

Understated cost of property may lead to more tax (1/5/19)

Real estate (RE) acquisitions mean considerable spending, which often has the parties looking to cut their costs. A common solution involves understating the acquisition cost, but that may lead to a dispute with the State Revenue Service (SRS) and an extra tax assessment potentially exceeding the upfront saving. This article explores a few things you'd better omit from your contract relating to the acquisition cost of RE.

Artificially minimising the tax burden

As you may know, income arising on the sale of RE is treated as a capital gain. If the selling price of RE exceeds its acquisition cost together with any investment, the seller is liable to personal income tax (PIT) on the difference.

For example, the parties agree on a total RE acquisition cost of €150k. For tax optimisation purposes, however, the contract provides that the acquisition cost of the RE is €50k, but the built-in kitchen furniture, household appliances and home decor items are sold with the RE for an agreed price of €100k separately stated in the contract.

Understating the RE price might seem advantageous to both parties. The seller hopes to dodge PIT because the deal on paper gives him no income or even a loss, i.e. the selling price is equal to or lower than the acquisition cost and creates no taxable income. The buyer agrees to understate the price mostly to reduce the stamp duty payable for having his title entered on the land register, which is calculated as a percentage of the selling price (€50k in our example).

It's the buyer who's at risk

If the buyer later decides to resell the RE, he should remember that for PIT purposes the SRS will claim that the acquisition cost is the selling price of the RE less the price of the movables. This may create a situation where the new selling price is considerably higher than the understated acquisition cost, meaning an increase in taxable income.

And if the taxpayer calculates taxable income based on the total RE price (including the price of the movables) and pays an understated amount of PIT to the SRS, he will be facing not only an extra tax assessment but also a late fee. As a result, after benefiting from a lower stamp duty, the buyer will eventually be required to pay more to the SRS.

Case law

This SRS approach to measuring the RE acquisition cost has been upheld by the Supreme Court finding that the price of movables separately stated in a contract is excluded from the RE acquisition cost, and the movables are not treated as accessories of the RE. In that case the owner has clearly expressed his intention to separate them from the main asset.

However, if RE is sold with its accessories for a single price, this will cover any movable accessories recognised as such under the Civil Code. In this case for tax purposes the single price payable for the RE and its accessories will be treated as the RE acquisition cost.

Extra losses

A property acquisition often involves borrowing costs – as you may know, the RE acquisition cost includes any interest payable on the amount the buyer has borrowed to acquire the capital asset. Since the separate price payable for movables is excluded from the RE acquisition cost, the case law finds that any interest paid towards the acquisition of the movables cannot be recognised as expenses associated with the RE acquisition and should therefore be excluded from its cost. The SRS will note how much of the loan has been used to buy the RE and will measure a proportional interest charge that may be deducted from taxable income.