So you've purchased property in the UK

Andrea Solana explains what a US person should keep in mind

One of the beneficiaries of the pandemic has been the UK housing market. During Covid, many people living with excess cash and the reality of spending more time at home turned their attention to property. There was a shift away from the city with people seeking more space and big gardens. As pandemic restrictions have come to an end and greater numbers of people have started returning to the office, demand for homes closer to the city have returned

The strong housing market has been supported by low borrowing costs, creating a scenario for many where, provided one has the capital to support a down payment and Stamp Duty Land Tax for a home purchase, the carrying cost of owning a home generally has remained more affordable than rent.

With inflation rearing its ugly head, this has put additional pressure on rents and is now starting to reflect in a trend towards higher interest rates. If interest rates continue to rise (which is certainly the expectation in the short-term), then we may see an eventual reversal of this trend. In the meantime, those who already own property, have purchased recently, or are in the process of purchasing have the opportunity to lock in what currently remains historically low fixed interest rates. So, if you have taken the plunge into the UK property market, what do you need to understand as a US person in the UK.

When you sell your property you may owe capital gains tax

It is well known that the UK does not currently charge capital gains tax on the sale of properties that qualify as your main residence. As property prices increase over time, this allows individuals to upgrade and downsize their properties and keep their gains intact, without the extra consideration of what might be payable to HMRC.

However, the rules in the US differ than the UK. In order for a property to be considered your main residence from a US perspective, you must have lived in the home for two out of the last five years. Provided this is the case, then the US allows an exclusion of capital gain up to $250,000 ($500,000 if both spouses meet the two-year requirement and file a joint tax return). Any gain in excess of the available exclusion will be taxable at US capital gains tax rates up to 20%. Additionally, if your income is in excess of applicable thresholds there may be a Net Investment Income Tax (NIIT) of 3.8% payable alongside the capital gains tax.

Foreign currency fluctuations may result in an additional tax to pay

When considering whether any capital gains at sale may apply, it is important to keep in mind that the fluctuation of foreign currency exchange rates can have a large impact on the recognition of gains upon disposal of real property. The exchange rate on the date of purchase and the date of sale are used to determine the taxable gain in local currency.

However, this isn't the only time that it is important to pay attention to foreign currency fluctuation. When a mortgage is redeemed, re-financed, or when a capital repayment is made, the owner must calculate whether there has been a gain or loss on the disposition of the mortgage due to exchange rate fluctuations. If a mortgage costs less at the time of the transaction due to the current exchange rate versus when the mortgage was obtained, the portion of gain recognized on the mortgage repayment, redemption or re-finance is generally taxed at ordinary income tax rates. Without careful consideration of the currency fluctuation over the period of ownership, a taxpayer can sometimes unknowingly create large gains in local currency.

If US taxes are owed and you have a non-US spouse you can consider ownership structure

When a US person is married to a non-US person, there is an additional consideration relating to the appropriate ownership structure. The sale of a main residence has tax implications for a US person whereas, as noted earlier, it is tax free from a UK perspective. When one spouse is not a US person, it can often be beneficial to think about the ownership structure of the property and determine whether it is in the family interest to consider Joint Tenants in Common or ownership in the non-US spouse's name. A US spouse is currently able to gift a non-US spouse up to $164,000 each year without using their lifetime allowance (currently $12.06 million). A gift of interest in the property, either through the use of annual gifts or through a one-time gift, could help the US spouse mitigate any taxes payable in the future. If the individuals are legally married in jurisdictions that recognize their marriage, then they would be treated under the rules for married individuals for Federal Tax purposes as it relates to ownership structure.

A lot of planning goes into a property purchase but for a US person, the planning doesn't stop once a property is purchased. Consideration needs to be given to how the property is paid for over time with an understanding of what triggers US taxation at different points in time. If you understand this then it can help to ensure you remain flexible and that you don't get adversely surprised after you have embarked on what is often your largest and most important financial decision. ★

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