Virginia La Torre Jeker

Tax watch

THE PROPERTY BUYING FRENZY

Handsome profits are possible with proper planning says Virginia La Torre Jeker.

The spectacular frenzy of the building and purchasing of property in Dubai has been nothing short of remarkable. Dubai's property market, while still quite young, is also very impressive. Foreign nationals have shown every confidence in the market and many are willing to commit to expending serious sums of money on purchasing properties here. Profits can be lost though, by a lack of forethought concerning certain issues. Some matters involve local real property issues that are not present in other countries. Relevant considerations are reviewed briefly in the first part of this article. The second part of this article explains some of the home country tax matters that the foreign national should take into account before purchasing. This is an area often overlooked but that can have significant and far-reaching implications. If the Dubai property investment turns out to be a boon, the investor will have succeeded handsomely. Yet, few realise that those profits can be eaten up quickly by hungry tax authorities in the investor's home country. Proper planning can alleviate the bite. At a minimum, the investor's initial purchasing considerations and cash projections should take into account these tax implications.

Considerations before investing

The UAE legal issues

The Dubai community holds out great expectations for its forthcoming "new lands law". This long awaited piece of legislation should enable foreign nationals to register and be issued a title deed for their ownership of Dubai property, via the local Lands Department.

The potential investor should be aware that the law is still a bit unsettled with regard to foreign ownership of real property in the UAE. While the Federal law doesn't prohibit the ownership of UAE property by a foreign national, to date, registration procedures have not yet been formulated. Developers are currently working with the Dubai Lands Department on this matter. Under current Federal law, nothing prohibits Dubai from passing legislation permitting the foreign ownership of Dubai property, and general consensus seems to be that the "lands law" will be formally promulgated. Thus, while it appears that the Dubai lands law would not conflict with the Federal law of the UAE (and most people agree that it is unlikely that future Federal law would overturn the Dubai "new lands law"), potential investors should be cognizant that in the worst case scenario, the UAE government would have the right to issue a Federal Law to bar foreign ownership of Dubai property. Such an outcome would seem unlikely given the UAE's progressive stance and its potential for attracting foreign investment. Additionally, comfort can be found in an existing provision of the UAE federal law concerning the inheritance of property, which itself implies that foreign nationals can own real property in the UAE.

Aside from the federal constitutional issue about Dubai's ability to pass a law authorising foreign ownership of property, are there any other legal matters that should be considered by the foreign person wishing to buy property here? In a word, YES! The purchaser may be at risk with regard to the initial monies deposited. The properties in question are often not yet built, yet purchasers are paying the developers a large percentage of the purchase price. As of yet, there is no requirement under Dubai law for protection of the purchaser in the event difficulties arise with a developer who is not backed by the UAE government. The matter is most likely left to the contractual agreement between the purchaser and the developer. Purchasers should consider that the contract is undoubtedly drafted in favor of the developer. There is also some uncertainty regarding the Sharia law implications of real property inheritance. Finding a solution for the possible Sharia law problem can be accomplished, but the solution may result in a disadvantageous tax position vis a vis the investor's home country.

Home Country Tax Concerns

Dubai's tax-free environment makes the emirate an attractive place to live and work. Living in such a tax haven makes it easy to forget that the matter of taxes cannot be completely ignored for many foreign nationals. Quite often the tax laws of the investor's home country must be considered before taking the investment plunge into the Dubai property market.

United States

This is especially so for US citizens and green card holders who are subject to current US income tax on their worldwide income (that is income - e.g., dividends, rents, interest, capital gains, etc. -- earned from anywhere on the globe) even though the person is not living in the United States. The first stage of consideration must be given as to how the property will be held. Will it be held by an offshore company, a trust structure or in the US individual's name?

Many persons consider using an offshore (i.e., non-US) corporation (for example, one created in the British Virgin Islands, BVI) to prevent issues of inheritance under Sharia law. While this strategy may possibly avoid the Sharia law issues, it can raise some serious US tax matters. Without the prior proper US tax advice, the BVI company would undoubtedly be treated for US tax purposes as a "controlled foreign corporation", passive foreign investment company" and / or a "foreign personal holding company." Characterisation as any of these may cause serious adverse income tax consequences to the US shareholder. Examples include, immediate taxation to the US shareholder of income (such as rent) earned by the BVI company even if the BVI company makes no distribution to the US shareholder; transmutation of any proceeds upon sale of the property from favourably taxed "capital gain" to unfavorably taxed "ordinary income"; imposition of imputed interest charges. Further, if the property was used as the personal residence, lack of proper planning can result in loss of the US$500,000 tax exemption against the gain on the property. Aside from these concerns, comprehensive annual information reporting to the US tax authorities (IRS) is required of US shareholders of foreign corporations. Stiff monetary penalties apply for noncompliance. Ownership through a foreign trust structure can have disastrous US tax consequences and must be very carefully examined beforehand.

The second stage of planning involves how the property will be used and how it will be financed. Tax concerns here include whether interest paid with respect to the property can be deducted for US tax purposes; offsetting of rental income by other expenses deducted as "trade or business expenses" and capitalisation of certain other costs.

The third stage of planning involves how the property will be disposed. The purchaser of several properties 'on spec' will have very different tax issues to that of the long-term investor. Furthermore, both of these owners will have different tax results to that of the US person who has been using the property as his personal residence. If ownership of the property has been through a poorly planned foreign corporation, it can result in adverse tax results as well as the loss of significant tax benefits upon sale of the property. Owners must consider, as well, that the US Estate and Gift Tax issues can be triggered as a result of the ownership of the property.

Other Countries

While most other countries do not impose as complicated and harsh a tax regime as the United States, nationals of other countries should be aware of how their home country tax rules will apply when purchasing a property in Dubai. For example, citizens of the United Kingdom would be advised to carefully think about whether the tax authorities of their country will consider them to have been UK "resident" or "nonresident" in any year in which rental income is earned from the Dubai property or in which capital gain is earned on its sale. Thus, the year of departure from the UK and the year of return to the UK are critical years in which care must be taken with respect to the property. If considered "resident" then the income and gains can be subject to UK taxation; but depending on the circumstances, taxation on a pro-rata basis may be assessed. A similar concern arises with respect to ownership of the property through a foreign (i.e., non UK) corporation that is in turn, owned or otherwise controlled or managed by a UK national. In the absence of proper planning, such a non-UK corporation can under certain circumstances be taxed under the UK corporate tax regime, thereby subjecting to UK tax, the rental income and/ or capital gains earned on the Dubai property.

Canadian nationals living overseas must be very careful to ensure they have obtained "nonresident status" for Canada tax purposes and that such status is continuing when they earn income from the property. In certain circumstances, the issue of "nonresident status" can be a very gray and ambiguous area of the law. Only if a Canadian national is "nonresident" when earning rental income or capital gain on sale of the property, will these amounts escape taxation by Revenue Canada. It should also be borne in mind that upon return to Canada, the national will be deemed to have sold the Dubai property (despite lack of actual disposition) and will be taxed accordingly at such time. Such a "deemed" sale at the time of re-entry means a valuation of the property would be required. Obtaining a valuation in the Dubai market might prove extremely difficult. Also, the Canadian national wishing to avoid Sharia law inheritance issues must take careful advice before establishing a foreign corporation to own the property. In some cases, ownership through a foreign corporation can result in imposition of a higher tax.

Australian nationals living abroad must also be concerned with, among other tax considerations, whether they have obtained "nonresident status" for purposes of Australia's tax laws. If an individual is nonresident, then only Australian sourced income is taxable in Australia (at higher 'non-resident' rates). If the individual is considered an Australian resident, tax is payable on such individual's worldwide income (thus, capital gains earned on sale of the Dubai property and on any rental income earned from it would be taxable). Under Australia's rules, there are four main tests for residency, the primary one being the so-called "residence test". If an individual resides in Australia according to the ordinary meaning of the word, the other tests do not need to be considered. The other three tests are known as statutory tests. If the individual is unable to satisfy the "residence" test, then he must consider the statutory tests to determine residency. Residency should be determined each income year separately and independently. The fact that one qualifies as a nonresident in one income year does not mean treatment as a nonresident will follow in subsequent or previous years. If it is held as an investment and not for personal purposes, "residency" status will also affect deductibility of the various expenses incurred with regard to the Dubai property (e.g., interest payments, maintenance costs and the like). The nonresident cannot deduct such expenses to offset Dubai rental income earned on the property; whereas the resident may do so.

In summary, many variables are involved with a particular national's home country tax system. They should be carefully considered and proper planning undertaken in order to maximise the profits we all hope are on the horizon with making a Dubai property investment. ■

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