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# Private Wealth

THE LEADING LEGAL ADVISORS FOR HNW INDIVIDUALS AND FAMILIES



A guide for US  
purchasers of UK  
residential property

*Uncovering the traps beyond the transaction*

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*The UK and London in particular remains an appealing destination for HNW US families looking to relocate or invest in residential property, despite the potential to find themselves swimming against the tax tide.*

*When acquiring UK property, aside from seeking legal support on conveyancing, US purchasers should seek advice on the broader tax and legal implications. As with any substantial acquisition or investment, there will always be traps for the unwary. Where US purchasers are concerned, the traps can be more common and more dangerous. Taking advice from the outset will enable pro-active planning and help to avoid costly future mitigation.*

*In this report, Forsters' partners from across Private Client, Residential Property and Family, along with specialists in the industry, share their insights on the current UK market for US buyers and how best to navigate the specific risks for US-connected clients.*

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## A POSITIVE OUTLOOK OF THE UK PROPERTY MARKET

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Hugh Dixon of Knight Frank's Private Office shares this view, commenting that:

"London's super-prime residential market shrugged off Brexit and even looked through the pandemic, confirming the UK capital as the world's leading wealth destination. After five years of price falls, the capital is set for a reset and the latest numbers from Knight Frank's super-prime data confirm London is performing well."

### HIGH-VALUE LONDON HOMES REMAIN POPULAR

Property experts from across the industry agree that the UK residential property market, particularly high-value London real estate continues to be a popular choice for international buyers, both as a place to call home and for investment purposes.

### DESPITE RECENT TAX CHANGES

Prime Central London property is expected to remain attractive to foreign purchasers, even with the recent changes to SDLT, which have included:

- The introduction of a surcharge of 2% for non-UK resident purchasers completing on purchases from 1 April 2021.
- A surcharge of 3% introduced in April 2016 for purchasers who already owned a residential property anywhere in the world (and were not replacing their main residence) at the time of completion.

This means that SDLT rates for individual purchasers can now be as high as 17%.

Encouragingly, in Hugh's experience, this isn't having an adverse impact on the market:

"Overall this isn't something that we're currently seeing amongst most UHNW clients – mainly because a lot of activity is coming from domestic buyers or international buyers already based in London. When international clients return to the London market, it will be interesting to see how much of an impact this will have.

However, the cost to purchase in the UK against other markets, remains competitive. Key motivators for clients purchasing here also remain unchanged – capital preservation, the UK education system and cheap debt – all real driving factors for clients and reasons why they choose the UK and London in particular."

### PARTICULAR INTEREST FROM THE US

In terms of the international marketplace, Knight Frank report continued appetite from "across the pond" and Hugh observes that

"interest is coming from both the East and West Coast of the US, specifically the key wealth hubs including LA, NYC and Miami."

Whilst many US buyers are relocating domestically to Miami to avoid the high New York and California property taxes, the UK also remains attractive due to its lower holding costs.

### UK-US CROSS BORDER ISSUES

As the allure of UK property for US buyers continues to grow, it is important to draw attention to the specific UK-US cross border issues that may arise from US connected persons owning UK property. Here, we explain some of the key cross-border issues at play and reveal the planning options available to protect against these risks.

## TAX AND ESTATE PLANNING CONSIDERATIONS

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### EXPOSURE TO UK INHERITANCE TAX

The acquisition of UK real estate by a non-UK domiciliary will always come with an increased exposure to UK inheritance tax (IHT). The value of UK property in a person's estate will be subject to IHT at a flat rate of 40% on death if and to the extent that it exceeds the deceased's available 'nil rate band' amount of up to £325,000. This may come as a shock to clients from the US, where the amount that can pass free of Federal estate tax is currently \$11.7m!

In the past, non-UK domiciled individuals (who are only exposed to IHT on UK assets) would have been advised to acquire UK real estate through a non-UK registered holding company, which would serve as a "situs blocker" and protected the value of the property from IHT. However, following the introduction of anti-avoidance legislation in April 2017, shares in a non-UK registered company will now be treated as UK assets for IHT purposes (so will be exposed to IHT, regardless of the deceased owner's domicile) if and to the extent that their value reflects the value of underlying UK residential property.



## TAKING OUT A MORTGAGE

The options for mitigating this IHT exposure are now very limited. In most cases, the only option will be to purchase the property with the benefit of a commercial mortgage, which should be deductible against the value of the property for IHT purposes. Of course, this comes at the cost of paying interest to the lender, and whether this is worthwhile will vary from case to case. Where US persons are taking out mortgages to fund purchases, there are some extra considerations to be taken into account.



Borrowing from individuals (e.g. friends or family) or non-UK resident trusts offers less IHT protection when viewed holistically because, although the debt should be deductible from the borrower's estate for IHT purposes (subject to various legislative conditions being met), the benefit of the debt will be subject to IHT in the lender's hands. This was another of the changes introduced in April 2017.

Coutts

As explained by James Rose,  
a Private Banker at Coutts & Co:

“For US people, getting a UK mortgage can present a number of issues. Many banks will struggle to lend to people whose income isn't denominated in GBP and will want to see the income being received into a UK bank account. These issues are further amplified for HNW individuals, who are often not salaried individuals but instead have complex income streams. In these circumstances, it may be better to find a lender who can adopt a more pragmatic approach and potentially consider the client's wider asset base to support the application. Furthermore, while many US clients may want to consider taking an Interest-Only mortgage for tax planning purposes, a number of changes to mortgage regulations over the last decade mean that few banks are willing to offer these any more. Nonetheless, US clients should be careful about taking a “flexible” mortgage product (such as those which you repay and redraw) and should seek specific tax advice as these products can have unintended US tax consequences as well. Overall, it is worth looking for a Private Bank or specialist mortgage lender who can take into account more complex client circumstances as well as engaging with a tax adviser who understands both countries tax regimes.”



On a positive note, Christiaan van den Hout of Vie International explains that:

## LIFE INSURANCE

Given the limited scope for IHT planning, many clients will choose to accept the IHT burden and, instead, take out life insurance to cover the liability that will arise on their death. If they do this, they should be advised to take out the policy through a life insurance trust (or assign the benefit of the policy to a trust) to prevent the proceeds themselves being subject to IHT.

“US-connected clients are likely to have access to the US life insurance market, which can sometimes offer more appealing solutions than the UK market. The larger US domestic life insurance market can offer a number of enhanced benefits including more sophisticated underwriting, flexible products, more robust legal guarantees and superior pricing. It is not uncommon to see discounts of 20-50% on life insurance products sourced in the US versus the UK when considering permanent (‘whole of life’) and short 10-year term policies.

US persons will automatically qualify for the US life insurance market as will non-US persons who can demonstrate sufficient US nexus. In the UK, the level of cover available is typically commensurate with the tax liability on UK situs assets. The US does not have this same restriction; once US nexus is demonstrated, a larger amount of insurance can be obtained based on the client's total worldwide assets, including wealth held in offshore entities such as companies and trusts.

Further, for some non-UK domiciled individuals who claim the remittance basis of taxation, remitting foreign income or gains into the UK to fund a UK life insurance policy may incur tax charges that ultimately require grossing up the premium figure. For these individuals, remitting the same offshore funds into the US to pay the premiums on a US policy does not incur the same tax charge.”

But US citizens and residents will also need to ensure that the trusts they create will take the form of US irrevocable life insurance trusts (“ILITs”).



Dina Kapur Sanna of Day Pitney LLP comments that:

“Assuming the ILIT is properly drafted and administered, at the death of the donor-insured, the insurance proceeds will not be includable in the insured’s taxable estate and will also be exempt from income taxes.

If an insurance policy is transferred to the trust or purchased by the trust and is completely owned by the trust, cash gifts can be made to the trust each year to pay the premiums without the ownership of the insurance being attributed to the insured. This can keep the full death benefit of the policy out of the estate of both the insured and the surviving spouse; provided, however, if the policy is transferred to the trust, there is a 3-year survival requirement for the proceeds to escape estate tax on the death of the donor.

The gifts to the trust can be designed to qualify for the \$15,000 annual gift tax exclusion through what are sometimes called “Crummey” withdrawal powers exercisable by the beneficiaries (usually the spouse and children, or in the case of a two-life policy, by children and more remote descendants).”

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## WILLS

Clients who acquire UK real estate should also be advised to consider putting in place a UK will. For married couples, the UK will should be structured in a way that allows access to the spouse exemption from IHT, so the tax liability can be deferred until the second death. While this can potentially be achieved in a foreign will, the added benefit of having a UK will in place is to facilitate the administration of the UK estate on death.

In particular, to obtain probate of a foreign (e.g. US) will in the UK, the Probate Registry will require an affidavit of foreign law (provided by US counsel) confirming the validity of the will as a matter of local law and who is entitled to administer the estate. This gives rise to an additional administrative hurdle (and associated costs) for the executors that would not arise if there was a local will in place. Having said that, if primary probate is granted in the US, the Probate Registry will generally accept a court-exemplified copy of the US will to probate in the UK without an affidavit. But this option has its own disadvantages, including the inevitable delay in administering the UK assets.



## CAPITAL GAINS TAX ON THE FAMILY HOME

For UK capital gains tax (CGT) purposes, gains realised on the disposal of a person’s main home benefit from 100% relief, assuming the property has been that person’s main home throughout the period of ownership. This is not the case for US income tax purposes, where only the first \$250,000 will be exempt and the balance will be subject to tax. This US tax overlay can cause the UK relief to be wasted.

Therefore, in the case of a couple with one US spouse and one non-US spouse, it will generally be most tax efficient for the main home to be owned solely by the non-US spouse. But where the US spouse is funding the acquisition of the property, it’s not that simple! Due to the absence of an unlimited spousal exemption from US gift tax on gifts to non-US citizen spouses, the gift itself could have adverse US transfer tax consequences. To address this, the US spouse might consider making annual gifts of fractional interests in the property to the non-US spouse. Under current rules, the US spouse can make gifts of up to \$159,000 to the non-US spouse each year free of US Federal gift tax. These regular gifts can add up over time to improve the CGT position.

## ASSET PROTECTION CONSIDERATIONS

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### USE OF TRUSTS

While the use of trusts to hold UK residential property can potentially offer some degree of asset protection when compared to outright personal ownership, this protection may not be as robust as clients would like. In the event of a divorce, for instance, trust assets can be considered a financial resource available to the spouse who is a beneficiary (although this will depend on the terms of trust, distribution patterns, etc.) and the trust may even be treated as a “nuptial settlement” if it is settled by one or both of the couple, or by a third party for their benefit. If a court finds the trust is a nuptial settlement (which is comparatively rare but not unheard of) it will have extensive powers to change the terms of the trust, remove/replace trustees, order distributions, etc. This is in stark contrast to the position in the US, where trusts are generally robust and immune from variation.

The use of trusts might also be unattractive from a tax perspective. For instance, the value of the property would suffer an IHT charge of up to 6% every ten years while it was held in trust. The property would also continue to form part of the estate of the settlor (so be subject to IHT on his or her death) unless he or she was irrevocably excluded from benefit. Excluding the settlor from benefit is unlikely to be practical if he or she wishes to occupy the property. Furthermore, holding the property in trust would give rise to reporting obligations for the trustees, who would need to report the existence of the trust and details of its beneficiaries to HMRC through the Trust Registration Service.

As a result, there will only be very limited scenarios in which trust ownership will be appealing. Generally speaking, direct personal ownership will be the preferred route for the family home.



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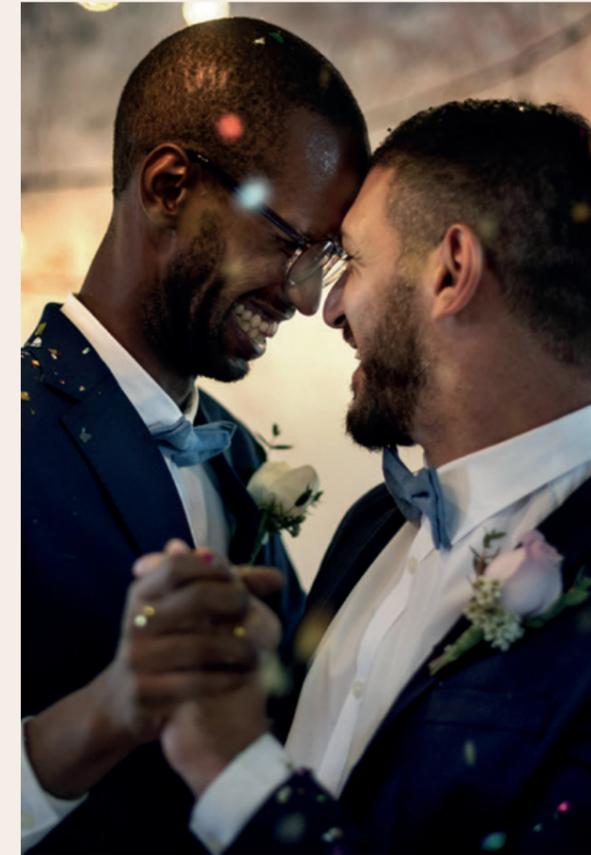
### PROTECTING ASSETS FROM SEPARATION OR DIVORCE

Rosie Schumm | Family Partner

#### Nuptial agreements

A pre-nuptial agreement offers the best degree of protection for UK property on divorce. Parties are able to define marital property (which is to be shared) and separate property (to be ringfenced) and can also set out levels of spousal and child maintenance payable on separation. Provided the agreement meets the parties' respective needs, and those of any children, it will generally be considered binding.

There are many reasons why people have a nuptial agreement, including;



(i) if there is an actual or expected disparity between the wealth of the spouses;

(ii) there are assets which have been in one of the parties families for generations that a party would like to protect against divorce; and

(iii) if it is not a first marriage and a party wants to preserve assets for children of a previous marriage.

The aim of such agreements is to provide certainty and security if the marriage did breakdown, and more power to a couple to make arrangements for the future, rather than leaving everything up to the court. Above all else, a pre-nuptial agreement saves acrimony and potentially significant costs if there were a divorce in the future.

Pre-nups will be familiar territory to many US-connected clients, but there are some additional considerations and differences that they will need to be aware of on moving from the US to the UK.

UK pre-nups are not automatically enforceable like pre-nups in the US, but are instead guided by UK case law. This case law states that the starting point is that nuptial agreements will be upheld, but they must meet certain conditions including;

- (i) the pre-nup has been entered into freely;
- (ii) each party has taken independent legal advice;
- (iii) there has been full financial disclosure by both parties; and
- (iv) the agreement is fair. This element of fairness is the second differentiator between UK and US pre-nups; if a US pre-nup is in place, it must satisfy the principles of fairness to be upheld in the UK.

It would be wise for any clients that are moving from the US to the UK to have their arrangements reviewed by UK counsel and revised or supplemented, if necessary, to provide more robust protection against claims on divorce. Alternatively, if a nuptial agreement is not in place, a move to the UK or an investment in UK property may provide the impetus to negotiate a post-nup.



### Cohabitation

There can also be a risk of claims against property on the separation of unmarried cohabitants. While there is no such thing as common law marriage in England and Wales (and the starting point on the separation of unmarried cohabitants is that neither party will have any ongoing financial obligations towards the other), there are a number of means through which one party can make a claim against the other with respect to property.

In England and Wales, cohabitation is a patchwork quilt of potential claims that can call on various different areas of law, including property, family, trust and children law, to make a claim. For example;

a) Claims for the benefit of children – The court could make a settlement or transfer of property order, to provide a home for the child for their minority (NB: Any capital awarded to purchase a property is likely to be held in trust until the child's majority or the end of full-time education, when it will revert to the payer).

(b) Trusts of land – One party may be able to rely on actions during the course of a relationship (e.g. conversations, oral agreements, regular payments towards outgoings in relation to the property etc.) to establish a beneficial interest pursuant to an implied, resulting or constructive trust. The latter is most relevant in the domestic context. Alternatively, a party can rely on proprietary estoppel to claim a beneficial interest.



They must show:

- (i) an assurance on the part of the other party (e.g. leading them to believe they will have some right in relation to the property)
- (ii) that they relied on the assurance to their detriment; and
- (iii) that it would be unconscionable for the other party to deny them the right they expected to have.

In terms of protection against this, a cohabitation agreement would be recommended. This allows parties to regulate the terms of their cohabitation, providing clarity both during the course of the relationship and in the event that it should break down.

The agreement would incorporate or be accompanied by a declaration of trust in relation to any real property, confirming the parties' respective beneficial interests. The agreement can also deal with a wider range of issues, including how household expenses are to be split; what happens if one party wishes to sell the property and the other does not; financial support during and after cohabitation; and living arrangements and financial provision for children.

Security and clarity of such a kind is extremely beneficial to a couple if the relationship breaks down in the future.

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## CONCLUSION

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*The UK and London in particular remains a leading destination of choice for wealthy international families.*

*While there will often be additional challenges for US-connected clients, these can be navigated with the right team on board. Forsters' Private Wealth includes UK-US cross border specialists experienced at guiding US connected clients through the property transaction process as well as the longer-term implications of holding UK property. Along with our strong network of expert contacts we are on hand to provide comprehensive support. Please do get in touch with any member of the team to find out more.*

### Our Team



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