MOVING OVERSEAS AND LETTING A UK PROPERTY – WHAT SHOULD YOU DO?

Selling a property in the UK to finance a new home in Australia can be hugely compelling, particularly given the equivalent £ cost of property in Australia at the moment. So long as the property being sold in the UK has been your main residence throughout the period of ownership, and you sell before leaving the UK (or indeed shortly afterwards), there should be no capital gains tax to pay, and you can transfer the funds to Australia without restriction.

But what about the situation when you want to let out your former UK home? How does the tax work then? Unsurprisingly the UK Inland Revenue will have some interest in what you are doing and you must take care to jump over all the necessary barriers - if you don't you can expect to be subject to penalties and interest. Similarly, once you have become a tax resident of Australia the Australian Taxation Office will require you to provide details of your UK let property. So are you taxed twice on the same income?

Looking first at the UK Inland Revenue: you should be aware that a surplus of rental income over allowable rental expenses remains taxable in the UK, irrespective of where you live and whether you are resident outside the UK. This is further complicated in that once you leave the UK to live abroad your tenant (if you have not appointed a letting agent) or the letting agent (if you have) is required to deduct tax at the basic rate from your rental income less the allowable expenses, and must pay this to the Inland Revenue. However, you can apply to FICO (the special tax office that deals with these issues) for approval for your property income to be paid to you without tax being deducted.

You will also be expected to submit a UK Tax Return each year, even if the rental expenses exceed the rental income. Rental expenses includes mortgage interest (not capital), and you can usually expect to be entitled to UK personal allowances which will normally absorb all if not most of the surplus rental income, meaning that little if any tax will be payable to the UK Inland Revenue.

However, once you become tax resident in Australia you become chargeable to tax on your worldwide income and capital gains. As a result, you must include details of your net UK property income on the supplement to your Australian Tax Return, and the net income will form part of your assessable income that is chargeable to tax in Australia. And as you might have hoped, you will be given credit for any tax you have paid in the UK when computing the amount of tax that you have to pay in Australia.

However, here's the nasty sting in the tail. The Australian Taxation Office requires an Australian resident to withhold tax from any interest paid to a non-resident. Usually this withholding tax rule applies to interest paid by an Australian bank to a non-resident depositor. However, if you maintain a mortgage loan on your UK property you will be required to withhold 10% of the gross mortgage interest and remit that sum to the ATO every time you make a payment of interest. Failure to do so renders you liable to penalty interest, and the inability to deduct the mortgage interest from the property income when computing the amount of income to be treated as assessable to tax in Australia.

The practical problem arises when you consider that your UK-based lender is not going to look favourably on your withholding 10% of the sum they are expecting to receive - it could easily put you in default on your loan - and so this 10% could represent an additional cost that cannot be recovered, nor indeed treated as a deduction and offset against your personal tax bill.

Each case will have to be looked at on its merits with particular regard to the lender's borrowing conditions, and some negotiation with your mortgage lender will almost certainly be required.

We are currently seeking clarification from the Inland Revenue's Centre for Non-Residents on how credit can be obtained for the tax paid in Australia - and if you would like to be kept informed please email us.

The capital gains tax position will depend on your personal tax status when you dispose of the interest in the property:

- If you return to the UK and resume tax residency you can expect the sale to be dealt with under the UK capital gains tax provisions, and as such you should:
  - Look at the gain on the property over the **whole period of ownership**.
  - Include an allowance for inflation (the indexation allowance) for the period from when it was first owned (or March 1982 if later) up to April 1998.
  - Apportion the resulting gain between the period when the property was the main residence (plus an additional three years) – this gain is exempt from the charge to tax – and the balance – which is potentially taxable. Note there may be further exemptions depending on whether you resume occupancy of the property before selling it.
  - Include a further (valuable) letting exemption, which can reduce the chargeable gain by as much as £40,000 per owner (ie £80,000 for a property held in joint names).
  - Include a deduction to allow for tapering relief.

  Given the above and the availability of an Annual Exemption it is frequently the case that there is no capital gains tax payable on the disposal of a property that has been let – although clearly the computation has to be prepared on the property's sale to confirm the actual position.

- If you are resident in Australia when you dispose of the UK property your taxable income will include the gain on the disposal of the property, measured with reference to the property's value **when you enter Australia** (meaning you will need to obtain an independent valuation of the property at the time that you move to Australia – probably from a local estate agent.) So long as you do not sell the property until you have been tax resident in Australia for more than 12 months you will also be entitled to the usual 50% discount on the capital gain (see our separate factsheets that discuss capital gains in Australia.) Note that Australia has no equivalent to the UK's capital gains tax annual exemption – the net gain is included in taxable income in computing the tax due for the income year.

Although slightly outside the normal situation, if your UK property investment is in a property that is used as a furnished holiday letting (and such properties can have very attractive tax planning uses), the tax treatment will be different. Contact us for more information.

Collett & Co Chartered Accountants can be contacted by email on info@collettandco.com, by telephone on 02380 488 786 (ask for Alan Collett), or by writing to us at Enterprise House, Ocean Village, Southampton, Hampshire, England, SO14 3XB. We will be happy to provide a 15 minute telephone appraisal without charge.