

Overseas Buyers of UK Property – Avoiding the Inheritance Tax Trap



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The UK, and in particular, the London property market has become increasingly attractive to overseas buyers with beneficial exchange rates and falling prices. Many buyers do not appreciate that by purchasing the property in their personal names they are potentially building up an inheritance tax problem. When a UK property is bought by someone who is non-UK domiciled which means someone without strong UK connections, they come within the scope of UK inheritance tax, which they could otherwise avoid.

The following frequently asked questions are intended to explain the problem and the simple way to deal with it.

What is Inheritance Tax (IHT)?

IHT is payable on the property of someone who dies and who is either UK domiciled or has certain assets in the UK. For IHT purposes, a long period of residency in the UK can mean you are deemed UK domiciled.

Why does it apply to me if I am not resident/domiciled in the UK?

IHT is payable on any assets situated in the UK including land/real estate regardless of the nationality or domicile of the deceased. This means that if you own property in the UK, it is within the scope of UK IHT simply because the property is in the UK.

What is the potential liability?

The current IHT rate is 40% of the net value after deducting an exemption which is called a “nil rate band” presently £325,000, and debts. To give a simple example, if there is a property worth, say, £2.5 million which has a mortgage of £0.5 million then after deducting that mortgage and the “nil rate band” there is a net estate of approximately £1.7 million giving IHT of about £680,000.

What can I do about this?

The most common way of dealing of this would be to acquire UK property in the name of an offshore company. Provided that the shares in the company are not held by someone with UK domicile, UK inheritance tax is generally avoided.

Which type of company is best?

Any company incorporated and run from outside the UK is likely to be acceptable. The key point is that, on death, the gift is of the shares in the offshore company and not of the property in the UK. This means that for a non-UK domiciled person, no UK IHT should be payable. If that same non-UK domiciled person owned the UK property direct then UK IHT would be payable.

Which jurisdiction is best for the offshore company?

It depends on the personal circumstances and your choice. There are pros and cons for various jurisdictions. Companies formed in the BVI or the Channel Islands are very common. Some key factors to consider are:

- Make sure there are no or minimal local taxes
- The trustworthiness/ reliability of the administrators
- Security and stability in the jurisdiction
- Anonymity / confidentiality
- Costs
- Provision of information
- Acceptability to third parties such as banks providing a mortgage

What are the taxes and costs of the offshore company?

Generally the company is set up so it is not required to pay local taxes and this is usually possible provided that it is not trading locally. Of course, there will be formation costs and annual running costs. These vary considerably depending on jurisdiction of the company, where it is administered, whether these are other or more complex structures, such as trusts, set up with the company and the extent and quality of the service provided.

What about confidentiality?

In most jurisdictions it is now necessary for the authorities to know the identity of the beneficial owners for anti money laundering and other purposes.

Different countries have different regimes as to whether the identity of the shareholders is open to public inspection. However, where this applied the matter is dealt with by the administrator providing a nominee shareholder service so that the identity of the ultimate shareholders is not publicly available.

Is it possible to get a mortgage using an offshore company?

The answer to that is generally yes. The lending bank will of course want to do full due diligence on the company and on the individual(s) behind it including obtaining financial information on the beneficiaries. You will also almost invariably have to give a personal guarantee. Non recourse lending is not generally available in the UK.

What about other taxes?

Tax is a complex issue and is not proposed to cover it here in great detail. However UK capital gains tax is generally not payable on the sale of UK land/ real estate where the owner is non resident. The income derived from the property is liable to UK income tax at the basic rate after deduction of mortgage interest and costs. Tax may be payable in the country where the beneficiary is tax resident on any gains or income arising from the property and purchases should always be looked at in a context of the overall tax position of the beneficiary and tax advice obtained.

What if I intend to sell the property after a short period?

If the property is sold prior to death then the question of IHT will not arise. The longer the property is held, the greater risk of death before sale, hence IHT on the owner's estate.

Are there any other reasons to use a corporate vehicle to acquire a property?

The Land Registry in the UK is open to public inspection online. This will give the name of the interested owner as well as the price paid (if any). There is not much that can be done concerning the publication of the price but where the property is held in the name of an offshore company or trust, there is no disclosure of the underlying beneficial interest.

What if I already own a UK property in my own name?

You can transfer the property into the name of an offshore company or trust. There is potentially Stamp Duty Land Tax (SDLT) payable which could be as much as 4% of the market value. Depending on the particular circumstances there are schemes whereby SDLT can be mitigated or avoided. These are complex and usually only cost effective if the value of the property is over £1 million.

Is there any else I could consider?

Combined with the setting up of the offshore company you may want to look at more complex ownership structure for the offshore entity such as a trust. Also if there is any other tax planning you can make. If you still want to hold the property in your own name then you will need to make a UK will to govern what will happen to the UK property in the event of your death. A will made in the country of your domicile will not generally cover real estate in another country.

*Sykes **Anderson** LLP is a niche law firm based in the City of London specialising in UK and international property and tax.*

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