

Year End Insight for US Taxpayers

We are in a better position than when we wrote to you this time last year, in terms of already knowing US tax rates for 2012 and some of the likely changes ahead. The Chancellor's UK Autumn statement is due on 29 November 2011 and at that stage we hope to be able to highlight further planning before the end of the UK tax year next April. In the meantime, this Insight looks at routine year end planning alongside some topical practical points and general alerts.

US tax rate changes

The US tax rates in force for 2011 remain for 2012, giving some certainty in the medium term. There are proposals in the September American Jobs Act, to re-introduce restrictions on itemised deductions for adjusted gross income over \$200,000 (\$250,000 if married filing joint), so that the tax value of all deductions will be limited to 28%. The Act also says that, after 31 December 2012, carried interest will be taxed as income from self employment, rather than as capital gains, a move that the UK is likely to watch with some interest. More recently, President Obama has proposed a higher tax rate for people making more than \$1 million a year, but analysts give these proposals little chance of being enacted in their current form.

Paying UK taxes by 31 December 2011

We are finding that it regularly takes several months, at best, to receive a US tax repayment where a foreign tax credit carry back claim is made. Therefore, it is important that clients who pay UK tax on their worldwide income (and who are on the "paid" basis for claiming foreign tax credits) pay their UK tax liability by 31 December 2011 to ensure that this

can be taken as a credit on their 2011 US tax return.

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For new 50% taxpayers, who also had significant amounts of income untaxed at source in 2010/11 (e.g. from self employment, investment income or gains), it is likely that payments on account will have been insufficient to offset the final liability. This, coupled with a higher payment on account for 2011/12, may mean a considerable UK tax payment is needed toward the end of the year.

You may also wish to consider pre-paying part of your 2011/12 UK tax liability by 31 December 2011 in certain circumstances; for example, if significant capital gains have been made, or if you are a partner in a UK partnership or member of an LLP or if you are a member of a US LLC and have received distributions in the UK tax year. Please contact us if this might apply to you.

Remittance basis charge – a creditable tax

Clients paying the Remittance Basis Charge (RBC) should also consider payment before 31 December. Now that the IRS have confirmed that this charge will be a creditable tax (for further information see our August 2011 news article), it may be of wider appeal to US taxpayers with significant investment income outside the UK. The RBC can be

paid directly to HMRC from offshore funds without this constituting a taxable remittance and we will provide you with further details when we contact you about your UK payment. It seems reasonably certain that the RBC will go up to £50,000 from 6 April 2012 for those who have been UK resident for more than 12 years. Even though the charge is creditable, there will still be clients for whom worldwide UK tax will be cheaper going forward and advantage should be taken of any restructuring opportunities before 5 April 2012.

Ensuring that adequate US estimated tax payments have been made for 2011

If payments were required for 2011, estimated tax payment vouchers would have been sent with your 2010 US return along with filing instructions. For those taxpayers that have not made these payments, a catch-up payment can be made with your 4th quarter estimated tax payment on 15 January 2012 to reduce any late filing penalty. Clients should be aware that there may also be individual State estimated taxes to consider.

Charitable contributions for the dual taxpayer

We always remind clients making charitable contributions that it is possible to make a donation that qualifies for both UK and US tax relief. If you have gifts planned for this UK tax year, to reduce your effective rate of UK tax, you will benefit by donating to a charity that has dual registration, for example many of the US colleges, or through Anglo-American Charitable Foundation, or the dual tax payer option that Charities Aid Foundation provides.

By making your contribution by 31 December 2011, the contribution (plus Gift Aid relief) is tax deductible for US purposes and will be given for the 2011 tax year. If the contribution is made in January, it will be given in 2012. In addition, if you contribute prior to filing your 2010/11 UK return, UK relief can be claimed against that year's income.

New UK penalty regime – important change

Compared to the US, the penalty regime for tax returns filed after the due date (31 January) has always been quite benign. That has now changed and penalties will apply to 2010/11 returns not submitted on time, regardless of any tax at stake. The fixed penalties start at £100 rising to £1,300 after 6 months and £1,600 after a year. In addition, there is a late payment penalty of 5% at 30 days, 6 months and 12 months for tax not paid. As no extensions are possible, it is vital that we have complete information for your UK return by 7 November 2011 at the latest, in order to ensure that it can be completed on time.

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Enhanced reporting of foreign financial assets

As we highlighted last year, 2011 US returns will require reporting of foreign financial assets in excess of certain thresholds, originally thought

to be \$50,000. A draft form 8938 and instructions has recently been issued. It suggests that for taxpayers living outside the US, this threshold will usually only be met if foreign financial assets are worth more than \$200,000 on the last day of the year or \$400,000 at any time in the year. This threshold is \$400,000 and \$600,000 if you are married and filing a joint return.

The types of foreign financial assets that must be reported include any financial account, and assets such as securities and stocks, interests in any "foreign entity" (including trusts and estates) and any financial instrument that has an issuer or counterparty that is not a US person and are in addition to the usual Foreign Bank Account Report (FBAR). If no US tax return is required, there is no need to complete form 8938, although the FBAR may still be needed.

Failure to file either an FBAR or form 8938 can result in a penalty of \$10,000 and we shall be giving this careful consideration as we send out the US checklists next year.

US gift and estate tax planning

For a US domiciliary, the exemption from gift tax is currently \$5m. The estate tax threshold has increased to the same amount, to the extent not used during lifetime, with the added benefit that any unused relief can be transferred to the surviving US spouse. Both exemptions and the maximum 35% rate are in place until the end of 2012 at least.

For Americans who own their main residence jointly with a non American spouse (or those who wholly own the main residence in their own name) and who face a potentially high US capital

gains tax bill on sale, the increased exemption, coupled with a depressed housing market, might mean it is a good time to change the ownership, depending on the effects of exchange rates.

In 2011, a US citizen can still gift up to \$13,000 to any individual and up to \$136,000 to a non-citizen spouse without affecting the lifetime gift tax exemption of \$5m.

A US husband and wife can elect for gift splitting to make a combined amount of \$26,000 to any individual, provided a gift tax return is filed.

As usual there are some things to think about by the end of the year, but we have a relatively stable US tax horizon for at least the next 12 months.

HMRC and IRS' alert notices for fraudulent emails

A word of warning in relation to emails that appear to be from HMRC or the IRS. There has been a huge increase in the number of phishing emails being sent, encouraging people to apply for UK and US tax repayments online, as well as requesting disclosure of all financial accounts in respect of FBAR filings. Neither the IRS nor HMRC ever contact taxpayers by email to advise them about tax due or repayments and in fact are actively involved in trying to shut down these scam sites. Do try to avoid opening any links if you receive this kind of email and never disclose any bank account or other personal details. More information can be found on the HMRC and IRS websites.

Please get in touch with your usual Buzzacott contact if you have any questions.

IRS Circular 230 disclosure

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