

Top Ten Tax Tips for Overseas Property Owners

By Carl Bayley BSc ACA

1. Don't Forget You Still Have UK Tax To Pay!

Arguably, this is more of a warning than a tip, but it is vital to remember that any UK resident buying property abroad is still exposed to UK tax on that property. This may include UK Income Tax on rental income, UK Capital Gains Tax on property sales and UK Inheritance Tax on any foreign properties you leave to your children.

The UK tax burden is often greater than any foreign tax liabilities, so it makes sense to undertake UK tax planning for your foreign property. Many of the same planning techniques that work well on UK property can be used equally effectively on foreign property, although there are associated opportunities and additional pitfalls to be wary of.

2. Main Residence Relief for Foreign Holiday Homes

As most people know, your 'main residence', i.e. your home, is exempt from Capital Gains Tax. There is nothing in UK tax legislation to say that a foreign holiday home cannot be a UK resident's main residence for Capital Gains Tax purposes. A holiday home can be treated as your main residence by making an election to that effect, generally within two years of buying the property.

The foreign property must be your own holiday home for at least part of the time but, by making the election, you will be able to exempt some or all of the capital gain on your foreign home from UK Capital Gains Tax.

Beware, however, as you are only allowed one main residence at any time and, if you're married or in a civil partnership, you're only allowed one between you, so electing to treat your holiday home as your main residence could backfire if you sell your main house back in the UK.

There is, however, one way that you can get the best of both worlds.

Every property which has ever been your main residence at any time during your ownership is also exempt from Capital Gains Tax for the last three years of your ownership. You could therefore elect to treat your foreign property as your main residence for just a short period, say a week. That week will then buy you three years worth of exemption. In other words, you would lose just one week's worth of exemption on your main house but gain three years (and a week) of exemption on your foreign holiday home.

3. Travel at the Treasury's Expense

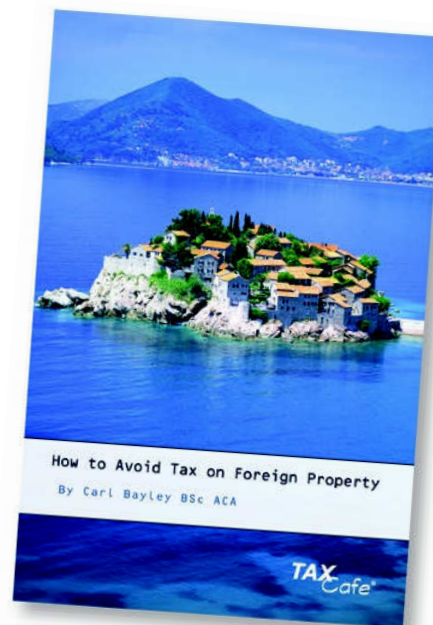
If you're renting out foreign property, you have a foreign rental business. Like any other business, you're entitled to claim tax relief for your business expenses. That includes any travel costs which you incur for business purposes.

Furthermore, all foreign property rentals are treated as one business. Hence, for example, you could claim the cost of going to Cyprus to look for a possible new rental property against the rental income from a villa which you already have in Spain.

4. Understand the Local Taxes

Most countries will tax foreigners on any property that they own in that country. Local taxes often apply to property purchases, property sales and rental income. Furthermore, you will often have to pay annual taxes on foreign property, even if you do not rent it out. Many countries also have gift and death taxes.

Where you have been liable for foreign tax on your property, you will often be entitled to 'double tax relief' against your UK tax liability on the same income or capital gains. This allows you to deduct the foreign tax which you have paid from your UK tax bill. The UK Revenue will allow you to make this deduction as long as they are happy that the foreign tax which you have



paid is broadly equivalent to the UK tax that you are deducting it from.

Be careful, however, as every country has a different tax regime and not all of them are compatible with the UK tax system. If you suffer a foreign tax which is different in character to any UK tax, or which arises when no UK tax is due, you may not get any relief for it at all in the UK.

So, a foreign tax at 30% which is deductible from your UK tax liability on the same income may actually cost you less than a foreign tax at 10% for which no double tax relief is available. All these factors need to be considered before you invest in foreign property.

5. Do You Want Double Tax Relief?

As a general rule, it is usually worth claiming double tax relief for any foreign taxes whenever you can. By claiming double tax relief, you deduct the amount of foreign tax paid from your UK tax liability.

However, you cannot get any repayment of foreign tax through a double tax relief claim and the best you can ever do is to reduce your UK tax liability to nil.

Sometimes, however, the amount of foreign tax paid may actually be more than the entire amount of your taxable income or capital gain as calculated for UK tax purposes. In these situations, it is better to claim the foreign tax as a business expense rather than to claim double tax relief.

When you claim foreign tax as a business expense, it reduces the amount of taxable income or capital gain liability in the UK and can even create a tax loss. This loss can be carried forward to give you future tax relief and hence, in some situations, can actually give you better value for your foreign tax than a double tax relief claim.

6. Reduce Your Foreign Exchange Tax Risk

All UK tax calculations for individual taxpayers are carried out in pounds sterling. This creates some particular problems when it comes to capital gains on foreign property. You may make very little gain in the local currency, but when you translate your purchase and sale costs back into sterling, you may have a big Capital Gains Tax exposure in the UK.

Let's say you buy a property in Utopia for 100,000 Utopian dollars at a time when the exchange rate is two Utopian dollars to the pound. That means you have a purchase cost of £50,000.

Later, you sell the property for 120,000 Utopian dollars. In local terms, you have a modest gain of 20,000 Utopian dollars. However, let us suppose that the exchange rate is now 1.2 dollars to the pound. This means that your sale proceeds for UK Capital Gains Tax purposes are £100,000 and you have a taxable gain of £50,000.

Maybe that's fair: after all, if you bring the money back to the UK, you will have made a profit of £50,000 on your investment.

If, however, you hang on to your Utopian dollars, they will become a new chargeable asset for UK Capital Gains Tax purposes and may give rise to a capital gain or capital loss when you eventually spend them or exchange them into sterling or any other currency.

The real problem to watch is that if you make a capital loss on your foreign currency in a later UK tax year (year ended 5th April), you will not be able to set that

loss off against the earlier capital gain on your foreign property.

The tax tip here, therefore, is to make sure that you dispose of your foreign currency sale proceeds in the same UK tax year as you dispose of the foreign property itself.

7. Get VAT Back with Leaseback

In the UK, we are accustomed to the idea that any purchase of residential property is exempt from VAT. This is not the case in every country, however, and many European countries charge VAT, at rates of up to 20%, on new residential property purchases.

One way to recover the VAT on such a purchase is to enter into a 'leaseback' scheme. Under these schemes you, the owner, lease the property back to a hotel operator. This means that your property becomes a business property and you are able to recover the VAT. Typically, you are allowed a few weeks of personal use of the property each year and, eventually, after a suitable number of years, it is yours outright again.

The scheme only works for certain types of property, such as hotel rooms and apartments, and may carry disadvantages for other foreign taxes, such as higher Income Tax rates; so it's one to investigate carefully before you sign up.

8. Borrow to Save

Many countries impose Wealth Tax, Inheritance Tax, or both, on foreigners owning property in their country.

Wealth Tax is usually an annual charge on the property owner's net wealth in the country.

Foreign Inheritance Tax also usually applies only to a foreigner's net assets in the country.

In most cases, you can reduce your net wealth in the foreign country for tax purposes by taking out a mortgage on your foreign property. In this way, it will usually be just your net equity in the property which attracts foreign tax.

If you don't actually need a mortgage, you can invest the borrowed funds somewhere else outside the country where your property is located.

9. Avoid Evasion

When you buy property overseas, you will usually be acquiring tax obligations in that country. In fact, many countries require prospective foreign property purchasers to register themselves with the local tax authority before they can complete their purchase.

If you want to sleep at night, you need to make sure that you fulfil your local tax obligations in the country where your property is situated. Many foreign tax authorities have the power to seize property where taxes are unpaid.

Naturally enough, the local tax authority will write to you in their own language. Do not ignore this correspondence just because you don't understand it: this is no defence. You will need local help and advice to make sure that you deal with the local tax authority appropriately and meet all of your obligations as a taxpayer in the country.

10. Expect the Unexpected

If the UK tax system seems like Double Dutch, why should you expect foreign taxes to be any different? Every country has its own tax and legal system and, when you buy property abroad, you must abandon all of your preconceptions.

Assume nothing until you have investigated the local tax system thoroughly. Your destination country is likely to have different taxes, different tax rates, a different tax year and a whole different set of rules, regulations, reliefs and exemptions.

Local property and succession law are likely to be different as well and a UK investor who overlooks this fact may well have to suffer a great deal more than just tax!

Carl Bayley is the author of How to Avoid Tax on Foreign Property, available from www.taxcafe.co.uk