

Briefing Note - SIPPs investing in Spanish residential property

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This document is supplementary to, and should be read in conjunction with, Briefing Note - "[SIPPs investing in UK residential property](#)".

The possibility of individuals using their pension fund to buy a second home in the sun has clearly captured the imagination of the press, advisers and pension savers alike.

Anyone who has followed this issue since outset will be aware that there are some not insignificant problems in owning overseas property in a SIPP.

Whilst one or two SIPP administrators have made general statements about allowing investment in overseas property through their SIPPs, none, as far as I am aware, have come up with a definitive solution.

I have had several meetings with UK and Spanish advisers on this subject and whilst I have no doubt that we could deliver a sensible overseas property solution for the most popular jurisdictions, I remain sceptical about the likely level of take up.

A recent survey that we have conducted has shown that Spain, along with France, is where most of the interest lies. Survey results can be found at [survey results](#).

The purpose of this document is to consider the issues relating to owning Spanish property in a SIPP and if interest dictates, I may extend this to cover other jurisdictions.

Legal ownership

The legal ownership of a residential property will rest with the SIPP, although the form of this will depend upon a number of factors, not least the structure of SIPP, the jurisdiction involved and the value of the property.

It is not possible for a Spanish property to be registered in the name of a UK Trust and hence the majority of SIPPs cannot hold a Spanish property directly in the name of the trustee(s).

One solution is for the SIPP to own shares in a Spanish company, the Spanish company in turn then owning the property and also borrowing any money in conjunction with a mortgage. Ownership of the Spanish company maybe via a UK holding company. Clearly there are not insignificant costs associated with the establishment and running of a Spanish company. It should be noted that a SIPP can own shares in unquoted UK and Spanish companies after April 2006.

Alternatively, some form of nominee agreement may be structured to own the property but again this could prove complex.

At all times, the SIPP administrator must keep control of the property as failure to do so could leave them exposed to a significant tax liability.

The ownership problems are not insurmountable, it is the variation of solutions between jurisdictions and the associated expense that is likely to cause the headaches.

Anyone who has owned overseas property will know that there is a certain hassle factor in being the legal owner and the thought of our SIPPs owning several hundred or even thousand residential properties dotted around the world, fills me with some trepidation!

Overseas tax

Whilst UK pension schemes are exempt from UK income and capital gains tax, they are not exempt from overseas taxes. Overseas taxes can normally be offset against any UK tax due, under the prevailing double taxation treaty, but clearly if there is no UK tax due then there is no credit to be obtained from such a treaty.

Hence, we will see below that in many cases a SIPP will be taxed broadly as if the individual owned the property. This will, of course, minimise any tax benefits.

Excessive costs and minimal tax savings are very likely to make this market far less popular than may first appear the case.

Further, this potential lack of popularity is undoubtedly one of the issues that is holding some SIPP administrators back from investing significant resources in developing this market prior to A-day.

The actual tax treatment will depend whether the property is owned directly by the SIPP (or its nominee) or by a Spanish company.

Taking the direct ownership route first.

Income tax - The SIPP will pay Spanish income tax at 25% on any rent (with no deduction for expenses or interest). There is a deemed notional income equal to between 1.1% and 2% of the property value if no rent is received.

Capital gains tax - Simplifying what is quite a complex issue, broadly the SIPP will pay 35% capital gains tax on the disposal of a Spanish property. There is an inflation adjustment and the gain on sale is based on the declared value as set out in the Escritura de Compraventa, the official purchase document.

5% of the sale price will be withheld at sale and used as a credit against the SIPP's capital gains tax liability. Any adjustment is then dealt with directly with the Spanish tax authorities.

Other Spanish taxes –

Impuesto sobre el Valor Añadido (**IVA**) on new properties or a transfer tax on resales, is levied on the declared purchase price, at 7%. Taxes on development land are somewhat higher.

There is also an **annual wealth tax** levied on the property, which can range between 0.2% and 2.5% of the net declared value.

In addition, there are **notary and registration fees**, which can be between 2% and 4% of the purchase price.

Inheritance tax

One possible advantage in relation to buying Spanish property through a pension fund could be inheritance tax. This is a hidden problem for many individuals who currently own property personally in Spain and this tax could be mitigated by owning the property through a SIPP. This issue will turn on the ownership structure of the property and is not without its complications.

Property owned by a Spanish company

There are variations to some of the above taxes if a Spanish company owns the property.

The Spanish company pays 40% **corporation tax** on rental profit (i.e. expenses are deductible). There is also an element of notional rent if the SIPP member uses the property rent free. The **annual wealth tax** will not apply.

Capital gains tax can in certain circumstances be as low as 15%, with no 5% retention by the purchaser required. Any dividends paid to shareholders however, will be subject to a Spanish 15% withholding tax. This withholding tax cannot be reclaimed by the SIPP. The tax position for more complex sale structures e.g. involving a sale of the shares in the Spanish company, rather than the sale of the property, is beyond the scope of this Briefing Note.

Complications can arise when capitalising the UK holding or Spanish company and the detail of this is also outside the scope of this Briefing Note.

Borrowing

It is tempting to be persuaded by my argument that the 50% borrowing rule would not apply to the Spanish company, as the pension scheme is not borrowing the money. I have received a letter from Ivan Lewis MP, who has Ministerial responsibility for pensions within the Treasury. He advises that in such cases, the borrowing limits will apply, although I do still remain unconvinced of this interpretation based on the current structure of Finance Act 2004.

Benefit in kind

The benefit in kind rules will apply as for UK residential property, although this issue is further complicated where a Spanish company owns the property. An example on how to calculate the benefit in kind can be found in my Briefing Note entitled "[SIPPs investing in UK residential property](#)".

Where the property is owned in a Spanish company, it is not clear from my reading of the Finance Act 2004 and Income Tax (Earnings and Pensions) Act 2003 whether it is the pension fund or the Spanish company that will be providing the benefit, although for practical purposes, one assumes that the resulting tax position should be broadly neutral.

White money, black money and brown envelopes

Whilst money laundering regulations have finally filtered into the Spanish way of business life, there is still evidence of "brown envelope" deals being part of purchasing property in Spain.

Whilst apparently "acceptable" in Spain, it is difficult to see how UK pension funds could even contemplate participating in a transaction that effectively defrauds the Spanish authorities. Refusal to cooperate may mean that the vendor will not sell the property to the pension fund (as clearly this will lead to the vendor paying a higher capital gains tax bill based on the full sale price rather than the lower declared value).

Summary

I sense that there is a lot of time being wasted on this subject by clients talking to advisers who are in turn talking to SIPP administrators, with no real conclusions being reached. If this document does nothing other than allow advisers to temper some of their clients' exuberance, then it will have succeeded in its objective.

I still remain unsure as to whether we will allow overseas residential property into our SSAS's or SIPP's and this will I am sure be largely dictated by the level of demand. My instinct at the moment is that faced with the above issues, many clients who have decided to buy abroad, will do so personally rather than through their pension fund.

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