

Principles of Investing for American Citizens Living in the UK



"Principles are ways of successfully dealing with reality to get what you want out of life" ~ Ray Dalio, CIO of Bridgewater Associates.

Beginning your investment journey as an American citizen living in the UK can seem daunting. Whether learning to drive on the opposite side of the road or clarifying how His Majesty will tax your US investments, living in the UK can pose a unique set of challenges. Without the guidance of an experienced advisor or a playbook for dealing with those challenges, it can be very easy to succumb to inertia when thinking about important financial decisions. That inertia, which could relate to restructuring inefficient investments or collapsing structures that are no longer fit for purpose, can compound the financial implications of those challenges and prevent US-connected families from adequately planning for their future.

Although these challenges may be complex and costly, they are all solvable and can present planning opportunities for the informed family. In a world that provides an almost infinite supply of information to anyone with a smartphone, making the right decision about navigating some of these challenges can be overwhelming. Instead of paving the way to structuring the 'perfect' portfolio or identifying the most effective tax planning strategy, we can inevitably fall prey to 'analysis paralysis' by attempting to incorporate every minute detail into a decision. In our experience, those challenges can be successfully navigated by understanding and implementing the basic principles for investing as an American citizen living in the UK.

Kyle McClellan and Ollie Cutting, Wealth Managers at MASECO Private Wealth, have outlined a roadmap of some key principles you should familiarise yourself with before setting sail on your investment journey as an American living in the UK.

"Someone is sitting in the shade today because someone planted a tree a long time ago" ~ Warren Buffett

The first and one of the most important "principles" within this series is devoted to financial planning, which should be considered a universal principle for investors of all creeds. Irrespective of citizenship or residency, identifying your financial goals and quantifying what is required to achieve them can lay the foundations for a successful investment experience. The basics of an effective financial plan should provide you with a roadmap for achieving your goals that account for the idiosyncrasies of your personal circumstances.

Principle 1: Create a financial plan

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Common financial planning goals may include:

- 1) Purchasing your first property in the UK
- 2) Retiring at age 50 with an investable asset base that can sustain £100k of spending per annum in retirement
- 3) Funding a child or grandchild's college tuition
- 4) Charitable giving to support specific causes or leave a legacy
- 5) Shielding offshore investments from inheritance tax in the UK

Although many goals may feel out of reach to begin planning for, they should be identified as soon as possible and woven into the thread of your financial plan to maximise the probability of success. A lack of a goal or moving goal posts almost guarantees failure. To encourage adherence to the plan, long-term goals should be distilled into actionable short-term goals, such as targets for savings and/or investment returns, that can be reviewed and adjusted as your circumstances change over time. This helps to provide an investment strategy with quantifiable targets and helps to determine success by framing performance with an objective benchmark. At MASECO, we distil those short-term goals into a roadmap using a specialist cash flow planning tool, which helps to initially set a portfolio's direction and monitor its progress over time.



As American citizens in the UK maintain a foothold on both sides of the Atlantic, financial planning opportunities may be available to them that are not available to non-US citizens, which can provide a rare silver lining for transatlantic families. Ensuring your financial plan considers the interplay of those opportunities or the ramifications of decisions in both jurisdictions is, therefore, a crucial determinant of success. Important questions to answer during the financial planning process for Americans may include:

- 1) Are my taxable assets invested in a location, ownership structure, and strategy that promote optimal tax-efficiency?
- 2) Have you maximised US Social Security and UK State Pension entitlement?
- 3) Are allowable pension contributions being maximized in both the US and UK?
- 4) Are excess foreign tax credits being used effectively?
- 5) Are US education (529) plans structured appropriately for UK residents?
- 6) For couples with multiple nationalities, are assets being structured in a way to take advantage of opportunities available in both tax jurisdictions?

All of these questions are designed to highlight gaps or inefficiencies in the structure of your investments and can form a basis for addressing issues that improve your bottom line. Although some of these issues may appear intimidating to the untrained eye, they can be solved with thoughtful planning and advice from a financial planner – the most important but challenging part of the planning process is taking the first step. However, it's a decision your future self will thank you for.

If you would like to discuss your cross-border financial planning needs further, please feel free to reach out to Kyle McClellan or Ollie Cutting from our Private Wealth team.

Principle 2: Structure your investments tax efficiently

"You must pay taxes. But there's no law that says you gotta leave a tip." - Morgan Stanley

As both the US Internal Revenue Service (IRS) and the UK's HM Revenue & Customs (HMRC) can demand their pound of flesh from Americans residing in the UK, tax efficiency should be considered the holy grail of any investment strategy – nobody likes paying double tax, after all! To invest tax-efficiently, it is essential to appreciate that Americans are taxed on a worldwide basis, irrespective of their residency, domicile, or where income and gains arise. Coupled with the various nuances of the domiciliary rules in the UK – which were sensationalised by the headlines focusing on the financial affairs of Rishi Sunak's

family - investing tax-efficiently as an American living in the UK can be challenging and potentially costly if not approached correctly.

Although toeing the complex line between US and UK taxation can be challenging, it is not an insurmountable task. To ensure your investments are structured tax efficiently, there are several key themes to understand before beginning your investment journey:

- 1) If you are an American citizen living in the UK, how will you be taxed in each jurisdiction?

UK Taxation:

Remittance Basis

If you are an American citizen that has recently moved to the UK, you should familiarise yourself with the Arising vs Remittance Basis of taxation in the UK. Although it may not make for the most exciting reading, it's an exercise that can pay (literally!) dividends in the long run.

As a starting point, the Remittance Basis of taxation will only be available to you if you are a UK resident but not yet domiciled. It can allow you to shelter the income generated and capital gains realised on non-UK assets (like a US brokerage account or US rental property) from UK taxation providing you do not remit (e.g., bring the money in) to the UK. Opting for this method of taxation may not be without costs, though – if you have been resident in the UK for more than 7 years, you may have to pay the "Remittance Basis Charge" to continue enjoying this privilege, which can either cost £30,000 or £60,000 per annum depending on the length of your stay in the UK. Additionally, if you will likely need to access these offshore funds at some point whilst living in the UK, you will want to make sure you take appropriate steps where possible (for instance, income sweeping) to limit the cost of future remittances.

As the Remittance Basis of taxation allows you to shield US assets from UK taxation, it can be an incredibly useful tool if your stay in the UK is more of a sojourn rather than a long-term move. If you fall into this camp, you may technically not need to structure your US investments tax efficiently from a UK perspective. However, this should still be considered if you would like the ability to remit your non-UK assets without incurring additional tax charges.

Arising Basis

If you are an American citizen domiciled or Deemed Domiciled in the UK, you will pay tax in the UK on the Arising Basis. This method of taxation exposes your worldwide income and capital gains to UK taxation. If you fall into this camp, your non-UK assets would automatically fall into the scope of UK taxation and need to be structured tax efficiently from a UK perspective. We believe that most Americans will end up paying tax in the UK on the Arising Basis after being in the UK for more than 7 tax years as paying the Remittance Basis Charge often doesn't make sense when also taking the requirement to pay worldwide US tax into consideration.

US Taxation:

Fortunately, or perhaps unfortunately, depending on how you look at it, the US's method of taxation is easier to understand. If you are a US citizen (including accidental Americans), you are required to report and (potentially) pay tax on your worldwide income and gains irrespective of your residency.

2) If you are taxed on the Arising Basis, are your investments structured tax efficiently in both jurisdictions?

a. We and many of our fellow counterparts in the industry have written copiously on this topic. If you are interested in learning more about tax-efficient investments for Americans, please read:

<https://masecoprivatewealth.com/insights/all>

<https://masecoprivatewealth.com/whitepaper>

3) If you are a UK resident but non-domiciled, have you considered structures to protect your offshore investments from UK inheritance tax before becoming deemed domicile (which occurs after being UK resident for more than 15 out of the last 20 years)?

4) Are your investments held within appropriate tax wrappers that shield your investments from US and UK tax?

Although this list is by no means exhaustive, it should serve as a useful basis for understanding your tax obligations and how you can structure your investments tax efficiently. As US and UK taxation can be a thorny topic, we highly recommend that you seek the advice of a specialist US and UK qualified tax advisor before making any investment decisions. If you would like to be introduced to a tax advisor or discuss any of the topics this principle touches upon, please contact Kyle McClellan or Ollie Cutting from our Private Wealth team.

Principle 3: Devise a strategic asset allocation

"On average, 90 percent of the variability of returns and 100 percent of the absolute level of return is explained by asset allocation." ~ Roger G. Ibbotson, Professor Emeritus in Practice of Finance, Yale School of Management.

A key principle for successful investing is devising a strategic asset allocation in line with your investment goals and objectives. A strategic asset allocation refers to the target weightings for different asset classes within a portfolio, such as equities, fixed income, real estate, alternatives, etc. Despite common misconceptions, your strategic asset allocation will tend to be the main determinant of your portfolio's returns, as opposed to timing the market (buying and selling at the 'right' time) or picking the best stocks within an index. With the future being inherently uncertain and difficult to predict, positioning your portfolio for a specific event is usually a fools' errand. Your strategic asset allocation should ensure you achieve your goal irrespective of future market conditions.

Your strategic asset allocation should consider the following:

1) Risk vs reward

a. Understanding that risk and return go hand-in-hand is one of the most basic but important principles of investing. Investors who own volatile investments are typically compensated by a "risk premium" but must accept greater volatility as a result. Your strategic asset allocation should be personal and tailored to your emotional risk tolerance, current and future financial needs, and investment time horizon.

2) Diversification

a. Diversification is commonly referred to as "the only free lunch of investing" and is one of the cornerstones of successful investing. Ensuring appropriate diversification within a portfolio is key to maximising returns for a given level of risk. Considering your exposure to different asset classes, geographies, and currencies will be important for optimising the risk and reward profile of your portfolio through wide diversification.

3) Currency

a. Managing currency or exchange rate risk can be a complex challenge for American citizens living in the UK. A seemingly tax-efficient investment may pose hidden currency risks that could reduce purchasing power in the UK.

b. Holding US Dollar-denominated bonds or fixed income can add an additional layer of complexity to a portfolio. For instance, an American living in the UK may invest with a US Dollar lens, primarily for tax reasons, yet plan to retire in the UK and require an income of British Pounds in retirement. The adage of not "letting the tax tail wag the investment dog" has great relevance in this scenario because investors holding US bonds (i.e. bonds that are priced and pay income in US Dollars) will be subjected to the to-and-fro of currency markets; namely, the GBP – USD currency pairing. As the US Dollar depreciates, the value of your US bonds positions in the UK will also lose value, which can complicate capital preservation and income generation in retirement.

c. To effectively manage currency risk, one approach is to diversify bond or fixed income exposure away from the US, as a stream of coupon payments in US Dollars may not be appropriate for retirement. Instead, American citizens living in the UK should ideally match the income from their investments (typically derived from bonds or fixed income) with the currency of their future liabilities to protect against fluctuations of the dollar.

4) Portfolio Rebalancing

a. Defining an objective process for rebalancing your portfolio will be crucial for managing risk, capitalising on market dislocations or corrections, and keeping your emotions in check. A rebalance refers to the process of realigning the weightings of your portfolio's investments with the target, where overweighted (or overvalued) asset classes are sold to purchase underweighted (or undervalued asset classes). It is commonly performed twice a year or when raising or adding capital to ensure the portfolio remains invested within the agreed risk parameters.

b. Agreeing on the parameters at the outset of any investment is important for ensuring a rebalance takes place, regardless of market conditions or sentiment. Systematic rebalancing of your portfolio can help automate contrarian investment practices (i.e. purchasing when others are selling) and ensure you capitalise on market dislocations when they take place.

Principle 4: Establish the right professional network (tax, wealth, legal, mortgage, etc)

"Growth is never by mere chance; it is the result of forces working together" ~ James C Penney, American Businessman and Entrepreneur, Founder of the JCPenney Stores.

Moving to the UK and adjusting to how life works across the pond can be a daunting task for families that are busy with work commitments, helping their kids adjust to new schools, or perhaps finding the perfect pub for a Sunday Roast. Dealing with financial issues, paperwork and planning with forethought can naturally fall by the wayside, which is why it's important to build a strong team of trusted advisors who can help to lighten the burden. The right team of professionals can provide the foundations for dealing with unexpected events, whether positive or negative and building the right team from the outset provides the comfort that there is always someone on hand to help.

We have covered at length the complexities faced by Americans when it comes to financial planning, investing, and ensuring that tax exposures have been considered. The UK and the US have enjoyed a 'special relationship' for generations that has fostered a healthy tradition of transatlantic migration in both directions. As the relationship has grown and developed, so too have specialist advisory practices like MASECO Private Wealth, who enjoy 'simplifying the complex' when it comes to being American and living in the UK or vice versa. Finding the right Wealth Manager is a strong starting point, however, it is also important to tap into a wider network of professionals in the US-UK space as and when required. Often, experienced advisors for UK clients might be restricted or less qualified in their ability to advise on the US considerations, and it is preferable to work with professionals with a proven track record of helping Americans in the UK. The following are some of the most common situations requiring great teamwork:

1) Tax Compliance

a. Americans in the UK must consider tax implications from a UK (HMRC) and US (IRS) perspective but also work with someone who understands the interplay between the two tax systems, by interpreting the US-UK tax treaty and ensuring proper usage of foreign tax credits. This creates a third field in tax for specialist US-UK advisors, and a good Wealth Manager can help to introduce you to an appropriate advisory firm.

b. You may benefit from paying taxes in the UK within the calendar year to allow you to file in the US and not overpay taxes, having to reclaim them at a later date. This highlights the potential benefit of working with one firm on both tax returns.

c. Interests in Trusts and company shareholdings can often require deeply specialist advice from the right professionals for dual taxpayers. Your Wealth Manager should be able to flag areas that require closer attention from a tax or legal professional.

1) Estate Planning

a. Families with a transatlantic financial footprint may have to consider inheritance tax and probate in both the US and UK. To avoid any contentious disputes during probate and ensure assets are distributed appropriately, drafting a Will that allows for flexibility in retirement could be sensible. Lawyers that understand both jurisdictions are rare, but your Wealth Manager should know where to find them.

b. Trusts can be effective estate planning tools when set up correctly. As is often the case, what works in the UK for a Briton might not be appropriate for those holding a US passport. Legal and tax professionals with a clear understanding of the US and UK are invaluable when setting up wealth protection vehicles for future generations, as-is your Wealth Manager for ensuring the underlying investments are held in a diversified, tax-efficient strategy.

c. Life insurance policies established in another jurisdiction may not always remain fit for purpose when you move. Your Wealth Manager can assess the policies from an investment and currency exposure standpoint and bring in professionals on the insurance and tax side to determine whether it might make sense to wind down existing policies or consider a restructure (for instance, migrating them into Trusts) with the help of a specialist lawyer.

3) Purchasing Property

a. If an American is buying a new home in the UK, they may need a specialist mortgage advisor or credit specialist to help them access the best rates on offer.



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4) Banking relationships

a. Private Banks often impose higher than standard minimum cash balances on US individuals living in the UK. Such individuals may benefit from being introduced to lending options against their invested assets, whether in the UK, US or offshore, or to banks that have a wider range of options for Americans living in the UK.

5) Charitable giving

a. Donating can be more tax-efficient for the donor in many cases if they seek the advice of a partner firm that understands how to create tax-relief from both an IRS and HMRC perspective when making donations in either jurisdiction.

b. For wealthier families, setting up a Foundation can have a multitude of benefits, from tax-efficient investment to ensuring donations are tax-efficient on both sides of the Atlantic. Specialist firms exist to set up Foundations fit for dual US-UK taxpayers.



Americans have a natural gift for finding their counterparts when they relocate to the UK, be it through youth softball leagues, Oscars viewing parties, college alumni events, or watching late-night playoff football games on a Sunday down at Passyunk Avenue (in West London...not Philadelphia). Advice professionals have gleaned some of this same social spirit, and so the firms that enjoy working with Americans in the UK are becoming ever more familiar with one another and will share best practices and recommend clients to work with one another. This collegiate spirit and specialist network is an important asset, and so whether you are wondering if it makes sense to fund an ISA account like your British neighbours (usually not, unfortunately), or whether an element of your financial plan requires legal or tax advice, your Wealth Manager will be happy to direct you to an appropriate professional for the job.

Principle 5: Securing your assets from top to tail and managing risk beyond the markets

"Safety isn't expensive, its priceless" ~ Jerry Smith, American Football Player

Building a sound financial plan that allows you to meet your goals can often involve an element of risk, given the intrinsic link between investment risk and return over the long-run. A sound Wealth Manager will analyse the required risk you need to take from a pure investment standpoint in order to achieve success and explain the interplay between volatility, diversification, inflation and currency risk to guide you towards a portfolio with the appropriate level of market risk for your needs. It is natural for many clients to consider their risk from a portfolio and markets standpoint – which are of course important – but there also wider factors that highlight the importance of working with the right specialist Wealth Manager and their team to create a safe environment for your investments to perform in.

1) Appropriate Regulation

a. Americans in the UK are, by nature of their tax and regulatory complexities, straddling two financial regulatory environments and often have a presence in both the US and UK either physically or through their financial asset accounts. Making sure that your Wealth Manager is qualified and regulated to provide advice in the UK (under the Financial Conduct Authority (FCA)) and the US (under the Securities and Exchange Commission (SEC)) provides a strong base to help ensure that there is adequate advisory competence and compliance with rules on either side of the Atlantic.

b. Often, UK based firms will have the ability to provide advice to Americans physically resident in the UK, but there may be a risk that if a client makes an unexpected return to the US their advisor can no longer fully support them. Furthermore, perhaps the UK based advisor is unable to advise on US based retirement accounts or lacks knowledge about the US implications of certain UK investment choices, for example, which makes it hard to develop a comprehensive financial plan.

c. It is best to find an Advisory firm that is committed to serving you as a client type. We have seen major banks in the US cease to work with Americans living overseas due to the regulatory environment and time cost associated with keeping up to speed. Firms that specialise in working with Americans living abroad are incentivised to ensure they are on top of European, UK and US regulations to ensure their core client base has access to the right advice.

2) Securing Assets with the Right Institutions

a. Fund manager selection: Intelligent investing involves ensuring diversification across asset classes – buying funds with different characteristics such as their geographic exposure or market segment, and importantly buying funds that are tax-efficient in the US and UK if you are American living in the UK. Choosing the right fund manager is important – if a fund has UK reporting status one day, it might not the next, and so you should buy funds from a provider that understands the tax and regulatory environment. Your Wealth Manager should ideally have regular dialogue with them and, whilst no guarantees will be given by a product provider in this respect, at least the Wealth Manager should understand their commitment to keeping tax efficiencies in place.

b. The investment industry has expanded over time, so thousands of fund providers, banks, and investment platforms can purchase securities. Thorough due diligence should be conducted on an ongoing basis to ensure that reputable businesses run the funds you are purchasing with good governance, and it's important for your Wealth Management firm to have a good relationship with the custodial bank that secures your investments.

c. Your advisor should be able to articulate what happens to your assets in the worst-case scenario where a fund management business, or even a bank, goes out of business – are you protected by the US or UK government, for example, and to what degree? Overall, you should be able to rely on the risk assessment frameworks of your investment team to reduce the chance of your assets losing value as a result of institutional failure.

Principle 6: Find an Investment Philosophy that works for you and stay the course

"It's not hard to make decisions once you know what your values are." ~ Roy E. Disney, co-Founder, The Walt Disney Company

We are all human beings with human emotions and impulses which can give in to fear and greed if left without a system of beliefs to shape the way we make everyday decisions. For this reason, investors can often be their worst enemy – selling when the markets are down, buying at the top, or choosing expensive investment offerings having been overly excited by the prospect of year-on-year market outperformance. Major studies tell us that the average equity and bond market investor has underperformed the general market over time (Source: DALBAR Quantitative Analysis of Investor Behaviour 2020).

It is well understood that risk and return are intrinsically linked over the long-term but without a core set of beliefs or guidelines within which to invest, it is easy to reduce your chances of reaping the rewards associated with the level of risk you take. At MASECO, we refer to our belief system as our Investment Philosophy, which defines why and how we recommend the strategies we do and how we can help our clients make rational, evidence-based decisions along their wealth accumulation journeys. Choosing the right philosophy to follow can be hard, but seeking out the following characteristics might be a good place to start:

1) Choose a Wealth Manager that has an Investment Philosophy!

a. It is surprising how many Wealth Management practices do not have a documented set of core beliefs on which they rely. However perhaps representative of a changing tide away from 'flavour of the month' investment strategies towards evidence-based, quantitative approaches. If a Wealth Manager cannot clearly define the values that underpin their investment decisions, it could be a warning sign that their decisions are based on impulse instead of data.

2) Trust an evidence-based approach

a. A wealth of data exists in the modern era, whether in the balance sheets of public companies or stock price movements recorded every second. This data is ammunition for academics and investment professionals, who are constantly seeking patterns and connections between business activities and the impact on stock prices over time.

b. Whichever Investment Philosophy you decide to place your trust in, ensure that it is founded on a rational approach that can be evidenced by data. Of course, historical data is not an indicator of future performance, but understanding how security prices have moved over time can provide a useful guideline for the probability of generating future returns above a given benchmark.

3) Pay attention to costs

a. The theory of finance and investing has evolved significantly in the 21st century, in tandem with technological progress and computing power. There are over 100 documented 'factors' of investing; perceived linkages between security price movements and underlying data, which could lead to outperformance above the general market by holding the right investments.

b. The challenge still is putting theory into practice at an affordable cost. If a strategy involves too much trading, or high fund fees as a result of paying for a team of star quantitative analysts, it may be that the potentially high gross returns become less attractive on a net basis after the total fees are taken into account.

c. It is practical to seek out a strategy that tries to generate an additional return above the market by investing in factor-based strategies that are cost-effective to implement.

d. From the hundreds of strategies written into academic theory, only a handful are practical and affordable in the real world. A good investment philosophy should carefully consider costs to drive a high risk-adjusted net-of-fees return.

e. Tax-inefficiency is a cost, too – often we see strategies that are overly focused on gross returns, without considering the net return after fees and taxes. This is particularly sensitive for Americans living in the UK.

4) Diversify, diversify, diversify...

a. It is becoming more widely understood by the average investor that diversification or spreading risk across many different types of security and asset class, is a healthy way to invest for a smoother investment journey.

b. It is important, however, to look for a systematic approach for how and where to diversify your investment portfolio. At a high-level, you will want to understand how your investments would be split between Fixed Income (bonds), Equities (stocks), or Alternatives like real estate and commodities, for example. Beyond this, your Wealth Manager should be able to define how they over and underweight exposures geographically, by market segment, industry, or security type.

c. It is easy to feel diversified if a manager has a long list of recommended positions or complex-sounding fund names in their allocation. This does not always mean you are truly diversifying your portfolio risk. For example, a US S&P500 index fund may track the index of the 500 largest US stocks by market capitalisation, whereas a smarter option could be a US large cap fund that holds 1500+ positions and takes a more careful approach to the weighting of each company stock within its fund to avoid overweighting too heavily towards the largest companies, which can often be the most expensive.

d. Avoid home country bias – in our years of investing for Americans living in the UK, and Britons living in the US, we have seen a clear trend in US-based managers having a natural overweight to the familiar – US stocks, and in the UK – UK stocks. Taking a global approach, weighted broadly by market capitalisation, places less reliance on their home country having a ‘good year’ to generate strong performance.

e. Always be cautious of an approach that claims to beat the markets by a significant margin. It could be that the cost of doing so is diversification – markets are cyclical and it is best to avoid greed and try to capture the performance of global markets, giving yourself a chance of outperformance, while ensuring a good level of downside protection. This is achieved by carefully thinking through diversification.



Principle 7: Plan for the next generation

“Each generation will reap what the former generation has sown” ~ Anonymous

Although winning the title of the “richest person in the graveyard” is an accolade few of us will care for or personally benefit from, estate planning is a crucial component of many of our client’s financial plans, especially for those who have both US and UK inheritance tax (IHT) to contend with. Unfortunately, even though death and taxes are fates all of us must inevitably plan for, formalising our estate plans can commonly be left as an afterthought until goals in our own lifetimes are met, such as purchasing our first home, putting our children through university, or investing for retirement. While this behaviour is perfectly understandable, getting a head start on estate planning can allow us to maximise the “excess wealth” (i.e. capital that is highly unlikely to be spent in our lifetime) that is passed on to the next generation and available to support our philanthropic goals.

If you, like many of our readers, have connections to both the US and UK, your estate plan may need to consider the rules on both sides of the Atlantic. Understanding the dynamics at play in both jurisdictions can therefore be a good starting point for beginning the estate planning process.

Inheritance Tax (IHT) Considerations:

UK IHT

Any UK non-domiciled individual living in the UK for more than 15 of the last 20 years is deemed to become ‘domiciled’ in the UK. This matters because the UK assesses IHT based on an individual’s domicile status. ‘Domicile’ is a long-term, sticky tax status in the UK (not to be confused with ‘residence’), and those who are domiciled (or deemed to be domiciled) in the UK have their worldwide estate fall into the UK inheritance tax net (‘non-doms’ who do not yet meet the deemed domicile threshold are subject to UK inheritance tax on UK-situs assets only).

The UK offers a paltry IHT allowance in comparison to the US. If you are domiciled (or deemed domiciled) in the UK, your individual IHT allowance for worldwide assets (i.e., the estate value you can pass on without tax) will be £325k under the current rules. Some individuals can benefit from an additional £175k allowance should their main home be passed on to an immediate family member, but this benefit begins to be phased out for individuals who have estates worth more than £2mn.

In most instances, the value of your estate above the allowed threshold would be exposed to IHT at a rate of 40% - yikes!

US Estate Tax

The US has far more generous allowances but chooses to tie its' estate and lifetime gifting rules together. While the US also charges IHT at a rate of 40%, under the current rules, an individual has a "lifetime gift and estate tax exemption" of just over \$12mn. This, however, is due to sunset back to an inflation adjusted amount of the previous allowance of \$5mn (c.\$6mn) at the end of 2025. Therefore, even after the US's lifetime gifting and estate tax exemption reverts back to the c. \$6mn threshold, the UK's IHT regime remains incredibly important to manage appropriately.

Once you have a broad understanding of your IHT obligations, we naturally begin to consider strategies to reduce our exposure and increase the excess wealth we can pass on. Some of those strategies may include:

1) Gifting

a. With the need to closely manage and navigate the differences between the UK and US rules and available thresholds, many turn to the possibility of making gifts during their lifetime. The impact of doing so is very different in the US and the UK, so it is key for clients to understand what making a gift will mean for their estate when they die.

b. In the UK, while you are alive, you can consider making a potentially exempt transfer (PET) gift to reduce your UK taxable estate. Providing it meets the relevant criteria for a PET, it will be fully exempt from UK IHT if you (the donor) survive seven years from the date of the gift. If you pass away within the seven-year window, the gift, or a portion of it may remain taxable within your estate. Gifting assets that are unlikely to be used within your lifetime can therefore be very effective for reducing your exposure to UK IHT.

c. Although the US's lifetime gifting and estate tax exemption is more generous than the UK's, their gifting rules are less flexible. Generally, any gift above the annual gifting exclusion (\$16k per individual in 2022) would reduce your lifetime exemption available to offset future gifts as well as your US estate at death.

2) Trusts

a. Trusts can often be used to achieve numerous objectives and can be particularly useful in managing a non-domiciled individual's exposure to UK and/or US IHT.

In our experience, the most common uses of Trusts within estate plans for US-UK connected families are:

i. Excluded Property Trusts (EPT)

If you are neither domiciled nor deemed domiciled in the UK, an EPT can be settled to shield offshore assets from UK IHT. Many of our clients consider this strategy with their estate planning attorneys, who should be consulted to advise on the tax and IHT implications, to meaningfully lower their exposure to UK IHT alongside their broader goals and objectives.

ii. Qualified Domestic Trust (QDOT)

If you are a US citizen married to a non-US citizen (or vice versa) and have an estate valued above the lifetime gift and estate exemption, US estate tax may be liable at your death when assets pass to your non-US citizen spouse. QDOTs can be used to defer that tax charge until the non-US spouse passes away which can also generally align the timing of estate tax being payable in both jurisdictions.

iii. Irrevocable Life Insurance Trust (ILIT)

If you are considering taking out a life insurance policy as part of your estate plan, creating an ILIT to own that policy may offer numerous IHT and legacy planning benefits including ensuring that the insurance proceeds themselves remain outside of your taxable estate.

3) Charitable donations

a. Charitable donations are a complex topic (that probably demands a dedicated article for US-UK connected individuals!) because donations must be carefully planned to enjoy the full benefit in both the US and UK. Fortunately, if you have philanthropic goals, charitable donations are generally a tax-efficient means of reducing your taxable estate (in the US and UK) that can also offer additional income tax benefits.

These are just some of the strategies you can consider within your estate plan. As you may have guessed, the strategies discussed within this principle are complex and should be discussed with the relevant tax and legal professionals. If you would like an introduction to an estate planning attorney or tax advisor that can opine on your unique IHT position, please contact Kyle McClellan or Ollie Cutting from our Private Wealth Team.

The Legal Stuff

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