WEALTH MANAGEMENT

Keeping More Money In Your Pocket Through Tax-Efficient Investing

Having clearly defined personal wealth goals and objectives is the first step towards determining an appropriate investment strategy and asset allocation. The additional value add comes with giving proper consideration as to how to meet your goals in the most tax-efficient and optimal manner. As a US person living in the UK, it can be very important to make sure that you avoid the tax traps that are littered within the investment world to mitigate any overall costs of investing.

As discussed in previous articles, generally many non-domiciled individuals begin paying tax in the UK on worldwide earnings after 7 years of residency, that is, unless there is reason to pay the annual Remittance Basis Charge (RBC) to remain on Remittance Basis taxation. If you choose to pay the annual RBC, under the rule changes that came into effect in April 2017, any non-domiciled individuals who are UK resident for more than 15 out of the last 20 years automatically move to paying tax in the UK on worldwide earnings as they arise.

From an investment perspective, when you are a US person paying tax in the UK on an Arising Basis, it is important to look closely at the structure of both onshore and offshore assets. For any assets that are held outside of a recognised tax wrapped structure (for example, a Traditional IRA, Roth IRA, 401k or UK occupational pension scheme, etc.) you should ensure that the underlying assets you own are tax-efficient not only from a US perspective but also from a UK perspective. Doing so, will help mitigate any unnecessary and disadvantageous tax charges.

Many people are aware of the need to avoid Passive Foreign Investment Companies, or PFICs, as they are more commonly referred. From a US perspective, any investment in non-US regulated collective investments results in PFIC exposure which, unless a special mark-to-market election is made in the first year of ownership, may translate to recognised gains being taxed at the highest marginal income tax rate (currently 37%) plus an interest charge applied over the period of ownership. Not to mention there are also annual informational reporting requirements to think about on your US individual tax return. In addition to traditional non-US collectives being subject to PFIC treatment in the US, common UK products such as onshore and offshore investment bonds as well as collective EIS and VCT schemes are also subject to this regime. Additionally, it is always worth a reminder that due to the fact that ISA's are considered taxable accounts from a US tax perspective, any collectives held within an ISA would be subject to PFIC treatment as well.

What people are less familiar with is how to also remain UK tax-efficient at the same time as being mindful of US tax. From a UK perspective, owning US regulated collective investments such as mutual funds or exchange traded funds (without UK reporting status) can bring about similar treatment to the PFIC regime in the US. Any offshore collective investments that do not have UK reporting status will attract offshore income gains (OIG) taxation as opposed to capital gain treatment. A Higher or Additional Rate taxpayer will find themselves paying 40% or 45% income tax on gains as opposed to 20% capital gains tax. Additionally, OIG assets can potentially bring about two layers of taxation at death. OIG assets are deemed to be sold at death with income tax being assessed. Then, to the extent that you are also deemed domicile for UK inheritance tax purposes, the assets (less the applicable income tax paid) are also includable in your UK estate. So, whilst making these changes after already crossing over to the Arising Basis is usually not ideal, it is better to address the inclusion of OIG assets within your investment structure sooner rather later to avoid any surprises.

So, in summary, the following types of securities are considered tax-efficient for a US person living in the UK:

- Individual shares
- Individual bonds
- US regulated ETFs with UK reporting status
- US regulated mutual funds with UK reporting status.

These types of investments should allow you to claim favourable capital gains rates in both the US and the UK as well as utilise the (current) £11,700 capital gain allowance in the UK on any sales in a given year.

Ensuring that the structure of your investments is tax-efficient from both a US and UK perspective is an important ingredient to having a successful investment experience. It will not only allow you to take advantage of available US and UK allowances, but it will also allow you to mitigate incurring unnecessary tax costs which ultimately act as a headwind to investment returns. By optimising the tax efficiency of your assets your capital will not need to work harder than it needs to and allows you to hold on to more of your hard-earned money which is almost always the desired outcome.

Risk Warnings And Important Information

All investments involve risk and may lose value. The value of investments can go down depending upon market conditions and you may not get back the original amount invested. Your capital is always at risk. Currency exchange rates may cause the value of an investment and/or a portfolio to go up or down.

The information in this article is provided for information purposes only and does not take into account the specific goals or requirements of any particular individual. You should carefully consider the suitability of any strategies along with your financial situation prior to making any decisions on an appropriate strategy.

The information is based on our understanding of current tax law and practice and sets out some basic information about certain tax considerations from an investment perspective. However, MASECO Private Wealth is not a tax specialist. All tax rules may change and we strongly recommend that anyone considering investing seeks their own tax advice. The tax treatment of any investment or particular strategy will depend on the individual circumstances of each person and may be subject to change in the future. This document does not constitute and should not be construed as investment, tax, accounting, legal or any other advice.

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