

YOURPLACEABROAD

NOTES ON TAX TREATMENT OF OVERSEAS PROPERTY

10 KEY ISSUES TO CONSIDER

Ownership Issues

1. Certain European countries have legal systems based upon the Napoleonic code (for example, France and Spain). Such systems as a general rule do not recognise trusts and have what are known as 'forced heirship' rules (this means that it is not possible to determine who property passes to under your will). This can cause some apparent difficulty in deciding how the property should be owned, as individuals may be reluctant to hold the property in their own names due to the forced heirship rules. However, as detailed below, this can be dealt with in practice.
2. A further difficulty is that, if a company is used to hold the property, there may be benefit-in-kind issues for the shareholders / directors of the company if the property is made available for their use at below a market rent. Again this issue can be dealt with in practical terms (see below).
3. Where the property is owned by individuals, the forced heirship rules will generally involve an interest in the property passing to children on death. Provided that married couples own the property in their joint names, the practical difficulties associated with this on the death of the first spouse are reduced, and indeed the transfer of part of an asset to the next generation at that stage can be good tax planning, provided it is dealt with as part of the overall inheritance tax planning process.
4. Where the property is owned by a company, and is potentially available for letting when not occupied by the director/shareholder, the benefit-in-kind can be greatly reduced by introducing key-holding procedures which mean that the property is clearly only available to the director / shareholder when he or she is occupying it.

Specific Tax Issues

5. Individuals who are both resident and domiciled (see below) in the UK are taxable in the UK on their worldwide income and capital gains. Thus any rental income and any profit on ultimate disposal of the property are potentially subject to UK taxation. However, this statement is qualified in a number of respects below.
6. It is possible to offset against rental income any expenses relating to the property, although such expenses will be restricted by reference to any private use made of the property. Thus, as mentioned at 4 above, it can be advantageous to make the property available for letting

when not occupied personally, in order to maximise the amount of expenses available to offset against the property income. Such expenses include interest on borrowings to purchase the property, provided they are in the form of a loan as opposed to an overdraft.

7. It may be possible to establish the property as a main residence for capital gains tax purposes. This can be done by election within two years of acquiring the property, and may only be for a relatively short period of time. The advantages of this are twofold. Firstly, the last 3 years of ownership of the property will then be treated as a period for which the property was the main residence of the owner. Secondly, if the property is available for letting, a further relief known as letting relief will be available, which may relieve gains of up to £40,000 for each joint owner. This is a further argument for personal ownership of the property. Also, where the property is owned for at least 3 years, taper relief will be available for UK capital gains tax. This gives a 5% discount for each complete year of ownership from 3 years to 10, giving a maximum discount of 40%. It follows from this that an 'off-plan' purchase and sale is ineligible for any taper relief (as the property will not be owned for long enough) and indeed may well be considered by the tax authorities to be taxable as a trading transaction rather than a capital gain. The main significance of this is that the annual capital gains tax exemption would not be available to offset against any gain in such circumstances.
8. It is possible that you may be able to establish yourself as not domiciled in the United Kingdom for tax purposes. Typically this may be possible if you are a first or second generation UK citizen whose father was born abroad and was not domiciled in the UK at his birth. HM Revenue & Customs rulings on domicile status can be obtained. The advantage of non-domiciled status is that income and gains arising outside the UK are not taxable here provided they are not sent to the UK. Typically this means that overseas property owners in this situation use the rental income arising to live on whilst at the property.
9. Similar rules to the above apply for inheritance tax purposes. Thus a non-UK domicile does not have to include foreign property in his or her estate for inheritance tax purposes. However, people who are not domiciled here for income tax and capital gains tax purposes become deemed domiciled here for inheritance tax purposes once they have been resident here for 17 tax years.
10. All of the above can be complicated by the terms of tax treaties between the UK and the relevant country in which the property is situated. Typically such treaties will involve the latter country reserving taxing rights over income and gains in respect of properties in that country. However, there are often two saving graces. Firstly, UK residents are often entitled to tax allowances in overseas countries (again under the terms

of treaties) which will reduce overseas tax exposure. Secondly, the UK will give credit for any foreign tax paid against UK tax liabilities.

The above is a very general outline of the tax issues relating to overseas properties, and should not be relied upon in the absence of specific advice on individual circumstances. It has been prepared by Mark Simpson, Director of Tax at Frenkels Chartered Accountants of Salford Quays.