

Sale of foreign property: implications for individuals (2/24/20)

In today's dynamic world, it is not uncommon for a tax resident of one country to sell some real estate ("RE") they own abroad. In such cases we need to examine the tax laws of both the person's country of residence and the country of origin of the property or income, as well as international treaties. This article explores an example from our practice involving a Latvian tax resident selling their Russian RE in the light of Latvian tax laws, the Latvia-Russia double tax treaty, and other important aspects.

Background

In 2019, a Latvian tax-resident individual sold his RE in Russia. He had held it for more than 60 months, and it was his sole RE for the last 60 months before the sale.

The buyer is a Russian tax resident, and the transaction is concluded in Russia.

The transaction is covered by a contract of sale and performed partly in cash, with a safe deposit box rented at a bank for the transfer of cash. The contract states the amount payable in cash and gives information about the safe deposit box rental. The transaction involves more than EUR 30,000 in cash.

Our analysis

Russian tax laws are not analysed in this article. According to the information available to us, Russian tax laws provide that a person's income from selling RE in this case attracts a 0% Russian PIT. Cash transactions in this amount are legal in Russia (if certain criteria are met, such as a written contract stating the price).

Under the double tax treaty, income from selling Russian RE primarily attracts Russian PIT or a similar tax. The double tax treaty does not, however, give Russia an exclusive right to charge PIT on this income, so we also need to examine the tax laws of the person's country of residence (i.e. Latvia).

Under Latvian tax laws, a Latvian resident's income from selling RE (regardless of the country of origin of that income) attracts Latvian PIT payable through filing a capital gains tax return. The option of tax credit available under the double tax treaty means that PIT or equivalent tax paid in Russia may be deducted from the Latvian tax liability. In this case a 0% tax has been charged in Russia, so if this income does not qualify as exempt under section 9 of the PIT Act, the capital gain will attract Latvian PIT at the full rate of 20%.

Exempt income

We also need to assess whether the income might qualify as exempt in Latvia.

Section 9 of the PIT Act lists types of exempt income, and the Act lays down a number of criteria that must be met if income arising on the sale of RE is to be exempt. Section 9(1)(33.1), for example, exempts such income if the taxpayer has held the RE for more than 60 months and it has been his sole RE for the last 60

months before the sale. It is important to note that this provision is not restricted to Latvian RE, so income from selling foreign (Russian in the example) RE may also qualify as exempt under section 9(1)(33.1). The State Revenue Service has yet to comment on whether this exemption is available on foreign RE sales.

When selling Latvian RE, it is easier for the taxpayer to show that the criteria are met in order to exempt the income. For example, the land registry holds information about the period the taxpayer owned the RE. When selling foreign RE, it is in the taxpayer's own interests to gather all the necessary documents that would help show that the criteria are met to ensure the income qualifies as exempt.

Reporting the income

Any taxable income arising on the sale of RE has to be reported as a capital gain. Any exempt income from selling RE has to be reported on the annual income tax return. If exempt income exceeds EUR 10,000 a year, the person has to file the annual income tax return. The income mentioned in the example exceeds this amount and originates abroad, so the person is clearly required to file the annual income tax return for 2019, along with documentary evidence of the income origin and proof it qualifies as exempt.

In practice, along with the annual income tax return, it is advisable to file a copy of the contract of sale and excerpts from the Russian land register to prove the holding period (plus a Latvian translation). In the case of receiving income by bank transfer, the annual income tax return should be accompanied by a bank statement to prove receipt.

Cash transactions

In the example the person receives some of the selling price by bank transfer in accordance with Russian tax laws. As a Latvian tax resident, the person is governed by restrictions on cash transactions imposed by the Taxes and Duties Act. Section 30(8) makes it illegal to receive more than EUR 7,200 in cash. Unfortunately the lawmaker has made no exceptions for transactions completed in accordance with foreign tax laws, so we recommend examining all the aspects of Latvian tax laws carefully before starting a transaction abroad. A transaction that is legal abroad may be subject to restrictions in Latvia that may cause the taxpayer to be punished for making such a transaction in accordance with the Taxes and Duties Act.

Useful information on RE transactions can be found on the [SRS website](#). If you need help from tax professionals, please feel free to contact Alina Ruskova (alina.ruskova@pwc.com) at the stage of planning your transaction.