WEALTH MANAGEMENT

Eight Questions To Ask Yourself If You Are An American Living In The UK

As an American living in the UK, almost nothing related to your financial affairs is easy. The consequences of seemingly simple decisions – such as how to pay for a new home or purchase a mutual fund - may create unnecessary tax charges and complexities. Americans resident in the UK need to make financial decisions considering the interplay between two jurisdictions and the impact across the whole of their investment and wealth management spectrum.

Below are eight common questions which can help you identify where the complexities in your financial lives may exist and steps you can take to address them.

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Q1. How long have you been resident in the UK?

Most Americans living in the UK are considered to be non-domiciled individuals for UK income tax purposes. In the first seven years that you live in the UK, non-domiciled individuals have the ability to pay tax in the UK on what is called the Remittance Basis. This means that you will pay UK tax on income earned in the UK and any untaxed income deemed to be brought onshore to the UK. However, after seven tax years, most non-domiciled individuals begin paying tax in the UK on worldwide income as it arises as the alternative involves paying an annual Remittance Basis Charge. And, after fifteen tax years, individuals generally lose the ability to choose taxation under the Remittance basis altogether. This results in Americans reporting worldwide income in both the US and the UK and claiming a tax credit, where appropriate, in the allowed jurisdiction. Once an individual is paying tax in the UK on a worldwide basis, the UK will tax any mutual fund or exchange traded fund investments held in the US at income tax rates instead of capital gains taxes, unless the fund investment has applied for something called UK reporting status with HMRC. As such, it is important to consider a review of your US investment portfolio in the years leading up to being taxed on the Arising Basis, to ensure that your US investment portfolio doesn't unknowingly attract unfavourable tax rates in the UK.

Q2. Have you ever invested in Mutual Funds or ETFs in the US? Do you still have those investments?

Many Americans who move to the UK do so with the intention of staying for just a few years. Often two years turn into five years which turn into ten years or more. As noted earlier, after being resident in the UK for more than seven tax years, many Americans begin paying tax in the UK on what is called the Arising Basis. This means that you are reporting your worldwide income to the UK tax authorities as it arises regardless of whether that income is remitted into the UK or not. Unless a non-UK collective investment has gone through a special reporting process with HMRC, the UK will view any gains earned on funds outside of the UK as Offshore Income Gains (OIG). This means that any gains earned on a fund without UK reporting status is subject to UK tax based on your UK income tax band as opposed to the more favourable capital gains tax rates. Additionally, any OIG assets do not receive the benefit of the UK capital gains tax allowance. As such, in order to keep your financial affairs more flexible, it often makes sense to review the structure of your investments before beginning to pay tax in the UK on the Arising Basis and make any appropriate changes. HMRC publishes a list of offshore funds that have undergone the UK reporting status process.

Q3. Do you have any investments in Unit Trusts, Investment Bonds, ISAs, Collective Funds or ETFs either in the UK or anywhere else outside the US?

Once Americans gather assets outside of the US, they will often begin looking to invest in non-US based investments. However, investing in many non-US based investments can be highly tax inefficient from a US perspective. Any non-US regulated collective investments are considered to be something called a Passive Foreign Investment Company, or PFIC. Unless a special election is made in the first year of ownership, PFIC gains can often attract tax at the highest marginal income tax rates in the US (regardless of the level of your other income) as well as an interest charge. Up to 100% of the gain can be paid in tax. PFICs do not receive the benefit of capital gains tax rates in the US and PFIC gains cannot be offset against another PFIC loss. Common UK products, unless recognised under the US-UK income tax treaty, will often attract PFIC treatment. As ISAs are viewed as taxable accounts from a US tax perspective, the US tax authorities will look through the ISA wrapper to the underlying holdings and tax them based on the character of the investments. If you have ISAs it is important to invest in individual securities to then avoid PFIC treatment. If you hold any non-US regulated collective investments you should seek advice from a US-UK tax adviser to determine the tax consequences of selling and you should consider restructuring your finances to hold more tax-efficient investments.

Q4. What are your plans for the future? Are you intending to stay in the UK or return to the US?

Many Americans believe they will return to the US but don't know when. Others are equally unsure whether they will remain in the UK, go elsewhere or return eventually to the US. Your long-term residency intentions in retirement and an understanding of where your long-term liabilities are will have important implications on how your investment assets are best structured. Foreign exchange risk can creep into portfolios if they are not structured properly, and having an understanding of where this lies is crucial when designing an investment portfolio. For example, the reference currency of your growth assets matters less when you have an unhedged globally diversified portfolio versus the denomination of your fixed income investment assets.

Q5. Do you have Pensions in the UK, US or elsewhere?

Holding a recognised pension asset under the US-UK income tax treaty can offer real benefits to appropriately managing the overall structure of your investment base. For example, if your long-term intentions are to remain in the UK and you hold recognised tax deferred pension assets in either the US or the UK, this can be a good place to shelter pure Sterling investment exposure within your portfolio without attracting negative tax consequences that can result from PFICs. Alternatively, if your intention is to return to the US, there may be opportunities to custody your UK pension on a US platform allowing US based investments to be held within the pension.

Q6. Do you know whether you have any Excess Foreign Tax Credits and do you know how you can utilise them?

Since UK tax rates are generally higher than US tax rates, many people generate excess FTCs on their US tax return that build up over time. These excess credits can be carried forward and utilised for up to ten years on foreign income that does not attract extra tax in the UK but attracts tax in the US. There are limited scenarios that these can be used, but this can be a valuable planning tool if the opportunity arises. Some common uses of excess FTCs can be towards UK pension contributions, contributions to an individually owned Enterprise Investment Scheme (EIS), or a Roth IRA conversion of deemed foreign source contributions made to an employer 401k plan. It can be beneficial to review opportunities to utilise excess FTCs with a US-UK tax adviser.

Q7. Are you Married? If so, what is the nationality of your spouse?

Two US citizen spouses generally have less complications and complexities to consider with respect to the structure of their financial assets. However, when one spouse is a US person and the other is not, more consideration is often needed to determine the optimal structure of any investment assets. For instance, the non-US spouse will usually be able to take advantage of all of the tax favourable UK products without exposing themselves to negative US tax consequences whilst the US spouse cannot. Additionally, it can often be beneficial to review the ownership structure of real property when both spouses are not US persons.

Q8. Are you aware of the difference between the UK and US Estate/ Inheritance Tax Limits and the different Gifting Rules in the UK and US?

This is an area of potential change under Trump's tax proposals but, in general, the US is very generous with its estate tax allowances, currently \$5.6 million (2018 thresholds), for US citizens and those considered domiciliary residents for US gift and estate tax purposes. Lifetime gifting is tied to the US estate tax allowances, with any gifts in excess of \$15,000 (to non-spouse individuals) or \$152,000 (to non-US spouses) per year going towards the individual's estate tax lifetime allowance. The UK on the other hand currently allows for generous lifetime gifting in the form of Potentially Exempt Transfers (PETs) and for a £325,000 nil rate band per individual for inheritance tax. Whether an individual is considered deemed domicile or not will impact appropriate strategies for managing exposures in both jurisdictions.

Managing optimal strategies for one jurisdiction is not easy, but having to understand and consider the interaction between two can make things even more complex. Taking the time to understand where those complexities in your financial lives lie, and seeking advice from a professional who understands how the US and UK rules interplay, can be incredibly valuable to keeping things simple, flexible and optimal as your plans inevitably evolve.

Risk Warnings and Important Information

The value of investments can fall as well as rise. You may not get back what you invest.

The above article does not take into account the specific goals or requirements of individuals and is not to be construed as advice. You should carefully consider the suitability of any strategies along with your financial situation prior to making any decisions on an appropriate strategy.

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