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TAX IMPLICATIONS OF HOUSING ALLOWANCES AND PURCHASE OF A RESIDENCE ABROAD

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A U. S. citizen employed abroad may solve his residence needs in the host country by renting premises or buying a house. In order to defray residence costs, a U. S. expatriate may receive a housing allowance from the American employer. This study deals with the tax treatment of such allowance from the employee's viewpoint and from the payor company's viewpoint, in each of the 18 Latin American countries.

Where housing abroad is solved by purchasing, tax consequences under the foreign law are discussed with respect to imputed rental value of the owned residence, gains or losses resulting from the disposition of real property used as residence, and possible qualification under low-cost-housing incentive laws in each of the 18 Latin American countries.

HOUSING ALLOWANCE

A housing allowance will be taxable in any of the Latin American nations. This treatment is, of course, consistent with the disallowance of the deduction of personal expenses, which all the Latin American tax systems contemplate.

However, there is a country where a deduction is allowed for the rent paid: COLOMBIA (Law No. 27 of December 22, 1969, Art. 2). The limitations on such a deduction are twofold. In the first place, the maximum deduction is 5,000 Colombian *pesos,* or about US $250.00 per year. In the second place, such deduction combined with others for education, medical expenses and other professional services, has to be reduced by the amount

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that "net income" exceeds 40,000 Colombian *pesos* (US $2,000.00) within the taxable year.

As for the deductibility of the allowance by the payor, a preliminary distinction is called for — whether the employer is a) a domestic company or a foreign company doing business within the host country through a permanent establishment, or b) a foreign company not so established within the host country.

In situations described under a) above, the allowance would be deductible only if it is regarded as part of the salary. Even in this case, there may be two limitations: 1) if the allowance is paid to a manager or director, there may be specific limitations as to the amounts deductible; this is true in COLOMBIA, Law No. 81 of December 22, 1960, art. 43, as amended by Decree No. 1366 of July 20, 1967 — BOLIVIA, Regulations art. 63-2 — PERU, Supreme Decree No. 287-68-HC of August 9, 1968, art. 38-n — VENEZUELA, Income Tax Law of December 16, 1966, art. 5, paragraph 2; 2) if the country has a social security system, the deduction may be conditioned on proof of payment of the social security contributions; this is the law in COLOMBIA and CHILE.

Should the housing allowance not be treated as salary, it would be regarded as a bonus. Cash payments in the nature of a bonus or allowance for normal expenses are deductible if required by law. They may also be deductible even if not required by law, but if they are considered as being ordinary and necessary business expenses. Such an allowance would not be so treated in GUATEMALA, URUGUAY, VENEZUELA, CHILE,[1] and perhaps BRAZIL.[2]

In situations described under b) above, the allowance, as a general rule, will not be deductible, for foreign companies having no permanent establishment within the host country are taxed on the gross income derived therefrom, or are allowed an overall fixed deduction for expenses incurred within or without the country.

PURCHASE OF RESIDENCE

If the expatriate employee purchases a house to use as his residence during the assignment, some interesting tax consequences may result. One, he may or may not be taxed on the imputed rental value of his residence. Two, he may or may not be taxed on the gains derived from the sale of his residence. Three, he may or may not qualify for certain tax incentives.

Imputed Rental Value

The imputed rental value, nonexistent in the United States or in Canada, has been a long standing feature of Latin American income tax systems. It may apply to the house occupied by the taxpayer, to the house that he owns and is temporarily vacant or occupied with his consent by someone else, and to any spare house he may have in a resort place. This study will discuss the first situation only, where the expatriate employee lives in his own house.[3]

At the present time the imputed rental value of the residence is expressly subject to income tax in BOLIVIA,[4] CHILE,[5] COLOMBIA,[6] COSTA RICA,[7] ECUADOR,[8] and PERU.[9] EL SALVADOR used to tax it until 1961 and ARGENTINA and URUGUAY until 1964. URUGUAY still applies on the imputed rental value a tax on rentals.[10]

The imputed rental value is expressly exempt in BRAZIL (Decree No. 58400 of May 10, 1966, Art. 36-d), EL SALVADOR (Decree-Law No. 472 of December 20, 1963, Art. 21 No. 12), NICARAGUA (Decree-Law No. 55 of December 16, 1952, Art. 14-g) and DOMINICAN REPUBLIC (Law No. 5911 of May 22, 1962, Art. 37-b).

Where the imputed rental value has been neither expressly exempted nor taxed, the respective statute has to be analyzed.

In GUATEMALA and HONDURAS the definition of income is broad enough to include income from the possession of assets.[11] Yet, in practice, no tax is collected on the imputed rental value in either of those two countries.

In PANAMA, the imputed rental value was expressly exempt until 1964 by the single paragraph of Article 697 of the Fiscal Code. Such provision was repealed as of January, 1965 by Law No. 9 of December 23, 1964, which also amended Article 696 of the Fiscal Code, introducing a broad definition of income subject to tax. Article 697 was amended by Decree No. 33 of February 12, 1970, Art. 1, with respect to other matters; thus, the current status of the law is uncertain.

In MEXICO, PARAGUAY and VENEZUELA, that tax applies on income "taxable according to the law." Since the law of neither country refers to the rental value of real property, it would appear that the imputed rental value is not taxed.[12]

Where a U.S. expatriate is subject to tax on the imputed rental value of his residence, it may be of some solace to him, if he can claim it, to know that for purposes of the foreign tax credit, such tax may be creditable

against his United States tax liability. The Board of Tax appeals held in 1929 that a French tax levied on persons not domiciled in France but having there one or more residences, and fixed at a sum equal to seven times the rental value of that or those residences, was an income tax as that term is used in the U.S. Internal Revenue Code.[13]

On the other hand, U.S. Tax Court in F. W. Woolworth Co. v. Commissioner of Internal Revenue, 54 USTC 1233 (1970), has held that the tax imposed on the imputed rental value of property capable of actual occupation, under Schedule A of the English Income Tax Act of 1952 does not for foreign tax credit purposes qualify as an income tax or a tax paid in lieu of an income tax. This does not mean that where the tax is indivisible because of being a part of the overall income tax law, the portion attributable to the rental value is to be disallowed as a credit, even though such imputed income should be excluded in computing the limitation prescribed by Section 904 of the U.S. Internal Revenue Code (I.T. 4074, 1952-1 CB 87).

Taxation of Capital Gains

If a U.S. expatriate has sold the house, he may pay ordinary income tax, or a capital gains tax, or be tax-free altogether, depending on the country.

The background of this diversity lies in the influence of the French tax system. Under the traditional concept of income derived from such system, capital gains, occasional profits or any other appreciation of net worth were not regarded as income. This is gradually changing. Fifty per cent of the Latin American nations regard capital gains as income.

Nonetheless, those countries that do include capital gains in their definition of income may still add a special computation of the gain (usually accounting for inflation), or prescribe a special rate, or exempt certain gains otherwise covered by the general concept of income.

For instance, gains are ordinary income in COLOMBIA (Law No. 81 of December 22, 1960, Art. 39), but such gains are exempt if the property has been held over 2 years (Law No. 81, Art. 47),[14] EL SALVADOR (Legislative Decree No. 472 of December 20, 1963, Art. 45, as amended by Legislative Decree No. 255 of January 29, 1969) where the tax is computed according to the number of years during which the property was held,[15] GUATEMALA (Decree-Law No. 229 of June 23, 1964, Art. 1-a), HONDURAS (Legislative Decree No. 25 of December 20, 1963, as amended, Art. 10), MEXICO (Income Tax Law of December 30, 1964,

Art. 60-III, 70, 71 and 80), PANAMA (Fiscal Code Art. 696-e as amended by Law No. 9 of December 23, 1964, Fiscal Code, Art. 701 and Decree No. 60 of June 28, 1965, Art. 20-f), and VENEZUELA (Income Tax Law of December 16, 1966, Art. 1 paragraph 2).

Other countries have not evolved to the all encompassing concept of income but felt that occasional or capital gains should be taxed. Thus, a separate law was passed. Cases in point, ARGENTINA (Occasional Gains Tax Law, Art. 13 and 14), CHILE (Law No. 15564 of February 14, 1964, Art. 49, 50 and 57), PARAGUAY (Decree-Law No. 51 of February 25, 1972, Art. 4 and 5),[16] and DOMINICAN REPUBLIC (Law No. 291 of March 29, 1972, Art. 1 through 18). In these three countries, if a new residence is purchased, the tax may be deferred by treating as cost of the new house, the adjusted basis of the old, academic relief for the U.S. expatriate returning to the home country upon completion of his assignment abroad.

PERU takes a hybrid position: a 6% tax is levied on gains from sales of real property under Art. 33 of Law No. 16900, but such tax is creditable against the income tax.[17]

Finally, there are capital gains tax havens: BRAZIL (since 1967 by virtue of Decree-Law No. 94 of December 30, 1966, Art. 2), BOLIVIA, COSTA RICA, ECUADOR, NICARAGUA, and URUGUAY.

As for the eligibility of the foreign tax as a credit against the U.S. tax due by U.S. citizens employed abroad, there is no doubt that such a tax would be creditable. This holds true even if the taxing country does not regard capital gains as income, because, for a particular foreign tax to qualify as a creditable tax under section 901 of the Code, it must be shown that the tax imposed by the foreign law is a tax on income within the United States concept thereof,[18] and capital gains are income, under the U.S. tax concept of income.

Low-Cost Housing Incentives

Ownership of low-cost housing is encouraged through tax privileges in several Latin American countries, such as ARGENTINA, BRAZIL and VENEZUELA.

In ARGENTINA, sellers of low-cost houses may claim a special deduction from the selling price thereof.[19]

BRAZIL allows resident individuals to deduct from gross income 15% of amounts invested in deposits, mortgage notes or in any other form, pro-

vided it is proven that such investments are made exclusively for the purpose of financing the construction of low-cost housing pursuant to a program previously approved by the Minister of Finance, and provided that the investor complies with several requirements set forth by Decree-Law No. 1161 of March 19, 1971.[20]

A resident of low-cost housing is indirectly aided in VENEZUELA by a provision of the income tax law granting exemption to the builder for his gains from sales thereof, to the lessor for the rentals of eligible premises, and to lenders of funds used in financing the construction of low-cost housing.[21]

CONCLUSION

A housing allowance paid to a U.S. expatriate will be taxable to him in any of the 18 Latin American nations, while the deduction by the employer would be allowed if the allowance paid is regarded as salary or as another necessary expense of a domestic taxpayer. As a general rule, a nonresident taxpayer may not deduct such payments.

Should a U.S. expatriate own his residence, he may be taxed on the imputed rental value thereof in Bolivia, Chile, Colombia, Costa Rica, Ecuador and Peru. In the other countries an express or implied exemption exists, or the situation is not clear and the authorities do not apply the tax on imputed rental values.

No general rule can be advanced regarding taxation of capital gains from the sale of a residence. Those countries which treat such gains as ordinary income tend to limit and qualify the application of the tax or expressly exempt them. Argentina, Chile, the Dominican Republic, Paraguay and Peru levy a tax separate from the income tax on such gains, for they are not regarded as "income." Six countries do not apply any tax on gains from the sale of real estate.

Ownership of a U.S. expatriate may have special fiscal advantages if the value of the property is sufficiently low, in Argentina, Brazil and Venezuela.

NOTES

[1]According to Opinion Ruling of July 26, 1970, the deduction of expenses for lodging of foreign technicians is disallowed.

[2]The Brazilian approach to treatment of housing allowances may be inferred from the position taken with respect to traveling expenses. According to Opinion

Rulings No. 581 and No. 582 of August 25, 1971, an employer may deduct as necessary business expense, the cost of transporting a foreign technician to Brazil and back to his home country. However, the cost of traveling to the home country on vacation is not a necessary expense even if required by the employment contract, and, therefore, is not deductible, while the employee must report the amount paid on his behalf for such a vacation as earned income from employment.

[3]For an exhaustive study of taxation of rental value in Latin America, see Public Finance Booklet No. 6 of the Joint Tax Program OAS/ODB, Pan American Union, Washington, D. C., (1967) entitled *El Concepto Fiscal de Renta y la Renta Imputada de la Casa Habitada por su Propietario* by Alvaro Magana (Inter-American Tax Research's correspondent for El Salvador).

[4]Under Supreme Decree No. 3299 of January 16, 1953, Art. 11, occupants of their owned urban property have been subject to income tax. The rate was set forth by Art. 12 of the same Decree, which, in turn, was repealed by Supreme Decree No. 5111 of December 1, 1958.

This anomaly of a tax without a rate to apply to was resolved with the enactment of Supreme Decree No. 08693 of March 12, 1969, which, ignoring Supreme Decree No. 5111, provided that "the 12% tax on imputed income equal to 4% of the property's appraisal has been reduced to 6%. Thus, the effective tax is 2.40 per thousand of the appraisal, instead of 4.80%."

[5]Under Art. 20-1-d of Law No. 15564 of February 14, 1964, as amended by Law No. 17073 of December 30, 1968, the amount of this rent is presumed to be equal to 5% of the appraisal value of the property, up to 25 "minimum vital salaries" (20,825 *escudos* in 1971) plus 7% on the excess.

[6]Pursuant to Art. 34 of Law 81 of December 22, 1960 and Regulations, Decree No. 437 of February 22, 1961, the rent is fixed as specified percentages of the appraisal value for real property tax, or the purchase price, ranging between 6% for valuations of at least 100,000 Colombian *pesos* and 12% if it exceeds 500,000 Colombian *pesos*.

[7]Pursuant to Art. 5-1 of Law No. 837 of December 20, 1946, rent has been estimated at 5% of the appraisal value for real property tax purposes. However, under Legislative Decree No. 4961 of March 10, 1972, effective March 11, 1972, imputed rental value is taxed with a progressive rate ranging between 2% where the registered value of the building does not exceed 100,000 *colones*, and 10% if such value exceeds 1,000,000 *colones*.

[8]Subject to applicable deductions, houses occupied by their owners are presumed to yield a service income equivalent to 4% of the municipal commercial appraisal after excluding 100,000 *sucres* thereof (Income Tax Law Codified by Supreme Decree No. 1283 of August 24, 1971, Art. 22 and Regulations, Supreme Decree No. 1410 of September 21, 1971, Art. 28).

[9]Article 57-B of Supreme Decree No. 464-H of November 23, 1965, restated by Article 21 of Supreme Decree No. 287-68-HC of August 9, 1968, provides that the imputed rental value is 7% or 7.5% of the value of the property, depending on whether this value is lower or higher than 300,000 *soles*, respectively. This tax is collected by local governments but it is creditable against the national income tax (Art. 36, 115-a and 84-a of Supreme Decree No. 287-68-HC).

[10]The tax on rentals of urban property was established by Law No. 11617 of October 20, 1950, Art. 4, later repealed by Art. 85-XIII of Law No. 13637 of December 21, 1967, and reinstated by Law No. 13645 of April 4, 1968, Art. I.

The rates in effect are those fixed by Law No. 12464 of December 5, 1957, Art. 8 and range between 1% for rentals up to 200 *pesos* and 6% for rentals in excess of 600 *pesos*. Rentals of houses occupied by their owners are to be estimated as 1% of the value of the property.

[11]Income is defined by the Income Tax Law of Guatemala (Decree-Law No. 229 of June 23, 1964) in Art. 1 and 4, and by the Income Tax Law of Honduras (Legislative Decree No. 25 of December 20, 1963) in Art. 1.

[12]In Paraguay, the regulations under the law imposing income tax on rentals from real property, Decree No. 24129 of January 25, 1967, deal exclusively with rentals actually received by owners.

[13]Hugh C. Wallace v. Commissioner of Internal Revenue, 17 U.S. BTA 394 (1929).

[14]To qualify for this exemption, the seller's net worth in the preceding year may not exceed 100,000 Colombian *pesos*. Article 171 of the Regulations, Decree No. 437 of 1961, which added that the property should be a capital asset, has been declared null and void by the Council of State in decision of October 30, 1970.

[15]Decree No. 215 of December 2, 1968 replaced Art. 45 of the Income Tax Law and imposed a 4% tax on the net capital gain from real property. Under the strong opposition of the public and of the bar association, the Legislative Assembly unanimously voted to repeal Decree No. 215 retroactive to the date it became effective, expressly reviving Art. 45 and amending it as to the statute of limitations for assessing deficiencies.

[16]Art. 41-a of Decree-Law 9240 of December 29, 1949, whereby such gains were exempted, has been repealed by Art. 4 of Decree-Law 51. According to Art. 11 of the Regulations under Decree-Law 51, Decree No. 2552 of April 10, 1972, the new levy applies to conveyances executed on or after February 27, 1972.

[17]Article 150 of Income Tax Law, Supreme Decree No. 287-68-HC of August 9, 1968.

[18]Biddle v. Commissioner, 302 U.S. 573 (1938), Ct.D. 1303, C.B. 1938-1, 309.

[19]Article 81 of the Income Tax Law No. 11682, text ordained in 1968, as amended by Law No. 18511 of December 31, 1969. Income Tax Regulations, Art. 163 as amended by Decree No. 4540 of October 8, 1971.

[20]Investments of economic and social interest are deductible within the limits established in Law No. 4357 of July 16, 1964, Art. 14 (Art. 92 of Decree No. 58400 of May 10, 1966).

[21]Exercising the authority granted it by Art. 3 Nos. 1, 3 and 10 of the Income Tax Law of December 16, 1966, the Executive Branch last issued Decree No. 382 of September 16, 1970, which has been implemented by Joint Ministerial Resolution No. 129 of September 30, 1970, Ministries of the Treasury and of Development and State.