WEALTH MANAGEMENT

Four Financial Areas To Assess Ahead Of The US Tax Year End

With Autumn in full swing and the end of the calendar year fast approaching, now is the time to be reviewing your finances ahead of the end of the US tax year. Making informed planning decisions with an understanding of your full financial situation will help to ensure you enter the New Year as efficiently as possible. Below are four key financial areas we believe you should consider:

1. Review your Year to Date Realised Gain and Loss position to determine any Capital Gains Tax (CGT) Planning Opportunities

This year's volatile markets may mean that some investment positions carry unrealised gains whilst other positions carry unrealised losses.

From a US standpoint, it may be beneficial to review your year to date realised gain position alongside any rebalancing, and consider whether there is any carry forward or current year capital losses which can be used to offset any realised capital gain in this financial year. Harvesting losses may help offset CGT liability and your exposure to the 3.8% US Net Investment Income Tax.

Of course, if you are a US and UK taxpayer paying tax in the UK on an arising basis, you must remember to consider your gain and loss position from both a USD and GBP perspective and, to the extent that you hold investments offshore from the UK, you must also consider whether or not you are able to benefit from offshore losses offsetting offshore gains. With GBP being currently relatively weak against USD, we believe that it is likely that positions with USD unrealised losses are in fact unrealised gains in GBP terms and you don't want to get unnecessarily caught out by failing to consider foreign exchange movements.

If you pay UK tax on an arising basis, you are entitled to £12,300 annual tax-free CGT allowance before GBP gains are chargeable. This may help you to utilise some loss harvesting from a US perspective while not creating a large tax bill from a UK perspective. If you haven't been using your annual UK CGT allowance, you should factor it into your yearly planning, because it is lost if not used.

2. Consider the use of any US annual gifting allowances

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Should a US individual exceed the lifetime exclusion thresholds (currently $12.06m), their estate will be liable to gift and estate tax at 40%. Regardless of whether your wealth is currently above threshold levels, should you have more wealth than is necessary to meet your long-term financial needs, it might be important to consider using the annual allowances provided to help manage exposure to UK IHT. From a US perspective you can gift up to $16,000 dollars annually to any non-spouse individual you wish before using any of your available lifetime exclusion. This gifting allowance is on a per individual basis, so you can give $16,000 to any number of people whilst remaining within the US allowances. If you are married to a non-US citizen, this annual allowance is a higher £164,000. So, if you are a US citizen who married a British citizen this is something to consider as part of your legacy planning.

Comparatively in the UK, you can become subject to UK Inheritance tax (IHT) at 40% when your total assets exceed £325,000 (or £500,000 if you qualify for the Residence Nil Rate Band as well). Given the much lower thresholds available, lifetime gifting becomes an important consideration for many. Generally, when you give gifts in excess of £3,000 in a year, unless it meets another specific exemption, the gift will be considered a Potentially Exempt Transfer (PET). Provided you survive the PET by seven years, this gift will then generally fall outside of your eventual UK taxable estate. Additionally, one of the exempt gifts in the UK is something called 'a gift out of income'. For individuals who have healthy cash flows and can afford to give out of excess earnings without impacting their standard of living, this can be a neat way to give assets away without being considered a PET.

The arguably more generous lifetime exemptions in the US can allow US individuals living in the UK to engage in lifetime giving strategies that move assets outside of the UK IHT net while also using some of their US lifetime exemptions.

3. While considering annual gifting, review your charitable giving intentions

Charitable giving intentions often form part of any holistic Wealth Plan. The are many different methods and potential ways to give. Between the US and the UK, there can be income tax, inheritance tax and capital gains tax benefits if done properly. It may be sensible to consider if a qualified Donor Advised Fund (DAF) is a suitable vehicle for helping you achieve your giving and saving goals. Dual qualified DAFs can allow you to benefit from income tax savings in both the US and the UK at the time of donation. Once the funds are within the DAF, you can direct those funds towards charities located around the world provided they can be validated and seen as equivalent charities in the US and UK.

As with most gifting, it can be important to think strategically about which assets you choose to donate. For example, if you have assets that carry large unrealised gains in either USD or GBP, or assets that might be considered Offshore Income Gains (OIG) from a UK perspective, it may be beneficial to consider gifting the appreciated assets over cash. Outside of the income tax and CGT benefits that can be realised, any charitable gifts made during your lifetime are excluded from your estate upon death.

4. Consider any US/UK pension contribution allowance opportunities and US distribution requirements

As a US and UK taxpayer, you should think about your total level of annual income and be sure to utilise the available UK and US pensions contribution allowances for the financial year.

In the UK tax year 2022/2023 you can contribute to a UK pension up to an annual limit of £40,000. The UK allows individuals to carry forward any unused allowances from the previous three tax years as well. This means some individuals who qualify may have up to £160,000 available to contribute and receive tax relief in the UK. Note that your annual allowance begins to taper by £1 for every £2 you earn over £240,000, to an allowance of £4,000 once your earnings exceed £312,000. For those with excess cash flow, contributions can produce multiple benefits. First, you will reduce your annual UK income tax bill. Second, you gain the ability to invest in GBP collective investments in a tax deferred manner without being impacted by US Passive Foreign Investment Companies (PFICs) reporting. Third, UK pensions provide protection from UK IHT as they do not form part of your taxable estate.

Beware, if you do not use the annual allowance for a particular year, you will lose the opportunity after four years. Should you contribute more than the equivalent US contribution allowances in a given year (currently $20,500 or $27,000 depending on whether you are under or over the age of 50), you should ensure you have sufficient excess foreign tax credits (FTCs) available on your US tax return to avoid any US tax bill as the level of annual tax relief on pension contributions differs between the US and the UK. Your tax adviser can confirm your excess FTC position.

To the extent you have US earnings, you can also consider whether any contributions to US pensions are appropriate. Traditional IRAs and Roth IRAs carry an annual allowance of $6,000 ($7,000 if aged 50 or over) which provide an additional opportunity to add to tax deferred or tax-exempt savings. Additionally, if you are a UK Partner considered to be self-employed but limited by the UK annual allowance tapering, you can consider opportunities to fund a SEP IRA (which allow for contributions of up to $61,000 ($67,500 for aged 50 or older) and subsequently utilise FTCs to move the SEP IRA contributions into a Roth IRA tax free. Each vehicle can provide benefits in the right situation so if you haven't been diligent here previously, check if you are entitled to contribute this year and in the future.

On a standalone basis these annual exemptions and allowances may not seem significant. When combined and utilised annually with disciplined consistency, however, the tax efficiency gains over the long-term may become substantial

Separate from contributions into retirement plans, you should also consider whether any Requirement Minimum Distributions (RMDs) apply for your own US pension accounts or any inherited US pension accounts before the end of the year. If any RMDs are required, be sure to take the distribution before the end of the calendar year, as penalties can be assessed up to 50% should the distribution fail to be taken.

On a standalone basis these annual exemptions and allowances may not seem significant. When combined and utilised annually with disciplined consistency, however, the tax efficiency gains over the long-term may become substantial. The end of Summer always leads into an acceleration of days towards the end of the year which can approach very quickly without you noticing. Be sure to have a call with your tax adviser or Wealth Manager early who can assist you with your annual planning efforts in good time before the calendar year ends.

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