Buzzacott

Stepping Stones

A guide on moving to the UK from the US

What you need to know

If you're a US citizen living in the UK or you're planning to move here, there are a number of important life stages that you will need to plan for. With a good plan, you'll be ready for any challenge or opportunity life might throw at you while you're in the UK.

There's probably a Stepping Stone that's relevant and important for you right now at your current stage of life. We created this series to help you understand each area in more depth, no matter where you are.

Plan your next step now by clicking one of the Stepping Stones chapters in the contents on the right.

faucet

noun US

a device that controls the flow of liquid, especially water, from a pipe

tap

noun UK

a device that controls the flow of liquid, especially water, from a pipe

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Arriving in the UK

So you've just landed in the UK, or maybe you're just about to move over. You probably have a million things on your mind right now – where to start? Making sure you're taxed efficiently.

Whether you're here permanently or just for the foreseeable future, change of this magnitude can be overwhelming – especially from a financial planning perspective. Most of our clients feel that way at first, so we totally understand.

There are a few very important things you should know about UK taxation. Firstly, UK tax laws are unique and very different from the US, and to that end, so are the portfolios of each and every one of our clients.

To give you a rough idea of what we mean by this, the case study on the right highlights some of things we did to help one of our current clients who moved to the UK from New York. In the end, our client benefited from all of the following:

- Simpler tax compliance
- No reporting of US investment income on their UK tax return
- Making higher pension contributions
- Saving £9,000 on a £30,000 Enterprise Investment Scheme (EIS) investment
- Avoiding hefty penalties for non-compliance, especially with respect to the Foreign Bank Account Reporting (FBAR) forms

Case study

When Robert's employer assigned him to work in the UK, he had already accumulated a large investment portfolio in the US. Having done some research on the differing UK tax system, when he approached us at Buzzacott he was naturally very concerned about the tax implications around his investments and also his new residence status.

Minimising tax on investments

We explained that while he was now regarded as resident here in the UK, Robert would not be regarded as domiciled here. Domicile essentially means 'place of permanent belonging' and as Robert had made no definite plans to remain here in the UK for the rest of his life, he would not be regarded as UK domiciled.

Because of Robert's non-domiciled status, he could choose the remittance basis of taxation. This basis meant that all non-UK investment income and gains could be free from UK taxation, as long as said income and gains are not remitted (i.e. not brought) to the UK. The rules are complicated and they become less favourable the longer an individual is here. However, for the first seven years of residence, this opportunity can be used without an additional charge. In Robert's situation, the use of the remittance basis would be tax efficient.

cell

noun US

a phone that is connected to the phone system by radio instead of by a wire, and can be used anywhere its signals can be received

mobile

noun UK

a phone that is connected to the phone system by radio instead of by a wire, and can be used anywhere its signals can be received

Correctly structuring investment accounts

Looking to the future, Robert considered bringing money from his US investment account to the UK. While this seemed a relatively straightforward task, in reality this posed an issue. Why? Well when an individual claims the remittance basis and then brings money to the UK from an investment account, it is deemed to be taxable on income and gains that are remitted first.

This can undo all of the original planning to use the remittance basis and can in fact cause double taxation – a tax principle referring to income taxes paid twice on the same source of income. To avoid this issue, we normally advise our clients to create a separate investment account into which interest, dividends and capital gains are paid.This gives clients the option in the future to bring money from the main account into the UK, tax free.

Unfortunately, many US banks, such as the one Robert used, are unable to do such account structuring. Therefore, he made the decision to bring approximately £100,000 from his US investment account shortly after arrival in the UK, in order to fund a potential UK property purchase in the future.

Fortunately for Robert, the transfer of £100,000 was regarded as capital (and therefore tax-free) as the funds in the investment account had all been generated before Robert moved to the UK. If he had waited a few years before bringing the money to the UK, the transfer would have been regarded as firstly composed of whatever income and gains had been generated since becoming resident, which would have meant that it would be taxed.

Minimising tax on employment

As an American living abroad, you'll still be taxable in the US on employment income. However, you can use the foreign earned income exclusion to exclude up to $108,700 (for 2021) from US taxation. For those earning in excess of this amount (including the foreign housing exclusion), taxes paid in the UK are used to offset the US tax due, generally meaning that those who are employed in the UK don't have to pay US tax on employment income.

In Robert's case, as with all our clients, we considered whether it is better to utilise the foreign earned income exclusion, or to rely on claiming UK taxes paid as foreign tax credits, to offset the US taxes. The latter made the most sense, as not using the foreign earned income exclusion but relying wholly on UK taxes paid, meant that there were more UK taxes paid than were needed in order to offset the US taxes.

These unused foreign tax credits can be very useful as they can offset the US tax on tax relief opportunities in the UK, such as pension contributions and investments in Enterprise Investment Schemes, both of which are UK tax advantaged but are not on the US side, which is why having excess foreign tax credits is so useful.

With our assistance, Robert made use of these opportunities, allowing him to contribute more to a UK pension and also make a £30,000 UK investment, which saved him £9,000 tax. The excess he did not use can now be carried forward for up to 10 years.

Complying with UK and US tax laws

No two cases are ever the same and for Robert we spent some time understanding his situation and determining the US and UK compliance requirements. One important aspect of this was the Foreign Bank Account Reporting (FBAR) form. FBAR compliance is required where the aggregate balance of all non-US accounts exceeds $10,000 at any point during the year, whether or not the non-US account has any income.

Failure to file these forms where required can result in large penalties. Robert not only had his own accounts, but also had signatory authority over some of his employer's accounts. We collated the necessary information and prepared the FBAR reports for him, together with the US and UK tax returns.

pants

noun US

an outer garment covering the body from the waist to the ankles, with a separate part for each leg

trousers

noun UK

an outer garment covering the body from the waist to the ankles, with a separate part for each leg

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Owning UK property

Whether you're buying your first home, or investing in real estate, owning UK property as an American is not necessarily as simple as it may seem at first glance.

When owning UK property, there are a number of tax considerations to bear in mind in order to ensure that you are not caught out in the long run. As ever, the complex world of being an American abroad can be negotiated with relative simplicity and the help of a little planning. To highlight how these rules can be easily overcome, we've shared Shirley's story who moved to the UK from the US and bought a house here with her husband. As a Buzzacott client, our advice helped Shirley benefit from:

- Saving a US income tax bill of $50,000
- Saving a potential US income tax tax bill of $7,377 upon re-mortgaging her home
- Saving $1900 on her Net Investment Income Tax

Case study

US citizen Shirley moved to the UK in the mid 90's and not long after, Shirley and her non-American husband George bought their first home together. Now with a growing family, they want to move to a larger home but find themselves faced with a potentially unmanageable US tax bill on Shirley's portion of the property.

As is the case with many married couples, Shirley and George held their home under a joint tenancy. This means that as an American, Shirley would be taxable in the US on 50% of the overall increase to the value of her home. She also has a UK mortgage, something for which the US has some rather unusual rules.

Capital Gains Tax (CGT): US v UK

On the US side, as Shirley has owned her home and used it as her main residence for at least two years out of the five-year period ending on the date of sale, Shirley can claim a capital gain exclusion in the US of up to $250,000. Any additional taxable gain is then taxed at a rate of 20%.

By contrast, in the UK Shirley and George can claim the UK property as their Principal Private Residence (PPR) as they lived in the property from the date of purchase to the date of sale. Therefore, the entire gain arising from the sale is exempt from UK CGT, leaving Shirley with a potential US tax bill of $50,000 on her anticipated gain of $500,000.

Foreign mortgage gain

Having taken out a joint mortgage with George to purchase their home, Shirley must also deal with the US tax rules governing mortgage debt denominated in foreign (non-US) currencies, when she sells her home. Under US rules, Shirley is deemed to transact in US dollars and consequently any foreign currency transaction is always deemed a 'trade' for US purposes. In other words, paying off her UK mortgage could trigger a gain or loss when the mortgage is relinquished.

Shirley and George re-mortgaged in 2012, and unfortunately since then the US dollar has risen against the pound, leaving her with an exchange rate gain of $36,833 on the relinquishment of her mortgage. This could have resulted in a potential tax bill of $7,377. Fortunately for Shirley, she had enough excess tax credits to offset this on her return and reduce the liability to nil.

zip code

noun US

a group of numbers or letters and numbers which are added to a postal address to assist the sorting of mail

postcode

noun UK

a group of numbers or letters and numbers which are added to a postal address to assist the sorting of mail

Buzzacott

Net Investment Income Tax (NIIT)

This is an additional tax of 3.8% imposed on investment income and capital gains where the taxpayer's income is over certain thresholds. For Shirley, who files as 'Head of Household', she will suffer this tax on all her gains over a modified adjusted grow income threshold of $200,000, which initially would have left her with an additional tax bill of $3,302. All in all, Shirley's US tax bill was expected to be $53,302.

Stamp Duty Land Tax (SDLT)

SDLT is a progressive tax levied on the purchase of UK (excluding Scotland) properties on a sliding scale system starting at 0% with a purchase price of up to £125,000, up to 12% on property values over £1.5million (Scotland has a similar Land & Buildings Transaction Tax). Once paid, the SDLT is added to the cost basis of the property to reduce the eventual gain upon disposal.

In addition to her joint property in the UK, Shirley inherited a property in the US from her mother in the early 2000's. As of 1 April 2016, an additional 3% SDLT will be charged on the purchase of a UK property if a person owns two or more residential properties. This means that because of Shirley's old family home in the US, she will face an additional 3% SDLT on the purchase of her new home in the UK.

Our solutions

CGT

Since Shirley is taxable in the US on 50% of the gain over $250,000, the best solution was to decrease Shirley's holding in their UK property ahead of it being sold. Following our advice, Shirley and George changed their ownership from joint tenants to tenants in common.

By utilising the US annual gift allowance of $157,000 (for 2021) per year, and the lifetime gift allowance of $11,580,000 (for 2020), Shirley was able to reduce her holding in the property down to 25%. This left her with a US taxable gain of $250,000, which was covered by the US exemption. This was great news for Shirley as it removed both her US CGT liability entirely, and reduced her NIIT down to a more manageable $1,402.

Our advice helped Shirley save $51,900 on her US tax bill, now just $1,402.

SDLT

When transferring property in this manner, it is important to check whether there was any consideration received on the transfer for SDLT purposes.

HMRC charge SDLT on the amount of consideration given in exchange for the property and in Shirley's case, her husband George has taken on an additional 25% of the mortgage in exchange for an additional 25% of the property. If that portion of Shirley's mortgage were over the SDLT threshold of £125,000, they would owe SDLT on the exchange. However, as the mortgage is low enough this will not be an issue here.

Shirley has a buyer lined up for her house in the US and because it will be completed within three years of her UK house purchase, she can apply for a refund on the additional 3% SDLT.

Another important aspect of a transaction like this is legal advice because wills may need to be updated and a conveyancing solicitor is needed to prepare the transfer documents.

second floor

noun US

of a building, where you arrive after climbing one flight of stairs

first floor

noun UK

of a building, where you arrive after climbing one flight of stairs

Marriage and tax

When thinking about marriage, tax probably won't be one of the first things that springs to mind. However, as an expat if you do decide to enter into a marriage, you will need guidance on how it may affect your tax situation. Unfortunately, there isn't a clear cut answer for everyone.

Our expatriate tax experts have advised numerous clients about the US and UK tax consequences of marriage and provided a summary below of what you need to look out for to better understand your tax position as an unmarried versus a married couple.

US filing status

As an unmarried couple, you would normally have a Single filing status. However, when you get married this could change to Married Filing Separately or Married Filing Jointly. If you previously had a Head of Household filing status, this could also change to Married Filing Separately, Married Filing Jointly, or you could even remain as Head of Household in certain circumstances.

Married Filing Separately

This is when married taxpayers elect to file their US tax returns separately. For US/non-US spouses, the default rule is for the US spouse to file separately.

Filing separately can be beneficial when one spouse is a non-resident alien, which is a person who is not a US citizen and does not pass the green card or substantial presence tests used to determine tax status. Also, where filing separately might be equally beneficial is where both spouses are on high incomes and filing jointly would shift a couple into the 37% tax rate bracket.

For most taxpayers, filing jointly makes use of the lower tax bands, which lowers the US tax liability. You might also forfeit a number of tax credits that are available if you file separately, such as the child tax credit.

Case study

Rachel and Frank are two US citizens living in the UK, who each have taxable income of $500,000 in 2018. When filing Single, their US tax liabilities would have been $152,943 each ($305,886 in total). Whereas Married Filing Jointly moves them into the 37% tax bracket creating a joint liability of $340,144. This is an increase in the US income tax liability of $34,258.

As the couple are UK resident, some or all of this income could potentially be foreign sourced and foreign tax credits could be used to reduce the US tax liability down to nil. In this example, the main disadvantage would be the reduction in the excess foreign tax credits carried over to the next year.

Therefore Married Filing Separately could be a better option for Rachel and Frank if they had US sourced income (such as US rental income, US dividends, or effectively connected income to a US trade or business), or if they wanted to preserve their excess foreign tax credits.

Married Filing Jointly

Married taxpayers can elect to file jointly or separately. For US/non-US spouses, the default is for the US spouse to file separately unless there is an election made for the non-US spouse to be a resident alien for tax purposes. In most situations, it is more beneficial for married taxpayers to file jointly as the lower tax bands are doubled and there are various tax credits that you're more likely to get if filing jointly.

bachelor party

noun US

a party for a man who is going to get married, to which only his male friends are invited

stag do

noun UK

a party for a man who is going to get married, to which only his male friends are invited

If you're a non-resident alien spouse, electing to be a resident alien, and have large income not subject to US tax, you would have to comply with additional informational reporting requirements, which you wouldn't otherwise.

Case study

Lindsey and Ben are married. Lindsey is a US taxpayer and has $200k of taxable income in 2019. Ben is not a US taxpayer but elects to be a US taxpayer to file jointly as his taxable income is $0. Filing jointly in this example would potentially be worthwhile as the tax savings can be up to nearly $9,000.

Below are the US tax liabilities for each filing status:

- Married Filing Separately – $45,316
- Married Filing Jointly – $36,349
- Head of Household filing – $43,898
- Single – $45,316

From the above, you can see that being married does not increase the tax liability and if filing jointly you can make an even larger saving.

Head of Household filing

To claim Head of Household, you must generally be unmarried, although if you're married to a non-resident alien this counts as unmarried for these purposes. You must also have paid at least half the costs of keeping up a home for the tax year and had a qualified person, such as a dependent, living at home.

This is more advantageous than Married Filing Separately and is useful in an example when the non-resident alien spouse does not want to elect to be a resident alien. The main disadvantage is having to check each year whether you qualify for this filing status.

Case study

Taking the example of Lindsey and Ben, if Ben decided not to elect to be a resident alien due to the additional paperwork required for the foreign financial asset reporting, then the next best option for Lindsey would be Head of Household, provided that she qualified for this tax status.

Transfer taxes

Transfer taxes is usually the main tax advantage of being married. The ability to transfer assets to each other and have an unlimited marital gift tax and UK inheritance tax exemption. However, again there can be complications if there is a US citizen spouse married to a UK citizen and domiciled spouse. The marital exemption is limited in both the US and the UK.

In the US, the marital exemption is limited to $157,000 (for 2020) per annum for lifetime gifts from a US to a non-US domiciled individual. There is no marital exemption on death for transfers from a US to a non-US spouse, but this might not be an issue if the US spouse's estate is below the current $11.58 million (for 2020) lifetime exemption amount. If the estate exceeds this then you may want to consult with a lawyer to have your wills updated to potentially include some planning involving a Qualified Domestic Trust (QDOT) to help defer any US estate tax to the second death.

For transfers from UK-domiciled spouses to non-UK domiciled spouses, there are also marital exemption limitations. In the UK, the marital exemption is limited to £325,000 for both lifetime gifts that are not exempt under the potentially exempt transfer rules, as well as transfers on death.

There is also a nil rate band that is available in the UK of £325,000, which is in addition to the marital exemption.

Other tax benefits of marriage

'No gain no loss' on transfers of assets between spouses can help to avoid double taxation if transferring assets when not married, as the US will generally not tax the gift of an asset for capital gains purposes, but the UK does unless you are married.

The point being that an unmarried person who receives an asset that has appreciated in value inherits the original cost basis, meaning they could be subject to US tax on the same gain once the asset is sold. Married couples with low income (with one spouse earning less than the personal allowance) can potentially transfer a portion of their personal allowance.

By working with us, our clients are able to get a clear understanding of their UK/US tax position before their marriage so that they are aware of any obstacles and can plan ahead with peace of mind. Being dual US/UK qualified tax advisors, we can provide prompt and effective advice under one roof.

chips

noun US

a wafer-thin slice of potato fried or baked until crisp and eaten as a snack

crisps

noun UK

a wafer-thin slice of potato fried or baked until crisp and eaten as a snack

Setting up a UK business

If you're a US citizen looking to set up a UK company, due to the complex cross-border tax legislation between the US and UK, and the compliance burden, it is vital to seek advice first. There are many variables to consider before taking the most tax efficient course of action.

If you've already established a UK company, you should consider how the 2018 tax reforms impact your global tax bill and whether an alternative type of business structure would be preferable. Without careful consideration and advice, the complexity of US/UK cross-border tax rules could see more of your hard-earned money go straight to the pockets of the taxman! The case study below includes examples of how we helped a client, including advice on four key areas of US tax:

- Form 8832 is the entity classification election, known as the 'check-the-box' election
- Controlled Foreign Corporation (CFC) rules, including Subpart F anti-avoidance rules
- Passive Foreign Investment Company (PFIC) rules and tax treatment
- Global Intangible Low Taxed Income (GILTI)

Case study

Larry is a UK resident US citizen and is a sole director and shareholder of a small business. The business was set up as a UK limited company, which completed financial accounts and Form CT600, paying UK corporation tax at a rate of 19%. Larry heard about the complications that US citizens can face when they are owners of foreign corporations, and so came to Buzzacott for specialist advice.

In the US, the limited company is treated as a corporate entity (much like the UK) and in general you are only personally taxed on the dividend distributions from the company, assuming you don't take a salary. However, since 2018 there has also been a potential GILTI tax to consider too, which is an additional tax on US owners of foreign companies (see more information on GILTI on the next page). There is scope in the US to make a 'check the box' election on Form 8832, which allows you to change the classification of the business from that of a corporation to a disregarded entity. The change in classification would result in the net income from the business being subject to US taxation on Schedule C of your personal tax return and taxed at your ordinary rate of income tax, as if you were self-employed.

Should Larry 'check the box'?

In order for Larry to make an informed decision as to whether or not it would be beneficial for him to 'check the box', we provided him with projective and comparative calculations based on his expected future revenue income, as well as cash extraction needs. We also took into consideration the US and UK tax implications of the exit strategy of the company, analysed Larry's personal tax position, specifically his use of foreign tax credits, and provided him with a detailed report of our findings. Practical guidance, such as making the company year-end on 31 December to tie it up with the US tax year end, was also given.

Our tailored report enabled Larry to make an informed decision regarding the most suitable method of reporting the UK limited company in the US. For Larry, this meant that the 'check the box' election was the right course of action. As well as the potential tax savings, Larry's decision also took into consideration the burden of additional compliance costs when reporting the UK limited company.

crosswalk

noun US

an area of road where vehicles must stop if pedestrians wish to cross

zebra crossing

noun UK

an area of road where vehicles must stop if pedestrians wish to cross

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We recommended the one-off filing of Form 8832 entity classification form ('check the box'), and the yearly reporting of Form 8858 ('information return of US person with respect to foreign disregarded entities'), which is essentially a simplified version of Form 5471. The change in classification of the entity also removed the need to worry about any complex PFIC, Subpart F Income Tax and GILTI tax rules (more information below).

The exit strategy from the company was a key element in the decision making as Larry wanted to retain the benefit of the Entrepreneurs' Relief (now called Business Asset Disposal Relief) for capital gains purposes in the UK. This is the reduced Capital Gains Tax (CGT) rate of 10%, which would normally be irrelevant given the US long-term CGT rate of 20% and the additional 3.8% Net Investment Income Tax (NIIT) potentially due. The 'check-the box' strategy could potentially result in no US CGT due, therefore retaining the benefit of a 10% tax rate on the disposal of the business.

Our straightforward report took on a holistic approach, taking into consideration the tax consequences for the life of the company, and gave a well-rounded and simplified account of the potential results by comparing the various routes our client could take. This format helped eliminate any unnecessary stress and ultimately made the decision making process simpler and more efficient.

No matter what our clients come to us with, we take the time to fully understand their current position and goals and therefore tailor our advice specifically to their needs.

More information on...

Subpart F

In general, if you own greater than 50% of the shares of the limited company, you may be subject to Subpart F rules. This could apply if the limited company received the following types of income: dividends, interest, rent or royalties, to name a few. It could also apply to income from personal service contracts where the corporation does not designate who performs the services. The Internal Revenue Service (IRS) would tax the US person on their proportional share of the Subpart F income earned by the CFC, regardless of whether this has been distributed to them.

PFICs

If you're the US owner who owns less than 50% of the shares or voting rights (directly, indirectly and constructively) then the above Subpart F rules would not be a problem.

However, there is a risk that a limited company in this situation could be treated as a PFIC if there was no 'check-the-box' election made. A limited company would satisfy this criterion if at least 75% of its income or 50% of its assets produce either passive income or no income.

For US owners of PFIC stock, a punitive tax treatment applies when there are either distributions of dividends or disposals of PFIC stock for a capital gain. Additionally, the PFIC would have to be reported year on year on Form 8621 ('information return by a shareholder of a PFIC'), which would incur further costs.

GILTI

As a result of the Tax Cuts & Jobs Act of 2017, US owners of foreign companies need to consider the implications of the one-off transition tax as well as ongoing GILTI tax. The transition tax is a one-off tax on the accumulated earnings and profits, so it will not be a consideration for US individuals setting up new businesses. GILTI is the US shareholder's pro-rata share of net income from a CFC, less a 10% deduction for depreciation on tangible assets. GILTI is charged to tax at 37% for a US individual and neither the IRC s250 deduction nor foreign tax credits apply against the tax.

The global tax bill could potentially be more than 80% when considering UK corporation tax, GILTI tax, and UK income tax on dividends.

A solution to this, is to elect for the company to be transparent (making a 'check-the-box' election), or making a s962 election to elect for the shareholder to be treated as a US company, or making use of the GILTI High-Tax Exclusion where income is subject to foreign taxes in excess of 90% of the US corporate tax rate. However, it will depend on each individual's circumstances as to what action (if any) to take, and there could be other mitigation techniques to avoid the GILTI tax issues.

zee

noun US

twenty-sixth letter of the alphabet

zed

noun UK

twenty-sixth letter of the alphabet

Taxation for children

If you're an American parent living in the UK, your child may well have US citizenship, so you should view their US tax obligations the same way as you would for adults. In this chapter, we explore the US tax relief available when you have a child.

There are certain tax filing requirements that need to be considered when you have a child who is a US citizen and several factors should be taken into account when making savings for the future. Below are the key areas that parents need to know to ensure their children stay tax compliant and also some updates on the various tax reliefs that can be received.

US children – the importance of clarifying citizenship

If your child was born in the US, they are automatically a US citizen. If you're a US citizen parent and your child is born outside of the US, your child can also be a US citizen but it is best to seek US immigration advice in these circumstances. Your child can also be a US citizen even if they don't apply for a US passport.

We see a large number of 'Accidental Americans', which are individuals unaware of their US citizenship, who were born in the US due to their parents being on a work assignment or holiday.

As a US citizen, US children must comply with the same tax rules as their parents, which includes worldwide taxation. It is possible to relinquish US citizenship but you normally need to wait until adulthood (18 years old) before this can be achieved.

US tax on dependants

Your child is your dependent for US tax purposes if they are a US citizen, under 19 (or 24 and in full time education), and you pay more than half of their support. In the years before 2018, you were able to claim a tax-free personal exemption for each of your children, which was deductible against taxable income. This is no longer the case as all personal exemptions have been scrapped from 2018.

Because US children are subject to US tax on their worldwide income, it is possible that your child will need to file their own US tax return. However, in many cases you are able to elect to include your child's income on your tax return, if they are your dependent and meet certain conditions.

If your child's interest, dividends and other unearned income totals more than $2,200, amounts exceeding this may be subject to 'kiddie tax' rates, which is now at the parent's tax rate. The idea behind these rules is to prevent parents from sheltering assets in their children's name to benefit from the lower rates of tax. Earned income for dependents is taxed at their own marginal personal rates.

diaper

noun US

a piece of towelling or other absorbent material wrapped round a baby's bottom and between its legs to absorb and retain a baby's doings

nappy

noun UK

a piece of towelling or other absorbent material wrapped round a baby's bottom and between its legs to absorb and retain a baby's doings

Case study: The kiddie tax

Sarah and her daughter Megan are both US persons. Megan is 16 and Sarah is dependent and therefore subject to the kiddie tax rules. Megan earns $500 from a paper round and received $3,000 bank interest in 2018. Megan will pay tax on the $500 at personal tax rates and be subject to a tax rate of 15% on the interest income, after the $2,100 exclusion is given. If Megan wasn't caught by the kiddie tax rules, her income would have been fully covered by her own standard deduction and no tax would have been due.

US tax relief for parents

You may be able to claim a Child Tax Credit of up to $2,000 per qualifying child under the age of 17. This is the maximum credit you can claim in 2018, double the amount in 2017, but is subject to income limitations. Tax credits can also be given for qualifying childcare expenses. The amount of relief available is dependent on your adjusted gross income.

Other filing requirements

Children must comply with IRS overseas filing obligations in the same that way you do. This includes the requirement to file a Foreign Bank Account Report (FBAR), where the aggregate value in their non-US accounts exceeds $10,000 at any point in the tax year. If they hold shares in your non-US company, they may also have to file Form 5471, though it is possible for you to do so on their behalf.

Saving for their future – university plans

A tax effective way of saving for your children's future can be achieved by setting up a section 529 college plan (or university as we call it in the UK). This enables you to save for their future costs in a tax effective way, as funds used for 'qualifying higher education expenses' are not taxed. Income earned in the plan does not need to be reported on yours or your child's tax return.

This can also be a good way of gifting funds to your children for estate planning purposes, without giving them the ability to control the funds.

As these plans are held under trust, care should be taken to ensure the plan does not become a UK resident trust, which could create a UK tax burden. If your child does not go to university there will be a tax charge on future distributions from the plan. If your child goes to a UK university there could be a tax charge on the child in the UK at the time of distribution of funds from the trust.

UK matters

As always, UK/US taxpayers should consider the taxation by both countries for all income. Due to its tax-free status, creating a Junior Individual Savings Account (ISA) for your child can look appealing from a UK tax perspective. However, the IRS will not recognise its tax-free status and income will be taxable in full.

There are similar anti-avoidance principles in the UK with regards to reporting and taxation of your child's income. If your child gets more than £100 interest from money sources given by a parent, the parent will pay income tax on the interest. UK childcare tax saving schemes, such as employer childcare vouchers, will save UK tax but will not achieve the same saving in the US, which could lead to US tax due on such benefits.

Since April 2018, employer childcare vouchers have been replaced with a new tax-free childcare scheme managed through National Savings & Investments (NS&I). Childcare vouchers continue to operate alongside the new scheme but the scheme has been closed to new entrants since 6 April 2018. The new 20% top up of childcare from the government is seen as tax relief, so an adjustment to foreign tax credits is required.

US children need to comply with the US tax rules in the same way that an adult would. There is no minimum age to become a US taxpayer. The IRS has anti-avoidance provisions in place to ensure taxpayers cannot avoid tax by holding assets in their children's names. UK and US taxpayers should be mindful of schemes beneficial in one country, that can cause a tax issue in the other.

mom

noun US

a person who fulfils the role of mother in a family

mum

noun UK

a person who fulfils the role of mother in a family

Trusts

There are US tax and compliance issues for US citizens, residents and green card holders (referred to as US persons) who are the settlor or a beneficiary of a non-US trust. This Stepping Stone focuses on the tax issues that US beneficiaries face.

With millions of people migrating into and out of the US there are many situations where there are:

- Non-US (foreign) trusts with US beneficiaries
- US trusts with foreign beneficiaries
- Foreign trusts with US beneficiaries (US domestic trusts that have been exported out of the US due to the trustees moving out of the US)

It's important to understand the implications for the US beneficiaries, as there are some adverse rules that can result in high or unexpected taxation.

Case studies

Rohit, a British and Indian citizen, was resident and domiciled in India with his parents and siblings. He was accepted at a US university so moved to America to study, initially on a student F-1 visa (case study one). After university (case study two), Rohit continued to live and work in the US initially with a company sponsored visa, which then led to him becoming a green card holder.

Rohit is the beneficiary of a trust established in the Cayman Islands by a great-grandparent who has since deceased. There are substantial funds within the trust consisting mainly of cash and a portfolio of non-US financial assets made up of collective investment funds. The trust has historically paid educational costs on behalf of Rohit and received advice at the time but the trustees are now looking for current advice, should there be future distributions made to Rohit as a US person.

Case study one: Rohit's student F1 visa

Matters of residency

We advised Rohit on his US residency status under the Substantial Presence Test (SPT). You could be a resident under this test if you have been present in the US on at least 183 days during the three-year period that includes the current year. For the purpose of this test, each day of presence in the current year counts as a full day. Each day of presence in the preceding year is counted as one third of a day and each day of the second preceding year is counted as one-sixth of a day.

However, under the Internal Revenue Code and Treasury regulations, there is an exception to the SPT for students who are admitted temporarily to the US as a non-immigrant under an F-1 visa who substantially complies with the requirements of being admitted. We advised Rohit that he would substantially comply with the visa requirements relevant to residence for tax purposes if he was not engaged in activities that are prohibited by the Immigration & Nationality Act. For example, if he is found to have accepted unauthorised employment or to have maintained a course of study that is not considered by the IRS to be full time.

On the basis that Rohit was not engaged in such activities, the days of US presence during the period he was in the US on an F-1 visa were excluded from the substantial presence test, and therefore Rohit was a non-resident for income tax purposes.

However, we did advise that capital gains could still be taxable to exempt students resident in the US. In addition, state tax rules should be considered where the state tax does not follow the federal income tax return (in this case, it was not an issue).

gas

noun US

a light fuel oil that is obtained by distilling petroleum and used in internal combustion engines

petrol

noun UK

a light fuel oil that is obtained by distilling petroleum and used in internal combustion engines

'Throwback' tax rules

As the trust is considered a foreign non-grantor trust, normally we would be concerned about the 'throwback' tax rules, which can apply to distributions of accumulated income/gains within the trust. For these rules, the trustees would be advised to calculate annual Distributable Net Income (DNI), which if not distributed becomes Undistributable Net Income (UNI). Distributions are matched first to the current year DNI before the prior year UNI. Distributions of DNI keep their character when distributed to beneficiaries, so you can take advantage of the lower tax rates for qualified dividends and long-term capital gains.

Distributions from UNI are taxed at the marginal income tax rate, with an interest charge depending on how long the UNI is deemed to have accumulated. The concepts of UNI and DNI apply to foreign non-grantor trusts even when there are no US beneficiaries. For example, in Rohit's case there were no US beneficiaries for many years, and now one of the grandchildren has moved to the US and received direct and indirect distributions. Therefore, there were many years' worth of accumulated income and gains (UNI) as the value of the trust had grown over the years with little being distributed out. Normally we would be concerned with the situation where there is a US beneficiary of a trust that has accumulated a large amount of UNI, as the tax consequences of UNI being distributed to a US beneficiary are taxed at higher 'throwback tax' rates.

Passive Foreign Investment Company (PFIC) rules

Based on the collective investment funds held being non-US funds, PFIC fund rules would also need to be considered. US rules stipulate that a US taxpayer will be treated as an indirect shareholder of a PFIC to the extent of a beneficiary's proportional interest in a trust. Quantifying the level of a US person's proportional interest in the trust is based on the facts and circumstances of each individual case. If attribution applies in respect of a PFIC, US tax may be due on the US owner regardless of whether any actual distribution is made to them (more information on PFICs can be found in the investments and pensions chapter).

Our advice was that capital gains from the sale of collective investment funds represented PFIC 'excess distribution', which are taxed as ordinary income and therefore not taxable to Rohit being a non-resident under the F-1 visa exemption. This was a surprising outcome that holding PFICs was better from a US tax perspective than holding directly held equities. Although we did advise that if Rohit lost his exempt status, he would need to ensure he is out of their PFIC positions before becoming US resident under the SPT.

US tax filing

We finally concluded that Rohit would not have a US tax return filing requirement, as he is non-resident alien with no US sourced income or gains. However, we advised that he would need to file Form 8843 each year that he is exempting himself from being resident, as a student resident in the US under an F-1 visa. Form 8843 is due to be filed by 15 April following the end of the US tax year. By working with us, Rohit was able to get a clear understanding of his US tax position before his move to the US and was able to implement a plan to avoid unnecessary reporting requirements, and an unnecessary US tax bill.

Case study two: Rohit's company sponsored visa

PFIC rules

Thankfully due to previous advice given to the trustees in case study one, once Rohit (the US beneficiary) lost his exempt status under an F-1 visa, the trustees no longer held any PFICs therefore no attribution to the US beneficiary, and we are left with just throwback tax issues, and UNI/DNI calculations.

US tax filing

Rohit has had a US tax return filing requirement since giving up his F-1 visa and moving to a company sponsored visa, and he now has a permanent resident status with his green card. For any year that Rohit receives a distribution from the trust in the future, he will need to report this on Form 3520. If the trustees have prepared current DNI calculations and historic UNI calculations, they can provide Rohit with a Foreign Non-Grantor Trust beneficiary statement showing the current year income, prior year accumulated income and any trust corpus that is matched to the distribution. Without this, Rohit would be forced to prepare Form 3520 using the default method, which taxes the entire distribution as accumulated income and normally leads to a larger tax liability due to the 'throwback tax' rules.

By working with us again at the next stage of his journey, Rohit and the trustees were able to get a clear understanding of the US tax requirements. Once Rohit decided to remain in the US, we advised both Rohit and the trustees on their reporting requirements and the tax implications of holding certain investments.

eraser

noun US

a piece of rubber used for erasing pencil or ink marks

rubber

noun UK

a piece of rubber used for erasing pencil or ink marks

Estate and inheritance tax

Like with income tax planning, US citizens living in the UK need to consider both US and UK tax rules when it comes to gift, estate and inheritance tax planning.

While income tax planning is normally the prime focus for most individuals, gift, estate and inheritance tax planning is often just as important for the transfer of property to the surviving member of a family.

For those with a US and UK connection, both US and UK tax rules should be considered in conjunction to ensure the preservation of wealth during lifetime and after death for the eventual beneficiaries of the individual property.

To highlight how these rules can be navigated, take a look at the case study on the right to see what steps our client Jason took to save money.

Case study

Jason moved to the UK from New York in December 2006 and is a US citizen. In July 2005, he married Maria but they are since divorced. Jason is 51, in good health and he has three children. He owns a UK property worth £1million, a US bank account worth $3million and cash in UK bank accounts worth £1.5million.

Jason wishes to pass his wealth on to his children. He heard that the UK Inheritance tax (IHT) rules have changed for non-UK domiciliaries and he was concerned about his worldwide exposure to inheritance and estate tax, so approached Buzzacott for specialist advice.

What can Jason do?

As Jason has US and UK estate and inheritance tax exposure, with no planning in place he will most likely be exposed to a 40% inheritance tax bill on his worldwide estate.

In the UK, each individual qualifies for the nil rate band (£325,000 in 2021), meaning the first £325,000 of their estate is excluded from UK IHT. US estate or gift tax is only applicable where the total value of a deceased US citizen's estate exceeds the lifetime exclusion amount. The US lifetime exclusion is currently $11.58million.

As Jason's estate ($6.25million) is under the US threshold, his primary concern will be UK IHT, but he should consider how to preserve his £325,000 exemption where possible.

trunk

noun US

an enclosed space at the back of a car for carrying luggage or other goods

boot

noun UK

an enclosed space at the back of a car for carrying luggage or other goods

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Lifetime gifting

One of Jason's UK bank accounts has a cash balance of £500,000. He would like to pass the cash to his children in a US and UK tax efficient manner and wants to give them the gift directly. For UK tax purposes, a gift can be fully excludable from IHT if the donor survives seven years from the date of the gift. If the donor dies within seven years, the gift remains taxable in their estate. Jason is in good health and expects to live seven years so it makes sense from a UK tax perspective for him to gift the money to his children now.

For US estate tax purposes, any lifetime gifts will be deducted from the lifetime allowance (currently per person) but it is possible to gift up to the annual allowance (currently $15,000) of your estate per recipient, each year, without reducing your estate allowance.

Jason could therefore gift up to $15,000 to each of his three children per year, with the gifts remaining outside the scope of US estate tax. Provided he lives seven years from the date of the gift, they will also not be subject to UK IHT. In addition, there is an annual UK gift allowance of £3,000 to each child and potentially if the gifts are considered regular and out of Jason's income, they could be entirely exempt gifts without the need to survive seven years.

If Jason gifts $15,000 (approximately £11,500) to each of his three children annually, over a 10-year period, he could exclude £345,000 from his taxable estate. If Jason remains within the US gift annual allowance of $15,000, he could save £138,000 in taxes.

Deemed UK domicile

UK domiciled individuals are subject to UK IHT on their worldwide assets. Non-UK domiciled individuals are only subject to UK IHT on their UK status assets. Under general UK law, it is possible to keep your domicile of origin in the US, where domicile is based on your intention to return to the US.

However, since 6 April 2017, it is possible to acquire deemed-UK domiciled status when an individual has been resident in the UK for at least 15 out of the last 20 tax years. As things stand, since Jason arrived in the 2007/08 UK tax year, he will be deemed UK domiciled from 6 April 2022. With no planning in place, from this point his worldwide estate in excess of £325,000 will be subject to UK IHT.

Excluded property trust

Jason would like to give $2million of the US investment portfolio funds to his children, but restrict them from withdrawing until they are 25 years old. Jason could set up an excluded property trust before 6 April 2022 with the funds he would like to give to his children.

For a UK domiciled individual, settlement into a trust is a chargeable inheritance tax event. However, Jason is not deemed domiciled in the UK, so only his UK assets are subject to UK IHT. As the US account is non-UK based and Jason is currently not deemed domiciled, he could therefore settle the funds into a non-UK trust, creating an excluded property trust which will be outside the scope of UK IHT. The funds can therefore be passed to his children without being subject to UK IHT. If Jason settles $2million (approximately £1.5million) into the new trust, he could save his estate £600,000 in inheritance tax.

Working with Buzzacott, Jason benefited from timely, practical and cost effective joined up US/UK tax advice. We were also able to refer him to a law firm to help with the legal side of setting up a will and the creation of an excluded property trust outside the UK.

schedule

noun US

a chart showing the departure and arrival times of trains, buses, or aircraft

timetable

noun UK

a chart showing the departure and arrival times of trains, buses, or aircraft

Divorce

The Tax Cuts and Jobs Act of 2017 changed the US tax deductions for alimony payments for post-2018 divorce agreements and has made getting divorced more costly than ever for some.

If either you or your spouse are US citizens and UK resident, you should consider how the US and UK tax systems interact as it may affect the value of the assets you transfer. The following case study demonstrates what you need to be aware of to make an already stressful time less difficult.

Case study

Michael (previously UK resident but now US and New York resident) and Jane (UK resident) were seeking a divorce and needed Buzzacott's assistance with the following advice:

- Estimated UK and US tax liabilities on the disposition of the UK matrimonial home
- The transfer of a UK pension
- Wording for draft Orders of the Court
- Complications such as remitting offshore funds into the UK

UK matrimonial home

With a disposition, we helped Michael and Jane to gain the understanding that Jane would not be subject to UK tax as the Principal Private Residence Relief covered the gain. However, Michael would need to pay US federal tax of up to 20%, Net Investment Income Tax (NIIT) of 3.8% and New York State income tax.

In this case, Michael had owned and lived in the property for two out of the last five years before the sale, and could therefore benefit from a $250,000 exclusion to reduce the taxable gain in the US. The US tax above the exclusion is something Michael could not avoid in his circumstances, but in understanding this, Michael and Jane could come to an amicable split in terms of the transfer of sale proceeds from the property. Michael was also subject to US income tax of up to 39.6%* on his foreign mortgage exchange rate gain as well as a 3.8% NIIT charge. Michael and Jane had a GBP denominated mortgage and as it cost fewer dollars to pay off the mortgage than it cost to acquire the liability,

Michael had a foreign mortgage exchange rate gain. However, he was able to utilise his excess foreign tax credits and reduce the US tax liability by $20,000, but foreign tax credits could not reduce the New York State income tax charge or the NIIT charge as foreign tax credits do not apply to these taxes.

*(This was the previous top rate, which has been reduced to 37% from 2018).

UK pension

Michael wanted to see if there were any tax consequences of transferring a share of his UK pension to Jane. In the UK, many pensions enable a share in pension rights to be transferred on divorce. Jane would receive the pension distributions in the future and would be subject to UK tax. While this is an easy answer for the UK, the UK plan was a non-qualifying plan for US tax purposes and any part of Michael's pension that was transferred to Jane would be a taxable distribution for US tax purposes.

While there is a possibility of relief for US federal tax under the US/UK double tax treaty on the transfer from US tax, it would not apply for New York State tax purposes.

fall

noun US

the season after summer and before winter, in the northern hemisphere from September to November and in the southern hemisphere from March to May

autumn

noun UK

the season after summer and before winter, in the northern hemisphere from September to November and in the southern hemisphere from March to May

With this knowledge, Michael was able to make an informed decision on whether he would transfer a different asset to Jane by comparing the tax exposure of transferring a share of the pension with the tax exposure of transferring other assets.

Review of wording for draft Orders of the Court

As the divorce was executed prior to 31 December 2018, alimony payments could continue to be deducted for the duration as stated per the agreement. For Michael, alimony deductions helped to reduce his overall tax bill. For Jane, as she was not a US citizen and resided in the UK, which has a favourable tax treaty with the US, there was no concern as the UK does not tax alimony payments (referred to in the UK as maintenance payments).

The wording of the UK Order of the Court must be written so that the alimony payment meets the various requirements set out in the Internal Revenue Code. In addition, Michael was paying child support to Jane and with our advice, ensured that the entirety of the child support could be deducted as alimony. Michael managed to increase the amount he could deduct on his US tax return by up to £3,000 per month.

Assistance on future complications

We helped Michael to avoid future UK tax on the transfer cash lump sum to Jane by advising him to use funds situated in the UK as they have already been subject to UK tax so there would be no additional UK tax on transfer.

If a transfer of offshore funds (which have not previously been subject to UK tax) was made prior to decree absolute, Michael would have to ensure that he did not become UK resident within five years of leaving the UK. This is because the offshore funds contained capital gains, which would be subject to UK Capital Gains Tax if Michael met the temporary non-residence rules.

If a transfer of offshore funds (which have not previously been subject to UK tax) was made after decree absolute, this would not be a taxable remittance by Michael as long as he made a transfer to Jane's offshore bank account and Jane subsequently remitted the funds to the UK. We carried out an independent tax assessment, which ensured that there were no conflicts of interest.

As we deal with a variety of different clients on a day-to-day basis, we have built up knowledge to assist us with the complexities of certain assets that individuals hold and may transfer as part of a divorce.

Our wealth of experience in divorce allows us to ensure we have the full and complete picture and avoid making assumptions. By ensuring that we have the right information at the start of our engagement, we can meet the strict deadlines the courts set.

truck

noun US

a large, heavy motor vehicle for transporting goods or troops

lorry

noun UK

a large, heavy motor vehicle for transporting goods or troops

Buzzacott

Investments and pensions

US citizens living in the UK need to carefully plan investment strategies to avoid higher tax charges. You should also think carefully about how you take your pension.

Tax inefficient investments can seriously affect any gains you make and are a nasty surprise for many people. To give you an example of what you could save with effective investment planning, the case study below shows how one of our clients benefited from all of the following:

- Avoiding paying a 63% global tax rate on investment gains
- Saving $198,125 on global tax bills
- Minimising future global tax rate exposure to just 23.8%

This Stepping Stone also shows you:

- What PFICs are and how to avoid them
- How to avoid paying double taxation
- Options for withdrawing from your UK/US pensions to minimise taxation

Case study: Avoiding the seven year tax trap

Brian is an American client of ours who had been living in the UK for six years and was approaching the seven-year remittance basis deadline, meaning that he would pay both US and UK tax on his large portfolio of US mutual funds if he sold after the deadline.

Brian decided that after seven years he would not want to pay the annual remittance basis charge of £30,000 as it would not be worth it financially, and the ability to remit current year income and gains to the UK without an additional tax at that stage was preferable.

Substantial savings

We looked at the total taxes Brian would pay if he sold before or after the deadline. Since he purchased the US mutual funds, they had risen in value by over $500,000, so if Brian sold before the deadline, the US Capital Gains Tax (CGT) and Net Investment Income Tax (NIIT) would total $119,000.

However, if he delayed the sale until a future year after the deadline, he would instead need to pay 45% UK income tax when they were sold, as well as 3.8% NIIT. This would have resulted in a global tax bill of around $317,125, after taking exchange rates and foreign tax credits into consideration.

By pointing this out, Brian decided to sell early and saved around $198,125, simply by proactive planning. If he had left the sales until later tax years, he would have paid 63% of US dollar gains as tax.

Creating a better future

To avoid this problem in the future, our Financial Planning team provided independent financial advice, resulting in Brian investing his funds with investment firms that specialise in Americans living in the UK.

He ended up reinvesting into a portfolio of US mutual funds that had UK reporting status, which meant that any future gains would be taxable at a global rate of just 23.8% – a significant reduction.

elevator

noun US

a platform or compartment housed in a shaft for raising and lowering people or things to different levels

lift

noun UK

a platform or compartment housed in a shaft for raising and lowering people or things to different levels

Other top tips

Avoiding double taxation

It's normally important to consider the timing of the UK tax payment to avoid double taxation. Generally, if UK tax is paid in the same calendar year that income is generated, it can reduce the US tax due.

Passive Foreign Investment Companies (PFICs)

Avoiding PFICs will save you time, money and stress. Americans should be wary of investing in non-US collective investment funds, which normally fall into the definition of a PFIC. In some cases, PFICs can lead to global tax rates that could easily exceed 70%. However, there are several methods of avoiding PFICs and the regulations surrounding these. If you want more advice or examples, get in touch and one of our experts will run you through the potential pitfalls of PFICs.

Withdrawing pensions

If you have US and UK pensions, there are a number of factors to take into account to ensure you minimise the tax paid upon withdrawing your pensions. These include how the pensions have been taxed to date and where you expect to be living when you come to take benefits from the pensions. Considering only the US/UK tax consequences, the following shows how pension distributions are taxed:

Plan location	What received?	UK tax	US tax
UK	25% lump sum	Nil	Nil
UK	Balance	Taxed if resident	Taxed but fixed-term contract available
US	100% of sum	Nil	Taxed
US	Partial distribution of sum	Taxed if resident	Taxed but fixed-term contract available

To minimise your US/UK tax exposure, the pension distributions should be taken in the following order:

- 25% UK lump sum – this will be tax free
- 100% US distribution of sum – tax payable to the US at 37%
- UK balance – UK/US tax (If UK resident, tax payable to the UK at 45%. If US resident, tax payable to the US at 37%)

The flexibility around the pension order withdrawal will often depend on the type of pension, as some require the balance to be taken at the same time as the 25% lump sum. At Buzzacott, we can look at your circumstances and advise you on the best approach you can take to reduce your overall taxation liability on your pension funds. We know that navigating an unfamiliar tax environment can be confusing and we're here to simplify it.

restroom

noun US

of a building, a room containing a fixed receptacle into which a person may relieve themselves, typically consisting of a large bowl connected to a system for flushing away the waste into a sewer

loo

noun UK

of a building, a room containing a fixed receptacle into which a person may relieve themselves, typically consisting of a large bowl connected to a system for flushing away the waste into a sewer

Contents

Repatriating to the US

When an American expat repatriates to the US, it's not necessarily the end of their US/UK tax journey. In his Stepping Stone, we summarise what to look out for to help you understand your tax position before you move back to the US.

We have advised numerous clients about the US and UK tax consequences of repatriating to the US and there are four main areas that we encounter.

1, Sale of a UK home

If you're UK resident

There is Principal Private Residence (PPR) relief, which reduces the capital gain chargeable to tax if you have owned and lived in the property as your main home. If you leave your UK home and move into a US home, there is a period of nine months (a new rule from 5 April 2020) to sell the home before you get exposed to UK Capital Gains Tax (CGT), as only a nine month period of absence in the final period of ownership will qualify for PPR relief.

If you're not UK resident

There are non-resident CGT rules that you must abide by. These rules include the revaluation/uplift in cost basis to 5 April 2015, if applicable. It also requires a non-resident CGT return to be filed (and any tax paid) within 30 days of conveyance.

Key tax consideration

As a US citizen, you are also subject to federal income tax on any gain at 20% (long-term gain). Any UK tax paid can be taken as a credit to reduce the US federal tax. There is an exemption of up to $250,000 of gain per person if the home was owned and lived in for two out of the last five years before sale. If you're married to a non-resident alien (NRA) spouse, you could think about planning to gift the property to the NRA for them to sell before becoming a US resident, avoiding federal income tax. If you're a US resident when the property is sold, the main difference for US tax purposes depends on whether you are living in a state that has income tax. It's normally more tax efficient to sell the asset before moving to this state because it is an additional tax with no foreign tax credits allowed.

2. UK pensions

Unless you're of age to receive distributions from your UK pension, your UK pensions will continue to be reported on the foreign informational forms such as the Form 8938 (Statement of Specified Foreign Financial Assets), and for Form 3520-A/3520 if the pension is classified as a Foreign Grantor Trus). However, after many years of being in the UK, many of our clients have accumulated some tax free basis in their pensions, as most of the time employer contributions are taxable, employee contributions are not deductible, and growth (of earnings and accretions) within the pensions can be taxable unless treaty relief is claimed. Therefore, moving back to the US and receiving pension distributions could be tax efficient.

Key tax consideration

Ilt's important to distinguish between lump sum distributions and regular periodic pension payments. Lump sums are still taxable in the UK under the US/UK tax treaty, except for the 25% tax-free lump sum amount, which will be tax-free in both the US and the UK. Periodic payment amounts would be taxable in the US, although tax-free basis in the pension could mean the tax liability is reduced. Tax-free basis is a federal income tax rule and may not necessarily follow to a state income tax return. In particular, states like California will want to tax in full, as they do not necessarily follow the federal income tax return.

detour

noun US

the action of turning something aside from its course

diversion

noun UK

the action of turning something aside from its course

Case study

Back in the 2010/11 UK tax year, our client Melina made the maximum annual contribution to a Self-Invested Personal Pension (SIPP) of $212,500, for which basic tax relief of 20% was given. The relief was given within the SIPP, with the £212,500 contribution being grossed-up to £255,000.

The US did not give relief for such a contribution, therefore the SIPP generated tax-free basis for US purposes. However, the income contributed to the SIPP was fully absorbed by foreign tax credits in that year and this had accumulated over the previous 10 years. This meant there was no US tax liability, even though no relief was given in the US on the pension contribution.

Melina then retired back in the US and the amount already taxed on the US return of £255,000 will not be taxed again for US tax purposes (ignoring state tax issues). Under the current US/UK tax treaty, pensions are only taxable in the country of residence, so UK tax will not be payable on any periodic payments from the plan. For Melina, this meant that there was a permanent deferment of US and UK tax on £255,000 worth of income upon moving to the US.

3. Estate tax planning

If you've not had your estate or inheritance tax planning looked at for a while, and if it did not consider your return to the US, it would be sensible to have this updated. Factors such as the length of stay in the UK, whether UK citizenship was acquired and assets acquired over the period in the UK could all be relevant when it comes to estate and inheritance tax planning.

Case study

Mary is a US national who moved to the UK in 2000. Under common law in both the US and UK, Mary never had the intention to remain permanently or indefinitely in the UK, so she therefore kept a US domicile status. However, Mary is UK deemed domiciled as she was a UK resident for more than 15 out of the previous 20 years. Mary never acquired a UK citizenship. So where is she domiciled for treaty purposes?

Assuming her permanent home was in the UK, Mary will be UK treaty domiciled. She becomes US treaty domiciled if she sells her UK permanent home and moves to the US and obtains a US permanent home. This changes the estate tax and inheritance tax exposure dramatically.

4. Sale of a UK business

If you're UK resident

When you sell your UK business, any gain will be subject to UK Capital Gains Tax (CGT) at 20%. You may be able to claim Business Asset Disposal Relief for UK CGT purposes, as long as you've met the applicable qualifying conditions. This reduces the UK tax rate on the capital gain on qualifying disposals to 10%.

If you're not UK resident

When you sell your business, no UK CGT will be due provided you are not 'temporarily non-resident'. Broadly speaking, you will be temporarily non-resident if you were a UK resident for at least four out of the seven tax years prior to departure, and become a UK resident again within five years of leaving.

If you sell your UK business while you are temporarily non-resident, the capital gain will become liable to UK CGT in the year you return to the UK.

Key tax consideration

As a US citizen, you are subject to US federal income tax on any gain at up to 20% (long-term gain) as well as 3.8% Net Investment Income Tax (NIIT). Any UK tax paid can be taken as a credit to reduce the 20% US federal tax but not the 3.8% NIIT.

If you're US resident when the business is sold, there will also be state tax to pay if you are living in a state which taxes capital gains. If you have previously made a 'check-the-box' election for US tax purposes with respect to your UK business, this could potentially result in no US federal tax being due as the business is disregarded as a separate entity from yourself. While this can be a good exit strategy, a 'check-the-box' election has other tax implications and you should seek professional advice if you're considering this.

airplane

noun US

a vehicle designed for air travel that has wings and one or more engines

aeroplane

noun UK

a vehicle designed for air travel that has wings and one or more engines

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Tell us what you need or ask us a question

+44 (0)20 7556 1200 / enquiries@buzzacott.co.uk

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