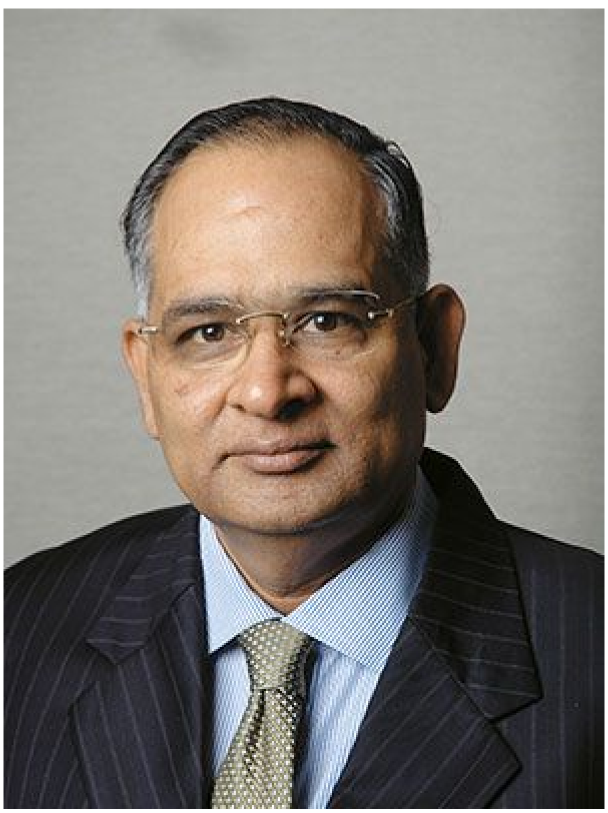
# Tax Issues to Look Out for While Buying International Property

by Pravin Palande

**TP Ostwal, a specialist in international taxation,** tells Forbes India about some of the tax issues that an investor should keep in mind while entering into an international real estate transaction


TP Ostwal, a specialist in international taxation

**Which countries have the best regulatory framework for real estate investment?**
It is difficult to name the countries as there are too many countries that have good regulations. Currently, many European countries are going through a financial crisis and it is difficult to take a call on their regulatory aspect. It is important to look at the political and economic risk of each country. Before buying a property, one must understand all the aspects of buying very well, including costs associated with the purchases, both direct and indirect.

**What are the indirect costs?**
Stamp duty, transfer duty and registration charges are the important indirect costs. But there are a lot of hidden costs that might be present in many countries. The investor needs to be very careful about these hidden costs.

If the investor is not going to use the property himself and put it for rent through some agencies there, one needs to know the terms and conditions and the laws of the country. If agencies are going to manage your property for weekly or monthly rental or long-term lease, what are they going to charge for it?

So, we need to enquire about it at the beginning. To understand these aspects, you need to have a very committed and known advisor.

**Can one finance an international real estate transaction?**
India permits a resident Indian to take away $200,000 of funds out of India every year per individual out of his own funds. You can't take a loan in foreign currency for these transactions. Individuals are not allowed to borrow without RBI permission and that's why this becomes a very inefficient way of acquiring property abroad.

**Why is this transaction inefficient?**
Since you are putting your own money for buying a property, this transaction becomes inefficient as you are not in a position to use cheap borrowed funds for buying such properties. Internationally, interest rates are low—around 2 percent to 3 percent. If you put these funds in Indian bank deposits, you could have got much higher returns. You can make a post tax return of at least 7 percent, without any risk. Hence, there's an opportunity loss if you need to invest your own money [to buy] property outside India.

**What is the way around this?**
Buy property through a company. For this, one needs to have a company in India. Such a company can, subject to certain conditions and restrictions, set up a 100 percent subsidiary company in the foreign country for business purposes. The business purpose of that company should be clear. Your subsidiary company outside India can then buy property out of funds sent to such subsidiary company in any country.

**How can we explain business purpose?**
One should demonstrate the business purpose of the subsidiary company. One can set up a subsidiary or joint venture under the automatic route, subject to the fact that the capital does not exceed 400 percent of the net worth of the Indian company.

Out of the capital contributed for doing business abroad in the subsidiary companies, one can buy property partly out of the company's own funds and partly out of international borrowings. Such borrowings could be at a cheaper rate of interest prevailing in foreign countries, i.e. by leveraging your ability to borrow against mortgage of property.

Let us suppose a property is worth $800,000. The Indian company can send $200,000 to a subsidiary company abroad and then take a $600,000 loan, carrying an interest of 2-3 percent against mortgage of property, and purchase the property worth $800,000. So, in this way, one can take advantage of the lower interest loans without blocking your own funds.

**How will my rental income get taxed?**
If you are an individual buying property abroad and earning rental incomes, then whatever income is earned abroad will be subjected to tax in the country where you get the income. There is also a possibility that such income will be taxed again in the country where you are residing, say for example, in India.

However, India has tax treaties with a number of countries, hence taxes paid abroad will be available for setoff against your tax liability in India and one would pay the differential tax in India. In the event the tax rate is higher in the other country, refund of excess tax would not be available in the country of residence. One should consult an expert to find out whether the rental income of a property is taxable in both the countries, i.e. country where the property is situated and country of residence of the individual. In some cases, it is taxable only in the country where the property is located, whereas in others it is at both places.

India has approximately 87 treaties; one needs to read the fine print to understand how it works for individuals and corporates. Buyers should concentrate on Article 6 of the tax treaty which is related to immovable property income.

**What about capital gains?**
If you sell the property, you will be subjected to capital gains tax in the country where the property is situated. There are some countries which do not levy capital gains, like Dubai, Singapore, Cyprus and Mauritius. One should examine the treaty provisions between the countries to find out whether capital gains tax can be levied in both the countries or in one of the countries whereby capital gains tax liability in the other country can be mitigated.

But, even in such an event, you as an individual will still be taxed in India. On the capital gains, if such gains are long term [say, you are selling the property after three years], then you will have to pay a tax of 20 percent in India; if it is short term [the property is sold within three years], then normal tax at 30 percent is applicable. Apart from capital gains, one should examine tax liability under the Wealth Tax Act in India, wherein tax at 1 percent per year on wealth above Rs 30 lakh will be levied, unless the property is let out.

**How do you sell off an international property?**
You have to see if there are any capital gains taxes levied on the exit transaction.

If the property is purchased in the name of a company, you can simply sell the company and that gives you an exit from the property as well.

With a view to taxing such overseas transfers, the UK is introducing new laws from 2013 on property held through foreign companies and now there will be higher property tax and higher stamp duty and capital gains on indirect transfer of an overseas company holding property.

However, buying a property through the subsidiary companies structure would avoid taxation in the country of residence [if it is India], presently. But this may not be true for other countries.

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