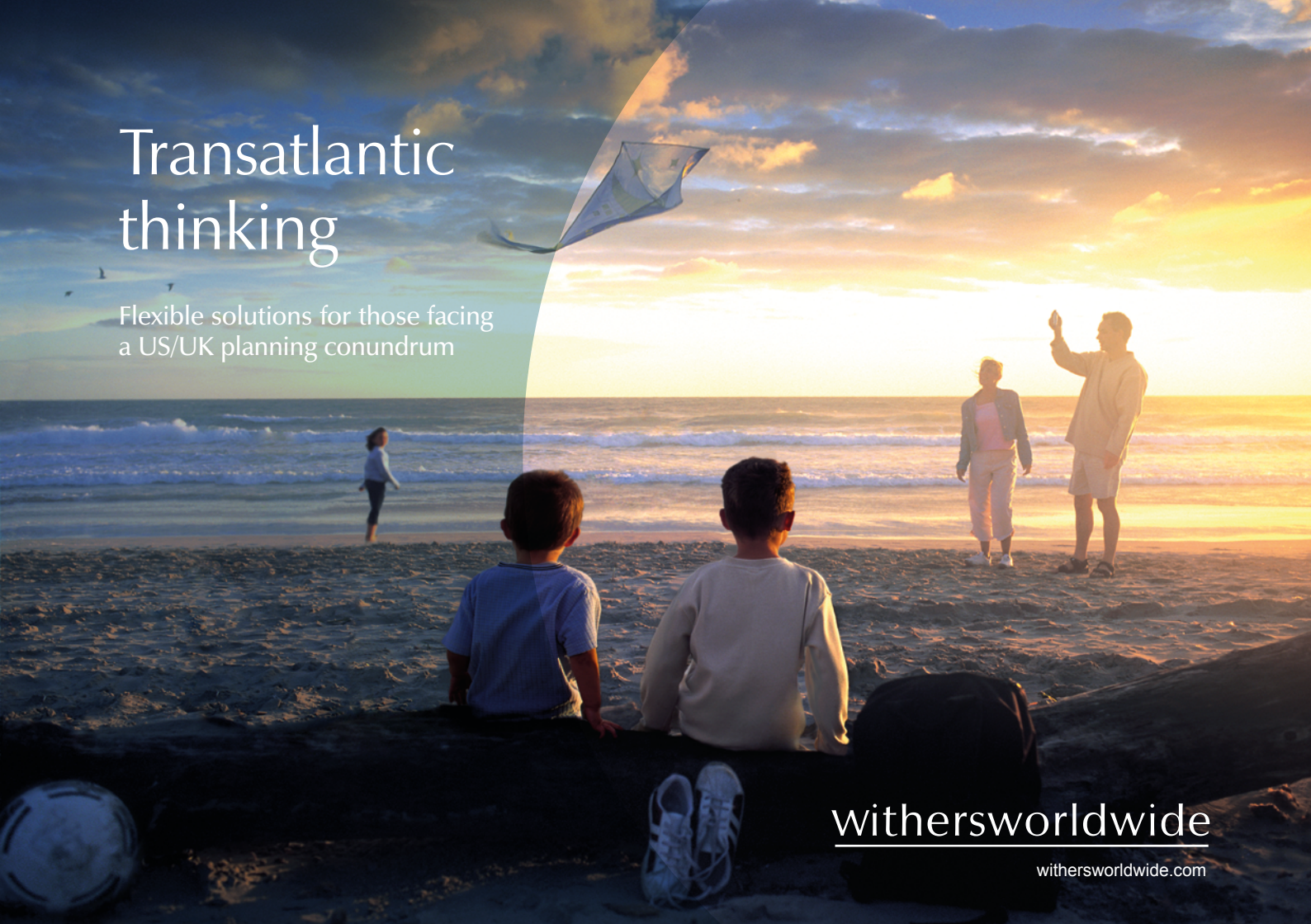
Transatlantic thinking
Flexible solutions for those facing a US/UK planning conundrum
withersworldwide
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Introduction

Most people understand the importance of having a will and long term plan for their assets (generally known as an ‘estate plan’) to safeguard their family’s future. However, unless the process is made easy and affordable, making a will can remain, perennially, on the ‘to do’ list. This is all the more likely when the permutations are made more complicated because a member of the family is a US person.

To illustrate the complex issues that can arise in this area, we have provided a case study of what one might, at first sight, assume to be a straightforward situation. In fact, and as we show, it is anything but.

Withers advises clients on similar scenarios every day. We have seen virtually every tax and financial variant affecting US/UK couples, and have developed tailored estate planning models for them all.

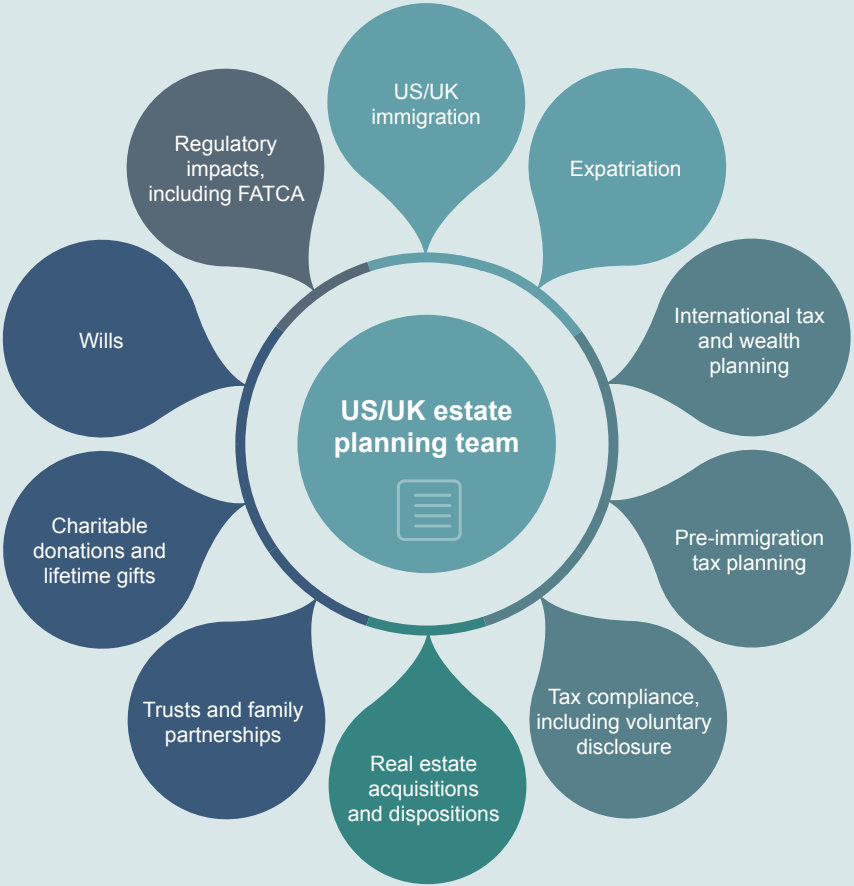
The team

Our dedicated and highly specialised US/UK tax and estate planning team has in-depth experience across all the issues that can arise.

We deliver an integrated suite of services, taking into account the combined impact of US and UK regulation in these areas. We can offer these services under one roof; meaning we offer joined-up legal advice in both jurisdictions, led by one point of contact.

Please contact us to let us know how we can help you to plan for a secure future.

The Withers US/UK Private Client and Tax team



Integrated US/UK estate planning – why is it so important?

People increasingly move between the US and the UK. In doing so they often acquire property, business interests and other assets in either or both countries and elsewhere. This usually creates complex tax and estate planning issues for these individuals – and for their families – often without them knowing.

Access to timely and integrated US/UK tax and estate planning advice is therefore essential. By raising awareness of common misconceptions and mitigating potential exposure to income, capital gains and transfer taxes in both countries, this advice can play a critical role in safeguarding the family's financial position and protecting wealth for future generations.

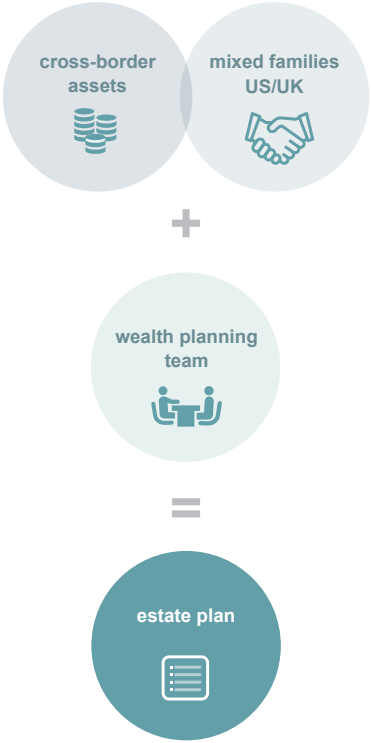
Under one roof

With a large legal US/UK wealth planning team, trained to address cross-border issues, Withers is dedicated to being equipped to handle – under one roof – the complex tax and estate planning issues that can arise for 'mixed' families and families with international assets. We recognise that the issues that need to be considered are always different and that every family will have its own particular objectives but, in our experience, it is usually possible (sometimes with some creativity) to create efficient and effective estate planning documents that 'work' in both the US and the UK and in other jurisdictions relevant to that family's situation.

Our integrated approach means that clients benefit from having a single, highly experienced point of contact. As well as ensuring that issues are resolved as quickly and cost-effectively as possible, the integrated advice we provide is an essential strategic resource – ensuring that assets are preserved for the long-term benefit of the family as efficiently as possible.

Families increasingly have an international dimension. Withers' London based US and UK estate planning lawyers have ready access to the Withersworldwide offices in Asia, the United States and Europe which ensures access to in-depth advice on the global issues that can arise.

Case study



An everyday situation?

The family

Scott Kesselring is a US citizen who has lived in London since the early 2000s (having moved following graduation from university in the US). Now in his early 40s, Scott is employed by a City-based private equity fund.

He is married to Anne, also in her early 40s, who is English. They have two young children, Finn and Esme, aged eight and ten respectively, who were both born in the UK. Now that she is the primary homemaker, caring for Finn and Esme, Anne no longer earns a salary. She has never held a US green card.

Scott and Anne met in the UK and they have been married for about six years. Although Scott has a notion that he would like to go back to the US on retirement, both he and Anne are happily settled in London and plan to continue living in the UK for the foreseeable future and at least until the children start to think about tertiary education.

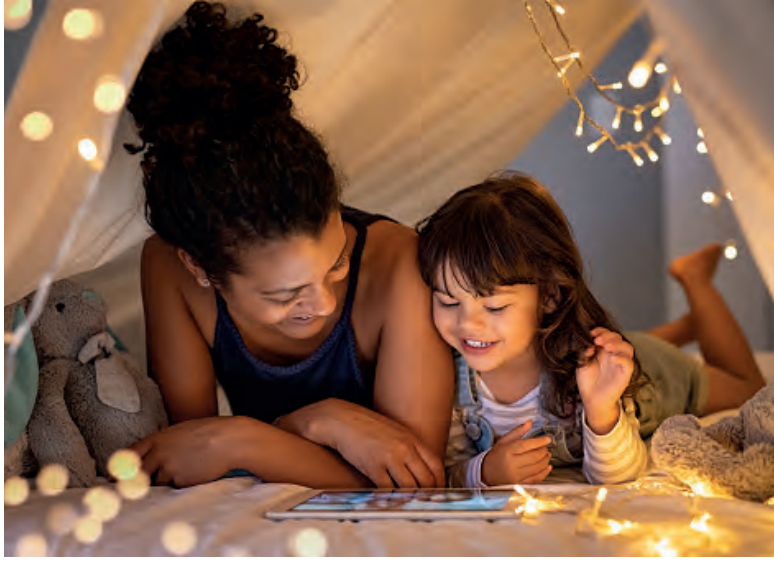
Their assets

Scott has investments worth in the region of $10m, including an investment portfolio (including some IRA accounts) which is run out of the US. He and Anne own their London home (which they purchased with a mortgage for £2m) as beneficial joint tenants. The mortgage has been paid off and (after a little renovation) the house is now worth in the region of £5m. Anne inherited some assets from her parents when they passed away, although the bulk of her parents' £1.5m estate is now held in trusts for Finn and Esme.

Scott's parents are both still alive and are still living in the US. They have assets in the region of $20m and are in the throes of undertaking their own estate planning with their long-term US estate planning attorney. They plan to leave their assets to Scott and his two brothers.

Both Scott and Anne have low value term life insurance policies – taken out when they took out their mortgage. Scott has recently taken out some whole of life cover to provide for Anne and the kids should something happen to him.

Neither Scott nor Anne has made a will. They both considered doing so when Finn was new-born, and then again after Anne's parents passed away, but have never agreed on who should be guardians of Finn and Esme so have never got around to it.



Their objectives

For Scott and Anne, the overriding priority is to secure the financial well-being of their family without paying more tax than they need to. They have heard about the ways in which US and UK tax and regulation can impact the finances of people in their situation, including the drive by the US Treasury to ensure that it receives the correct amount of tax from US persons living overseas. Scott has already considered expatriating from the United States as a possible course of action. But the issues seem so complex that he has repeatedly postponed seeking advice.

Focusing on the issues

Scott and Anne consider themselves to have a simple situation. In our experience their situation is far from unusual but – as can be seen from some of the issues identified below – there are a number of complexities that lurk behind this apparently everyday fact pattern.

They do, therefore, need early tax and estate planning advice. Set out below are some of the main areas on which Scott and Anne need to focus. The aim is to safeguard their family's financial well-being and prevent their hard-earned wealth being unnecessarily depleted by avoidable double taxation.

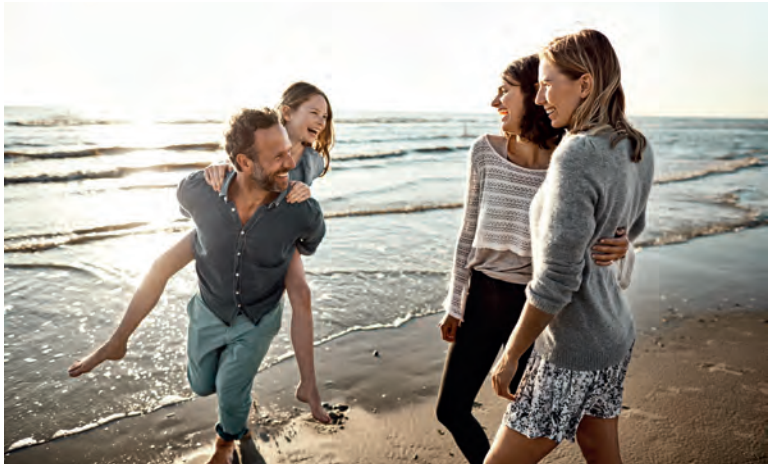
Buying property in the UK

Like Scott, many Americans own real estate in the UK. Unfortunately, many of them unwittingly fall foul of US federal estate, gift and income tax laws because they didn't take US tax advice before buying the property. Scott's situation highlights what is, in our experience, one of the most common problems. Estate agents and conveyancers in the UK frequently advise married couples to buy homes as beneficial joint tenants – on the basis that if one of the couple dies the other will inherit the home automatically and without the complications of probate.

However, where one of the couple is a US person, this can give rise to numerous tax issues.

US federal gift tax

When two Americans are married, they can simply transfer assets between them without triggering any US federal gift tax (there is an unlimited marital deduction for transfers to a US citizen spouse). This deduction does not apply to transfers to a non-US citizen spouse. Instead there is a limited annual exclusion.



As a result, when an American buys real estate jointly with his or her non-US citizen spouse, there might be gift tax implications on the initial purchase, or more likely on the later sale of the property. Any gift over and above the amount of the annual exclusion will be reportable in the US and the amount of the excess will absorb at least part of the US citizen's lifetime gift tax allowance. In circumstances where that allowance has already been fully absorbed, this will result in US federal gift tax being payable.

US federal income tax

In the UK a relief is available to exempt from tax the gain arising when someone sells their main home. In the US, however, a person generally can only exclude up to $250,000 of capital gain from the sale of a main home. Consequently, Scott may find that, although there is no UK tax to be paid when he and Anne sell their home, there could be substantial US tax on the gain. Further issues arise when there is an outstanding UK mortgage and these can be negatively exacerbated by currency fluctuations.

This means that for US income tax purposes, it may often be better for a couple to buy their home in the non-US spouse's name. If the federal estate and gift tax unified credit exclusion amount is high and unlikely to be completely absorbed by transfers made by the US spouse during life or on death then he may decide simply to make an outright gift of the property, or the money to buy the property, to the non-US spouse. If, however, there is lower headroom between asset values and the credit shelter exclusion amount such that a gift could trigger US gift tax, an alternative might be to loan the non-US spouse the money (the US tax code allows such loans to be non-interest bearing). Care is needed to ensure that the IRS does not assert that the transfer is a gift.

Qualified Domestic Trusts (QDOTs)

If, like Scott, an American owns property jointly with their non-US spouse, the full fair market value (i.e. not just half) of the property is included in the American's taxable estate, except to the extent that the non-US spouse can show that they contributed to the purchase or to mortgage payments. As a result, US federal estate tax may apply on the American's death, with UK inheritance tax due only when the second of the two of them dies. If the American passes away first this mismatch can result in avoidable double tax.

Property bequeathed outright to a US citizen spouse qualifies for a full US federal estate tax marital deduction. However,

property left to a non-US citizen spouse over and above the American's credit shelter amount does not qualify for the deduction unless it is left in a special type of trust known as a Qualified Domestic Trust ('QDOT'). This trust can often be an essential tax-planning tool and the possibility of including the necessary mechanism should be considered in all US/UK estate planning scenarios to ensure that such a trust can be funded as necessary (and particularly if the credit shelter exclusion amount is reduced before the American has got round to updating his will. Without it there is a real risk of assets being taxed both in the US and in the UK with no tax credit being given in either country.

Expatriating from the United States

Every year, many US citizens and green card holders renounce their citizenship or lawful permanent resident status. However, before expatriating, Scott needs to be aware of a number of issues affecting him and his children.

Under US tax law, certain US citizens and green card holders are subject to a special tax regime when they renounce citizenship or 'expatriate'. These individuals are referred to as 'covered expatriates'. Generally, a covered expatriate is any US citizen or long-term green card holder (i.e. held a green card for eight or more years) who expatriates and either has a net worth of $2m or more, exceeds a US income tax liability threshold or fails to certify that he has satisfied all US tax obligations for the previous five tax years. As Scott's net worth exceeds $2m, he would be considered a covered expatriate and thus would be subject to the special tax regime if he were to expatriate (and, as explained below, Scott's children – who are automatically US citizens – would be taxable on assets they received from him).

Under this special expatriation regime, Scott would be treated as if he sold all his assets when he expatriated and US taxes would be due on the gains from the deemed sales. Further, Scott's children (as US citizens) would be subject to tax at the applicable gift or estate tax rate when they received a gift or bequest from him (without the benefit of the credit shelter exclusion amount).

There are exceptions and planning methods that may enable people to avoid these harsh rules.

Tax compliance – 'voluntary disclosure'

Scott moved to the UK to continue his studies and had no significant income when he did so. When he did start earning in the UK he always ensured that he filed any UK tax returns on time. He did not realise until his bank contacted him, following the implementation of FATCA, however, that he had an ongoing duty to file US tax returns in addition to the UK returns. Further, he had no idea at all that he had an obligation to make a separate return detailing his non-US bank accounts (FBARs). This was a mistake. As a US citizen, he should have been filing a tax return with the IRS each year. Even green card holders are under an obligation to file US tax returns each year as they are subject to tax on their worldwide income even after moving from the US and even beyond expiry of the green card.

Scott needs to take immediate action to rectify the position. We will be able to advise him as to the various alternative routes to US tax compliance and are well positioned to conduct negotiations with the IRS as necessary.

Leaving assets to US heirs who are UK tax resident

As Finn and Esme are both US citizens, they too are subject to US tax law. This raises significant estate planning issues that must be addressed, particularly in relation to the trusts set up by Anne's parents.

Assets held in a properly drafted trust for the benefit of US persons are not subject to US federal estate tax (regardless of value), however, where trusts are not properly drafted, over one half of all the assets could be unnecessarily lost to the US government – not just once, but at each successive generation.

While transfer taxes may be of limited concern in the case of trusts below the credit shelter exclusion amount, the same cannot be said about income taxes. It is essential, where possible, that trusts set up to benefit US children should qualify as 'grantor trusts' during the settlor's lifetime. Grantor trusts are disregarded for US federal income tax purposes, with any income, gains or losses attributed directly to the donor. After the donor's death non-US trusts could be subject to the confiscatory tax and interest charges under the US 'throwback' rules. These rules can cause virtually the entire distribution from a non-US trust to a US person to be payable to the US government in tax where the trust has previously accumulated income or gains. The fact that the trusts for Finn and Esme were established under Anne's parents' wills means that they are not grantor trusts and that action will need to be taken to mitigate against the impact of the 'throwback' rules.

Even where mitigation is put in place, there will be US reporting on any distributions from the trusts to the children, which can include deemed distributions via the use of trust property. In addition, consideration will need to be given to the FATCA reporting required in relation to these trusts. It is not unusual for US based CPAs to be unfamiliar with these reporting obligations and for American beneficiaries to find themselves unwittingly non-compliant.

Issues also arise for Scott's parents if they wish to ensure that the estate planning that they put in place is efficient from a UK tax perspective. Any assets that they leave outright to Scott may be brought into the UK inheritance tax net. Leaving assets in trust for Scott (or Finn and Esme) will potentially give rise to UK tax issues in the hands of the beneficiaries if the trustees are non-UK resident and benefits are received by the beneficiaries while they are tax resident in the UK. We are able to work with the parents' long-time trusted US advisers to design a plan that can prevent US assets being eroded by UK inheritance tax while mitigating a potential US/UK income tax / CGT mismatch when benefits are received.

A proper estate plan is the last – and essential – piece of the puzzle

Anne and Scott's tax profiles are not aligned. Anne is a UK domiciliary but Scott is a US citizen who is not yet 'deemed' domiciled in the UK.

If Scott dies first leaving his estate outright to Anne, US estate tax would be payable unless Anne transfers a portion of the assets of Scott's estate to a QDOT. However, because Anne is a UK domiciliary, her transfer of those assets to a QDOT would trigger an immediate UK inheritance tax. Either way, the amount that Anne would have at her disposal to support her and the children would be significantly less.

Worst of all, the balance of whatever is left at Anne's death would then be taxed again in the UK – this time to inheritance tax at 40% with no credit given for the tax already paid in the US on the same assets. The table below sets out how that tax might look – assuming that Scott dies leaving $12.5m at a time when the US estate tax rate is 40%, the US 'credit shelter' amount is $10m* and that no QDOT is established on Scott's death.

Similarly, suppose Anne dies first and leaves her estate (of £2.5m) outright to Scott. AsScott has lived in the UK long enough to be deemed domiciled in the UK for UK tax purposes, their UK domiciles would match and UK spouse exemption would apply to exempt inheritance tax in relation to assets passing between the two of them. If, however, Scott had come to the UK later and had yet to be tax resident in 15 or more of the prior 20 tax years, their UK domiciles would not match. In that event, only a limited spouse exemption would be available (assuming they did not want to take advantage of the limited provisions under the US/UK double tax treaty or make an election for Scott to be treated as UK domiciled for inheritance tax purposes). The table below again sets out the potential outcome in that scenario – with the UK estate being taxed first in the UK on Anne's death and then again in the US on Scott's death.

Without planning	value of assets	death tax	tax-free amount	tax	total tax	% of assets
Scott's estate if he dies first						
on Scott's death	$12.5m	40%	$10m*	$1m	$5.6m	44.8%
remaining assets on Anne's death	$11.5m	40%	assume none available	$4.6m		
Anne's estate if she dies first and Scott is deemed non-domicile						
on Anne's death	£2.5m	0%		£0	£1m	40%
remaining assets on Scott's death	£2.5m	40%	assume none available	£1m		
Anne's estate if she dies first and Scott is deemed domiciled						
on Anne's death	£2.5m	40%	£325,000 + £325,000	£740k	£1.4m	56%
remaining assets on Scott's death	£1.76m	40%	assume none available	£704k		

With a Withers' estate plan	value of assets	death tax	tax free amount	tax	total tax	% of assets
Scott's estate if he dies first						
on Scott's death	$12.5m	deferred	not relevant	none	$1m	8%
remaining assets on Anne's death	$12.5m	40%	$10m*	$1m		
Anne's estate if she dies first						
on Anne's death	£2.5m	40%	£325,000 + £325,000	£740k	£740k	30%
remaining assets on Scott's death	£1.76m	no inclusion	not relevant	none		

If Scott and Anne instructed Withers to produce US/UK integrated estate plans, tax would only be paid once in relation to each of their estates as illustrated below – potentially saving the children millions. Without planning the children could end up with only around 53% of their parents' gross estates notwithstanding the US10m US federal estate and gift tax unified credit exclusion amount.

Early advice is essential

The situation in which Scott and Anne find themselves is far from unique, and, as illustrated, the extent and complexity of the issues that can arise is extremely far-reaching. For all individuals, irrespective of nationality, estate planning is an essential step. Central to this process is an up-to-date, tax-efficient will that accurately reflects your wishes.

At the same time, consideration should be given to related matters including making lifetime gifts to dependants, ensuring pensions and life insurance are held in the most tax-efficient way, assessing ownership arrangements for jointly-held property and, where appropriate, the establishment of trusts.

Where US/UK couples are concerned, the combined effects of US and UK tax and regulation must be taken into account at every stage. Provided this is done early, you will be providing your family with a stable financial foundation for the future.

How we can help – next steps

Our US and UK qualified professionals have helped thousands of clients to create and sustain tax-efficient structures for protecting their wealth and their family's future prosperity.

If you believe that any of the issues we have identified in this brochure apply to your situation, we recommend an early consultation with us, where we can establish your circumstances and make recommendations for your future. We know how important it is to be clear about fees and about the scope of the work to be done. In most cases we are able to agree a competitive price to produce US/UK integrated estate planning documents. Where other work is required, we will give you an idea of costs once we have talked through your particular needs.

The saying goes that there are two certainties of life. Taxes seem very likely to be on the increase as governments strive to 'level up' in the post pandemic world. Good planning in advance of the other certainty can provide peace of mind and relief from a heavy burden as well as tax mitigation.

We are always open to a no-obligation consultation to discuss how we may be able to help you. If you require further information please contact us on +44 20 7597 6364.

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