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Property market responds with first increase in prices

James Debono

As prospective property sellers are weighing the impact of the new property tax regime the market has already displayed the first signs of an anticipated increase in prices.

"Prospective property sellers are adopting a wait and see approach as they wait for the government's next move," Michael de Maria, general manager of Cassar and Cooper Real Estate Ltd told Business Today.

Estate agent Frank Salt concurs with de Maria that the market is still biding its time, as the full impact of the proposed 12 per cent withholding tax has not yet sunk in.

Yet according to de Maria, an initial tendency towards higher property prices is already being registered just a few days after the budget.

The reason for this upward spiral is that people are realising that the replacement of the original 35 per cent tax on capital gains with a 12 per cent withholding tax amounts to an increase in taxes.

Business Today can reveal that under the new regime a homeowner who bought a house for Lm 50,000 in 1994, at Lm100,000 today would end up paying more tax than under the previous capital gains tax regime.

This is because under the previous tax regime sellers were not taxed on the whole capital gain but on the gain less an allowance for normal inflation, a maintenance allowance, any ground rent paid on the property and any improvements and expenses that have increased the value of the property.

The absence of an inflation allowance in the new tax regime was first revealed by the Green Party's spokesperson for the economy and finances Edward Fenech.

In the meantime the prospect of higher property prices resulting from the new tax regime is not welcomed by building contractor Angelo Xuereb.

"Higher prices mean a lower demand and in the long term an upward spiral will have a negative impact on the construction industry," Xuereb told Business Today.

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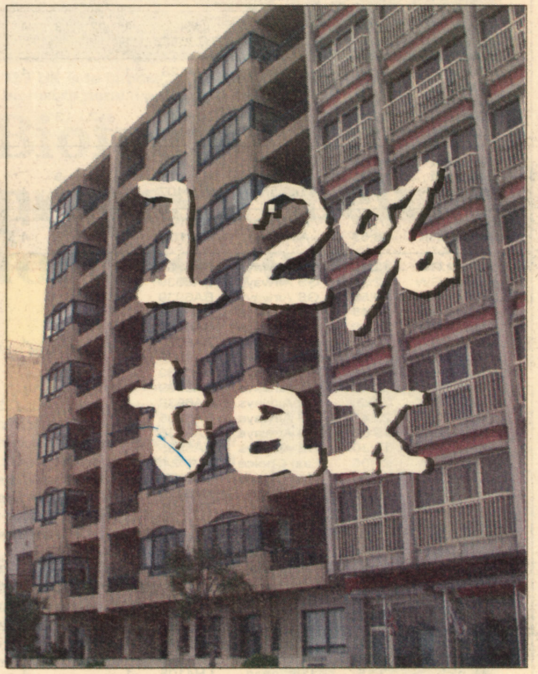

The withholding tax may not have the desired impact to entice owners to put their property on the market

Banks could reduce loan facilities as government attempts to curb evasion


People plying their trade in construction will have to be VAT registered as banks will be obliged to ask for fiscal receipts

James Debono

Government's budget proposal to tighten the fiscal grip on building contractors and construction tradesmen by imposing an obligation on banks to ask for fiscal receipts has received a cold reception in financial circles, with sources telling Business Today that banks could respond by reducing loan facilities.

So far contractors, electricians, plumbers and others engaged in construction have managed to evade government's tightening fiscal net because property developers are not expected to provide banks with a fiscal receipt accounting for such services when applying for loans earmarked for property development.

In order to address widespread tax evasion, the government is proposing legal amendments through which banks will only be able to lend money for property development if the demand for such loans is accompanied with a contract of acquisition and fiscal receipts on the works conducted.

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Venture capital fund stuck at lawmaking stage

Matthew Vella

A year since Budget 2005, and the Lm900,000 venture capital fund promised in the last budget for small enterprises and industry has not been set up yet.

With no mention of the fund in this year's budget speech, the Federation of Industry has lamented the absence of "good instruments" to increase research and development, such as the venture capital fund.

But the chairman of Malta Enterprise Corporation, Joseph Zammit Tabona, says the fund is "certainly something we want to set up as fast as possible" and is expected to be created "within the next months."

A ministry spokesperson said government was hoping "the bureaucratic hurdles are overcome at the soonest such that the fund can be operational by the end of the year."

According to the ME chairman, the process is being held up in the drafting of the legislation and getting though the state aid monitoring board.

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Government should scrap the whole thing – Frank Salt

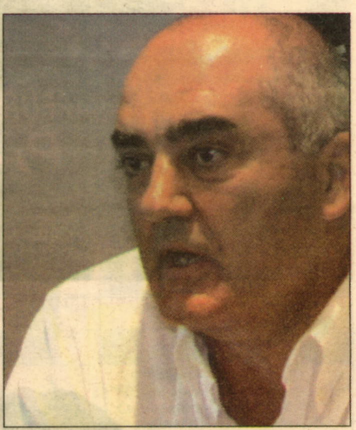
◂ page 1 The government has already declared that it is reconsidering the impact of this measure on categories like separated couples who are forced to sell their property after a short time span.

But Frank Salt is sceptical on the idea of exempting people from the tax regime on the basis of "exceptions," as the property market is made up of human beings and is therefore full of all sorts of "exceptions".

"The government should simply admit a mistake and scrap the whole thing rather than creating another administrative monster to cater for exceptions," contends Salt.

Edward Fenech: concerned the reform may be condusive to property hoarding since properties purchased in recent years are to be subject to a high rate of tax

Frank Salt: The government should simply admit a mistake and scrap the whole thing rather than creating another administrative monster to cater for exceptions



Angelo Xuereb: It is a pity that the one of the few economic sectors which is currently experiencing growth is being penalised

Average home owner

The Green Party's spokesperson on finances, the economy and tourism Edward Fenech disputes Parliamentary Secretary Tonio Fenech's claim that the measure is very advantageous to people who have owned property for a long time, because he has failed to note that under the existing system tax payers are not taxed on the whole capital gain but on the gain less an allowance for normal inflation and a maintenance allowance.

Business Today can reveal that if an average homeowner had bought a home for Lm 50,000 in 1994 and sold it for Lm 95,000 in 2004, the tax paid would have amounted to Lm 10,866. Yet if the new 12 per cent withholding tax had applied he would have ended up paying an extra Lm500.

Instead of Lm 10,866 he would have ended paying Lm11,400.

Yet this is a very conservative figure, as it does not take into consideration other expenses which can be deducted.

The income tax law which used to regulate the previous tax regime, states that for the purpose of ascertaining the gains or profits arising from any transfer of immovable property a number of expenses should be deducted.

Apart from the cost of acquisition and the inflation element other expenses like maintenance, the payment of any ground rent paid on the property as well as improvements and other expenses, which would have increased the value of the property since it was acquired, can also be deducted.

In the light of the increase in taxes, homeowners could be induced to seek higher prices in order to benefit from the new tax regime.

In fact the same homeowner would have benefited from the new regime by selling the same property at Lm120,000 instead of Lm95,000.

By selling the property at Lm120,000 under the old capital gains regime he would have paid more than Lm19,000 in tax. Now he would only pay Lm14,400.

Fenech also expressed his concern that the reform may be conducive to property hoarding since properties purchased in recent years are to be subject to a high rate of tax and therefore owners may hold on to these properties for long to ensure that they can recover the 12 per cent 'sales tax'.

Edward Fenech also remarked that under the new rules, tax losses can no longer be used to offset capital gains, meaning that persons or companies that are in distress and have to sell their properties under duress will no longer be able to avail themselves of losses incurred in the past.

Construction industry

Building contractor Angelo Xuereb is concerned that the new tax regime will result in a rise in property prices, which will have a long-term negative impact on the building industry.

"It is a pity that the one of the few economic sectors which is currently experiencing growth is being penalised," Xuereb told Business Today.

Xuereb is not expecting a slowdown in construction over the next few years.

"In the next few years the rhythm of construction will not be affected as projects have already started," Xuereb told Business Today.

But as the price of property increases, buyers will decrease thus negatively affecting the construction industry contended Xuereb.

While acknowledging that the reduction on inheritance tax will put more properties on the market, this positive impact will be cancelled by the impact of the withholding tax.

Both Xuereb and Frank Salt concur that some building developers will benefit from the new tax regime.

"Contractors who have acquired land in the past would have higher profit margins with the 12 per cent tax but those who have acquired land at current prices will suffer," Salt told Business Today.

Xuereb contended that one should distinguish between contractors and developers.

"Contractors only provide services to developers and at present only 25 per cent of the value of properties can be attributed to construction costs. 30 years ago, construction costs used to amount to 75 per cent of costs," Xuereb said.

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Property sold at Lm95,000

Previous regime – capital gains	
Sale Price	Lm 95,000
1995 Purchase Cost	Lm 50,000
Inflation Allowance	Lm 11,951.88
(based on RPI Index 1995-2004)	
Maintenance Allowance	Lm 2,000
(0.4 per cent per annum)	
Total Cost	Lm 63,951.88
Gain	Lm 31,048.12
Capital Gains Tax	**Lm 10,866**
New regime – withholding tax	
12% tax on sale price	**Lm 11,400**

Property sold at Lm120,000

Previous regime – capital gains	
Sale Price	Lm 120,000
1995 Purchase Cost	Lm 50,000
Inflation Allowance	Lm 11,951.88
(based on RPI Index 1995-2004)	
Maintenance Allowance	Lm 2,000
(0.4 per cent per annum)	
Total Cost	Lm 63,951.88
Gain	Lm 56,048.12
Capital Gains Tax	**Lm 19,616.84**
New regime – withholding tax	
12% tax on sale price	**Lm 14,400**

The income tax law which used to regulate the previous tax regime, states that for the purpose of ascertaining the gains or profits arising from any transfer of immovable property a number of expenses should be deducted