activity within the commune in such a way as to guarantee a consistent and uniformed approach to the development and to ensure the functionality of the buildings.

4.2 Architect's and building contracts

In the building contract, a person undertakes to carry out any work, using his/her own required organizational means and at his/her own risk, against corresponding remuneration. A written form of the contract is not necessary, but is nevertheless recommended. The contractor is liable for non-fulfillment or delayed fulfillment of the work. Where a **building contractor** is obligated to construct a building, the contractor is allowed to use the help of third parties to carry out and to complete the work. The third party may even be an **architect**, if the buyer uses one. In this case, the architect represents the interests of the buyer and supervises the work to ensure that it is carried out in accordance with the buyer's wishes with regard to the materials used, the method of construction, etc.

The law provides two possibilities for modifying the agreed price. Firstly, for unforeseen circumstances leading to an increase or reduction of the amount agreed upon, or, secondly, for unforeseen difficulties when erecting the building.

The contractor is liable for the fact that his/her work is **free from deficiencies**. Any defaults must be removed at the contractor's cost and the price must be appropriately reduced. The Italian law presupposes that buildings by their nature have a long service life. Should, therefore, deficiencies show up within **10 years** from the time of construction, and cause the collapse of a building, the contractor will be liable. The contractor has to be notified of the defaults within one year after their detection (see also section 3.9 above).

4.3 Completion of construction and formalities

If the construction work is **not completed within the set time limit, permission for the continuance of the building activity has to be applied for**. This means, in essence, applying for a new building permit. A problem could arise where construction, which was previously allowed (especially when the building permit expired some years ago), would no

longer be allowed today. This would mean that the construction could continue but only under restrictions.

If a building permit is issued, all **building activities have to be in line with that permit**. Any deviation from the permit is considered an illegal act. In cases of violation against any building laws, the buyer has to verify that an application for a *condono* or an application for a *sanatoria* was filed in due time.

The **amnesty for unlawful buildings** or *condono* has been law since 1985 and was last used in 1999 as an instrument for a 'belated cure'. It allows for the **subsequent granting of building permits for unlawful buildings**, provided that in every individual case there exists the legal prerequisites for a belated permit. The law set out exactly which kind of violations of building laws could be 'cured', if an application was received within the statutory term and, in particular, corresponding **fines** were paid, then a belated permit could be granted. Unless there is another amnesty (*condono*), then there is only one other possibility of belated cure and that is through a *sanatoria* (*law dated February 28, 1985, No. 47*). The *sanatoria* is more restrictive than a *condono*. It is essential that the statutory conditions for a *sanatoria* are met and these conditions are set out in *article 13* of the above-mentioned law. These conditions are where real estate developments, subject to building laws, were undertaken without a building permit; where there are deviations from an existing building permit; or where alterations to the terms have been made. The person, who caused these **violations of law, can apply for belated cure** if, at the date of the violations, the preconditions for granting the permit would have existed and still exist at the time when applying for the *sanatoria*.

The **completion of a building** has to be declared to the appropriate land survey office, which must receive the plans, separately for each unit of real estate (e.g. apartment, garage, cellar, attic, etc.). The completed building must comply with the specifications of the building permit. Otherwise it will violate building laws and this will lead to administrative and legal consequences. When erecting a building in *Italy*, **the authorities will not check** whether the building is in agreement with the existing standards. It is, however, prescribed by law that each property, before being used for residential purposes, has to have a *certificato di abitabilità* (certificate of fitness for human habitation). This certificate can be applied for at the community. Violations of building laws will become apparent at the latest when the real estate is to be sold and there is no connection between the files of the land survey registry and the reality of the situation. This could eventually lead to making it impossible to sell the real estate.

4.4 Deficiencies and warranty claims regarding new constructions

Warranty claims and the terms involved were already mentioned above (see Section 3.9 on page 407). Should construction work result in a collapse of the building causing personal and property damage, the contractor will be liable unless he can prove that the collapse was not caused by faulty workmanship.

Deficiencies of new constructions are regulated by the Italian law, *article 1655 et seq.* of the *Codice Civile.* The contractor is liable for the fact that his work is free from **deficiencies,** unless the owner **knows and accepts these deficiencies**. Otherwise, the owner has to notify the contractor of the deficiency within 60 days. After expiration of this exclusive

term, the deficiencies can no longer be asserted. The possibility of assertion of a deficiency will **become statute-barred** after **two years** from the handing over and acceptance of the real estate.

5 Rental and tenancy

5.1 Rental and lease agreements

On January 1, 1999, a new tenancy law came into force, which replaced the former laws. The former laws will remain in force until the contracts concluded under them have expired. The main amendments of the new tenancy law are the following: The tenancy contract **has to be made in writing**; verbal agreements are null and void. The minimum term of a contract is **four years**; it can be **renewed for another four years**, unless the landlord gives at least **six months' notice**, indicating one of the reasons required by law. One reason could be for personal use by the landlord or his/her family. Further reasons could be heavy damage to the building, which make it necessary to renovate the real estate and the tenant remaining there would hinder the renovation; or it could be the necessary structural renovation of the whole building or planned additions to the building. In certain cases, the change of use of real estate that was originally intended for residential purposes only, is possible if that change of use will serve certain social or cultural services (also if these services are exercised by legal entities). The **renewal of the contract by the tenant and the notice by the tenant must be declared in writing and by registered mail** to the owner, observing the six-months' notice period. Otherwise, the contract will **automatically expire**. In certain circumstances, the law will grant fiscal advantages to those owners who can prove that the tenancy contract was registered, that the *ICI*-tax levied by the community was paid, and that the real estate has been duly covered by the annual tax return.

The **leaseholder** has the contractual obligation to use the real estate for the purpose for which it has been leased. The owner of agricultural land has the **right to check** whether the **leaseholder is fulfilling this contractual obligation**. If not, he may be entitled to terminate the contract. In this connection, the *coltivatore diretto* for agricultural land should be mentioned. This is normally a small farm, where the soil is cultivated by the leaseholder with his/her own means and with family help. This agricultural 'entrepreneur' is not the owner of the means of production, namely the soil, but can only cultivate it against paying a rent. The law *No. 203* of *May 3, 1982* was introduced, which has brought new regulations on leaseholding. The **leasehold contract runs for at least 15 years and the leaseholder can withdraw from the contract at any time**. The owner of the soil can **only terminate the contract if the leaseholder is acting in violation of the contract**. Otherwise, he would have to take legal action and would have to apply for the annulment of the contract by court order. The statutory provisions are **unilaterally to the advantage of the small farmer**.

5.2 Regulations on protection of tenants and rent control

Under Italian law, there are regulations regarding the rent and any increase, which is to the advantage of the tenant. The rent can only be increased within the statutory contract term of four years by the index of the *ISTAT (Istituto Nazionale di Statistica)*. This is an adjustment for the increase in the cost of living and the inflation rate. The tenant has the

right to renew the tenancy contract for another four years, whereas the landlord can only give notice for one of the reasons already mentioned. If the real estate is sold, the tenant will have a **legal right of pre-emption**. The right of pre-emption has to be offered to the tenant by registered mail, stating the purchase price, terms of payment and possible takeover of loans. The tenant will have **60 days from receipt of the offer to agree to the offer or make a counter-offer**, also by registered mail. The purchase of a real estate does not affect an existing tenancy contract, i.e. the **purchase does not cancel tenancy**. The tenancy relationship is just transferred to the new owner.

6 Successions and gifts

6.1 Applicable law and jurisdiction

The foreign owner of real estate in *Italy* also needs to **observe the Italian rules** and regulations concerning the transfer of real estate upon death or by way of donation. This is set out in international private law, which is regulated in *Italy* by law *No. 218* of *1995, article 46.* According to these regulations, in cases of inheritance, reference is made to **the material national law of the devisor**. Ownership of real estate by a foreign owner who has died will be handled, as far as the regulation of succession is concerned, according to the **legal status of the deceased.** *Article 51* of the same law deals with the transfer of the real estate itself. With respect to the procedural right of jurisdiction applicable in disputes concerning an inheritance, the **Italian courts have jurisdiction** for movable and immovable property, which is situated in *Italy* (see *article 50*).

Foreign heirs must send a **succession application** to the competent registry in *Rome*. The registry in *Rome* is competent for those cases where a foreign owner has died and passed the real estate to his heirs. Foreigners with residence in a foreign country have to file this application within **12 months**. Its purpose is to enable the taxation of the inheritance in cases where the heirs are subject to taxation and to pay the taxes for clearance of the entries in the land register and land survey register. Notification is to be made on a form, which must be duly completed and accompanied by documents proving the succession (e.g. death certificate, data on the degree of relationship, birth certificates, certificate of inheritance or the will on which the heir bases his/her entitlement to inherit, documents on the property to be obtained from the land survey registry, etc.).

6.2 Fundamentals of succession and gift/donation laws of Italy

Legal succession

Inheritance derives either from the legal succession or from the will of the deceased. Legal succession according to **Italian law is bound to a hierarchy**. It defines the persons who will be left a share of the wealth of the deceased. In the first place, these are descendants, legitimate and illegitimate, and the surviving spouse. If no child or spouse exists, then the next closest relatives to benefit will be the parents and the brothers and sisters of the deceased.

In cases of a married couple with two children, the surviving spouse and the two children would each inherit one-third (if there are more children; the estate will be divided into

corresponding shares). In the case of one child, the surviving spouse and the child will each inherit half of the estate.

According to the Italian law of succession, the **person entitled to a statutory forced share** (i.e. spouse and legitimate and illegitimate children) cannot be excluded from the inheritance, **not even by a will**. The statutory forced share is always equal to the legal claim of inheritance, i.e. there is no reduced statutory forced share, as provided in the law of succession in some other civil law countries.

Will

The **will** is a formal act and requires **written form**. The will can be **handwritten or recorded by a notary public**. The recording of a will can be public or private. A public will is drawn up before a notary public in the presence of two witnesses. However, the will can also be made as a secret document. The will must be written by the deceased and signed at the end. If a third party is called in for drawing up the will and if the will is typewritten, each half page must be signed by the deceased. Then the will is sealed and handed to the notary public in the presence of two witnesses. The deceased can, in general, freely dispose of his/her wealth. This freedom is restricted in as far as the law reserves a certain share (**statutory forced share**) of the wealth for certain persons, and these persons are entitled to their share even against the deceased's wishes.

Gifts

The Italian *Codice Civile* defines a **gift or donation** as a contract, in which one party voluntarily enriches another party, transferring one of his/her own rights or assuming one of the other party's liability. A donation is a **formal contract**, which has to be drawn up by **public recording** before a notary public. When the contract is to be signed, the contracting parties and the witnesses need to be present. The assets transferred by donation, no matter whether they are **movable or immovable assets,** must always be transferred by a public contract. The making of a donation requires full legal capacity (see Section 3.3 above) for an explanation of what constitutes legal capacity to act). An **exception to this rule** is a donation in respect of a future marriage **(*donazione abnuziale*)**. This is a donation between the future spouses or a donation of a third party to the future spouses. For such donations, the donation is perfected through the fact of the subsequent marriage. Moreover, the usual formality of recording before a notary public is not necessary.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

The Italian law offers in certain cases **tax benefits** for the purchase of real estate. These benefits are also applicable to foreigners if they fulfill the necessary requirements. To take advantage of such tax benefits, the real estate must not be a luxury property. The qualification of a real estate can be obtained from the land survey registry. The property has to be in the commune in which the buyer has his **main residence** (*residenza*) or in the commune in which the buyer will take his *residenza* **within 18 months after the notarized agreement**. The notary public has to include a corresponding declaration to this effect in

the contract. If the main residence is not taken in accordance with the declaration, the difference in tax will have to be paid. A sufficient place of residence is also the place where the **buyer is gainfully employed or – if the buyer works as an employee in a foreign country – the place where his/her company has its head office or a subsidiary.** The **tax benefit** also applies to Italians having emigrated to a foreign country, but now wanting to take up their main residence in *Italy*.

7.1.1 Real estate transfer taxes

The tax levied on a purchase qualifying for **tax benefits is 3% of the purchase price** stated in the notarized purchase contract. In addition, the following taxes are applicable: register, mortgage and land survey tax, each to a fixed amount of Euro 129.12. The purchase contract of the notary public and the annexes attached to the notarized contract will cost one fee stamp of Euro 10.33 for every four pages, i.e. the exact amount of the cost depends on the number of pages of the contract.

If the purchase of the real estate is not subject to tax benefits or if it is not agricultural real estate, a **total tax of 10% of the purchase price stated** in the notarized contract will be levied. The 10% tax is broken down as follows: 7% **register tax**, 2% **mortgage tax**, and 1% **land survey tax**. However, the purchase price cannot be reduced by the parties to enable them keep the tax to be paid as low as possible. The purchase price declared in the notarized contract must not be below the value of the land survey registry. The latter is the calculated value which is determined based on the *rendita catastale* by means of **multiplication factors specified by the fiscal authorities**. The amount of the *rendita catastale* is taken from the land survey register. The notary public will advise the parties if they indicate a purchase price below the value of the land survey registry. This could result in a fiscal investigation.

Agricultural real estate is subject to a far higher tax rate, namely between **17% and 19%** of the purchase price indicated. However, the value in the land survey register of agricultural real estate is usually very low.

7.1.2 Sales tax (value added tax)

Where a buyer intends to purchase real estate that is still to be constructed, the contractor who is going to build and eventually sell the property, will request the **10% of value added tax** on the purchase price declared before the notary public. If the real estate is subject to tax benefits, then the contractor will require only **4% of value added tax**. Where a buyer purchases real estate from a legal entity, as a one-time purchase tax, a **value added tax of 20%** would have to be added to the declared purchase price. New properties which are built by a contractor and which, from the point of view of the land survey register, are **deemed a luxury real estate** (i.e. more than 240 m^2 living space, real estate with parks, swimming pool, sports grounds, furnishings of high-quality materials, etc.) will be taxed with **20% value added tax**. The possibility to buy such luxury real estate at a reduced value added tax rate is excluded.

7.1.3 Real estate registration and notary charges

The **notary's fees and all purchase taxes are due for payment at the moment of signing of the contract** and are payable to the notary public, who, in turn, is responsible

Table 1 Estimates of notary's fees

Value of property in Euro		Total notary's fees in Euro *
100,000	results in	3,400
200,000	results in	4,000
300,000	results in	4,450
400,000	results in	4,700
500,000	results in	5,100
750,000	results in	5,500
1,000,000	results in	6,100
1,500,000	results in	6,900
1,750,000	results in	7,100
2,000,000	results in	7,400

* Empirical values/estimates.

for passing them on to the fiscal authorities. The amount of the notary's fees depends on the purchase price fixed and is derived from the scale of notary's fees. The notary public has, however, a large **scope of discretion** for fixing the fees. In practice, the notary public will set the fees at his/her own discretion because there is a considerable difference between the amount usually charged by the notary public and the amount according to the fee scale. It is possible that for the same value, quite different fees will be charged as some notaries public are expensive and others are not. One should **obtain a cost estimate** from the notary public in order to have a precise assessment of the costs and thus prevent unpleasant surprises later on. The **charges for the land register**, which are also collected by the notary public, are low and are of no real significance to the total amount of costs arising from the purchase. The few examples given in Table 1 – which are only estimates of the notary's fees – relate to the value of the property.

New constructions are subject to sales tax. This could be either the reduction of tax to 4% or the **reduced value added tax** of 10%, which is to be paid to the builder. Otherwise, there are no tax benefits for new constructions and they are subject to the same recurrent taxes as existing buildings.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

The annual real estate tax is the *ICI* (*Imposta Comunale Immobiliare*) tax. It is a **local tax** for the benefit of the commune in which the real estate is located. The amount of *ICI* can vary from one commune to another. It is normally between **4 and 7 thousandths** of the fictitious capital amount calculated via the *rendita catastale.* At present, the *ICI* is due **in two installments per year**: In **June/July** and in **December**. In *Italy*, the owner of the real estate is responsible for paying the taxes. Usually there is no reminder to pay the tax by the fiscal authorities. The owner has to use the services of an accountant or similar expert, who will calculate the *ICI* tax for the owner and complete the necessary paperwork.

7.2.2 Income tax

Real estate is also subject to income tax. For individuals, this is the *IRPEF* (*Imposta Reddito Persone Fisiche*) tax, taxing the total income of an individual, independently of how it

is earned. In principle, a **fictitious income** from the real estate is taxed. This income is calculated on the basis of the land survey data. The amount of tax depends on the individual's tax class, as this fictitious income will be added to the other income of the individual. The total income determines the tax rate. The lowest tax rate is 23% for an income up to Euro 15,000, the highest tax rate is at present 45% for an income over Euro 70,000. For persons subject to limited tax liability in *Italy*, there is no special tax rate. The same tax rates apply.

For real estate acquired with tax benefits and used as the main residence, tax concessions apply. In this case, no income will be assessed for the real estate.

7.2.3 Net wealth tax

There is no net wealth tax in *Italy*. However, its reintroduction is sometimes discussed by politicians.

7.3 Capital gains tax

Since January 1, 2002, there is no longer any capital gains tax for individuals and legal entities. The tax, the *INVIM*, was abolished as of December 31, 1992, with exceptions.

Real estate that is part of the assets of a legal entity is still of fiscal relevance. Depending on the value of the real estate in the financial statement of the company and whether this value differs from the purchase price, the sale will be subject to the usual taxation for companies, the *IRPEG* (*Imposta Reddito Persone Giuridiche*).

7.4 Inheritance and gift taxes

On October 23, 2001, the law *No. 383 of October 18, 2001* came into force, which set out new regulations for inheritance and gift tax. **Inheritance tax and gift tax were in general abolished**. The **abolition** of the inheritance tax is valid for all heirs. **Gifts are tax- free only for spouses and relatives up to the fourth degree (cousins)**. Gifts to other persons are tax-free up to an amount of Euro 180,759.91. If this exempt amount is exceeded, the gift, if it is real estate, will be taxed like a regular sale. This means that for agricultural real estate a tax rate of 15% applies, for other pieces of land 8% applies, and for buildings 7% or 3%, depending on tax benefits, applies. In the case of a gift, the law provides that certain values transferred as a gift and **resold within five years** will be subject to capital gains tax. From the fiscal point of view, the resale is treated as if the gift was never made.

In case of a tax-free inheritance or gift, the **transfer in the land survey registry** from the deceased to the heir or from the donor to the benefactor will be subject to a tax. This could be a fixed amount of tax of Euro 129.12 for the mortgage tax and Euro 129.12 for the land survey tax, if the property is transferred as *prima casa.* In all other cases, the mortgage and land survey tax will amount to a total of 3% (1.5% plus 1.5%) of the land survey value of the property.

The declaration of succession, which has to be handed in **within six months of death (for foreigners within 12 months)**, must still be filed with the registry in charge, despite the abolition of inheritance tax, because taxes are payable for the transfer of a real estate that is subject to a tax-free inheritance or donation. (These are a mortgage tax of 2% and the land

survey tax of 1%.) If, however, the prerequisites for a transfer as the main residence (*prima casa*) are satisfied, the two above-mentioned taxes will amount to only Euro 258.24.

7.5 Other taxes and charges

There are no further recurrent or one-time taxes for real estate. Additional costs to be considered might be fire insurance or a building insurance. These insurances are not compulsory under Italian law. Accordingly it is at the discretion of the owner to take out such insurances.

Since a condominium is part of a complex of apartments, in which many owners reside, the down payments to cover the condominium charges should be mentioned. These costs depend on the size of the condominium and on the expenses to be paid by them; they are apportioned to the individual owners by thousandths of a share.

7.6 Incorrect (lower) statement of sale price on the sales agreement

In *Italy* it is still common, but of course illegal, to indicate before the notary public a lower purchase price than the real market price (under-recording). In view of the tax burden, this temptation is always great and was until December 31, 2001, also in the interests of the seller, who had to pay capital gains tax. The lowest possible value of the purchase price is the value registered in the land survey registry. Where a buyer purchases a real estate from a legal entity, and the price paid is lower than the market price, he could be taking a risk if the legal entity becomes bankrupt within two years after conclusion of the notarized contract. The receiver could, if the purchase price stated in the notarized contract does not correspond to the market value, challenge the purchase contract and reclaim the real estate. The buyer could then try to get his/her purchase price back from the receiver, but only for the amount stated in the notarized contract. The only other alternative would be to admit tax evasion because in reality he/she has paid a higher purchase price. This would then lead to an investigation by the fiscal authorities. The **consequences** are the following: (a) if the amount evaded **does not exceed** Euro 51,645.69, then a person may have to pay a fine, the amount of which depends on the amount of tax evaded; and (b) if the amount of tax evaded **does exceed** the above-mentioned figure, then a person will face a criminal prosecution. A conviction could lead to a prison sentence from six months up to four years, which will be published

Another consequence of declaring a lower and incorrect statement of a sale price is that both the buyer and seller will have falsified the sales agreement, which could lead to criminal prosecution. If convicted of falsifying the documents, a person may be sentenced to up to two years' imprisonment. The sentence imposed will be toward the heavier side, if the buyer and seller have misled the notary.

However, in *Italy* the recording of an incorrect lower purchase price in the sales contract does in principle not affect the validity of the purchase contract.

7.7 International taxation

There are about 60 **double taxation treaties** in force between *Italy* and other countries, including all countries in the *EU*, the *United States, Canada* and *Australia*. There are other

treaties that are not yet in force. All of them, however, are based on the ***Model Convention of the OECD*** (*Organization for Economic Development and Cooperation*).

According to the *Model Convention* and most of these double taxation treaties, a person who is resident in a contracting country may be taxed according to the law of another country by virtue of his/her residence, permanent stay, place of the management of his/her company or other similar characteristics. This means that a resident of one country, who derives income from or owns capital in another country, may be taxed according to the laws of the other country. *Article 6* of the *Convention* provides that income derived by a resident of one contracting country from real estate situated in another contracting country, may be taxed in the latter.

To avoid double taxation on income derived from such real estate which has already been taxed in another country, the *Convention* provides **exemption** or **credit methods** for taxpayers. According to the exemption method, the double taxation treaty signed between *Italy* and *Germany*, for example, provides that the Italian fiscal authorities can tax the income from the rental or leasehold of holiday property in *Italy*. The German fiscal authorities are not allowed to include this income in the basis of assessment of German income tax. Accordingly, the German authorities only have the right to tax the German income of the German taxpayer applying the tax rate that would be applicable to the latter's income if the income earned in *Italy* had been added. The credit method, on the other hand, is when a resident or citizen of a country, such as the *United States*, pays the amount of income tax to *Italy* as a credit against his/her income tax liability in the *United States*.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

According to *article 5* of the *Schengen Treaty*, the entry of foreigners will only be allowed if they are in possession of a valid passport or an equivalent traveling document as well as documents justifying the purpose and conditions of their stay in *Italy*, if they can prove that they have sufficient financial means to stay in *Italy* and to return to their home country. A valid visa has to be presented, if prescribed, and there must be no contra-indications to bar the entry. The foreigner must not represent a danger to public order or national security to *Italy* or another member state of the *Schengen Treaty*.

Nationals of the member countries of the *European Union* as well as nationals of *Iceland, Liechtenstein* and *Norway*, are not considered foreigners.

The permanent residence in *Italy* requires a **residence permit** for the group of the *extracomunitari*, i.e. the nationals of non-EU countries. Members of EU-countries will get a **residence card** (*carta di soggiorno*). The application for a residence permit in *Italy* has to be filed within **8 workdays after entering into *Italy*** with the police headquarters (*questura*) of the province in which the foreigner wants to take up residence. The validity of the residence permit is normally limited in time, depending on the reasons for the visa.

Nationals of countries in the ***EU*** are entitled to receive a **non-limited** *carta di soggiorno* (residence card) for their stay or settlement in *Italy*. The conditions for permanent settlement are that an **EU-national has lived for at least five years** in *Italy* with a duly granted

residence permit or if the EU-national is the spouse, minor or parent of an Italian national or another national of an EU-country with *residenza* in *Italy*.

A bilateral treaty between non-member states such as *Switzerland* and the *EU* as well as the individual EU-member countries with regard to the free movement of persons (*treaty of freedom of movement*) aims to gradually introduce the freedom of movement of employed and non-employed persons. There will be a transitional term of 12 years until there is full realization of freedom of movement between *Switzerland* and the *EU*. For Swiss nationals seeking employment in *Italy*, access to the Italian labor market will remain regulated for the first five years after the treaty comes into force. During the first two years, the regulations will be similar to those for non-EU/EFTA nationals (agreement on residents) with the difference that Swiss nationals will enjoy preference over these foreigners.

8.2 Tax residence

First of all, two terms have to be clarified, the *residenza*, on the one hand, and the *domicilio*, on the other hand, which are defined by *article 43, paragraphs 1* and *2* of the *Codice Civile.* A ***domicilio*** is the place where a person mainly pursues his/her business and activities and which is not necessarily the same as the ***residenza***. A *domicilio* is not, generally speaking, a person's permanent address. It is for example, a mailing address for a person who, while living and working in *Italy*, has not a permanent address in *Italy*. The *residenza* is the place where the person normally has his/her permanent residence/address. It is a fine distinction between both terms and it is, of course, possible for a person to have *domicilio* and *residenza* at the same address. However, the distinction becomes clear when considering that, for example, with *residenza*, a person is registered on the official electoral role, giving that person the right to vote, whereas with *domicilio*, there is no such right. Most foreigners often keep their *residenza* in their home country and establish a *domicilio* in *Italy*, by virtue of which they will pay taxes on their income earned in *Italy* according to the Italian tax laws. The take-up of residence, the *residenza*, in *Italy* means that the person is considered to be a resident in *Italy* and so he/she can apply for an identity card or similar papers. Certain official certificates (e.g. on marital status) can also only be applied for at the authority of the place of one's *residenza*.

In cases where a foreigner keeps his/her main residence in his/her home country and only has a *domicilio* in *Italy*, but earns an income, he/she will be taxed according to the applicable double taxation treaty. Applying for a *residenza* would mean that the foreigner becomes fully taxable in *Italy*, even with income earned in a foreign country. For income earned in a foreign country, again, the respective double taxation treaties apply (see Section 7.7 above).

To voluntarily take up a fiscal status, namely to become an Italian taxpayer, a *domicilio fiscale*, pursuant to *article 1 of the TUIR* (*Testo Unico delle Imposte sul Reddito*) in *Italy* mean that all income earned in foreign countries (taking into account any double taxation treaties) is taxed according to Italian law.

In recent years, there have been in *Italy* a series of changes in taxation, which led to the abolition of such relevant taxes as wealth tax, capital gains tax on real estate, inheritance tax, reduction of gift tax, and reduction of the maximum tax rate. For example, on certain capital income, a withholding tax of 12.5% is now paid directly to the Italian fiscal authorities. Through this payment of the *imposta sostitutiva*, this type of income is taxed at a rate of 12.5% only.

The present general income tax rates in *Italy* are as follows:

	Tax rate
Up to Euro 15,000	23%
From Euro 15,001 to 29,000	29%
From Euro 29,001 to 32,600	31%
From Euro 32,601 to 70,000	39%
Over Euro 70,000	45%

8.3 International taxation for residents of Italy

Taking up fiscal residence in *Italy* means that income earned in other countries will be subject to the respective double taxation treaty, depending on the kind, the amount and the source of income.

Accordingly, the double taxation treaties (see Section 7.7 above) provide that income derived by a **self-employed resident** of a contracting country (*Italy*) in respect of professional services or other activities of an independent character is taxable only in the country unless he/she has a fixed base regularly available in another contracting country (for example, the *United States*) for the purpose of performing his/her activities. If the person has such a fixed base, the income may be taxed in the other country but only so much of it as is attributable to that fixed base, or if the person is present in that other country for a period or periods not exceeding 183 days in any fiscal year.

With regard to salaries, wages and other similar remuneration derived by an **employed resident** of *Italy*, they are taxable in *Italy*, unless the employment is exercised in another contracting country (for example, *United States*). Salary derived by an Italian resident in respect of employment performed in another contracting country is taxable only in *Italy,* if the resident is present in that other country for a period or periods not exceeding 183 days in any fiscal year and if this salary is paid by, or on behalf of, an employer who is not a resident of that other country, and the salary does not come from a permanent establishment or a fixed base which the employer has in that other country.

9 Checklist: Real estate acquisition in Italy

- Are there **persons having right of pre-emption** (i.e. tenants), who could prevent or cancel the sale?
- Do **encumbering entries**, such as mortgages, easements or rights of way, exist?
- Does the real estate comply with the valid standards of land survey registration and **building law**?
- In case of a purchase/sale by **a married couple**, how is the spouse who is not the owner of the real estate treated in the contract?
- Is the seller a legal entity and has the risk of **bankruptcy** been taken into account?
- What was the amount of the **down payments** in the preliminary contract? Normally they will amount to 10%. Is their possible repayment secured?
- In certain regions of *Italy* (e.g. *Sicily, Southern Italy, Umbria*), the danger of **earthquakes** is quite high. Also other threats of nature (e.g. landslides, avalanches in the Alps, etc.) have to be taken into consideration.
- The risks of an incorrect statement of sale price on the sales agreement **(under-recording)** have to be considered.
- The **total cost** and taxes should be calculated in due time before entering into any real estate transaction.

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Contents: Malta

1 Introduction

The Republic of *Malta* consists of three islands, *Malta, Gozo* and *Comino*. They are situated in the center of the *Mediterranean Sea*, just 80 kilometers off the southern coast of *Sicily, Italy*. The climate is typically Mediterranean with mild winters, pleasant spring and autumn seasons and hot summers. *Malta* is the more heavily populated island; *Gozo* is quieter and more rural; whereas *Comino* is uninhabited.

The population is just under 400,000 and the official languages are *English* and *Maltese*. In practice everybody in *Malta* can speak *English*. The mainstay of the economy is tourism; the secondary pillars of the economy are the financial services sector, manufacturing, the semiconductor industry and the *Freeport*.

Malta became independent from *Britain* in 1964 after being a colony for nearly 200 years. It has been a Republic since 1974. It is a fully fledged democratic country with respect for the rule of law. *Malta* is a member of the major international organizations, including the *United Nations* and the *Council of Europe*, the *International Monetary Fund* and joined the *European Union* on May 1, 2004.

Malta has a sound infrastructure. Telecommunications, postal links, courier services, banking and all other services are, generally speaking, very efficient and of a very high standard. The national airline, *Air Malta*, operates 35 direct flight routes mostly within *Europe* and the *Mediterranean* regions and most major European airlines have frequent flights to *Malta*. There is a frequent sea link with *Italy*.

Malta traditionally is a civil law country and its laws are based on the *Roman law* and on the *Napoleonic Code*. Its legal institutions are very old and the law courts have been established on the island for many hundreds of years. *Malta*'s legal system is on a par with other European countries and the rule-of-law is jealously safeguarded.

Malta's laws are enacted by a freely elected Parliament and there is a strict separation of powers between Parliament, the Executive and the Judiciary, ensuring that *Malta*'s *Constitution* reigns supreme over any law that Parliament enacts.

2 Real estate ownership

2.1 Different forms and types of ownership

There is only one type of ownership, and that is outright title, but ownership can be limited in a number of ways: the more common limitations are the subjection of the ownership to the payment of *ground rent* (*emphyteusis*) or to the life enjoyment of a particular person (*usufruct*). Real estate can be co-owned by several persons either because they have purchased the real estate together or because they have inherited the real estate from a common *testator* (or through intestate succession). A co-owner cannot be forced to remain in co-ownership with the other owners and can ask for the liquidation of the co-ownership, either through agreement or through judicial partition.

Malta has recently enacted a *Condominiums Act* which regulates the administration of apartment blocks and has subjected most disputes to arbitration.

Every owner has the right to build on his/her property but this is subject to the planning regulations in force and not all real estate can be built on. The *Malta Environment and Planning Authority* has the function of issuing building permits.

Timeshare has spread in *Malta*, especially with regard to foreigners purchasing a right to a period of time for spending their annual holidays in *Malta* The sector was completely unregulated up to some time ago but has now been subjected to the *Doorstep Contracts Act* which deals with the matter. The most important issue is that a purchaser of a timeshare has the right to rescind (annul) the *contract* within 15 days of the agreement having been signed.

2.2 Easements, charges, liens and mortgages

There are a number of *servitudes* (*easements*) that can burden real estate; some are active and some are inactive and some depend on the location or situation of the particular real estate. Therefore, for example, there might be a right of way over real estate, a lower roof may be subject to the receipt of rainwater from a higher roof, existing windows and doors cannot be blocked. *Servitudes* can be created by agreement between two parties; sometimes they can be created unilaterally by will or by the 'decision of the owner of two tenements' and at times *servitudes* are created by law. It is important to check whether the property is subject to any *servitude* since some of them can be quite important and onerous and can limit considerably the enjoyment or development potential of the property.

There is no right to *retratto* and once the real estate has been sold it can never be recovered from the buyer. *Retratto* existed in the older law but it has long been abolished. Therefore once a seller has sold the real estate, there is no way he/she can recover it from the buyer.

The terms '*liens*' and '*mortgages*' do not exist under *Maltese* law. *Causes of preference* over immovable property are classified as being either *hypothecs* or *privileges*. A *hypothec* is usually voluntary and granted by agreement between the creditor and the debtor owning the real estate. A *hypothec* serves as security to ensure the repayment of a debt; the creditor holding a *hypothec* against the real estate will be able to claim payment of the debt in preference to other unsecured creditors. A property might be subject to multiple *hypothecs* which then rank according to their date of registration, with an earlier *hypothec* enjoying preference over a later one. A *privilege* is a cause of preference granted by operation of law in particular circumstances where the law considers that a particular creditor should enjoy a right of preference over ordinary creditors.

In all cases these causes of preference constitute a privileged title against the real estate and the charge over the real estate will follow the property, irrespective of who the owner is. A creditor enjoying a *cause of preference* over the real estate has the right to ask for the *judicial sale* of the real estate in satisfaction of his/her credit against it. It is naturally very important to check that no *hypothecs* or *privileges* are registered against a piece of real estate to ensure that no claims are entered against it after it has been bought.

Real estate can be subject to the ***usufruct*** of another person; *usufruct* is the right to the enjoyment of the real estate by a person different from the owner, and the most common form of *usufruct* is that granted in a will to the surviving spouse over the estate of the deceased spouse. Other forms of *usufruct* are very rare today.

Property can also be subject to *emphyteusis* (payment of a *ground rent*), which means that the buyer of the property, apart from paying the purchase price to the seller, will also have

to make an annual payment. There is a more complete section about *emphyteusis* below (see Section 3.3.3).

2.3 Protection of ownership, proof of ownership and registration

Ownership is proved primarily by notarial deed registered in the *Maltese Public Registry*. The registration system is rather primitive but effective. Every *notarial deed* of *transfer* of real estate is registered under the name of the seller and the name of the buyer; in order to prove ownership, a search is entered in the *Registry* on the name of the person alleging to be the owner, and if the searches reveal a contract of purchase and no subsequent contract of sale, then the ownership is proved. Liabilities (*hypothecs* and *privileges*) are registered in the same way and therefore if a search on an owner's name reveals no *liabilities* it means that the real estate is not burdened by debts.

More recently a *Land Registry* has been created which is recording a database of all real estate in *Malta* and is run by the government. Eventually once all real estate has been entered into the database, the old registration system will be phased out and it will be possible to obtain details of ownership and liabilities by looking up the individual property, rather than having to search for the owner's name.

3 Purchase and sale of real estate

3.1 The sales agreement

The sales agreement is divided into two parts: the preliminary agreement and the final deed of transfer. The preliminary agreement (convenium) is a private agreement between the seller and the buyer. It is usually drawn up by a lawyer or *notary,* even though it is possible for the parties to draw it up themselves. The *preliminary agreement* is an agreement between the parties whereby the seller promises to sell a given real estate to the buyer who promises to buy the real estate. The price and all the other conditions of the sale are fixed in the *preliminary agreement* and these conditions are binding and cannot be varied on the *final deed of transfer*, unless both parties agree to the changes.

The **preliminary agreement is binding** on the parties and none of the parties can opt out of the agreement unless there is a valid legal reason for doing so. Such would usually be the discovery of a defective title of the seller, an unavoidable burden on the real estate or the discovery of defects in the real estate. A party who changes its mind can be forced through legal action to buy (or sell) the real estate.

It is common practice today for the buyer to pay 10% of the purchase price to the seller, which is usually held in escrow by a notary public. Should the buyer opt out of the agreement with no valid reason at law, then, instead of forcing the purchase through judicial action, the seller has a right to retain the sum paid on account of the price.

The *preliminary agreement* is usually valid for three months during which period a notary public will undertake researches in the *Public Registry* with the aim of collecting enough information to satisfy the buyer that the seller has title to sell the real estate and that the real estate is not burdened by *hypothecs*, *privileges* or *servitudes* that have not been disclosed.

A recent change to the law in *Malta* has imposed on the parties the obligation to register the preliminary agreement with the *Maltese Inland Revenue* and 1% of the purchase price is now payable to the *Inland Revenue* on account of the final transfer duty (5%). Preliminary agreements which are not registered will have no legal validity and will not be enforceable against a defaulting party.

Once the buyer is satisfied, then the notary public will publish a *final deed of transfer* which effectively *transfer*s the title to the real estate once the deed is registered in the *Public Registry*. The notary must register the deed within 15 days from publication.

The only legal form of *sales contracts* are those published by a notary public and any sale done by private agreement between the parties without being formalized before a notary public has no effect.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

Property purchased by a married couple who have been married and domiciled in *Malta*, or who have established themselves in *Malta* subsequent to their foreign marriage, is considered to belong to the spouses in equal portions, through the *community of acquests*. Although it is the practice to have both spouses appear on a contract, a property bought in the name of one of the spouses is still presumed to belong to the community of acquests. However, if the buyer can prove that he/she has used his/her own assets not belonging to the community of acquests to purchase the property, he/she would have a claim equal to the purchase price against the assets of the community. Husband and wife are prohibited from selling property to each other.

Real estate is governed by the *lex situs* and therefore Maltese real estate will always be subject to Maltese law and it is not possible to change or choose the law that will govern real estate. Foreigners who purchase real estate after they have established themselves in *Malta* will become subject to the community of acquests regime; they can, however, opt out of this by entering into a public deed prior to their establishment in *Malta*. They can also opt out of the community of acquests if this has already become operational, but they would need the authorization of the Civil Court.

3.2.2 Options and pre-emption rights

It is possible to establish a *right of first refusal* for a property, in which case, before selling freely on the market, a seller would be obliged to offer the sale to the person enjoying the *right of first refusal*. This right can only be granted contractually and there is no such right granted by the operation of law.

Property can, of course, be rented out to third parties and rental agreements are private agreements that are not registered in the *Public Registry*. Therefore it might happen that a property that is sold is subsequently found to have been rented to third parties by a previous owner. *Malta* has very particular rent laws whereby rentals granted by an owner prior to June 1995 will never expire except in very particular circumstances and are also inherited by subsequent generations. It is, therefore, very important to ensure that the real

estate being purchased is not leased or rented by the seller. The sales *contract* will usually specify that the real estate is being sold 'with vacant possession' and if this is not found to be the case, then the buyer will have a right of action against the seller for rescission of the contract.

3.2.3 Agricultural real estate

There is no difference between the purchase of urban and agricultural real estate. However at the present moment, foreigners from outside the *EU* are not allowed to purchase industrial or agricultural real estate and are only allowed to purchase residences.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

There is at the moment no discrimination between nationalities and any foreigner can purchase real estate for residence, but not agricultural or industrial property. However every purchase must be authorised by an *AIP Permit* (*Acquisition of Immovable Property Permit*) which, although a mere formality, limits the right to own only one property at a time.

Following *Malta*'s accession to the *EU*, a new regime came into force concerning *AIP permits* which will still, however, be required for all non-Maltese purchasers who are not resident in *Malta*, whether the purchaser is an EU citizen or not. Non-EU citizens will still only be able to buy one residential property and nothing else.

EU citizens who are buying their first real estate in *Malta* and who are not resident in *Malta* will require an *AIP Permit* which will always be granted subject to the minimum price being adhered to whereas EU citizens who are resident in *Malta* will be free to buy a first property without restrictions. The situation changes as regards the purchase of a second property and no person, whether an EU citizen or not, will be allowed to buy more than one property. The only exception will be for EU citizens who have been residing in *Malta* for more than five years who will be free to buy a second property.

There are certain areas in *Malta*, usually the more costly and upmarket developments (called *Designated Areas*) where no *AIP Permit* is necessary and where there are no restrictions on the number of properties that can be purchased. In these areas foreigners are allowed to buy more than one property and are entitled to rent the real estate to third parties, but they must declare the rental income to the Maltese *Inland Revenue.*

Rental of other property in a non-designated area is only allowed if the property is an independent villa with a swimming pool; again the income must be declared to the *Inland Revenue.*

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

Every seller and every buyer must have the legal capacity to act; therefore they must be capable of contracting under *Malta*'s civil law and if they are acting on behalf of others, they must be duly authorized by a *power of attorney.* Although it is possible to have a verbal

power of attorney, it is the practice to reduce this to writing and where it is executed outside of *Malta*, it is usually witnessed by a foreign *notary public* or Maltese *consular office*, and although this is not mandatory it is recommended.

3.3.2 Third-party claims and unpaid taxes

Third parties cannot claim any rights against the real estate or against its new owners unless their right has been registered and protected by a *hypothec* or *privilege* (see above) or unless they enjoy a *servitude* or *usufruct* (see above). However, tenants of real estate cannot be evicted just because there is a change in ownership of the real estate. There are no taxes on property in *Malta* and therefore there will never be unpaid taxes burdening the real estate; any personal tax owed by the seller will never have any effect on the real estate being sold, unless the unpaid tax has been registered and protected by *hypothec* or *privilege*.

Emphyteusis (ground-rent)

In *Malta* there is a particular legal institution called '*emphyteusis*' which comes from *Roman law* and is very widespread. It can have very important consequences at law and therefore must be carefully considered. *Emphyteusis* can only be created by *public deed* and therefore will result in *notarial* searches.

Emphyteusis is a charge imposed on the real estate for an annual payment by the buyer to the seller of property; the payment is called ***ground rent***. It is common to find that real estate is sold for '*x*' Maltese liri subject to an *emphyteusis* attracting a *ground-rent* of '*x*' Maltese liri. This means that the buyer, notwithstanding that he/she has paid the full price to the seller, would still be bound in addition to make the annual payment of the *ground rent*. No matter how small the charge is in monetary terms (sometimes it can even be a few cents per year), the *ground rent* must be paid.

If the *ground rent* is not paid for three years, the person entitled to receive the *ground rent* can ask the court to impose a term for payment on the debtor, and if the *ground rent* remains unpaid, **the court will order the real estate to revert to the creditor of the *ground rent***. It is therefore very important, especially for foreigners, to make sure that they pay the *ground rent* annually. It has happened sometimes that foreigners owning real estate subject to *emphyteusis* do not come to *Malta* for a number of years and forget to pay the *ground rent*; and once they return they find that the court has ordered the reversion of the real estate to the *beneficiary*.

Moreover, *emphyteusis* can either be temporary or perpetual and can be revisable. Where the *emphyteusis* is temporary, the real estate will revert to the *beneficiary* when the period of *emphyteusis* expires. Therefore the buyer will only be the owner for the specified period of time. Where the *emphyteusis* is perpetual, this does not arise.

Perpetual emphyteusis can be cancelled (redeemed) by the buyer by making a one-time payment to the beneficiary of the *ground rent*. The payment is calculated at 20 times the ground rent for one year. Therefore if the *ground rent* is 1 lira, the payment due will be 20 liri and payment of this sum will free the real estate from the *emphyteusis*.

Where the *perpetual emphyteusis* is revisable (that is the *ground rent* is revised from time to time depending on certain conditions), then it can only be redeemed after the first revision.

It is important to ensure that the real estate one is buying is not subject to *emphyteusis*, and if it is so subjected it is important to make sure of the terms and conditions of the *emphyteusis* prior to acquisition of the real estate. These terms and conditions can be onerous and must therefore be investigated in detail prior to the acquisition.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Environmental protection, preservation of the countryside and protection of historical monuments are within the powers of the *Malta Environment and Planning Authority*. *Malta* is divided into 'building' and 'green' areas and it is very difficult to obtain any form of permit to develop 'green' areas. Also, restrictions apply even within the building areas and not every kind of development is possible; certain real estate are scheduled in varying grades and development is only allowed according to the scheduled grade of the real estate. Historical monuments or houses of historical importance cannot be purchased by foreigners.

3.3.4 Access to relevant records and documents

Registries and documents are not usually checked by the buyer but by the notary public who then passes on the collected information to the buyer's legal firm for vetting of title and *liabilities*. Although it is not always the practice for a buyer to engage a legal firm, it is not correct to rely on the notary's searches since a notary has no right to give advice to either of the parties and, moreover, a notary public has no professional responsibility for interpreting the results of his searches in the *Public Registry*. Therefore, engaging the services of a lawyer besides those of a notary public is recommended.

A buyer would also do well to engage the services of an architect to inspect the building for structural problems and also to check with the *Malta Environment and Planning Authority* that the real estate has been built according to the proper permits.

3.4 Key points that a seller should consider

Although the law does not regulate how expenses necessary to formalize the *contract* are to be paid, the following practices have in time become consolidated, so that it will be very difficult to get parties to agree differently.

Transfer tax is paid by the buyer in addition to the agreed price; *notaries' fees* and researches are paid by the buyer; *capital gains tax* is paid by the seller; *estate agent's fees* are paid by the seller; *lawyer's fees* are paid by the party engaging the lawyer; and *architect's fees* are paid by the party engaging the *architect*.

3.5 The execution of a real estate purchase transaction

The execution of the purchase contract must be done through a notary public who will, within 15 days, register the contract in the *Public Registry*. Any other form of execution is not valid and is of no consequence. A deed of transfer which is not registered in the *Public Registry* by the notary will have effect between the contracting parties but will not bind third parties until it is registered. A notary who omits to register the contract will be liable for damages.

3.6 Powers of attorney

Powers of attorney, under Maltese law, can be verbal or written, and both versions are valid. However, in practice, only the written form is used in contracts of sale and a copy of the power of attorney is usually attached to the original contract of sale. Powers of attorney executed outside *Malta* are usually witnessed by a Maltese consular officer or by a foreign notary public. Although this is not mandatory, it is advisable.

Spouses who sell real estate of the community of acquests are both required to sign the transfer deed; in practice many times the husband only signs the deed using a power of attorney from his wife; this power of attorney between spouses is regulated by a particular Maltese law which requires a notary or lawyer to witness the power of attorney and to state on it that he/she has warned the spouses of the gravity and importance of the power of attorney. A spouse who can prove that a power of attorney used by the other spouse was irregular will have a right of action to annul the sale of the real estate.

3.7 Financing

Financing can be carried out in three ways. The seller may accept to transfer the title of the real estate to the buyer although the full price may not yet have been paid. In this case, the buyer would normally agree on the contract to make monthly (or other periodical payments) to the seller and to pay an agreed interest rate which cannot be more than 8% per annum. If interest is stipulated in excess of 8% the debtor can refuse to pay the excess, and if the excess has been paid it can be recovered by the buyer. Where part of the purchase price is paid to the seller after the title of the real estate has been transferred, the seller on the sale contract would reserve in his/her favour a special *privilege* over the real estate being transferred, and this *privilege* would be registered in the *Public Registry*. The effect of the *privilege* is that the seller's right of preference to recover his debt would follow the real estate, even if the buyer sells it to a third party. If the buyer or subsequent third party defaults on payment, the seller can bring a judicial action to have the property sold by auction and the seller would be paid from the proceeds of the judicial auction.

Alternatively, the buyer can seek financing from a private person. Where the foreigner contracts a loan, it would be the practice to register a *special privilege* in the lender's favour against the real estate to ensure repayment of the loan.

A third option is for the buyer to seek a bank loan from one of the commercial banks. These are easily available and banks would normally finance up to 90% of the purchase price. Banks protect their loans by also registering a *special privilege* against the real estate being sold.

3.8 Purchase through a company

At the moment Maltese law does not allow foreigners to purchase real estate through a corporate structure, whether incorporated in *Malta* or outside *Malta* Therefore no *AIP Permit* will be approved unless the applicant is a physical person. However, corporate structures are allowed to buy real estate within the *Designated Areas*.

3.9 Defects and warranty claims

The Maltese civil code by operation of law imposes an obligation on the seller to guarantee the real estate sold against *latent defects* and *peaceful possession*. The two warranties can be

excluded by the parties to a sales contract if they agree on this. *Latent defects* are defects in the real estate which the buyer could not have reasonably discovered for him/herself. *Peaceful possession* means that the buyer will not be molested or hindered in his enjoyment of the real estate by third-party claims. In both cases the buyer has a right of action against the seller for restitution of part of the price or for rescission of the sale.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

All building or modifications to buildings must be preceded by an application to the *Malta Environmental and Planning Authority*. If building is undertaken without a permit, the authorities have the right to stop the works by issuing an *Enforcement Notice* and eventually they have a right to demolish illegal constructions; only in certain cases can the breach be remedied by paying a large fine.

Buildings that have been constructed without the necessary permits will not be connected to water and electricity services. Moreover it will be very difficult to resell buildings that are not covered by a regular building permit. Banks will not lend money to buyers if the real estate is not covered by a proper building permit. Therefore, it is important that a buyer engages the services of an architect who can check that all the permits are in order.

4.2 Architect's and building contracts

It is not very common in *Malta* to have a contract signed with the architect or builder because their responsibilities are in any case regulated by the law. *Malta* is a civil law country which means that damages are automatically imposed on parties who default on their obligations, the main obligation being that agreements must be carried out in good faith and according to the necessary standards of diligence. Therefore both the architect and the builder are responsible for the stability of the building for a period of 15 years and any work they undertake must be completed satisfactorily. Independently of whether there is a contract, their responsibilities cannot be avoided. That being said, it is still advisable to engage a legal firm to draw up a contract with both parties.

4.3 Completion of construction and formalities

There are no formalities to complete when the construction is finished, except that a building inspector from the *Malta Environmental and Planning Authority* will visit the premises and issue a certificate stating that the building complies with the relative permits.

4.4 Deficiencies and warranty claims regarding new construction

This has already been covered above and, as stated, both the architect and the builders have a responsibility at law to guarantee the construction for a period of 15 years.

5 Rental and tenancy

5.1 Rental and lease agreements

There is no difference in Maltese law between renting and leasing agreements, which both mean the same thing. Maltese rental agreements are especially complicated but the

situation has become more stable since 1995. Prior to 1995, complicated rules made it nearly impossible to evict a tenant or to raise rents with the result that the rental market in *Malta* was almost non-existent. Buyers who might suspect that the real estate they are purchasing has been leased to third parties before 1995 would be well advised to seek legal advice before proceeding further.

Since 1995, all new *rental agreements* have been freed from the regulations of the old laws and the terms and conditions are now governed by an agreement signed between the parties. It is not necessary to register these agreements in the *Public Registry* and, in theory, they can be written by the parties and signed by them. However, in practice, rental agreements are drawn up by legal firms or by notaries.

There is no restriction on rentals by foreigners and any foreigner can rent anything at any price and for any period of time. Foreigners renting property can, under certain conditions, re-rent it to third parties but this income must be declared to the Maltese tax authorities. Foreigners holding a *Permanent Residence Permit* must rent at a price of at least Euro 4,230 per year.

5.2 Regulations on protection of tenants and rent control

As stated above, prior to 1995, there were many rules which protected tenants and these applied mainly to Maltese tenants who used the rented houses as their ordinary residence. These have been abolished for agreements signed after 1995 and today all new rental agreements are regulated by the terms and conditions agreed upon in the contract.

6 Successions and gifts

Inheritance in *Malta* is regulated by the Civil Code and includes forced heirship provisions.

6.1 Applicable law and jurisdiction

As a general principle, the law of the country where the real estate is situated (***lex situs***) will regulate the way real estate is inherited. On the other hand, the succession to the movable estate of a foreigner passing away in *Malta* will be regulated by the law of his/her domicile.

6.2 Fundamentals of the succession and gift/donation laws of Malta

Immovable property situated in *Malta* is subjected to Maltese law as the *lex situs* and, therefore, foreign wills regarding Maltese property will only be recognized and enforced if they follow, at least in broad principle, the dictates of *Maltese Civil Law.* For a foreign will to apply, the will would need to follow three main conditions: (i) the foreign will must be validly drawn up according to the laws of the country where it is drawn up; (ii) children cannot be completely excluded from the inheritance of their parents; (iii) couples with children cannot leave more than 25% of the real estate in ownership to the surviving spouse but can leave each other the *usufruct* over their state (life enjoyment); a recent change to the Maltese Civil Code now allows the testator to leave his whole estate to the surviving spouse on condition that the children receive at least the legitim (reserved position) due to them. This law will come into effect in 2005.

It is usually sensible to draw up a will in *Malta* to regulate the Maltese real estate. Wills are drawn up by a notary public and usually a married couple will draw up a common will (*unica carta*) which means that the dispositions of the will become effective with regards to the heirs only when both of the parties have passed away; a surviving spouse will not normally be able to vary such a will though this can be authorized in the will itself.

Until recently if the parties did not draw up a will, the property was inherited according to the rules of intestate succession which meant that the children would inherit the property and the surviving spouse would not receive any part of the husband's estate except for the usufruct over half the deceased's estate. A recent amendment to the Civil Code (which will come in to effect during 2005) has changed this situation so that in intestate succession a surviving spouse will inherit half of the deceased's estate in ownership and the other half will be inherited by the children. A surviving spouse also retains the right of habitation in the matrimonial home.

It is possible to donate real estate and this is treated as a transfer for all intents and purposes. Therefore donations must be done by deed published by a notary and registered in the *Public Registry. Transfer tax* at 5% must also be paid on donations. Husband and wife cannot make donations to each other.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

Every transfer of real estate attracts the payment of 5% duty, paid to the notary. The notary will pay the duty to the *Inland Revenue.* 1% is paid with the preliminary agreement and 4% with the publication of the transfer deed.

7.1.2 Sales tax (value added tax)

Malta taxes **capital gains** made from the resale of real estate. Tax is levied where the seller has not owned the real estate for more than three years as his/her Maltese residence. If the seller had resided in the real estate as his/her ordinary residence for at least three years prior to the resale, there is no capital gains tax.

Capital gains is considered to be the difference between the acquisition and the sales price, less some minor deductions for maintenance of the real estate, etc. Capital gains are added to the seller's normal income for the year of the sale and are then treated as ordinary income for the purposes of taxation. Therefore the rate at which they are taxed depends on the *tax ceilings* (bands) in force at the time. At the moment, in practice, capital gains are usually taxed at 35%.

In order to secure the payment of capital gains, at the moment of signing the *transfer deed*, the notary will by law deduct 7% of the transfer price and pay this to the *Inland Revenue* on account of the tax liability.

7.1.3 Real estate registration and notary charges

The land registration and *Public Registry* fees are minimal and are of little concern to the parties. *Notaries* will usually charge a fee of 1% of the purchase price, plus disbursements for copies, searches, etc. The cost of searches has increased considerably in the last few years and it is normal to allow for that in the real estate budget. Lawyers representing either the buyer or the seller will usually charge around 2% of the purchase price.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

There are no real estate taxes or rates.

7.2.2 Income tax

There is no wealth tax in *Malta* and income tax will not be affected by the real estate's value except in the case of resale where capital gains tax can come into play.

7.2.3 Net wealth tax

There are no recurrent taxes or fees due and once the real estate is bought, there is nothing else to pay. There are no local council rates, waste collection rates or similar. There is no *wealth tax* in *Malta*.

7.3 Capital gains tax

The only tax payable on sale is capital gains tax, which is tax paid on the difference between the purchase price and the sale price. It is the same as general income tax, with a maximum tax rate of 35% for gains (income) over Lm 15,000. There are exceptions in case the real estate serves as one's main domicile.

7.4 Inheritance and gift taxes

There is no succession duty in *Malta* on movables, but the *transfer* of real estate by inheritance attracts payment of duty at 5%. Duty is paid to a *notary public* who will then publish a deed transferring the real estate to the heirs. It is the *notary public*'s obligation to pay the 5% duty to the *Inland Revenue*.

The same can be said for gift tax. Gifts/donations of immovable property are taxed at 5% but there are certain exceptions for donations to family members where the tax payable is reduced. There is no gift tax on movables.

7.5 Other taxes and charges

There are no other taxes or fees involved with the sale or purchase of real estate.

7.6 Incorrect (lower) statement of sale price on the sales agreement

It used to be an unfortunate practice in *Malta* to under-declare the value of real estate to mitigate the payment of transfer taxes and capital gains tax. This is not recommended and

can have negative consequences in the long run for the buyer. Firstly, the *Inland Revenue* has the right to fix the 'estimated market value' of the real estate and levy tax on the 'undeclared' portion; there is also a fine equal to 10 times the value of the evaded tax, but in practice this is very rarely invoked.

The consequence of under-declaring the value of real estate can be considerable. Should the buyer in time sue the seller for rescission of the contract because of defects in the construction or because of faulty title, the courts will invariably order the seller to refund only the price that appears on the contract and no proof is allowed to show that part of the price was not declared to the notary public. Apart from that, if the purchase price is low, capital gains on the resale will be higher because the difference in price between the low purchase price and the resale price will be higher.

A new provision of Maltese law now makes it mandatory on the parties to a preliminary agreement to register the agreement with the *Inland Revenue* and to pay 1% of the purchase price on account of the eventual transfer tax of 5%. Unregistered agreements will have no legal validity. This should substantially reduce the problem of under-declaration of the purchase price.

7.7 International taxation

Malta has negotiated 32 double taxation treaties, mostly with the *EU* countries.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Malta has aligned itself to the *Schengen Area Agreement* and therefore any foreigner needing a visa for the Schengen Area will require a visa to enter *Malta*.

A foreigner can live in *Malta* either as a *permanent resident* or as a *temporary resident*.

A temporary resident can stay in *Malta* for a period of three months and this can be extended by applying to the *Immigration Section* of the *Malta Police. Extended visas* are granted for a maximum period of one year and are easily renewable provided the applicant can prove that he/she has sufficient means to maintain him/herself. A *temporary resident* who remains in *Malta* for more than 180 days becomes liable to tax the same as any ordinary *Maltese resident*. Rates start from 10% and go up to a maximum of 35%.

A permanent resident can stay in *Malta* indefinitely without the need to have a visa. A permanent resident pays tax at 15% only on income remitted to *Malta* but the global estate is not taxed in any way.

8.2 Tax residence

Malta is an ideal place to establish one's tax residence by taking advantage of the *Permanent Residence Scheme*. This scheme enables a foreigner to assume a Maltese tax residence and will for all purposes be considered to be a Maltese taxpayer, paying tax at the special fixed

rate of 15%, but only on income remitted to *Malta.* Income not brought to *Malta* is not taxed at all.

Fiscal residence in *Malta* is not difficult to establish and its main advantage is that it does not require a minimum period of actual residence in *Malta.* The only requirements are that the permanent resident rents an apartment and pays a minimum annual tax of Lm 1,800 (approx Euro 4,500).

8.3 International taxation for residents of Malta

Malta has double taxation treaties with most countries in *Europe*, with the exception of *Switzerland* and *Ireland*. The double taxation treaties are all based on the *OECD Model Treaty* and will generally mitigate tax considerably.

9 Checklist: Real estate acquisition in Malta

- Do not sign a preliminary agreement before you have taken legal advice.
- With the preliminary agreement, expect to pay 10% of the purchase price as a deposit on account of the final payment and 1% on account of eventual transfer tax.
- Do not underdeclare the purchase price.
- Appoint a notary of your own choice.
- Get legal advice about the notary's researches before signing the final deed.

Taxes and charges are as follows:

- 1% of the purchase price for the notary public.
- Up to 2% of the purchase price for legal advice.
- 5% of the purchase price as transfer tax.
- A small sum (equivalent to a few hundred Euro) for researches in the Public Registry.
- Capital gains tax is always paid by the seller.
- Estate agents are paid by the seller.
- Funds used to buy real estate should be brought into *Malta* through a Maltese bank account.

10 Bibliography

There is no relevant literature available.

11 Addresses

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Monaco

Principality of Monaco
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1 Introduction

The *Principality* of *Monaco* is a sovereign state on the Mediterranean Sea, entirely surrounded by *France*. It is situated 22 kilometers from *Nice* and some 20 kilometers from the Franco-Italian border at *Menton-Ventimiglia*. The form of government is a constitutional monarchy, with strong executive powers reserved for the Sovereign Prince. The *Grimaldi* dynasty has ruled *Monaco* since 1297.

The country is one of the world's smallest states territorially (197 hectares). There are some 7,000 Monegasque citizens. Foreign residents comprise the remainder of the 32,000 residents.

Monaco's independence has been historically guaranteed by *France*, through a series of treaties concerning many aspects of political and financial life. The treaties are currently under reconsideration, following *Monaco* attaining full membership in the *United Nations* in 1993. *Monaco* became a member of the *Council of Europe* in 2004, a process that has caused considerable reconsideration of political structures, in accordance with that organization's requirements. It is the very strongly voiced desire of Sovereign Prince *Rainier III* that *Monaco* adheres to the *Council of Europe*.

Monaco is not a member of the *European Union*. However, a customs union exists with *France*, with the result that some of the advantages of the free exchange of goods apply to *Monaco* identically as they do to its neighbor. The currency is the Euro. *Monaco*'s tax system is independent of *France*, although French nationals, with some exceptions, are considered to be residing in *France* for income tax purposes if they reside in *Monaco*. Similarly, value added tax is applied in *Monaco* in an identical manner, and with identical rates as in *France*, the standard rate being 19.6%.

The legal system is entirely independent of *France*, but the legal *Codes* (*Civil Code, Penal Code, Code of Civil Procedure, Code of Criminal Procedure, Commercial Code*) are based on the *Napoleonic Code*, with some important differences from *France*. The court system again is similar to the French system, and a number of the sitting magistrates are French judges seconded to the *Principality*, who however swear allegiance to the Prince. Money laundering legislation has been enacted and is strictly enforced.

As regards real estate, the system adopted by *Monaco* is similar to the French system, but entirely independent. *Monaco* has its own estate registry. Taxation of real estate transactions is entirely established by *Monaco* law.

Monaco is generally divided into five areas: *Monacoville, La Condamine, Moneghetti, Monte-Carlo* and *Fontvieille*. The original part of *Monaco* is *Monacoville*, where the Palace of the *Grimaldi* family is situated, and *La Condamine*, where *Port Hercule*, a port known to the ancient Greeks, is found. *Monte-Carlo* was developed in the mid-1800s, when the famous casino was built. *Moneghetti* is a residential area bordering *France* on the west side of the *Principality*, with a number of older buildings. Finally, *Fontvieille* is a new town, built on 22 hectares of landfill into the sea beginning in the 1970s, which now houses a stadium, commercial center, a hotel and housing going from public housing to some of the highest cost buildings in the *Principality*.

2 Real estate ownership

2.1 Different forms and types of ownership

Ownership of real estate in *Monaco* can take a number of forms, but the general manner of ownership is the equivalent of fee simple, that is outright ownership of property. The most common form of ownership is the ownership of a **condominium apartment**. The cooperative form of ownership is unknown. In the condominium apartment, the owner owns the walls, and a percentage of the common areas. The relationship between the various owners in the building is regulated by a set of statutes adopted by the building co-owners, and binding on their successors. Ownership is perpetual and not limited in time.

While timesharing properties are not illegal they are not used in the *Principality*.

2.2 Easements, charges, liens and mortgages

Through a **'usufruct'** the various ownership interests can be divided, so that one person may have the right to occupy the real estate during his/her lifetime (*usufruit*), with the other owners having a reversionary interest at death (*nue propriété*).

It is also possible to grant **a long-term lease** (*bail emphytéotique*) to a party, which is a ground lease, with the property reverting to the owner at the end of the lease. This form is most commonly used on government-owned land leased for development purposes.

Real estate may have *servitudes* granted between private parties or with the state. The most common forms of servitudes are those relating to rights of passage of public utility facilities (cables, pipes, etc.). But it is also possible to obtain servitude on neighboring real estate which will preserve, for example, a particular view.

Real estate may also be burdened by liens and encumbrances, relating to debts of the seller, or financing by banks, or to undertakings made to third parties.

2.3 Protection of ownership, proof of ownership and registration

Only notaries (of which there are three in the *Principality*) may register a transfer of title to real estate at the **Registry of Deeds** (*Conservation des Hypothèques*), the property register. Proof of ownership is established by establishing an unbroken chain of title for 30 years, by the depositing of the 'authentic act' of purchase in the notary's minutes *('au rang des minutes*'), and by registering the authentic act at the *Registry of Deeds*.

The notary will then produce an *attestation* as proof of ownership by the buyer, and the certified copy of the act of purchase. In the case of the purchase of a company, ownership of the shares will evidence ownership of the company assets.

3 Purchase and sale of real estate

3.1 The sales agreement

The Monegasque *Civil Code*, as regards sales, considers an agreement between two parties to be 'perfect' when there is an **agreement as to the price to be paid and the thing to**

be sold. Because of this, a private agreement between a seller and a buyer as to the sale of real estate, where the real estate is sufficiently identified and the price is agreed, or can be determined by the contract, can be enforced at law.

The private sale cannot be registered at the *Registry of Deeds* without the intervention of a notary, but it may be registered at the tax office, to give it certainty as to its date. The registration at the tax office will require payment of 6.5% registration tax, applied to the value of the contract.

In order for title in the real estate to transfer then to the buyer, a court order will be required, which means that absent agreement to sign before a notary, a lawsuit will be necessary.

Most sales agreements are accompanied by the **deposit of 10%** of the value of the purchase price, **usually in escrow** with the notary or with the lawyers charged with the sale in the event of a transfer of shares of a company owning real estate in *Monaco*. Thus, the sales agreement that results in a lawsuit (a rarity in the *Principality*) will put at risk the buyer's deposit, and the seller's title. In effect, if the buyer sues to enforce the private sales agreement, then the buyer will 'publish' at the registry the fact that a lawsuit concerning title to the real estate is pending. All buyers will then be 'on notice' and will purchase subject to that risk.

The more formal sales agreement, which may but does not have to be entered into in the presence of a notary, is known either as a ***compromis*** or as a ***promesse unilatérale de vente***. The difference between the documents, in Monaco law, is similar to the difference in French law. With the *compromis*, there is an agreement on the price and the object of the sale, usually subject to **conditions precedent**. Once the conditions precedent are fulfilled, there is then a perfect sale. A court may order the transfer of title to a property if all conditions precedent are fulfilled, but one of the parties refuses to complete.

With the ***promesse unilatérale de vente***, however, there is only an option to purchase, which may or may not be exercised. If it is not, the consequence is that the potential buyer's deposit is lost. But the title to the real estate will not be ordered to be transferred by the competent court, because there has been no agreement of sale. In fact the *compromis* will state 'Seller sells and Buyer buys …' whereas the *promesse unilatérale de vente* will state 'Seller grants the right to purchase to the Buyer, who will exercise that right by …' and specifies the dates and the manner in which the option to purchase can be exercised.

The sales agreement in either case can be in the form of a private contract or of a notarial contract. It can remain unregistered or be registered, in order to give notice to third parties.

It will also contain undertakings that the real estate to be sold will not have mortgages superior to the purchase price of the real estate, a precise description of the real estate, and a referral to all *servitudes* concerning the real estate, or to the fact that there are none other than those in the preceding sale documents.

In general, the initial sale agreement is an offer drafted by a real estate agent in *Monaco* on behalf of one party, the buyer usually, and accepted by the other party. The parties may then enter into a more formal agreement, or may proceed directly to the notarial sale of the real estate. The *compromis* or *promesse unilatérale de vente* will generally be drafted by a notary or by other lawyers in *Monaco*, including foreign lawyers, where the transfer of real estate is concluded by transferring shares of a non-Monegasque company. The real estate agent is required to have a mandate either from the seller or from the buyer.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

Where married individuals are selling real estate, it is possible that because of the matrimonial regime to which they are subject, the spouse could possibly have an ownership interest, despite the fact that the real estate's title is in the name of one spouse only. This would be the case where spouses are considered married in the '**community property regime**'. It is necessary in those cases to obtain the consent of the other spouse for the sale of real estate. There is also a requirement to obtain a spouse's consent to sell the matrimonial home.

3.2.2 Options and pre-emption rights

Similarly, unless it is stipulated in the documents of purchase of the real estate, there is generally no statutory right to pre-emption on real estate. Tenants, for example, do not, unlike in *France*, have a first right to purchase the apartments they occupy, in the absence of a clause to that effect in the lease, which is exceedingly rare. A right of pre-emption will only exist when stipulated in the *acte de vente*, and, as a result, few properties are so burdened.

3.2.3 Agricultural real estate

There is almost no agricultural real estate in *Monaco*, and therefore no special provisions exist in this regard.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

There are no restrictions on the acquisition of real estate by foreigners in any part of *Monaco*. **Certain apartments are reserved**, for rental purposes, to persons having a certain length of residence in *Monaco*. Other apartments, owned by the state, are reserved for persons having special needs or special rights as regard their low income or their Monegasque nationality.

But all real estate on the market is freely purchasable by foreigners, either directly in their own name, or through companies. **There is no prohibition to purchasing a real estate through an 'off-shore company'** – as there will be no taxation in any event either of the ownership or on resale.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

The notary, if the real estate is being sold, or the lawyer, in the event that a company holding real estate is sold, will verify the capacity of seller and buyer. If one of the parties is a physical person, then the verification will consider whether the party is competent to buy or sell, whether they are adults (in *Monaco* the age of majority is 18 years but foreigners are assessed in accordance with the age of majority in the country of their nationality).

As regards companies, a lawyer should verify that they exist, are in good standing in their jurisdictions, and that their directors or administrators have full capacity to act. For that purpose they will demand certificates of incorporation, certificates of good standing and certificates of incumbency. For companies from civil law countries, extracts will be required from the corporate registries.

3.3.2 Third-party claims and unpaid taxes

The notary or a lawyer will verify with the *Registry of Deeds* that the real estate is not burdened with mortgages or other liens and encumbrances. It is rare to find a tax lien in the *Principality* because there are **no real estate taxes** and **no occupancy taxes**. More typically, there may be a lien to secure the recovery of common charges of the building that may have remained too long unpaid. In all instances, a strict verification of the origin of the funds used by the seller to purchase originally, and by the buyer will be necessary to satisfy money laundering laws.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

There is no particular legislation for the protection of the countryside or as regards environmental protection. Building permits in general, and modifications of façades in particular, will only be granted after the approval of the *Service de l'Urbanisme*, which will take the aesthetic aspect of the building under consideration.

3.4 Key points that a seller should consider

The seller should inform the buyer of any **hidden defects** of which he/she is aware. The preliminary contracts and deed should relate any **apparent defects** in the real estate so that the buyer cannot deny having been informed.

It is not customary to subject a purchase to a satisfactory survey.

The seller will not be concerned regarding the taxation of the gain resulting from a sale, because there is **no capital gains taxation**. However, he/she should preserve all invoices from works done on the property to ensure that his/her buyer may have recourse against the contractors. He/she should also be able to justify approval by the authorities of all modifications of the interior layout of the apartment.

The seller needs to be concerned about the **capacity of the buyer to pay** and the **source of funds** used for the purchase. The source will be verified by the notary or the lawyer charged with the transaction. Nonetheless, the seller is not exempt from making a **declaration of suspicion** regarding the origin of the funds should any suspicious facts regarding the buyer come to his attention. Real estate commissions are usually charged to the seller, at 5% plus value added tax. They may also be requested of the buyer, at 3% plus value added tax.

3.5 The execution of a real estate purchase transaction

Because any modification of apartments or houses in *Monaco* requires the approval of the *Service de l'Urbanisme*, it will be necessary to verify when purchasing whether any works have been completed without such an authorization. The notary will do this by reviewing the last registered plan for the property and the current description.

The *Registry*, on the other hand, will record all modifications in the ownership, all liens and encumbrances. The *Registry* is very much up to date in the *Principality* with the result that it is possible to personally consult it prior to purchase to determine whether there are any pending transactions with regards to the same property.

Buyers normally pay the **registration costs** of the purchase. If the purchase is of real estate (rather than shares of a company) then the documentation will be by *acte authentique*, which can only be signed **before a notary**. The notarial fees and registration costs are 9% of the purchase price.

If the purchase is of shares of a company, then unless the company is a Monegasque civil or commercial company, there will be no registration costs. Registration of the transfer of shares is required if the company is a Monegasque company (typically a Monegasque '*société civile immobilière*'). In that case the transfer documentation (sale of shares) is taxed at 6.5%. Transfers of company shares may take place by *acte authentique*, before a notary, but frequently are completed before accountants or lawyers.

Ordinarily, then, the purchase of real estate is executed before one of the three notaries of the *Principality*. The notary guarantees 'good title' in the real estate and the absence of all liens and encumbrances.

The notary will have verified the prior ownership of the real estate (the '*origine de propriété*') to ensure that there are no clouds on title during the period of 30 years (the statutory limitations period). Because of the small size of the *Principality* and due to the fact the *Registry of Deeds* has virtually no delay in the registration of documents, disputes as to title in real estate are very rare in the courts. Real estate commissions are usually charged to the seller, at 5% plus value added tax. They may also be requested of the buyer, at 3% plus value added tax, but are freely negotiable.

3.6 Powers of attorney

Individuals selling or buying real estate must either be present or grant a power of attorney to a third party, often the local lawyer or a clerk in the notarial office, to execute the official transfer documents. The powers of attorney must be notarized, or registered before a consular officer. *Monaco* is a signatory of the Hague Convention on the execution of documents, and therefore an *apostille* will be recognized.

The same formality of the power of attorney will be necessary to register a mortgage on a property in favor of a lender, both for the borrower and lender's representative.

Where the entity being represented is a company, then a minute of the corporate meeting authorizing the purchase or sale or mortgage may specify the identity of the person who can represent the company to sign the act. In that event, the minute may replace the power of attorney, although more frequently the minute will authorize the issuing of that power, in which case, a formal power must be executed.

3.7 Financing

Real estate purchases may be financed by loans in whole or in part. The registration at the *Registry of Deeds* of a **mortgage or lien to secure repayment** must be done by a notary,

unless it is a judicial mortgage ordered as a measure of protection for a creditor by the local court.

Local or foreign banks or companies may provide finance. The interest paid to foreign entities is not subject to withholding tax. One difficulty will be in obtaining a satisfactory evaluation of the real estate in order to ensure the lender of the safety of the security offered. The Monegasque market is small, and unusual, and the experts that normally operate for lending banks on the *Côte d'Azur* may frankly say that they cannot evaluate Monaco real estate accurately.

Real estate is valued on a price per-square-meter basis, with balconies and terraces generally being included for one-third of their size.

Companies that are not regularly authorized financial institutions cannot habitually engage in real estate financing in the *Principality* without running the risk of being considered as illegally engaging in the banking business.

3.8 Purchase through a company

Foreign or local companies may purchase real estate in *Monaco*. There is no counter-indication from a tax point of view, as there could be in neighboring *France*. In fact, many Monegasque apartments are held in either *sociétés civiles immobilières* created under Monegasque law, or foreign on- and off-shore companies.

3.9 Defects and warranty claims

In general, **no warranties are given for apartments sold that are more than 10 years old**. The purchase is usually made on an 'as is' basis. However, if there has been renovation by the previous owner, then the intervening contractors may have residual warranties for the works, within a 10-year period of completion, depending on the nature of the work, and the date on which it was accepted by the owner. This is why it is important upon purchase of an apartment to request copies of all contracts with the contractors who participated in any works done.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

Any construction, and any rebuilding or renovation that requires the modification of a façade or exterior of a building, or the modification of inner walls of an apartment, whether or not they are bearing walls, requires a **building permit**. The permit is requested of the *Service de l'Urbanisme* in *Monaco*, and will be presented by a **Monegasque architect**. Foreign architects may and often do participate in the projects in the *Principality*, but must collaborate with a Monegasque architect to do so.

4.2 Architect's and building contracts

The responsibilities of the architect are detailed under various articles of the *Civil Code*, with regard to his/her client. The architect's responsibility is for 10 years following receipt of the works by the client.

The architect's contract will be based on a standard contract elaborated by the Monaco architects' association. It is common that the architect's fees will be elaborated in accordance with the different aspects of his/her missions with payments being due once that aspect of the mission is complete. For example, the various stages of the architect's mission could be as follows:

- Preparation of plans with client's approval
- Preparation of the request for a building permit
- Obtaining of building permit
- Preparation of the *marché* or request from contractors to bid on the project
- Evaluation of the bids; choice of contractors
- Supervision of the works
- *Récolement* – or review of the works by the authorities, with a view to approval
- Reception of the works by the client.

The fee would be in this way compartmentalized, although being based on a percentage of the works – normally 10% without value added tax (*VAT*, French *TVA*). The contract clauses and fee structure can be freely negotiated.

4.3 Completion of construction and formalities

The type of building contract will depend on whether the works to be done are a new construction of a multistory apartment house, or the renovation of an existing building, apartment or of a portion of an apartment. Where there are major works, that is construction or reconstruction of walls, roofs, electrical and plumbing systems, then the contractor will normally have **insurance covering a 10-year period** from the reception of the works. This is not a legal requirement in *Monaco*, but it is generally observed. For major building projects, a bank guarantee ensuring completion is normally required.

The building works must comply with the permits issued, whether on an individual basis, or a global (building site) basis. There is an inspection by the authorities upon the declaration that the works are complete.

4.4 Deficiencies and warranty claims regarding new construction

The procedure for enforcing rights under warranty claims is a judicial procedure, which will require the nomination of an impartial building expert to review the works, and evaluate the complaints concerned. The expertise process is generally lengthy and expensive, but is the only alternative where the contractor's insurance companies refuse to settle matters. Litigation is frequent, unfortunately.

5 Rental and tenancy

5.1 Rental and lease agreements

For foreigners choosing to become residents in the *Principality*, the option exists to rent rather than purchase real estate. Legislation exists that limits certain apartment's availability

to long-term residents and citizens. Such apartments, generally in older buildings, are subject to a form of rent control. However, the legislation is currently under attack, and there are projects to severely modify it or eliminate it altogether. It is important for the foreigner intending to purchase an apartment to know whether the real estate might be subject to such legislation. However, for the foreigner becoming a resident in a rental apartment, this is less important, because they will not have the option to lease such favorably priced properties.

The law of *Monaco* does not otherwise protect residential tenants. Expulsions for non-payment of rent are relatively easy to obtain from courts and to enforce with the assistance of bailiffs and the police. There is no prescribed length of time for which a residential apartment must be leased by an owner, unless the protective legislation applies. Leases are generally for either a one- or three-year period, with rental increases based on French construction indexes applying for the longer term leases. The owner may refuse to renew the lease, and may apply whatever lease increase the market will bear at the expiration of the contract. Similarly, a tenant has no pre-emptive right to purchase.

Typically, the lease agreement will contain a clause that automatically renews the lease for a period equal to the lease period, or for a period limited to one year, unless notice of the intention not to renew is given by either party at least three months prior to the lease's termination.

Tenants pay the condominial common charges on apartments in advance on a quarterly basis. Payments should be reconciled by the building managing agent at the end of each year with the actual expenditures. In principle the owners of the building should pay that portion of the charges which concern the general maintenance of the building (major works and renovations).

All tenants must have insurance to guarantee their neighbors and other third parties in the event of damages flowing from the use of the apartments (generally covering water damage and fire).

Tenants taking over apartments are sometimes asked by the prior occupants to pay the equivalent of '**key money**' for certain fixtures that may remain behind. This is not illegal, but the new tenant should not consider that they will be able to require the same amounts when they decide to leave, or are asked to leave, their apartments.

For residential tenants, a **three-months' deposit** is usually required. This deposit is kept either by the real estate agent or the owner, and it is not interest bearing. It should be returned at the end of the lease, and its purpose is not to guarantee the payment of rent, but the wear and tear on the premises, that will be determined by comparing the report of the visit by the owner and tenant at the beginning of the lease, with the same report made at the tenant's departure. This report, known in French as an *état des lieux*, may be done in the presence of a bailiff (*huissier de justice*).

5.2 Regulations on protection of tenants and rent control

Rules protecting commercial tenants exist under *Law no. 490 of November 24, 1948*. Commercial leases are, at the tenants' option, made for the duration of nine years, and the tenant may terminate it every three years. The owner may not refuse to renew the

commercial lease without paying the tenant an indemnity, which is often equal to one year's turnover. The tenant may sell his commercial lease (residential tenants may not sublet without the owner's approval).

Certain types of apartments are subject to rent control usually in older buildings, although the system is the subject of intense scrutiny and changes in its application are expected. Other forms of rent control exist, with a **certain class of apartments reserved** only for persons having resided in Monaco more than five years and having had an activity for more than six months during that period. Such tenants are entitled to a six-year lease on the apartments available. Rents and terms and conditions of lease agreements are otherwise freely negotiable, and the legislation and case law is not protective of sitting tenants regardless of the length of time they have inhabited the premises or the cost of the improvements they may have made to the leased apartment.

6 Succession and gifts

6.1 Applicable law and jurisdiction

Monaco applies Monegasque law to all real estate situated in the *Principality*. Thus if a foreign national owns real estate in *Monaco*, at his death, the Monegasque *Civil Code* will apply as to how the real estate is bequeathed, which means that children will have a reserved right to inherit a portion of their parent's Monegasque real estate, and parents equally of their children.

The question of choice of law, as regards movable property, in the event of death, is however very differently resolved. Monaco jurisprudence applies the law of the nationality of the decedent to his movable estate. *Monaco* recognizes the principle of private international law known as *renvoi* so that the citizens of those foreign countries, whose law looks to the place of domicile of a decedent, will have Monegasque law applied to their successions. Citizens of countries that apply the law of the nationality of a decedent to his/her estate will find that their national law controls their movable or personal property at death.

6.2 Fundamentals of the succession and gift/donation laws of Monaco

The rules on inheritance under Monegasque law are that one child will inherit one-half of his/her parent's estate, two children will receive two-thirds and three or more children will receive three-quarters. The remaining part of the estate can be freely left by the person, by establishing a valid will, to whomever he/she feels should receive it.

Where real estate is owned by a company, then the shares of the company are considered to be **movable property**, and the inheritance of those shares would not automatically be subject to Monegasque law, and reserved heirship.

A foreigner may make a valid will in *Monaco* in one of the three forms – **handwritten**, **authentic** (before a notary) or **mystic** (by turning over to a notary a sealed envelope containing the will). In addition, *Monaco* will recognize a will that is made in a form that is valid according to the nationality of a testator, or valid in accordance with the law of the country in which the will is made. This means, for example, that while a joint will is radically invalid under Monegasque law, it is valid for spouses of German nationality.

Monegasque law provides that foreigners whose national law allows the formation of **trusts** may validly create trusts in *Monaco* to arrange for their succession, either by a trust established during their lifetimes or at the time of their death through their will. The form required under Monegasque law must, however, be respected – that is, the trust must be created before one of the Monegasque notaries (a foreign trust may be brought into *Monaco* under recent changes in the trust law). Any other form of trust created by will is invalid, and will render the will itself invalid, under current jurisprudence.

The matrimonial regime established by spouses at the time of their marriage and in the course of their first matrimonial domicile will be respected in order to determine rights of inheritance. Thus the estates of foreign spouses whose national law at the time of marriage, and the law of whose first matrimonial domicile was the community property regime, will take into account the surviving spouse's community property rights.

Similarly, *Monaco* will recognize the law of the nationality of a married couple as regards property rights in the event of divorce. Where the spouses are of different nationality, then *Monaco* will apply the *Principality*'s regime, which is the separate property regime.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

The transfer of title to real estate is subject to registration taxes and notarial fees. See below, Section 7.1.3.

7.1.2 Sales tax (value added tax)

With regards to new buildings, *Monaco* follows the value added tax regulations of *France*, and therefore the acquisition will be subject to value added tax (*VAT*, French *TVA*) if the sale is the first transaction on the apartment within five years of the completion of the building. Notarial costs to be paid by the buyer will then be approximately 2%, and any offer will be considered tax included (*toutes taxes comprises* or *TTC*) unless it is specified otherwise.

7.1.3 Real estate registration and notary charges

Registration costs at acquisition are of approximately 9%, of which 7.5% are the registration taxes and stamp duties and the remainder represent the notarial fees. Acquisition costs are always borne by the buyer, not by the seller.

It is possible to purchase real estate with a lower acquisition tax, in a regime of *marchand de biens* or **real estate dealer**. The registration cost will be approximately 2%. However in that case, the real estate must be resold within four years, or a tax penalty will be applied. The capital gain earned in a *marchand de biens* transaction is subject to value added tax.

Fees for the purchase of shares of property-owning companies are freely negotiated. Some lawyers will request a percentage-based fee while others will bill on an hourly rate basis.

7.2 Annually recurring taxes and charges

The only continuing costs will be the **condominial common charges**, and for tenants, the **lease agreement tax** (*droit au bail*, equal to 1% of the value of the lease and common charges upon registration and renewal)

7.2.1 Real estate tax

There is no land or real estate tax in the *Principality*. Following completion, there are no real estate taxes, habitation or occupancy taxes in the *Principality*. There is no withholding tax for the foreign company selling real estate and no requirement to file a tax return, unless the transaction is made under the *marchand de biens* regime.

7.2.2 Income tax

***Monaco* has no income tax on individuals**. It applies a business profits tax to those businesses where more than 25% of the annual turnover is derived from clients outside of *Monaco*.

7.2.3 Net wealth tax

There is no net wealth tax in *Monaco*.

7.3 Capital gains tax

There are no capital gains taxes in the *Principality*.

7.4 Inheritance and gift taxes

There is no inheritance tax between spouses, parents and children, regardless of the nature of the property, whether real or personal. The highest rate of inheritance tax, between unrelated persons, is 16%. Gift tax follows the inheritance tax.

7.5 Other taxes and charges

Real estate commissions are usually charged to the seller, at 5% plus value added tax. They may also be requested of the buyer, at 3% plus value added tax. However, commissions are subject to negotiation, and may be freely discussed by the parties concerned.

7.6 Incorrect (lower) statement of sale price on the sales agreement

The declaration of a false, low, price in an authentic act is a penal offence. *Monaco* retains the possibility of pre-empting properties by offering a price equal to the declared price, increased by 10%. However, the use of such a possibility is exceedingly rare.

7.7 International taxation

Monaco has two double taxation treaties with *France*. These only concern income tax and estate tax and are only applicable to Monegasque and French nationals.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

No customs or border controls exist on land between *France* and *Monaco*. Customs and border controls are situated at the Port of *Monaco*, for those entering by boat, and at the heliport.

Foreigners may freely come to *Monaco*. If they intend to settle in the *Principality*, they must make a request to the authorities **within eight days** of their arrival. If they do not intend to settle in *Monaco*, then a foreigner may remain **up to three months** without having a residence permit.

The procedure to establish residence varies in accordance with nationality. All citizens of the *European Community* may apply for residence directly at the foreign police services in *Monaco*. Other nationals must apply at the French consulate at their current place of residence. *France* will in any case, even with EU nationals, be entitled to express its approval or disapproval of the application which will affect whether the foreigner is allowed to reside.

The procedure can take from six weeks to four months depending on whether the request is made directly in *Monaco* or through a French consulate. Once the ***visa long séjour*** (the visa allowing establishment in *Monaco*) is granted, and the foreigner arrives in *Monaco*, he/she must report and request the ***carte de séjour*** from the police.

Applicants must show they have either gainful employment in the *Principality* or sufficient means to live without working, which is generally done by producing a letter from a bank in *Monaco* to that effect. Foreigners will be asked to show that they are of good moral character by producing copies of their police records or declarations from reputable professionals. They will also be asked to produce birth records, medical certificates and proof that they have appropriate accommodation in the *Principality*.

Once residence is granted, the foreign person is required to reside in *Monaco* for at least six months of the year in order to maintain the residence permit. The foreign resident will be required to show proof of a residence, in the form of a lease or ownership documents, and to prove use of utilities (electricity, telephone and water) conforming to an actual residence, in order to be allowed to renew his/her residence permit.

8.2 Tax residence

Because the *Principality* has no income tax, it is not concerned with the fiscal place of residence of its residents. It is, however, very concerned, and enforces strictly, the requirement that the residence be a real and effective residence and not a sham.

8.3 International taxation for residents of Monaco

Again because *Monaco* has no income tax and no double taxation treaties with any country other than *France*, there is at present no incidence of double taxation for those becoming *Monaco* residents. But for the same reason, residents may find themselves subject to the highest withholding rates in the countries of origin of their income.

9 Checklist: Real estate acquisition in Monaco

- Determination of the appropriate real estate one seeks to find: residential or commercial, income generation or capital appreciation, price range determined on a Euro per-square-meter basis and section of *Monaco,* older building or newer building, with or without concierge, with or without parking, with or without view of the sea.
- Selection of whether to purchase real estate or company-owned property.
- Determination of manner of purchase, whether through a company, trust or other entity, or whether in the individual's name.
- Selection of appropriate real estate agent in accordance with the general market serviced (high end, middle range, low end or commercial).
- Visits to real estate.
- Selection of notary or lawyer.
- Offer to purchase accompanied by 10% deposit made to the name of a notary, lawyer or agent.
- Signature of a preliminary contract (*promesse* or *compromis*) binding the parties and formalizing the deposit.
- If condominium, review of the *règlement de copropriété* (Condominium Statutes) and annual running costs (*charges*) and works voted by the real estate owners that may be charged to new owners.
- If company, same as above, but additional due diligence investigation of the company, the real estate and of its beneficial owners.
- If works are required on the real estate, determination if the works will be authorized by the managing agent of the building and the *Service de l'Urbanisme* of *Monaco.*
- Conclusion of the transfer of ownership at the notary (or in the case of a company at the lawyer's office) and payment of the purchase price, fees and registration costs as applicable, following verification by the notary of the power of the buyer and seller to act, and of clear title on the real estate.
- If direct real estate ownership, registration of the transfer at the property registry (effected by the notary) and payment of registration fees within one month of signature.
- If ownership through a company, notification immediately to the company administrators, banks, etc., of the change in beneficial ownership, and change, if so decided of company administrators, contact numbers and addresses.

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Contents: Portugal

1 Introduction

Portugal, a former seafaring nation and for over 800 years an independent nation state, lies in the west of the *Iberian Peninsula*, of which it makes up around one sixth. The island chain of *The Azores* and the island of *Madeira* also belong to *Portugal*. From a landscape and climatic point of view, the Portuguese mainland is very varied, with its coastline of almost 800 km in length. From the Spanish border the land falls gently away to the Atlantic, which guarantees abundant precipitation, and so *Portugal* appears as a garden, which is marked by the Atlantic and also by the Mediterranean climate.

Since *Portugal*'s accession to the *European Union* in 1986, strong socioeconomic development has taken place in the country, which thereby re-established contact with its European neighbors, after a long period of isolation. *Portugal* is also in the Euro currency zone.

The membership of *Portugal* in the *EU* led, moreover, to an increase in the demand among the foreign community for local real estate. The real estate prices in large cities or holiday areas are comparable today with those of other EU countries.

The Portuguese real estate market is noted for a large quantity of newly built properties for sale, whose standards of luxury are up to normal standards of quality, an insignificant rental market and a still hesitant interest in the renovation of old properties.

2 Real estate ownership

The right to private property and to the transfer of real estate during life and on death is based on *Article 62* of the Portuguese constitution. Property law and the various types of property are almost exclusively governed by the Portuguese *Civil Code*. The only real estate rights and restrictions are those that are set out expressly in the legislation. Portuguese civil law differentiates between rural and urban land (*prédios rústicos* and *prédios urbanos*). A rural plot of land means a distinct part of the land together with the buildings situated on it, which are not economically independent of it. An urban plot of land means the buildings, which are anchored to the ground, with the areas which serve them.

2.1 Different forms and types of ownership

Sole ownership, joint ownership and collective ownership

The sole owner has comprehensive powers of ownership over his/her real estate.

If two or more persons own the property rights over a piece of real estate simultaneously, then **joint ownership** exists. While the sole owner can avail him/herself of his/her property rights independently, in the case of joint ownership all the joint owners make use jointly of the rights in the piece of real estate, and take part according to their **shares** in the receipt of income and the payment of expenses.

The administration of joint real estate is carried out according to the principle of a majority of the joint owners, to whom at least half of the shares must belong. Every joint owner is free to dispose of his/her share in the abstract sense, or to encumber it. However, charging

or disposing of a specific part of the real estate requires the consent of the remaining joint owners.

Further, every joint owner has the right to division of the real estate concerned, and can sue to enforce this right in the event of disagreements. Should a prohibition on division be agreed, this may not last longer than five years; a prolongation can be agreed after the expiry of this period. The co-owners have a legal right of pre-emption if the share of a fellow co-owner is disposed of, or if it is given to a third party by way of payment.

A further form of co-ownership is **collective ownership.** Types of collective ownership are specified as matrimonial collective ownership of goods, inheritance collective ownership, or collective bodies without legal personality.

In contrast to joint owners, the collective owner has no abstract share, which he/she could dispose of freely. Collective ownership ends with the dissolution of the underlying legal relationship.

Tiered ownership

The institution of tiered ownership makes up a further form of real estate. Each tiered owner has the sole property in his fraction, and is a co-owner of the common parts of the building. Already existing buildings can retrospectively be converted to tiered ownership, after the agreement of the responsible communal authority. Tiered ownership is established in the same way as for normal real estate, via contract, possession for a prescribed period, or court decision. Disposal is governed by the general rules. There are many tourist resorts, predominantly on the *Algarve*, that have been established using the tiered ownership model. In a real estate acquisition of this sort, the contract of establishment and also the house and resort rules should be checked over, in order to avoid later surprises.

Building leases

Building leases consist in the fact that a building can be erected on another person's land, either for a period of time or in perpetuity. The property in the building and in the land fall under separate ownership. The lessee under the building lease has either to pay a once and for all **price** or to meet a **periodic ground rent** payment.

Timesharing

The law of timesharing underwent a definite expansion in the 1990s, in particular in the strongly developed holiday areas of the *Algarve* and *Madeira*. The right to occupy by reference to time (*direito real de habitação periódica*) is regulated in the legislation, which implements *EU Directive 94/47* on the protection of the buyer, with regard to certain aspects of contracts concerning the acquisition of timesharing rights in real estate. The owner of a timeshare can, provided he/she observes his/her duties regarding maintenance, make use of the real estate as an owner during the agreed period of time. The law of timesharing is distinguished, moreover, by its **simple transferability**. Timesharing can only be set up by a **notarized deed**. The legal owner receives a Portuguese **Land Certificate**, on which the constituent components, which make up a timeshare, are based. The buyer must also be given a written completion document, which must contain further essential

information, the component parts of the contract. The non-resident buyer must also be given an officially certified translation of the certificate (into one of the official languages of the *EU*) and a completion document. Timeshares can be transferred to third parties, and can be encumbered and inherited. Transfer is effected by endorsement on the certificate, with notarially authenticated signatures of both parties. The conclusion of a written preliminary contract, which must also be officially authenticated, is also possible. The buyer has a mandatory **right of cancellation**: he/she can cancel within a time limit of 10 working days from the date of the preliminary contract or the transfer of the timeshare.

2.2 Easements, charges, liens and mortgages

As well as the law of property, which stipulates complete ownership over a piece of real estate, there are so-called **limited property rights**, which burden the real estate and grant the current owner **rights of use, rights of guarantee (sale) or acquisition rights**. Beneficial use, the right to use and reside, the right to grant a building lease and rights of easement number among the limited property rights. Among guarantees over real estate are the mortgage, the assignment of income from real estate, the right of retention and right to provisional satisfaction of certain state and municipal demands (land tax, purchase tax, gift and inheritance tax and court costs, which are a burden on the relevant real estate or the revenue arising from them, come under this category). Rights of pre-emption make up the tangible acquisition rights, which will be explored in section 3 below.

Beneficial use

Beneficial use gives the beneficial user the right to make various uses of the affected real estate during a specified period of time. Beneficial use rights can be established via contract, will, prescription or provision of statute.

Use and residence

Besides beneficial use, Portuguese law also recognizes the tangible right to 'use and residence'. When the right affects a residential building, it is categorized as **right of residence.** The provisions of beneficial use rights are used in a way that is subsidiary to right of residence. The owner of the right of residence cannot encumber or lease out the right, however.

Building leases

The law of building leases also represents a type of servitude, which belongs to the above types of real estate, because it demonstrates characteristics that are similar to those of ownership.

Easements and administrative covenants

A burden is classified as an easement where it is imposed on a piece of real estate for the benefit of another piece of real estate with various owners. The commonest forms are rights of way, which allow access to a specified piece of real estate, and administrative covenants, for example the prohibition on building in the area bordering on streets.

Mortgage

The mortgage is a **strictly accessory right**, which is put in place over the real estate to give security for the claims of the mortgagor or of a third party. The mortgage can be contractual or imposed by law or court order, and is extinguished, *inter alia*, when the underlying claim no longer exists. National and municipal land, building leases and the beneficial use of tangible property and rights can be burdened with a mortgage. The **voluntary mortgage** arises under contract or unilateral declaration. It can also be established or modified by will. As an exception to the general rule that a simple declaration of the parties is needed to render a tangible legal right effective, to establish an effective mortgage this must be **registered in the *Land Register***.

Portuguese law does not recognize the concept of **underlying debt**, which is not an accessory.

2.3 Protection of ownership, proof of ownership and registration

Under Portuguese law, property ownership passes at the time of the **sale contract by notarial deed**. This deed has **constitutive effect.** Portuguese law does not recognize concepts such as the notarized real estate conveyance agreement under German law. On account of the **fundamental rule of publicity** and on account of legal certainty, the rights acquired must, however, be inscribed in the register, and only become valid against third parties when they are so registered. It is possible theoretically to transfer the same piece of real estate at different times to different purchasers. However, the only person who has an absolutely effective title is the purchaser in good faith who is the first to register his/her rights at the *Land Register*, even if his/her title was acquired at a later date. The other buyers will only have the right to claim damages against the seller.

Proof of ownership should be provided exclusively by the production of **an extract from the *Land Register***. Cases in which a piece of land has not yet been registered are relatively rare, and are almost always confined to very rural areas in north and central *Portugal*. On account of the predominantly low level of land ownership in that area, the division of real estate on inheritance, and moreover high emigration in the 1960s and 1970s, the parcels of real estate and their registered rights are only determinative of ownership to a restricted degree. It was not until the coming into force of the new *Land Registration Act* on October 1, 1984, that compulsory registration for all real estate in *Portugal* was introduced. Until then, many rural pieces of real estate were exempted from the obligation to register.

In these regions, including a number of potential holiday areas in the coastal regions, the most up to date information about the legal relationships that exist can mostly be obtained from the responsible **tax office**. It issues a type of **property tax register booklet** (*caderneta predial*), for all urban and rural real estate, from which the nature of the real estate and the burdens affecting it, together with the priority order of the owners and the proprietary worth of the real estate, can be determined. Moreover, every plot of real estate is allocated a **number**, under which it is dealt with by the responsible tax office. With the introduction of the geometrical *Land Register* in *Portugal* in 1989, a national process of land valuation began – this did not include all areas – which has also led to the alteration of the plot numbers at the tax office. The rural plots, which are already included in the *Land Register*, never have

more than three numbers, and are allocated into various sections within a community. With rural plots that are not yet included in the *Land Register*, it sometimes happens that the effective areas of land do not correspond with the areas inscribed in the old Register. It is advisable here to carry out a valuation.

However, one must note the fundamental point that the proof of ownership can only be provided via an up to date extract from the register – the *caderneta predial* cannot be substituted for it. One should also bear in mind that in some *Land Register* offices, on account of the large amount of work involved, or due to lack of staff, registrations are not carried out until long after the applications for registration. A delay of six months between application and completion of registration is not uncommon. For this reason attention must be paid to the **current status of the extract from the register.**

3 Purchase and sale of real estate

3.1 The sales agreement

The purchase contract must be **made the subject of a deed signed before the notary.** A purchase contract that does not satisfy this requirement is null and void. This nullity means that the real estate cannot be passed, and the purchase contract will also not be registered in the *Land Register*. **Property passes on the conclusion of the notarized purchase contract.** The parties can be represented by persons holding a power of attorney for this purpose. In *Portugal* the parties can have the purchase contract notarized by a Portuguese notary of their choice. There is no territorial responsibility as with other Portuguese public offices.

The notarized deed containing the purchase contract is drafted in the Portuguese language and is read out aloud. The notary makes sure that each party has understood the contents of the purchase contract and that this reflects the will of the parties. Contracting parties who do not speak Portuguese must bring an interpreter with them. He translates the purchase contract simultaneously and will also appear in the purchase contract.

In general, a notarial purchase contract is not very comprehensively drafted. Before binding oneself by contract, one should insist on having a copy of the text of the deed, so as to be able to check this through. This is advisable due to legal particularities or insufficient linguistic knowledge of the parties or the interpreter, in order to avoid later difficulties.

The risk is generally greater for the buyer than for the seller. The buyer should therefore have the documents that are relevant to the purchase checked over by a lawyer. It is also useful to enter into a **preliminary contract** with an enforcement clause, in order to bind the seller to carry out the contract, and also to be able to enforce his expressed obligations through the courts, should this be necessary. In order to protect the buyer's rights, one should also not dispense with a provisional registration of the purchase in the *Land Register*. This purpose is also served by the provision of a **bank guarantee** on the part of the buyer, in the amount of the purchase price; it should remain in force until the buyer's property rights are finally entered in the *Land Register*. On account of the non-automatic and non-simultaneous registration and checking of the real estate purchase by the *Land Register*, at the time of the notarized purchase contract – the registration will not be put in hand until the buyer's application is made after the conclusion of the notarial deed – the buyer should also

protect him/herself, in every case, either through a provisional registration or by provision of security on the part of the seller.

In the case of **preliminary contracts** for the transfer of property in buildings or residences, or for the establishment of other property rights, the notarized signatures of both parties are required by law. In the case of corporate entities, the authority to represent the party concerned is proved by provision of an extract from the business register or equivalent documents. Further, the permission to build or use the real estate should also be produced to the notary, and this will be appropriately certified in the purchase deed. In general, **the preliminary contract is only effective to create an obligation,** so that the seller can in theory transfer the real estate to a third party, and the buyer can only bring a claim for damages against him/her. However, the buyer may register his/her acquisition provisionally, to have effect against third parties, at the *Land Register* – which can be done either by a unilateral declaration of the seller on a special *Land Register* form, or by registration of the preliminary contract. The provisional registration will remain effective for as long as the contractual obligation is supposed to be valid, and it can be prolonged for six months to a year after expiry of the original prescribed period, on application of the parties. On expiration of the prescribed period, the provisional registration expires automatically. When the promised contract is concluded and is entered in the *Land Register*, the provisional registration is converted into a final one.

In contrast to German law, Portuguese law has a governing **principle of causality**. For the establishment or transfer of a property right, the transaction, in which the willingness to transfer is declared, is sufficient. This means that **on conclusion of the purchase contract the transfer of real estate takes place simultaneously.** The purchase contract is therefore not only a causative transaction, which creates obligations, but also an actual disposal. The registration of the real estate in the *Land Register* is not a new legal transaction, and can be required by the buyer without any additional permission from the buyer, based on production of the purchase contract and the *caderneta predial* or an equivalent certificate from the tax office.

Third parties acting in good faith are protected in Portuguese law, on the one hand through a shortening of the periods of prescription and on the other hand by *Articles 243* and *291* of the Portuguese *Civil Code*. The latter relate to errors in the previously concluded legal document. According to *Article 243* of the Portuguese *Civil Code*, the nullity that results from a fictitious transaction cannot be invoked against the purchaser in good faith. In general, the purchaser in good faith is protected by *Article 291* against the nullity or annulment of the prior legal transaction. Acquisition of property in good faith is possible, according to this provision, when its registration is requested before the registration of the judicial proceedings for nullity or annulment of the previous legal transaction, or before the registration of the settlement between the parties involved in the previous legal transaction stating that this has no effect. However, this only applies when the said registrations do not take place in the first three years after conclusion of the void or voidable contract. In other words: after expiration of three years from the conclusion of the challengeable or nullifiable legal transaction, the buyer in good faith can realize his/her rights fully if his/her registration is made before the registration of the proceedings for nullity or nullification of the previous transaction or of the settlement between the previous parties declaring the ineffectiveness of their legal transaction.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

The Portuguese conflict rules regarding the substance and effects of the legal or contractual property rights between spouses refer directly to the **common law of the spouses at the time of the marriage**. If there is no common nationality, the rules look to the law of the usual place of residence at the time of the marriage. If there is none, the law where the matrimonial home is situated is to be applied.

In the case where foreign law is applicable and one of the spouses has his/her usual residence in *Portugal*, the use of Portuguese law of property can be agreed by contract.

Portugal has signed the *Hague Convention of 14 March 1978 on the law applicable to matrimonial property regimes*, nevertheless it has not yet ratified the convention. On account of its Article 2 the Convention applies even if the nationality or habitual residence of the spouses is not that of a contracting State. The general point of application for the Hague Convention is the first usual place of residence of the spouses after the marriage, and – under certain conditions – the common nationality of the spouses, so that the results that follow from use of the Portuguese conflict of law rules can be altered as a result of the Convention.

If Portuguese law is applicable, the parties concluding the marriage can choose, by marriage contract within the legal limits, the property regime and its contents. Equally, the choice of a foreign governing law is allowed. This may not, however, take the form of a general reference to the foreign law concerned.

Portuguese law is governed by the **principle of the immutability of the property regime**, which only permits a few named exceptions. The legislative Portuguese property regime, which is applicable where there is no marriage contract or an invalid contract, is that of the **communality of property acquired during the marriage**. In a few exceptional cases, the legislation makes the spouses subject to the property regime of separation of assets. Besides the property regime of communality of property acquired during the marriage (*comunhão de adquiridos*), Portuguese law recognizes **separation of assets** (*separação de bens*) and **communality of assets** (*comunhão geral de bens*), but these must be agreed by contract before the marriage.

The **general regime of communality of property acquired during the marriage** has effects on the property rights of the spouses. Property that is acquired by the spouses during the marriage becomes a part of the matrimonial property, unless it is acquired using one of the spouse's own assets. To address this, one must make an express choice of 'sole property' in favor of the contracting spouse, in the relevant purchase contract. The other spouse must be in agreement, which will be documented by a declaration of his/her agreement. If a spouse subject to the communality regime has acquired a piece of real estate, without a simultaneous contractual agreement with the other spouse, then he/she can only dispose of the real estate jointly with the other spouse. A preliminary contract for the sale of real estate should therefore always be signed by both the vendor-spouses, as the spouses can only dispose jointly.

Similarly to the property regime of communality of assets acquired during marriage, in the case of **communality of assets**, the agreement of both spouses is necessary for the

disposal of real estate. Only in the case of **separation of assets** can the spouse dispose of his/her real estate without the agreement of the other spouse. However, if the real estate in question is also the **family home, the agreement of both spouses is necessary,** even in the case of separation of assets.

For foreign purchasers, the exact **stipulation of the civil and property regime in the sale contract** is also important, possibly with the presentation of a marriage certificate and a consular declaration regarding the property regime, as this must always be stated in the case of married persons. The document must state correctly who has acquired real estate from the spouses, so that the correct entry is made in the *Land Register* and no problems arise when there is a further disposal or charge of the real estate.

3.2.2 Options and pre-emption rights

The free disposability of real estate can be restricted, through agreed or legal rights of pre-emption, in favor of other persons. If such a right of pre-emption exists, the owner, who has decided to sell, is obliged to sell to the pre-emptor on the same contractual terms.

Options and rights of pre-emption can be agreed between the parties **contractually** and can also be established **by will**. In order to be valid, they must be **in writing.** As a rule, contractual pre-emptive rights **are only effective to create a legal obligation** between the parties, so in cases of enforcement or insolvency, rights of pre-emption cannot prevail. The contractually agreed option, however, will then **also have tangible effect**, if the prescribed **special requirements as to form** are satisfied, and a corresponding entry in the *Land Register* will follow. A contractually agreed option with tangible effect has, however, no priority over the rights of pre-emption prescribed by law. The usual **legal rights of pre-emption** are stipulated in favor of co-owners, tenants and co-inheritors. Further, owners of servient pieces of land possess a legal right of pre-emption if the dominant property is disposed of. The owner of the burdened property has similar rights if a building lease is disposed of. On the disposal of rural real estate, there are in certain circumstances legal rights of pre-emption in favor of the owners of neighboring rural real estate.

As an instrument of political control of land, **the public administrative authorities** are allowed a **general right of pre-emption**, which is transposed into many legislative provisions. On the acquisition of pieces of land or buildings, enquiries should be made of the responsible town authority as to whether a right of pre-emption in favor of the public authority, whether town council or other establishment, subsists (many historic town districts have a right of pre-emption in favor of the town). **Legal rights of pre-emption are not entered in the *Land Register*.**

3.2.3 Agricultural real estate

The law specially regulates the acquisition and use of rural real estate. In the tax office as well as at the *Land Register,* plots of real estate are designated as rural, agricultural (*prédios rústicos*) or urban real estate (*prédios urbanos*). A rural plot of real estate is, as a rule, also to be regarded as a piece of agricultural real estate – as such, it cannot be built upon.

In order to avoid the fragmentation of rural real estate into uneconomic plots, *Portugal* has rules for the maintenance of productive minimum-sized plots, which vary according to

region and type of cultivation between 0.5 ha and 7.5 ha. On the acquisition of rural real estate, one should ensure that in the case in question the current minimum cultivable unit in hectares (*unidade mínima de cultura*) remains intact.

Should a rural piece of real estate be situated within an agriculturally protected zone (*reserva agrícola nacional – RAN*), the minimum cultivable unit is doubled automatically. Moreover, rights of pre-emption in favor of neighboring real estate have to be borne in mind.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

Since the introduction of the free movement of capital at the beginning of the 1990s, there are no longer any restrictions on the acquisition of real estate by non-residents, even if these are not nationals of EU member states. However, certain **notification requirements**, which serve statistical or administrative purposes, must be observed: capital transactions, which qualify as foreign direct investment or as investment in real estate, must be notified to the *Bank of Portugal.* Foreign investment operations, under which falls the acquisition of real estate by non-resident natural or corporate persons – insofar as the acquisition is for the creation or strengthening of economic, stable and long-term bonds of an undertaking which has been established or is to be established in *Portugal* – are to be notified to the *Portuguese Investment Agency* (*Agência Portuguesa para o Investimento – API*) within 30 days of the transaction.

In other respects there are **no restrictions** on the acquisition of real estate by foreigners who have their place of residence abroad.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

The only person authorized to sell the real estate is the person who is entered in the *Land Register* as its owner. With joint property or property held in common, the latter brought about by inheritance, marriage or business association without legal personality, all the joint owners or common owners must agree to the sale. **Natural persons of full age and capacity** can conclude the purchase contract themselves or have their wishes represented by an attorney. Persons who lack capacity are minors (under 18 years old) and persons who are under the authority of trustees. Persons with limited capacity are natural persons who have been declared by court order to be without capacity to deal. In the case of persons who lack capacity absolutely, a legally authorized representative has to act; with persons of limited capacity, for example those without capacity to deal, the appointed trustee has to act alongside the person without capacity.

In the case of legal persons, it is necessary to check whether they are established according to law and therefore have capacity to deal. In trading companies this is established from the commercial register or from relevant documents (certificate of incorporation, certificate of good standing, etc.). Legal persons act via their representatives according to law. The authority of the lawful representatives is established in the case of registered corporate entities from the commercial register. An extract from the register remains valid for one year. Besides the obtaining of a current extract, it is however also advisable to examine the current constitution of the present corporate body, as the authority to deal

in certain situations is often subject to the agreement of other representatives. Legislative restrictions also have to be borne in mind. Therefore, the transfer and mortgaging of real estate, which is owned by a limited liability company, is based on agreement by shareholders' resolution, if the by-laws of the company do not provide otherwise.

3.3.2 Third-party claims and unpaid taxes

In order to satisfy proven demands of creditors, the real estate of a debtor can be encumbered in the context of enforcement proceedings. The encumbrance is then only valid against third parties when it is entered in the *Land Register*. After entry of the encumbrance in the *Land Register*, the only rights that can be registered are those that do not conflict with the encumbrance.

Further, by way of a provisional measure, a piece of real estate can be affected by a freezing entry. After a judgment is obtained in the main action, the provisional measure can be converted into an encumbrance in the context of ancillary enforcement proceedings.

Further, on grounds of **unpaid taxes or national insurance contributions**, there can be enforcement proceedings resulting in the real estate being encumbered. For this, the tax office of the debtor's place of residence or the location of the real estate is responsible. Charging in the context of enforcement proceedings by the tax offices has also to be inscribed in the *Land Register*. One can obtain information from the responsible tax offices regarding possible pending proceedings or the existence of tax debts on the part of the seller of the real estate.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Besides agricultural reserved areas, which have already been dealt with above, in the context of environmental protection and nature conservation there are also the **national ecological reserves** (*reserva ecológica nacional – REN*), the **nature conservation areas**, the **coastal areas** and the **woodlands**, where use and building activity are strictly regulated by various legislative texts. In the *REN* areas, which chiefly consist of sensitive areas as regards ground water reserves, all types of construction or destruction of the vegetation are forbidden. The *REN* areas are also specifically identified in all town and country planning documents. The classification or declassification of *REN* areas is carried out via ministerial decision, which takes prior advice from the national *REN* commission. The **ground protection zones of the coastal areas** comprise a 2 km wide strip, which extends from the highest tidemark into the interior. Its use and any changes of use are regulated in a legislative decree, which also regulates coastal town and country planning and all construction and building projects that are not comprised within a development plan.

For the protection of the qualifying wooded areas against arson, there is a general 10-year building ban on areas affected by forest fires, together with an obligation on the owner or tenant to replant trees. The felling of specified types of tree, including the olive tree, pine, cork and stone oak, is forbidden.

Every owner is responsible for avoiding **pollution** on his property and, in particular, is responsible for ensuring that no damaging effects or dangers for neighboring lands or for public health emanate from his area. The owner can be compelled by the public authorities to

clean up pre-existing pollution at his/her own expense. An examination of possible pollution before the purchase is therefore necessary.

The *IPPAR* (*Instituto Português do Património Arquitectónico*) is responsible for the classification of real estate which is under **historic site/listed buildings protection.** If a piece of real estate is listed, the owners are under particular maintenance obligations and under a duty to present an appraisal to *IPPAR* in the case of any plans to carry out alterations. The listing of buildings is published in the government's official journal as well as being **registered in the *Land Register***. As compensation for the particular burdens that listed buildings carry with them, these buildings are exempt from real estate tax and from transfer tax on changes of ownership.

3.3.4 Access to relevant records and documents

As soon as the interested buyer has chosen a suitable property, the following points should be checked: The entry of the real estate in the ***Land Register*** (*registo predial*) must be in the **name of the seller**. From an extract from the register one can check whether the real estate is the subject of adverse entries. It is also important to pay attention to the status of the entries, as these can deviate by several months from the print date of the register extract.

The real estate must be **registered at the tax office**. The responsible local tax office provides a kind of real estate booklet (*caderneta predial*) for every urban or rural property. From this, in similar fashion to a *Land Register* extract, the state and the owners of the real estate, as well as its value, can be established. The *caderneta predial* is as a rule handed over by the former owner to the new owner, and can be kept up to date. Instead of a real estate tax register booklet, a certificate can also be obtained.

When acquiring residential buildings that were erected after 1951, it is necessary to check, in addition, whether a **dwelling permit or planning permission** exists. This inquiry is made of the responsible local authority. When acquiring real estate for building purposes, the appropriate local plans should be checked at the responsible local planning authority.

3.4 Key points that a seller should consider

The seller has, as a rule, a more secure position than the buyer. The seller has to make sure that his property rights are entered in the *Land Register* in accordance with the law, and that the real estate is also correctly described therein. The description of the real estate in the *Land Register* must correspond with the description of the real estate at the tax office or in the *caderneta predial*. For buildings, which require planning permission for residential or other use, this also has to correspond in content with the entries at the *Land Register* and tax office. Should this not be the case, then the entries must first be harmonized before the conclusion of the purchase contract. The seller also has to comply with the legally stipulated notification requirements toward those having rights of pre-emption.

3.5 The execution of a real estate purchase transaction

The search for real estate or a buyer for real estate takes place either via an estate agent or through direct contact between buyer and seller. If one instructs an estate agent, one should make sure that he is officially registered.

During the preliminary negotiations the relevant documents are checked and the requirements of the contract are agreed: as a rule these are set out in a **preliminary contract**. It is advisable to have the preliminary contract checked by an independent lawyer.

For a purchase contract in respect to real estate being formally valid, the signatures of the parties have to be notarized; authorities to act and any powers of attorney are also checked by the notary. The planning and residence permits must also be produced to the notary; they will be noted in the preliminary contract. On conclusion of the preliminary contract, a **down payment** on account of the purchase price is due, which can amount to **between 10% and 40% of the purchase price**. Here it is important to know that if the buyer does not comply with the provisions of the purchase contract, he/she loses any installments already paid toward the purchase price. However, if, on the other hand, it is the seller who does not fulfill the contract, he/she must pay back twice the amount of any installments to the buyer.

In order to conclude the preliminary contract and to proceed further, both parties must have a Portuguese **tax number**. This can be requested at any tax office on presentation of a passport or personal identity document, together with a Portuguese address for tax purposes. Non-residents must appoint a tax representative resident in *Portugal*.

Before conclusion of the purchase contract, in the form of a notarized deed, the **transfer tax** has to be paid at a tax office. Proof of this has to be produced to the notary. The purchase contract itself is executed at a notary public's office of the parties' choice. Notaries are at the present time civil servants, responsible to the *Ministry of Justice*. A partial privatization of notaries is however expected soon, according to which there will be private notaries, but public notaries will also be available. A current extract from the *Land Register* has to be produced to the notary – the *caderneta predial* as well as the construction or use permit, and for residential buildings completed after 30th March 2004 the technical habitation form (*ficha técnica de habitação*) an official form containing technical data of the building. The parties also have to identify themselves to the notary by means of passports or personal identity documents, and, if applicable, their marriage certificates. Furthermore, appropriate proof of authority to deal or power of attorney should be considered, together with the tax number. The **buyer as a rule pays the notary's fees**.

The notary is obliged to check the actual value payable on the transfer of real estate, for the purpose of checking the calculation of transfer tax, and for this the preliminary contracts, which are attached to the purchase contract, must be produced to the notary.

With a certified copy of the notarized deed containing the purchase contract, the buyer can then apply for his/her name to be registered in the *Land Register*, as well as for the real estate to be transferred into his/her name with the tax office (deadline 60 days).

3.6 Powers of attorney

According to Portuguese conflict of law rules, the existence, extension, alteration, validity, effect and cancellation of powers of attorney, which deal with the disposal, or administration of immovable property have to be dealt with according to the law of the state in which the real estate is situated. This law is also applicable in relation to the **form** of the power of attorney. A power that is to be used to deal with real estate in *Portugal* must, under Portuguese law, contain a **notarized certification of the signature and handwriting of the donor of the power.** The power can either be drawn up as a notarized deed or as a private document with a notarial certification attached. Should a foreign notary draw up

the power, an apostille according to the *Hague Convention of October 5, 1961, Abolishing the Requirement of Legalisation for Foreign Public Documents* must also be attached. The granting of a power of attorney can also be carried out directly, in Portuguese, at the local Portuguese consulate.

3.7 Financing

The usual financing of acquisition, refinancing or building or conversion works in relation to real estate is carried out by means of bank loans. As a rule, the bank will finance, according to the financial standing of the borrower, between 60% and 80% of the assessed value of the real estate. The interest rate will be agreed between the bank and the borrower. Until recently the maximum term of a loan was restricted by law to 30 years. Now the banks can set their own terms of the loan, under the supervision of the *Bank of Portugal*. Loan contracts occur in practice with a term of up to 50 years, with installments payable by the borrower up to the age of 70. Usually, however, contracts have a **term of 25 to 30 years.** As security for repayment the banks generally require mortgages and life assurance. **Savings accounts for building** are of interest because of their **tax advantages**, and because they offer a reduction of the notarial and registration charges for the real estate purchase of around 50%. In general, the banks are also willing to grant loans to owners who are not resident in *Portugal.* The conditions are often stricter, however, as in addition to the usual mortgage and life assurance, guarantors and other additional forms of guarantee are required.

A purchase of real estate can also be financed via **leasing contracts**. The landowner is or becomes the lessor, who devises the real estate to the lessee, in consideration for a payment. By this method, 100% finance can be obtained. In the case of leasing contracts affecting land, the legal minimum term is 7 years, and the maximum term is 30 years. Leasing contracts for real estate have to be in writing. The signatures have to be notarially certified, and the use or building permit has to be produced. A notarial deed is, however, not necessary. The leasing contract must be entered in the *Land Register*. Leasing contracts can be concluded with or without the option to purchase. In the case of a purchase option, the total of the purchase price that still has to be paid may not amount to less than 2% of the value of the leased real estate. The leasing rates, in which the amortization and finance costs are reflected, are as a rule payable in monthly or three-monthly installments. Main residences as well as second homes and holiday homes can be leased.

3.8 Purchase through a company

Natural or legal persons who are not resident in *Portugal* can invest freely in Portuguese companies, or can form companies. Among the most common types of companies is the limited liability company – which may also take the form of a one-man company – and the joint stock company. The formation of a Portuguese company is relatively bureaucratic and slow. One should allow two to three months for the formation. If one forms a real estate holding company, particular requirements have to be observed.

If a company with limited liability is used as the owner of a real estate, transfer tax becomes payable at the moment when 75% or more of the shares are acquired. The position with joint stock companies is different. The acquisition of real estate via companies gives rise to additional costs, due to the need to prove the company's powers and obligations. Therefore,

in each individual case the financial risks should be checked, especially with regard to the taxation aspects. The purchase of a company is basically only worthwhile financially when the property will not be used permanently for one's own residence.

In many holiday areas on the *Algarve*, real estate is frequently owned or purchased by **offshore companies**. The advantage is principally the fact that, on transfer, only the company's shares change hands; a notarial deed is not necessary for the purchase contract, nor is transfer tax payable. On the purchase of an offshore company, it is advisable to carry out the legal checks on two levels: to check the legal status of the company, as well as that of the real estate.

One should also note that the **tax rules** for offshore companies in *Portugal* have been tightened. The **land tax** on real estate that is owned by an offshore company is automatically fixed at 5% **of the value of the real estate** (*valor patrimonial tributário* – fiscal property value), and is thus appreciably above the 0.2% to 0.8% tax rate for other real estate.

Since June 2003, there has been a uniform real estate transfer tax of 15%, on the acquisition of real estate by buyers who have their place of residence or place of business in a state or area that has favorable tax treatment (according to a list published by the Finance Minister).

3.9 Defects and warranty claims

Portuguese law distinguishes between **legal defects and physical defects.** The seller is obliged to sell the object free from defects. Legal defects are, under Portuguese law, the charges and burdens that exceed the normal legal limits of the current category according to law. Legislative or public law burdens are excluded from this. Only a buyer who at the time of the purchase had no knowledge of the burdens has a claim for protection, on the grounds that he/she entered into the contract as a result of a mistake or misrepresentation on the part of the seller. In these cases, the buyer can annul the contract and claim damages from the seller. In the case of deceit, the compensation will include the negative effect on the contract. If there has been a mistake, the compensation is limited to damage suffered. If mistake or deceit did not cause the contract to be concluded, but merely influenced the amount of the purchase price, the buyer can also demand a suitable reduction of the purchase price, besides the damages. A claim for annulment has to be commenced within one year after purchase date.

In regard to **liability for physical defects**, the seller of an object is liable for defects, which reduce the value of the object, or prevent the use of the object for a particular purpose. Further, if the object lacks a particular characteristic, which the seller claimed it possessed, he/she is liable; also where it lacks characteristics that are necessary for the stipulated use.

In the case of immovable property, the buyer has to start proceedings on grounds of a defect within **one year** of becoming aware of the defect, but **in any event not later than five years** after the transfer of the real estate. There is a debate about whether these time limits also apply to defects that are not serious – therefore, to be on the safe side, these defects should be notified formally within 30 days of becoming aware of them, and never later than six months after the transfer of the real estate.

The Portuguese legal system recognizes as claims for breach of contract a claim for annulment on the grounds of mistake or deceipt, remedial works, a claim for repayment or reduction of the purchase price, as well as the award of damages.

An exclusion of liability is only possible if it is restricted to situations of minor carelessness.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

Building on land is only allowed in designated building zones. This **designation as a building zone** (*lote*) must be registered in the *Land Register*.

Zones where building is permitted, with the current reasoning and particular rules for building, can be established from the municipal **local plans**, as well as from the national classification of ecological and agricultural protected areas, nature reserves and historic listed buildings.

For building plans, one must obtain either a **building license** or a **planning permission**, for which the town council or the mayor is responsible. A building license must also be obtained for the rebuilding, enlargement, conversion or demolition of listed buildings. If there is already a local plan, then a planning permission is sufficient for building on a plot of land. No permissions are needed for maintenance or conversion works to the interior of non-listed buildings, which do not involve an alteration of the structure, façade, roofline or foundations. Preliminary information can be obtained from the town council, concerning the likelihood of obtaining permissions and concerning construction taxes, as well as about public law limitations, before a formal application is made.

4.2 Architect's and building contracts

In the case of **contracts for works,** there is a distinction between carrying out work for which permission is required, and other cases. Works contracts for the carrying out of work, which require permission, **must be in writing.** As well as the identification of the parties, the contract must contain the **certification of the building company**, the building project and its technical specification, the value of the contract, time limits and the method of payment. Only registered or certified building firms must carry out works requiring permission; the value of the building project must correspond with the building works valuation category in which the firm is certified. As regards **architects' contracts**, no particular form is required.

4.3 Completion of construction and formalities

After completion of the real estate, an application must be made to the local authority for a **permission or license for use**. In the course of the permission process, the local authority may arrange for its expert to inspect the site, in order to check that it corresponds with the approved building project. Further, the site book, which must be kept on site and must be maintained by the architect or engineer who is responsible for the works, can be inspected at any time.

Completion of the building has to be reported to the local **tax office**, which will update the real estate tax register booklet and revalue the real estate.

4.4 Deficiencies and warranty claims regarding new construction

The person undertaking the construction, who will often be the main contractor for the project, can be held responsible for defects in and damage to the real estate. Frequently, however, the **building quality standards** cannot be compared with the high central European standards – particularly as regards noise and heat insulation – so in this regard **claims** for remedial work or damages **are difficult to pursue**, if specific and concrete quality standards have not been set out in the real estate contract. It is advisable in every case to require **security for contractual performance** from the builder.

The builder must check the real estate for defects, on handover, and must raise such matters without delay; such matters can give grounds for delaying handover or making it subject to conditions. Only **hidden defects**, that is, defects that are not immediately visible may be **notified within 30 days** of acquisition of knowledge. The builder has the right to claim remedial work or rebuilding or a **reduction** of the real estate price. A **withdrawal** from the real estate contract is possible if because of the defects the real estate is no longer suitable for the purpose envisaged. The above demands must be pursued **within one year** of refusal to accept the real estate, or acceptance subject to conditions, because otherwise they will become time-barred. In the case of hidden defects on handover of the real estate, the limitation period runs from the time of discovery of the defects, but in any event this may not be more than **two years** from the handover of the real estate.

The **limitation period for serious defects** in building, conversion or renovation of buildings is **five years**, if no guarantee period has been agreed. The deadline for notification is one year after knowledge of the defects; the same applies for the deadline for requesting remedial work or compensation.

5 Rental and tenancy

5.1 Rental and lease agreements

Portuguese law distinguishes between land and forestry lease contracts, as well as between rental contracts for permanent residential purposes and for commercial and professional use. On the other hand, general provisions on rental agreements and leases are set out in the Portuguese *Civil Code*, and these are particularly applicable to rental agreements for temporary purposes, holiday homes, garages and non-residential land.

Land and forestry leases must be **made in writing**. The minimum term for agricultural leases is 10 years, apart from a few exceptions. The maximum term is limited to 30 years. Forestry leases also have a minimum term of 10 years, but a maximum term of 70 years.

Rental agreements for residential, commercial and professional purposes must equally be made **in writing**. A fundamental distinction must be drawn between rental agreements with restricted duration, which were not introduced until the rental law reform of 1990, and rental agreements that tend to be unrestricted in time. Rental agreements that have a tendency to

be unrestricted in time differ from those that are effectively time-restricted, in that the latter can be terminated freely, by both parties, once the contractually agreed term has expired, provided the legally stipulated notice periods are observed, whereas the former are subject to an automatic extension and may only be terminated by the landlord in a few exceptional cases, which are set out in the legislation.

The length of rental agreements which are effectively limited in time may not be agreed at less than five years and no more than 30 years. Further, it must expressly be set out in the agreement, that this is of restricted or effective duration, within the sense of the urban rental rules (*Regime de Arrendamento Urbano – RAU*). In cases of doubt, the contract will be presumed to be unrestricted in time. Commercial or professional rental agreements can also be concluded with a restricted term. In the case of rental agreements that are unrestricted in time, no minimum term is prescribed, but in default of agreement these are deemed to last for six months. The maximum term is again 30 years. Agreement on the term is mainly important for determining the necessary notice period to be given by the lessor, on account of the rule regarding the automatic prolongation of the rental agreement.

Rental agreements whose length exceed six years must in addition be entered in the *Land Register*. If they are not registered, the validity of these agreements is restricted to six years. Rental agreements which are not specified as being for permanent residential purposes, in particular such agreements which concern **holiday homes**, are governed by the general rules concerning rentals in the Portuguese *Civil Code*, and are not subject to the strictest rules for the protection of tenants.

5.2 Regulations on protection of tenants and rent control

The lessee in a forestry lease can terminate this in writing at any time, subject to observation of a notice period of two years. The lessor can only terminate the agreement on grounds of specified breaches of contract by the lessee. There is no automatic legally prescribed extension of the contract. The situation is different in the case of agricultural leases. These are extended automatically by five years on expiry, if nothing to the contrary was agreed. The contract can be terminated in writing, at the end of either the original or the extended period, subject to the lessor observing a notice period of 18 months and the lessee a notice period of one year. On the sale of agricultural or forestry real estate, the lessee has a **legally prescribed right of pre-emption**.

Rental agreements, which are unrestricted in time, can be terminated in writing by the tenant only at the end of the original term of the agreement or at the end of its automatic period of extension. The notice period in the case of an original or extended rental term of rental agreement of three months to one year amounts to 30 days; it is 60 days in the case of a term of over one year and up to six years; and six months in the case of periods exceeding six years. Rental agreements whose original term was less than one year are extended automatically by the period of the original term. In agreements with a term of over one year, the automatic period of extension is one year. As grounds for termination, besides breaches of contract by the tenant, the landlord in these rental agreements of unlimited duration can only invoke the need of the real estate for his own use, or the enlargement or construction of new buildings in order to enlarge the let space. Termination of the rental agreement by the landlord must then take place in the context of court proceedings.

In rental agreements with an effectively restricted term of five or more years, the tenant can terminate at any time, subject to a notice period of 90 days. The landlord can terminate at the end of the original or extended period of the agreement. His notice to terminate must be served by the court, and this has to be requested of the relevant court a year before expiry of the notice. In the absence of termination, the rental agreement is extended automatically by a minimum of three years, unless the parties have expressly agreed otherwise in the contract. Commercial and professional rental agreements that are restricted in time are extended by the initial term if the parties do not agree to the contrary. The parties can agree the notice period for termination by the landlord quite freely; however they cannot agree the notice period for the tenant. The tenant has a **right of pre-emption** if the let real estate is sold or pledged.

The landlord has to be responsible for normal maintenance of the real estate, and must carry this out. Exceptional maintenance work or improvements can only be required by the landlord if these are stipulated by the local authority or some other legal obligation or by an agreement between the parties. The tenant may only undertake work that alters the real estate, with the agreement of the landlord.

The landlord, in accordance with an annually determined official formula that is related to inflation, can increase the rent annually. The updating of the rent does not take place automatically, however, but must be notified to the tenant annually in advance.

The government intends to introduce **changes to the rental legislation**. The intention is to make Portuguese landlord and tenant law more flexible, in order to animate the almost non-existent residential rental market.

6 Succession and gifts

6.1 Applicable law and jurisdiction

Portuguese private international law provides that, on a succession, the personal law of the deceased at the time of his/her death is applicable. The personal law is the law of **nationality** of the person. In the case of stateless persons it is the law of the place of usual residence. Further, testamentary capacity is governed by the personal law of the testator at the time of a testamentary disposition. Dispositions on death are valid in form, if they comply with the local laws of the place where the disposition is made, or the personal law of the testator, whether it be at the time of the disposition or at the time of death; or if they comply with the law that the local conflict of law rules deems to be applicable.

Portugal has not yet ratified the *Hague Convention on the conflicts of laws relating to the form of testamentary dispositions of 5th October 1961.* The most important starting point for the Convention is the applicability of the law of states, in which the testator makes a disposition, or has his/her place of usual residence, or in which the real estate is situated. In the case of testamentary dispositions in respect of real estate situated in *Portugal*, the non-Portuguese testator, if he is a national of a member state of the above-mentioned Convention, should, to be on the safe side, comply with the form required in *Portugal*, especially as Portuguese law does not recognize holograph wills.

Capacity to dispose of property (including cases of gifts) in respect of real estate situated in *Portugal* is regulated by the personal law (law of the home country) of the person

effecting the transaction. However, as regards acquisition, transfer and loss of possession and ownership, and other property rights in respect of real estate, the applicable law is that of the place in which the property is situated (so-called *lex rei sitae*). International jurisdiction over property rights in respect of real estate situated in *Portugal* lies exclusively with the Portuguese courts.

6.2 Fundamentals of the succession and gift/donation laws of Portugal

Portuguese law distinguishes between public and private wills. The **public will** is made by a public declaration, which is drafted by a notary. The **private will** is prepared and signed by the testator, and must be accepted formally and as regards its contents by the notary. The private will can be placed in the custody of a notary. **Portuguese law does not recognize simple holograph wills**. If the testator dies without having made a valid will, the **legal provisions on intestacy** come into play. The legal inheritors include the spouse, relations up to the fourth degree, and in default the state. The inheritance is apportioned per head except for a few exceptions.

Next of kin of the first degree are the spouse and the children; the spouse, however, has a guaranteed one-quarter share of the estate. **Next of kin of the second degree**: should no children or their offspring be alive, the parents of the deceased inherit – however, in this case the surviving spouse is entitled to two-thirds of the estate. **Next of kin of the third degree** are the siblings of the deceased. The other relations rank as next of kin of the **fourth degree**.

Spouse, issue and parents of the deceased have a **claim to a protected share**, which is to be borne in mind in dispositions on death or in lifetime gifts. The protected share of the spouse amounts to one-half of the estate, if neither issue nor parents are also living to inherit. The protected share of the spouse and the issue amounts to two-thirds of the inheritance. If there is no spouse but surviving issue, the protected share is one-half or two-thirds, according to whether there is one or more issue. If the surviving next of kin are only the spouse and the parents of the deceased, the protected share for these is also two-thirds. The division is carried out according to the rules of the statutory next of kinship.

In Portuguese law, the term **gift** means a contractual disposition, with no valuable consideration, acting to reduce the real estate of the donor, of a piece of real estate or an entitlement in favor of the other contracting party. Gifts of real estate are only valid when they are the subject of a notarial deed. Pure gifts in favor of a minor produce their effects independently of an acceptance by the minor in everything benefitting the minor. A gift can be subject to particular conditions or the carrying out of particular actions, and is revocable at any time, as long as it has not been accepted. This also applies if the donee rejects the gift.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

On the transfer for valuable consideration of real estate or subsidiary rights, **real estate transfer tax** is payable (*IMT – imposto municipal sobre as transmissões onerosas de imóveis*).

IMT replaced the former *SISA* – adapted from the French *assise* – as from the beginning of 2004, as part of the reform of real estate taxation. The acquisition of real estate through purchase or exchange is therefore taxable. If the handover of the real estate to the future buyer takes place simultaneously with the conclusion of the contract, the transfer tax is due at that stage. Long-term rental contracts (more than 30 years) of rural real estate are regarded as transfer value for fiscal purposes. The *IMT* is also due on the conclusion of irrevocable powers of attorney for the sale of real estate, or on surrender of contractual rights in a preliminary contract. The **tax rate** is **5%** for rural real estate. For urban real estate, the tax rate is **6.5%,** whereas for buyers who have their residence or place of business in tax havens, a uniform tax rate of **15%** is in force. The tax is payable **before conclusion of the purchase contract**, at a tax office of one's choice.

There is a **tax exemption** in various cases, in particular on the acquisition of own homes or dwellings, which serve exclusively residential purposes and which do not exceed Euro 80,000 in price. For prices over Euro 80,000 up to Euro 500,000, reduced tax rates apply. If the price is over Euro 500,000, the uniform tax rate of 6% applies.

The acquisition of 75% or more of the shares of a limited liability company, which is the owner of the real estate, is also subject to real estate transfer tax. Proof of payment of the real estate transfer tax must be produced to the notary for the notarial purchase deed, as must the preliminary contracts, which should enable the notary to check the actual purchase price.

7.1.2 Sales tax (value added tax)

The Portuguese **value added tax rate** is at present **19%**; the reduced rates are 12% and 5%. On *Madeira* and *the Azores* the rates are 13%, 8% and 4%. The general rule is that any transfer of real estate or of subsidiary property rights in land, which is subject to real estate transfer tax, is free of value added tax. Value added tax at the normal rate of 19% is therefore only chargeable on contracts for works and the purchase of building materials for the construction of the buildings. Work contracts, which come within the meaning of specific local authority or national dwelling-house building or renovation programs, are subject to the reduced value added tax rate of 12%.

7.1.3 Real estate registration and notary charges

Land Register and notaries' fees are prescribed by law in the relevant fee scales. Under the new *Fees Order*, which was introduced at the end of 2001, the fees are no longer determined by the commercial value of the transaction, but according to a fixed value for types of transactions that are supposed to correspond to the relevant investment. A fee of Euro 175 is payable for a notarial deed in respect of a purchase contract or gift contract. One should note that the notary also charges **stamp duty** (*imposto de selo*) as well as the fee. For transfers for value or for acquisition of the real estate or subsidiary rights by gift, this duty amounts to **0.8% of the value of the transaction**. The fee for the registration of the purchase at the *Land Register* in favor of the purchaser is Euro 125.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

The person or beneficial user of rural or urban real estate on 31 December in a year is obliged to pay **real estate tax** (*IMI – imposto municipal sobre imóveis*). This is a municipal tax, which in the context of the real estate tax reform has replaced the former *contribuição autárquica* as from December 1, 2003. The amount of the *IMI* is determined by the **fiscal property value** (*valor patrimonial tributário*) of the real estate concerned, which can be checked at the local tax office and which is also available from the *caderneta predial.* For rural real estate, the calculation of the value is based upon the revenue of the real estate; for urban real estate it is the **average construction and square meter real estate area price**, having regard to the area, designation, locality, quality and age. A real estate valuer, on the instruction of the local tax office, determines the fiscal property value. An owner who is not in agreement with the first calculated value of his/her real estate, can require a second valuation. The **values of real estate that were calculated under the old system of the *contribuição autárquica* can differ very markedly**. Fundamentally, newer buildings have a much higher real estate value than older buildings. The old property values (*valor patrimonial*) should progressively be brought into line with the new fiscal property values (*valor patrimonial tributário*) during the next few years. On the transfer of a real estate that was valued under the old system, a valuation according to the rules of the *IMI* takes place automatically. It is expected that the fiscal property value of a piece of land will amount to approximately 80% to 90% of its market value.

The *IMI* tax rate for rural pieces of land is 0.8% of their fiscal value. For urban lands, evaluated according to *IMI* rules it varies between 0.2% and 0.5%. For the remaining lands it is between 0.4% and 0.8%. The municipal authority is obliged to fix the annual tax rate within these margins: large cities tend to fix rates at the top end of the band. Real estate that is held by ***offshore* companies** are charged a **fixed tax rate of 5%.**

Real estate, which is acquired for one's own permanent residential purposes, can be exempted from land tax for a period of six years, on application by the taxpayer, if its fiscal value does not exceed Euro 150,000. For fiscal values of over Euro 150,000 up to Euro 225,000, the exemption is restricted to three years.

7.2.2 Income tax

Persons who receive income from real estate situated in *Portugal*, toward which the profits from a land sale also count, are liable to income tax on that income. The obligation to pay tax also exists for persons who are not resident in *Portugal*. For the applicable tax rates, see section 8.2 below.

Income from rental, leasing, parting with the right to use or with related facilities or services is taxable as well. For pieces of land, the maintenance costs as well as the land tax can be deducted. In the case of blocks of buildings, proven costs for maintaining the common parts are also deducted.

If the building is used for his/her own purposes, the owner only has to bear the land tax. The land tax can then not be deducted. No further tax is applicable.

7.2.3 Net wealth tax

At present, there are no further taxes on real estate besides those mentioned.

7.3 Capital gains tax

On a disposal for value of rights in land, or assignment of contractual options or other rights that derive from contracts regarding land, any **capital gain** (***mais-valia***) arising is taxable as income. For the relevant tax rates for residents of *Portugal*, see section 8.2 below.

The taxable gain is determined by the difference between acquisition cost and the proceeds of sale. For persons resident in *Portugal*, the taxable gain is reduced by 50%. Proven costs that have increased the value during the last five years can be deducted. If the purchase and sale are separated by more than 24 months, the purchase value is also affected by an annual updating relief formula, which is determined by the Finance Minister. The tax rate is determined by reference to the total taxable income. **For non-residents** the capital gain is taxed at a **uniform rate of 25%**.

The capital gain which arises on the sale of own homes or own residences, which are the elected main residence of the taxpayer or his family, is tax free if the total profit on sale, after deduction of any bank loans outstanding, is reinvested within two years in the acquisition of another own home, own residence or building plot situated in *Portugal*.

7.4 Inheritance and gift taxes

Within the context of the reform of real estate tax, the legislation on urban *SISA*-tax, inheritance and gift tax is being completely abolished. From January 2004 the transfer for value of real estate is taxed within the framework of the *IMT*. Bequests and gifts are now subject to **stamp duty** (*imposto de selo*). The gratuitous transfer of land situated in *Portugal*, as well as its acquisition by prescription, is subject to stamp duty at the uniform rate of **10%** of its fiscal property value. In the case of gifts, as well as the 10% charge, there is an additional charge to stamp duty of 0.8% of the fiscal property value. This additional charge does not apply to inheritance and acquisition by prescription.

Spouses, children and parents, when beneficiaries of gratuitous transfers, are exempted from stamp duty. Stamp duty on gratuitous transfers is applicable only to natural persons. If the gift is to a company, the capital gain will be taxed within the framework of corporation tax. The gratuitous transfer of shares in a company is not subject to stamp duty in *Portugal*, if the owner is not resident in *Portugal*.

7.5 Other taxes and charges

Stamp duty, which is applicable to contracts, certain deeds, books and papers. On the transfer for value of real estate or other tangible rights in real estate stamp duty of 0.8% of the value is applicable. In some districts **sewerage rates** may be payable in addition by owners of real estate.

7.6 Incorrect (lower) statement of sale price on the sales agreement

With the introduction to the new real estate taxation legislation, the practice of understatement should officially be brought to an end. This objective will be pursued on the one hand

by the application of lower rates of tax, accompanied by the adaptation of the obsolete real estate values to the real market values, and on the other hand by increased exchange of information as regards tax data.

In the case of an understatement of the value, one must reckon not only with the fiscal and/or criminal consequences, but also with possible difficulties in the later pursuance of claims by the buyer or seller in the event of non-fulfillment of the purchase contract. A purchase contract in which the parties knowingly declare a purchase price that does not correspond with the price actually paid, is a void **sham transaction**. The nullification can be brought about both by the parties to the transaction and by their heirs. An understatement can also have negative effects on the capital gains tax payable in the future. It should not be forgotten that the state, the municipalities and other public bodies, on assertion of a false or sham price, have a right of pre-emption, if it is proved that the taxable value is 30% (or Euro 5,000) over the value that has actually been taxed. The right of pre-emption must be subject of court proceedings.

An understatement of value can be pursued as **tax fraud**, and on amounts of tax evaded of over Euro 7,500 **a sentence of up to three years imprisonment** can be the consequence.

7.7 International taxation

Portugal has concluded treaties for the avoidance of double taxation with many European states, among them *United Kingdom, Germany* and *Switzerland*, as well as the *United States* and *Canada,* in the area of income tax. Inheritance and gift taxes are not dealt with by any of the treaties.

Income from immovable properties that are situated in Portugal and belong to a person resident abroad, can be taxed in *Portugal*. This also applies to profits that arise from the disposal of immovable property.

The incomes or profits that have been taxed at source in *Portugal*, are exempt from additional taxation in the state of residence of the taxpayer, but can be taken into account in determining the tax rate (tax rate reservation).

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Portugal is a member of the *Schengen area*. In order to travel to *Portugal* a valid passport or personal identity card, according to the country of origin and for the duration of the planned stay, is necessary; in some circumstances, a suitable visa is also needed. American, Australian and Canadian nationals can enter *Portugal* with a valid passport if their stay for the purposes of tourism or business does not exceed 90 days.

Within the *EU* there is the right of free movement of persons, which Swiss nationals can also make use of on the basis of the bilateral treaty between *Switzerland* and the *European Union* and its member states regarding free movement – in force since June 1, 2002. For short stays of up to three months, EU and Swiss nationals need no visa and no permission to

stay. In general, visas are granted for short stays, study and work purposes, temporary and permanent residence, and these are obtainable at the responsible Portuguese consulates.

For EU or Swiss nationals to **take up permanent residence** in *Portugal*, a residence permit (*cartão de residente)* is necessary. The application has to be made within three months after arrival, at the foreign nationals' office that covers the place of residence. For the permit, **sufficient financial resources** for one's maintenance have to be demonstrated (contract of employment or declaration of commencement of activity for self-employed persons, together with first receipts for income), as well as a health insurance policy that is valid for *Portugal,* two photographs and a valid personal identity card or passport.

The conditions for granting a **residence permit to non-EU nationals** or persons without equivalent status to EU nationals are appreciably stricter, as these persons do not enjoy freedom of movement. Before inward travel, a suitable visa for taking up residence should be sought at the responsible Portuguese consulate. Information will be supplied there about the documents that are necessary. As a rule, however, necessary items are, *inter alia*, a doctor's certificate, an extract from the central criminal records, information about the type of residence in *Portugal*, declaration concerning the purpose of the stay and proof of available financial means; in the case of employees, the contract of employment accompanied by a positive assessment by the employment supervisory authorities; for self-employed persons, proof that the applicant can practice his profession in *Portugal*, as well as proof of opening of a Portuguese account in the name of the applicant, containing a minimum balance of 14 times the Portuguese minimum wage ($5{,}500 \times 14 =$ approx. Euro 77,000). After entering *Portugal*, a residence permit should then be applied for.

8.2 Tax residence

On taking up residence in *Portugal*, one's **entire income arising worldwide** is subject to income tax in *Portugal.* Income arising during the course of the tax year is taxable. According to Portuguese law, a person has his residence in *Portugal* if he stays there for longer than 183 days, either continuously or with interruptions, or even if he stays for a shorter period, if he has a place of residence, which is intended, as his usual residence. **There is no wealth tax in *Portugal*.**

The income tax rates for natural persons for the year 2004 are as follows:

	Percentage	
Taxable income	(A) Normal	(B) Average
Up to 4,266	12%	12.000
Euro 4,266 to 6,452	14%	12.6777
Euro 6,452 to 15,997	24%	19.4333
Euro 15,997 to 36,792	34%	27.6667
Euro 36,792 to 53,322	38%	30.8700
Above Euro 53,322	40%	–

The provisions of the tax are governed by the following rules: if the taxable total exceeds Euro 4,266, it will be divided in two. In one part, which corresponds to the highest amount of

this class of income, the relevant tax rate of Part B will be applicable. The remaining amount will be subject to the next highest rate of tax of Part A.

8.3 International taxation for residents of Portugal

For the avoidance of double taxation, *Portugal* has concluded treaties with almost all European countries, as well as with many countries outside *Europe*, among them the *United States of America* and *Canada.* If a person is regarded by two contracting states as resident for tax purposes, this can have the consequence that both states apply the worldwide income principle for themselves. The double taxation treaty is then used to determine the country in which the person has his/her place of residence and which country is to be regarded as the country of source.

Usually, the country of residence is the one were the person possesses a **permanent place of residence**; if the person has places of residence in both states, the place where the means of support is situated will be decisive. The usual place of residence stands in second place, and in third place is the country of nationality. If the responsibility for tax cannot be determined according to those criteria, the countries will *negotiate* this in a mutual agreement.

9 Checklist: Real estate acquisition in Portugal

- **Checking the legal title** of the real estate, by obtaining extracts from the *Land Register*, Finance Ministry records (*caderneta predial*) and construction or use permit. Examination of the remaining authorizations of the buyer or seller.
- Possible physical **survey of the condition of the real estate**, survey and examination of historic burdens and encumbrances.
- Application for a Portuguese **tax number**.
- Drafting and concluding a preliminary contract with an enforcement clause, having regard to the necessary formalities as well as to the provisional registration of the preliminary contract, or provisional registration of the purchase in the *Land Register*. First **down payment** toward the purchase price.
- Payment of the **transfer tax** at the tax office.
- After final examination of the relevant documents, conclusion of the **notarial deed which comprises the purchase contract**, and **payment of the balance of the purchase price**.
- Registration of the purchase on the *Land Register*, with production of a certified copy of the notarial deed making up the purchase contract and with the proof of payment of stamp duty (in case of gratuitous transfers).
- Changing the record of the real estate at the local tax office, into the name of the buyer, and possible application for exemption of the land tax.
- Important: If there is a demonstrable non-compliance with the purchase contract on the part of the buyer, he/she loses the installments on the purchase price that have already been paid. If it is the other way round, the seller must refund the buyer with double the installments that have been paid.

10 Bibliography

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1 Introduction

Pursuant to the national constitution in force since 1978, the Kingdom of *Spain* (*Reino de España*) is a hereditary monarchy with a parliamentary democratic system of government. The King is head of state. The legislative body is a bicameral parliament (*Cortes*) consisting of the House of Representatives (*Congreso de los Diputados*) and the Senate (*Senado*). The latter is the representative body of the 17 autonomous regional authorities (*Comunidades Autónomas* or *Autonomías*). *Spain* has a landmass of 505,990 square kilometers and approximately 41 million inhabitants. The principal urbanized areas are *Madrid*, in the middle of the country, and *Barcelona*. In addition, the coastal areas and archipelagos are, in the majority, densely populated. Climatically, the extremes are greater inland than on the southern and eastern coasts, so that it can be noticeably cold inland, especially in winter, remaining mild nearer the sea. In summer, it is hot all over *Spain*.

The Spanish real estate market has been experiencing a boom since the middle of the 1990s due both to a continually strong domestic market and a steady rise in the demand from abroad. In comparison with the rest of *Europe, Spain* traditionally has one of the highest percentages of condominiums. This has led to an annual double-digit price rate increase in the real estate sector. For that reason, it is practically impossible to speak of 'bargains' in Spanish real estate when making an international comparison. However, the increase in price has been accompanied by significantly improved standards of quality, thereby justifying the higher costs.

Factors such as economic and political stability, population density, climate as well as the interesting and varied geography combine to make *Spain* an ideal investment location and above all a strategic place to live within the framework of *Europe* or the *Mediterranean* region.

2 Ownership of real estate

2.1 Different forms and types of ownership

Sole ownership

Article 33 of the *Spanish Constitution* of 1978 guarantees the right of ownership, which is an absolute right limited only by the constitutionally guaranteed social function. In the *Spanish Civil Code* (*Código Civil* – hereafter *Cc*), the **right of ownership** grants the (sole) proprietor the unique and exclusive **right to use and dispose** of his/her property without limitation except as established by law (*Article 348 Cc*). The owner is thus able to use his/her real estate and its fruits, possess it directly or indirectly, dispose of or encumber it, enclose, demarcate and separate it, as well as to proclaim his ownership and ward off any interference to his/her real estate. Pursuant to *Article 350 Cc,* the owner of real estate has ownership over its surface as well as that which lies beneath. The right of possession and use of the airspace (*vuelo*) above a real estate, e.g. by building on it, is also derived from *Article 350 Cc.* From this same right, the owner in turn accrues a temporarily **transmissible building right** (*Derecho de superficie*) that can be alienated or encumbered.

Co-ownership

Co-ownership exists when several legal or natural persons are **jointly entitled to ownership of real estate.** At the same time each individual owner is entitled to a share (*pro indiviso*) of the undivided common real estate.

Although the configuration of **joint ownership** *'pro diviso',* whereby co-owners hold real estate jointly without any assignment or division of the whole, is widespread in other jurisdictions, it does not exist under Spanish law. However, a statutory concept similar to joint ownership arises, where within the context of a co-ownership community, agreements are reached to jointly alienate or encumber portions of the co-owned real estate. Nevertheless, this is still not a form of common real estate in the sense of a collective ownership.

In the context of the co-ownership community, each co-owner has the **full and exclusive ownership of his/her share.** Nevertheless, each co-owner is entitled to use the whole of the real estate and to receive the fruits from the whole real estate that correspond to his/her ownership share. In return each one is obliged to bear the corresponding pro rata **maintenance costs**.

Alteration or transfer of the joint real estate may only be undertaken unanimously. Each co-owner may, however, encumber or alienate his/her own common share. No co-owner can be compelled to remain in the community, even though the law permits agreements on **minimum affiliation** for up to 10 years, which may be extended when they expire. The issue of potential pre-emption rights of co-owners may have to be considered.

Each co-owner has the right to demand the **dissolution of the community**, insofar as this does not render the intended use of the real estate impossible: the rights of third parties cannot thereby be affected. If the real estate is indivisible, which may be the case with a large number of properties, then it must be sold and the proceeds divided.

Condominiums

A particularly relevant form of co-ownership has its basis in the ***Law on Horizontal Property*** (*Ley sobre la Propiedad Horizontal*, hereafter *LPH*): According to this, the **common elements** of residential semi-attached or detached units or of an apartment building are co-owned by the owners on an individual basis by means of a so-called **Declaration of Division** (*Declaración de división horizontal*) of units, each one being owned individually. Therefore, within this physically connected space, private **individual ownership** and joint co-ownership exist side by side. These **ownership communities** govern themselves principally based on the will of the members as expressed in bylaws.

Timesharing (part-time easement)

Part-time occupancy rights or timeshares are a very relevant topic in *Spain*. As a consequence of the comprehensive, though late, implementation of the EU timeshare directive at the end of 1998, the ban on further designation of these rights as *Multipropiedad* ('Plural ownership') can be highlighted as the most drastic and most exceptional change. These rights are now in fact designated as **timeshare rights** (*Aprovechamiento por turnos de bienes inmuebles*) in order to avoid any further suggestion that the rights correspond to ownership rights of the user. Rather, in the present framework of timeshare in *Spain,* it is a matter of an atypical, limited right *in rem* of the user.

The easement must have a **minimum duration** of seven days per year; at the same time the relevant agreement may not give rise to an obligation of less than three or more than five years. Rights of users acquired prior to the introduction of the law remain in existence without a time limitation as long as other strict statutorily determined standards are observed.

Said standards oblige the owner of the timeshare property to observe a multitude of **consumer protection regulations**. In association with the operating company, the owner must create a system for use in the form of a **public document,** in accordance with legal requirements. The document must then be recorded in the **Ownership Registry (*Registro de la Propiedad*)**. Furthermore, there are a number of provisions which strictly regulate the conclusion of the contract. For existing contracts, the legislator had allowed a transition and adjustment period of two years up to the end of 2000.

Non-compliance with these provisions grants the user **extensive grounds for termination of contract.** The grounds are so far-reaching that the introduction of the law could have been paraphrased with the slogan, 'Reorganization of Timeshare: Timeshare abolished!' However, it cannot be overlooked that a large number of existing contracts continue in force and will continue to be the subject of legal disputes and subrogation.

2.2 Easements, charges, liens and mortgages

The right of ownership of real estate is limited by easements, respective rights of occupiers of adjoining property, statutory rights of pre-emption or first refusal, or inalienability and other rights *in rem* of third parties. The latter basically serve to grant rights *in rem* in the broader sense such as the securing of liabilities or obligations as well as the securing of the acquired elements, i.e. unsolicited option or pre-emptive rights, through an interest in real estate.

Usufruct (beneficial use)

The legal right of **usufruct** (*Usufructo*) conveys to the usufructuary the right to use and enjoy the fruits of a real estate without being the owner. The usufructuary is obliged to maintain the real estate in form and substance.

Unless otherwise agreed upon within the grant of the usufruct, the authorized person can make use of the real estate, receive its fruits, e.g. from renting it out, encumbering it, or even assigning his/her right. On the other hand, the usufructuary is obligated to the absolute owner (***nudo propietario,*** in *Spain* one speaks of the 'naked' property, *nuda propiedad*) and is bound to preserve the real estate, to bear the brunt of its expenditures and encumbrances, as well as to return it at the end of the agreed period. The owner is obliged to bear the cost of extraordinary repairs insofar as they are required.

The right may expire: after a specific period of time; on the demise of the usufructuary; on the concurrence of the right of usufruct and the title to the 'naked' property in one person; and, also, in the event of the destruction of the real estate subject to the usufruct.

The right of usufruct may be created by agreement of the parties or it may arise at law. **Usufruct in favor of a legal entity** is limited to a maximum of 30 years. The most common form of usufruct in *Spain* is the testamentary appointment of a surviving spouse as

usufructuary of the deceased's estate, irrespective of whether the spouse acquires a statutory right of usufruct alongside descendants or heirs of a more distant rank. Furthermore, the right of usufruct is frequently employed in the acquisition of real estate where ownership is intended to pass to successor heirs but the testators-to-be are meant to maintain possession and control of the real estate by means of usufructuary right. When succession occurs, the usufruct simply expires and this legal gain alone is subject to inheritance tax.

Right of use and right of residence

Spanish law recognizes the right *in rem* of use and residence (*Derecho de Uso y Habitación*) as a subform of usufruct. This right is strictly personal. Consequently, it cannot be transferred to another person in any way.

Heritable building right

By means of a **heritable building right** (*Derecho de superficie*), independent ownership is established on land belonging to another. The beneficiary of the heritable building right becomes entitled thereby to construct on or under the land of the real estate owner and, by paying annual **lease**, has ownership of the building. The heritable building right is separate from the formal property right over the plot of land and thus the heritable building right breaches the fundamental principle of acquisition of ownership by **accession** (*Derecho de accesión*).

The essential characteristic of the heritable building right is that ownership of the constructed building erected is transitory in nature. The right terminates once the agreed time period lapses and ownership passes to the owner of the real estate, no payment being accrued as a result, although this can be negotiated. The **duration of the heritable building right** between private persons may not exceed **99 years**. In the case of building leases arranged by municipal authorities, the maximum duration is 75 years.

An imperative condition for the validity of the heritable building right is its formal creation in a **public deed**. The heritable building right must be recorded in the Ownership Registry. In the case of the heritable building right, the entry in the Registry is the **constituent act**, in contrast to the fundamental principle of informality in the creation of rights *in rem* in *Spain*.

For the owner of the land, the principal advantage of the heritable building right is that he/she is titleholder of the appreciation in value of the real estate. In addition, the owner gets a financial return and, in the long run, becomes the owner of a building. Real estate investors who do not wish to assume the risks of financing and constructing a building may find an effective and profitable alternative way with a heritable building right.

Leasehold (land rent)

Leaseholds **(*Censos*)** constitute land charges that are – systematically in an inappropriate way – regulated within the framework of the contractual relationship rather than in the context of the real estate law regulations of the second book of the *Cc*. **Emphyteusis** (*censo enfitéutico*) is distinguished from the **land rent on the granting of capital** (*censo consignativo*) and the **land rent on conveyance of the property** (*censo reservativo*). Today one frequently finds old, expired land rents recorded in the Ownership Registry that are canceled in the context of the first subsequent authorized amendment.

Land easements

Land easements (*Servidumbres*) are rights *in rem* to the benefit of a property of a third party. The easement encumbers a **servient property** in favor of a **dominant property** that benefits from the easement. Easements can arise either as a matter of law or based on the will of the parties, whereby the **acquisitive prescription** plays an important role. In principle, an easement agreement does not require any particular form; nevertheless only a public or notarized document or a judgment may be recorded in the Ownership Registry. Rights of way, water rights, easements for light and views, etc., are examples of **statutory land easements. Voluntary land easements** may be of many kinds, even including the right 'to take part in local festivities from the balcony of a servient apartment'. In addition to the usual grounds for the expiry of a right, the failure to exercise the easement for a period of more than 20 years should be noted.

Mortgages

Within the scope of **encumbrances on real estate**, Spanish law only recognizes the **mortgage (*Hipoteca*)**, which is exclusively structured as a strictly accessory security right. In contrast to other jurisdictions, an **agreement of a charge on the land** is not possible. Nor does a mortgage debenture or a mortgage note exist in Spanish law. Only **registered mortgages** are recognized.

A precondition of recording a mortgage in the Ownership Registry is, as with all entries, the presentation of a public or notarized **document recording its creation**, thus precluding the entry of privately composed agreements. The entry of a mortgage in the Ownership Registry is the constituent act in the creation of the mortgage.

The **commercial mortgage** is the standard mortgage in Spanish law and includes a pre-existing demand for payment as well as interest, default payment interest and costs of judicial enforcement.

The **maximum ceiling mortgage** (*hipoteca de máximo*) guarantees claims for payment up to a specific amount or ceiling where the actual amount of the claim is either not yet known at the time the mortgage is created or changes during the period of validity (e.g. credit on a current account). The upper limit of liability of the real estate, the credit period, the extended periods, where applicable, as well as the due dates of the amortization on the credit account must be stated at the time of creation of the mortgage.

In principle, Spanish law does not recognize **a consolidated mortgage** (*hipoteca solidaria*), i.e. a mortgage that encumbers several properties equally as security for a specific claim. Nevertheless, in practice there is **an important exception** that can be implemented, especially when financing arrangements for real estate developers. A mortgage is first created on a single and usually large real estate. Later, when the real estate is divided, a consolidated mortgage is deemed to exist, from the viewpoint of the protection of creditors, i.e. several properties respectively insure the entire claim.

The **unilateral mortgage** (*hipoteca unilateral*) alleviates the situation regarding the creation of mortgages in international legal relations. It is possible for the borrower to create a mortgage without the immediate participation of the creditor. The mortgage is then recognized in the place of residence or at the location of the creditor's office. If the creditor

does not respond to the request of the borrower within two months, by presenting his/her declaration of acceptance at the Ownership Registry, the mortgage expires.

From a practical financial viewpoint, Spanish law regards a real estate encumbered with a mortgage as an economic unit. Consequently, **the liability of the mortgage** extends to all the component parts that are naturally connected with the real estate, including the improvements (*mejoras*), i.e. renovations, rebuilding, etc., but not to new buildings that are only included in the official documents of the mortgage by express agreement. Also, by law, liability does not extend to permanently installed furniture and fittings, nor to fruits and revenues owed (*rentas*) but not yet collected (most notably, house rents). Therefore, if the mortgage is intended to extend to these items, they must be separately incorporated into the records documenting the creation of the mortgage.

The mortgage extends to the interest agreed upon within the scope of the credit contract and, in such case, to default payment interest and costs of judicial enforcement. According to Spanish mortgage law, except where limited by contract, interest accrued during the last two years as well as interest due and payable in the current year can be guaranteed by mortgage. This can be extended for up to five years if the parties agree. In addition, the mortgage guarantees the possible costs of judicial enforcement where this may be an additional claim in the future, up to a maximum of 20% of the secured principal claim.

Following the reform of the Spanish civil procedure rules at the beginning of 2001, creditors now have at their disposal, in addition to the usual types of procedures, i.e. recognition procedure and the general security enforcement procedure, a more effective summary **mortgage enforcement procedure** with shorter deadlines. The legislature has also incorporated an extrajudicial notarial enforcement procedure (*venta extrajudicial*) into the new civil procedure rules.

When the claim secured by the mortgage **expires**, the real estate owner does not acquire any type of land charge that prevents subsequent encumbrances from rising in preference in the Ownership Registry. **The mortgage is satisfied** when a public document of satisfaction, signed by the mortgage holder or mortgagee, or a judgment with the force of law is recorded. In addition, the owner can now file for satisfaction without the participation of the mortgage holder after a lapse of a specific period of time.

Statutory mortgages essentially protect the following groups in *Spain*: family members in family claims (*e.g.* for maintenance expense, inheritance, etc.) and insurance and ownership communities, insofar as their members fail to comply with their payment obligations, such as employees' wages, to a certain extent. Furthermore, claims of the state, the provinces and the municipalities are insured through statutory mortgages against their claims of the last two tax years, insofar as the corresponding acknowledgment of the debt is registered.

2.3 Protection of ownership, proof of ownership and registration

In contrast to other legal systems, Spanish law allows ownership of real estate to be established by means other than an entry in the Ownership Registry (*Registro de la Propiedad*). In fact, an acquisition that is **completely detached from the Ownership Registry** is possible. The entry in the registry is merely **declaratory**, i.e. as evidence of legality, but **not** the **constituent act for the creation of the right of ownership**.

Therefore, any qualified written or other type of document about the relevant acquisition of real estate in its original form can be sufficient **proof of ownership**. Nevertheless, it is regularly the notarial contract of sale or deed, the ***escritura pública***, that provides proof of the right of ownership.

Since problems in proving ownership are unavoidable because of the possible informality in the acquisition of ownership, Spanish legislation provides legal or notarial procedures by means of which a person's right of ownership can be established and, most importantly, subsequently entered into the Ownership Registry. In detail, this is a matter of the **Proof of Ownership Process** (*expediente de dominio*) or the **notarial Act of Disclosure** (*acta de notoriedad*), both of which are regulated in the Spanish mortgage law, *Ley Hipotecaria* (hereafter *LH*).

In spite of the informality, entry into the Ownership Registry has an importance that should not be underestimated since the principle of the ***bona fide effect* of the Spanish Ownership Registry** is stipulated in *Article 34 LH*, which reads: *'A third party who, in good faith and in return for payment, acquires a right from a seemingly entitled person according to an entry in the Ownership Registry, is protected in his acquisition from the moment in which the right is recorded, even though, subsequently, the title of the transferor is annulled or terminated for reasons that did not themselves emanate from the Ownership Registry.'* This is **one of the most important provisions of Spanish real estate law** and unambiguously demonstrates the tremendous significance of the recording in the Ownership Registry

The legal basis for the **Ownership Registry** (*Registro de la Propiedad*) is found in Article *605 ff. Cc* in conjunction with *Article 1 ff. LH*. Pursuant to *Article 1 LH*, it is the task of the Spanish Ownership Registry to register or provisionally record those legal documents and contracts that affect ownership or other rights *in rem* in land. Formally, pursuant to *Article 3 LH*, **rights may only be entered on the basis of public documents or notarial deeds** (*escritura pública*), **enforceable proof of indebtedness**, court decisions or other official court documents. By contrast, the entry of privately drawn up contracts is categorically excluded.

The Spanish Ownership Registry is maintained in such a way that a separate sheet is created for every real estate. The **Ownership Registry sheet** is divided into **three columns**. In the right-hand column, every legal event connected with the corresponding real estate is entered in strict chronological sequence, whether a transfer of ownership, an attachment, a mortgage or an easement. The foregoing narrow column, the middle column, serves to consecutively number the entries. The column on the left contains the marginal notes (*notas marginales*). The most diverse legal circumstances are entered in this column, which usually refer to the transaction recorded in the other two columns, such as tax liabilities of the real estate or the expiry of encumbrances on the real estate or the acceptance thereof, etc. In individual cases, the legal transactions to be recorded in the column on the left are specified by law.

Every document that is presented to the Ownership Registry is recorded in the **Registry Diary** (*Libro Diario*) specifying the precise date and time. In the past, documents received by mail were not considered by virtue of application of the principle of personal presentation. This no longer applies. However, the time of receipt is deemed to be the moment in which the mail is opened in the Ownership Registry (pursuant to the mortgage regulation, *Reglamento hipotecario,* hereafter *RH*), which is a somewhat uncertain practice. This is of

great significance, since, in Spanish law, a fundamental principle is that the earlier right has precedence over that which is established at a later time (*prior tempore potior iure*).

3 Purchase and sale of real estate

3.1 The sales agreement

Ownership of real estate is transferred in *Spain* according to the **doctrine of *Título* and *Modo***. According to this doctrine, two elements are necessary for an effective transfer of ownership: an underlying transaction (the *Título*, e.g. a sales contract, a donation, or something similar) and an act of transfer (the *Modo,* e.g. the handing over of the keys of a dwelling or the simple agreement to transfer possession of a property).

The buying of real estate in *Spain* is **essentially informal**: *Article 1278 Cc* specifies the fundamental legal effectiveness of contracts, regardless of their form. Although *Article 1280(1) Cc* establishes the obligation to notarially authenticate real estate transactions, the law nevertheless contains no rule of nullity in case of non-observance of this provision. In fact, *Article 1279 Cc* grants both contractual parties the right to demand that the other party complete the legally required form, which implies **that informal contracts are fully valid**.

A further important difference between other jurisdictions and Spanish real estate law is the **informality in the handing over of property**. Under Spanish law, the transfer can be made by means of oral agreement or other type of implied action. A much-cited example of this is the act of handing over the keys. However, any other *de facto* granting of the power of disposal can also be regarded as a transfer of possession and therefore as procurement of ownership.

In addition, the issue of public sale contract documents is also tantamount to transferring possession, thus waiving the need for any other separate transfer of real estate. This would only cease to apply if special rules or clauses with regard to the granting of possession had been agreed in the notarial deed or *escritura*.

Usually, the process of Spanish real estate transactions begins with the signing of the **privately drawn up sales agreement**. This is not however to say that it would not also be possible to immediately sign a notarial deed or *escritura pública*, thus waiving the need for the private contract, but this is not the usual practice in *Spain*. In contrast to many other jurisdictions, in *Spain*, the **private contract binds the parties** in exactly the same way as a notarial contract of sale.

The occasional practice is to take the real estate under consideration off the market for a short time prior to concluding the private contract in return for the payment of a small **reservation fee**. If the interested party then reneges on the acquisition, he/she usually forfeits the fee.

All the essential contractual conditions (agreement on the acquisition of completely unencumbered real estate, purchase price, manner of payment, date of transfer, fittings, etc.) should be determined without exception in the privately drawn up contract. As a rule, a **down payment** for the amount of a **maximum of up to 15% of the purchase price** is agreed upon in this contract.

If this down payment is agreed upon as ***arras penitenciales***, or deposit, pursuant to *Article 1.454 Cc*, then this means that the parties can free themselves of the contract, which

would, however, result in the following financial consequences: if the buyer fails to meet his/her obligations under the privately drawn up sales agreement (payment of the balance of the purchase price and attendance at the signing of the notarial document), then he/she basically loses the down payment. On the other hand, if the seller fails to meet his/her obligations (attendance at the signing of the notarial document and granting of possession), then he/she is obliged to **repay double the amount of the down payment** to the buyer. This is probably the most frequently encountered arrangement in practice.

The privately drawn up contract can also refer to a simple **purchase option** instead of to a purchase. In that case the party entitled to the option acquires the right to purchase a specific property at a specified price within the option period stipulated in the contract. Instead of a down payment, an option price is agreed, to which the option grantor is entitled just for holding the real estate in reserve in favor of the option taker. This differs principally from a contract of sale with an *arras* agreement pursuant to *Article 1.454 Cc* in that the **option grantor cannot be released from the contract simply by repaying the buyer double the amount of the *arras***. Thus, the buyer basically has a stronger position, for which he/she must, of course, pay the option price, which as a matter of principle is not offset against the purchase price, a frequent exception in practice being, however, that the offset is explicitly agreed upon.

This sort of a purchase option can also be agreed upon in notarial deed or *escritura pública* instead of by means of a private sales agreement and, in this case, even entered in the Ownership Registry. *Article 14 RH* nevertheless prohibits the agreement of an option period of more than four years. The advantage of agreeing on a purchase option in a notarial deed lies primarily in the legal security for the buyer, whereas the disadvantage lies in the additional costs incurred such as for taxes, notary and the Ownership Registry.

Once the privately drawn up sales agreement has been concluded, the notarial deed is usually executed within the timeframe foreseen for transfer of the real estate and for payment of the balance of the purchase price as agreed in the privately drawn up contract. All conditions and ancillary obligations in this connection effectively agreed upon in the privately drawn up contract should be fulfilled.

In summary, it should again be pointed out that the **decisive step within the scope of acquisition of real estate** in *Spain* is the **conclusion of the privately drawn up contract of sale**. This contract stipulates all those obligations of the parties, the partial fulfillment of which will already have taken place between the date of the conclusion of the private contract and the subsequent notarial document. The already fulfilled items from the private contract – e.g. renovation of an apartment – will no longer be mentioned in the subsequent notarial deed.

Nevertheless, the buyer should ensure that all the **items still to be fulfilled are stated** in the *notarial deed*. These can be, for example, taxes still to be paid, contract costs and other separate arrangements. This recommendation to incorporate the still unfulfilled obligations in the notarial deed is clear from the jurisprudence of the highest Spanish court, the *Tribunal Supremo*, on the relationship between two partially contradictory contracts: in order to resolve a conflict, it is determined that **the later contract** is always **regarded as the final agreement** between the parties, i.e. the *notarial deed*. None of the parties can rely on previous obligations concluded in a privately drawn up contract alone.

The issuance of the public document or notarial deed generally indicates the legal conclusion of the real estate transaction and it is a prerequisite in order for the new real estate owner to record the change of ownership **in the Ownership Registry** and thereby be appropriately protected against *bona fide* third parties. Moreover, anyone carrying out further business with this real estate, for example, creating a mortgage, will always wish to see the owner's notarial deed. On authenticating further dealings regarding the same real estate, the notary is normally accustomed to making a note of the later transactions on the original deed so that neither multiple transfers nor encumbrances can be undertaken within a short period of time using one and the same document.

***Bona fide* acquisition by unentitled persons:** As already indicated, *Article 34 LH* is the principal rule regarding *bona fide* acquisition by unentitled persons as recorded in the Ownership Registry. Where the alleged titleholder challenges a successful acquisition by a third party in good faith, the titleholder must prove that the third-party buyer knew about the inaccuracy in the Ownership Registry and consequently acquired the real estate interest in bad faith. This difficulty is of considerable significance in *Spain* since legal transfers can effectively take place without publication in the Ownership Registry, meaning that the Registry often does not reflect the legal reality.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

According to *Article 9 Cc* the **effects of marriage** are governed by the law of the jurisdiction of which the married couple are citizens (the *lex patriae*). Consequently, any existing family law-related limitations on real estate dispositions are to be determined in that way. The competence of each spouse to buy or sell depends on his/her individual matrimonial property regime.

The **community of assets** (*sociedad de gananciales*) is the default statutory matrimonial property regime in *Spain*. Accordingly, each spouse is entitled to half of all rights and accrued assets acquired during the existence of the community of assets. In addition, the law recognizes the **community of accrued assets** (*sociedad de participaciones*). As a third option, the married couple can agree to a **separation of assets** (*separación de bienes*).

Where the standard regime of the community of assets exists, sale by one of the spouses always requires the **consent of the other spouse**. If the matrimonial property regime is not obvious, authorities such as a notary or registrar will always presume that the regime of community of assets exists and will require express consent.

In practice, this presumption will frequently apply, contrary to legal necessity and requirement, even with regard to foreign matrimonial property regimes that are completely different and do not recognize any provisos for consent. Therefore one should **always be ready to prove the seller's authority at the time of transfer.**

Furthermore, it should be noted that numerous other applicable **rules exist pertaining to the law of forum** of individual autonomous regional corporations in matters of family and hereditary rights. In *Catalonia*, for example, the standard statutory matrimonial property regime is the separation of assets, whereby the transfer of **the family home** in *Catalonia*

or *Andalusia* requires the consent of the other spouse, even if the transferring spouse is the sole owner of the property.

In individual cases, it may be imperative that a lawyer performs a professional and detailed inspection of the prevailing situation in the respective region prior to the real estate transaction in order to avoid investing considerable sums of money in a transaction that may be challenged at a later date.

3.2.2 Options and pre-emption rights

In addition to **rights of pre-emption** (*tanteo*), Spanish law also recognizes the **right of first refusal** (*retracto*). However, the right of first refusal corresponds, from a practical standpoint, almost entirely to the right of pre-emption and thus both rights can be regarded as virtually the same. The contractual right of pre-emption can be agreed for a **maximum period of 10 years** and may be recorded in the Ownership Registry and thereby be enforceable *erga omnes*, that is, against every person.

Of greater significance than contractual rights of pre-emption are the **statutory rights of pre-emption** in favor of **tenants** (*Article 25* of the *Spanish Law on Municipal Tenancy, Ley de Arrendamientos Urbanos*, hereafter *LAU*), **co-owners, adjacent owners of agricultural real estate** and the **transmittable long-term leaseholder**. Within these different rights of pre-emption, the right of a co-owner takes precedence over the right of a tenant or adjacent owner.

The most relevant pre-emption right in practice provides that the owner has to serve notice on the tenant of his/her **intention to sell** and of the essential contractual terms. Following notification, the tenant has 30 calendar days within which to exercise his/her pre-emption right, if desired. If the owner does not sell the real estate within a period of 180 days, the notification loses its validity and has to be reissued. If a conflict between contractual and statutory pre-emption rights were to arise, the former would only take precedence if it had been recorded in the Ownership Registry prior to the conclusion of the contract of sale.

In addition, **rights of pre-emption in the public interest** exist in favor of municipalities, for example, by virtue of the **special historical and cultural significance of buildings**. Each *Autonomía* regulates this issue in its own territory. Due to the numerous possibilities concerning the existence of such pre-emption rights, their application to a given situation should be studied beforehand.

3.2.3 Agricultural real estate

The concept 'agricultural land' is not governed by any special measure in Spanish private real estate law. Rather, the concept belongs exclusively to administrative law.

The transfer and acquisition of agricultural and rural land in general is not subject to any limitation in *Spain.* However, agricultural construction obligations may be partially attached to rural land (for example, due to previously granted subsidies), that are a charge on the right to use the real estate freely. Exceptional cases of this nature are definitely subject to a duty of disclosure by the seller. Otherwise, if circumstances so require, inquiries to the regional environmental minister can afford the buyer greater legal security.

Furthermore, in connection with rural land, one can describe the following fundamental categories of land: Traditionally, there are **three categories of land** in *Spain*: **urban land, land suitable for urban development** and **rural land** (*Suelo Urbano, Suelo Urbanizable* and *Suelo Rústico*). The current text of the law designates 'rural land' as **'land unsuitable for development'** (*Suelo no urbanizable*). This last category was seen as a catch-all category in earlier construction laws, that is to say, all land that was not urban or suitable for urban development was categorized as unsuitable for development. The Land Law of 1998 (*Ley del Suelo*, hereafter *LS*) amended this categorization to the effect that since then the catch-all category is land suitable for urban development.

Consequently, rural land now has to be expressly shown as such in the general municipal plans for the development of local real estate insofar as a region is to be excluded from possible building development. Only the ***Balearic*** and ***Canary Islands*** are **exempt** from this change in the basic principle as the previous system is still being implemented due to special factors. Simply said, this means that one can now build anywhere except where land has been specifically assigned as land not suitable for development.

At any rate, allocation to one of the three aforementioned land categories depends on the **municipal development plan**. To this end, and in particular with regard to plots of rural land that are being bought for construction, an inquiry should always be made to the municipality about the absolute minimum legal construction requirements for the construction site, such as, for example, the minimum size of the plot for construction, the permitted volume of construction, minimum clearances, building heights, number of floor spaces, etc.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

The regulation governing foreign investment (*Normas en materia de inversiones extranjeras en España* of July 1, 1992) has liberalized all investments in *Spain* since 1992, meaning that investments no longer require **permits**. It should be noted that rules on investment are always linked to the place of origin of the investment and not nationality. EU citizens are exceptions to this rule. Since 1999, **foreign investments** have only been considered as such if the amount has exceeded Euro 3,005,060.52. The previously mandatory process of prior government verification of the investment amount has now been replaced by a simple retroactive notice to the appropriate government office, which is merely for statistical purposes. In addition, there is now an obligation to report investments where the **capital inflow originates from so-called tax havens** prior to carrying out the investment.

Special zones of interest for national security with limitation on acquisitions by foreigners were created by law in 1975. These primarily concern coastal zones and those islands in which the percentage of foreign ownership of real estate may not exceed certain threshold values. However, exceptional circumstances have had an important effect on these regulations. Thus, these provisions lapsed for **EU citizens** with *Spain*'s entry into the *European Union* in 1986. Nonetheless, **non-EU citizens are still requested to apply for specific authorization** for their purchase transactions which may cause delay and consequently even threaten the success of the purchase process, as sellers might be under time pressure, and authorization formalities can take some time. To avoid any problem, buyers should check the applicability of national security rules as far ahead as possible.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

The **seller's authority to dispose of real estate** results from his/her ownership status. If applicable, the person entrusted with the sale may also be an agent, in which case the mandate does not need to be given in a particularly formal way, which is the situation frequently encountered when concluding a privately drawn up contract. On the other hand, an adequate notarial verification of the authority to dispose must always be carried out on authentication of public documents.

The capacity to act and conclude a contract basically conforms to Spanish international private law according to the personal statute of the acting party, as determined by his/her nationality and thus dependent on his/her right of residence. In this context, the rule laid down in *Article 10.8 Cc* is of importance, according to which contracts on immovable property situated in *Spain*, concluded for consideration, will be effective in *Spain* if concluded by a person who in fact lacks capacity to contract according to his/her right of residence, because the grounds for that person's incapacity to contract would not necessarily lead to incapacity to contract under Spanish law.

Under Spanish law, a person comes of age, or **reaches majority**, upon attaining his/her 18th birthday and is then entitled to undertake all functions of civil life.

Legal entities – which, in *Spain*, will mostly be a limited liability company, a ***Sociedad de Responsabilidad Limitada*** (hereafter S.L.) – are usually represented by a **manager** (*administrador*) or an **authorized person** (*apoderado*) that will prove their right to act on behalf of their company through a notarial deed of **appointment of manager** (*nombramiento de administrador*) or **authorization** (*apoderamiento*). Those deeds must generally be registered in the Commercial Registry (*Registro Mercantil*) to have full legal validity.

3.3.2 Third-party claims and unpaid taxes

Encumbrances in favour of third parties only ever have an effect on the public if they are **recorded in the Ownership Registry**. This affects both the rights already mentioned and also possible provisional **judicial attachments of the real estate** as security for claims asserted in court (so-called *embargos preventivos*). These are comparable to a seizure *in rem* and are entered in the Ownership Registry by means of **attachment notes** (*anotación preventiva*). Furthermore, future claims based on succession rights that are registered in the Ownership Registry can also be in conflict with a clean purchase. However, **provisions on encumbrance-free *bona fide* acquisition** apply, that is to say, these should not be considered insofar as they are not recorded in the Ownership Registry and the buyer, in good faith, is unaware of their existence.

The **real estate tax liabilities** of the prior owner can arise on the one hand from non-payment of current taxes such as local real estate tax (*Impuesto sobre Bienes Inmuebles*, hereafter *IBI*) or from non-payment of non-recurring taxes such as the real estate acquisition tax (*Impuesto sobre Transmisiones Patrimoniales*, hereafter *ITP*) or similar. While the former is directly attached to the real estate even without a corresponding annotation in the Ownership Registry (always ancillary to the delinquent taxpayer!), in the case of *ITP* debts or similar,

a **Notice of Tax Liability** (*afección fiscal*) must be entered in the Ownership Registry. In addition, there is an obligation on the real estate buyer to withhold 5% of the purchase price from non-residents and to forward it to the tax authorities: this obligation also encumbers the real estate. According to *Article 64* of the General Spanish Tax Law (*Ley General Tributaria*, hereafter *LGT*), the general **statute of limitations on tax obligations** in *Spain* is **four years** from the end of the period of submission for the tax self-assessment form.

Finally, without the necessity of an annotation in the Ownership Registry, the real estate is liable for **debts owed to an ownership community**.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Particularly in the case of **rural properties**, it should be verified whether the real estate is located in a specially protected area, whether for environmental reasons or forestry, species or landscape protection or as a nature reserve. There are regulations that can limit rights of use inherent in the right of ownership, such as building development plans, agricultural or hunting use, even partially including the simple access to private properties. Formal inquiries to the appropriate regional environmental minister, for example, can afford greater legal security.

In the case of real estate located near the sea, the possibility of any building development has to be studied in the context of the Spanish **Coastal Law** (*Ley de Costas*) of 1988. The Coastal Law has as its objective an orderly development of the Spanish coastal area, which is after all 7,880-kilometers long. Today, almost 40% of the Spanish population lives on the coast, although development on the coast is in fact even denser since tourist use is not included in this figure. The law divides the strips of land immediately bordering the sea into **various zones of protection**, within which different types of development are possible: the national **public maritime zone** (*Zona de Dominio Público Maritimo*), the **protection zone** (*Servidumbre de Protección*) and the **zone of influence** (*Zona de Influencia*). In the protected zone, which is a strip that extends inland 100 meters from the water's edge at high tide, no buildings may now be built for residential purposes, which include hotels. However, certificates of exemption do exist and also certain zones that had already been advertised as building land before the Coastal Law came into force are exempted. These advertised areas operate in non-compliance with the law under a variance or continuation permit. A review of this situation is nevertheless urgently required for the very fact that **municipalities are still to some extent issuing permits that do not take the Coastal Law into account**, as it does not fall within the competences of the municipality.

Since the adoption of appropriate waste disposal standards in *Spain*, **liability for contaminated sites has become** a core problem in the area of environmental law. *Article 27* of the *Spanish Waste Management Law* (*Ley de Residuos*) determines **the principal liability of cause** and ancillary liability of **condition** of all the owners of real estate for the remediation of that real estate. The authorities are empowered to proceed directly against any liable person who fails to meet the relevant obligations. It must be emphasized that owners of contaminated real estate are also responsible for remediation of sites contaminated before the standards pertaining to environmental law had come into force. If the authorities detect pollution, they can demand the recording of an attachment note in the Ownership Registry and this encumbrance can have a direct effect on the value of the real estate.

In the case of **listed** buildings, it should be observed that, on the one hand, prohibitions against modification or demolition may exist, which, however, may be offset against tax advantages such as the exemption for owners of listed buildings from payment of wealth tax or real estate tax.

3.3.4 Access to relevant records and documents

In addition to verification of the Ownership Registry records, the interested party should request to be provided by the seller with a copy of the most recent record of payment of the real estate tax, a copy of the notarial deed and, if applicable, a certificate from the ownership community that the seller is up-to-date with his/her payments.

3.4 Key points that a seller should consider

In *Spain*, **estate agents** are scarcely regulated by law, which is why case law has had to define the essential issues. Since 2000, anyone is able to work as an **estate agent**. Notwithstanding, the seal of quality of the official estate agents (***Agente de Propiedad Inmobiliaria***, hereafter *API*) who are organized in professional chambers, provide these professionals with a degree of respectability.

In *Spain*, the seller of real estate always bears the **estate agent's commission**, which is regulated only for the *API*s and usually amounts to **5% to 7% of the purchase price.** The seller should therefore include this in his/her calculations from the outset and should accordingly agree with the estate agent the amount and the due date of the commission. Thus, it should be clarified whether the commission is payable at the time when the contract is concluded (normally the private contract) or instead only falls due at the exchange of the respective actions of performance of the contract, that is, transfer of ownership against receipt of the total purchase price.

It should be considered whether the conclusion of an agreement in **exclusivity** with an estate agent is in the seller's interest in certain cases. In *Spain*, it is customary to commission several estate agents in order to achieve more exposure and consequently more offers.

The type of preliminary contract is another point to consider. While the **unilateral option contract** usually offers the buyer the greatest certainty that the purchase will take place, it may actually be more in the seller's interest to conclude the aforementioned *Arras* contract from which he/she can unilaterally be released by repaying twice the amount of the down payment in the event that he/she gets a better offer. To ensure payment of the **purchase price to the seller**, the basic rule to be observed in *Spain* is that, after the down payment, the balance of the purchase price is usually paid with a certified bank check or in cash no later than but no earlier than the signing of the deed before the notary. Vehicles such as **notarial escrow accounts, fiduciary accounts**, etc., are unfamiliar and are thus difficult for notaries to accept. Insofar as the buyer is not required to pay part of the purchase price until a later date, it is advisable to agree on the inclusion of a **resolutory condition or condition subsequent clause** (*condición resolutoria*) in the notarial deed, which is thus recorded in the Ownership Registry.

In addition to the estate agent's commission, the seller should include the tax consequences of the sale in his/her calculations from the outset. Basically, the seller has **to pay tax twice**

on the increase in value realized. On the one hand, the municipality should tax the tax imposed on the objectively ascertained increase in value, which is calculated on the basis of public municipal rates. On the other hand, the national fiscal authorities tax the subjectively generated increase in value, which is the difference between the original cost of acquisition and the proceeds of sale. Details of these issues can be found in the section on taxes.

3.5 The execution of a real estate purchase transaction

The **standard sequence of reservation, private contract** and **notarial deed** has been described above. The handling of a real estate purchase rests principally in the hands of a lawyer, as notaries in *Spain* essentially have a solely authenticating function.

It should be emphasized, however, that the role of Spanish notaries in improving legal security during the acquisition of real estate has increased significantly since the introduction of the statutory **Duty of Cooperation between Notaries and Land Registries** in 1992. Pursuant to *Article 175* of the *Spanish Notarial Regulation* (*Reglamento Notarial*, hereafter *RN*), a preliminary inquiry at the Ownership Registry is a prerequisite for notarial authentication of the transfer of real estate. The notary makes the inquiry to the Ownership Registry by fax, whereupon the registrar is obliged to communicate the current status of the register to the requesting notary within a maximum of three days. However, this inquiry does **not prevent further access to the Ownership Registry**. Indeed, during the following nine days, the registrar is obliged to notify the notary of any interim recordings affecting the real estate on the same day as their receipt at the Ownership Registry. This system ensures that the parties are always certain of knowing the current status of the register on the day of authentication.

As a complement to this procedure, the notary is obliged to immediately notify the Ownership Registry by fax of the authentication of any new deed relevant to the real estate. A party can renounce this obligation, which obviously is not recommendable in a normal transaction. On the basis of this notification, the registry gives a rank of priority to the **notice of receipt**, including the date of receipt of the notarial fax message. If the fax arrives outside the opening hours of the Ownership Registry, which in *Spain* are 9 a.m. to 2 p.m., then the notice of receipt is dated as the start of the opening hours on the following day. In order to confirm the rank order and to extend the legally prescribed duration of 60 working days (Saturdays included), the original deed must be presented at the Ownership Registry within 10 working days of the date of the notice of receipt. If the deed is then not presented for entry within 60 working days, the priority-ranked notice of receipt is deleted. If the procedure is correctly followed, the right accredited in the deed is recorded in the Ownership Registry. The beneficiary is comprehensively protected in his/her ownership *erga omnes*.

A further prerequisite for the recording is the previous settlement of taxes arising from the purchase. As a rule, this procedure is not normally handled by the notary but rather by the retained lawyer or by a ***Gestoria***: these are agencies that specialize exclusively in the handling of administrative transactions and formalities.

Following this whole process, the buyer of the real estate receives an ***escritura pública*** or notarial deed as title and proof of ownership. It is furnished with all the stamps and tax receipts but more specifically with the original recording of the Ownership Registry concerning the completed recording.

3.6 Powers of attorney

Powers of attorney basically need to be **in the form of a notarial deed** and, furthermore, have to be certified and sealed with a **Hague Apostille** if issued by a foreign notary. Spanish powers of attorney are very detailed and frequently extend over several pages. This is due to *Article 1713 Cc*, according to which the granting of full powers of attorney for anything other than purely administrative transactions requires express designation. Pursuant to *Article 10(11) Cc*, the power of attorney for real estate transactions could in fact be subject to foreign law and thus to fewer and less restrictive provisions. Nevertheless, in practice, interpretative difficulties before Spanish notaries and Ownership Registry registrars are encountered frequently, meaning that an **adjustment to Spanish custom** in this area is **almost certainly required**.

If no notarial deed containing a power of attorney is available, then the authorized agent can act orally or in writing as a so-called **'oral commissioner'** (*Mandatario verbal*). The grantor of the power of attorney can subsequently remedy the formal deficiency by means of an official **notarial declaration of ratification**.

3.7 Financing

In *Spain*, foreign financing for mortgage secured bank loans is quite usual. Since loan contracts and mortgage securities are routinely joined in one single notarial deed, they are also referred to as '**mortgage loans**' (*Préstamo hipotecario*).

It is characteristic to agree on a fixed interest rate for the first year followed by an annual adjustment to the variable and slightly higher European money-market interest rate (EURIBOR). Due to the sustained period of low interest, banks now offer fixed interest loans more and more frequently. In individual cases up to 100% of the value of the real estate can be financed, although the norm is **financing of up to 80%.** Spanish credit institutions even grant similar loans **to foreigners and non-residents**, although due to the necessarily reduced security scope (limited to the insured real estate alone), maximum financing may be presumed to be no more than 70%.

Frequently, when buying a new construction directly from the developer, there will be an offer to assume that the loan contract of the developer is already in existence with his/her financing bank. Of course, the loan conditions in that case are usually not quite as good as one may obtain from individual negotiations; however, the buyer and successor to the loan can save the cost of his/her own mortgage security by subrogating (*subrogación*) the existing mortgage. Finally, it should be noted that numerous foreign banks and financiers now grant loans for the acquisition of Spanish real estate and frequently secure such credit lines via mortgages on Spanish real estate.

3.8 Purchase through a company

Tax motives usually lie behind purchases through a company. A practice in *Spain* has been to incorporate a standard stock or limited corporation that acquired, maintained and sold real estate, as if it was the company's commercial activity. In this way, real estate owners tried to take advantage of corporations' tax privileges, without strictly being entitled to do so, which could have grave consequences if a tax inspection discovered such irregularities.

Due to the **specific fiscal situation for non-residents in *Spain***, it was mostly members of this group that tried to save money through such constructions.

The **situation has greatly improved for non-residents** since the *Sociedad Patrimonial* (Personal assets' corporation) was introduced by the Spanish legislator in 2003. The advantages of this company type of purchase are discussed further below.

A purchase by a corporation does not in itself differ from the purchase by a natural person, as once the real estate has been acquired the corporation also has to pay in full the real estate acquisition tax, *ITP*, or value added tax, *IVA*. On the other hand, where appropriate, tax advantages may be gained upon the acquisition of a corporation that already owns the real estate or upon the inheritance of the shares, and thus the real estate.

In so doing, the acquisition may be made via a Spanish or a **foreign corporation**, even an ***offshore corporation***. Spanish law does not recognize any **barriers to acquisition with regard to foreign companies**, which means that a foreign corporation may acquire ownership of real estate in *Spain* at any time without limitation, as long as the required procedures for the acquisition of real estate by foreigners are respected.

The most suitable Spanish vehicle for such a procedure is the limited liability company, ***Sociedad de Responsabilidad Limitada*** (*S.L.*), which corresponds to a company with limited liability. Such a company can be easily incorporated with a small start-up capital of Euro 3,006, be maintained by a single shareholder and requires a chairman. There are undoubtedly a few tax advantages for companies, for example, **companies are not subject to the wealth tax on assets** and no municipal ***Plusvalía* tax** is incurred on corporate transfers.

However, if all the legal and, especially, tax-related regulations are complied with, the savings in the end may not be such as to justify the effort of establishing and maintaining **a standard company** and its management aspects, such as the orderly keeping of books and the **annual filing of reports and accounts with the Company Registry** every year.

In contrast, a detailed examination of the applicable tax laws shows that, even with the *per se* tax-exempt transfer of corporate shares, the buyer cannot legally avoid payment of the Property Acquisition Tax, *ITP*, when buying real estate through a company set up solely for that purpose, as corporations **with business assets of more than 50% in real estate** are taxed as real estate when transferred. In addition, the seller will have to declare his/her gain on disposal, to the extent that the Spanish fiscal authorities establish the true value of the transfer.

Even the ability of conveying to the buyer the idea of buying a company instead of the real estate directly may be questioned. A possible construct for an economic structure using a corporation has thus not to be excluded but has to be examined on a case-by-case basis in order to withstand inspection by the fiscal authorities.

In general, it can be said that **until recent tax developments (**see those mentioned immediately below) **it did not appear to be cost-efficient** to analyze **the labor and** other **costs of a corporate structure** unless the real estate had an appreciable value.

Notwithstanding the foregoing, the Spanish legislator has recently **introduced a new form of company from a fiscal point of view**, which mixes elements of corporate taxation with those of personal income tax. The purpose of this *Sociedad Patrimonial* (Personal assets'

corporation) is to enable the owners of significant personal assets to arrange their real estate within corporate structures and consequently gain tax advantages as opposed to the standard personal income tax regime. Thus, current earnings through the corporation are taxed at a 40% rate, which is slightly higher than the general corporate tax rate of 30% or 35%, while special incomes, such as **transfer gains, are taxed with a significantly lower rate** of 15%. This attractive form of the *Sociedad Patrimonial* is of clear application for non-residents in *Spain* and therefore **a true and attractive alternative for those non-residents buying real estate through a company in *Spain***.

Foreign corporations, regardless of whether they are offshore corporations in a tax haven or corporations from other countries, are subject to an **annual 3% special taxation for legal persons on the cadastral value of the real estate**, meaning that an acquisition via a foreign company will seldom be worthwhile. This may be appraised differently where a corporation has its registered office in a country that has signed a double taxation convention with *Spain*, including an information exchange clause, because corporations from these countries may be **exempt from this specific taxation**. Moreover, reference should be made to the prior **duty of notification in the case of capital inflows from tax havens**.

3.9 Defects and warranty claims

The law governing purchase guarantees protects the buyer with respect to the **size of the land and contractually warranted characteristics of real estate.** The system set out in *Article 1469 ff. Cc* is of particular note: if the purchase price is agreed on the basis of a square-meter price and it is later apparent that the land is considerably smaller or larger than the parties had assumed, then the law provides for an equitable means of adjusting the purchase price. In practice, the real estate is then sold as *cuerpo cierto*, which roughly translated means **'purchased as stands'.** In addition, the parties tend to agree that the buyer knows and accepts the physical and legal condition of the real estate. The buyer's rights of guarantee often revolve around hidden defects. The claim period expires **six months** from the transfer.

In the case of **an acquisition from unentitled sellers,** the rules on good faith apply first. However, in spite of this, *bona fide* acquisition can still result in the seller transferring the real estate to several *bona fide* buyers within a short time, the so-called **double sale**. In this case, Spanish law stipulates that the buyer who first registers his/her property right in the Ownership Registry is entitled to ownership. Additionally, **the buyer of a third-party real estate** is contractually entitled to claim damages against the seller.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

The **various construction zones** ('urban', 'suitable for urban development' and 'rural lands' or building land, prospective building land and land unsuitable for development) and the need for access to or inquiry about community development and land use plans have already been mentioned in section 3.2.3 above. It should be pointed out that **development costs** are borne by owners with respect to **prospective building land**.

Building projects require a **building permit** (*licencia de obra*), which must be issued before the start of construction. The autonomous regional authorities have legislative powers in this area while the municipalities are usually responsible for administration. Practically all newly constructed and reconstructed buildings require permits. **Small building projects** (*obra menor*) are subject to at least a duty of disclosure. The application procedure for the corresponding building permit is usually handled by an architect who submits the application with a building project (*proyecto*) to the appropriate authority. The project has to include a description of the construction, detailed plans, models for technical details and construction material, as well as any further documents required by the individual authority, as appropriate. The project requires **an endorsement by the relevant professional association of architects**. In addition, the total cost of the scheme should be specified, which is used as the basis for the calculation of administrative fees and **construction taxes** (*Impuesto sobre Instalaciones y Obras*). Depending on the individual municipality, these may amount to approximately 4% of the costs of construction.

The duration of the process varies dramatically from project to project and from authority to authority. A reasonable estimate would be between one and three months for the duration of the **standard procedure**, although this timeframe may be easily extended once the preliminary examination by the competent body determines small, or formal but rectifiable, deficiencies in the application of which the applicant is informed. It is common to all procedural regulations of relevance that the effective granting of applications basically results from the **inactivity of the administration** (*silencio administrativo*) unless the building project is incompatible with the applicable general plan for the development of local real estate or building code provisions. Once granted, the building permit has a limited period of validity, which can usually be extended.

Since the responsible authorities in *Spain* are no longer deterred from ordering the demolition of buildings, it is not advisable to erect **unlicensed buildings**. The **statute of limitations for breaches of construction** dispositions is usually four years or even up to 10 years in the case of a very serious breach. There is also the possibility that **the statute of limitations** will not apply.

4.2 Architect's and building contracts

Architectural contracts are not specially regulated in *Spain* and are subject to rules on works or sale contracts, as applicable. In addition, architectural contracts have been essentially defined by case law. Accordingly, the planning and management of the building project are the two essential contractual duties. It should be observed that only architects accredited in *Spain* may work on construction projects. In addition to the **fully qualified architect** (*arquitecto superior*), in *Spain* there is also the **technical master builder** or foreman (*aparejador* or *arquitecto inferior* or *técnico*), who takes charge of the supervision of the construction and is a subordinate of the architect.

The actual construction contract should be **categorized as a contract for work and services** between the developer (*promotor*) or building owner (*propietario* or *dueño de la obra*) and the contractor (*constructor*). The Spanish law regulating the building process (*Ley de la Ordenación de la Edificación*, hereafter *LOE*) was introduced in May 2000. The law concentrates on defining the multilayered mass of those involved in the construction and their rights and responsibilities on the building site, the aspects of final acceptance

and other associated formalities. Above all, questions relating to **guarantee rights on the building site** and their coverage through a **system of mandatory insurance policies** have been regulated, which were previously non-existent or were developed only thanks to an increasingly extensive system of jurisprudence.

Notwithstanding the *LOE*, the actual construction contract continues to be a traditional contract for work and services, within the scope of which the contractor has to erect the building on his/her own account, by his/her own means and at his/her own personal risk.

4.3 Completion of construction and formalities

Under Spanish law (*Article 6 LOE*), the handing over of the real estate is **usually a two-tiered process**. In practice, at the end of the construction work, the building contractor requests partial acceptance from the real estate owner or developer, whereupon, within the framework of a common act of acceptance, all elements requiring further work are recorded in a report. Once these deficiencies have been rectified, a new and final acceptance or certificate of completion is provided. This final acceptance triggers **the statutory liability and periods of warranty**. Reference should be made to fictitious acceptance, insofar as the real estate owner or developer does not comply with the request within 30 days.

Numerous documents and records should be handed over to the real estate owner or developer at the time of acceptance. With the **building book** (*libro de edificio*), the owner or developer receives, among other things, an original copy of the planning documents, citing all those involved in the construction, the architect's **building completion certificate** (*certificado final de obra*) as well as the public **declaration of approval for first occupancy** (*licencia de primera ocupación*). The owner or developer requires these documents in order to notarially authenticate the **new building declaration** (*declaración de obra nueva*), by means of which the real estate building development, in conformity with the law, may be recorded in the Ownership Registry. In addition, the owner needs a **certificate of habitability** (*cédula de habitabilidad*), which is also a public document that allows the real estate to be registered for electricity, water, gas and other utility connections.

4.4 Deficiencies and warranty claims regarding new construction

The **tiered system of liability for construction deficiencies**, introduced by the LOE, leads to those involved in the construction being liable and accountable during differing periods of time for deficiencies of varying importance. In this way, those individuals, under whose responsibility a deficiency arose, are always liable. In the case that this cannot be determined, a **catch-all developer liability** exists. In order to manage this wide spectrum of liabilities arising on grounds of consumer protection, the law further provides for possibilities of recourse for those involved in the construction.

The **period of liability for building deficiencies** in weight-bearing parts, foundations, etc., lasts **10 years**. Those involved in the construction work are liable, for three years, for all deficiencies affecting habitability (hygiene, health, noise abatement, technical equipment, etc.) and for one year for all other deficiencies. A **claim is actionable within two years from the date on which the loss occurs.**

In order to insure guarantee claims, the legislator has ordered the obtainment of **compulsory insurance** and that proof of their existence be handed over to the end consumer along with

the building book. If this is not done, the completion of the new construction cannot be recorded in the Ownership Registry, which then makes it almost impossible for the buyer to take out a mortgage with a financing bank because, within the scope of end-financing, banks only lend on 'declared' new constructions, thereby making the transfer of the new construction significantly more difficult. However, during the handing-over phase, only the insurance covering the 10-year liability for weight-bearing construction elements is obligatory. Furthermore, those developers who build for themselves (*autopromotores*) are exempted from the obligation by law.

Rights under civil law on sales and, where applicable, other further-reaching contractual guarantee claims, remain unaffected by these regulations. In *Spain*, it is a very widespread practice to directly **purchase real estate from the real estate development companies (*promotoras*)**. This entails a series of consumer protection provisions, the most important of which is the **securing of installment payments by means of bank guarantees** as set out in the *Collateral Law of 1968*. According to this law, the repayment of advance payments of the buyer before or during the construction period on the part of the real estate developer should be secured by means of the granting of a deficiency guarantee or an appropriate pledge and the undertaking that the **amounts received are to be deposited in special accounts**. In the case of non-fulfillment of contractual obligations, the real estate developer is obliged to return the full amount plus a 6% interest rate. Furthermore, reference should be made to the obligation in all advertising materials. In practice, the customer usually only receives such a guarantee if it is **specifically requested** and if the customer assumes the additional costs. In view of the frequent delays in construction completion and the practical impossibility of the proper security for payments, it is strongly recommended that the aforementioned guarantee be requested.

5 Rental and tenancy

5.1 Rental and lease agreements

The basic regulation of renting in the Spanish Civil Code has been replaced by the so-called 'Law on municipal tenancy' (*Ley de Arrendamientos Urbanos*, hereafter *LAU*), which came into effect in 1995. The *LAU* differentiates between **rent contracts for residential purposes** and those for other purposes (e.g. commercial rent, seasonal rent contracts). Also, in Spanish law, there are no **legal provisions governing lease contracts**. Nevertheless, these legal relationships do of course exist (*arrendamiento de industria*). The following descriptions apply both to renting and leasing.

Although an **informal rent contract is valid,** which can even be concluded orally, each contractual party can request the other to formulate the rent contract in writing. The option of a notarial execution of the contract might also be recommendable, as this allows the contract to be entered in the Ownership Registry, which grants the tenant greater protection.

The **rent** is basically freely negotiable. During the first five years, it may be adjusted to the consumer price index, and from the sixth year of tenancy the parties can agree on other methods of adjustment. An increase in rent is also possible where renovations have been carried out. The deposit of rent is mandatory but it may not exceed one month's rent for

the renting of accommodation and two in the case of rent contracts for other purposes. The lessor can be obliged to pay the deposit of rent at specific public offices, according to regional legal norms. The rent deposit is **repaid without interest**.

In the absence of written approval by the lessor, a **prohibition on assignment and subletting** exists in rent contracts for residential purposes. Rights to terminate exist, in particular in the case of the non-execution of necessary repairs by the lessor, severe disturbance by the lessor in regard to use and occupation, non-payment of the rent, unapproved subtenancy or assignment, willful damage to rented real estate, disturbance or other dangerous or unlawful activities in rented real estate as well as where the real estate is no longer destined to be residential.

5.2 Regulations on protection of tenants and rent control

Insofar as residential rent is concerned, the provisions protecting tenants cannot usually be waived. The **duration of the tenancy** is basically freely negotiable; however, special regulations exist in the case of rent contracts for residential purposes (but not in the case of seasonal rent contracts). In the case of an agreement for a duration of less than five years, the lessee can unilaterally extend the tenancy for a total of five years and again, if necessary, for another three years. Contracts with a duration of more than five years can only be terminated after a notice period of two months by the lessee. If no explicit term is agreed, a term of one year is deemed to have been initially agreed.

The lessee's heirs are entitled to become beneficiaries of the real estate until its contractual end where they are spouses, partners, and relatives of the ascending or descending line, siblings or handicapped relatives provided that they have lived in the rented real estate prior to the death of the main tenant.

In the case of transfer of the dwelling, the buyer becomes a party to the tenancy until the end of the contractual duration or the minimum term of the lease. The **statutory right of pre-emption of the lessee** has already been mentioned. A contractually agreed waiver of the statutory right of pre-emption is only possible in the case of contracts with a duration of more than five years. In contrast, with regard to the commercial tenant and lessee, most protective provisions are subject to the disposition of the parties and thus may be waived.

6 Succession and gifts

6.1 Applicable law and jurisdiction

When determining the applicable law of succession, Spanish international private law adheres to the **personal statute, which is in turn determined by the nationality of the testator**. Thus, Spanish law does not adhere to the principle of residence or location.

Spain is one of the signatory countries to the *Hague Convention of 5 October 1961 on the Conflicts of Laws Relating to the Form of Testamentary Dispositions*. Accordingly, a testamentary disposal in *Spain* is always formally effective and valid if it is established pursuant to the legal provisions of the jurisdiction of residence of the testator, of the place of establishment or the place of location of the real estate.

According to Spanish international private law, **gifts and donations** are subject to the law of residence according to one's personal statute.

6.2 Fundamentals of the succession and gift/donation laws of Spain

Under the Spanish law of succession, the possible **applicability of rules pertaining to the regional law of several Spanish regions** must be noted. These are regional civil law regulations belonging to the Spanish *Autonomías*, which, for example, apply in *Aragón, Catalonia, Navarra*, the *Basque region, Galicia* and on the *Balearic Islands*. Within the scope of this regional law, there are deviations from the generally applicable provisions of the *Cc*, which, however, play no part in the scope of an international transaction to which the rules of the international private law apply.

The general Spanish law of inheritance recognizes **testamentary** and **statutory** (*sucesión ab intestato*) **legal succession**. Within the scope of the testate succession, it should be observed that contracts of inheritance or joint and/or mutual will and testaments are inadmissible. Wills and testaments in *Spain* can be either personally prepared in writing, by holographic will (*testamento ológrafo*), or by a notary, with a distinction being made between the open and closed version (*testamento abierto* or *testamento cerrado*). In addition, there is a **central registry for wills** (*Registro Central de Últimas Voluntades*) in *Madrid*, to which Spanish notaries have to forward all wills executed before them. This institution is extremely practical because, following the death of the testator, it is merely necessary to request the information regarding testamentary disposition in order to find the notary with which the testator executed his *last* will. One can then request a copy of the last will and testament from that notary's office. If no last will and testament is available, a certificate of inheritance should be requested from the relevant probate court, which is a complicated and time-consuming process.

Finally, a peculiarity of Spanish law should be noted according to which the **inheritance** must be accepted and declared as such. This can be accomplished either orally or implicitly but is usually done by means of a public document or notarial deed, which is entered in the Ownership Registry. Even if the testator has left a last will and testament, **entitlements to the statutory portions of the inheritance** (*legítima*) inherent in Spanish law must be observed: the children of the testator or their descendants are entitled, by law, to a portion of the estate in the amount of two-thirds, one-third of which is to be divided equally among them and another third of which is to be divided among the entitled persons at the testator's complete discretion. The final third is entirely discretionary. If no descendants exist, the parents and other ascendants are entitled to half of the legal estate, unless there is a surviving spouse, in which case the parents of the testator are entitled to a third.

The surviving **spouse** has a **statutory lifelong right of usufruct** over a certain part of the legal estate according to the type of heir. Thus, the spouse's right corresponds to a third of the legal estate if there are descendants, to half the legal estate if there are ascendants, and to two-thirds of the legal estate in the absence of descendants and ascendants.

Statutory succession provides first that descendants of the testator and, in the absence thereof, the ascendants, shall receive equal portions. The surviving spouse inherits prior to the relatives of the collateral line. If the married couple were separated, siblings of the testator and other successive relatives in the collateral line inherit. The statutory law of succession continues into the fourth generation, whereof the state inherits.

The Spanish law of donation stipulates **mandatory notarial authentication of donations of immovables**, otherwise the contract is void.

7 Taxes and charges

Both the central Spanish state as well as the autonomous regional authorities (*Autonomías*) and municipalities have tax levying as well as tax collection competences in various areas, meaning that, for example, an acquisition transaction can trigger diverse tax obligations and may require handling before different tax authorities. In particular, reference should be made to the significantly **different tax regulations that apply in the *Canary Islands*** and also partially in the ***Basque Region*** and ***Navarra***.

The terms or abbreviations *NIF, CIF* and *NIE* constantly come up in the tax administration of Spanish real estate. The following applies: ***NIF*** (*número de identificación fiscal*) is the general **taxpayer's account number for Spanish nationals**; ***CIF*** (*código de identificación fiscal*) is the **taxpayer's account number for legal entities** (thus, to be precise, the *CIF* is really a subcategory of the *NIF*); ***NIE*** (*número de identificación de extranjeros*) is the **taxpayer's account number for foreigners**, irrespective of whether they reside in *Spain* or not.

A non-resident real estate owner in *Spain* is not obliged to **appoint a tax representative**, if the tax authorities are provided with an address of residency as a mailing address. However, a practical problem often arises whereby postal deliveries that trigger tax deadlines are left and forgotten in a mailbox in *Spain* and the recipient is never made aware of the delivery or the deadline. Thus, in most cases, it is advisable to appoint a tax representative.

7.1 One-time taxes and charges on a purchase

7.1.1 Real estate transfer taxes

In the case of a purchase of real estate, either value added tax (*VAT, Impuesto Sobre el Valor Añadido*, hereafter *IVA*) or the **land acquisition tax** (*impuesto sobre transmisiones patrimoniales,* hereafter *ITP*), which is levied by the *Autonomías*, falls due. The *ITP* rate now stands at **7%** in almost all *Autonomías* and only falls due if the transfer is not subject to *IVA*. In summary, ***IVA* has priority over *ITP* and they are mutually excluded**. In individual cases, according to the specific *Autonomía*, certain reductions of these tax rates apply for fittings and furnishings acquired at the same time (e.g. furniture, 4%) but above all for social policy reasons in place at the time of acquisition if the real estate concerned is publicly promoted housing.

In the case of new constructions (but not in the case of the purchase of a new construction from a developer), the purchase of the land is subject to *ITP*. **Construction tax** (*Impuesto sobre Construcciones, Instalaciones y Obras*) also has to be paid, which, depending on the municipality, can amount to up to approximately 4% of the construction costs. Furthermore, in the course of the notarial declaration of new construction, the owner has to pay a tax rate on the final value of the building development, which usually lies between 0.5% and 1%, and **stamp duty on notarial documents**, which is known as **document tax** (*Impuesto sobre los Actos Jurídicos Documentados*, hereafter *AJD*).

Usually the buyer must pay *ITP* and *AJD* within 30 working days of the authentication (Saturdays are considered working days) to the relevant *Autonomía* in the form of self-assessment (*autoliquidación*). **In the case of non-observance of the obligation, the real estate cannot be entered in the Ownership Registry**. Besides, any delay will incur the legal interest rate on arrears during the whole delay period and, additionally, a one-time surcharge on overdue payment of up to 20% according to the duration of the delay.

7.1.2 Sales tax (value added tax)

The ***IVA*** (*VAT, Impuesto Sobre el Valor Añadido*) is usually **16%**. This value added tax does not fall due on the private sale of real estate or on the second or subsequent transfers of the constructed real estate, subject to the *ITP*. However, the purchase of building land and corporate property is subject to the regular rate of 16%. However, the **tax rate is reduced to 7%**, insofar as the acquisition concerns housing as well as necessary fittings (such as garages, a limited number of storage rooms, etc.). The tax is levied by the seller within the purchase price and paid by the seller to the tax authorities within the quarterly *IVA* declaration and installment payments.

Reference should also be made to the fact that documents, which are transactions subject to *IVA*, are also subject to the document tax *AJD* in addition to *IVA*, as notarial documents – meaning that the tax burden of a newly constructed dwelling can amount to 8%.

In the case of second and subsequent acquisitions, and insofar as the buyer is also a person subject to value added tax, such as a corporation, the parties can waive the statutory exemption from the value added tax obligation, which applies to second and subsequent acquisitions and normally results in the *ITP* taxation. **In other words, the transaction is again subjected to value added tax**. The advantage is that this can be compensated in regular business operations due to input tax deduction entitlements. However, reference should also be made to the fact that corresponding documents are then subject to *AJD*, whereby the corresponding tax rates of the *Autonomías* are usually then raised to 1.5%. The key to understanding this systematic taxation is the separation of taxes: while the value added tax remains with the Spanish central state, *ITP* and *AJD* go to the *Autonomías*.

7.1.3 Real estate registration and notary charges

In addition to taxes, fees for notarial authentication and for recording in the Ownership Registry burden the acquisition of a real estate. Statutory fee scales exist for professional groups, notaries and registrars (*Registradores*). As a rough guide, the costs of real estate acquisition (notary, Ownership Registry) amount to **approximately 3%** of the purchase price stated in the deed.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

The calculation of the annual municipal real estate tax (*Impuesto sobre Bienes Inmuebles,* hereafter *IBI*) is based on the **cadastral value of the real estate** according to a municipal scale.

The legal basis for the determination of the cadastral value is *Article 8 ff.* of the Cadastral Law (*Ley del Catastro Inmobiliario*, hereafter *LCI*) according to which the value of a real estate consists of the value of the land as well as its property development. According to the wording of the law, the cadastral value should be equivalent to the current market value, which it should not exceed in any circumstances. In fact, **the cadastral value is**, for the most part, **significantly lower than the current market value.**

Pursuant to the law on municipal taxes (*Ley Reguladora de las Haciendas Locales*, hereafter *LHL*), the real estate tax can amount to at least 0.3% up to a maximum of 1.1% of the cadastral value. The owner of the real estate is always subject to the tax on January 1 of the respective year.

7.2.2 Income tax

Spanish law differentiates between the income taxation for residents (*Impuesto sobre la Renta de las Personas Fisicas,* hereafter *IRPF*) and for non-residents (*Impuesto sobre la Renta de los No Residentes,* hereafter *IRNR*). In *Spain*, the **personal use of the real estate for residential purposes is also taxed**. The assessment basis for non-residents is the estimated economical value of use, which is calculated at a maximum of 2% of the cadastral value. A **25% tax**, with no possibility of deduction, is imposed on this value. As for non-residents who rent out their real estate, the realized gross income is also taxable at 25% with no possibility of deduction.

7.2.3 Net wealth tax

In *Spain,* the net wealth tax (*Impuesto sobre el Patrimonio,* hereafter *IP*) applies equally for residents as for non-residents, although the applicable allowable deduction for residents of approximately Euro 110,000 does not apply to non-residents. The taxation is scaled and lies **between 0.2 and 2.5%** of the assessment basis, which is the highest of the following three values: the cadastral value, the purchase price, or the officially determined value. The tax rates are progressively scaled, the highest rate is applied to real estate assets that have a total value of over Euro 10 million. Taxation may be avoided or at least lowered through reducing the net value of the wealth, e.g. through mortgage financing of the purchase act. It has to be noted here that no net wealth taxation applies on companies, so purchase through a company can be a solution for non-residents to avoid net wealth tax.

7.3 Capital gains tax

In *Spain*, the profit generated when real estate is transferred is first subject to income taxation for residents (*IRPF*) or non-residents (*IRNR*) and, additionally, the municipalities levy a communal taxation on the appreciation in value that has occurred during ownership of the real estate according to objective criteria, and which is taxable. This is a taxation of appreciation in value of urban land (technically: *Impuesto sobre el Incremento del Valor de los Terrenos de Naturaleza Urbana, IIVT* but, in general, Spanish usage and hereinafter known for simplicity as **'Plusvalía'**). The two concepts are frequently confused, although they exist alongside each other and should be distinguished.

Gain on disposal

In the case of residents, the gain on disposal has to be attributed completely to the taxable income, which should be taken into account within the general income taxation. However, the profit then is not subject to tax, if and insofar as it has resulted from the transfer of one of the main dwellings used personally by the seller and if it is invested in a new dwelling within specific deadlines. Insofar as the profit is taxable, **the flat tax rate for residents amounts to 15%**. In the case of **non-residents, the gain on disposal is taxed with a 35% tax rate**. The gain on disposal is calculated, for both residents and non-residents, from the difference between the purchase and transfer prices, although the former is adjusted by multiplying it with an annually determined national coefficient and the latter is reduced by the actual costs and taxes incurred.

In order to secure the tax liability of the non-resident, which is often difficult for Spanish authorities following the transfer of the real estate, the Spanish legislator has developed the following system:

The **buyer who acquires his real estate from a non-resident in *Spain* has to retain 5% of the purchase price** and pay it directly to the Spanish tax authorities. The buyer has one month to pay the retained amount to the tax authorities of the place of the real estate, whereupon the seller has an additional three months to submit a tax return. In this tax return, the tax retention (*retención*) is offset against the calculated overall tax liability of the seller pursuant to the above criteria.

In the case of non-fulfillment of this obligation, **the real estate itself becomes liable**, which implies that the buyer will endeavor to ensure that the amount is retained and paid to the tax office. The only exception to the retention obligation is the transfer of real estate that the seller had acquired prior to December 31, 1986, since the previous tax regime applies whereby no income tax is incurred.

Tax on appreciation in value – Plusvalía

The person subject to tax in this instance is the seller of the real estate, although, in the case of gratuitous transfers, for example, by inheritance or donation, the beneficiary bears the tax burden. The *Plusvalía* is calculated by multiplying the cadastral value of the land (without buildings) by the number of years the seller has been in possession of the real estate, **limited to a maximum number of 20 years**. The value determined in this way is then multiplied by a maximum coefficient of 3.7%. The result of this calculation is the basis for taxation, which is then taxed at a municipal rate that cannot exceed 33%. In the case of two transfers within a year, the *Plusvalía* only falls due once.

7.4 Inheritance and gift taxes

Pursuant to the Spanish law on inheritance and donation tax (*Ley del Impuesto de Sucesiones y Donaciones*, hereafter *LISD*), a limited tax obligation ensues for assets located in *Spain,* which even applies to non-residents. **In the case of residents, the tax obligation extends to all global assets without exception**. With regard to real estate located in *Spain*, the recording in the Ownership Registry is dependent not only on the prior declaration of acceptance of inheritance in a notarial deed but also on the proof of compliance with inheritance taxation formalities.

The deadline for submission of the tax return is within six months of the succession. The statutory period of limitation is equivalent to the general fiscal statutory period of limitation contained in *Article 64 LGT*, which is four years. **Until recently, in particular in the case of non-residents, it was the normal practice to allow the inheritance tax to become time-barred**. Due to the enormous misuse, the statutory period of limitation now only runs from the date on which any Spanish administrative authority is notified of the corresponding taxable event, i.e. that the succession or donation has taken place. This should make it more difficult for tax liability to become time-barred in the future. It is, however, under discussion why the person's death, as an objective event, should not justify commencement of the statutory period of limitation.

Basically, all assets located in *Spain* are taxable, which includes bank accounts, motor vehicles and other movable property. In addition, the legislator adds a lump sum of 3% of the value of the legal estate for fittings and furnishings of the house of the testator (*ajuar doméstico*). Furthermore, **the current market value of the property forming the real estate is taxable**. This is not easily determined and so the cadastral value is set as the lower limit, which is upwardly adjusted as required. Pursuant to *Article 19 LISD*, the state has a right to acquire the real estate at the declared value if the taxed values deviate by more than 50% from the actual value. To prevent default application of this provision, the **adjustment coefficients**, which provide the current market value from the point of view of the tax authorities, may be requested from the relevant tax authorities.

Spanish law provides for a few **allowable deductions** in the case of inheritance taxation but, in the case of donation taxation, **no deductions** are allowed. However, the *Autonomías*, which receive the corresponding tax income, can create additional deductions and exemption criteria. Usually, these only apply to residents. The most important of such exemptions is the reduction of the taxable value of the main dwelling of the testator by 95%, insofar as it is transferred to immediate heirs and the real estate is occupied by those heirs.

It should be mentioned that a potential abolition of the inheritance tax in *Spain* is being widely discussed and experts foresee a substantial lowering of inheritance and donation tax in the near future. However, for the time being, Spanish inheritance and donation taxation is subdivided into the following tax classes:

Class 1: Direct descendants and adopted children under the age of 21 (inheritance allowable deduction of Euro 15,956 plus Euro 3,990 for every additional year under 21, up to a maximum of Euro 47,858).

Class 2: Direct descendants and adopted children as of 21 years or more, spouses and direct ascendants (inheritance tax allowable deduction of Euro 15,956).

Class 3: Siblings and distant ascendants and descendants (inheritance allowable deduction of Euro 7,993).

Class 4: All other heirs (no allowable deduction).

The **tax scale** is **progressively** structured and has a total of 16 grades **ranging from 7.65% to 34%**. The maximum rate applies to Euro 800,000. Finally, the sum of this calculation must

be multiplied by a coefficient based on the net assets of the inheritors as per the following table:

Assets of the heirs	Tax class		
	I and II	III	IV
Euro 0 to 402,678	1.0000	1.5882	2.000
Euro 402,678 to 2,007,380	1.0500	1.6676	2.100
Euro 2,007,380 to 4,020,770	1.1000	1.7471	2.200
More than Euro 4,020,770	1.2000	1.9059	2.400

The interesting and, above all, unusual aspect of this system, from an international comparison, is the fact that for the overall tax burden, the existing assets of the heir receiving the inheritance are of significance. The **maximum tax burden is 81.6%**. It should be noted that *Article 23 LISD* provides for the **offsetting of inheritance tax paid overseas** against the Spanish inheritance tax for those subject to unlimited inheritance tax.

Of course, with such high taxation, ways are repeatedly sought to avoid or circumvent the inheritance tax, for example, by means of corporate share transfers. By law, it is not the nominal corporate value (for example, Euro 3,006 is the minimum corporate capital, in the case of an SL), that is set as the taxable value but rather the real value, which corresponds to the current market value according to adequate and orderly accounting. Certainly, there is much speculation in what is a **gray area of the 'wording of the law vs law in practice'** and it is indeed partially tolerated by the Spanish tax authorities. However, this should never be relied on in terms of asset planning. Instead, individual assessment and advance planning are imperative.

Finally, in light of the aforementioned move to reduce the inheritance and donation tax, it is likely that, in the medium term, a perceptibly smaller tax burden will ensue from these transfers. It should be borne in mind that the transfer of real estate by means of an inheritance or donation also results in **Plusvalía taxation** on the beneficiary's estate.

7.5 Other taxes and charges

There is an **extraordinary tax**, to which **non-resident legal persons** who are owners of or have rights of usufruct or use over real estate located in *Spain* are subject, the *Gravamen Especial sobre Bienes Inmuebles de Entidades no Residentes*. The purpose of this special duty is a **counter-measure against tax evasion** and a penalty for the anonymity of companies that are real estate right holders despite the absence of a registered office in *Spain*.

The amount of the extraordinary duty amounts to **3% of the cadastral value**. The holders of the property rights are, however, obliged to inform the administration of any appreciation in value. If no cadastral value is available the value is determined according to the provisions regarding wealth tax. **Exemptions exist on special request for legal persons from states that have ratified** a double taxation convention, including an information exchange clause with *Spain* and, also, for those persons that own the company who are either resident in *Spain* or are, in turn, in a state subject to the application of such a double taxation convention, including an information exchange clause.

However, **companies with registered offices in tax havens** (e.g. *Gibraltar, Jersey, Liechtenstein, the Bahamas, Panama*, etc.) are not exempt from the obligation to pay the duty, insofar as they have property rights in *Spain*.

7.6 Incorrect (lower) statement of sales price on the sales agreement

Under-declaration is a crucial issue with regard to Spanish property: taxes, Ownership Registry and notary fees, gain on disposal and also warranty, reversed transaction are in the focus when talking about 'A-money' and 'B-money' concerning real estate transactions ('A-money' is a commonly used term for the officially declared price, while 'B-money' is the non-declared part of the purchase price).

The **duplicity of contracts** described in previous sections regarding the coexistence of a privately drawn up contract and the notarial deed makes possible the most extensively used practice of under-declaration in Spanish real estate transactions. As there is initially no obligation to sign a privately drawn up contract, it is possible to immediately sign the notarial deed. **For this reason, the Spanish tax authorities cannot request the submission of privately drawn up real estate purchase contracts**. Accordingly, buyer and seller are in a position to destroy the privately drawn up contract once the notarial deed has been signed. This in turn means that a higher purchase price can be agreed in the privately drawn up contract than in the notarial deed, which is then the only valid contract in existence and thus the 'undeclared earnings' exist from the moment the privately drawn up contract is substituted by the notarial deed.

The under-declaration has several consequences and thereby distorts the contractual reality and the reality officially declared. Under civil law, the contract continues to be effective and under fiscal law, it is an actionable tax offence. **The under-declaration does not endanger the purchase** but both parties may be liable for claims by the defrauded tax authorities. Beyond certain limits, **criminal actions** may also be possible.

The Spanish tax authorities have four years to examine and, if necessary, to issue **supplementary tax assessment notices** for the amounts declared in the document and the tax assessment. These can of course be answered and challenged. Furthermore, in the case of **tax evasion, interest and interest on arrears** will be levied.

Moreover, on transferring the property at a later date, an under-declared acquisition can lead to a **considerably higher taxable gain on disposal**, which is usually more expensive than the cost of declaring the actual purchase price in the notarial deed. However, it is this very situation that explains why nowadays many sellers insist upon declaring a lower price in the notarial deed.

Practical considerations also clarify the dangers of under-declaration: the seller transfers ownership by signing the notarial deed and loses his/her ownership of the real estate at that moment, which is when the purchase price also falls due (*do ut des*). **This is the moment when the buyer is the most insecure** because, although his real estate interest is not protected *erga omnes* until recorded in the Ownership Registry, the buyer has already paid the purchase price in full but has a receipt (the notarial deed) for only part of that amount. This may cause problems in the long run as regards the rights of **guarantee** or, in case of misrepresentations, etc., even **the return of the real estate**.

7.7 International taxation

Most of the double taxation conventions signed by *Spain* adhere to the principle of **taxation in the state of location** as regards **revenues from real estate**. The conventions, which are all similar in content, subject the **gains on disposal of immovable assets** to taxation in the state of location. However, it is different in the case of a gain on the disposal of a right, even if this was linked to an interest in real estate, as for instance the sale of a company that holds real estate that would be taxable in the **state of residency** of the seller. In principle, the majority of the Spanish double taxation conventions adhere essentially to the **tax credit (imputation) method**.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

There are **no barriers** for citizens of EU countries as regards entry and residency in *Spain*.

The **liberalization of the immigration rules** extends to all citizens of the member states of the *EU* as well as the citizens of those states that belong to the *European Economic Area*, and Swiss nationals. Certain family members, who live permanently with the entitled person, namely the spouse, children under 21 years of age or, in addition, the ascendants of the entitled person, are also included insofar as they receive maintenance payments from the entitled person.

The law grants the entitled person **freedom of entry and exit, freedom of residency and freedom of movement within the national territory**, as well as the right to assume an activity whether self-employed or for a third party. **A valid identity card or passport is sufficient for entry**.

Persons from non-EU member states mostly require a visa, which can be refused on grounds of public safety, law and order or health. The visa then entitles the bearer to a stay of up to three months.

The following groups need no permit for a permanent residency: citizens of member states of the *EU* or the *European Economic Area* or *Switzerland* as workers, students or holders of a permanent right of residence and family members from *Spain*, as well as persons of the first group, who work in *Spain*, but are usually resident in another state.

To exercise an activity, service or a course of study, the internal national regulations apply in the same way as for Spanish citizens.

A permanent right of residency is granted to all citizens of EU member states, who were economically active in *Spain* and fulfill one of the other prerequisites: (a) ended working activity at retirement age with previous 12 months uninterrupted working activity and three-year residency in *Spain*; (b) ended working activity due to permanent disability and two-year residency in *Spain* (this time requirement is waived if a pension is being received from the state due to the disability); (c) relocation of the working activity to another state after three years while retaining normal residency in *Spain*.

Thus, this regulation does **not apply to retired persons** who were not previously employed in *Spain*. Nonetheless, retired or otherwise financially independent EU citizens can apply for a residency permit as long as they prove their financial independence.

Even if they are family members, persons from non-member states of the *EU* still require a residence permit. A temporary permit is granted for a period of three months to one year. In the case of an intended residency of more than one year, the applicant receives a five-year permit, which is renewable. The permit for family members is dependent on the right of residency of the main person.

The application for a residence permit must be made within one month of entry. Exemptions are available where the applicant is unable to provide the visa necessary due to his/her own personal situation or the situation in his/her country of origin. The permit should always be granted within three months. The entry or the residency permit can be refused for reasons of public safety, law and order and health.

8.2 Tax residence

Anyone who lives for **183 or more days per year in *Spain*** or has his/her center of operations in *Spain* should be considered as a **resident for tax purposes** or a **tax resident**. The 183-day time period can also consist of several periods with considerable interruptions. A resident's global income is subject to income tax in *Spain*. The **maximum tax rate is currently 45% but recent political statements have indicated lowering income and corporate tax to a standard 30% rate in the near future**.

In addition, where residence is taken up in *Spain*, the global assets of the tax subject are subject to **net wealth tax**, which may be considerable, with a maximum rate of 2.5% (for an **interesting recent exception to that principle** see further below). There are, of course, wider options as regards a dynamic structuring of the income tax situation that must be analyzed carefully for each individual case. **Personal advice from a legal and tax consultant** is indispensable in this context.

Within the scope of freedoms granted by the *European Union*, especially the ***Schengen Treaty***, it is more difficult nowadays for the Spanish authorities to determine the fiscal residence of a person. The Spanish tax authorities try to prove that the tax subject is a tax resident in order to be able to tax his/her global revenues. For that very reason, in the case of tax residence in tax havens and low-tax countries, a **certificate of tax residence** is required. Notwithstanding, the Spanish tax authorities may initiate an investigation to determine tax residence in *Spain*. An indication of tax residency is, for example, the permanent residence of the spouse and, if applicable, dependent children living in *Spain*. The tax authorities can draw on any imaginable indication of tax residence, such as the request for submission of the appropriate invoices for electricity, water, telephone, etc.

Recent tax legislation opens **opportunities for employees** that fix their tax residence in *Spain*: those can still **be taxed during a period of up to five years as non-residents**, thus being taxed in *Spain* only with their Spanish income and assets in *Spain*. Thus, potential foreign assets will not be considered by Spanish tax authorities as for net wealth taxation. Besides, only earnings obtained in *Spain* will be taxed with a flat 25% income tax rate, although no deductions will be allowed. Still, compared to the 45% taxation rate on high incomes, this regulation seems attractive.

8.3 International taxation for residents of Spain

Spain has signed double taxation conventions with many states. These conventions govern the imputations of the various revenues. **The content of most of the taxation conventions**

adhere to the structure of the model *OECD* convention. Clauses regarding the exchange of information of the authorities of the respective countries exist with several countries. Recently, there have been indications that these information transfer possibilities should be used at least within the *EU*.

9 Checklist: Real estate acquisition in Spain

- The payment of a **reservation fee** should be avoided if possible, as the money is frequently not reimbursed in the event that the contract is finally not concluded, even though there may exist a legal right to reimbursement.
- Examination of the **proof of disposal of the seller**. The seller can act on his/her own behalf or on that of a third party. Where **estate agents** are used, the scope of representation and conditions should be thoroughly investigated.
- Investigation of the entry in the **Ownership Registry** of the real estate and its encumbrances.
- **Private contract** contains all the essential terms, both the framework points and the detailed individual matters. It is legally binding. The contracting parties should ensure that all undertakings and promises are in writing, that is, included in the contract.
- **Realistic time schedule**, particularly in an international context. Organization of the financing aspects can take time, and generally the carrying out of formalities in *Spain* is often time-consuming.
- Total costs: **all handling and tax costs** should be realistically planned from the outset.
- **Installment payments** should only be made in return for a guarantee.
- In the case of an **ownership community/condominium**: Are larger investments planned? Is the seller up to date with his/her contributions?
- Coastal area, *Balearic Islands, Canary Islands*: **Is building allowed in these areas?**
- **Candor regarding the 'official' purchase price**. Should a contracting party wish to specify a lower price in the notarial deed than the effective purchase price, it may lead to a number of consequences that are not all favorable. Appropriate caution is essential.
- **Tax-optimized acquisition and transfer planning:** A tax expert should be consulted before buying or selling real estate in *Spain* to **reduce the fiscal impact** of any of these transactions because other opportunities for saving are not easily encountered.

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Switzerland

Swiss Confederation
Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

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1 Introduction

Switzerland, known officially as the *Swiss Confederation*, is a federal republic rooted in a long tradition. It comprises 26 cantons which are considered as sovereign (autonomous, politically independent) entities within the framework of the federal constitution. The Swiss communes (approximately 3,000) also enjoy relatively broad autonomy. Although many branches of law are now treated uniformly throughout the country, there nevertheless remain many important domains which are subject to differing regulations between the cantons. This applies particularly to taxation, but also to other areas, so that in many cases there are several possible answers to a question about the legal situation prevailing in *Switzerland*.

In contrast, private law is laid down uniformly at federal level. It is of central importance to our concerns and is enshrined principally in two legal codes: the law relating to real estate is laid down in the *Swiss Civil Code* (*CC*; in German, *Schweizerisches Zivilgesetzbuch, ZGB;* and in French, *Code civil suisse, CC*), and the private-law regulations affecting real estate transactions are comprised in the body of *Swiss Code of Obligations* (*CO*; in German, *Schweizerisches Obligationenrecht, OR*; and in French, *Code des obligations, CO*). Together, these two legal codes contain the codified private law of *Switzerland*.

Switzerland has attracted foreign buyers of real estate for many years, not least because of its exceptional political and economic stability. The Swiss themselves, however, are a nation of tenants. Compared with other western countries, *Switzerland* has a very low rate of owner-occupancy, only about 35%. Attempts to explain this state of affairs have often pointed to the high cost of residential property in *Switzerland*. Real estate is generally regarded as being expensive, particularly because the country is densely populated so that little land is available, thus causing prices to rise. In reality, there is enough building land available but it is distributed very unevenly throughout the country. This situation is also confirmed by the fact that the rate of owner-occupancy varies so greatly between the cantons. Relatively high prices (and low rates of owner-occupancy) are found in and around the cities of *Basel, Zurich* and *Geneva*, but many regions have enough reserves of building land that is quite suitable and even attractively priced.

The new immigration laws relating to citizens of the *EU* allow every financially independent holder of an EU passport to settle in *Switzerland*. Once resident here, EU citizens have the right to acquire property throughout *Switzerland* almost without restriction.

2 Real estate ownership

In *Switzerland*, property is guaranteed by the Federal Constitution, whose *Article 26(1)* states simply and unambiguously: 'Private property is guaranteed'.

Property law, and thus the various types of property, are regulated by the *Civil Code*. The *CC* splits property rights into two categories: firstly, that of the comprehensive **ownership right** and, secondly, that of **restricted property rights** (easements, usufruct and other servitudes, charges, liens and mortgages).

2.1 Different forms and types of ownership

Sole ownership

Real-estate ownership refers to particular pieces of real estate, the independent and permanent rights recorded in the land register, as well as mines and co-ownership shares relating to particular pieces of real estate.

The (sole) owner of a piece of real estate has the most comprehensive power of disposal and legal control possible within the scope of the prevailing legal and factual limits.

Co-ownership

A distinction is made between two types of collective ownership, namely co-ownership and joint ownership. **Co-ownership is the normal case of collective ownership** and is presumed unless otherwise established and in cases of doubt.

A co-ownership share in a piece of real estate is treated like a property, and co-ownership shares may be independently sold, mortgaged, or seized by creditors. In contrast to joint ownership, co-ownership implies that the entire property is divided up into **portions** (**quotas**). Each co-owner possesses the rights and obligations of an owner with respect to his/her portion, which is correspondingly recorded in the land register.

Joint ownership/joint tenancy

Joint ownership **presupposes one of the following legal relationships**: community of property between spouses, community of property within a family as defined in *Art. 336 et seq. CC* (*Gemeinderschaft; indivision*) or an ordinary partnership (*einfache Gesellschaft; société simple*), general partnership (*Kollektivgesellschaft; société en nom collectif*) or limited partnership (*Kommanditgesellschaft; société en commandite*). An individual joint owner has **no independent right to the joint property** and its disposal invariably requires the **agreement of all joint owners**. The individual share of a joint owner cannot be recorded in the land register.

Condominium ownership

Condominium ownership (*Stockwerkeigentum; propriété par étages*) represents a **particular kind of co-ownership**. In principle, the regulations relating to co-ownership also apply in this case unless any special legal stipulations pertaining to condominium rights take precedence over them. Every condominium owner has a **special right** to make exclusive use of specific parts of a building. In addition to the use of the premises, this in particular includes their internal fixtures and fittings. This special right may apply to entire stories or parts of them; the latter must comprise self-contained apartments or areas with their own access as well as separate arrangements for garages, cellar compartments, hobby areas, etc. Ownership of a condominium is recorded by entry in the land register. The co-ownership shares designated as condominium ownership are listed on separate pages of the land register, whereas the page for the entire property remains unchanged. In addition to describing the parts of the building, which must be precisely delimited and

to which the special rights apply, the instrument of establishment (condominium deed) must also contain the corresponding **value quotas** which define the extent of the entitlement of each condominium owner in the overall property. These value quotas form the basis for weighing the voting powers of the individual condominium owners at the **condominium owners' meeting** as well as for apportioning the communal expenditures for the administration and maintenance of the property. Each condominium owner is in principle free to sell his/her share. However, the instrument of establishment (condominium deed) or later agreements often include a pre-emption right in favor of the other condominium owners.

Right to build

The right to build (*Baurecht; droit de superficie*) represents an easement that gives a person the right to erect or retain possession of a building on a piece of land which he/she does not own. Such right to build is, unless otherwise agreed, transferable and may be inherited, and can, as long as it is defined as an independent and permanent right (i.e. valid for at least 30 years), be recorded as a property in the land register. In the case of such a right to build, the **ownership of the completed building** remains with the **person entitled to the right to build**, i.e. ownership of the land and the buildings upon it are separate. An independent building right can be set up for a maximum period of a hundred years. Also, the contract establishing an independent and permanent building right must be publicly authenticated to be valid. As a rule, payment of building-right interest is agreed and the land owner receives a lien to the building right to secure his/her claim.

Since January 1, 2004, it is also possible to establish an easement that gives a person the right to plant and retain possession of plants on a piece of land which he/she does not own (*Pflanzendienstbarkeit; plantations*), similar to the right to build.

Timesharing (timeshares)

Swiss law does not actually allow ownership of property to be divided up into various periods of use calculated over the year. However, various arrangements to this effect in contractual and company law are possible. Thus participation in a company (for instance in the form of shares) or membership of an association may be acquired, and these in turn imply the utilization of property owned by the company or association.

In contrast to the *EU*, *Switzerland* makes no specific legal stipulations relating to timesharing. Thus purchasers of timeshares have no right of revocation after conclusion of an agreement. Swiss law offers only limited ways of withdrawing from a timesharing agreement despite the fact that this has far-reaching financial consequences for the purchaser. However, the Swiss Government is now planning to introduce regulations in line with the *EU*'s timesharing directive.

2.2 Easements, charges, liens and mortgages

Easements, servitudes, usufruct, charges, liens and mortgages form what are known as restricted property rights. To be validly erected, they need to be entered in the land register. In contrast to the comprehensive property right of ownership, these imply only limited

control over a property. Restricted property rights limit ownership to the encumbered real estate and to this extent take precedence over the property rights of the owner. If restricted property rights conflict with one another, then – with a number of legal exceptions – priority on the basis of seniority applies, i.e. a **right established earlier has precedence over one established later**. This arrangement is also associated with the principle of the precedence of easements, i.e. if a piece of land encumbered with an easement is mortgaged, the easement is included in the mortgage. Conversely, an existing lien has precedence over a later established easement, license or restrictive covenant. However, precedence of rights may be freely agreed when they are established; and for liens and mortgages there are even legal provisions for a corresponding setting of priorities.

Usufruct

Usufruct (*Nutzniessung; usufruit*) gives its beneficiaries the full right to possess and use a property (or part of a property) which they do not own. It represents a **personal easement**, i.e. it depends on the beneficiary and ends at the death of natural persons or after, at most, 100 years where the beneficiary is a legal person. Accordingly, usufruct may not be transferred to another person, although its exercise may, in certain circumstances, be granted to someone else. The beneficiary is responsible for the administration of the property, but the beneficiary may also let the property and retain the proceeds of the rental (in contrast to the right of residence). However, the beneficiary must undertake to treat the property with due care and is liable to compensate the owner for any damages. Usufruct of property requires an entry in the land register. If usufruct of a property is set up based on a contract, this contract must be publicly authenticated.

Right of residence

By analogy, the same conditions apply to rights of residence (*Wohnrecht; droit d'habitation*) as to usufruct. However, in contrast to the latter, the right of residence is restricted exclusively to dwelling at no cost. The beneficiary may not let the apartment or house. If the dwelling right has been arranged by contract, public authentication and entry in the land register are also required. However, a dwelling right may be neither transferred, seized nor inherited, and can be drawn up exclusively in favor of an individual person.

Right to build

The right to build represents an easement which gives someone the right to erect or retain possession of a building on a piece of land which he/she does not own. As a building right also represents a kind of property ownership, it has already been treated under Section 2.1 on page 575.

Easements on property/servitudes

Whereas personal easements (*Personaldienstbarkeiten; servitudes personelles*) such as usufruct and rights of residence benefit a specific person, easements on real estate (*Grunddienstbarkeiten; servitudes foncières*) involve an encumbered and an entitled real estate. The respective owner of the encumbered real estate must **tolerate** certain interferences by the

respective owner of the entitled property (such as right of way or right of passage) or **restrict** the exercise of his/her ownership right in a certain way (e.g. not build higher than one story). Also, the owner of the encumbered real estate can only be obligated to refrain from taking action or to exercise tolerance, but not to take action on his/her own account. However, the Swiss *CC* does make provision for an easement on real estate to involve the obligation to take action, but only as an ancillary content, such as the obligation to maintain installations which serve the exercise of the easement or may otherwise be necessary. A **written contract is sufficient** to establish easements on real estate; public authentication is not required. However, the establishment of an easement on real estate also requires its entry in the land register.

Real estate charges

In contrast to an easement, a real estate charge (*Grundlast; charge foncière*) obligates the owner of the real estate to **take action**. However, the owner is not personally liable to perform, as liability is restricted to the relevant real estate. A real estate charge is a kind of half-way house between an easement on real estate and a lien or real estate security interest. As long as the services associated with the real estate charge are performed, it acts much like an easement, but if the services fail to be performed, the real estate becomes liable in the same way as for a real estate security interest. A special feature of real estate charges in *Switzerland* is that they can be **redeemed**, and the debtor is in any case bound to a real estate charge for a maximum of 30 years. To establish a real estate charge by contract, public authentication and entry in the land register are required.

Other easements

Art. 781 CC defines a category of easement known as 'other easements' which are positioned somewhere between personal easements and easements on real estate. For every easement that can be established as an easement on real estate, it is also possible to establish a personal easement according to *Art. 781 CC*. However, easements of this kind do not represent an entitlement for the respective owner of the real estate but for a specific person and can, as a rule, be neither inherited nor transferred.

Liens and mortgages (real estate security interests)

Liens and mortgages (real estate security interests – *Grundpfandrechte; gages immobilières*) are used to secure claims and to mobilize the value of a real estate. In *Switzerland* real estate security interests can be established in the form of a **simple mortgage** (*Grundpfandverschreibung; hypothèque*), a **mortgage note** (*Schuldbrief; cédule hypothécaire*), as well as in the form of a real estate bond (*Gült; lettre de rente*) which, however, is almost obsolete. All liens result from the conclusion of a publicly notarized agreement and entry in the land register. In the cases of the simple mortgage and the mortgage note, the debtor is personally liable.

The **simple mortgage** is for securing any kind of debt. Although the debtor is also personally liable in the case of a **Schuldbrief**, this most widely used mortgage note is a security that may also be used to mobilize the value of the real estate. A mortgage note may be transferred, ceded or mortgaged outside the land register in accordance with the law on

securities. The creation and continued existence of a mortgage note is independent of the secured claim.

The claim secured by a lien must be exactly defined in its amount and recorded accordingly in the land register. The lien covers the entire real estate with all its parts and belongings. It is clearly apparent from the land register whether any liens or mortgages exist on the real estate and how high these may be. If the claim is for a specific sum, this must be entered and the security is then liable for the capital claim plus a maximum of three due annual interest payments, collection costs and any default interest (known as the **capital mortgage**). A simple mortgage allows a claim to be secured even if its amount is not exactly defined. In such cases, the land register merely specifies a maximum amount for the demand, and the liability cannot exceed this figure (known as a **maximum mortgage**).

2.3 Protection of ownership, proof of ownership and registration

The **Swiss federal land register** (*Art. 942 CC*) registers the existence and extent of ownership of private rights to real estate. Although it is called a federal land register, it is actually managed by the cantons. There is no centrally managed property register for the whole of *Switzerland*. The land register comprises a journal, a general register, a description as well as plans, supporting documentation and auxiliary registers. In addition, various **types of land registers** are current in *Switzerland*. Apart from the **Swiss federal land register** (managed by the cantons), **cantonal land registers** continue to exist, although these lack the full legal force of the federal register in some respects.

The federal government exercises general supervision over the land registry system via the *Swiss Office for Land-Register and Land Law* (*Eidgenössisches Amt für Grundbuch- und Bodenrecht*). However, the cantons are responsible for setting up the land registry offices, defining the administrative districts, appointing and remunerating the officials as well as assuring cantonal supervision. They manage the land registers and are liable for all damages resulting from defects in this respect. The land registers in most cantons are now completely or partially computerized.

Swiss land registers refer to individual properties. The properties entered in the land register include **real estate, independent and permanent property rights**, as well as any mines and **co-ownership shares** inclusive of **condominium units**. The owners of the properties are identified by means of an auxiliary register (or list) which is organized by municipality or land-register districts. As a rule, the entries in the land register are made by means of a written declaration by the owner of the relevant real estate (submission of registration). They are based on deeds (purchase, donation, easement-establishment and estate-division contracts) as well as on agreements and approvals. These deeds are kept by the land registry office as evidential records.

Anyone is entitled to inspect the land register without special authorization. Those who credibly assert a relevant interest may inspect additional data forming part of the land register or obtain an extract of this data. The correctness of the entries in the land register is presumed by law. The argument of being unaware of an entry in the land register has no legal validity.

As a rule, an **entry in the land register is subject to the following requirements**: (1) a valid sale, donation or exchange agreement; (2) the seller or donor must be entered in

the land register as an owner; (3) the seller or donor must be authorized to dispose of the relevant objects; (4) the seller or donor must agree to the entry of the new owner in the land register.

The law relating to land registers is not fully covered by the *Civil Code*. Supplementary regulations are found in the directives of the federal authorities, especially in the *Land Register Ordinance of February 22, 1910* (*Grundbuchverordnung; l'ordonnance sur le registre foncier*) as well as in official decisions of the cantons.

3 Purchase and sale of real estate

3.1 The sales agreement

Sales agreements, provisional agreements as well as agreements on purchase and repurchase rights which refer to real estate always require **public authentication**. The same applies to any changes in such agreements. **Non-compliance** with these stringent formal requirements renders the relevant agreement **invalid**. For the purchase of real estate, this means that neither the seller nor the buyer is bound by a written agreement unless it has been drawn up in the appropriate form by a notary public.

Swiss law makes a distinction between the contractual act creating an **obligation** and the actual **transfer of ownership**. The act of creating an obligation to ownership transfer and the actual transfer may take place concurrently or separately. However, the transfer of ownership depends on the existence of an effective act of disposal. This is known as the **causality principle**. In *Switzerland* (unlike, for instance, in *Germany*), this causality applies even after a disposal act has been concluded, and a defective or even invalid act creating an obligation is not remedied by an entry in the land register. This means that in such a case the land register can be subsequently corrected by a **request for rectifying the land register**. However, this does not exclude *bona fide* acquisition by an unauthorized party. The **principle of the irrebuttable presumption** of the accuracy of the land register contents means that a *bona fide* third party who acquires a real right on the basis of an entry in the land register can assume that the land register is correct and that his acquisition can no longer be contested.

The conclusion of the sales agreement does not yet make the buyer an owner. The actual transfer of ownership only takes place when the seller has submitted his application to make an entry to the land register or when the new owner has been entered in the land register. When the contract has been fulfilled, the buyer pays the purchase price and the seller procures the real estate for the buyer by registering the entry in the land register. **Ownership is transferred to the buyer only when the entry is made in the land register**. In most cases, all rights and obligations as well as benefits and risks are transferred simultaneously with the entry in the land register. This must be noted particularly when acquiring real estate on the basis of a separate works contract.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and the matrimonial property regime

Before one can examine any existing restrictions of sale or acquisition on the basis of the matrimonial property regime, it must be clarified which **property regime actually applies**.

This question is regulated by the Swiss international private law. There are no state treaties that would take precedence in these matters. In *Switzerland*, the spouses may choose between the law of the country in which they have their matrimonial domicile and the law of the country whose citizenship one of them possesses. If one or both of them possess multiple citizenship, the law of one of the countries involved may be freely chosen. Although this choice of law may be made by a simple written statement, it is usually made in the form of a marriage contract. A choice of law may be made at any time and changed again at any time.

If no national law is chosen, the property regime is subject to the law of the country in which the spouses have their matrimonial domicile. If the spouses have never possessed simultaneous domicile in the same country, their common citizenship (*lex patriae*) shall be applied. Their common citizenship must already have existed before their marriage and not only as a result of it. If they do not have a matrimonial domicile nor possess a common citizenship, then the matrimonial property regime according to Swiss law applies.

In *Switzerland*, most spouses have not concluded a marriage contract and are consequently subject to the legal property regime, which is the participation in acquisitions during marriage (*Errungenschaftsbeteiligung; participation aux acquêts*). This property regime means that the spouses personally administer and use their respective assets during the marriage. When the marriage ends, a mutual settlement takes place on the basis of the prevailing property regime. In contrast to their own property, (in particular, assets which belong to a spouse at the beginning of the property regime or which are later acquired by him/her free of charge, for instance by inheritance), the mutual settlement includes the respective earnings from employment of the spouses, revenues from their respective estates, benefits from personal insurance schemes and similar assets. In principle, each spouse obtains half of the other's assets, corrected by specific deductions and additions.

The **separation of property** which applies both as a result of a marriage contract and, in certain circumstances, by law, implies that each spouse administers and uses his/her assets him/herself without in any way requiring the consent of the other spouse. In principle, complete separation of their respective assets exists.

In cases of **community of property**, which is the only property regime that may be established solely by contract, almost all assets are held in joint ownership and administered jointly by both spouses. Apart from its regular administration, the spouses can obligate their common household or dispose of their joint matrimonial property only with the consent of the other spouse.

An important **restraint on disposal** concerns legal transactions relating to the **matrimonial home**. A spouse may perform such transactions only with the express consent of the other spouse, **even if the disposing spouse is the sole owner of the family dwelling**. The sale of agricultural land which is administered jointly by both spouses also requires the consent of both spouses.

3.2.2 Options and pre-emption rights

Various legal rights of pre-emption must be considered. These may be neither inherited nor ceded and have precedence over contractual option and pre-emption rights. A legal right of pre-emption applies mutually to co-owners, just as between the holder of a right to build

and the respective landowner. In the case of agricultural land, additional pre-emption rights exist in favor of the relatives of the seller as well as in favor of the leaseholder.

Options to buy, pre-emption rights (*Vorkaufsrecht; droit de préemption*) or re-purchase rights (*Rückkaufsrecht; droit de réméré*) can be established contractually for a **maximum duration of 25 years**. The relevant contract must be officially authenticated, and a right of pre-emption can be noted in the land register. The note gives it a specific force with respect to any rights that may be subsequently acquired.

3.2.3 Agricultural real estate

A number of special laws and regulations apply to agricultural land in *Switzerland*. These are largely laid down in the *Federal Law on Rights to Agricultural Land* (*Bundesgesetz über das bäuerliche Bodenrecht; loi fédérale sur le droit foncier rural*).

3.2.4 Restrictions regarding acquisition of real estate by foreigners

The acquisition of real estate by non-resident foreigners has been greatly restricted in *Switzerland* since the early 1960s. This group comprises natural persons who are not Swiss, EU/EEA and EFTA citizens or who do not possess a Swiss **residence permit C**, as well as legal entities domiciled abroad or foreign-controlled legal entities domiciled in *Switzerland*. **Citizens of *EU/EEA* and *EFTA* member states** holding a residence permit in *Switzerland* have the same rights as Swiss citizens and are consequently eligible to conduct all real estate business without restrictions. The citizenship of the acquirer's spouse is immaterial.

After relevant measures had initially been taken by means of an urgent federal ordinance, the *Federal Law on the Acquisition of Real Estate by Non-residents* (*Bundesgesetz über den Erwerb von Grundstücken durch Personen im Ausland; Loi fédérale sur l'acquisition d'immeubles par des personnes à l'étranger*), known as *'Lex Friedrich'*, came into force in the 1980s. This law was then revised on April 30, 1997, with few, but significant changes (the revised version is known as *'Lex Koller'*).

In principle, the revised legislation also makes the acquisition of real estate by foreign nationals subject to approval, and the cantons continue to be responsible for enforcing the law. However, the revised law of 1997 broadened the definition of the **circumstances for an exemption**. A check must therefore be made before every entry in the land register or corresponding act of disposition to determine whether an exempting circumstance is present or not in the particular case.

In principle, all commercial real estate, i.e. premises used for business purposes, can now be acquired **without approval**. These premises do not need to be managed by the acquirer of the real estate. This means that foreign nationals can now invest in purely commercial real estate without restrictions. However, purely non-commercial real estate (such as dwellings, private houses, city apartments, tenements, etc.) continue to be subject to approval, and in practice this approval is seldom granted.

This leads to demarcation problems in mixed premises. Depending on zone assignment, it may be specified that business premises must include a certain proportion of residential accommodation. Commercial real estate subject to such residential-share rules may normally be acquired without approval.

Private apartments and houses that are used by their owners as their principal residence are **no longer subject to approval**. The restriction on net living area has also been lifted, although the area of the real estate must not exceed 3,000 m^2. Foreign nationals who hold at least a valid residence permit B may acquire property for their own use. However, the acquisition must be made in their own name. If the foreign national relinquishes his Swiss domicile again, he/she may nevertheless retain the real estate.

Secondary residences may also be acquired **without approval** under certain conditions. A foreign national who is a citizen of an *EU* or *EFTA* member state and works in *Switzerland* as a cross-border employee can acquire a secondary residence in the region of his/her workplace without approval. He/she must live in the dwelling him/herself and is not permitted to let it. Note here that, for the time being, special rules apply for citizens of the new member states which joined the *EU* on May 1, 2004.

Secondary residences are otherwise **subject to approval**. A foreign non-resident may be granted approval to acquire a secondary residence in a location to which he/she has exceptionally close links worthy of being upheld. Somewhat more than half the cantons recognize this as a valid reason for granting approval.

In contrast, **vacation homes** are invariably **liable to approval**. A **quota system** is applied to them. Each canton is allocated a specific quota within whose framework approvals may be granted. In addition, vacation homes may be acquired only in places specifically designated by the cantons as tourist resorts. Quota allocation and approval practice vary widely between individual cantons as well as between different communes within a canton. Both cantons and communes are also authorized to introduce more extensive restrictions by law. So it may well be the case that a vacation home can be easily acquired in one commune, whereas the neighboring commune imposes an absolute ban on further approvals. It is consequently important to clarify in detail exactly before every purchase and every down payment whether an approval exists or will be granted for the real estate to be acquired.

If a foreign national acquires Swiss real estate from another foreign national, this acquisition is subject to approval in exactly the same way as an acquisition from a Swiss national.

Apart from the acquisition of full ownership, the obligation to obtain approval also extends to all other rights which grant the acquirer ownership-like status, such as options and pre-emption rights, usufruct, the conclusion of long-term rental and leasehold agreements, unusual financial arrangements which place the (domestic) property acquirer in special dependence on the (foreign) creditor, etc. The legislation also expressly covers changes of **economic (beneficial) ownership**. Whenever real power of disposal is acquired over real estate, an acquisition (which may be liable to approval) exists. The determining factor is always the economically authorized person standing behind an acquisition, so that fiduciary relationships are not relevant and always looked through.

Violations of the Swiss acquisition restrictions result in various **sanctions** under civil, **criminal** and **administrative law**. In the first instance, a violation leads to invalidity in civil law, and in most cases to nullity of the legal transaction liable to approval. An approval based on false information is revoked, and sanctions under immigration law may also be imposed. Evasion of approval obligation, giving of false information and the disregard of obligations may in addition be punished with fines and prison sentences. Because of the comprehensive scope of application of the acquisition restrictions and the corresponding sanctions, **evasive**

legal transactions are not permissible in *Switzerland*. In cases of doubt it is always wise to submit details of a planned acquisition of real estate to the relevant approving authority.

Other restrictions on acquisition

If the seller is also a non-resident and is merely liable to (restricted) tax in *Switzerland* on the real estate in question, the buyer of a property will not be entered in the land register until the tax authorities have confirmed that all taxes have been paid. A corresponding confirmation must therefore be requested from the seller.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

In principle, every acquirer must check the capacity to act and entitlement of the seller and (presumed) owner. This is because a sales contract concluded with a party who lacks entitlement or the capacity to act or conclude contracts may be completely ineffective or contestable, depending on the situation and circumstances. In *Switzerland*, those who are of age and capable of forming judgments are considered to possess legal capacity. A person is of age at 18.

The seller's entitlement must be verified by means of a current extract from the land register, or by means of an extract from the commercial register and corresponding powers of attorney depending on the situation (property of a company, agency).

3.3.2 Third-party claims and unpaid taxes

Every buyer should comprehensively check out any existing claims of third parties which may encumber the real estate. Various easements, licenses and restrictive covenants, as well as liens, can have considerable impact on the value and potential resale of the real estate.

If the seller has not paid tradesmen's bills in connection with the building project, the tradesmen may enter what is known as security interests of craftsmen and contractors or **building tradesmen's lien** (*Bauhandwerkerpfandrecht; hypothèques des artisans et des entrepreneurs*) in the land register. They must do this within three months of completion of the work. For the new owner, this lien means that his/her property is liable for payment of the outstanding bills. This must be considered when acquiring a newly built house or apartment and proof must be requested from the seller that no bills are outstanding.

In addition, **the real estate is liable for any taxes on real estate gains not paid by the seller**. The buyer must consequently secure him/herself in this regard, and may do this by a bank guarantee or by withholding a corresponding sum via a notary.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Environmental protection and contaminated land

Environmental protection and the problem of contaminated land have acquired increasing importance in *Switzerland* in recent years. Swiss environmental law stipulates that the cantons are responsible for cleaning up landfills and other contaminated land if these lead

to damaging or annoying effects or if a real danger exists that such effects may occur. The *Directive on contaminated land* which came into force in 1998 regulates the uniform treatment of such areas throughout *Switzerland* and ensures the required legal security.

Accordingly, **clean-up of contaminated land** may be required by the authorities not only within the scope of a building project but **at any time**. As a rule, the costs must be borne by the **respective owner**. Corresponding checks must be made before every acquisition of a piece of land, as the possible presence of hazardous substances both below ground and in the building materials affects the value and resale options of the property and may even render it unsellable. It can also incur major costs. See www.altlast.ch.

Protection of nature and the cultural heritage

As a rule, nature protection regulations do not affect correctly zoned real estate. Nevertheless, it makes good sense to clarify the prevailing situation. The website www.umwelt-schweiz.ch of the *Swiss Agency for the Environment, Forests and Landscape SAEFL* (*Bundesamt für Umwelt, Wald und Landschaft, BUWAL; Office Fédéral de l'environnement, des fôrets et du paysage, OFEFP*) gives a good overview of the topic. It should also be noted that bodies such as nature protection and environmental organizations (e.g. *WWF; Greenpeace*) as well as the *Swiss Heritage Society* (*Schweizerischer Heimatschutz; Patrimoine Suisse* – see www.heimatschutz.ch) have the right to object or appeal against building projects. This may lead to unexpected obstacles in certain cases.

More significant are the **restrictions on historical buildings** subject to monument protection. The federal government, cantons and communes invest in preserving historical buildings, and the authorities keep a record of this cultural heritage (see www.kultur-schweiz.admin.ch). Such restrictions are noted in the land register and mean that no changes may be made without approval by the authorities. However, the authorities may also intervene in a not (yet) classified building which may be deemed worthy of protection in the event of a building or renovation project. Thus, for example, in the city of *Zurich*, an owner will often not find out whether and to what extent his/her building is considered worthy of preservation until he/she enquires about a reconstruction or other building matter. So care must be taken when buying a historical building which may be classified as a protected monument. When considering a building project, it is wise to consult the relevant authorities as well as interested bodies (such as the *Swiss Heritage Society*) in advance in order to avoid undesirable surprises.

The advantage of monument and heritage protection is that owners of protected buildings may be eligible for government funding to cover the costs of renovation and similar work. The buildings to be supported by the federal government are selected in close coordination with the cantonal departments of monument preservation. These pass the relevant applications to the heritage protection and monument preservation section of the Swiss Federal Office of Culture (*Bundesamt für Kultur; Office Fédéral de la Culture*). The federal government supports not only buildings of national interest, but also monuments of regional importance. In addition to federal grants, cantonal and communal grants may also be available.

3.3.4 Access to relevant records and documents

Swiss land registers provide definitive information about ownership. The land register must consequently be consulted in all real estate transactions. In addition, the documents that

were used by the former owner, the seller, as a basis for entering the real estate in the land register, must also be consulted.

Whoever buys a share in a condominium must request copies of all relevant minutes and documents concerning the condominium owners association, and especially a copy of the minutes of the last general meeting, a list of expenditures and the name of the administrator. In particular, he/she must check whether the meeting has decided on any building works that have not yet been carried out, or other large expenditures.

3.4 Key points that a seller should consider

From the seller's viewpoint it is particularly important that the **purchase price** is **paid in full or secured** before or concurrently with the transfer of ownership. In *Switzerland*, this is usually secured by an unrevocable undertaking to pay or hand over of a certified bank check. In Swiss contracts dealing with the sale of used real estate, all liabilities are usually excluded. In addition, the seller must consider who is responsible for which fees and taxes. In many cases, notaries' fees and property transfer taxes are split 50–50, but this distribution is ultimately a matter for negotiation. However, the seller is always liable to pay the **capital gains tax** on the property.

Broker's commissions are normally borne by the seller and, as a rule, range between 1% and 5%, and for larger sales are usually set at not more than 2% of the purchase price. In the case of a property search commission, however, a broker's fee may also be demanded from the buyer. Broker's fees can be freely negotiated between the parties concerned. They are subject to *value added tax* (*VAT*).

3.5 The execution of a real estate purchase transaction

In buying real estate, a distinction must be made between a purchase concerning a new and as yet undeveloped property still at the planning stage, and a completed building.

The procedure for purchasing real estate can vary between cantons, depending on whether cantonal practice involves an official or a private notary. Where self-employed **private notaries** authenticate property business (as, for example, in the canton of *Vaud*), the procedure takes place via the notary's fiduciary account. The notary acts practically as an *escrow agent* and receives the entire purchase price, which he/she does not transfer to the seller until the entry in the land register, and thus the handover of ownership, has been completed.

In cantons with **state-employed notaries** (such as the canton of *Zurich*), the land registry is usually on the same premises as the office of the notary who performs the authentication. Accordingly, the buyer and seller (or their representatives) are usually present together when the land register applications are checked and the land register entry is signed by the seller, in response to payment by the buyer. Payment is usually made either by a certified bank check or an irrevocable undertaking to pay from a Swiss bank in favor of the seller.

In the case of a double sale, which is almost impossible in *Switzerland* in view of the country's secure land registry system, whoever is first entered in the land register acquires the real estate. In such a case, the other buyer merely acquires claims for damages.

In the case of new and not yet (completely) built properties it should be noted that the purchase price must usually be paid in several installments in advance and in accordance with the progress of building so that the buyer incurs a risk – which may be considerable – depending on the building contractor. This may be secured with a corresponding bank guarantee. Unlike many other countries, however, *Switzerland* has no legislation in this domain to protect the buyer.

3.6 Powers of attorney

Special or general powers of attorney may be granted. Although powers of attorney require no specific form, those concerning real estate transactions usually require corresponding **official authentication** (signatures certified by a notary, i.e. notarized), which quite generally also makes good sense for important legal transactions. Powers of attorney concerning transactions with real estate and rights to land are invariably subject to the jurisdiction of the place in which the relevant real estate is located, and a choice of law is excluded in this regard.

3.7 Financing

In *Switzerland*, both banks and some life insurance companies grant mortgages against corresponding collateral of up to about 80% of the current market value of the real estate. However, this applies only to acquirers or owners of real estate who are resident in *Switzerland* and can produce proof of corresponding income. Foreign buyers of real estate often encounter considerable restrictions when trying to obtain local financing, unless they hold corresponding assets, such as securities or cash deposits at a Swiss bank. This may, in most cases, be used to finance the purchase of real estate. This kind of business is handled particularly by the two major banks *UBS* and *Credit Suisse*, but also by the cantonal banks, the *Raiffeisen* banks as well as some smaller institutions.

Current interest rates for mortgages in Swiss francs are extremely low in a historical comparison (see Figure 1), so it is worth while checking out the possibility of debt financing. In *Switzerland*, a mortgage may also make good sense from a tax viewpoint.

At the end of November 2002 the *Zurich Cantonal Bank* reduced its interest rate for first variable mortgages to 3.5%. This rate is taken to be the reference interest rate for calculating rents. The last time such low interest rates were recorded was between 1946 and 1958. In March 2003, this rate was reduced by another 0.25% to a record low of 3.25%. Swiss mortgage rates are consequently at their lowest level ever.

3.8 Purchase through a company

In *Switzerland*, it is **impossible** for **foreign nationals** who count as non-residents (see section 3.2.4 above) to acquire residential real estate via a company, and that includes a Swiss company. This is, in principle, not permissible even if the ownership relationships are disclosed.

In contrast, purely commercial real estate may be acquired without restrictions via Swiss or foreign companies, and interesting possibilities accordingly exist for tax-efficient structuring.

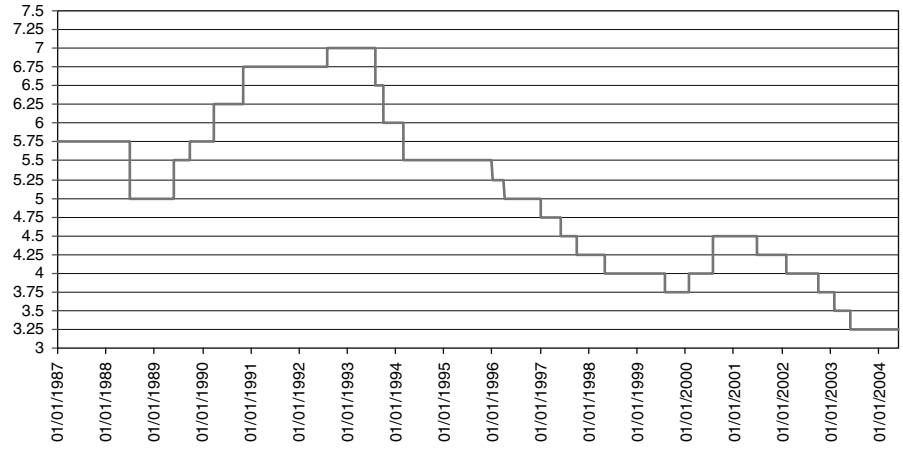

Figure 1 Mortgage rates 1987–2004 (*Source*: Zurich Homeowner's Association 06/2004)

3.9 Defects and warranty claims

In principle, the seller is liable for any title and material defects. Any relevant warranty claims lapse within five years. For used real estate, however, any warranties are normally relinquished by the seller in the sales agreement. Only fraudulently concealed defects can justify warranty or damage claims. For newly built real estate, see section 4.4 below.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

The Swiss *Zoning Act* (*Raumplanungsgesetz; Loi fédérale sur l'aménagement du territoire*) obliges the cantons to define specific utilization zones, such as agricultural, industrial and construction zones. This is done in cantonal zoning laws that define the actual zones that exist and the way in which the land in these zones may be used. More detailed elaboration of these zones is left to the individual communes. A glance at the commune's *zone allocation plan* will show in which (construction) zone the real estate to be acquired lies – and to what extent relevant restrictions may exist. In contrast, building restrictions based on private law such as easements are entered in the land register.

The communes are relatively free to issue **building permits**. It makes sense to start any planning work as early as possible and to submit a building application in good time. It is also recommended to discuss the building project in advance with the competent authorities of the relevant commune and to check out the legal situation and the required authorizations. There is no obligation to use an architect in *Switzerland*, and the profession of architect is not even protected. Nevertheless, architects, draftsmen and other experts are in most cases required in order to satisfy all the formalities and to prepare detailed plans. Any neighbors affected by the planned building work should also be informed at an early stage, and the neighbor's concerns should be taken into account as far as possible. Such precautions will preclude any lengthy legal proceedings due to their objections.

4.2 Architect's and building contracts

The architect's contract

In *Switzerland*, the architect's contract is based on the **mandate** of the Swiss contract law as set out in the *Swiss Code of Obligations*, although elements of a **contract for work and services** may also play a role. The *Swiss Society of Engineers and Architects* (*Schweizerischer Ingenieur und Architektenverband, SIA; Société suisse des ingénieurs et des architects, SIA*) has issued guidelines which have acquired great practical importance as 'general terms and conditions of business' for the construction industry. *SIA Standard 102* is of special interest with regard to architects, as it lays down their conditions of service and fees. Simple contracts are dealt with only in a relatively summary manner by the law, as they apply to many liberal professions. Special attention should be paid to fiduciary duty and the duty to take due care, as well as to the stipulations that a commissioned party is liable for neglect of duty and that the contractor may revoke his/her order – in principle – at any time. As it is not uncommon for architects to have no liability insurance for construction damage, it is important to check that such cover is in place.

The professional designation of 'architect' is not protected in *Switzerland*, so that anyone may open an architect's office and call him/herself an architect.

The building contract

In *Switzerland*, contracts regarding building/construction work are normally based on the (private) *SIA Standard 118*, which is usually included in contractual agreements as a matter of course. However, it may make sense to adapt this standard to a specific building project. It is important for the person commissioning the building work (known here as 'the principal') to insist that the building contract can be modified only with his/her agreement. This applies particularly to changes that involve financial obligations: these should be checked by the architect or builder but must not be carried out without the principal's approval. The same applies to the final account, which is checked by the builder but must be approved by the principal.

4.3 Completion of construction and formalities

The building must be constructed in accordance with the building permit and completed within the appropriate time. The local building authorities must be informed of the start of the building work and of its progress at regular intervals until the building is ready for occupation. They will then inspect the building. In addition to this official inspection, the principal must precisely record all defects at handover of the building, as the warranty and claim periods start from the day of handover.

4.4 Deficiencies and warranty claims regarding new construction

Almost every building has some defects, so it is important to proceed with great care at the handover of the building and to record all deficiencies. The builder is obliged to produce a defect-free building. If the builder fails to do so, the law grants the principal three **defect rights** in addition to the right to claim damages, namely the **right of rescission, price**

reduction or **rectification**. In the building industry, however, the particular stipulation of *SIA Standard 118* usually applies, which in the first instance grants the builder the option to rectify the work. Only if the builder fails to rectify the defect within the agreed time period do the other defect rights come into consideration. If the builder fails to rectify the defect, the principal may commission another tradesperson with the rectification work as soon as the legal period has elapsed. The principal may also demand an advance from the defaulting builder to finance the replacement work.

In *Switzerland, SIA Standard 118* normally makes provision for a **warranty period of two years**, which begins with the handover of the building. During the warranty period, the principal may give notification of defects at any time, with the exception of those which might give rise to further damage, which must be notified immediately. In most cases, however, no immediate notifications are made, but an initial defects list is prepared at handover of the building to the principal and a second defects list before the warranty runs out at the handover of the keys. The builder's liability continues for what are called **hidden defects** and only lapses **five years** after handover of the building or 10 years in the event that the builder has deliberately concealed any defects.

5 Rental and tenancy

5.1 Rental and lease agreements

As mentioned at the outset, *Switzerland* is a 'country of tenants'. There consequently exists an extensive body of legislation and legal precedence concerned with rental law. The interests of the tenants are represented particularly by the *Swiss Tenants Association* (www.mieterverband.ch). The interests of the real estate owners are represented principally by the *Swiss Homeowner's Association* (www.hev-schweiz.ch). The fundamentals of Swiss rental law are laid down in the country's *contract law*. In addition, regulations exist on renting and leasing residential and business premises, and the *criminal code* also contains articles that protect tenants.

Standard form contracts are often used to conclude rental agreements. It is usual to pay a rental security amounting to between one and three monthly rents. This sum is paid into a designated bank account which is held in the tenant's name but can be disposed of only with the agreement of the landlord.

At the sale of rented or leased real estate, the existing rental and leasing agreements are transferred to the buyer. The buyer can give notice of terminating the rental or leasing agreement by the next lawful termination date, but only under the condition that he/she can assert urgent personal need. However, the latter provision does not apply if the rental is recorded in the land register.

5.2 Regulations on protection of tenants and rent control

In *Switzerland*, endeavors to protect tenants have led to government intervention for many decades. Free setting of rents on the residential market existed only between 1925 and 1936, as well as – after a decade-long phase of emergency regulations – a year and a half in the early 1970s. Since then, tenant protection regulations have come into force, some of them

with a broader impact, but tenants' protection is not as comprehensive in *Switzerland* as in some other European countries.

Legal restrictions cover **protection against rent abuse** and other abusive demands by landlords as well as **regulations for protection against eviction**. The increased eviction protection for tenants includes minimum legal periods of notice, the stipulation that all notices to terminate tenancy must be made on specific forms, the obligation to justify the notice, ways of contesting notice and extensions of the rental period.

6 Succession and gifts

In these domains, the *Swiss Private International Law Act* (*PILA*) covers the relevant international jurisdiction, the applicable law and the recognition of foreign decisions.

6.1 Applicable law and jurisdiction

The applicable law is based on the **principle of habitual residence**, i.e. it depends primarily on the country in which the testator had his/her last domicile. If no domicile may be determined on the basis of the *PILA*, the usual residence takes the place of the habitual domicile.

So if the testator had his/her **last domicile in *Switzerland***, Swiss inheritance law will apply to his/her entire global estate (in line with the principle of indivisibility of an estate). However, if the testator has foreign citizenship both at the time of the choice of law as well as at the time of his/her decease, he/she may choose the law of the country of his/her citizenship (*lex patriae*) via a testamentary disposition or an inheritance contract. A partial choice of law is not permitted. Where a **testator's last domicile was abroad**, the Swiss provisions on the conflict of laws refer to the corresponding law of the country of domicile.

The *Hague Convention on the Conflicts of Laws relating to the Form of Testamentary Dispositions of 5 October 1961* applies to the **form** of testamentary disposition. Accordingly, a disposition of this kind is always formally effective and valid when it has been set up either in accordance with the stipulations of the *lex patriae* of the testator, the stipulations of the place of its formation or, in the case of real estate, of the place where it is located.

6.2 Fundamentals of the succession and gift/donation laws of Switzerland

At the testator's death, the estate is transferred automatically and as a whole to the inheritors (in line with the principle of **universal succession**). Acceptance of the inheritance is not required. If neither a disposition in contemplation of death nor an inheritance contract exists, or if these are invalid due to defects in their form or content, then legal succession applies. **Compulsory portions** allocated to the surviving spouse and close relatives should also be considered. Special stipulations apply to agricultural real estate.

At the death of a **married testator**, the marriage is dissolved and the actual estate is determined as soon as the **matrimonial property settlement** has been concluded, i.e. the mutual economic claims on the basis of the matrimonial property regime have been determined and settled.

Legal succession

Swiss succession law is based on the ***per-stirpes* system of the three generations of grandparents, parents and children**. The closest inheritors of a testator are his/her descendants. Children inherit equal shares, and the place of any predeceased children is taken by their children (grandchildren of the testator) or their descendants. If the testator dies without issue, the estate passes to the parents. The mother and father each inherit half the estate. The siblings of the testator or their descendants (nephews and nieces) inherit in place of any predeceased parents. If there are no descendants on one side, the inheritance falls to the inheritors of the other side. If the testator leaves neither issue nor inheritors of the parental family, the inheritance passes to the grandparents' family. If the grandparents on the paternal and maternal sides survive the testator, each side inherits equal shares. Predeceased grandparents are succeeded by their descendants, i.e. uncles, aunts and cousins of the testator. If one grandparent is predeceased and also leaves no issue, the entire half of the estate falls to the inheritors of the same side. If there are no inheritors on the paternal or maternal side, the entire inheritance falls to the inheritors on the other side. The inheritance right of the relatives ends with the grandparents' family.

The **inheritance right of the surviving spouse** depends on the inheritors with whom he/she must share the inheritance. If he/she must share it with the testator's descendants, he/she receives half the inheritance. If he/she has to share it with parents, siblings, nieces and/or nephews, three-quarters of the inheritance falls to the surviving spouse.

If the testator leaves no inheritors, the inheritance falls to the canton in which the testator was last resident, or to the commune to be designated by the legislation of this canton.

Testamentary dispositions

Testamentary dispositions are often also known as the '**last will and testament**'. This is a unilateral declaration of a person's will, which becomes effective in law at the death of the declaring party. Whoever leaves a spouse, children or parents, may dispose freely of his/her assets after these have received their **compulsory portion**. The latter comprises three-quarters of the legal inheritance right for children, a half for the spouse and a half for each of the parents. It is possible to **favor the surviving spouse** over their common children or those who issued from the marriage by granting him/her the right to the entire share to which these children are entitled.

Additionally, Swiss law makes provision for the institution of an **inheritance contract** or an **inheritance renunciation contract.** These are bi- or multilateral legal transactions. Whereas the testator may at any time supplement, replace, modify, fully or partially revoke, even destroy his/her will, an inheritance contract requires the cooperation of all those concerned if any changes are to be made.

Donations/gifts

A distinction is made between **immediate gifts** and the **promise to make a gift**. In the case of an informal gift from one person to another, the conclusion and fulfillment of the contract

take place concurrently, whereas they occur at different times in the case of a promise to make a gift. The latter must be made in writing to be valid. A purchase in which the purchase price is intentionally set very low is known as a **mixed gift**, a circumstance which may change the tax consequences. If the purchase price is purely symbolic, the contract must be considered a pure gift.

7 Taxes and charges

The federal structure of *Switzerland* is also reflected strongly in the country's tax system. Fiscal sovereignty is an entitlement of the federal government as well as of the cantons and their communes. Each canton has its own tax laws with its own tax rates, tax allowances, etc. The relative independence of the cantons in the sphere of taxation ensures healthy competition, and the tax burden is accordingly moderate in an international comparison for both natural and legal persons. Another consequence is, however, that the tax burden may vary greatly between the individual cantons and communes, and the Swiss tax system is far from transparent.

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

Most cantons levy a conveyancing tax on the transfer of real estate (*Handänderungssteuer; droits de mutation*). The federal government levies no taxes of this kind. The remunerative transfer of ownership of real estate is normally taxable. As a rule, the basis for assessment is the purchase price or the taxable value of the real estate, the tax rates varying between 1% and 3% in the different cantons. In most cantons, it is usual for conveyancing taxes to be shared 50–50 between buyer and seller.

7.1.2 Sales tax (value added tax)

In *Switzerland*, **value added tax (*VAT*)** is levied at federal level. The standard rate currently is 7.6%. The actual sale of real estate is not liable to *VAT*. However, builders may opt to pay *VAT*. In addition, *VAT* is levied on all building work and materials.

7.1.3 Real estate registration and notary charges

The acquisition of real estate and the establishment of liens and mortgages on it are liable to land register and notary charges. Like conveyancing taxes, these are not regulated uniformly across the country and can vary greatly from one canton to another (see Table 1). Even payment is not the same everywhere. In most cantons, however, the following practice has become established: the costs (notary and land register costs, conveyancing tax) are shared equally by the contractual parties. In some cantons (such as *Vaud* and *Neuchâtel*), these costs are usually borne by the buyer. The costs associated with real estate security interests are normally borne by the buyer. In the end, however, parties are naturally free to apportion any costs among themselves.

Table 1 Acquisition costs and capital gains taxes in selected cantons

Canton	Notary charges [4]	Land register fees [4]	Real estate transfer taxes	Establishment of liens and mortgages	Capital gains taxes
Berne	0.1–0.5%	Sfr 100–500	1.8% (or 0.9% for purchase by descendants or spouse)	0.25%	2–8% [1]; 2% reduction per ownership year, max. 70%; supplement for ownership under 5 years, max. 70%
Grisons	0.2% [2]	0.1% [2]	1–2%	0.3% [3]	5–15%; 1.5% reduction for each ownership year over 10 years, max. 51% rebate
Lucerne	Max. 0.3%	0.2% [7]	1.5% [8]	0.2%	Tax 0.023 to 25.62% (profit-dependent) for short ownership supplement to 50%; for long ownership reduction by up to 25%. No tax on profits below Sfr 13,000
Nidwalden	Max. 0.25%	0.1%	1% (purchase by issue or spouse tax-free)	0.2%; max. Sfr 8,000	14–40% depending on duration of ownership
Schaffhausen [6]	0.1%	0.6%	–	0.3% incl. authentication fees	0.8–30% depending on duration and intensity of profits
Schwyz	0.09% + ca. Sfr 350 copying fees	Ca. Sfr 100	1%	0.09% of lien sum + ca. Sfr 200 copying fees	9–40% depending very strongly on holding time and profit intensity
St Gall	0.2%; max. Sfr 12,500	0.2%; max. Sfr 12,500	0.5–1%	0.3% total max. Sfr 6,000 per lien	Up to 33.5% for short holding, supplement up to 5%; for long holding reduction by max. 40.5%
Ticino	Sfr. 200 + 0.1–0.5%	0.3% stamp duty, 1.1% land register or conveyancing fees	–	0.1% stamp duty 0.4–0.7% of lien sum 0.2–0.5% for mortgages	Depending on ownership duration, 3–30%
Thurgau	0.1%; max. Sfr 5,000	0.4%; max. Sfr 20,000	1%	0.15%; max. Sfr 10,000	40% of profit on the property [5]
Vaud	Max. 0.7% (for immediate transfer)	0.15%	3.3%	0.3% land register fees; max. 0.5% notaries' fees	7–30%
Zug	Sfr 350–1,000	0.4%	0.4%	0.15% for lien deeds, 0.3% for mortgage notes + Sfr. 20 per title	10–60%, depending on profit intensity and ownership duration
Zurich	0.1%	0.25%	– (As of January 1, 2005)	0.1% authentication fees, 0.25% land register fees	11–40%; supplement up to 50% if ownership <2 years; reduction up to 50% if ownership over 5 years

Most cantons and communes charge handling fees and other ancillary charges of up to Sfr 300. The percentages refer to the purchase price, the sum of the lien or the profit obtained respectively. Most cantons also charge minimal fees for issuing vouchers, publications, etc.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

Fourteen cantons (and in some cantons, the communes) levy a special wealth tax on real estate known as **Liegenschaftsteuer**, which is payable annually in addition to the general wealth tax. It is calculated on the market or taxable value of the real estate (excluding the debts encumbering it, i.e. any such debts are not deductible) and ranges between 0.05% and 0.2%.

7.2.2 Income tax

Both the federal government and the cantons levy taxes on income from real estate. In addition, a (hypothetical) income, known as the **own rental value**, is taxable even if the real estate is used by the owner. So a distinction must initially be made depending on whether the real estate is rented or used personally by the owner.

In the case of rental, the rental income is subject to income tax, although loan interest, administrative expenses and maintenance (value-preserving expenses, but not value-increasing investments) may be deducted.

In the case of owner use, fictitious rental incomes are calculated. Every piece of real estate is assigned its **own rental value**, which may be significantly below the market value, especially for older real estate. This rental value is subject to income tax, but here too the loan interest, administrative expenses and maintenance are tax deductible.

The tax burden varies greatly between the individual cantons and communes. Income tax has a progressive structure throughout the country, with highest tax rates ranging between 12% for an annual income of about Sfr 250,000 (cantons of *Schwyz* and *Zug*) and 34% for an income of about Sfr 500,000 (canton of *Geneva*). In contrast, direct federal tax is uniform throughout *Switzerland*. It also has a progressive structure, reaching a maximum of 11.5% for an income of about Sfr 800,000.

Notes on the table:

[1] This corresponds to 'simple tax'. The final tax rate depends on the tax schedule of the canton, the local commune and the parish. The 'simple tax' is multiplied by the tax schedule of the canton, the local commune and possibly the parish.
[2] Official registrars in Grisons are the patented notaries, the district notaries and the land register administrators.
[3] The figures are: 0.2% for drawing up and authentication, and 0.1% for entry in the land register. An additional 0.1% is charged for preparing the title deed for a mortgage note.
[4] Notarial services are subject to 7.6% VAT, whereas pure land register fees are non-VAT liable.
[5] For holding periods under 3 years +1% per month, for periods over six years, each additional year −4%, max. −72%.
[6] In the canton of Schaffhausen, all public authentications of property rights on properties are performed at the cantonal land registry office.
[7] Of the cadastral value if this is higher than the sale price, otherwise of the sales price.
[8] Acquisition by spouse or descendants tax free. Company conversion/merger/break-up tax free.

7.2.3 Net wealth tax

In *Switzerland*, the cantons tax the assets of natural persons, whereas there is no wealth tax at federal level. Here, too, differences between the cantons are considerable. The tax schedules are usually progressively structured. For assets up to 250,000 Sfr the tax ranges between 0.2% and 0.4% in most cantons. For assets of 1,000,000 Sfr and more it is between about 0.4% and 0.7% per year.

Half the cantons also levy a special wealth tax on real estate, as already mentioned above in section 7.2.1. It is calculated on the taxable value of the property (excluding any debts which encumber it) and varies between 0.05% and 0.2%.

7.3 Capital gains tax

Switzerland imposes a capital gains tax on real estate at the cantonal level. It is known as real estate gains tax (*Grundstückgewinnsteuer; impôt sur les gains immobiliers*). It is levied on the difference between the cost of procurement and the revenue obtained from the sale. It is payable by the seller and is independent of his/her income and asset circumstances.

It is calculated on the basis of the tax rate applicable in the canton and the duration of ownership (the longer this duration, the lower the tax rate). In the case of a 'normal' duration of ownership (from about 4 to 6 years), the maximum tax rate ranges from 30 to 40% in most cantons. This rate declines as the duration of ownership increases by about 50 to 70%, and increases for short durations by about 25 to 50%.

Only real estate transfers resulting from a sale are considered for capital gains tax. Real estate transfers based on gifts, inheritances or settlements of matrimonial property regimes are normally not taxable. However, in the event of a sale subsequent to a tax-free real estate transfer, the capital gains tax then payable is calculated on the basis of the original purchase value.

If an owner-occupied property is sold and the revenue from the sale is used within an appropriate period to acquire or build a replacement property for immediate occupation (known as a replacement acquisition), the capital gains tax is deferred.

Capital gains with regard to real estate are, however, taxed if they result from a business activity (i.e. if the real estate constitutes a business asset) or if the seller of the real estate falls within the definition of a 'professional real estate dealer' as developed by case law in the tax administration and the courts.

7.4 Inheritance and gift taxes

The federal government levies no inheritance or gift taxes. They are raised by the cantons, and more and more cantons are moving over to exempting spouses and close relatives completely from these taxes. Spouses are now exempt in almost all cantons, and in most

cantons descendants as well. Inheritance and gift taxes are levied on descendants only by the cantons of *Appenzell Innerrhoden, Berne, Geneva, Glarus, Grisons, Jura* and *Vaud* (see Table 2). There is also a growing trend to improve the treatment of cohabiting partners, who are in some cases already placed on an equal footing with spouses, i.e. completely exempt. The canton of *Schwyz* levies neither inheritance nor gift taxes.

Real estate is always taxed where it is located. If the testator or donor is domiciled in *Switzerland*, the canton of his/her domicile is responsible for taxing his/her movable assets.

Switzerland has also concluded several agreements on the avoidance of double taxation concerning inheritance and gift taxes.

7.5 Other taxes and charges

Considerable **access charges** must be expected for new buildings (e.g. charges for connection to the public sewerage system).

If the activities of a private real estate investor exceed the limits of 'normality', he/she risks being regarded as a **property dealer** from the viewpoint of taxation. In that case, all income from real estate (gains from sales as well as current income from rentals) is regarded as earned income and is liable to regular income tax. Social security contributions of about 10% are additionally payable.

7.6 Incorrect (lower) statement of sale price on the sales agreement

The practice of stating a lower sale price than the actual price on the sales agreement in order to reduce the tax burden is encountered in *Switzerland* as elsewhere. In this way not only is a part of the conveyancing tax avoided, but the seller also 'saves' taxes on the appreciation of the real estate. This procedure is also illegal in *Switzerland*. Such a lower statement invariably invalidates the sale agreement and incurs sanctions in tax and criminal law. It should also be noted that appeal by a party to the nullity of the agreement may in turn count as an abuse of law.

7.7 International taxation

The double taxation agreements concluded to date allow *Switzerland* to tax domestic real estate as assets and any profits accruing from it as income to an unlimited extent. The contracting state must either exclude Swiss real estate from its own taxation or credit it against Swiss taxes. Most contracting states, such as *Germany* and the *USA*, opt for the **tax credit system**.

The agreements do not cover the question of the international distribution of the debt and debt interest encumbering Swiss real estate. Because *Switzerland* does not simply – like all other countries – accept its 'Swiss' debts and debt interest (with respect to each real estate),

Table 2 Overview of cantonal inheritance taxes

Accruals of inheritance	To children				To spouses				To siblings
	Allowance in Sfr	% Rate	Tax in Sfr at accrual of inheritance		Allowance in Sfr	% Rate	Tax in Sfr at accrual of inheritance		% Rate
			100,000	500,000			100,000	500,000	
AG	–	Tax free	–	–	–	Tax free	–	–	6–23
AR[3]	–	Tax free	–	–	–	Tax free	–	–	22
AI	50,000	1.5	750	6,750	–	Tax free	–	–	6
BL	–	Tax free	–	–	–	Tax free	–	–	0–16.5
BS[2]	–	Tax free	–	–	–	Tax free	–	–	7.5–16.5
BE[3]	100,000	1–2.5	–	5,500	–	Tax free	–	–	6–15
FR[4]	–	Tax free	–	–	–	Tax free	–	–	6
GE[5]	–	2–6	3,050	21,550	–	2–6 7–11	3,050	21,550	12.6–23.1
GL[2,6]	–	Tax free	–	–	–	Tax free	–	–	4–10
GR[1,7]	13,000[7]	1–4	1,000	19,600	–	Tax free	–	–	1–4[7]
JU[8]	–	1–3	1,125	9,500	–	1–3[8a] 2.5–5[8b]	1,125 3,437	9,500 23,437	7.5–15
LU[9]	2,000	1–2[9]	2,000	10,000	–	Tax free	–	–	6–12
NE[10]	50,000[10]	3.0[10]	1,500	13,500	–	Tax free	–	–	15
NW	–	Tax free	–	–	–	Tax free	–	–	5
OW	–	Tax free	–	–	–	Tax free	–	–	Tax free
SH[2]	–	Tax free	–	–	–	Tax free	–	–	4–16
SZ	–	Tax free	–	–	–	Tax free	–	–	Tax free
SO[1,11]	–	0.8–1.2	800	4,000	–	0.8–1.2	800	4,000	4.8–11.2
SG[3]	–	Tax free	–	–	–	Tax free	–	–	20
TI	–	Tax free	–	–	–	Tax free	–	–	5.95–15.5
TG[13]	–	Tax free	–	–	–	Tax free	–	–	4–14
UR	–	Tax free	–	–	–	Tax free	–	–	4–13
VD[12]	50,000	0.024–3.5	1,005	14,295	50,000	0.024–3.5	1,005	14,295	5.28–12.5
VS	–	Tax free	–	–	–	Tax free	–	–	10
ZG	–	Tax free	–	–	–	Tax free	–	–	4–8
ZH[2]	–	Tax free	–	–	–	Tax free	–	–	6–18

Notes on the table

- The data given in the table constitutes no substitute for clarification of the details in an individual case.
- Gift taxes may deviate from the figures given in the table.
- The tax rate refers to the tax on taxable assets after deduction of allowances.
- The diversity of cantonal practice precludes a transparent overall presentation.
- Some cantons keep minor inheritances and bequests generally tax free.
- Diverse cantonal tax exemptions exist for disabled recipients or minors, or for designated uses (education, marriage, household effects).
- Taxation of children in most cases also applies to other descendants (grandchildren, great-grandchildren). However, some cantons make a distinction between children and succeeding generations.
- The assessment of the taxable assets, especially for real estate and business assets, is variable (tax value, market value, capitalized value or preferential assessment with subsequent equalization).
- In most cantons, gifts and advances on inheritances by testators to inheritors are added variously to the accrual of the estate as regards tax allowances and tax progression.

1 Cantons which levy estate tax (tax on the estate, not on the individual accrual of the estate).
2 Allowances for siblings: BS, Sfr 2,000; GL, ZH, 10,000; SH, Sfr 10,000; 15,000.
3 Allowance for all other inheritors: BE, 10,000; SG, 10,000; AR, 5,000; AI, 5,000.
4 FR The communes may levy taxes of up to two-thirds of cantonal tax.
5 GE A spouse without children pays inheritance tax of 7–11%.
6 GL A building tax is levied as a supplement to the gross inheritance tax (currently +15% of inheritance tax) to fund the canton's building program.

Tax in Sfr at accrual of inheritance		To nephews and nieces			To non-related persons			
		% Rate	Tax in Sfr at accrual of inheritance		% Rate	Tax in Sfr at accrual of inheritance		
100,000	500,000		100,000	500,000		100,000	500,000	
6,000	73,800	12–32	12,000	109,200	12–32	12,000	109,200	AG
20,900	108,900	32	30,400	158,400	32	30,400	158,400	AR[3]
5,700	29,700	9	8,550	44,550	20	19,000	99,000	AI
11,800	76,091	0–27.5	19,667	126,818	0–44	31,467	202,909	BL
7,350	52,290	10–22	9,800	69,720	22.5–49.5	22,050	156,870	BS[2]
5,400	43,800	11–27.5	9,900	80,300	16–40	14,400	116,800	BE[3]
6,000	30,000	9	9,000	45,000	30	30,000	150,000	FR[4]
17,619	107,919	16.8–27.3[5*]	21,798	128,898	42–54.6[*]	49,896	268,296	GE[5]
3,600	39,200	7–17.5	6,300	68,600	10–25	9,000	98,000	GL[2.6]
1,000	19,600	1–4[7]	1,000	19,600	1–4[7]	1,000	19,600	GR[1.7]
10,312	70,312	12.5–25	17,187	17,187	20–40	27,500	187,500	JU[8]
9,000	57,000	6–12	9,000	9,000	20–40[15]	30,000	190,000	LU[9]
15,000	75,000	18	18,000	18,000	45[16]	45,000	225,000	NE[10]
5,000	25,000	5	5,000	25,000	15[17]	15,000	75,000	NW
–	–	10	10,000	50,000	20[17]	20,000	100,000	OW
7,800	70,600	6–24	11,700	105,900	10–40	19,500	176,500	SH[2]
–	–	Tax free	–	–	Tax free	–	–	SZ
9,915	54,000	9.8–23.7	21,308	116,500	12.8–31.2	28,144	154,000	SO[1.11]
18,000	98,000	30	27,000	147,000	30	27,000	147,000	SG[3]
7,947	59,917	7.74–18.5	10,331	77,892	17.85–41	23,841	179,751	TI
6,000	70,000	6–21	9,000	105,000	8–28	12,000	140,000	TG[13]
7,000	50,000	6–19.5	10,500	75,000	12–30	21,000	150,000	UR
8,118	62,500	7.92–16.5	12,177	82,500	15.84–25	24,354	125,000	VD[12]
10,000	50,000	10	10,000	50,000	25	25,000	125,000	VS
4,320	28,360	6–12	6,480	42,540	10–20[17]	10,800	70,900	ZG
6,750	67,500	10–30	14,000	117,000	12–36	16,800	140,400	ZH[2]

[7] GR — In addition to cantonal estate tax, the communes can levy tax on accrual of the estate (not included in the examples, as they are very diverse) and gift taxes. Advances on inheritances are subject to estate tax. The cantonal gift tax is higher than the estate tax (flat rate of 5%). The maximum rate of 4% for the estate tax always applies irrespective of relationship for a total estate > Sfr 520,000. Both this sum and threshold for the estate tax depend on the national consumer price index (as per Art. 4 of the tax law). The threshold for descendants is Sfr 13,000.

[8a] JU — If the spouse has children from a marriage with the testator.

[8b] JU — If the spouse has no children from a marriage with the testator.

[9] LU — Accrual of the estate to children: Canton tax free. However, the canton has granted the communes the competence to levy an inheritance tax of up to 2% for descendants. Currently 27 of 107 communes forgo inheritance tax. Practically all communes have made use of this right. For descendants under the age of 14 or who are permanently disabled, a tax-free allowance of Sfr 20,000 applies. Gifts and advances during the last five years before death are included in the calculation for determining the assets liable to inheritance tax, earlier gifts are generally tax free. It is foreseen that as of January 1, 2005, the partially revised tax law will come into effect in the canton of Lucerne. One aspect of this revision will be the integration of an allowance for descendants of Sfr 100,000. For practicality the canton will forgo a gradation of the allowance according to the above-mentioned current rules.

[10] NE — Allowance of Sfr 50,000 applies only to descendants and parents.

[11] SO — The spouse and descendants pay estate tax of 0.8–1.2%, but no tax on accrual of the estate. The other inheritors pay estate tax and tax on accrual of the estate. The table lists the overall tax. Gifts to spouses and descendants are tax-free; allowance for other gifts Sfr 13,100.

[12] VD — On accruals of the estate up to Sfr 55,000 to the spouse or descendants, Sfr 50,000 is tax free, for higher accruals the allowance is reduced. In addition to the canton, individual communes also levy inheritance tax.

[13] TG — For inheritors who require permanent care and support: Sfr 100,000 tax-free. For all other inheritors, usual everyday gifts and one-time bequests: Sfr 5,000 tax free.

[14] NE — Partnership also applies to same-sex couples.

[15] LU — Cohabiting > 5 years and dependant or partner: 6%

[16] NE — Cohabiting > 5 years: Tax rate 20%

[17] NW, OW, ZG — Cohabiting > 5 years: Tax free

but only a share of its worldwide debts and debt interest (as a ratio of Swiss to the worldwide assets), double deductions or deduction gaps may occur.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Foreign nationals who need no visa to enter *Switzerland* as tourists or business visitors may remain in the country for **up to three months without a permit** as long as they pursue no gainful employment there. After three months, they must interrupt their stay for at least a month. However, foreign nationals may enter *Switzerland* several times within any year and are under no obligation to register their presence there as long as they do not remain more than three months in the country without interruption during that year and **not longer than six months in total**. *Switzerland* has relatively liberal visa regulations, i.e. citizens of many countries need no visa to enter the country as tourists.

One often hears that it is exceptionally difficult to obtain a residence permit in *Switzerland*. This is incorrect in comparison with other western European countries or those of North America: at least for entrepreneurs, investors and financially independent persons it is often considerably easier to obtain a residence permit in *Switzerland* than in comparable countries.

However, acquisition of real estate in *Switzerland* is not associated with a residence permit, despite the fact that the acquisition of residential real estate itself requires authorization.

Types of residence permits and the quota system

Since the bilateral agreements between *Switzerland* and the *European Union* came into force, **a distinction must be made between citizens of an *EU* or *EFTA* member state and other foreign nationals**. Note also that the bilateral agreements between *Switzerland* and the *EU* is not automatically extended to the new member states that joined the *EU* on May 1, 2004. Regarding these new members states, an additional protocol to those agreements are currently being negotiated but concrete regulations are unlikely to take effect before 2005.

The following types of residence permit exist (the color of the permit is given in parentheses):

L (violet)	Short-stay permit for carrying on a short-term gainful occupation as well as for other temporary sojourns
B (grey)	Yearly renewable residence/work permit
C (green)	Settlement (permanent residence) permit
G (brown)	Cross-border work permit
F (light blue)	Permit for temporarily accepted foreign nationals
N (dark blue)	Permit for asylum seekers
Ci (red)	Permit for gainfully employed spouses as well as children of members of foreign representations or international organizations.

For citizens of member states of the *EU* and *EFTA*:

L (*EU/EFTA*)	Short-stay permit
B (*EU/EFTA*)	Long-term residence permit (for 5 years)
C (*EU/EFTA*)	Settlement permit
G (*EU/EFTA*)	Cross-border employee's permit
Ci (*EU/EFTA*)	Permit for gainfully employed spouses as well as children of members of foreign representations or international organizations.

A **quota system** is in place in *Switzerland* to control and limit the number of gainfully occupied foreign nationals in the country. Residence permits for gainfully occupied persons may be issued only within the scope of the annually fixed maximum quota. All foreign nationals who wish to carry on gainful employment in *Switzerland* are subject to these quota restrictions. Special quotas continue to apply to EU/EFTA citizens during the transitional periods before the free movement of persons becomes a full reality.

Residence permits for non-citizens of EU/EFTA member states

Apart from special situations as well as permits for students, trainees and patients on health cures, non-EU/EFTA citizens may obtain a residence permit in *Switzerland* only **as gainfully employed persons or as pensioners**. To obtain a permit as a pensioner, the foreign national must be at least 55 years old, show close ties to *Switzerland* and have sufficient funds.

A foreign national may acquire a permit to become gainfully employed in *Switzerland* if a Swiss employer can prove that he/she is indispensable for a specific function in the company, that he/she possesses the relevant qualifications for this function and that no suitable candidate can be found on the Swiss labor market (as well as recently also on the European labor market – i.e. precedence is given to Swiss and European citizens).

If a foreign national establishes a company in *Switzerland* and is employed by it in a senior position, then in most cases (but in various ways depending on the canton) a residence permit will be issued to him/her as a gainfully employed person within the scope of the economic promotion program where this may be justified by economic reasons of sustained relevance to Switzerland. These reasons in particular include the creation of new jobs for which domestic employees may be recruited, the opening up of new markets, the securing of export sales and economically significant links abroad, as well as the creation of new tax revenue. The requirements vary depending on the canton.

In practice, therefore, financially independent persons can usually acquire a residence permit. However, they may be required (if they are younger than 55) to establish a business in *Switzerland* and to carry on certain activities even if they do not actually wish to be gainfully employed in the country.

Residence permits for EU/EFTA citizens

Since 2002, it has become significantly easier for citizens of *EU* and *EFTA* member states to acquire a domicile in *Switzerland*, irrespective of whether they are gainfully occupied or not. A major aim of the **bilateral agreements** which came into force on June 1, 2002 (between *Switzerland* and the *EU* as well as between the individual *EU* member states) **on**

the free movement of persons is to gradually introduce free movement for both working and non-working persons. A transitional period totaling 12 years up to complete realization of free movement of persons between *Switzerland* and the *EU* has been agreed. For **gainfully employed persons**, access to the Swiss labor market is regulated during the first five years after the free movement agreement comes into force. During the first two years, the regulation is similar to that for non-citizens of the *EU/EFTA* states (precedence to Swiss residents), with the difference that EU/EFTA citizens have precedence over non-citizens.

Financially independent persons who have EU or EFTA citizenship, are **not gainfully occupied** and have sufficient funds to live in *Switzerland* without working there, may already **acquire a residence permit with no further restrictions**. This means that a non-working financially independent person who is younger than 55 may simply apply for a residence permit and need not demonstrate any close ties to *Switzerland*.

The **flat-rate or lump-sum taxation** open to foreign nationals living in *Switzerland* who are not gainfully occupied offers extremely attractive conditions for wealthy Europeans to acquire a domicile in *Switzerland* (see also the details in the following sections on taxes).

In addition, this new ruling means that such foreign nationals may obtain a residence permit for the whole of *Switzerland* without any geographical restrictions and may acquire real estate without authorization. If they give up their domicile at a later stage, they may nevertheless retain the real estate.

A good overview of the applicable rules in the law concerning foreigners may be found under www.auslaender.ch.

8.2 Tax residence

Taxation on global income and assets

Unrestricted tax liability applies to persons who live in *Switzerland* or stay there for a certain period. In the case that one moves to *Switzerland* to establish one's domicile here, this tax liability begins from the date of entering the country, in the case of a stay in *Switzerland* after 30 days, in the event of gainful economic activity or after 90 days if the person concerned does not work in *Switzerland*. However, these domestic regulations may be modified on the basis of double taxation agreements.

The **entire global income and net assets** of persons with fiscal residence in *Switzerland* are subject to taxation, with the exception of foreign real estate and permanent business establishments abroad.

In *Switzerland*, the federal government as well as the cantons and communes levy various taxes. Although the *Tax Harmonization Act* (*Steuerharmonisierungsgesetz; Loi fédérale sur l'harmonisation des impôts directs*) designed as framework legislation entered into force in 1990 and introduced a certain standardization of taxation by the cantons, these and the communes are still free to set tax rates and allowances. Relatively large differences consequently exist between the individual cantons and communes, leading to competition between locations, thus promoting an attractive tax environment.

Both the federal government and the cantons levy **income tax**, and the cantons additionally charge a **wealth tax** on the net assets of natural persons, which can be quite considerable

for larger assets. All cantons except for *Schwyz* also impose **inheritance and gift taxes**, although in almost all cantons the spouses, and in most of them also the descendants, enjoy complete exemption. **Private capital gains are always tax free**, although some important restrictions have been introduced in tax administration practice.

In addition to these taxes, social security contributions are also payable depending on the situation (up to about 10% of income earned by self-employed persons or up to about Sfr 11,000 for persons who are not gainfully employed). Some of these contributions may have the character of taxes.

Lump-sum taxation

Taxation based on expenditures, usually known as flat-rate or lump-sum taxation (*Besteuerung nach dem Aufwand/Pauschalbesteuerung; imposition d'après la dépense/forfait fiscal*) is an interesting Swiss peculiarity which is available to foreign nationals under certain conditions. Essentially, anyone who is not a Swiss citizen, takes up fiscal residence in *Switzerland* for the first time or after having been away from the country for 10 years and does not carry on any gainful employment there, is entitled to apply for lump sum taxation.

This taxation is based on the living expenditures of the taxpayer and his/her family. Lump-sum determination actually applies to the taxable basis. A minimum level of living expenditures is assessed in the calculation, based on at least a five-fold rental value of the apartment (or house) in which the taxpayer lives. The tax may also not be lower than income tax on Swiss-sourced income calculated on the regular scale. Moreover, the option exists of **modified lump-sum taxation**, where the assessment is also based on the income from which the taxpayer claims full or partial exemption or refund of foreign taxes on the basis of a double taxation agreement concluded by *Switzerland*.

Most cantons apply minimum rates established by the law, regulations or practice. The minimum basis for assessment ranges from about Sfr 150,000 to 500,000, depending on the canton, which leads to **minimum lump-sum taxes** of between ca. Sfr 50,000 and 250,000 per annum. Social security contributions are also payable, the maximum for non-gainfully employed persons, i.e. about Sfr 11,000 per person per annum, being applied in most cases.

8.3 International taxation for residents of Switzerland

Switzerland has concluded agreements to avoid double taxation with more than 50 countries. They apply to all natural and legal persons domiciled in *Switzerland*. Some agreements impose certain limitations for persons who are taxed on a lump-sum basis. Among the matters regulated by the double taxation agreements is the **reduction of foreign withholding tax on** dividends, license fees and interest. Depending on the double taxation agreement to be applied, this tax may be either reduced or completely waived. The non-recoverable share of foreign withholding tax can be completely or partially credited against Swiss taxes. Tax reduction is granted as long as double taxation agreements are not abused. Abuse stipulations of this kind form part of numerous agreements, but the Swiss government also took unilateral measures against improper claims on double taxation agreements concluded by the federal government. This is known in brief as the **abuse regulations** (*Missbrauchsbeschluss; Arrêté instituant des mesures contre l'utilisation sans cause légitime*)

and is probably unique in the world. More information on it may be found on the website of the *Swiss Federal Tax Administration* (www.estv.admin.ch).

Various agreements contain **special rules**, in particular with regard to persons subject to lump-sum taxation in *Switzerland*. The agreement with *Germany* is of special relevance here. *Germany* has various tax regulations which, in certain circumstances, make persons who leave the country liable to continued taxation even after leaving. The agreement with *Switzerland* includes certain rules to support these regulations. The totality of the internal German regulations in combination with the agreement between the two countries obliges those who plan to leave *Germany* for *Switzerland* on the basis of lump-sum taxation to exercise great care. They may, for instance, no longer retain any relevant links (such as a secondary residence or similar) with *Germany*. There are similar provisions in some other high-tax countries and in the respective double taxation agreement they concluded with *Switzerland*.

9 Checklist: Real estate acquisition in Switzerland

- **Public transport and access**: *Switzerland* is very well served by public transport. Nevertheless, the situation regarding accessibility by public transport should be clarified in each individual case. The same applies to the availability of local infrastructure (post office, schools, shopping facilities), as this can vary greatly. Practical help is provided by the internet page www.yourhome.ch, which contains aerial photos and maps as well as information on all Swiss locations.
- **Contaminated land**: Check whether the land to be acquired is recorded in a register which lists such areas (for more information, see www.altlast.ch).
- Is **approval for the acquisition mandatory** (it is always mandatory for the acquisition of real estate by non-residents)? Is approval likely to be granted?
- **Building zones and specifications**: Practice as regards building zones, building specifications, etc., is highly restrictive in some cases and can vary greatly between communes.
- Will approval be granted for a possible **extension/reconstruction**?
- Are there any stipulations regarding **heritage/monument protection**?
- Have all **duties and taxes** been completely paid by the previous owner? In some cantons, the notary retains a certain percentage of the purchase price to secure payment of capital gains tax. Where this is not the case, the requisite assurance must be demanded.
- Caution: For non-resident foreigners it is prohibited to use a **company** as an intermediary for purchasing residential property. Non-EU/EFTA foreign nationals – whether resident or not – acquiring residential real estate in *Switzerland* must do so exclusively and directly in their own names. On the other hand, resident EU/EFTA nationals may acquire real estate without restriction.
- **Purchases** in the vicinity of **Zurich airport** must be approached with particular care in view of the still unclear situation regarding flight paths.
- In the case of **oil heating**: Is there an outside oil tank (environmental liability risk)?
- Especially in Alpine areas: **Natural hazards** (flooding, avalanches, landslides) may represent a risk.
- When changing domicile: **Total tax burden**? There are considerable differences in income and wealth taxation between the cantons as well as between the communes within the individual cantons.
- **Inheritance and gift taxes** are levied on a cantonal basis in *Switzerland*. There are enormous differences between the cantons and taxes range from 0% up to 50%.
- **Capital gains tax**: Check the liability of the property, request assurances in this regard.

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1 Introduction

The common law basis for English real estate law stems from a completely different tradition of jurisprudence from that which is the basis of most laws in continental *Europe*. The differences in concepts of **ownership** and **rights** relating to land are not just matters of detail, they are often differences based on fundamentally different ideas. These differences are further complicated by the rules of **equity**.

Where readers are already familiar with the **common law** traditions of American law, they should again bear in mind that the American and English traditions have developed separately for two centuries and much American land law is based on a history of establishing ownership on a large continent where most territories had no existing towns or cities. English real estate law is very different from American law.

English law comprises a number of distinct elements:

- **Common law**: Which has its origin in the unwritten laws of the middle ages.
- **Equity**: A set of legal principles particularly associated with the law of trusts and having its origins in the function of the *Lord Chancellor* of *England* who was empowered to exercise the King's mercy in mitigating injustice which might sometimes be caused by the strict application of common law.
- **Parliamentary statutes** and
- **Precedents** set by judgments in court.

There is a clear distinction between rules relating to the creation of interest in real estate and the rules relating to chattels or movable property. It should also be noted that English law applies only in *England* and *Wales. Scotland* has its own legal system upon which the advice of Scottish lawyers should be taken.

For tax purposes, *England* and *Wales* are incorporated within the *United Kingdom*. The *UK* has its own tax regime covering *England, Scotland, Wales* and *Northern Ireland*.

2 Real estate ownership

From 1925 until recently, English law recognized only two legal estates in land, namely **freehold** and **leasehold**. (A third legal estate, **commonhold**, is shortly to be introduced under the *Commonhold and Leasehold Reform Act 2002*, as mentioned in more detail below.)

The most important **legal interests**, which exist in relation to both freehold and leasehold estates, are **easements** and **legal charges**. Most other interests and encumbrances take effect as **equitable interests**. The general principle is that legal estates and legal interests can only be created by means of a deed. There is an exception to this rule in the case of leases or tenancies with a term which does not exceed three years and certain other relatively rare exceptions. The ***Land Registry*** has recently announced an intention to make it possible to transfer legal interests online by electronic means, but there is still a great deal to be done before this project becomes a reality.

2.1 Different forms and types of ownership

Under English law, real estate comprises not only the land but also all buildings erected on the land. The ownership of a house could either be freehold or leasehold.

Freehold

The freehold interest is generally assumed to be cadastral and include everything beneath the surface and all the air above, as well as all buildings and structures on the land. Freeholds, therefore, do not normally exist for individual apartments. There are exceptions, but one finds them seldom (for example, in *Lincoln's Inn*, a lawyers' quarter in *London*, where there are '*flying freeholds*' created by private act of parliament in the 19th century).

In the case of long leaseholds, the buyer acquires the real estate on the strength of a long lease, with a term of, say, 99 years. This long lease is generally granted for a fixed price or premium and sometimes there is also a nominal rent to be paid to the freeholder. The tenant can then sell the house or apartment in the open market, subject to the conditions contained in the lease.

The granting of long leases gives a certain control over an estate to the freeholder (for example, local authority or a family trust such as the *Grosvenor Estate*, the family trust of the *Duke of Westminster*). Family trusts, which own large estates in exclusive areas of *London* (such as *Mayfair* and *Belgravia*), grant leases so that they can ensure that the façades and general appearance of buildings on the estate are kept in traditional style and they are therefore reluctant to sell freeholds that would give buyers freedom to change the external appearance of buildings.

Joint tenancies and tenancies in common

There are two forms of joint ownership in English law: *Tenancy in common* and *joint tenancy*. *Joint tenancy* is the more common for married couples, while *tenancy in common* is more usual for parties who are not in a long-term relationship. It should be noted that the word 'tenancy' in this connection applies equally to the freehold or leasehold interest.

In the case of a joint tenancy, title to the real estate passes automatically on the death of one of the owners to the surviving owner (for example, the widow or widower).

In the case of a tenancy in common, each joint owner is regarded as owner of a separate share in the real estate and on the death of one owner, that share will pass in accordance with the provisions of that person's testamentary disposition or in accordance with the rules of intestacy, where there is no valid will relating to the property. The shares in a property belonging to tenants in common can be unequal but, in the absence of any express provisions to the contrary, they will be assumed to be 50 : 50.

Joint ownership, whether by way of joint tenancy or tenancy in common, creates a **Trust for Sale**, which means (in the absence of a contract to the contrary) that any joint owner can require sale of the house or apartment. As mentioned below, on completion of the sale, tenants in common would each receive a share of the net proceeds of the sale in proportion to their specified interest in the real estate.

Commonhold

Commonhold is a new legal concept in English law. The Statute that creates this new form of title to land was passed in 2002 but the Statute provides for various sections to come into force on different dates, and some provisions remain to be implemented.

Commonhold is sometimes compared with the American condominium. The detailed provisions are very complicated but the overall intention of this *Act of Parliament* is that the occupier of commonhold property should be able to have a measure of influence over how other real estates within the commonhold estate are managed and used – for example, to overcome problems of antisocial usage or neglect of gardens.

For this purpose a management company is established and the occupiers are members of the company. The company will issue regulations concerning such things as use and standards of maintenance and create a mechanism for dealing with disputes between neighbors.

The *Commonhold and Leasehold Reform Act 2002* also introduced some rights for leaseholders who are not within a commonhold and on September 30, 2003, provisions came into force giving a new right for long leaseholders to manage their buildings collectively.

Timesharing

Under English law, **timesharing** creates only a contractual right to use a particular property at a particular time of year. It does not create any interest in land which can be registered at a *Land Registry*. Nevertheless, anyone entering into a timeshare contract in *England* or *Wales* would be wise to check that the timeshare company itself is registered at the *Land Registry*. It should be added that European Union laws established for the protection of timeshare customers are fully applicable in the *United Kingdom*.

Rights to build

A freehold owner has an inherent right to build on land, subject to planning regulations and the rights of adjoining owners (for example, rights of light and air). Rights to build for tenants will be controlled by the terms of the lease and may be excluded completely. A right to build does not pass by inheritance under English law unless there is a specific trust or contract document which creates that effect. It will be noted, later in this chapter, that certain tenancies of agricultural land can be inherited in limited circumstances.

2.2 Easements, charges, liens and mortgages

Easements

English law has no equivalent to the concept of personal **easements**. It would be possible to create comparable rights by contract, lease or **wayleave** agreement (under which, for example, a telephone company or electricity supplier has the right to run cables over a private piece of land). Also, for example, a right to reside in a property does not exist as an easement, although a tenant for life under a Trust would often have such a right and a wife may have a statutory right of occupation under the *Family Law Act 1996*. A tenancy for life may also be granted by a lease.

Easements are rights enjoyed by the owner or occupier for the time being of a piece of land (the **dominant tenement**) to be enjoyed over neighboring land (the **servient tenement**), for example easements for water supply, drainage, the use of drives and footpaths and, in the case of apartments, the use of entrance halls, passages and staircases in the apartment block. Easements are not personal rights but rights attached to the land, as a benefit for the dominant tenement and as a burden on the servient tenement. Easements and restrictions, which affect title to land, are registered in the title registers of the *Land Registry*.

Covenants

Among other **encumbrances**, which may affect land, the most common are **positive covenants** and **restrictive covenants**. Certain distinctions are made under English law. A positive covenant (for example, a covenant to keep a fence in good repair) is regarded as a personal covenant, which does not attach to the land but is binding only as between the parties who entered into that agreement. On the other hand, a restrictive covenant (for example, a covenant not to build any new structures on the land without the consent of the neighbor) is said to 'run with the land', so that it is binding for the time being on the owner of the land to which the restriction is attached. However, the right to enforce such restrictive covenants is an equitable right and not a legal right and it may lapse if the court comes to the conclusion that, for example, the party seeking to enforce the right initially allowed the breach of covenant to take place without objection or if the court is of the opinion that the circumstances of the dominant and servient tenements have changed so much that it is no longer appropriate to enforce the right. (This might be where the dominant tenement was originally another house but has been redeveloped for some other purpose, such as a shopping centre, and therefore no longer really benefits from the covenant.)

Restrictive covenants appear in the **Charges Register** of the relevant title at the *Land Registry*. Positive covenants would not normally be registered at the *Land Registry* although they are sometimes registered in a separate **Schedule of Personal Covenants**. These personal covenants would not be binding on anyone who bought the land.

In summary, the burden of negative obligations – 'restrictive covenants' – affecting the relevant piece of land passes automatically to a new owner on the transfer of title, but positive obligations do not.

Local land charges

It should be noted that individual apartments or houses may be subject to local land charges, which are not registered at the *Land Registry*. For example, it could be that a local authority has given financial assistance for the development of a particular plot of land where the grant of this assistance is subject to a condition that it should be repaid if the use of land is changed. The right of the local authority to repayment of the financial assistance in certain circumstances would be registered in the **local land charges** register of that authority. These rights and restrictions, which apply to the municipality, will be researched by the lawyer acting for a buyer by means of standard enquiries (called 'local searches') made with the local authority on behalf of the buyers.

Charges and mortgages

The law of mortgages was simplified by means of the *Law of Property Act 1925*. As a result of this statute, earlier forms of mortgage were replaced by an encumbrance known as a **legal charge**, which can be registered against the title to the real estate as security for a loan or other financial obligation. In the case of most mortgages for residential property, the legal charge is contained within the loan agreement but it is sometimes the case that the legal charge is given in a separate document to secure all of the owner's borrowings from a particular bank or building society. In any event the legal charge is to be registered at the *Land Registry*.

As mentioned below, certain new rules have been taken in effect since October 13, 2003, by virtue of the *Land Registration Act 2002*. This means that, for the first time, legal charges registered at the *Land Registry* will be subject to inspection by the public, unless special agreement is obtained to the contrary. At the same time the *Land Registry* introduced a new form of legal charge (form CH1), the use of which by banks and other lenders is not yet compulsory but is due to become compulsory in the next few years.

It should be noted that, in contrast to the law in some other European countries, the legal charge provides not only security for the payment of interest and repayment of capital but also secures other sums that may fall due to the bank under the terms of the loan agreement, for example the cost of carrying out repairs which should have been carried out by the borrower, or legal and other costs incurred by the lender in enforcing the terms of the loan agreement.

Additionally, English law has a concept of the **equitable mortgage**, which would typically be effected by the borrower depositing the title deeds of the house with the lender as security, without executing any legal charge that would be registered at the *Land Registry*. The lender would then return the deeds to the borrower on repayment of the loan. This form of transaction is now very rare because of the obvious risks for the lender and changes in *Land Registry* practice, as mentioned in more detail below.

Charges and encumbrances affecting residential property are registered in the *Land Charges Register* for the relevant title at the *Land Registry*. If the real estate has not yet been registered at the *Land Registry* (see section 3.3.4 below) the charge will be registered at the *Land Charges Registry*, in accordance with the *Land Charges Act 1925*.

Licenses and third-party rights

The owner of land may grant **licenses** to third parties, for example the owner of a country house may permit the grazing of horses or other animals in a meadow under an arrangement, which gives rise to a grazing license. It is possible that this arrangement is not recorded in any written document. If a **grazing license** is valid for a period of less than 365 days, the licensee is not given '**security of tenure**', that is, the right to continue the arrangement beyond the specified period. However, if the contractual period is greater than 364 days, this will create an **Agricultural Holding** (not a grazing license) with the result that there is an extended period of protection for the party grazing animals against termination of the arrangement. (See also section 3.2.3 below.)

2.3 Protection of ownership, proof of ownership and registration

Registration of real estate in *England* has existed only since 1925. There was an earlier system established in 1890 but it was seldom used.

However, because there was no general obligation to register title to real estate from 1925, but in most cases the obligation to register would only arise on the transfer of the particular title, the process of registering English real estate is not complete. Accordingly, unregistered land ownership remains in a number of places in *England* and *Wales*. For example, in 1980, the author's law firm acted for a client purchasing unregistered land in *Rochester* where ownership had not been transferred since the year 1215!

Because the real estate market in the south of *England* has been the most active, most of the land in this area is now fully registered.

Every registered title has its unique title number, so that the freehold and leasehold titles for the same piece of land will have different title numbers. The registers kept by the *Land Registry* consist of the following:

- the ***Property Register***, in which the piece of land is described and all easements noted as well as certain excepted rights (for example, mining rights);
- the ***Proprietorship Register***, in which the name and address of the owner is recorded;
- the ***Charges Register***, in which charges and encumbrances are either set out in full or briefly noted by reference to other documents.

As mentioned above, local land charges are not recorded at the *Land Registry* but in the local land charges register of the relevant municipality.

Trusts

It should be noted that under English law a distinction is drawn between *legal* ownership and *equitable* or *beneficial* ownership. Normally the buyer of real estate is not only the **legal owner** but also the **beneficial owner**. However, for a variety of reasons (for example, the wish to transfer the benefit of real estate to children under the age of 18) it is not uncommon for the legal title to be put in the name of two or more **trustees**. The trustees are 'legal owners' but for the benefit of other persons who are 'the beneficial' or '**equitable owners**'. The *Land Registry* only registers the names of the legal owners (the trustees) and when a prospective buyer is in negotiation with trustees, no details of the terms of any trust are available in public registers. The reason for this is that, under legislation passed in 1925, anyone buying from trustees acquires the real estate free of the interest of beneficial owners. The rights of beneficial owners simply transfer to the proceeds of sale and if the beneficial owners have any complaint about the transaction, their only claim is against the trustees. Accordingly the buyer of the real estate needs only check that the trustees are registered as legal owners.

3 Purchase and sale of real estate

3.1 The sales agreement

The provisions of the *Law of Property Act 1925* require that every contract for the sale of land and buildings should be in writing. There is no requirement in English law for

notarial attestation of the contract and indeed no legal requirement to use any lawyer at all. Nonetheless, because of the complexity of the rights and obligations associated with the **transfer** of land, it would be extremely unwise to buy or sell land without advice from a suitably qualified lawyer, normally a solicitor.

Although there is no compulsory form for the sale of real estate and the fundamental principle of freedom of contract applies, most *sale contracts* are based on a printed form, which is published as the **Standard Conditions of Sale**.

The Standard Conditions of Sale are divided into three sections:

Particulars of sale

This section contains a description of the real estate, the amount of the sale price, the amount of the deposit to be paid by the buyer on exchange of contracts, and the date for completion of the transfer and payment of the balance of the purchase price.

General conditions

These appear as printed conditions, which set out the rights and duties of the parties for the period between the date of the contract and the transfer date. It should be noted that the effect of these general conditions can be modified or cancelled by provisions included under the section 'Special conditions', as, for example, where the seller may be required to maintain insurance of the real estate until completion of the transfer.

Special conditions

These conditions can either deal with modifications to the general conditions or deal with other matters such as carpets, curtains and other furnishings. Similarly they may provide that the seller may remove certain items that the buyer might normally have expected to be left in the property.

It should be noted that ownership does not pass to the buyer upon signature of the contract but only on the execution and delivery of a further document called a **transfer**. Form TR1 is used for the transfer of the whole of a registered title and form TP1 is used for the transfer of part of a title. These forms are applicable both to freehold and leasehold real estate. Title to unregistered real estate was once transferred by means of a document called a **conveyance**, but there is now an obligation to register on the sale of unregistered land and therefore a form of a transfer will always be used. Where a short-term lease does not need to be registered, ownership is passed by means of a document called an 'Assignment'.

It was once the case that title to unregistered land passed immediately on the date of a conveyance. However, in theory, title to registered land does not pass at the date of the transfer but only when registration is completed at the *Land Registry*. In practice, however, the transferee is treated as being the new owner from the date of the transfer, except in very limited situations.

Although title to a property does not pass to the buyer on the execution of the contract, the normal rule is that insurance risks will pass to the buyer when contracts are signed. Accordingly the buyer should make sure that he/she has insurance arrangements in place

from that date. It is nevertheless possible for the buyer to negotiate a special condition in the sale contract, obliging the seller to maintain insurance until the transfer date.

3.2 Restrictions on sale and acquisition

English law has the fundamental concept of **freedom of contract**, which means that parties can agree to anything that is not forbidden or restricted by law.

3.2.1 Restrictions under family law and matrimonial property regime

If title to land is registered in the joint names of husband and wife, this creates what is known as a **trust for sale** where (as stated above) the rights of each individual are governed by one of two forms: joint tenancy or tenancy in common, as mentioned in section 2.1 above.

Matrimonial home rights

It is sometimes the case that a home occupied by a married couple has its legal title registered in the sole name of one of the spouses. *The Matrimonial Homes Act 1967* gave a wife a right of occupation in cases where the real estate was registered in the husband's sole name. The concept of matrimonial rights has now been extended by *section 30* of the *Family Law Act 1996*, which creates 'Matrimonial Home Rights' under which either spouse has a right to occupy the real estate where the other is the registered owner. This right only applies to what is described as the matrimonial home, so that in cases where one spouse owns more than one property the rights of occupation would not apply to an apartment or house that had not been occupied as a joint home. The right only lasts as long as the marriage subsists.

Accordingly, in any contract for the sale of a property where one spouse occupies by virtue of **matrimonial home** rights, that spouse should be joined as a party to the contract to agree to the sale and release the rights. To avoid possible fraud by the spouse who is registered as an owner, the contract should contain confirmation that the other spouse has had separate legal advice before agreeing to the sale.

Release of matrimonial home rights

A spouse entitled to matrimonial home rights may, by a release in writing, release those rights or release them as respects part only of the dwelling house affected by them (*s. 32* and *Sch. 4, para. 5(1), Family Law Act 1996*).

The legislation does not refer to any specific wording but a suggested form is given in *The Law Society's Conveyancing Handbook (*10th edn, edited by *F. Silverman)*, to be inserted into the contract:

> In consideration of the buyer entering this agreement I [name of spouse] agree:
>
> (i) to the sale of the property on the terms of this agreement; and
>
> (ii) that I will not register rights in relation to the property, whether under *FLA 1996* or otherwise, and that I will procure before completion the removal of any registration made by me; and
>
> (iii) that I will vacate the property by the completion date.

Where there is any danger of a conflict of interest of the non-owning spouse, that spouse should seek separate legal advice.

Where a charge has been registered

Where a contract is made for the sale of an estate or interest in a dwelling house (or for the grant of a lease) and that dwelling house is affected by a duly registered charge, the matrimonial home rights constituting that charge are deemed to be released on the occurrence of whichever of the following events happens first:

(a) an application by the spouse for the cancellation of the charge is delivered to the buyer or lessee or his solicitor, or;

(b) such application is lodged at the *Land Registry*.

Where the charge has been registered and the rights are extinguished by the termination of marriage, the *Land Registry* will cancel that charge on the production of valid evidence of the termination (*Sch. 4, para. 4*).

3.2.2 Options and pre-emption rights

Freedom of contract principles allow parties to agree a wide variety of arrangements involving pre-emption rights or options to purchase, but these rights must not infringe on the **rule against perpetuities**, so that these rights cannot subsist for an unlimited period of time. In most situations the absolute time limit for exercise will be 21 years, but for certain rights a perpetuity period of 80 years applies. If a lease term exceeds 80 years an option for the tenant to take a reversionary lease after the end of the term would still be valid if exercised within one year following expiration of the lease. Pre-emption rights or options should be protected by registration, or they may be unenforceable.

3.2.3 Agricultural real estate

Although the acquisition of agricultural real estate is, in principle, similar to the purchase of any other piece of real estate, it requires extra care because of the special factors necessary for the conduct of a successful farming business.

The laws which Parliament has passed in relation to agricultural real estate often provide more far-reaching rights to tenants of agricultural real estate than to tenants of residential or commercial real estate. For example, there are special tax concessions for the occupiers of farmland. In recent years the trend has been to move toward closer harmony with guidelines applicable in the *European Union* and also to take greater account of environmental issues.

The sale and purchase of agricultural real estate brings the parties into contact with some of the more esoteric elements of land law, which often have a distant historical origin – for example, laws relating to *Common Land*. Besides that, the use of **agricultural land** may be affected by other factors such as hunting and fishing rights, which may be of significant importance. The consequence of this is that the process of transferring agricultural real estate (of which a significant proportion is still not registered at the *Land Registry* but will now need to be registered for the first time) is more time consuming than other types of real estate purchase and it will often require the coordination of different areas of legal expertise.

Until the year 1995, the law provided considerable security of tenure for tenants of agricultural real estate. Of particular note is the fact that the rights could be inherited by family members on the death of a tenant. These tenancies were known as **agricultural holdings**, established by the *Agricultural Holdings Act 1986*.

Since September 1, 1995, tenants of agricultural real estate (with limited exceptions) are protected by the *Agricultural Tenancies Act 1995*. The tenancies are called **Farm Business Tenancies** (***FBTs***). Under this statute, a lease of agricultural real estate with a term of at least two years will be automatically renewed from year to year. There are rules for terminating these tenancies and these involve fewer restrictions on the freeholder than apply for agricultural holdings under the *Act of 1986*. In particular, *FBTs* cannot be inherited. Accordingly, it is important that the buyer of agricultural real estate should check very carefully whether any part of that land is affected by an agricultural holding or an *FBT*.

Furthermore, the buyer should take account of the possibility that the seller has allowed a third party to graze horses or other animals on part of the real estate. Such agreements do not have to be in writing to be valid and are referred to as 'grazing licences' if they exist for a period of less than 365 days. However, if such an arrangement has a term of 365 days or more it may be protected as an agricultural holding or as an *FBT* and therefore would be significantly more difficult to bring to an end. The buyer should check this carefully.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

English law has no restriction on ownership of real estate by foreign corporations or individuals.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

An individual acquires full contractual capacity on his/her 18th birthday, except in cases of mental impairment.

Children or adults suffering from mental incapacity may be given a guardian or administrator by record. Normally trustees will be appointed. Parents can be trustees for their children, often with a lawyer or other professional person acting as co-trustee. In these cases, as previously mentioned, the trustees are the legal owners of real estate and the children or mentally impaired persons will be the beneficial or equitable owners.

For individual sellers, it is appropriate to search the **bankruptcy** register of the *Land Charges* Registry to ensure that the seller is entitled to transfer the real estate. If the seller is a company, the company must pass the appropriate resolutions, and directors be authorized to sign on behalf of the company.

3.3.2 Third-party claims and unpaid taxes

On purchasing real estate, whether freehold or leasehold, it is most important to check whether any third parties have rights over it. Where title is registered at the *Land Registry* the title registers may show easements and other rights in favour of third parties as mentioned

above. Additionally, there are two categories of rights to be noted – **overriding interests** and **minor interests**.

Overriding interests include, for example, the rights of anyone in actual occupation of the real estate. Anyone purchasing a property acquires it subject to the burden of overriding interests, even if these may not be noted on the *Land Registry* title register. The *Land Registration Act 2002*, which mostly came into force on October 13, 2003, introduced a new obligation on the seller of real estate to disclose any overriding interests of which he/she is aware. This is not an absolute obligation to disclose all such interests and the buyer will in any event take the real estate subject to those rights that may exist. Any third-party rights that exist, other than overriding interests, are minor interests and will only obtain protection for the third party if they are registered at the *Land Registry*. In cases where there is no note on the *Land Registry* of a minor interest, the buyer will take the real estate free of any third-party rights.

In cases where title to a property is still not registered at the *Land Registry*, other rules apply to third-party rights, which should have been registered at the *Land Charges Registry* under the *Land Charges Act 1927*. If such interests are not registered, the general rule is that the buyer takes free from such interests. There is, however, a distinction to be made between 'legal interest' and 'equitable interest'. Legal rights (for example, a legal easement) bind all parties, regardless of whether the buyer had knowledge of the relevant interest. However, a person who buys in good faith and for valid consideration, will take the real estate free from equitable interests of which he/she has no knowledge. However, the buyer may be presumed to have knowledge of those things that should have been revealed by ordinary prudent investigation.

A lawyer who is instructed to advise on the purchase of real estate will make the appropriate enquiries and investigations as to what third-party rights exist over the property to be purchased and what rights exist over neighboring properties. Nevertheless, it is still wise to make a visual survey over the real estate where this may reveal rights that would not be disclosed by documents. For example, if a path crosses the land to be purchased, it may be evidence that a public or private right of way exists across the land even though this right may not be recorded in any title document.

The buyer of real estate will not, under English law, be automatically burdened by any unpaid taxes relating to that real estate. There is therefore no obligation on the buyer to check the tax status of the seller and the buyer will have no obligation to meet any tax liability of the seller. As mentioned below, the tenant of a property owned by a landlord who is resident for tax purposes outside the *UK* may be obliged to deduct tax from rental payments unless the landlord is able to obtain an exemption certificate from the *Inland Revenue*.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

There are regulations for the protection of the **environment** which may affect certain landowners and require that they enter into a management agreement with a public environmental body. However this would seldom relate to the owner of a house unless it was attached to a large acreage of land. The management agreement would provide that the landowner would make a fixed financial contribution to the cost of measures for environmental protection within the area. The apportionment of these payments at the time

of sale and the question of whether the buyer of the real estate will become subject to these financial charges can involve lengthy negotiations before the contract is settled. This situation is particularly applicable to purchases of farms and other large estates.

It should also be noted that certain localities are designated as being areas of *Outstanding Natural Beauty* or as being areas of *Special Scientific Interest*, for example, for the purpose of protecting rare plants, birds, insects, etc. Localities so classified have a specially protected status and in these areas the owner is unlikely to obtain planning permission to erect new buildings, even for agricultural use.

There are green areas around the outskirts of *London*, which are collectively known as '*The Green Belt*'. Until recently, it has been difficult to obtain planning permission for new buildings within the *Green Belt*, so that existing residential buildings have had an enhanced value. However, because of a huge demand for houses in the southeast of *England*, the government is reconsidering its policy for new construction within the *Green Belt* and it may be that in future years significant housing development will be permitted.

In the case of larger building developments, there may be additional requirements imposed on the developer, for example an obligation to produce an *Environmental Impact Study* and a *Traffic Impact Study* with his application for planning permission.

Buildings that are officially registered as being of historical or architectural interest (**Listed Buildings**) have special statutory protection which restricts the freedom of the owners to undertake alterations and the freedom of the planning authority to agree to such alterations. *Planning Policy Guidance Note 15 ('PPG15')* under the title '**Planning in a Historical Context**' now requires the responsible planning authorities to look more flexibly at the use of **historical buildings** and to reach balanced decisions in individual cases that would allow the use of the relevant building for purposes that fit contemporary needs in order to promote the continued maintenance of their historical character. It has been found that excessively strict policies rendered buildings unmarketable and hence they fell into ruin.

Listed Buildings (a term that may include just part of a building, like a historical staircase) are those that form an integral part of the urban environment and were not built more recently than July 1, 1948. Listed buildings fall into the following three categories:

- Grade I: Buildings of exceptional interest (approximately 2% of listed buildings).
- Grade II: Particularly important buildings of more than special interest (approximately 4% of listed buildings).
- Grade III: Buildings of special interest which warrant every effort to be made to preserve them.

It is now generally recognized that a change of use for old buildings can be a catalyst for restoration and future preservation. In certain circumstances the restrictions associated with the listing of a building can be relaxed where this is necessary to keep the building in prolonged use. It is unquestionably considered ideal if a building can continue to be used for its original purpose. This should be done wherever possible.

Alterations to or demolition of listed buildings requires the consent of the local planning authority or of the *Secretary of State*. However, work to repair the building using materials which are the same as the original, requires no consent.

Application for consent for works on a listed building should be made to the relevant planning authority which has eight weeks in which to consider the application. This time limit can be extended with the agreement of the applicant or in the event that any element of the application is changed.

It is important to note that retrospective permissions obtained in respect of works that have already been carried out are invalid. It is therefore most important that the necessary permissions are obtained for works on a listed building before construction commences.

3.3.4 Access to relevant records and documents

As a result of the *Land Registration Act 2002*, there has been a dramatic change in *Land Registration Rules*. The new rules took effect on October 13, 2003. From that date the *Land Registry* ceased to issue certificates of title in paper form and title to land depends only on what is recorded electronically within the *Land Registry*'s computer database. This database can be accessed online and this is part of a general government program to ensure that titles are easily available for public inspection.

There has also been a dramatic increase in the numbers of documents that are to be available for inspection on the register (for example, leases and mortgage documents that were referred to previously) but not available in full text. There has been concern that confidential information may now be accessible to the public. To meet these concerns, the *Land Registry* has created a procedure whereby an applicant may request that parts of a document be excluded from the copy to be shown in the public register. The basis of the request is that the information to be excluded is 'prejudicial information', that is, personal information likely to cause substantial or unwarranted damage or distress, or information likely to prejudice the commercial interests of the applicant. (It should be noted that price information is not considered to be commercially sensitive.) If an application to exclude some information from the register is granted, the record will nevertheless show that some information has been omitted from the register.

In the event that a piece of land has not yet been registered at the *Land Registry*, title can only be established by means of inspection of deeds and documents, generally held by the owner's bank or lawyers. Nevertheless some public information is kept at the *Land Charges Registry* in which certain encumbrances are registered, for instance an option to purchase or a restrictive covenant. If the seller is a corporation, investigations should be made at the *Companies Registry* which will have details of mortgages registered against that company. If a seller is an individual, it is also normal and appropriate to make a search with the **bankruptcy** register of the *Land Charges Registry* to ensure that the seller is entitled to transfer the real estate. On completion of any transaction for such a property, registration at the *Land Registry* is compulsory.

3.4 Key points that a seller should consider

If someone proposes to sell a house, he/she will generally be looking to acquire a new residence at the same time. It is therefore important to see that there are no impediments to the transaction proceeding to the planned timetable. Accordingly it is advisable to ask whether the buyer has a house to dispose of and how that sale is to proceed. In *England*,

this is referred to as a 'chain' of buyers and the ideal situation is to find a buyer who is 'chain free', that is someone who can buy without needing to sell a property.

It is particularly important in chain transactions, but also in other cases, to check whether the intending buyer has arranged satisfactory finance before marketing or sale negotiations with other possible buyers are discontinued.

As mentioned elsewhere, there are no restrictions on foreigners acquiring real estate in *England* but all those involved in a land transaction must be aware of strict duties to report any suspicion of money laundering.

3.5 The execution of a real estate purchase transaction

A purchase transaction generally commences with the intending buyer making a written but non-binding offer to purchase the real estate '**subject to contract**'. A person unfamiliar with the local market will often use a chartered surveyor to advise on the terms of the offer and to make that offer on his/her behalf. If this initial offer is accepted by the seller, the buyer will not be contractually bound to purchase until '**exchange of contracts**', that is when both parties have signed and exchanged their copy of a written contract.

In the interval between the offer and exchange of contracts, the solicitor will generally carry out the following investigations on behalf of the client. He/she will:

- check the title to the real estate and investigate whether any other party has a right of **pre-emption** or whether there are boundary disputes;
- establish the extent of the owner's rights and what easements, charges or other encumbrances exist;
- check any lease affecting the real estate and its associated documentation;
- check the ownership rights relating to **fixtures** and fittings within the property;
- where the real estate has been recently constructed, look at the construction documentation, building permits, etc., and ensure, where possible, that all guarantees are transferred to the buyer;
- make appropriate enquiries with the relevant local authority such as the town authority or county authority (which is often the responsible highway authority); investigations may also reveal any possible difficulties with building permits or permissions to change the use of the real estate or even a threatened compulsory acquisition of the real estate for municipal works or road construction.

In the light of the results of these investigations, and any tax considerations, the solicitor will negotiate the terms of the purchase contract.

When all the due diligence is satisfactorily completed, finance for the purchase arranged and agreement reached on all points within the purchase contract, the parties will proceed to an exchange of contracts. At this point, the buyer will pay a **deposit**, normally 10% of the purchase price. This deposit may be paid to the seller but it is generally preferable that it is paid to the solicitor acting for the seller to be held by him/her as stakeholder until completion of the sale.

The parties typically agree a period of four weeks between the exchange of contracts and transfer of the property (to allow for all appropriate removal arrangements to be made). During this period the solicitor will settle the terms of the transfer documents and check with the *Land Registry* that no new encumbrances have been registered against the real estate. Any necessary finance or mortgage documents will be signed and executed and a title report will be given to the lender to ensure that the money is available before the completion date.

After completion of the transfer of the real estate to the buyer, it used to be the case that stamp duty would be paid on the transfer document, the amount of duty being assessed according to the price shown. However, as mentioned below, stamp duty (a document tax) has now been replaced by **Stamp Duty Land Tax** (*SDLT*), which is a transaction-related tax. The buyer has to submit a self-assessment form to the *Inland Revenue* for *SDLT* purposes. It should be noted that even where the real estate is in an area of *SDLT* exemption, the *SDLT* return must still be completed and sent to the *Inland Revenue*.

If the *Inland Revenue* is satisfied with the completion of the self-assessment form, they will issue a certificate of receipt. This is an important document, as it must be submitted to the *Land Registry* with the application for registration of the transfer to the buyer. No registration will take place without this certificate.

It will be noted that there is a time lag between completion of the transfer and the application to register the transfer at the *Land Registry*. The buyer's solicitor will ensure that the buyer has priority over any new encumbrances by lodging a search form at the *Land Registry* to check what entries are on the title prior to completion of the transfer. The certificate of search returned by the *Land Registry* will state a priority period (approximately one month) and as long as the application to register the transfer is lodged with the *Land Registry* within this priority period, the buyer will have priority over any other applications which might be received by the *Land Registry*.

Real estate is normally sold, but where real estate is to be transferred by **gift** and not by way of sale, it should be remembered that legal ownership can only pass by means of a written transfer, registerable at *HM Land Registry*. Handing over the keys to the house will not pass legal ownership, but in certain circumstances, where the intention to make a gift is clear, the legal owner could become in equity a trustee of the real estate and the receiver of the keys becomes the beneficial owner. The tax considerations are mentioned below.

3.6 Powers of attorney

Documents relating to the sale and purchase or mortgage of real estate may be executed on behalf of one or more parties by a person acting under a valid power of attorney. A power of attorney may confer a 'general power' to conduct transactions in general or a 'special power' to execute documents for a specific purpose, for example, the purchase of a house.

- *Powers of Attorney Act 1971* is an Act relating to the creation of powers. It contains guidance as to execution of powers and effect of a 'general power of attorney'.
- *Trustee Delegation Act 1999* is an Act to amend the law relating to the delegation of trustee functions by power of attorney and the exercise of such functions by the donee of a power of attorney; and to make provision about the authority of the donee of a power of attorney to act in relation to land.

- *Enduring Powers of Attorney Act 1985* allows the donor to confer powers to a donee via a valid instrument (prescribed form). These powers will survive any subsequent mental incapacity by the donor.
  - There is an obligation on the donee to apply for registration of the power if it is apparent that the donor is becoming mentally incapacitated. When applying for registration the donee must comply with certain notice requirements (i.e. toward family members).
  - Power granted can be general authority or a more limited authority (similar to the restricted 'special power').
  - Where an instrument is expressed to confer **general authority** on the attorney it operates to confer, subject to the restriction imposed by *subsection* (*5*), and to any conditions or restrictions contained in the instrument, authority to do on behalf of the donor anything which the donor can lawfully do by an attorney. Limited authority is expressed as 'power to do specified things'. Both types of authority are subject to whatever additional restrictions and conditions are in the instrument. Under both types of authority (subject to conditions or restrictions) the donee may act in ways to benefit him/herself (*sections 3*(*4*) and (*5*)).

There are no statutory provisions that relate to automatic expiration of an enduring power after a certain time limit and there is apparently nothing in the Acts imposing an obligation to check if a power has been revoked.

Once an enduring power is registered under the *Enduring Powers of Attorney Act 1985*, the donor may not revoke it without the court's confirmation. Under the same Act the court has powers to revoke a registered power (i.e. under the provisions of the *Mental Health Act, Part VII*).

Any power granted overseas with the express intention of being effective in *England* would comply with English execution requirements, if it includes a straightforward jurisdiction clause that it is to be governed by English law.

3.7 Financing

Many banks in *England* offer mortgage finance but, for buyers whose normal residence is in another country, the formalities associated with the prevention of money laundering may be time consuming. If speed is necessary, it may be appropriate to arrange the necessary finance with a bank at home. If a person who is not resident in the *UK* takes up a loan facility to invest in UK real estate, he can set off the interest against his taxable income in the *UK*, regardless of whether the lender has its place of business in the *UK*. If a loan is granted by a family member or some other close acquaintance, it is not possible to offset more than a normal commercial rate of interest against taxable income.

3.8 Purchase through a company

Real estate may be purchased by a company, which will normally hold beneficially for itself, but may hold as nominee for another. In the former, limited liability should be available, but not in the latter situation. If the company is non-UK incorporated, it will be treated as a

UK resident for tax purposes if its central management and control takes place in the *UK*. Holding real estate through a company may also lead to a double capital gains tax liability if the company sells the real estate and the money is then extracted from the company.

3.9 Defects and warranty claims

The normal rule in a sale of any real estate is *caveat emptor*, i.e. buyer beware. However, the sales agreement normally imposes some obligations on the seller which would include an unlimited title guarantee. This means that the seller gives the buyer a guarantee against adverse claims of title to the real estate. This guarantee does not include any rights or encumbrances that might be discovered by making appropriate enquiries with the *Land Registry* or other public authorities.

It should also be noted that the guarantee does not relate to the physical condition of the real estate. A buyer can usually only take action against a seller in the case of the seller making a representation about the condition of the real estate, which then proves to be false. It is therefore normally advisable to have properties inspected by a professional surveyor and to make prudent enquiries about such things as flooding in bad weather and the nature of any building work that the seller has carried out on the house.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

Building control is exercised at a variety of levels and through different statutory bodies.

The general rule is that new buildings require building permits known as '**planning consents**' issued by local authorities under parliamentary statutes known as the *Town and Country Planning Acts* or, more briefly as the ***Planning Acts***. These laws relate to every kind of 'development', an expression which includes not only new construction but also particular changes in the use of a building, for example the conversion of a single family house into two or more self-contained apartments. There is also a ***General Development Order*** (*GDO*) which allows certain minor works to be carried out without the need for any application for planning consent, for example an extension of a living room. Even where the *GDO* is applicable it is still necessary to obtain approval of plans and specifications under the *Building Regulations*. These regulations are dealt with in a separate section of the local authority's building control department and focus more on the engineering aspect of construction to ensure that the regulations for structural stability, security, drainage and **environmental regulation** are complied with.

It should be noted that the *GDO* does not apply in the following two instances: (1) where the house is situated in a neighborhood that is classified as a **Conservation Area** in official local plans; and (2) where the house itself is a listed building.

Planning permission is required for all new construction to the exterior of the building. This does not include repair of the existing structure as long as the same materials are being used. Where work is to be carried out on a **listed building**, it is not only necessary to obtain **planning permission** but also separate building permit known as ***Listed Building***

Consent. In such cases, the local authority will be looking to monitor compliance with the outlines laid down by statutory consultees for such works, for example, *English Heritage*. Even where listed building consent is issued, it will frequently contain strict stipulations and conditions relating to the building materials and construction matters to be permitted. Breach of these conditions will attract sharp penalties.

4.2 Architect's and building contracts

It is naturally possible for an individual to engage his own **architect** and appropriate consultants for the building of a new house; however, this method of procurement requires experienced legal advice to ensure that the individual contracts for architects and consultants are not only appropriate in themselves but fully coordinated to avoid contradiction or gaps in responsibility.

It is much simpler to buy a newly constructed house from a developer who is a member of the *National House Builders Council* ('*NHBC*'), a recognized supervisory body for the house-building industry. A certificate issued by the *NHBC* gives the buyer a 10-year guarantee, up to a certain limit, against certain structural defects (such as inadequate foundations), and a two-year **guarantee** against more minor building defects. The rights attached to these guarantees can be transferred to a subsequent buyer, insofar as the relevant time limits remain unexpired.

In the case of renovation works or alteration works, an *NHBC Certificate* is unlikely to be available unless the house is almost entirely reconstructed (for example, everything except the original façade). Nevertheless certain insurance companies will offer limited guarantees for renovation works or building alteration works. In other cases, where no such guarantees can be obtained, the owner might simply look to the relevant trade contractors, such as electricians and roofing specialists, for specific guarantees relating to the work and perhaps also engage a project manager who will accept responsibility for adequate supervision of the work.

4.3 Completion of construction and formalities

A contract for the purchase of a house or apartment to be constructed by the seller usually provides that the buyer will pay the balance of the purchase price within 14 days following the date on which completion of the real estate is certified by the seller. The buyer would be well advised to have a provision entered into the contract allowing the buyer to inspect the real estate for defects when the real estate is certified, so that he/she can either contest the obligation to make the payment in the event that there are serious defects, or reach an agreement that a certain sum is to be retained until smaller defects are put right.

Additionally, all completed buildings should be inspected by a representative of the local authority *Building Control Department*, who should certify that it has been completed in accordance with the relevant planning conditions and **building regulations**. The buyer should insist on this being done before payment of the purchase price.

The buyer of an apartment is also well advised to ensure that the obligation to pay the money does not arise only when the apartment itself is completed, but when other communal facilities are also ready for use, such as lifts, car parks and communal swimming pool.

Additionally, the buyer should check that any conditions imposed by a bank or other lender before the loan can be drawn down are satisfactorily dealt with in the purchase contract. It may be that the bank will wish its own surveyor to inspect the completed building before the loan is granted.

4.4 Deficiencies and warranty claims regarding new construction

As mentioned above, the *NHBC* provides 'Buildmark Cover' guaranteeing against **building defects** where the builder is a member of the council. This cover falls into three parts:

- Problems before completion of the building – for example, where the builder becomes insolvent before the real estate is finished.
- Defects arising in the first two years – a free independent resolution service to deal with problems arising in the first two years.
- Problems arising during years 3 to 10. In this case, such building defects will need to be the subject of formal claim with *NHBC* who will provide the necessary claim documentation (see www.nhbc.co.uk).

5 Rental and tenancy

5.1 Rental and lease agreements

Under English law, a lease is not only a contract between landlord and tenant but it creates an 'interest in land'. The landlord can sell on his/her interest in the land without terminating the lease. The buyer from the landlord takes the land subject to, and with the benefit of, the lease terms. Similarly the tenant can assign its lease, subject to any contrary provisions that may be included in the lease contract.

In principle, every occupier who pays a weekly, monthly or yearly sum of money for the exclusive use of a house or apartment, has a tenancy under English law. The rights of the tenant are mainly governed by the terms of the lease contract (in accordance with the concept of freedom of contract) but they are also materially influenced by relevant statutes.

English law makes a difference between fixed term **tenancies** and periodical tenancies (for example, a lease for a term of seven years as opposed to a yearly tenancy). All lease contracts with a fixed duration of more than three years must be created by deed. Since October 13, 2003, there is an additional requirement that all leases granted for a term of seven or more years, or assigned at a time when seven or more years of the term remain unexpired, must be registered at the *Land Registry*. If the title of the landlord is already registered at the *Land Registry*, the tenant may be registered with title absolute. In the absence of proof of the landlord's title, the tenant may be registered with good leasehold title.

As to the influence of statute laws created between 1950 and 1990 had provided so much protection for tenants that landlords became unwilling to grant residential tenancies. In recognition of this, the government passed various *Housing Acts* and created new tenancies known as '**shorthold** tenancies' and '**assured shorthold** tenancies' which allowed landlords

to lease properties on the basis that they could recover possession of the real estate at the end of a fixed term, for example, three years. The tenant does not have an automatic right to renew the lease and the landlord (after giving appropriate notice) may either re-let the real estate at the end of the term or occupy the real estate for his own use.

5.2 Regulation on protection of tenants and rent control

Care should be taken about the **notices** to be given to **terminate** a tenancy. Under English law, a tenancy does not necessarily terminate automatically at the end of a fixed term of, say, two years. Where a landlord intends to terminate a tenancy he/she must consider any express provisions contained in the lease or tenancy agreement relating to the service of notice on the tenant. Secondly, the landlord must have regard to the statutory provisions which are relevant to the particular type of tenancy. The landlord must comply both with the contractual arrangements in the former and the statutory obligations in the latter. For example, under the *Housing Act 1988*, a tenant of an assured shorthold tenancy must be given at least two months' prior notice in writing before the end of the tenancy. If the tenancy agreement provides for three months' notice, the landlord must comply.

In the case of an agricultural tenancy, the *Agricultural Tenancies Act 1995* requires notice to be given at least 12 months but no more than 24 months before the date of expiry of the tenancy.

The present law states that assured shorthold tenancies have a minimum of six months' duration, but in November 2003 the government's law reform agency, the *Law Commission*, announced changes that will introduce a tenancy form with no minimum duration. It is expected that necessary legislation will be passed through Parliament during 2004. The proposal nevertheless provides for a minimum period of two months' notice to terminate such a tenancy.

6 Succession and gifts

6.1 Applicable law and jurisdiction

Under English law, when someone dies leaving a valid **will**, then his/her property will pass according to that will. If someone dies without leaving a valid will dealing with all of the property, the *Administration of Estates Act 1925* applies.

With regard to conflict laws, in the case of intestacy the rule is as follows:

(a) Where the property is movable, the applicable law is that of the country in which the intestate was **domiciled** at the time of his/her death.

(b) Where the property is immovable, the applicable law is that of the country where the property is situated.

6.2 Fundamentals of the succession and gift/donation laws of the UK

In English law there is no general obligation on a testator to leave any part of his/her estate to any particular person.

If someone dies leaving a spouse and children, that spouse is entitled to personal chattels, a statutory legacy of £125,000 and a life interest in half of the remainder of the estate. The other half is to go to the children, who inherit the remaining half on the death of the surviving spouse. If there are no children, all personal chattels and £200,000 go to the surviving spouse, and a half share in the residue. The remainder goes to the deceased's parents equally if more than one, or if there are none then on trust for the deceased's brothers and sisters, nephews and nieces.

If there is no spouse then the property will be distributed as follows:

- natural and adopted children, but, if none,
- parents, but if none,
- brothers/sisters (whole blood), but if none,
- brothers/sisters (half blood), but if none,
- grandparents, but if none,
- aunts/uncles (whole blood), but if none,
- aunts/uncles (half blood), but if none,
- The Crown (*bona vacantia*).

If a person is aggrieved because he/she has been left out of a will, has not benefitted from the intestacy rules or is dissatisfied with any benefit received, that person may apply to the court under *The Inheritance (Provision for Family and Dependants) Act 1975* provided he/she falls within a certain category of person (spouse, child, someone treated as a child, dependant or cohabitee). The court has discretion to vary the effect of the will or **intestacy** rules to reflect the legitimate claims of a dependent person.

It is generally desirable to have a will drawn up in the *UK* if UK real estate is owned by an individual. This avoids the necessity of a resealing of a foreign grant of probate in the *UK* in order to deal with the administration of a real estate owned by the deceased. Real estate owned by companies or trusts is generally required to go through the probate procedure.

7 Taxes and charges

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

Before December 1, 2003, any transfer of freehold or leasehold real estate was in principle subject to a one-off tax charge called **stamp duty**.

A new tax ***Stamp Duty Land Tax*** (*SDLT*) is chargeable on land transactions with effect from December 1, 2003. Stamp duty is abolished except in relation to transfers or other

dealings with stock or marketable securities. Stamp duty will continue to apply for a period of time (probably until the summer of 2004) to transfers of real estate involving partnerships and partnership interests.

Unlike stamp duty, *SDLT* is not a tax on documents. The tax is therefore chargeable whether or not the transaction is effected by means of a document (or instrument) – and the place of execution of any document, and residence of the parties to a transaction, have no bearing on the charge to tax.

Because *SDLT* is a new tax, for those familiar with stamp duty it is necessary to become familiar with some new concepts and terminology:

Land transaction. The acquisition of a chargeable interest in land.

Chargeable interest. An estate, interest, right or power in or over land in the *UK*, or the benefit of an obligation, restriction or condition that affects the value of any such estate, interest, right or power.

Effective date. If a transaction is completed without previously having been substantially performed, the effective date of the transaction is the date of completion; if a contract is substantially performed without having been completed, the effective date of the transaction is when the contract is substantially performed.

Exempt interest. A security interest (held for the purpose of securing the payment of money or the performance of any other obligation), a licence to use or occupy real estate and a tenancy at will.

Substantially performed. A contract is substantially performed when the buyer or a person connected with the buyer takes possession of the whole (or substantially the whole) of the land that is the subject matter of the contract, or the whole, or substantially the whole, amount of the consideration is paid (which in the case of a rack rent lease includes the first payment of rent).

Major interest in land. Any fee simple or term of years absolute – so it includes all freehold and leasehold interests.

Notifiable transaction. Most land transactions, including the grant of a lease even if it is exempt.

Linked transactions. Transactions forming part of a single scheme, arrangement or series of transactions between the same parties or persons connected with them.

The basic rules governing the charge to *SDLT* are as follows:

- *SDLT* is payable by the buyer on land transactions and is calculated by reference to the chargeable consideration provided by the buyer. The liability to account for *SDLT* is triggered by reference to the effective date of the transaction.
- If there is a contract for a land transaction that is completed by a conveyance, the contract and conveyance are together treated as a single land transaction that has an effective date on the day of completion. For these purposes, 'contract' includes any agreement and 'conveyance' includes any instrument. The terms thus refer to a contract to sell a freehold followed by a *Land Registry Transfer*, or an agreement for lease followed by the grant of the lease itself.

- If the contract is not completed with a conveyance, but is instead substantially performed as between the parties, the land transaction is treated as having an effective date that is the date of performance.

- If there is substantial performance of a contract, giving rise to a liability to notify and pay *SDLT*, and there is a subsequent conveyance, both are notifiable transactions. However, *SDLT* is only paid on the conveyance to the extent that the tax due exceeds the tax chargeable by reference to the contract.

Regulations issued on November 5, 2003, following a 'Technical Note' published by the *Inland Revenue* on October 20, 2003, contain a number of amendments to the rules set out in the *Finance Act 2003* designed to forestall attempts to mitigate the impact of the new tax, particularly in the context of lease grants. The headline points are as follows:

- The original proposals were that rent changes on review after **two** years from the date of the lease grant were to be ignored for *SDLT* purposes. The new rules will allow rent changes after **five** years to be left out of account when calculating the *NPV* of a lease for *SDLT* purposes when it is granted.

- Even after five years, if the rent is reviewed and the result is that the rent rises by more than 5% plus *Retail Prices Index* annually (referred to as an 'abnormal increase'), this will be treated as the grant of a new lease and *SDLT* will be payable by reference to the *Net Present Value (NPV)* of the increase for the balance of the term.

- Where a lease with an uncertain rent (such as a turnover rent) is granted, the new rules provide for a 'reasonable estimate' to be made for tax purposes at the outset. *SDLT* is paid by reference to the estimate. If the rent is still uncertain at the five-year point, then an additional return will be required for which the *NPV* is recalculated. If the rent becomes certain before the five-year point then the additional return will be required at that time. The new *NPV* calculation will be based on the highest rent in any period of 12 months in the previous five years. Depending upon the *NPV* calculated by making a 'reasonable estimate' at the outset, this may lead to a payment of further *SDLT* or a repayment of all or some of the tax originally paid.

The amount of *SDLT* payable in respect of a chargeable transaction is calculated as a percentage of the chargeable consideration. The percentage is calculated under a slab-system similar to that applicable for stamp duty, although the nil rate band for non-residential or mixed property is increased to £150,000.

Residential		*Nonresidential or mixed*	
Up to £60,000	0%	Up to £150,000	0%
£60,001–250,000	1%	£150,001–250,000	1%
£250,001–500,000	3%	£250,001–500,000	3%
Over £500,000	4%	Over £500,000	4%

Certain areas in *England* and *Wales* were designated as '**disadvantaged areas**' for the purpose of *SDLT*, and there is an *SDLT* exemption for real estate located in those areas.

7.1.2 Sales tax (value added tax)

Value added tax is not normally payable on the purchase of real estate (even on the purchase of a newly built dwelling) but will normally be payable on the cost of home improvements made (currently at 17.5% in the *UK*).

7.1.3 Real estate registration and notary charges

Fees payable to the *Land Registry* depend on the value of the real estate. The maximum fee is currently £750.

There is no requirement for a **notary** to be involved in UK land transactions.

7.2 Annually recurring taxes and charges

7.2.1 Real estate tax

There are no annual real estate taxes currently payable in the *United Kingdom*, other than *Council Tax* payable to the local authority.

7.2.2 Income tax

If the foreign resident or domiciliary is simply using the real estate as a home, then there should be no **income tax** as the real estate will not be generating any income.

If the real estate is being rented out, then the foreign owner will be taxable on the rental profits and must submit tax returns every year. If the owner is a non-UK resident then there is an obligation on the tenant or property agent to deduct basic rate tax (2003/04: 22%) before sending the net rents abroad.

It is possible for non-resident landlords to apply for approval under the *Inland Revenue*'s **Non-Resident Landlord Scheme** where, in return for a commitment on the part of the landlord to submit annual UK tax returns, the *Inland Revenue* will allow the rents to be sent abroad gross of tax. This is a cash flow advantage only – income tax will still be payable on the net profits of the letting business.

There are various methods of minimizing the income tax payable on the rents and the most common is to use borrowings, as the interest payments should be deductible against the **rental income** when calculating the tax payable provided the loan was taken out 'wholly and exclusively' for the purposes of the letting business; this is often a trap.

It should be remembered that if UK real estate is directly owned by a foreign domiciliary, upon his/her death (even if he/she is non-resident) there is a requirement that UK probate is taken out. This can be particularly irritating if the foreign domiciliary has no other UK assets.

If the real estate is rented out by a company, the income tax position is broadly the same as for personal or direct trust ownership, except that the company's liability to income tax is restricted to the basic rate (22% for the tax year 2003/04). If any back-to-back arrangements are used to reduce the company's liability to income tax on rents then, once again, transfer pricing needs to be considered.

If the company allows the real estate to be used to provide the foreign domiciliary with rent-free accommodation, then there may be an assessment on the foreign domiciliary's occupation as a **benefit in kind** under the UK's income tax regime.

7.2.3 Net wealth tax

There is no wealth tax in the *United Kingdom*.

Corporation tax

Corporation tax is payable by a company in respect of income received or gains realized on the same principles as income tax and capital gains tax for individuals. It can also be payable in respect of foreign companies that become tax resident in the *UK* by virtue of their central management and control being in the *UK*.

7.3 Capital gains tax

Subject to the five-year temporary non-residence rules, non-resident owners may dispose of UK real estate without any liability to **capital gains tax** (*CGT*). *CGT* is only payable if the taxpayer is actually resident or ordinarily resident in the *UK* during the year of disposal.

From a *CGT* perspective, direct ownership of owner-occupied real estate can be particularly effective as, if the real estate is the taxpayer's main or sole residence, it will be exempt from *CGT* by way of the **main residence exemption**.

Ownership through a company

A non-UK resident company (by virtue of being incorporated, controlled and managed outside the *United Kingdom*) will not suffer corporation tax on its capital gains. However, if the company has been controlled and managed in the *UK*, it will be liable to pay tax on its capital gains.

7.4 Inheritance and gift taxes

The major problem with direct ownership is that the real estate is a UK situs asset and as such is always subject to **inheritance tax** ('*IHT*'), regardless of the taxpayer's foreign domicile or residence. Thus, when the taxpayer dies *IHT* will be payable at the rate of 40%, insofar as the value of it and any other UK assets exceed the prevailing nil rate band (which for the financial year 2003/04 stands at £263,000).

However, there are various estate planning techniques which can be used to mitigate the *IHT* exposure on UK assets. For example, the **foreign domiciliary** and his wife and adult children could own any property jointly as 'tenants in common' – this maximizes the availability of the *IHT* exemptions as each owner will have the use of his/her own nil rate band of £263,000.

One of the most common means of minimizing the *IHT* exposure on UK real estate is to use borrowings secured on the real estate to reduce the equity of the real estate. The problem with this method is the funding of the interest payments since, if the foreign domiciliary has insufficient income in the *UK*, the interest payments will need to be funded from foreign

sources and this could result in a charge to tax if income is brought into the *UK*. However, this problem can be avoided by arranging for the offshore bank accounts to be strictly segregated between capital and income. As long as funds from the capital account only are remitted to the *UK* then, in most circumstances, this would avoid a charge to income tax.

Another technique is for the taxpayer to give the property to a younger member of the family. The gift will be a 'potentially exempt transfer' and as long as the donor survives the gift by seven years there should be no *IHT* payable. However, there are various anti-avoidance measures that can defeat the purpose of the gift.

The most common way of overcoming the *IHT* difficulties with personal or direct trust ownership is for the real estate to be owned by a non-resident company. Since the shares in the foreign company will be the relevant asset for *IHT* purposes they should, as foreign situs assets, be outside the scope of *IHT*.

Ownership by trustees

Ownership of UK real estate by trustees of a non-resident trust can overcome some of the problems associated with direct ownership, for example UK probate would not be required on the foreign domiciliary's death. However it does not get out of the *IHT* liability and there may be a charge on the benefit of occupation unless a full rental is paid.

However, trustees will not normally agree to own UK real estate directly as it exposes them and the trust to unlimited liability. This particular problem can be overcome by the use of a 'single purpose trust company'.

Briefly, a single-purpose trust company is a company formed exclusively for the purpose of acting as the trustee of the particular trust. Such an arrangement provides the benefit of limited liability, which is to be contrasted with a trust company used as trustees of a number of trusts, whose liability would be unlimited.

Because of the problems of unlimited liability, trustees frequently use an underlying company to hold real estate. Sometimes, however, the tax planning in relation to this has not been thought through.

7.5 Other taxes and charges

Other than *Stamp Duty Land Tax* (*SDLT*), *VAT, Inheritance Tax, Capital Gains Tax* and *Income Tax* there are no relevant taxes and charges apart from **Council Tax**, which is payable by the owner or occupant to the *Local Authority* depending on the value of the real estate.

7.6 Incorrect (lower) statement of sale price on the sales agreement

It is strictly illegal to state a lower price than the real price in the sale agreement. It is sometimes done to reduce the *SDLT* band, but will normally be discovered when the tax return is submitted.

Contracts for the purchase of land and transfers of title of land must be in writing. Until November 30, 2003, transfers of land were in principle subject to stamp duty, a deed tax which would be assessed on the price shown in the document. If the price shown in the

transfer document understated the true price being paid by the buyer, the lender and buyer and their respective legal advisers could be guilty of fraud on the *Inland Revenue*.

As mentioned in section 7.1.1 above, a new tax, *SDLT*, replaced stamp duty with effect from December 1, 2003. *SDLT* is a tax on transactions relating to land and not a document tax. Accordingly, the provisions of the contract and all related documentation may be brought into assessment and duty payable by reference to the consideration disclosed. As before, any failure to disclose the true consideration being paid could result in prosecution by the *Inland Revenue*. It should be noted that it is the buyer's personal responsibility to submit an accurate *SDLT* return to the *Inland Revenue* following completion of the transaction.

7.7 International taxation

Double taxation treaties are relevant to ascertain residence in respect of individuals if the individual is resident in the *UK* for UK domestic tax purposes, and in a treaty country for domestic tax purposes of that country. The double taxation treaty will set out rules for ascertaining the country in which the taxpayer resides for the purposes of payment of tax.

The rules in the majority of treaties follow the *OECD Model Convention*, the general rules of which are:

- If the individual has a permanent home available in one of those countries then he/she will be treated as resident in that country.
- If the individual has a permanent home in both countries, that person will be treated as resident in the country with which his/her personal and economic ties are closest.
- If the individual does not have a permanent home in either country, or the closeness of that person's personal and economic relations is inconclusive, he/she will be treated as resident in the country where he/she has a habitual abode.
- If the individual has a habitual abode in both or neither countries, he/she will be treated as a resident of the country of which he/she is a national.
- If the individual is a national of both or neither countries, the residence ultimately will be determined by mutual agreement between the taxing authorities of each country.

In respect of planning with the use of offshore trusts and companies, treaties are not normally very relevant, as most low-tax jurisdictions do not have any treaty with the *UK*. *Jersey* and *Guernsey* do have restricted treaties, but they are not in the form of the *OECD Model Convention.*

In respect of high-tax countries, treaties will be rather more relevant. If an individual is resident in a foreign country by virtue of the tests set out above under the treaty, the treaty will generally only allow the *United Kingdom* taxing rights over UK source income and gains. The latter will not be relevant for non-residents in any case.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Under European Union (EU) law, EU citizens and citizens of countries within the *European Economic Area* (collectively known as EEA nationals) are entitled to free movement within

the *EEA*. Such citizens entitled to this include workers, self-employed, providers and recipients of services, students, financially independent persons, retired persons and family members. They are entitled to a conditional right of residency, rights of entry, access to employment, self-employment, study and social security.

Switzerland is not a member of the *EU* or the *EEA* but by virtue of the *Immigration (European Economic Area) Regulations 2000*, Swiss nationals and their family members can also benefit from these same such rights to free movement as EEA nationals.

Immigration for EU/EEA and Swiss nationals

Nationals of countries in the *EEA* which, besides the *EU*, includes nationals of *Iceland, Liechtenstein* and *Norway* have been given the same rights as EU citizens to enter, live and work in the *United Kingdom*.

From June 1, 2002, Swiss nationals have the same rights as EEA nationals to enter, live and work in the *United Kingdom*.

For convenience, EEA nationals and Swiss nationals are referred to as 'EEA nationals' in this summary.

Family rights

If an EEA national has a right to live in another country, and lives in the *UK*, his/her family (whether or not they are EEA nationals) may join him/her.

Family members who are EEA nationals have the same 'freedom of movement' rights as the EEA national they are accompanying or joining. Non-EEA nationals do not have these rights (but may have other immigration rights of their own).

Family members living in the *UK* as the family members of an EEA national may lose their right to stay if the EEA national leaves the *UK* permanently or no longer has a right to live in the *UK*.

Rights as to working

An EEA citizen in the *UK* does not need a work permit to accept offers of work, or to work in employment, self-employment or in business.

Documentation

An EEA national with a right to live in the *UK* is not required to obtain a residence permit or register with the police. However, he/she has the right to apply for a residence permit. The permit confirms that the applicant has the right to live in the *UK*. If the EEA national does obtain a permit, it will usually be valid for five years.

Staying in the UK indefinitely

EEA nationals (apart from students) may apply for indefinite leave to remain in the *UK* (i.e. with no time limit or conditions upon their stay) if:

- they have had a residence permit for five years; and
- still have the right to live in the *UK*; and
- have been working or supporting themselves financially in the *UK* for at least four years and are still doing so.

EEA nationals who are now of pensionable age and retired or permanently incapable of work due to injury, etc., may qualify to live in the UK indefinitely in certain circumstances.

Non-EU/EEA nationals only have the right to live in the UK if they have the appropriate right of abode, visa or work permit.

8.2 Tax residence

Domicile for UK tax purposes is generally where an individual has his/her permanent home. Every person is born with a *Domicile of Origin*, but can change this by choice if he/she settles permanently or indefinitely in another country or state. It is distinct from residence for tax purposes. A non-UK domiciled and non-UK resident person will pay no inheritance tax (except on UK assets), *capital gains tax* or *income tax* (except on UK source income). A non-UK domiciled but UK resident person will be treated on the same basis except that he/she will be taxable on income and capital gains remitted to the *UK* or earned or realized in the *UK*. However, for inheritance tax only, a non-UK domiciled person will be treated as domiciled in the *UK* once he/she has been resident in the *UK* for 17 out of any 20-year period. The government is reviewing the domicile rules currently.

For individuals spending more than 182 days in the *UK* in any tax year (April 6th to April 5th), or more than 90 days on average over a rolling period of four years, it is likely that they would become UK tax resident. The consequence of that is that all UK source income and capital gains, together with any income and capital gains remitted to the *UK* from abroad, will be taxable, possibly at a top rate of 40%. The **remittance rules** are attractive for non-UK domiciliaries (i.e. whose permanent home is abroad) who are resident in the *UK*. This means that foreign source income and gains not remitted to the *UK* are outside the UK tax net. Non-domiciliaries are also not liable to UK inheritance tax (except on UK assets) unless they have been resident in the *UK* for 17 out of any 20-year period, or been domiciled in the *UK* within the last three years.

8.3 International taxation for residents of the United Kingdom

Where the UK resident suffers tax in another country, provided there is a double taxation treaty in force with the *United Kingdom*, only the primary taxing country will tax. This needs to be considered in each case.

Some UK residents will be taxable in their home country as well as the *UK*. In this situation, if there is a double taxation treaty, and the *UK* has a large network of treaties, then their liability to double taxation is likely to be relieved. Most treaties have a tie breaker provision that will determine which country has principle taxing rights, which will normally depend upon where the individual's main centre of existence actually is. Treaties are also useful in situations such as becoming non-resident to avoid capital gains tax. Whereas normally an individual has to be non-UK resident for five years to avoid a capital gains tax charge, if

the individual becomes tax resident in a country with an appropriate double taxation treaty, such as *Belgium*, then provided he/she becomes resident in *Belgium* under the tie-breaker rules, he would not need to be outside the *UK* for five years but could achieve this in about 15 months.

Where liabilities to UK tax arise, it may be necessary to consider whether any double taxation treaty relief applies.

9 Checklist: Real estate acquisition in the United Kingdom

- Easy rail connections and other transport links can have a significant impact on the long-term value of real estate. Similarly, the suitability of other local amenities for the buyer, such as schools, shopping and leisure facilities should be carefully checked, as there are very significant variations on the qualities of these facilities from place to place.
- In the light of the principle of *caveat emptor*, a professional survey and valuation (normally by a chartered surveyor) is strongly recommended.
- It is essential that the title, possible encumbrances and terms of the purchase contract be checked by a suitably qualified lawyer.
- Planning permissions and building regulations: It should be remembered that there may be very tight restrictions in relation to building works, especially for historic or architecturally interesting buildings or for buildings within a conservation area.
- Where a leasehold real estate is being acquired, check the tenancy conditions carefully to see that no restrictions conflict with your lifestyle and check whether you need **landlord's consent** for any proposed alterations to the property.
- Third-party consents for extensions and alterations: Check whether you will need consent of neighbors to alterations that you plan.
- Acquisition costs (for example, *Stamp Duty Land Tax*, legal and surveyor's costs) and the annual outgoings and local taxes should be checked.

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Annuities and Life Insurance
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AXA Art Insurance
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Government and Local Authorities

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USA/Florida

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1 Introduction

The history of real estate in *Florida*, much as the history of *Florida* in general, is relatively brief. Particularly in *South Florida*, where much of *Florida*'s population is concentrated today, trade in real estate did not become important until the 1920s.

But since the 1920s, the real estate market in *Florida* has boomed. Real estate in *Florida*, and the sale and purchase thereof, has always depended on the weather and on 'foreigners'. In *Florida*, 'foreigners' are '*non-Floridians*'. If the *USA* is considered a country of immigrants, *Florida* is the state of immigrants in the *USA*. Until a few years ago, *Florida* followed the general rule that more land for development could be found at any time and that growth had no limit. Only since the 1980s has it been recognized that growth has its price: water supply, protection of the environment, services for an ever-growing population and quality of life suddenly have become important issues. This does not come as a surprise if one considers that *Florida* has surpassed dozens of other states in population growth and that *Florida* is now the fourth most populous state in the *USA*.

Compared to other countries, real estate in many parts of *Florida* is still relatively inexpensive. Home-owners in the *USA* buy and sell homes at a pace that seems unimaginable to Europeans. Since 1990, it is seemingly impossible to lose money with real estate in *Florida*.

For that reason alone great caution should be used in *Florida*'s real estate market today. Experts warn that the incredible expansion of the US real estate market cannot continue indefinitely. On the contrary, it is expected that the US market will cool off drastically in the coming years. Given that profit margins will likely decrease, it is crucial to have a clear understanding of the legal aspects of a real estate transaction in *Florida*. Only buyers and sellers who understand real estate law in *Florida* can expect to be successful in the coming years.

2 Real estate ownership

2.1 Different forms and types of ownership

Ownership in fee simple

The most common and simplest kind of real estate ownership in *Florida* is ownership in *fee simple*. Ownership through *fee simple* has no end in time. There are four subcategories of fee simple ownership:

(a) Fee simple absolute

(b) Fee simple determinable

(c) Fee simple subject to a condition subsequent

(d) Fee simple subject to an executory limitation.

Fee simple ownership can be transferred through a ***deed*** or a **will,** as long as the deed or the will contains the required formalities. Absent indications to the contrary, **it is assumed that fee simple ownership has been transferred**. However, if the document contains

sufficient indications to the contrary, it is assumed that the ownership that has been transferred is not fee simple. For example, if the transferring person determines that the real estate should be held only during the life span of the receiving person, it is then assumed that ownership is a so-called 'life estate' (see below).

Fee simple absolute

Ownership in *fee simple absolute* has no limitations that would restrict or reduce the duration of the ownership. For this reason ownership in fee simple absolute is the most common and valuable form of property ownership. In case of doubt, it is preferable to hold ownership through fee simple absolute. The words ***fee simple*** and ***fee simple absolute*** **are generally synonymous**.

Fee simple determinable

Fee simple determinable is ownership in *fee simple* that **ends automatically when a predetermined condition occurs**. Ownership in fee simple determinable is identical to fee simple ownership, except that the period of time ownership is held in fee simple is limited. Ownership in fee simple determinable can be sold, gifted or inherited, but the successor owner is always bound by the condition.

Fee simple determinable is often expressed with sentences such as 'until ... occurs', 'as long as ...', or 'during the existence of ...'. Because there is always the possibility that an event in the future may terminate the current ownership of a fee simple determinable title, there is a corresponding ownership interest that is called a ***reverter***. According to Florida law a *reverter* must be limited to 21 years. **If the condition of the reverter has not occurred within 21 years, ownership automatically becomes *fee simple absolute***. A fee simple determinable differs from a *fee simple* s*ubject to a condition subsequent* (see below) in that a *fee simple determinable* ends automatically when a predetermined condition occurs. On the other hand, a *fee simple subject to a condition subsequent* gives the transferring party the right to take back the real estate when a predetermined condition occurs. A *fee simple determinable* differs from a *fee simple subject to an executory limitation* (see below) in that ownership in *fee simple determinable* reverts to the transferring party, whereas ownership in *fee simple subject to executory limitation* reverts to a third party.

Fee simple subject to a condition subsequent

Ownership in *fee simple subject to a condition subsequent* is real estate ownership that can be taken back by the creating party if a certain set of circumstances occurs. The right of the creating party to step in and take back the real estate is called ***Power of Termination***. Just like reverters, powers of termination are limited in *Florida*, with certain exceptions, to 21 years from the date of creation of the property interest.

A ***condition subsequent*** is normally created through expressions such as 'conditioned upon that ...', 'on the condition that ...', or 'but if ... occurs, then ...'. A *fee simple determinable* will not terminate automatically when the predetermined condition occurs. The creating party has to become active and assert his/her power of termination. Until the creator of the estate asserts this power, nothing changes in the property rights of the new

owner after the condition occurs. Furthermore, if the creator/transferor does not exercise his/her rights within a reasonable period of time, the right can be lost.

Fee simple subject to executory limitation

Ownership in *fee simple subject to executory limitation* is similar to the real estate interests described above, with the distinction that the ownership does not revert to the previous owner but to a third party when the condition occurs. This transfer of ownership to a third party occurs automatically without the third party having to become active and assert his/her rights.

Life estates – lifetime ownership

A *life estate* is a **time-limited property interest**, limited either to the life span of the receiving party or the lifetime span of a third party. If the duration of a life estate is limited to the life span of a third party, the ownership is called **life estate pour autre vie**. A *life estate* ends with the death of the measuring life. If the creating document (deed or will) does not state anything to the contrary, it is assumed that the measuring life is that of the receiving party. With few exceptions, *life estates* are not inheritable because they end with the measuring life. *Life estates* can be sold or gifted during the measuring life, but their value is greatly reduced by the fact that the receiving party does not know how long the ownership will last.

Because in case of doubt Floridian law always assumes that real estate is held in *fee simple absolute*, a life estate has to be described very carefully and precisely. The owner of a life estate is the absolute owner of the real estate during the existence of the life estate. He/she is entitled to all income generated by the real estate during his/her tenancy. However, the owner of a life estate does not have the right to squander the value of the real estate, so that the successor owner receives a property of reduced value. This means that an owner of a life estate must pay real estate taxes and maintain the real estate in acceptable condition.

Timesharing

Timesharing or *timeshares* are a **special variety of fee simple ownership in *Florida* for** less than one year in a given calendar year. ***Florida* is a pioneer for timeshare ownership**. In 1976 *Florida* enacted the first timeshare law in the *United States*, and the legal provisions have been revised and adjusted several times since then. A timeshare interest is usually purchased through transfer of 1/52 of an undivided interest in a vacation apartment, together with rights of use that can apply to a special type of apartment, e.g. a two-bedroom apartment, or a specific season (high/low season). Such rights of use create a ***floating timeshare***. Floridian law also permits exchange programs, where an owner first books a week, and then contributes this week to a pool out of which all contributors can take a week in other parts in the world. Offers of timeshares have very broad disclosure obligations. Offerors have to create and provide to interested parties a *public offering statement*, which explains the risks of the purchase and clearly informs the prospective buyer that he/she has a 10-day right of cancellation.

Concurrent estates

All the above-described real estate interests can be held in the name of one or several persons. If the real estate is held at the same time in the name of more than one person, the estate is called a *concurrent estate* or **co-tenancy**. The joint owners are often referred to as *co-tenants. Florida* generally recognizes **three different types of concurrent estates**: *joint tenancy, tenancy in common*, and *tenancy by the entireties*.

Joint tenancy

A joint tenancy exists when two or more persons have the undivided ownership of real property with the automatic **right of survivorship after the death of a co-tenant**. Whenever real estate is held by two or more persons, it is assumed that a *tenancy in common* has been created without an automatic right of survivorship for the surviving party. Therefore, this right of survivorship after the death of a co-tenant has to be expressly provided for in the will or deed creating the tenancy. The sole distinction between a *joint tenancy* and a *tenancy in common* is that the *joint tenancies* provide for this automatic right of survivorship after the death of a co-tenant. If a *joint tenant* transfers his/her ownership to a third party, the *joint tenancy* is automatically dissolved and a *tenancy in common* is created. In other words, the person who takes ownership from the transferring co-tenant in a joint tenancy does not become a new *joint tenant*, but rather a *tenant in common* (see below).

Tenancy in common

The **most common type of joint ownership** is a *tenancy in common*. Floridian law assumes that a *tenancy in common* is created when two unmarried persons jointly take ownership in real estate. All *tenants in common* have the right to own and control the entire property, which does not necessarily mean that all co-tenants have to be in possession of the real estate. Where a co-tenant controls ownership of a real estate under this form of ownership, it is assumed that he/she holds the property for him/herself and his/her co-tenants.

Where the title to real estate is transferred to two or more persons without further indications, the resulting interest is a *tenancy in common*. Real estate of a *tenant in common* can be freely transferred to a third party. The new owner will again become a new *tenant in common* together with the other *co-tenants*. A *tenant in common* cannot, however, transfer only a certain portion of a real estate (e.g. the southeastern quarter of the real estate). A *tenancy in common* **can be divided by the *co-tenants* at any time** (*partition*). A *tenant in common* can also demand the partition of the real estate or, where partition is not possible, can force the sale of the real estate and distribution of the proceeds among the co-tenants.

Tenancy by the entireties

A *tenancy by the entireties* is similar to a *joint tenancy* with the limitation that a *tenancy by the entireties* can be created **only between married persons**. When a deed in the name of a married couple does not contain any contrary indications, it is assumed that a *tenancy by the entireties* is being created. When a property is transferred to several persons, two of which are married to each other, it is important to ensure that the respective rights are carefully described. For example, there can be a *tenancy in common* in part and a *tenancy by*

the entireties in part. When one of the married owners under a *tenancy by the entireties* dies, ownership interest automatically transfers to the spouse.

It is important to understand that one spouse cannot transfer his/her portion in a *tenancy by the entireties* **without the consent of the other spouse**. Even a lease held in an *estate by the entireties* cannot be extended without the consent of both parties. Ownership in a *tenancy by the entireties* **cannot be partitioned or transferred by inheritance**, because the surviving spouse automatically takes the undivided ownership interest upon the death of his/her spouse.

Condominium

A condominium is a form of ownership in which the owner of a property, usually an apartment, owns a certain fraction of the common areas of an apartment building, together with one of the apartments. This form of interest is created by a so-called *declaration of condominium* to which all owners within the condominium are legally bound.

Future interests

All of the above-described forms of ownership can either be current or in the future. A future ownership occurs when the transfer does not occur immediately by way of deed. This is normally the case by transfer through a will. A discussion of all forms of future ownership would exceed the scope of this chapter. An attorney wishing to create a future ownership has to consider, however, that the future interest must vest within 21 years of the death of a currently living person. This rule is called ***rule against perpetuities*** and is strictly enforced.

2.2 Easements, charges, liens and mortgages

Florida recognizes **a variety of legal encumbrances on real estate**, including *easements, licenses, restrictive covenants, liens and mortgages*.

Easements

Explicit easement: An easement gives another person the right to use the property of another person to a limited extent. An easement right can be enforced against third parties. ***Easements* can be sold or gifted.** The property on which the easement is located is called the ***servient tenement***. The property that benefits from the easement is called the ***dominant tenement***. An easement appurtenant is an easement that benefits another property independent from the owner. An easement can be either positive, i.e. it entitles an owner to limited use of the servient tenement; or it can be negative, i.e. it may prohibit the owner of the servient tenement from undertaking specific activities.

An easement can either be **explicit, by implication** or created through **adverse possession**. If an easement is to be enforceable it must generally be **recorded in the public records**.

Because an easement is a property right, it is covered by the *Statute of Frauds*, which requires **written form**. An easement can either be created in a *deed* or with a separate

document. If the easement is on a separate document, it requires the same formalities as a deed.

Easement by implication: An implied easement can only be created if it **derives from an explicit *easement* in written form, or** if it is a **legal necessity**. The former can apply if, for example, certain necessary rights in a deed are not explicitly mentioned. The latter case can apply if a property that is part of a larger property parcel is transferred to a buyer who, without the *easement*, would have absolutely no access to a public road.

Easement by adverse possession: An *easement* by adverse possession is created in some cases where a servient tenement has been used for **20 years** without interruption. The alleged owner of the easement must prove that he/she has enjoyed the easement right for an uninterrupted period of at least 20 years; that he/she has done so openly and with the knowledge of the owner; that he/she has not been granted these rights with the explicit approval of the real estate owner; and that he/she has enjoyed these rights according to a clearly defined route. An example is a situation where a *dominant tenant* has continuously been driving over a neighboring property to get to his/her own property for at least 20 years. If the neighbor (*servient tenant*) has had knowledge of this activity and has neither protested nor given explicit approval, the *dominant tenant* may be entitled to an easement by adverse possession.

Charges

Floridian law does not recognize the concept of 'charges', but instead refers to 'encumbrances', all of which limit to some degree the ownership rights to the real estate to which they apply.

Restrictive covenants

A *restrictive covenant* can either be **public or private**. Public *restrictive covenants* are created by the legislature to protect the public interest (e.g. designation of a historic neighborhood and corresponding zoning restrictions). Private *restrictive covenants* are created by private persons or corporations. An example is the rules and regulations of a *condominium*, which bind all members of the *condominium*. Other examples are age restrictions of the owner in a building, e.g. owners must be 50+ years of age, or architectural restrictions through *restrictive covenants*, e.g. the color of the paint of the house, or restrictions concerning the type of house or construction in a given area.

Liens

Liens are easy to create and correspondingly common in *Florida*. They often arise from construction work and services. For instance, an architect or engineer in *Florida* can have a *lien* recorded on a real estate to secure payment for his/her services that benefit the property. He/she must adhere to certain formalities, and the lien can only be recorded in the correct amount of the services rendered. Recording an amount that is intentionally higher than the actual amount is illegal.

Particularly common with new construction, it is imperative to have all existing liens released by the closing date. The real estate owner must secure and record so-called

lien waivers or *satisfactions of liens* so that the title is not clouded by additional demands after closing. Title insurance will ensure that no liens that would cloud the title are discovered after closing. Even if disagreements over certain liens are pending, it is possible to transfer a clean title if a security deposit is made in the court registry in the amount of the lien.

Mortgages

A mortgage secures some sort of obligation, usually the requirement to repay a loan made for the purchase of real estate (purchase money mortgage). Without a mortgage, a lender would have no priority over other creditors of the borrower in case of non-payment. The mortgage enables the lender to assure repayment of the loan over all other creditors of the borrower by taking regress to the property on which the mortgage is recorded. The mortgage must be recorded in the public records to create priority as against subsequent lenders or trade creditors of the borrower. Mortgages remain an encumbrance of the respective property until a 'satisfaction of mortgage' has been recorded, which cancels out the mortgage.

Licenses

A *license* is the right to use the property of another person in a restricted manner. An example is the use of a property for logging purposes. Because a *license* is a **personal right, it is not required to be in writing**. A *license* usually cannot be sold, given away or transferred with a property. A *license* can be **revoked** by the licensor at any time. Thus, a license cannot confer a permanent right of residence.

Construction law and building lease

A discussion of construction law and building leases would go beyond the scope of this chapter. Suffice it to say that construction law is heavily litigated in *Florida*.

2.3 Protection of ownership, proof of ownership and registration

Evidence of ownership of real estate in *Florida* is established by a '***deed***'. The deed document can be a ***warranty deed*** (guaranteed title) or a ***quitclaim deed*** (transfer of an existing title including possible restrictions). The deed must be **recorded in the public records** to provide evidence of ownership to third parties. The public records are kept on the county level and contain property ownership records that can be traced back to the very first owner of a given piece of land in the distant past.

If several claims to the same real estate are recorded, **the claim that has been recorded first has priority** over those recorded at a later date. Therefore, the buyer of a property has an incentive to have the deed recorded in the public records as soon as possible after the sale. Once the deed has been recorded in the public records, it is assumed that all members of the public have been informed of the new ownership right. It is therefore imperative for a subsequent buyer to check the public records carefully for potential claims against the property. This record search is normally conducted by the ***title agent*** and is part of the transfer formalities.

The main function of the public property ownership records is to protect a buyer against property claims of earlier owners that have not been recorded. It must be stressed that

even the recording of a deed in the public records **does not provide complete protection** against competing claims. Just because a document has been recorded in the public records does not mean that it is automatically legal. If, for instance, the recording officer made an error, **the incorrect recording does not create legally enforceable rights in the party recording the instrument.**

It should further be noted that property deeds are not the only items that are recorded in the public records. For instance, court judgments against a judgment debtor can also be recorded in the public records of a county, thus creating a lien on real estate of the debtor in that county. If a certified copy of the court judgment is recorded in the public records, claims from this judgment take precedence over other claims recorded subsequently. If real estate, however, is held by a married couple as *tenants by the entireties* (see above), even the recording of a judgment lien in the public records does not give the creditor the right to execute against the real estate.

Floridian law determines which types of documents can be recorded by the clerk in the public records. Most clerks will record almost any document, provided that it is notarized (by a notary public) or certified (as a correct copy by a court). Every document to be recorded must show the name and address of the person who prepared the document.

Requirements for a valid deed

The most important document for the transfer of real estate is the *deed*. The following are the **minimal requirements** for a valid *deed* in *Florida*:

- **Exact legal description of the real estate** to be transferred as well as the *property ID number*.
- Name and social security number of the transferring person (*grantor*). The marital status of the grantor (married or single) should be stated.
- **Name of the new owner** (*grantee*): If the real estate is to be held by several persons, the document should state the future ownership relation between the parties.
- **Date** of the *deed*.
- The **signature** of the *grantor* must be clearly legible.
- The **signatures of two witnesses** who witnessed the *grantor* signing the *deed* are required. If the *grantor* is a corporation, the business owner, the president or chief executive officer, or another authorized officer of the corporation may sign the deed, which signing must also be witnessed by two witnesses. The names and addresses on the document must be legible. The corporate seal is sufficient in lieu of the two witnesses.
- **Notarization:** A *deed* should be notarized by a *notary public* so that the document can later be recorded in the public records. Non-notarized documents cannot be recorded in the public records.
- The name and address of the **person who prepared the document** must be on the deed, together with instructions to the clerk of court concerning what to do with the *deed* after the recording.

- There should be a 3″ × 3″ empty space in the upper right-hand corner of the first page of the document where the clerk will affix the recording information. The clerk generally records the book and page on which a particular *deed* has been recorded (e.g. *OR 1045, page 375*).

3 Purchase and sale of real estate

3.1 The sales agreement

Basic requirements

Contracts for the purchase and sale of real estate are enforceable only if they are in writing and signed by the party against whom the contract should be enforced; if they contain a clear mutual promise – called consideration; if the parties have agreed on all basic conditions of the contract; and if the terms of the contract, including the description of the real estate and the parties, are clearly defined.

Written contract

The **written form** of a valid contract is an **absolute requirement** for a real estate transaction in *Florida*. This can consist of several written documents, as long as these are all signed by the party against whom they are to be enforced. For instance, several letters and fax documents may constitute a valid contract. The *Florida Association of Realtors*, together with the *Florida Bar Association*, have developed a standard purchase and sales contract for real estate in *Florida*, which is periodically updated according to the latest legal requirements. This ***FAR/ Bar* contract** is used for the overwhelming majority of real estate transactions in *Florida*. An attorney who would like to become familiar with the modalities of a real estate transaction in *Florida* should carefully review the *FAR/Bar* standard contract because it contains most of the important details of a transaction. Separate additional documents may be added to the *FAR/Bar* contract as *addenda* or *riders*, which contain additional specific agreements. The **use of prepurchase contracts is not customary**.

A limited version of the Formulator Program which contains the *FAR/Bar* contract is available for downloading on www.formulator.com/states/florida/floridamain.html.

The only exception to the written form requirement of a contract for real estate exists when one of the parties has partially performed under an oral agreement.

Mutual promise of consideration

Mutual *consideration* is an **absolute requirement** for every contract in *Florida*. A purchase and sales contract is a mutual agreement containing the promise of the buyer to pay a certain amount of money or exchange another item of value to the seller, and the promise of the seller to transfer the title of the real estate to the buyer. Both promises must be backed by an appropriate consideration. The **buyer's promise of payment** and the **seller's promise to transfer the real estate** are normally sufficient.

Agreement on all basic conditions

A purchase and sales agreement for real estate is not enforceable if the basic terms and conditions of the contract are unclear or ambiguous. A purchase and sales agreement is clear and unambiguous if the contracting parties have actually reached an agreement concerning the terms and conditions that constitute the necessary requirements for a valid purchase agreement.

Description of the real estate

One of the most important parts of a valid purchase agreement is the property description. An adequate property description identifies the real estate without further proof. A description is adequate if a land surveyor can clearly identify the real estate using the description.

Signature of both parties

The buyer generally makes an offer by completing and submitting a full purchase and sales agreement, dated and signed unilaterally. The seller then has a certain number of days to countersign, or to make changes and then countersign the agreement. In the latter case, the contract with the changes is considered a counter-offer and must be accepted in writing by the buyer. **Only when total agreement exists has a valid contract been created**.

Preparation of the purchase agreement

In most cases use of a standard agreement is recommended, together with *riders* and *addenda*, if necessary. The contract most often used since 1973 is the above-described *FAR/Bar* standard contract. Hundreds of thousands of pieces of real estate have been legally transferred with this contract. Although a preprinted contract may not be appropriate for every transaction, the *FAR/Bar* contract is suitable for the vast majority of residential real estate transactions, and often for commercial transactions.

Contracting parties

The name of the seller must appear in the purchase contract exactly the same way as it appears in the existing title document. If, for instance, the title is held by Mr and Mrs X, a married couple, then the sellers must be listed as such in the contract. It is therefore advisable to consult the old deed prior to the completion of the purchase contract. It should be ascertained whether or not the property is the primary residence (*homestead*) of the seller (see section 3.2.1 below). If this is the case, both spouses must be listed as the sellers.

Real estate is often held in the name of a **corporation or *partnership***. If the real estate is owned by a *partnership*, the partnership agreement should be reviewed to ensure that a person authorized by the *partnership* signs the contract. In case of a *limited partnership*, all *general partners* must co-sign the contract. In case of a limited liability company under *Florida Statute §608.425*, the bylaws determine who can sign agreements. If the transferring party is a corporation, the exact name of the corporation and the state in which it is registered must be shown on the contract. The contract must be signed by the president or vice president of the corporation and, if possible, the corporate seal should be affixed to the

contract. Information concerning all Floridian corporations can be searched via the internet. It is highly advisable to review the corporate structure prior to signing a purchase and sales agreement with a corporation. (www.sunbiz.org/corpweb/inquiry/coremenu.html)

If the title is held in the name of a *trustee*, the trust document should be reviewed to determine if the approval of the trust's beneficiary is required for a valid transaction.

The name(s) of the buyer(s) in the purchase contract must be shown in exactly the same way the title for the property is to be held. An exception exists where the buyer plans to assign the agreement before closing to a yet to be founded corporation or partnership. In that case, the words '*or his/her assigns*' should appear after the name of the buyer. Contracts made in good faith with persons who are not authorized to sign them are not enforceable.

Legal description and survey

If the real estate is located in a *platted subdivision* or is part of a *condominium*, the legal description must contain the precise name of the subdivision or the *condominium*, as well as the book and page on which it is recorded (e.g. *OR 523, p. 1056*) and the recording information of the official condominium declaration.

An attorney who prepares the contract should never assume that a certain item is part of the property (e.g. washer/dryer). If there is any doubt, it is better practice to list the item specifically in the contract to make it part of the transaction.

If the real estate to be transferred is developed, the attorney must determine whether the improvements are a fixed part of the property, or ***personal property***, i.e. items that can be removed from the real estate. In the latter case, the contract must clarify which items are included and which are excluded. **The legal description must be carefully reviewed**. An attorney should never trust the legal description of the previous *deed*, because the smallest mistakes can make it into a document and may not be discovered over decades. Although the *title insurance* offers some protection in such cases, an attorney should never rely on insurance to replace careful drafting and review.

Purchase price and payment

The contract must clearly set forth the purchase price. If a down payment is made, it should be noted in the contract whether payment is to be made **directly to the seller** or into an *escrow account*. It should also indicate whether such a down payment is to be deposited in an interest-bearing account and who should collect the **accrued interest**. Sometimes, a second down payment is required before the closing. The same considerations apply for a second down payment as for the first.

The contract must state precisely how the balance of the purchase price is to be transferred at the time of ***closing***. The *FAR/Bar* contract provides that the amount must be paid in cash or with a cashier's check. It is advisable for the attorney to determine early how the final payment will be made, and prepare the contract accordingly. ***Official checks*** (guaranteed checks) have recently become a popular option. A buyer should verify whether his/her bank can issue such an *official check* for the closing.

Contingencies

The *FAR/Bar* contract contains detailed descriptions of the most common contingencies in Florida real estate purchase contracts. These contingencies can be included with simple checkmarks next to the specific contingency. After signing the contract, the seller has a ***due diligence* period**, in which he can carefully inspect the real estate. Some real estates are transferred '*as is*' – generally an indication of deficiencies. In such a case, it is particularly important that the buyer has the real estate immediately inspected by a professional inspector. If the inspection shows deficiencies, the contract can be cancelled within a certain period of time, usually **10 days**.

There are numerous **companies in *Florida* that specialize in inspections of real estate**. For a few hundred dollars, a buyer can have some certainty that the real estate satisfies minimum requirements. An inspection can also determine why a property is sold '*as is*'. The vast majority of real estates are sold with a simple **right of inspection**, and the right to have the seller repair the deficiencies. This right for repairs is often capped at a certain percentage, e.g. repairs to be made by the seller cannot exceed 5% of the purchase price. The inspection must be undertaken expeditiously and thoroughly. Problems that are not discovered within the inspection period usually cannot be claimed later by the buyer. Particularly, banks insist that the real estate is checked for **termite and roof damage** before making home loans.

Clear title

One of the most important requirements for a successful transaction is timely evidence by the seller that he/she has marketable title to the real estate. This should not be taken for granted. Because a property's *title can be clouded* for a variety of reasons, the purchase contract usually contains a clause that requires the buyer to make payment only if the seller can provide evidence of clear title. Although the seller in most contracts has the burden of proof for a clear title, it is the parties' decision who will pay for the costs associated with a title search. A **title insurance company** is generally retained early on to search title and issue a ***title commitment***. The *title commitment* confirms that the title insurance company will issue a title insurance policy once certain requirements have been met, e.g. a deed to the buyer has been executed and unpaid taxes and/or potential liens have been paid off. The parties then must comply with all these requirements prior to the closing date, so that a clear title is available on the closing date.

If real estate is acquired with third-party financing, the financial institutions, such as banks or savings and loan institutions, usually require a title insurance policy issued in their name. It is of utmost importance that a **separate policy is issued in the name of the buyer,** without which the buyer would have no regress should title problems arise. A separate policy for the buyer is often less expensive if issued by the same title insurance company that issued the bank's policy.

Unless the contract states otherwise, the seller has a reasonable time to provide clear title and to remove potential title problems. If title problems are found, the *FAR/Bar* contract states that the seller has 30 days after notice to remedy them. If these problems have not been removed, the buyer has the right to either buy the real estate in its existing state or

to cancel the contract. The seller is legally obligated to make a good-faith effort to remove the problems.

Prorated costs

Because the exact closing date is not known at the time the purchase and sales agreement is signed, and because certain costs accrue until the day of the closing, the contract usually contains a clause for *proration* of these costs. This cost proration is actually calculated when the closing date has been determined. The most common examples for proration are real estate taxes, home-owner's insurance (the property must always be insured), rental income, maintenance fees to the *condominium association* and prepaid maintenance costs.

Disclosure

In recent years, a clear trend has developed to require disclosure of certain information about a real estate prior to the sale. In most cases, the principle of *caveat emptor* no longer applies. In particular, in the case of condominiums, any information that could negatively affect the real estate, and is not readily apparent to the buyer, must be disclosed. It is therefore advisable that all potential problems are disclosed early.

Condominiums are particularly sensitive to this disclosure requirement. Even for resales, the law requires that extensive information must be disclosed to the buyer, including the *condominium association's* declaration, bylaws, rules and regulations, a valid copy of the *Declaration of Condominium*, and a list of frequently asked questions and answers. These documents are usually made available by building management so that a buyer and seller can inspect them at any time.

3.2 Restrictions on sale and acquisition

3.2.1 Restrictions under family law and matrimonial property regime

Generally, any restrictions on the sale of real estate in *Florida* depend on the entity in whose name the real estate is held. If the real estate is held by a person (or a corporation), only the consent of that person (or corporation) is necessary for the sale of the property. If the real estate is held in the name of several persons, the consent (signature) of all the owners listed in the title is required. This means, for example, that for the sale of a home owned by *tenants by the entirety,* the signature of both spouses is required for a legally enforceable agreement. If the real estate is held in the name of one of the spouses, the spouse's ability to transfer legal property depends on whether the property is a *homestead*, i.e., the **primary residence of the married couple**. If this is the case, the **consent of the other spouse** is required, even if that other spouse is not shown as an owner on the *deed.* If this is not the case, the owner listed on the *deed* can transfer the property without consent of the spouse. If there is any doubt, both spouses should sign the purchase/sale agreement and the *deed.*

Real estate and restrictions on its conveyance under Florida law are generally subject to the marital property regimes of the state of *Florida*. The only exception is the case where a married couple has a prenuptial agreement that provides for application of a different law, which is generally enforceable in *Florida*.

All marriages, in which at least one of the spouses has resided for at least six months in *Florida*, are subject to Florida matrimonial property law, including the worldwide properties owned by the spouses, regardless of the spouses' citizenship or place of marriage. Accordingly, in case of a divorce both partners are entitled to ***equitable distribution*** of marital property, which means that both parties will receive one half of the property created during the marriage (including real estate) and one half of the debt accrued during the marriage. Real estate owned in the name of only one spouse, but purchased during the marriage with marital funds, is also to be equitably distributed. Foreign property (i.e. property not within the *USA*) can be distributed by the court in case of a divorce, but the judge has no direct jurisdiction to enforce the distribution for such properties as provided in the final divorce judgment. In cases where a divorced party refuses to distribute foreign property as decreed by the court, the Floridian judge may compensate the spouse residing in *Florida* with a correspondingly higher share (of up to 100%) of the marital assets located in *Florida*, and may in addition award a money judgment. Such a money judgment can usually be enforced and domesticated abroad.

According to *Florida Statute* **a spouse cannot be entirely disinherited**. Each spouse has an *elective share* of the net value of the estate of a person who died as a Florida resident. This *elective share*, however, has to be elected within a certain period of time, and is considered waived if not so elected. In most cases the surviving spouse waives the *elective share*, so that the executor of the estate can freely sell the properties to be liquidated.

An additional complication arises if a property that represents a *homestead* is to be devised to non-heirs in a will. If the deceased leaves behind a spouse or minor child, the will cannot be executed as such. In such cases it is advisable to consult an attorney specializing in the field.

3.2.2 Options and pre-emption rights

Pre-emptive rights generally exist in the form of **options**, which are legally enforceable in *Florida* provided that a separate *consideration* was paid for the option. As a matter of law, no pre-emptive rights can be implied or derived from a rent or lease agreement. **There are no pre-emptive rights of the government**, e.g. for historic buildings. The government has, however, the right to take property for public purposes for payment of fair market price (*eminent domain proceedings*).

3.2.3 Agricultural real estate

Agricultural real estate is subject to special rules. Particularly where undeveloped property is purchased, the buyer must be mindful of applicable **zoning**. The *zoning* determines the development density and purpose of any given real estate. *Zoning variances* (deviations from the existing zoning) can be applied for, but are often hard to obtain. If such a *variance* is requested, neighbors usually have the right to object and decisions by the planning authorities are often more political than legal in nature. Property zoned as agricultural is usually taxed at considerably lower levels than developed property. Owners holding property for speculative purposes therefore often let some cattle graze on the property to assure lower taxation of their undeveloped property.

3.2.4 Restrictions regarding acquisition of real estate by foreigners

Foreigners generally have the same right to purchase real estate in *Florida* as do Florida residents. Foreigners have certain tax disadvantages (primarily estate tax) and limitations on liability (no *homestead-exemption* protection from creditors), but they are in no way restricted in their right to own or convey real estate in *Florida*. Mere ownership of real estate in *Florida* (as well as the entire *USA*) does not provide a basis for entitlement to a specific visa or residency status in the *USA*.

3.3 Further important preconditions for buying real estate

3.3.1 Capacity to act and entitlement of the seller

Once it has been determined who the title owner of a given real estate is, the legal capacity and entitlement of the seller to convey a specific property is almost a given. In a normal case the seller/buyer is an **adult (older than 18 years)** and has absolute ability to transfer or acquire property. **Married persons** are subject to special rules. **Children under age 18** and persons under guardianship can only act through their guardian. *Florida* law distinguishes between guardians for a person and guardians for a property. Only a guardian for property can sell real estate of a minor child. The *circuit court* with jurisdiction has to approve any sale of property owned by a minor through a guardian. **In case of death of a real estate owner,** only a *personal representative* with the consent of the probate court has the ability to sell the property. However, if real estate is owned by a married couple as *tenants by the entirety*, or by two or more persons as *joint tenants with right of survivorship,* title of the real estate is transferred to the surviving owner by operation of law upon the death of the other owner [co-owner]. If that surviving person wishes to sell the property subsequently, a notarized (and recorded) certificate of the *personal representative* is necessary, which waives all entitlements of the estate to the specific real estate. Without such a waiver by the personal representative, the personal representative can later take regress to the real estate, now in the name of a bona-fide third party, for payment of debts of the estate.

A **trust** generally acts through its *trustee*. Accordingly, if real estate is held in the name of a **trust**, the consent of the *trustee* is absolutely required for a sale of the property. Additionally, the trust instrument should be reviewed to determine whether the *trustee* truly has the legal ability to sell the property and that he/she is not subject to legal limitations. The basis for the legal capacity of the trustee to act (i.e. trust instrument) must be recorded together with the deed in the property records to give a buyer good title in a purchase of real estate from a trust.

Corporations/partnerships

A Florida corporation has capacity to sell real estate if there is no provision to the contrary contained in the articles or bylaws of the corporation. The same is true for Florida partnerships, where the partnership agreement is the determining document. This is not automatically the case with foreign corporations and partnerships, and the applicable law in the jurisdiction of the foreign corporation/partnership must be consulted (see also section 3.8 below)

3.3.2 Third-party claims and unpaid taxes

Competing claims or liens of third parties can generally be avoided by purchase of a **title insurance policy** by and for the buyer. The title insurance company, in the process of issuing the title insurance, generally reviews the public property records, from the present time back to the Florida land grant, and guarantees, with virtually absolute liability that no claims or liens of third parties exist. If this review turns up existing liens, e.g., for unpaid taxes, the necessary amount for payoff of the taxes is withheld from the purchase sum at closing and forwarded by the closing agent directly to the taxing authorities. Only with this proof of payment will the title insurance company issue its title policy. It should be noted that all title policies contain certain exceptions and qualifications that have to be observed. Certain obvious prescriptive rights of third parties and non-payment of certain taxes at time of closing are usually not insured. **Unpaid real estate taxes** generally lead to the issuance of a **tax certificate**. A tax certificate is offered for sale to the general public. In essence, the tax certificate provides that a member of the public has stepped in and paid the tax for a certain parcel of real estate. The seller has to pay off all tax certificates including accrued interest if he/she wants to regain and sell good title to the property. If a *tax certificate* has not been paid off by the owner within three years, the person who purchased the *tax certificate* can force the sale of the real estate for repayment of the tax debt.

3.3.3 Provisions for protecting the environment, nature and the cultural heritage

Environmental considerations in *Florida* have become a very important aspect in every real estate transaction. It helps to remember that environmental problems in *Florida* have to be remedied also by the owner of the property and not only by the party causing the problems. It is therefore particularly important for commercial properties that the property is inspected for environmental problems prior to the purchase. This is normally accomplished through a *Phase I Environmental Assessment ('EA')*, which costs approximately US$ 3,000. If no problems are discovered, no further testing is necessary. If however, contamination is found (e.g., oil or gas leaks from an old tank), a *Phase II EA* or even a *Phase III EA* needs to be undertaken, which are considerably more expensive. **Environmental testing prior to purchase** is the only true insurance against unpleasant surprises. Real estate in environmentally sensitive areas and waterfront properties is subject to additional strictures.

Historic preservation in *Florida* is far less advanced than in other countries. However, certain areas (e.g. *Miami Beach*) designated as historic have far more extensive historic preservation regulations. In those areas, properties barely older than 60 years are also subject to historic preservation regulations, so that even the slightest modifications require the approval of the local preservation board, which is sometimes withheld for the most obtuse of reasons.

3.3.4 Access to relevant records and documents

The single most important source of information for the purchase of real estate is the **public property registry**, which is maintained in the county where the real estate is located. The recorded property information generally consists of photographic scans of the relevant documents, such as deeds or lien documents, together with a computer record as to where those photographic records can be found. Anyone can view and copy the records, but

copies are relatively expensive. The property records are normally reviewed by the title insurance agent (often the attorney closing the real estate deal) because lay people invariably miss important entries in the records. Only notarized or court-certified documents can be recorded in the property records.

3.4 Key points that a seller should consider

The seller's prime objective in real estate transactions is to ensure that all legal impediments (hidden or obvious defects) to a sale are disclosed prior to the sale. Moreover, the seller has the obligation to present good and unencumbered title for closing. Ultimately, the main objective of the seller in a real estate transaction is to ensure that he/she receives the purchase price. Accordingly, the seller or his/her attorney has to ensure that at closing, payment of the purchase price is made in cash or cash equivalent. A seller should pay particular attention that the sale and purchase agreement does not contain any guarantees for which compliance cannot be met. The simplest form of a contract is an '*as is*' contract, in which the seller makes no promises concerning the condition of the real estate. However, an 'as is' sale may affect the value and therefore the purchase price of the real estate negatively. Most contracts have standard representations by the seller and give the buyer 30 days to inspect the real estate.

3.5 The execution of a real estate purchase transaction

The sale and purchase of residential real estate in *Florida* typically involves four separate steps (commercial properties are generally more complicated).

1. The seller enters an **agreement with a real estate broker** for the marketing of the property. The real estate broker enters the real estate in a so-called *multiple listing service*, a computer system that contains the overwhelming majority of available properties. As soon as the real estate has been entered into the *multiple listing service*, every broker in *Florida* has access to information concerning the real estate, and the assumption is that the broadest possible spectrum of potential buyers will thus see this real estate. The *multiple listing service* can be searched by specific criteria, such as number of bedrooms, price range, and location.
2. An interested buyer finds a property for sale either through a private search or through a real estate broker and submits an offer of purchase. This offer of purchase is normally made through a unilaterally signed standard purchase and sale agreement and a modest **down payment** (*earnest money*). The unilaterally signed contract is then presented to the seller, who can either accept the offer by countersigning or modifying the offer in a number of ways. If the seller accepts the offer and countersigns, the contract becomes legally enforceable. If only the slightest changes are made to the offer, the document becomes a counteroffer, which in turn has to be accepted or changed by the buyer who originally submitted it. The contract only becomes legally enforceable when complete agreement has been reached between the parties.
3. In many cases, the buyer requires **financing** for the purchase of the real estate. Loans are generally available through commercial banks or saving and loans institutions and in rare cases through an agreement for payment over time with the seller. Banks normally require an appraisal of the real estate, an exact survey, a roof and termite inspection, a

qualification of the credit worthiness of the borrower, as well as income verification for the borrower. It is generally the bank who determines who will be the *title agent* for a transaction, i.e. the agent who supervises and conducts the formalities of the property transfer. In simple transactions, the buyer and seller often agree to transact the entire transfer through a *title agency*, but it is generally advisable for each party to hire their own attorney. The *title agency* does not represent the interest of the buyer, but those of the bank.

4. The transaction is closed through the **delivery of the executed deed and entry of the deed in the public records of the county where the real estate is located.** At the same time, any unpaid portions of the purchase price are paid to the seller or distributed by the title agency to any third parties who must be satisfied to ensure clear title. Prior to the *closing*, the title insurance company presents to both parties a *title commitment*, which indicates exactly which steps have to be undertaken and which documents have to be provided to enable the title insurance company to issue its policy. **This title commitment in some way becomes the blueprint for the entire transaction.** After the *closing*, the title insurance company issues its title insurance policy if all these conditions have been complied with. The buyer is protected by this title insurance policy, if problems with the title to the real estate should arise after the purchase. If any unforeseen claims are made by third parties, the title insurance company is usually required to pay them off. Although purchase of a title insurance policy is not legally required for a transaction in *Florida*, it is absolutely recommended. Banks without exception require title insurance policies in their name as a condition to financing real estate purchases.

3.6 Powers of attorney

The validity of a power of attorney is generally judged by reference to Florida law, but it is advisable that the law of the jurisdiction in which the power of attorney is issued is also respected. A power of attorney that is valid under Florida law generally has to be signed by the party issuing the power of attorney, and must be notarized by a *notary public*. Because a Florida notary public can only notarize documents within the political borders of the state of *Florida*, powers of attorney to be executed abroad generally require signature before a consular representative of the *United States*. All powers of attorney must be in writing and the legal qualification of the issuing person has to be demonstrated. The power of attorney has to expressly authorize the actions to be taken by the beneficiary of the power. According to Florida law, a person can also issue a *durable power of attorney*, which gives another person, e.g. an attorney, the power of representation until further notice.

3.7 Financing

Financing for a real estate purchase in the *United States* is usually obtained directly from a **bank** or **savings and loan institution**, or indirectly from a **mortgage broker**. A *mortgage broker* collects the necessary information and documentation from the client (the party seeking financing), and searches for the most favorable interest rates and loan terms for the client. A *mortgage broker* is usually compensated for his/her services with a percentage (e.g., 0.25%) of the amount financed. Because mortgage brokers can often find a 0.5% to 0.75% more favorable interest rate for their clients, it is worthwhile for a prospective borrower to work with a mortgage broker.

The mortgage payment in the *USA* generally is applied in part to principal and in part to accrued interest. In most cases, the mortgage is repaid over 15 or 30 years, so that the real estate is owned free and clear after payoff. At the end of 2004, the fixed interest rate for a 15-year mortgage was approximately 5% and that of a 30-year mortgage approximately 5.5%. However, borrowers can negotiate even more favorable interest rates if they are willing to pay *points* at closing (i.e. 1 *point* equals 1% of the loan amount) or if they are willing to accept a variable interest rate.

Purchase agreements often contain a clause according to which the buyer is required to close the transaction only if suitable financing is available. The parameters for such financing are often spelled out in the purchase and sale agreement, for example 'a 6% fixed-rate mortgage for 30 years'. The purchase and sale agreement also determines how soon the buyer has to apply for financing, by when he/she has to have obtained a loan commitment, and how he/she has to inform the seller if he/she is unable to obtain the necessary finance. The buyer has to make a good-faith attempt to secure financing, and runs the risk of losing his/her down payment on failure to do so.

Foreign buyers are generally expected to provide a **down payment** of 20–40% of the purchase price from their own funds. Interest rates for foreign buyers are usually slightly higher than for Florida residents, given the higher risk of default. Non-residents also have to expect to present voluminous information and documentation to support credit worthiness, such as an *appraisal* of the property to be financed, a US credit report, bank references, credit references, corporate documents, reference letters from tax advisers, copies of the passport with the necessary visa, etc. If ownership of the prospective real estate is not to be held in the name of an individual, but of a foreign corporation, that must be disclosed at the initial meeting with the lender because many banks are not willing to lend to a foreign corporation, and most require a personal guarantee from a private person with sufficient credit worthiness.

At the time of the loan application, the lender must provide to the borrower a *good-faith estimate* of the costs and expenses expected to be incurred in connection with the loan.

The most important documents required for third-party financing are the **mortgage** and the **promissory note**. The promissory note is proof of the existing debt the borrower is required to repay to the lender. The mortgage gives the lender regress to the real estate if payment under the promissory note is not made as required.

The **promissory note** contains the promise of the borrower to repay a sum certain at a certain time at a certain interest rate. Promissory notes are usually negotiable papers. In contrast to payment notes in other countries, promissory notes in the *United States* can contain a variety of repayment provisions and can require repayment over long periods of time in a single document (a 15- to 30-year term is common). Almost every promissory note provides that if payment is not made as required, the lender can immediately demand payment of the entire loan amount and can, according to the mortgage, take regress to the real estate.

The mortgage document is a contract between the borrower and the lender to secure the payment obligations in the promissory note. The mortgage forms the basis of a lien on the real estate. The mortgage must be signed by the borrower/debtor and must be recorded in the public records of the county in which the real estate is located.

3.8 Purchase through a company

The purchase of real estate in the *United States* through a company offers certain advantages and is advisable in many cases. The main reasons for the purchase of real estate through a company are **limitations of liability** and certain **tax advantages**. Particularly in cases where the buyer intends to rent out the real estate or use it commercially; there is always a considerable risk that third parties could be injured on the real estate. Because **owner liability in *Florida* is relatively strict** for injuries occurring on the real estate, ownership through a corporation offers some protection. Because shareholders of a corporation in *Florida*, with very few exceptions, are protected against debt or liabilities of the corporation, liability claims as a result of injuries on a property can only be made against the owner of the property, i.e. the corporation. In most cases, the only asset of the corporation is the real property itself. Therefore, liability for injuries on the real estate is limited to the net value of the real estate itself. With private ownership, a person injured on the real estate could take regress against all assets of the real estate owner.

Real estate ownership through a corporation can also offer certain tax advantages to non-Florida taxpayers. In those cases, it is advisable to own the Florida real estate through a foreign corporation. In contrast to direct real estate ownership, the shares of a non-US resident in a foreign corporation are not part of the US taxable estate in case of the death of the foreign shareholder. Therefore, if a non-US resident owns the shares of a foreign corporation, which in turn owns the Florida real estate, the death of the foreign shareholder will not bring the real estate into the taxable US estate. Structures with foreign corporations have to be planned carefully, because even the slightest variations can have drastic tax consequences.

3.9 Defects and warranty claims

Warranty claims in *Florida* must be distinguished between claims related to title and **claims related to physical real estate**. Claims related to title in *Florida* by and large are covered by the title insurance. Claims against inadequacies of the real estate itself generally depend in *Florida* on the purchase and sale agreement or the general contractor agreement. The law does provide additional remedies in case of intentional misrepresentations by the seller.

The constitution of the state of *Florida* provides that the homestead of a Florida resident (US citizen or permanent resident) cannot be taken to satisfy judgments of claims by creditors. Over time, *Florida* has come to be known as **'debtor's paradise'** because even investments of millions of dollars by a Florida resident in the primary residence cannot be taken to satisfy claims. The sole exception to this rule are claims against the real estate itself, e.g. through mortgages where the real property has been pledged as a security. This **protection of the primary residency (homestead exemption)** will not prevent a lender from executing against a real estate pledged as a security. Because mortgages are generally secured through the real estate itself, the bank can take regress against the real estate even if it is the primary residence of the debtor. A filing for bankruptcy by the debtor will stop any and all execution efforts by third parties (*automatic stay*), but the existence of the mortgage creates the basis for the creditor to obtain relief from the automatic stay to proceed against the real estate even during the pendency of the bankruptcy.

4 New construction, rebuilding and renovation

4.1 Zoning law and construction permits

Construction permits from county authorities are required for all new construction and renovation work. Generally, construction permits will only be issued if the intended construction complies with existing *zoning* and comprehensive plan regulations. In cases where the intended construction is not in compliance with existing zoning and comprehensive planning, a *zoning variance* must be obtained, which is often difficult. Particularly if undeveloped land is purchased, the underlying zoning, which determines the applicable development density, must be carefully determined. To obtain a permit for any construction or renovation, the construction plans must be signed by a licensed architect (and/or licensed professionals relevant to the intended construction/renovation) and must be submitted together with the application for the construction permit. All deviations from approved construction plans during the process of construction are again subject to approval by the *Building and Permitting Department*.

4.2 Architect's and building contracts

In many new construction cases, the owner enters an agreement with a *general contractor* (and sometimes separately with an architect) for the construction of the intended building. In contrast, a builder or developer usually offers all-inclusive pricing for a model home that can be viewed prior to construction. When an owner does not want to buy an existing model from a developer, separate contracts have to be entered into with various specialists, which all have to be carefully coordinated. Because these agreements differ for each construction phase, and because such construction requires daily supervision, inexperienced owners should think twice before attempting to supervise their own construction. An owner in any case should only work with *licensed and insured general contractors and architects* and in no circumstances with unlicensed professionals, who need to have plans signed by another licensed contractor/architect. An architect's or general contractor's contract defines the terms of planning, construction supervision, technical control and execution of construction, as well as the deadlines and costs. Contracts with unlicensed persons/companies for work requiring a licensed professional are generally not enforceable.

4.3 Completion of construction and formalities

Timely completion of construction as provided in any agreement is the exception rather than the rule in *Florida*. Courts rarely penalize *developers* and *general contractors* for delays, even in extreme cases. **Construction quality** often leaves much to be desired and only meticulous supervision during the construction ensures decent construction quality. After completion of construction, the general contractor has to obtain from the *Building and Zoning Department* a *certificate of occupancy* or *CO*. Final payment obligations in construction contracts are often tied to the builder obtaining the *CO*, but the certificate itself does not indicate that the work has been completed perfectly. A *CO* is often issued even if there are still substantial cosmetic deficiencies in new construction.

4.4 Deficiencies and warranty claims regarding new construction

After completion of construction, and prior to acceptance, the buyer and the general contractor usually conduct a **walk-through**, where all construction deficiencies are entered in a *punch list*. Because it is often difficult for lay people to discover deficiencies, it is advisable to conduct the walk-through with a licensed construction inspector to be paid by the buyer. The builder must remedy all items on the *punch list* within a 'reasonable period of time'. Regrettably, there are often disagreements as to what constitutes 'reasonable period of time' and courts offer little assistance. It is advisable to consult with an attorney early on if it appears that the builder is not conscientious in remedying punch list items. The warranty period for a given construction object is set forth in the agreement, and there are no legal or customary warranties.

5 Rentals and tenancy

The residential lease statutes in *Florida* differ from commercial lease statutes. In general, Florida **Landlord and Tenant law gives the owner (lessor/landlord) far greater rights than the renter (lessee/tenant)**. There is always the assumption that if rent is not timely paid, or if the lease expires, the lessor/landlord has the almost absolute right to have the lessee/tenant removed from the property. Even decade-long tenancies do not entitle lessees to any special legal right to extend an expired lease.

5.1 Rental and lease agreements

The legal rights of residential tenants are somewhat broader than those for commercial tenants. They are set forth in Florida's *Residential Landlord and Tenant Act*. Condominium units are not covered by this law, and are subject to additional legal rules and protections. Lease agreements generally must be in writing, but a *tenancy-at-will* may be created through an oral agreement. The duration of a tenancy-at-will depends on the lease payment interval; for monthly leases, tenancies-at-will have a 30-day termination notice requirement. For shorter lease-payment periods, shorter termination notices apply. Contrary to the customary rule in the *USA*, a prevailing party in residential lease litigation is entitled to attorney's fees from the losing party. In *Florida*, it is customary to make **three monthly rent payments** at the commencement of a lease: first month's rent, last month's rent and one month security deposit. At the time of lease termination, the landlord must return the security deposit to the tenant within 15 days after the lease expires, or give notice within 30 days why the landlord is retaining a portion or the entire security amount. The tenant's obligations include the requirement to keep the property clean and to maintain the facility. The tenant must not disturb the quiet enjoyment of his/her neighbors or recklessly or intentionally destroy any part of the property. The landlord, on the other hand, is legally required to maintain the structural portions of the property, ensure that the property complies with all applicable laws and regulations, and pay for maintenance of locks, pest control, garbage disposal, water, sewer and, if necessary, heating. However, the landlord can shift the cost for those services to the tenant in a lease agreement.

5.2 Regulations on protection of tenants and rent control

Generally, *Florida* recognizes only **very limited tenant protection regulations**, mainly certain minimum termination notices. For those unfamiliar with US law, it should be stressed that a tenant does not acquire any rights as a result of long-term lease relations with the landlord. If the lease expires, or is legally terminated, the tenant must vacate the property immediately.

6 Succession and gifts

6.1 Applicable law and jurisdiction

The legal succession regime depends on the conflict rule of law of the applicable countries. Customarily, the legal succession laws of the country in which the decedent resided at the time of death or the law of his/her country of citizenship apply. This rule also applies to foreign real estate of the decedent and to shares of a foreign corporation owned by a decedent with last place of residency in *Florida*.

6.2 Fundamentals of the succession and gift/donation laws of Florida/USA

The following comment only applies to real estate owned by a natural person, and not to real estate owned by a corporation. Separate legal requirements apply to the latter.

Wills

Florida has extremely **strict rules for the validity of wills**. Wills in *Florida* must be **in writing**, but not necessarily machine-typed. In addition to the testator, at least **two witnesses** have to sign the will, and have to confirm that the testator and the witnesses signed the will in each other's presence. Florida law does provide for recognition of foreign wills, but only if those foreign wills were executed in accordance with the foregoing formalities. In particular, *holographic wills*, signed only by the testator without witnesses, are invalid in *Florida*.

Without a valid will, *Florida* law provides for application of the legal succession rules, which can lead to entirely different results than those intended by the testator. For testators with a will valid in another jurisdiction but invalid in *Florida*, the solution is a separate **Florida will** in which the testator makes specific decisions for the devise of property located in *Florida* and executed with the necessary legal formalities.

Legal succession

If an owner of real estate dies without a valid will, and his/her estate falls under *Florida* law, the real estate is divided according to the legal succession laws of *Florida*. If a decedent was married at the time of death, the following rules apply:

If **no surviving children** are alive, 100% to the surviving spouse. If biological children of both spouses survive, the first US$ 60,000 plus one half of the remainder goes to the surviving spouse. If biological children of the decedent are alive which are not biological

children of the surviving spouse, one-half of the estate goes to the surviving spouse, the rest to the biological children of the decedent.

If the **decedent was not married** at the time of death: 100% to the biological children. If no biological children survive, 100% to the father and the mother of the decedent. In cases where there are neither biological children nor parents, the estate goes in equal parts to the siblings of the decedent or their successors. In cases where there are neither biological children, parents nor siblings/successors of siblings, the estate goes in equal part to the parental or maternal grandparents or their successors. In cases where neither of the foregoing is alive, the estate goes to the relative of the last predeceased spouse, as if that spouse had survived the decedent. Within those categories, the succession is generally *per stirpes*, i.e. the distribution to children generally is in equal parts. If a child predeceases, that child's share goes to the successors of that child in equal parts. If the predeceased child has no successors, that child's portion goes to the surviving siblings.

Gifts/donations

The record owner of a property can freely give away or donate his/her property rights at any time. Obviously, the owner can only give the specific rights he/she owns, e.g. a life estate or similarly limited property rights. Moreover, gifts have similar tax consequences as inheritances (see below).

7 Taxes and charges

Because *Florida* does not impose state income taxes on individual taxpayers, Florida's state income consists primarily of sales taxes and real estate taxes.

7.1 One-time taxes and charges on purchase

7.1.1 Real estate transfer taxes

Deeds and other documents used to transfer real estate in *Florida* are subject to Florida's *documentary stamp tax*. This tax is currently set at US$ 6 to US$ 7 for each US$ 1,000 of the purchase price of the property, i.e. documentary stamp taxes for a US$ 200,000 property is US$ 1,400. If buyer and seller do not agree otherwise, this tax is to be paid by the buyer. The tax is normally paid at the time of recordation in the property records by submitting a separate form and a corresponding check. Because the amount of *documentary stamp tax* is listed on the document in the public records, and because the tax rate is generally known, the purchase price for a given property can be calculated from the recorded documents.

7.1.2 Sales tax

Florida has a *sales tax*, which is one of the most important and imposing taxes in *Florida*. With some exceptions sales tax is applied to all products or services rendered to end-users in *Florida*. The tax is usually not relevant in real estate transactions, but if a foreign purchaser of real estate intends to ultimately live on the Florida property, he/she should expect this tax to be applied to almost every purchase. As of January 1, 2004, the *sales tax* for *Miami-Dade*

County (*Florida*) is 7%, and for *Broward* County (*Fort Lauderdale*) 6%. Expensive products are taxed only for the first US$ 5,000.

7.1.3 Real estate registration and notary charges

All documents to be recorded in the public records are subject to recording fees. Currently, the *recording fees* in *Miami-Dade* County are US$ 6 for the first page and US$ 4.50 for each additional page. Other counties have comparable fees. A notary public in *Florida* has one main function, to notarize signatures. This service is often entirely or nearly free of charge.

7.2 Recurring annual taxes and charges

7.2.1 Real estate tax

Annual real estate taxes are, next to sales taxes, the most important source of revenue for the state of *Florida* from private individuals. Real estate taxes vary from municipality to municipality. For example, in *Miami-Dade* County alone, taxpayers are subject to dozens of varying tax rates, depending on the location of the particular property. If an owner has owned and lived in the same property for a long time, he/she may pay as little as US$ 800 in annual real estate taxes, whereas the new neighbor may pay as much as US$ 3,000 for a comparable property. This occurs because the law limits yearly increases of real estate taxes, whereas the entire increase in market value is assessed at the time of sale to a new owner. To **calculate real estate taxes**, the **market value** of the real estate is estimated and multiplied by a particular 'millage rate'. There are a number of **exceptions** to this rule. First, the property is almost always appraised at 10–20% below actual market value, in particular at times of rapid increases in real estate values. Secondly, the first US$ 25,000 of the value of the primary residence of a citizen or Floridian resident is not taxable according to the Florida *homestead exemption* laws (not to be confused with the *homestead exemption* laws previously discussed in connection with owner liability and legal capacity). Third, the annual adjustments to market value are limited, so that real estate that has been owned by the same owner for a long time is often taxed at a low rate. Conversely, real estate purchased recently or expanded in size by the owner is often drastically reappraised, which can lead to a doubling or tripling of real estate taxes overnight. **A buyer of real estate can therefore not rely on representations of the previous owner as to the tax amount paid in the past.** The exact calculation of real estate taxes for a particular property is rather complicated and often difficult to understand (even for experts). Owners may challenge overly aggressive reappraisals of real estate, and the assistance of an attorney is often advisable. The county government issues real estate tax statements around September for the current year, and payment before the end of November entitles the owner to a rebate.

7.2.2 Income tax

Income tax for individual US residents is assessed uniformly at the federal level, and depending on the state, additionally on a state level. *Florida* taxes the income of certain corporations, but not of individual taxpayers. All US citizens and permanent residents must pay income tax on their worldwide income. For all other persons residing in the *USA* the following rule applies: If the actual presence in the *USA* exceeds certain time limits, those

persons may also be subject to US income tax with their worldwide income (see below, *tax residence*). For foreign residents residing in the *USA* for less than the legal time limit, only *income actually earned* in the *USA*, e.g. from rentals of real estate in *Florida*, is subject to US income taxation.

7.2.3 Net wealth tax

The net wealth or estate of a living US taxpayer is not separately taxed in *Florida*.

7.3 Capital gains tax

Capital gains taxes in the *USA* are a political hot-button topic. Capital gains are **generally taxed similarly to simple income**. The tax is to be paid by the seller of taxable assets at the time of the sale of the taxable asset directly to the tax authorities. The capital gain is the difference between the original purchase price of the taxable asset and the sales price, minus expenses necessary for the maintenance of the real estate during ownership, as well as additional investments in the real estate during the time of ownership (e.g. additions improving the value of the real estate, legal expenses, documented repairs and certain costs in connection with the original acquisition). US taxpayers enjoy a substantial life-time exemption from capital gains taxes, which applies to foreigners only to a limited extent.

Real estate transactions in the *USA* are subject to the *Foreign Investment in Real Property Tax Act* of 1980 (*FIRPTA*), and the **direct taxation** related thereto. *FIRPTA* presumes that every seller of real estate is a foreign person, subject to direct taxation on any capital gains. Therefore, a US taxpayer has the legal obligation to prove at the time of sale of the real estate that he is not a foreign taxpayer. Every seller has to report his *FIRPTA* status to the tax authorities on Form 8288 and Form 8288-A, and, if appropriate, pay the withheld *FIRPTA* tax to the tax authorities within 10 days. Because non-payment of the *FIRPTA* tax can lead to a lien on the real estate, the buyer has to insist that all *FIRPTA* taxes are either paid immediately to the tax authorities at the time of closing or that written proof of tax-free status is provided, usually in the form of a 'non-foreign affidavit'.

FIRPTA provides that 10% of the sales price of the real estate has to be withheld as a direct tax, unless one of several exceptions applies: (1) if a buyer is purchasing the real estate for his/her own use and the purchase price does not exceed US$ 300,000; (2) if the seller has obtained a tax exemption certificate from the tax authorities according to which he/she is not subject to the tax or subject to a reduced tax; and (3) if the seller provides an affidavit at the time of closing to prove that he/she is not a foreign taxpayer.

Short-term capital gains are taxed at the seller's regular income tax rate. The applicable tax rate depends on the individual's *tax bracket* and the type of capital gains and is generally between 10% and a maximum of 28%. For real estate purchased after December 31, 2000 and held for at least five years, the highest tax rate will be 18%.

7.4 Inheritance and gift taxes

In civil law countries, the entire estate of the testator passes to his/her heirs at the time of death (principle of universality). Therefore, the heirs are the debtors and are responsible for the payment of inheritance taxes. In contrast, Florida law (and US law in general)

provides for the creation of a separate tax entity at time of death, the decedent's estate. Inheritance taxes are assessed to the entire value of the *estate*, and paid by the estate to the tax authorities. Disbursements by the estate after payment of estate taxes to the various heirs is no longer subject to additional taxation. The estate tax rates are as follows:

Over US$ 500,000: US$ 155,800 plus 37% for each additional dollar

Over US$ 750,000: US$ 248,300 plus 39% for each additional dollar

Over US$ 1,000,000: US$ 345,800 plus 41% for each additional dollar

Over US$ 1,250,000: US$ 448,300 plus 43% for each additional dollar

Over US$ 1,500,000: US$ 555,800 plus 45% for each additional dollar

Over US$ 2,000,000: US$ 780,800 plus 48% for each additional dollar

The extent to which a foreign citizen is subject to US estate tax depends on whether the person is considered a limited or unlimited US taxpayer. A foreigner is considered an unlimited taxpayer, meaning that his/her worldwide estate is subject to US estate tax, if the testator is domiciled in the *USA* for estate tax purpose at his time of death. A foreign natural person is considered domiciled in the *USA* if he/she has his/her residence or presence in the *USA* with the intent to live permanently in the *USA*. The right of taxation belongs to the state in which the decedent had his/her center of life. A US resident foreign citizen, therefore, is subject to the unlimited US estate tax.

In contrast, a person not domiciled in the *USA* is **taxed only to a limited extent**. This generally means that estate taxes are applied only to that portion of the estate that is actually located in the *USA*, e.g. real estate in *Florida*. Because non-domiciled taxpayers have only **very limited tax exemptions**, most of the value of a Florida property falls under this tax.

Because non-US residents are subject to different estate tax rules than US taxpayers, proper planning of real estate acquisition can lead to substantial tax advantages. For countries without a double taxation agreement with the *USA*, foreign testators who own US real estate in their individual names are subject to the full US estate tax. Unlimited spousal exemption is available for the surviving spouses only in cases where that spouse is a US citizen.

In stark contrast, shares in a foreign corporation owned by a non-US resident at the time of his/her death are not subject to US estate taxation. Accordingly, if *Florida* real estate is owned by a foreign corporation, which in turn is owned by a non-US taxpayer, US estate tax does not consider a transfer of the shares of that foreign corporation to the heirs to the decedent as a taxable transaction. However, the transaction may be subject to taxation in the decedent's country of citizenship.

Because the estate tax in the *USA* can be as much as 50% of the value of the estate, it is usually advisable for a non-US taxpayer to own Florida real estate valued at more than US$ 300,000 through a foreign corporation. Real estate brokers should advise such clients to contact an attorney prior to signing a purchase and sale agreement for real estate. If this is not feasible for any reason, the purchase agreement should at least contain the words 'and/or assigns' after the name of the purchaser, i.e. the contract can later be assigned to a third party, such as a foreign corporation.

In cases where a foreign investor has already purchased the Florida real estate in his/her own name or together with a spouse or family member, a **correction** of this problem is usually **difficult and expensive**. When the foreign corporation is formed after the purchase of the real estate, and the real estate is to be shifted into ownership of that foreign corporation, the transfer to the foreign corporation creates *FIRPTA*-obligations which can be rather substantial. Additionally, transfer taxes, documentary stamp taxes, title insurance fees and accounting costs are to be added, leading to a substantial expense.

7.5 Other taxes and charges

There are no other substantial taxes or fees relevant to real estate in *Florida*.

7.6 Incorrect (lower) statement of sales price on the sales agreement

An incorrect statement of the sales price for real estate for the purpose of evading taxes is **illegal** in *Florida* and extremely unusual. For every purchase of real estate a *HUD (Housing and Urban Development) statement* has to be signed by the parties, which documents all money flows at the time of closing. Stating a lower than actual purchase price is tantamount to tax fraud, and exposes the involved parties to substantial penalties, including jail.

7.7 International taxation

Many countries have double taxation agreements with the *USA*. As a result, US taxpayers are entitled to a credit for income and estate taxes they have already paid in their country of citizenship, and in turn foreign taxpayers are entitled to a credit in their country of citizenship for taxes they have already paid in the *USA*. In the case of Florida real estate ownership by a resident from a country with a double taxation agreement, this means that the Florida home-owner who is not a US tax resident can claim a tax credit in his/her home country for US income taxes paid. If, for example, the foreign owner of a home in *Florida* earns income in *Florida* from the rental of the Florida home to third persons, that income is taxable income in the *United States* and possibly also in the foreign country of citizenship of the owner. If both the country of citizenship of the home-owner and the *United States* are signatories to a double taxation agreement, taxes on the income earned in the *United States* from the rental of the home must be paid only once, either in the home country or in the *United States*, as provided in the double taxation agreement. Similarly, estate taxes paid after the death of a foreign owner of Florida real estate must not be paid again in the home country of the deceased real estate owner if the two countries have a double taxation agreement. Of course, such estate taxes for real estate owned in the *United States* by a non-US taxpayer can be entirely avoided in many cases with proper tax planning.

8 Immigration law and tax residence

8.1 Entry, residence and settlement of foreigners

Every foreigner who intends to work or be commercially active in the *USA*, including foreigners intending to purchase US real estate for investment purposes, must observe US

immigration laws. US immigration law contains detailed requirements for the immigration of non-US citizens. Until recently, US immigration was administered by the US *Immigration and Naturalization Service* (*INS*). The functions of the INS have been integrated into the newly created Bureau of US Citizenship and Immigration Services. Outside the *USA*, immigration applications are handled by US consulates and embassies.

It is important to note that **real estate ownership in the *USA* does not automatically confer the right of residence** in the *USA*. However, US immigration laws allow foreign investors to structure their immigration status in such a way that they obtain the right of staying in the *USA* for their intended purpose through a number of non-immigrant visas, and in some cases ultimately obtain the unlimited residency right (*green card*). Every non-US citizen is considered a 'foreigner'. Non-immigrants are foreigners who intend to stay in the *USA* for a limited, determined period of time. Immigrants are foreigners who wish to remain permanently for unlimited duration in the *USA*.

The following visa classifications may be available for foreign investors. Non-immigrant visas are usually issued by the US consulate in the home country of the foreigner. In certain cases it is possible to change the non-immigrant status of a foreigner after entry into the *USA*.

B-1 Visa

The B-1 visa is a **business visa** for foreigners who remain in the *USA* temporarily and who have a permanent residency abroad. The holder of a B-1 visa may engage in business activities, e.g. prepare contracts, search for real estate, review commercial investments, etc. The B-1 foreigner may not work in the *USA* for salary. Until April 2002, the B-1 visa was issued automatically for six months. Since then, travelers have to explain why they want to stay for up to six months. If a period of less than six months is justified, less than six months of a stay is approved. Real estate ownership in the *USA* may in certain circumstances be sufficient reason to justify a six-month stay.

H-1B visa

The H-1B visa allows US corporations and other organizations to temporarily hire foreign persons who, based on their education, qualify for certain positions requiring the hiring of foreigners. There are two categories of persons fulfilling the requirements for an H-1B visa: (1) **holders of university degrees and professionals** and (2) **persons who have attained exceptional reputation or skills in their field of expertise**. Foreigners wishing to invest in US real estate can possibly qualify for an H-1B visa if the intended investment is structured as a corporation, and offers the foreigner a professional position (e.g. investment adviser) and if the necessary requirements and/or professional experience is adequate and fulfilled. H-1B visas are usually issued for three years, but extensions of up to six years in total are possible.

L-1 visa

The L-1 visa is intended to enable foreign companies to transfer employees to the *USA*. The foreign employee has to have been employed by the applying company for at least one year

prior to application, and must have held a position of management or responsibility, or must have special skills or abilities. The holder of an L-1 visa first receives authorization to stay in the *USA* for one year for a new corporation or up to three years for an older existing corporation. The holder of an L-1 visa can apply for an extension and is also permitted to bring his spouse and his unmarried minor children to the *USA*.

E-Visa

The E-visa category authorizes foreign business owners, managers and employees to stay in the *USA* for an extended period of time to set up and manage a trading company. The requirement is that the majority of the corporation's trade must be between the *USA* and the foreigner's home country. This visa can also be obtained by foreigners from countries participating in the E-visa program, who make a substantial investment in the *USA*. The duration of the work authorization of an E-visa is between 1 and 5 years, and an **unlimited extension** can be obtained if the foreigner provides adequate proof that he/she will leave the country after expiration of the current stay.

Permanent residence and immigration visas

In addition to regular visas, some 10,000 permanent residency visas are annually available to investors fulfilling the following requirements: (1) the new business must have been formed by the foreign investor; (2) the foreigner must have irrevocably invested at least **US$ 1 million** (or at least US$ 500,000 in a special economic development area) in the new business after November 29, 1990; and (3) the new business must benefit the US economy and must create at least **10 full-time jobs** for US employees (the jobs of the visa applicant, his/her spouse and children are not counted for this purpose). The foreigner must hold a managing position within the new company. Visas in this category are issued **initially for a period of two years**. After two years, the immigration officials determine whether the foreigner has indeed created a commercially successful business, which conforms to the requirements of this visa category before issuing an unlimited and permanent residency permit (green card).

Each year the *USA* conducts a so-called **visa or green card lottery**, in which permanent residency authorizations are awarded to the winners. The odds of winning in the 2003 lottery were 1 : 142.

8.2 Tax residence

A non-US resident who resides in the *USA* for more than 183 days in any given calendar year, becomes a tax resident in the *USA* unless the taxpayer proves that he/she has a closer personal and economic connection to another country. To be exempted from US taxpayer status in these circumstances, the taxpayer must make a timely application to the tax authorities. The economic ties of such an applicant are presumed to exist where the individual is conducting his/her primary commercial businesses, or where the individual has his/her primary residence. Similar factors are considered on the personal side. The application has to be submitted no later than the due date for the personal income tax return, e.g. for the tax year 2003, no later than April 15, 2004.

Even persons residing for fewer than 183 days in a calendar year in the *USA* can become US tax residents. Tax law provides that residency days of the preceding year (one-third of the days counted) and the pre-preceding year (one-sixth of the days counted) are also taken into consideration in calculating the residency days for a year. If the total sum of those days is 183 days or more, there is the presumption that the foreigner is a US tax resident. As a result of this formula, a foreigner who resides in the *USA* for **less than 120 days in any given calendar year** will not fall under this presumption.

As indicated above, once an individual is a US resident for tax purposes, the entire worldwide income of that person is taxed on a federal level. Income tax for private individuals in the *USA* is taxed uniformly on a federal level, and, depending on the state, also on a state level. *Florida* has no personal income tax. On a federal level the following tax rates apply for personal income tax for a married individual, head of household:

Taxable income	**Tax rate**
From $0 to 29,600	15% of taxable income
From $29,601 to 76,400	$4,400 plus 28% of excess over $29,600
From $76,401 to 127,500	$17,544 plus 31% of excess over $76,400
From $127,501 to 250,000	$33,385 plus 36% of excess over $127,500
More than $250,000	$77,485 plus 39.6% of excess over $250,000

8.3 International taxation for residents of Florida

With the above-described residency in the *USA* (residency of more than 183 days in a given calendar year), even a foreigner without legal immigration status can become a US taxpayer. This can lead to the result that a person is taxed both in his/her home country and in the *USA*. To avoid this situation, the *USA* has entered **double taxation agreements** with numerous countries. According to these agreements, such individuals must be granted tax credits in their home country for taxes paid in the *USA*. These agreements also determine which country has jurisdiction over a taxpayer.

9 Checklist: Real estate acquisition in Florida

- **Search for properties** only with licensed brokers; request printout from the *Multiple Listing Service*; ask broker for a Comparative Market Analysis (CMA).
- Consult with an attorney prior to execution of a Purchase and Sale Agreement. **Caution:** The unilateral signing and submission of a Purchase and Sale Agreement often is tantamout to an outright purchase of the real estate given that the seller can accept the submitted contract, thus creating a valid final agreement.
- Is the purchaser an individual person or a corporation? Can the purchase agreement be assigned by an individual buyer to a company?
- For **third-party financing**: Immediately request from the bank a good-faith estimate of the expected closing costs, including sales price, real estate tax prepayment, legal costs (settlement fees), document preparation fees, abstract and title insurance, recording fees and inspection fees.
- **Due diligence**: Retain a specialist to carefully inspect the house for termite and roof damage, and other potential problems; order appraisal; order credit report for buyer; order title insurance commitment and begin assembling required documents; prepare documents for closing; review whether the real estate has all the necessary hook-ups, such as water and sewer; transfer cable, telephone, electrical, gas and water services from the old owner to new owner for the day of closing.
- **Review *HUD-Financing Statement* prior to closing** and thoroughly understand all financial transactions shown on the HUD financing statement. The law requires that all financial transactions have to be listed on this statement with precision. Ensure that sufficient witnesses are available for the closing. Documents can be pre-executed by the seller prior to closing, if necessary, abroad.
- **After *closing*** immediately send the deed to the recorder's office; withhold *FIRPTA* taxes and send to tax authorities; submit tax return the following year to obtain a partial or complete refund of *FIRPTA* taxes. For US residents or green card holders, apply for homestead exemption.

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11 Addresses

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Lehtinen, Vargas & Riedi, PA is a full-service law firm specializing in commercial law, with special focus on assisting foreign investors in Florida with real estate transactions, investments, zoning and land use law, formation of corporations and real estate acquisitions, as well as international and trade contract law and civil and criminal litigation. Claudio Riedi is a Swiss national and fluent in English, German and French. He specializes in the representation of European clients.

Real Estate Agents and Developers

The Sunshine Group Ltd
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The Sunshine Group Ltd, established in 1986 by Louise M. Sunshine, is one of the nation's premier marketing, leasing and sales organizations for luxury residential condominium properties and condominium hotels. The Sunshine Group Ltd distinguishes itself by its ability to analyze and create value for its clients. The creation of value is achieved in the predevelopment planning process through the firm's unique understanding of the luxury market as well as the quality of services amenities, and design that this market demands.

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Sharp, Smith & Harrison, P.A. handles all tax aspects of foreign investment transactions. The firm also specializes in preresidency US tax planning as well as representing foreign individuals and corporations involved in Internal Revenue Service tax controversies. This includes IRS international appeals and US Tax Court proceedings. The firm's attorneys have published a multitude of international tax articles that appear in leading international journals.

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David S. Willig, Chartered, assists foreign investors in the USA and American investors abroad. Qualified to practice law in Florida and France in real estate acquisition, the firm provides a full range of services, including professional notarial functions. The firm's international capabilities allow the firm to represent clients in a specialized and efficient manner, particularly with regards to international private law. Languages: English, French, Spanish and Portuguese.

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Ten State Street, LLP specializes in international business law and tax planning. The firm provides transnational investment strategies and is experienced in facilitating opportunities in various cross-border matters.

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Roedl & Partner is an internationally operating Professional Service Firm providing auditing, tax and legal services. We accompany business activities of our clients and customers on a worldwide basis. We are represented with 69 offices in 30 countries with strong market positions foremost in Central and Eastern Europe, Western Europe, Asia and the United States. One of our focal points is the consulting regarding foreign real estate investment structures i.e. auditing or preparing of cost benefit analyses, rendering tax advice and optimizing a legal structure in connection with investment fun structures.

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Dr. Emanuele Vavassori's internationally-based team designs management systems defining emotional intelligence flows, dedicated to the development of winning business models for the real estate market sectors. System services focus on the professional growth of individuals. Consultancy services are supplied through the integration of team advisors within corporate/organizational real estate systems. The change process project models provide for the application and growth of customized strategies, models, tools and techniques.

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US Government Portal
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US Department of State
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