For American Expats: How Foreign Exchange Movements Affect U.S. Tax on Overseas Property

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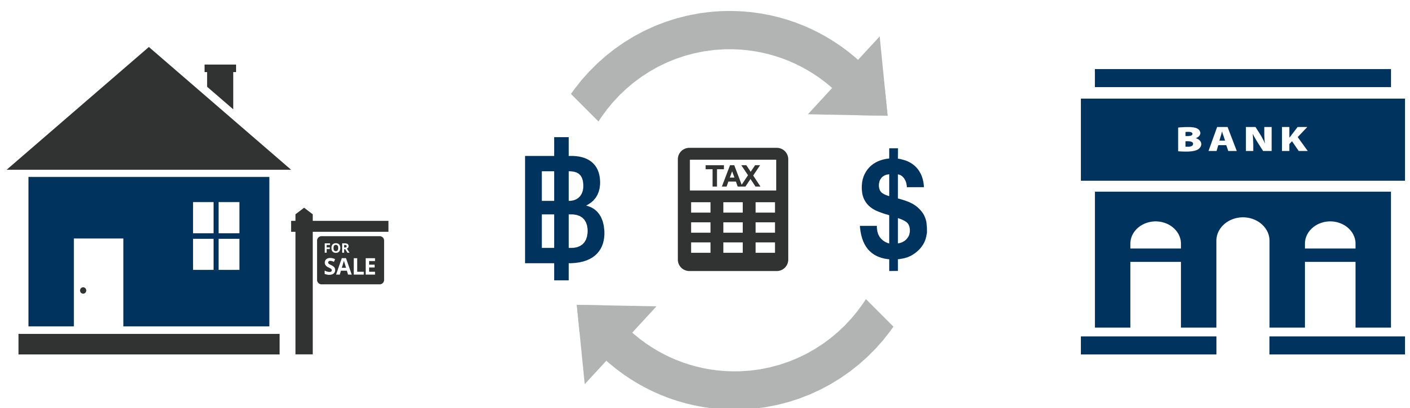
This article is for general information purposes only and is not intended as specific tax advice. Please consult your tax advisor for advice relevant to your situation.

Buying a home overseas is a significant financial decision for any expatriate. For American taxpayers who are taxed on their global income, it's important to understand how foreign exchange movements can impact the U.S. tax you may owe when you sell an overseas property.



Pay Attention to Currency Movements

Currency movements matter when calculating the gains on your overseas home for tax purposes. When you purchase your home, you must calculate the cost of your property in U.S. dollars (USD) by using the relevant exchange rate on the date of purchase. When you sell your property, you must translate the value to USD using the relevant exchange rate at the time of sale.

For example, if you bought a home in Thailand for THB 10 million when the THB/USD exchange rate was 36.0 THB to the USD, for U.S. tax purposes your cost in the property is USD 277,778. If you sell a year later and the property is still worth THB 10 million but the THB exchange rate has appreciated to 32.0 to the USD, your property is valued at USD 312,500. You have a gain of USD 34,722 for U.S. tax purposes even though the property did not increase in value in THB, and you'll owe U.S. tax on the gains since you didn't meet the two out of five-year rule.

Due to foreign exchange movements, it is possible to have a loss on the property in the foreign currency but a gain in USD, or a gain on the foreign property and a loss in USD. You could also gain on both the property and the currency, and in the worst case take a loss on the property and the currency. Currency movements add an additional layer of volatility and risk to what is often thought of as a "safe" and stable investment.

Foreign Currency Mortgage

The currency impact isn't limited to the effect on the value of the property. Currency movements can also create gains and losses in connection with foreign mortgages used to finance the property. Suppose you financed the above property with a THB 8 million interest-only loan. At purchase, the mortgage is valued at USD 222,222. At sale, you still have to pay off the THB 8 million mortgage. The THB has now appreciated to 32.0, however, which means it will cost you USD 250,000 to pay off the mortgage.

In USD terms, you have taken a loss of USD 27,778 on the mortgage. Unfortunately, you cannot deduct the loss against the gain on the property or against any other income. You will have to pay tax on the full USD 34,722 gain. After the loss on the mortgage and U.S. capital gains tax, your "gain" of USD 34,722 after U.S. tax is now a mere USD 1,736 if your capital gains are taxed at 15%. It will be essentially nothing if your capital gains are taxed at 20%. And this is before any taxes owed in your country of residence.

Be particularly careful of structured foreign currency mortgages marketed in the offshore markets that allow you to choose, and often switch, among a range of "low interest rate" currencies to fund an overseas property. This type of mortgage may seem like a clever idea at the time, but the only clever party in this transaction is the financial institution offering the product. With this product, you have effectively become a currency speculator. The example above showed the impact of a mortgage held in the same currency as the property. With a structured foreign currency mortgage, often your income is in one currency; the property is in a second currency; and the mortgage is in a third, typically low-interest-rate currency. The outcomes of such an arrangement can be unpredictable and extreme.

Note: *This article is intended to highlight some key considerations facing expat Americans when purchasing a primary residence overseas. It should not be taken for tax or legal advice. The rules and regulations and how they intersect with the U.S. tax code vary from country to country. Please consult your tax or financial advisor for your specific situation.*

This article is a revised and updated version of one that had appeared previously on www.crevelingandcreveling.com.

Additional Resources

How Exchange Rates Affect Your Expat Currency Decisions

IRS Publication 523: Selling Your Home

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