KEY POINTS

What is the issue?

US individuals, trusts and companies purchasing real estate in the UK are fully within the scope of UK tax on such investments and the laws of succession of the relevant part of the UK.

What does it mean for me?

Practitioners advising US clients should be alert to these considerations and the planning opportunities that may be available.

What can I take away?

An understanding of the key tax and succession issues to be aware of for US persons purchasing homes in the UK.

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Something to dwell on

CLAIRE WEEKS AND EMMA-JANE WEIDER CONSIDER UK TAX AND SUCCESSION ISSUES FOR US PERSONS PURCHASING SECOND HOMES IN THE UK

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In recent years, there has been a surge in interest from US investors looking to purchase UK real estate, particularly in London. There are a wide variety of economic, social and political reasons for this, but one of the main driving factors has been the favourable exchange rate (allowing US investors to maximise their budget).

This article focuses on the tax and succession issues applicable to purchasers looking for a second home in the UK.

UK TAX CONSIDERATIONS

Tax on purchase: SDLT

Stamp duty land tax (SDLT) is payable by the purchaser.[1] The rate increases in bands and additional rates apply to non-residents and purchasers of second homes. As a result, a US-resident purchaser of a second home in the UK is likely to pay SDLT starting at 5 per cent for the portion of the purchase price up to GBP250,000 and increasing (progressively) to 17 per cent for any portion above GBP1.5 million.

The position is more severe for purchasing non-resident companies, which pay a 15 per cent flat rate plus an additional 2 per cent where the company is non-UK resident.

Tax on continued ownership: ATED

Annual tax on enveloped dwellings (ATED) is payable by companies owning residential property valued at more than GBP500,000. This tax does not apply to property held by an individual or trustee but is likely to apply to a US limited liability company (LLC). The charge currently starts at GBP4,150, rising to GBP269,450 for properties worth more than GBP20 million.

Tax on disposal: CGT and corporation tax

Capital gains tax (CGT) and corporation tax are payable on the increase in value of real estate between the date of acquisition and the date of disposal (although, for non-residents, gains attributable to the period before 6 April 2015 should be non-taxable). The maximum rate for individuals and trustees is 28 per cent, and 25 per cent for companies.

CGT also applies to indirect disposals of 'property-rich' entities (an entity that derives 75 per cent or more of its gross asset value from UK real estate) by non-UK residents.

However, to the extent that tax is also payable in the US on the gain, the *UK/USA Double Tax Convention* (the Convention) should prevent double taxation. The Convention allows both jurisdictions to tax the gain but requires the US to provide a credit for tax paid in the UK.

Tax on death: IHT

The general position is as follows: inheritance tax (IHT) is payable on the value of an individual's worldwide estate if they are domiciled, or deemed to be domiciled for tax purposes, in the UK. By contrast, non-UK domiciliaries are subject to IHT only on UK-*situs* assets and certain other assets such as non-UK company shares whose value derives from UK residential property (directly or indirectly, e.g., through a chain of companies).[2] It also includes the receivables of loans used to acquire, maintain or improve UK residential property and money/property used as security, collateral or guarantee for such loans.

The headline rate of IHT is 40 per cent, although most individuals are entitled to a nil-rate band of GBP325,000, within which the rate is 0 per cent. Many individuals also benefit from a residence nil-rate band, which provides a further GBP175,000 at 0 per cent. Property passing between spouses is generally exempt. Subject to a number of conditions, borrowing can be used to reduce the value of the property for IHT purposes.

There are special considerations for US purchasers as a result of the *US-UK Estate and Gift Tax Convention of 1980* (the Estate Treaty).

For personally owned property, the Estate Treaty provides that the UK would have primary taxing rights over residential property, but this does not mean that the US cannot also impose tax. Instead, the US would permit a credit for any tax paid in the UK to be set against any estate tax payable in the US.

For company-owned property, the Estate Treaty prohibits the UK from imposing IHT on certain property, including the shares in an investment company (even where that company holds UK real property) where the decedent/transferor was domiciled in the US (and is not a UK national). It may, therefore, be expected that the Estate Treaty prevents the UK from taxing the shares. This may mean it is attractive for a US domiciliary to own UK residential property through a holding company. Similar protection from IHT may be available under the Estate Treaty in relation to debt receivables for loans used to purchase UK residential property.

The special IHT regime for trusts

With the exception of bare trusts, most trusts holding UK residential property (whether directly or through a non-UK company) will be subject to what is known as the 'relevant property regime' for IHT purposes. The value of trust property is subject to a periodic charge on the ten-year anniversary of the trust (maximum rate 6 per cent) and a proportionate charge on capital distributions from the trust between anniversaries.

The concept of US revocable (grantor) trusts does not easily fit within the UK tax regime. Many such trusts will not meet the UK tax definitions of trusts/settlements. Instead, they will be considered as bare trusts/nomineeships, such that the trust property forms part of the taxable estate of the grantor for IHT purposes (and the gains and income of the trust are the gains/income of the grantor).

SUCCESSION PLANNING

Although tax is often the starting point for conversations with clients, succession should perhaps be considered the most important factor, particularly given the complex and time-consuming nature of the UK probate process. We focus in this section on the laws of England and Wales.[3] Different rules may apply to property situated in Northern Ireland and Scotland.

Individual ownership

English-*situs* real estate is subject to the internal succession laws of England (regardless of the owner's domicile). There is no system of forced heirship in England.

A grant of probate (or letters of administration on intestacy) is required to pass property to an individual owner's heirs. Where property is held in joint names as joint tenants, the surviving co-owner automatically becomes entitled to the whole of the property by way of survivorship and a grant will not be required.

A US will could be admitted to probate in England, but this may take longer than the procedure for an English will. Many individuals therefore prefer to make an English will to govern succession to their English real estate only.

Companies (including LLCs)

The death of the shareholder will not affect the ownership of UK real estate held by the company. Provided the company is not a UK company, no English grant of probate is required.

US revocable (grantor) trusts

Putting aside the tax implications, many US persons will wish for the UK property to be held in trust.

Generally speaking, a trust that is not considered a bare trust/nomineeship offers the simplest solution from a succession perspective: the death of a beneficiary would not affect the ownership structure and the practical issues that can arise where there are multiple owners could be avoided.

However, a US revocable grantor trust is likely to be considered a bare trust (subject to the terms and the applicable law). If this is the case, it is unlikely that such a trust will be sufficient to pass title to English real estate, unless it has been executed in accordance with the English law requirements for a valid will. This gives rise to the risk of an intestacy unless the grantor has a separate will governing succession to the property.

CONCLUSION

Historically, many non-UK purchasers of residential property in the UK have utilised corporate structures (LLCs in the case of US purchasers). More recently, successive changes to the UK tax regime have generally made such structures unattractive (particularly for property intended for personal use as a second home): SDLT and ATED are the main additional costs compared to personal ownership. However, for US domiciliaries, the Estate Treaty may still provide IHT protection for corporately held property, which could justify the additional tax costs of SDLT and ATED. This must be assessed on a case-by-case basis. US domiciliaries should also consider whether debt structuring could mitigate the IHT exposure.

Where trusts are involved, particular care is required to avoid difficulties arising from a mismatch between the UK and US tax treatment of US revocable grantor trusts.

#INTERNATIONAL CLIENT #LAND AND PROPERTY #TAXATION #TRUSTS #UK #US

1 SDLT applies only to England and Northern Ireland (separate taxes apply in Wales and Scotland).
2 With effect from April 2017. **3** For the remainder of this article, England and Wales/English and Welsh are abbreviated to England/English.