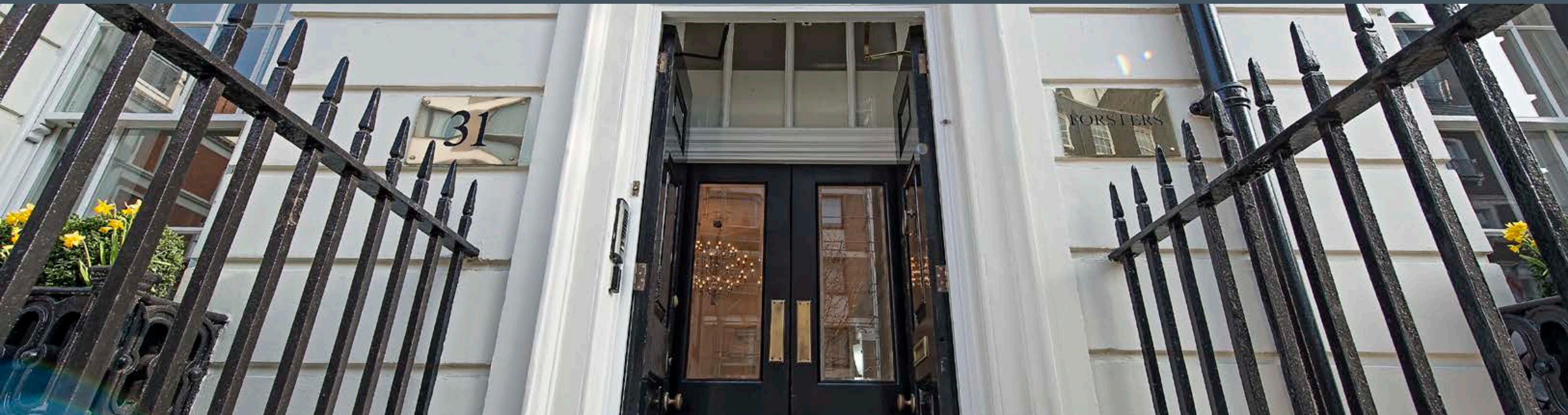
FORSTERS



Let's Make A Deal - Recent Tax Changes in the US and UK tax regimes that affect planning for clients living abroad

"A discussion regarding new tax planning and trust administration challenges for citizens living abroad with ties to both the U.S. and the U.K."

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Agenda

- Overview of UK taxation of non-domiciliaries up to 6 April 2017
- The UK remittance basis of taxation
- Key changes to the non-domiciled regime from 6 April 2017
- Fundamental concepts - residence and domicile under UK rules
- Excluded Property Trusts and Protected Settlements – benefits for UK connected citizens
- Non-State specific advantages of US trust jurisdictions for non-US families
- CRS – what is it and why is it relevant to US trustees
- Changes to UK inheritance tax treatments of UK residential property

Overview of UK taxation of non-domiciliaries up to 6 April 2017

- Remittance basis available indefinitely as long as non-UK common law domicile is maintained
- Inheritance tax on UK situs assets only
- Deemed domicile acquired for inheritance tax purposes only where resident in 17 out of the previous 20 UK tax years.

The remittance basis of taxation

- Available to individuals who are UK resident but non-UK domiciled
- Allows individuals to shelter non-UK source income and capital gains from UK tax by not remitting them to the UK
- Can be claimed for free for first seven years of residence
- £30,000 annual charge applies where UK resident for seven or more of previous nine tax years
- £60,000 annual charge applies where UK resident for 12 or more of previous 14 tax years
- Annual charge creditable against US income tax liability (Revenue Ruling 2011-2019)
- Previously available indefinitely (subject to maintaining non-UK domicile).

Key changes proposed for non-domiciliaries

- Deemed domicile for all tax purposes for long-term residents (15/20 year rule) exposure to IHT on worldwide assets:
    - no longer eligible to claim the remittance basis (meaning tax on worldwide income/gains)
    - implications for settlors of trusts
- Deemed domicile for all tax purposes for "formerly domiciled residents" ("**FDRs**")
- IHT on UK residential property held through offshore structures.

The non-dom changes: related measures

- Trust protections
- Capital gains tax rebasing to 5 April 2017
- Window of opportunity to separate "mixed funds"
- Favourable treatment not available to FDRs.

The concept of domicile under English law

- Every individual has a place of domicile
- Domicile of origin – acquired from parents at birth
- Domicile of choice – acquired by:
    - taking up residence in a jurisdiction <u>and</u>
    - forming an intention to remain there permanently or indefinitely
- Domicile of dependency - acquired from:
    - parents (while below age of 16) or
    - spouse (if married before 1 January 1974)
- Adhesive nature.

The UK Statutory Residence Test

Automatic non-residence

- day counting (16/46 days)
- full-time work abroad

Automatic residence

- day counting (183 days)
- only home in the UK
- full-time work in the UK

Sufficient ties test

- five specified "ties"
- day counting

The "sufficient ties" test: specified ties

- The family tie: spouse or minor child is UK resident
- The work tie: 40+ days working (>3 hours) in the UK
- The accommodation tie: accommodation available for use
- The 90-day tie: >90 days spent in the UK in either of the previous two tax years
- The country tie ("leavers" only): more days spent in the UK than any other country.

The "sufficient ties" test: day counting

Number of ties	Days an ARRIVER can spend in the UK without becoming UK Resident	Days a LEAVER can spend in the UK without becoming UK resident
0	182	182
1	182	120
2	120	90
3	90	45
4	45	15

SRT planning vs. treaty planning

For persons who wish to spend time in the UK there will be different levels of attachment to the UK:

Spends time in the UK but non-UK resident under the SRT

UK resident under the SRT but treaty resident elsewhere (e.g. in the U.S.)

- "Tie-breaker" tests apply (see next slide)
- Remittance basis of taxation not relevant
- UK tax returns must still be filed

UK resident under the SRT but not treaty resident elsewhere

- If non-UK domiciled then may claim the remittance basis of taxation

UK resident under the SRT and UK deemed domiciled and not treaty resident elsewhere

- Remittance basis of taxation not available
- Protected settlement regime available

UK resident under the SRT and UK domiciled under common law and not treaty resident elsewhere

- Remittance basis of taxation not available
- Protected settlement regime not available

Excluded property trusts

- UK equivalent of a US drop off trust
- Much easier for settlor/grantor to be a beneficiary without impinging on estate exclusion
- Significant benefits even where settlor/grantor is a US citizen.

The "protected settlement" regime

- Without trust protections, deemed domiciled settlors of non-UK resident trusts would be subject to tax on worldwide trust income and gains as they arose
- Protection introduced for trusts settled by individuals prior to becoming deemed domiciled
- New rules apply to **all** non-UK domiciled settlors of offshore trusts (not only those who are deemed domiciled under the new rules).

What is a "protected settlement"?

- Created by a non-UK domiciliary prior to becoming deemed domiciled in the UK for all tax purposes under the new 15/20 year rule and
- No additions made after settlor has become deemed domiciled (which would cause the trust to be "tainted" and lose its protected status).

Treatment of "protected settlements"

- No automatic attribution of trust gains to the settlor
- Capital gains tax only payable when the deemed domiciled settlor (or another UK resident beneficiary) receives a benefit that can be "matched" with trust gains
- Non-UK source income no longer automatically treated as the settlor's income (even where he/she can benefit from the trust)
- Non-UK source income taxed if the settlor (or another UK resident beneficiary) receives a distribution and that distribution can be "matched" with accumulated income in the trust
- Potential income tax liability for the settlor in respect of distributions to "closely-related" beneficiaries that are not otherwise taxable
- "Excluded property" status maintained for IHT.

"Tainting" protected settlements

- Protection lost forever if an addition is made to the trust by the settlor (or any trust settled by the same settlor, or of which he/she is a beneficiary) after the settlor has become deemed domiciled

- Great care must be taken to avoid inadvertent additions!!

- Broad definition of what constitutes an "addition", including:
  - adding value to property held by trustees
  - loan from settlor to trustees not made on commercial terms.

Where tainting will not occur

- Exceptions to what constitutes an "addition" include:
  - inadvertent additions not intended to confer a gratuitous benefit
  - cash added to pay trust expenses where expenses exceed available income (or where expenses are properly payable from capital)
- Failure to exercise power of revocation will **not** be treated as an addition.

Case Study 1

- US citizen couple
- UK resident but non-UK domiciled
- Became UK resident for the first time in January 2004 (so will become deemed domiciled in UK on 6 April 2018)
- Two young children at school in UK
- Plan to retire to US when children finish school in 5-10 years' time
- Substantial assets situated outside the UK
- Benefits of trust planning (for non-UK assets):
  - excluded property for IHT
  - no automatic attribution of income/gains to settlor for UK tax purposes provided "protected" status maintained.

Non-State specific advantages of US trust jurisdictions for non-US families

- Onshore jurisdiction with stable government that cannot be bullied
- No CRS (double edged sword!)
- Continuity of trustee for foreign grantor trusts
- Widespread use of trusts in domestic planning
- Disadvantages – UK and European tax and legal concepts less well understood

CRS – what is it and why is it relevant to US trustees

- CRS is broadly the OECD's own version of FATCA, applicable to the rest of the world. Unlike FATCA, CRS does not apply automatically – rather, jurisdictions must specifically sign up to CRS

- The US has opted not to participate in CRS – it will continue to pursue the same objective (i.e. the elimination of global tax evasion using offshore accounts and structures) under FATCA. A US resident trust would therefore not have direct reporting obligations under CRS – it would be treated as a passive NFE for CRS purposes

- However, CRS may be relevant to US trustees in the following circumstances:
  - The US trust holds non-US assets (e.g. shares in non-US companies, bank accounts) and
  - Such accounts, assets or companies are maintained or themselves resident in CRS Participating Jurisdictions.

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CRS – what is it and why is it relevant to US trustees continued

- In these circumstances, the appropriate Financial Institution in the relevant CRS Participating Jurisdiction (be it a bank, asset manager or underlying company) would be required to identify the Controlling Persons of the US trust – and to the extent any Controlling Persons are resident in CRS Participating Jurisdictions, they would be reportable under CRS

- In the event that a US trust does not have any connection with accounts, assets or companies in CRS Participating Jurisdictions, then the trustee would still be required to consider reporting obligations that may arise under the FATCA IGAs, where the equity or debt interests in the trust or the Controlling Persons of such a trust are held by residents of FATCA IGA jurisdictions.

Beware of anti-avoidance

- Anti-avoidance provisions, which catch those who advise on a move of the structure or assets to the US to avoid disclosure under CRS, may be incorporated into non-US domestic legislation, and breach of those provisions may result in penalties unless there is a good commercial reason for moving to the US

Inheritance tax on UK residential property

New legislation imposes IHT charge on:

1. Interests in closely-held companies which derive their value (directly or indirectly) from UK residential property
2. Partnership interests where the value of those interests are attributable (directly or indirectly) to UK residential property
3. The benefit of loans made to fund the acquisition, maintenance or improvement of a UK residential property
4. Assets used as collateral for loans made to fund the acquisition, maintenance or improvement of a UK residential property.

(NB. De minimis exceptions)

IHT on UK residential property: Taxable events

- Death of an individual – IHT @ 40%
- Lifetime gift into trust – immediate IHT @ 20% (and further 20% if settlor dies within 7 years)
- Outright gift during lifetime – IHT @ up to 40% in the event of death within 7 years
- ‘Relevant property' regime for trusts - ten-yearly charges and "exit" charges of up to 6%.

IHT on UK residential property: Points to note

- No grandfathering for existing structures/loans
- Two year "tail" for proceeds of sale/repayment
- Broad scope of loan/collateral provisions
- Double tax treaties may alleviate the issue (e.g. US-UK).

IHT on UK residential property: Example 1

- Offshore trust has made a loan to the settlor to fund the purchase of a UK residential property
- Benefit of the debt may be subject to tax on settlor's death under "GROB" rules (UK equivalent of s2036)
- Benefit of the debt also subject to 'relevant property' regime (6% IHT every ten years)
- Consider bank debt as an alternative (but note issues with collateral).

IHT on UK residential property: Example 2

- US citizen parents (non-UK resident/domiciled)
- Propose to lend $1million to a UK resident child to fund the acquisition of an apartment in London
- What are the IHT consequences?
- Does the US/UK estate tax treaty help?

Questions?

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