This article is intended to assist U.S. citizens, and their advisors, when considering whether to purchase property in the UK, either as an investment or home, or to use when visiting or working in the UK.

THE LONDON PROPERTY MARKET

The London property market is thriving and continues to go from strength to strength. Indeed, properties in the UK have seen an increase in value in the most recent published figures. Activity in the UK market is forecast to carry on growing.

London is a world-class city and has a great reputation as a global financial centre. It is an attractive and popular choice for those who wish to invest in property and particularly for those based abroad and wanting a base in Europe. Property prices continue to rise, particularly in London, despite the economic difficulties. A purchase in London is seen as a safe investment that will bring a healthy return. Despite an increase in the prices being paid, the yield remains very good and appealing.

The majority of property purchases in Central London are by overseas purchasers. Developments such as One Hyde Park and The Knightsbridge have helped ensure that the interest in London is kept alive.

Foreign investors are particularly interested in areas such as Knightsbridge, Mayfair, Belgravia and St John’s Wood. The rest of London also benefits from this interest as property values continue to rise throughout the area.

FORMS OF OWNERSHIP

This article assumes that the U.S. citizen will purchase the UK property in his own name, or jointly with his spouse or civil partner (the term “spouse” hereafter refers to either).

If spouses decide to purchase jointly, they should hold as “tenants in common,” a form of co-ownership that allows them to pass their respective shares on death by Will and provides the greatest scope for UK tax planning. However, if one spouse is a non-U.S. citizen, purchasing in their sole name may avoid U.S. tax on the rental income. Coordinated U.S. advice should be taken as there may be gift tax points to consider.

TAX ISSUES

Income Tax

U.S. citizens purchasing a property as an investment will be liable to UK income tax on the rental income. For tax year 2013/14, the rates are 20% on the first £32,010 (after any applicable reliefs and personal allowances), 40% on the remainder up to £150,000 and 45% on the surplus. Under the Non-Resident Landlord Scheme, income tax at 20% is effectively withheld from the rent by the UK letting agent (if any) or by the tenant unless the landlord actively opts out.

U.S. citizens purchasing a property for personal use should take advice on whether their proposed use of the property will make them UK resident for tax purposes. Under the UK statutory residence test, days of physical presence in the UK count towards UK residence, as can an individual’s “connections” to the UK, of which UK accommodation can be one. If the residence test applies, the worldwide income of the
U.S. citizen could be subject to UK tax. The 2003 UK/U.S. treaty should provide relief for any element of double taxation but a UK/U.S. accountant should be involved.

**Capital Gains Tax**

UK capital gains tax (“CGT”) may apply when a U.S. citizen sells a UK property if a gain is made over the acquisition cost of the property. The rate of CGT is currently 28%. However, CGT only applies if the individual is a UK resident in the tax year of sale or, has been a UK resident and sells when non-resident, and returns to the UK within five tax years. Up to 100% relief can be claimed if the UK property is the individual’s only or main residence.

**Stamp Duty Land Tax (SDLT)**

SDLT is a mandatory tax to which a buyer is liable when buying a property in the UK (regardless of residence status). The rate of SDLT varies according to the purchase price with the maximum rate of 7% applying to properties worth over £2m.

**Inheritance Tax**

UK inheritance tax (“IHT”) will apply if a U.S. citizen dies whilst holding a UK property or if he makes a gift of it during his lifetime. The rate on death is 40% on chargeable transfers in excess of £325,000 (a threshold known as the “nil-rate band”). Transfers between spouses are generally exempt but a restriction applies if the recipient spouse is non-UK domiciled, in which case the exemption is limited to £325,000.

The UK IHT regime is usually the main drawback for U.S. citizens purchasing UK property but mitigation planning is discussed below.

**ESTATE PLANNING**

**Wills**

It is important that a U.S. citizen makes a Will to deal with the succession to a UK property on death. The property will otherwise pass in accordance with the UK Intestacy Rules according to a fixed order of priority.

Having a Will also allows the U.S. citizen to include provisions to ensure the property passes efficiently from an IHT planning and U.S. estate tax perspective.

The UK Will may need to include a “credit shelter trust,” benefitting the spouse and any children, into which an amount equivalent to the estate tax applicable exclusion credit (a maximum of $5,250,000 for 2013) should pass. Whether this is to be included will depend on the terms of any U.S. (or other) Will and the value of the U.S. citizen’s estate, and legal advice on UK and U.S. Wills should be coordinated (not least to ensure that one does not revoke the other). Either way, an equivalent provision to make use of the IHT nil-rate band should be included or carved out of the credit shelter trust as necessary. Any remainder of the UK estate should pass to the surviving spouse in a form that qualifies for the estate tax marital deduction and IHT spouse exemption (subject to the restriction for non-UK domiciles referred to above). This structure ensures that IHT and estate tax are deferred until the survivor’s death. If the surviving spouse is not a U.S. citizen, the marital deduction will only apply if a qualified domestic trust (a “QDOT”) is used for the survivor’s interest, and the UK Will must be drafted so as to comply with the requirements for a valid QDOT.

**Further IHT planning**

Using a mortgage can be an efficient way to minimise an IHT liability as any borrowing on the property should be deductible from the property’s value for IHT purposes. Co-ownership will avoid IHT if the value of each person’s share falls under the nil-rate band but each co-owner must use or occupy the property in proportion to their share of the property. Otherwise, life insurance could be considered and a policy purchased to cover the estimated IHT liability on death.

**CONVEYANCING PROCESS**

The conveyancing procedure in England can be broken down into two elements, namely exchange of contracts and completion. The main steps are:

1. After a price is agreed, the seller and buyer will instruct separate lawyers.
2. The seller’s lawyers will draft the contract and compile documents relating to the property. Title to land in England and Wales is guaranteed by the state, and registered at the Land Registry.
3. The buyer should instruct a surveyor to investigate the physical aspects of the property. The cost is around £1,500 plus VAT (a sales tax levied at 20%).
4. The buyer’s lawyer will undertake due diligence including carrying out a number of standard searches, namely:
   - Local Authority Search. This is submitted to the Local Authority and deals with information relating to authorized alterations and works carried out at the property.
   - Drainage Search. This will confirm details of the water and drainage facilities.
   - Environmental Search. This identifies any possible environmental issues, including problems with past land use or contamination.
5. Planning Search. This advises of neighborhood statistics and of any new developments or applications relating to the surrounding area.
6. Chancel Repair Liability Search. Although uncommon, there remain properties affected by chancel repair liabilities. The liabilities often date back to medieval times, when the parish church was granted powers to charge rectorial properties for the upkeep of its chancel.

The buyer’s lawyer will deal with any issues and raise enquiries with the seller’s lawyer, if necessary.

5. When all enquiries have been dealt with, and the search results are received, the buyer’s lawyer will advise the buyer to proceed to exchange of contracts. Until exchange, it is open to either party to withdraw from the transaction, or renegotiate the price.

6. On exchange, the contract signed by the buyer is exchanged for the contract signed by the seller, and normally a 10 per cent deposit is paid. The sale is now legally binding and a completion date is fixed.

7. Between exchange and completion, there are various formalities to deal with, including signing documents and calculating funds required to complete.

8. On completion, the balance of the purchase price is paid, along with any other sums due, and the keys are handed over. Following completion, SDLT is paid and the buyer registered as the new owner.

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