

Assisting the American

DAVID TREITEL explains tax for the American living in the UK.

American citizens and green card holders are chargeable to US tax on worldwide income and gains – no matter when they last visited the States. For the majority, *annual* US return filing is required – with potentially severe penalties for non-compliance.

US citizenship is given to anyone born within the US, as well as to most children born overseas to US citizen parents. Sometimes this creates the trap of ‘unaware Americans’, people who genuinely do not know they are *automatically* American, but who are still caught by the US tax regime.

What are the basics?

US and UK rates appear similar. The UK 40% income tax rate is only slightly above the top 35% US rate. An 18% capital gains tax rate is similar to the long-term 15% rate. However, the difference is wider than it may sound, because under UK independent taxation the top UK rate ‘kicks in’ after allowances at £36,000 per person, whereas a married couple needs to have taxable income exceeding \$357,700 before getting to the 35% rate. Someone with straightforward affairs will typically pay more UK tax than they owe ‘Uncle Sam’, meaning that the US return frequently reports nothing payable in the States.

Nonetheless, US citizens with more than specified minimum incomes are *required* to file annually (in some cases on gross income as low as \$3,500). Indeed, an American living overseas can exclude up to \$87,600 of foreign earned income, so filing is still needed – whether claiming this ‘foreign earned income exclusion’ or ‘foreign tax credits’ – despite the zero liability. Additionally, foreign bank and security accounts need to be reported to the US Treasury (on Form TD F 90-22.1) where aggregate balances exceed \$10,000.

However, some individuals could still owe US tax on income or gains that are tax-free in the UK, but which could be taxable on an American including child benefit, premium bond prizes, National Saving Certificates, employer contributions to pension plans, redundancy pay and even a gain on selling a main residence! Equally, someone claiming to be not ordinarily resident or non-UK domiciled could still owe tax in the States.

KEY POINTS

- Nationality is based on birth or ancestry.
- American citizens are taxed for ever.
- US tax rates are lower than UK rates.
- UK exemptions for income and gains may not be available in the US.
- UK tax planning may not always be helpful!

How are investments taxed?

Because of the worldwide reporting requirements, US returns will need to reflect investments wrapped in ISAs. For example, interest on a cash ISA is taxable at marginal US tax rates. Even a straightforward shareholding can give rise to complexities. Because the 10% notional tax credit is not a creditable foreign tax, an investor with a decent sized portfolio might owe US tax on UK dividends – and indeed the US does not have a capital gains tax exemption!

Investments in collective funds such as unit trusts and investment trusts (whether or not wrapped in ISAs) are more complex because these are treated as ‘passive foreign investment companies’, so subject to mandatory additional US reporting on Form 8621. Tax on long-term growth is a minimum 35%, plus interest over the period of investment, so these frequently become a ‘bad thing’ from a US tax perspective.

A UK pension plan is not a qualified US plan although one can claim limited benefits under the US/UK treaty. If one does not elect for treatment under the treaty on Form 8833, then one is required under IR Code section 402(b) to include employer contributions as taxable income. These contributions plus growth (if highly compensated) must be declared as income on the US return. If employer contributions are not claimed under the treaty then these – plus employee contributions, plus reportable growth – form cost ‘basis’ when payments are made from the plan. To figure the amount of each withdrawal that is taxable one turns to IR Code section 72. This rarely results in ‘tax-free’ pensions, but will typically give rise to a reasonably large figure for ‘basis’ so a conventional UK pension plan can often be tax effective.

What are the opportunities?

Given that most US citizens in the UK are ‘non-doms’, life from a UK tax perspective is now frequently complex so it becomes vital to join up US and UK tax thinking.

Planning can include ensuring that UK tax is paid by 31 December each year to maximise foreign tax credits and reviewing investment or banking arrangements to achieve the best answer overall.

What is certain is that the US tax system cannot be overlooked! ■

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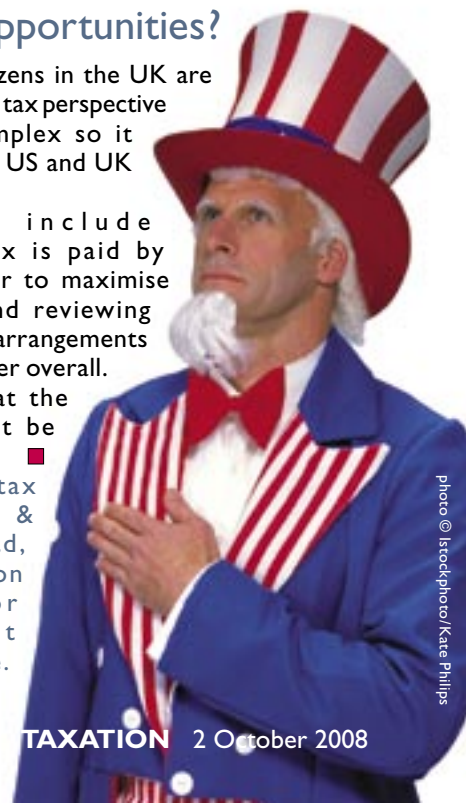


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