GOING EAST

Before heading to the UK there are several things you need to do to tidy up you US situation, and many more to get yourself properly establish in the UK.

LEAVING THE USA

US CITIZENS AND GREEN CARD HOLDERS LEAVING THE US

You may be leaving the US, but you are not leaving the US tax system. US citizens and green card holders must still file US tax returns while they are tax resident in the UK. There are however some significant differences that need to be considered:

- If you spend at least 330 days or each year outside the US, and you are employed or run your own business in the UK, then you may claim the Foreign Earned Income Exclusion, which allows up to $100,600 (2021 rate - indexed annually) of that employment or business income to be excluded from your US taxable income.

- If your UK employment or business income exceeds the maximum Foreign Earned Income Exclusion you can claim the UK taxes paid on the excess as a Foreign Tax Credit against the US tax on that income. As UK tax rates are higher than the US Federal tax rates, this usually eliminates the US Federal tax liability. However, you can't get credit for UK taxes against most State income tax.

- Investment income (interest, dividends and capital gains) are taxed in the US and the UK, with foreign tax credit being allowed in the UK for taxes paid in the US. However, as the UK tax rates are usually higher, there may be some additional tax payable in the UK on investment income. If you have substantial US business or investment income you may wish to consider the UK non-dom regime to keep these items outside of UK tax.

- When you open bank and investment accounts outside the US you have to complete an annual Foreign Bank Account Report (FBAR), and possibly a Foreign Asset schedule in your US tax return, giving full details of all your non-US financial accounts, with heavy penalties for non-compliance.

NON US-CITIZENS AND GREEN CARD HOLDERS PERMANENTLY LEAVING THE US

If you are leaving the US tax system, then you need to certify that you have filed and paid all taxes due to date of departure or given sufficient assurances to the IRS that you will do so.

- Except for foreign diplomats, certain students, and people in the US on visa waiver scheme or temporary business visas (B1/2), two weeks before departure you must file either Form 1040-C (if you have income in the current tax year) or Form 2063 (if you don't have income in the current tax year). Both forms require conformation that you have filed and paid the taxes dues on all tax returns due before your departure, and on Form 1040-C a computation of tax due on the current year income. It also requires payment of that estimated tax due, or security that it will be paid.

- Green Card holders who are leaving after more than eight of the last fifteen years resident in the US (Long Term Resident) must comply with the same rules as people revoking their US citizenship. They need to file form 8854. This form requires confirmation that all Federal tax returns have been filed for the last five years, and all taxes due have been paid. It also requires a statement of global net assets (valued at current market prices). Those with average tax liability over the last five years over $171,000 (2020 -indexed), or who's net assets exceed $2 million, may be liable for Expatriation tax on unrealized gains on their assets, deferred compensation and some tax deferred accounts such as IRAs and 529 plans.

TAX PLANNING CONSIDERATIONS BEFORE LEAVING THE US

- **Should you sell your US house?** Often when changing countries, the length of time that you will be away is uncertain. One way of dealing with that uncertainty is to retain your old home and rent it out until you return. However, if your US home has increased substantially in value since you purchased it, this may not be the best strategy. The first $250,000 ($500,000 for a married couple) of gain on your primary home can be excluded from your taxable income if you have lived in in for two of the last five years before the sale. Not selling the home within the first three years of leaving it means that this exclusion is no longer available. That could cost you up to $100,000 in additional taxes.

- **Rationalizing your investments.** If you hold on to your US investments and then sell them generating a capital gain when you are resident in the UK then that gain will be taxed at UK rates which are higher than US rates. It may make sense to realized significant gains before you leave the US, even if you reinvest in similar stocks at a later date. You also need to understand how recent regulations have narrowed the range of investment opportunities available to you. US rules mean that once you are not resident in the US you can no longer buy US Mutual Funds. Most will allow you to retain funds already invested if you intend to return to the US and can give them a US mailing address, but they can't accept any new investments. This includes mutual funds held through an IRA. However, beware that the UK treats most US mutual funds as "non-reporting" entities. This means that capital gains made while you are resident in the UK will be taxed at higher regular income rates rather than capital gains rates. Again, you may wish to sell and report the gains before you establish UK residence or decide to hold the investment unchanged until you return to residence in the US. Although you can hold direct investments in US stocks and bonds while non-resident, it may be very difficult to set up a new broker account once you cease to be US resident, so make sure you set up all the US broker and bank accounts you need before leaving. The investment situation does not improve if, while UK resident, you choose to invest in UK pooled investment funds (mutual funds, ETF's, hedge funds etc.). They are regarded in the US as Passive Foreign Investment Companies (PFIC). Income from a PFIC suffers not only a heavy penalty rate of US tax but demanding compliance paperwork with heavy penalties for errors in reporting. As a result of these restrictions, and the heavy compliance costs imposed by FACTA, many UK banks and investment managers will not provide investment products to US citizens or green card holders. You may need to search a while to get the service you need or to hang on to your US brokerage account for as long as you can. The only bright spot is that there are a few US mutual funds that have done the additional work to be registered as UK Qualified Reporting funds so the US citizens can invest in them from the UK without the UK tax penalty. If you wait until you have UK tax residence before addressing your investment strategy you may find your options are narrow and more expensive that planning your situation before leaving the US.

- **Your pensions.** Fortunately, there is a treaty between the UK and the US that recognizes the treatment of pension funds, including 401(k) and similar funds (but not IRA's), and does not apply these tax rules to investments held within such funds.

- **Social Security.** The UK and US have a treaty (Totalisation Agreement) on Social Security. If your US employer sends you to the UK for a fixed period of less than 5 years then you stay in the US system and the US employer pays into US Social Security for you and provides the UK employer with a certificate excluding you from paying UK National Insurance. In all other cases you stop paying into US Social Security and become liable for UK National Insurance. If necessary, years of contributing into the UK National Insurance scheme can be used when determining eligibility for US Social Security benefits.

ARRIVING IN THE UK

SOME CHARACTERISTICS OF THE UK TAX SYSTEM

Many parts of the UK system are similar to the US, but there are a some very significant differences:

- **The UK system taxes only individuals.** Married couples can't file a joint return. This means couples who have very unequal incomes may pay more tax under the UK system than the US, and they need to look closely at mechanisms to share income more equally, possibly by transferring the ownership of investments from the high income to the lower income partner.

- **Potential tax breaks on non-UK sourced income.** If you are not domiciled in the UK, with significant income from outside the UK (such as from non-UK business ownership or investments) and if you do not need the funds in the UK, then you can forego your tax-free personal allowance (£12,500 pa) in return for not paying UK taxes on your non-UK income that you don't remit to the UK.

- **Tax withholding - Pay As You Go (PAYE).** The UK has a much more sophisticated system for withholding tax (PAYE Tax codes) from employment income, so that if you only have employment income you may not need to file a tax return at all in the UK

- **Tax year.** The UK tax year runs from April 6th until April 5th of the following year.

RESIDENCE AND DOMICILE

These are two important concepts that impact your UK tax situation.

Your domicile is your long-term home. You acquire your domicile of origin at birth, usually inherited from your father. You may also acquire a domicile of choice by moving your residence and economic activity to another country with the intent to make it a permanent home. When you move from the US to the UK you do not normally change your domicile. One exception is if you are planning to make the UK your permanent home and acquire a domicile of choice in the UK. The other is if you had established a domicile of choice in the US (or some other country) but had a domicile of origin in the UK. Under recent legislation, for tax purposes, you will be deemed to be re-domiciled in the UK from the start of the second full tax year after you arrive back in the UK. Domicile is critical for UK Inheritance Tax. Not having UK domicile also may permit certain non-UK sourced income to be excluded from UK income and capital gains tax.

Tax residence in the UK. Tax residence is determined by the number of days physically present in the UK during the tax year. The number of days to be resident however depends on a variety of circumstances, including the number of days you work in the UK, whether you have accommodation available to you, whether you have a spouse or dependent children in the UK, and the pattern of visits in recent years. The only straightforward part is if you are in the UK for more than 183 days in a UK tax year then you are definitely UK tax resident for that year. Lots of UK ties and regular visits could get you classed as UK resident on as little as 17 days. You need to be careful about your records and document retention and get good advice to be correctly classified.

It is possible to be classified as tax resident in both the UK and the US in the same year. If that occurs there are tie breaker rules in the US / UK Tax Treaty to determine which country takes precedence.

ARRIVING IN THE UK

Employment and Social Security. If you are going to work in the UK you will need a National Insurance number. If you have a work visa your National Insurance number will probably have already been issued to you and is on the back of your Biometric Residence Permit. If not, you can apply online at the Department for Work and Pensions.

UK Income Tax and PAYE If you only have UK employment income of less than £100,000 per year you will not normally need to file a UK tax return. Any over or under payment at the end of the year will be adjusted through the PAYE system. If you need to file a tax return (Self-employment, foreign income, company director, or income over £100,000) then you need to register for a tax return. This is done online by creating a government gateway account at gov.uk and using that account to register for self-assessment at HMRC.

TAX PLANNING CONSIDERATIONS IN THE UK

- **Should you buy a UK house?** This depends on your family circumstances and how long you expect to be in the UK. Stamp duty (Transfer tax) on purchase can be between 2% and 12% depending on the price with an additional 3% if it is a second home. The house you left rented or empty in the US counts as second house and attracts the additional charge. Mortgage interest and property taxes (Council Tax) are not tax deductible. On the positive side there is no UK capital gains tax on the sale of your principle private residence. However, in your US tax return gain on sale in excess of $250,000 (or $500,000 for a couple) is taxable income, with no UK tax credit to offset the charge.

- **How should I manage my investments?** Direct holdings of stocks (shares) and bonds in either US or UK companies do not create unusual problems. If you are UK tax resident you pay tax on the interest and dividends received, and capital gains tax on any realized gains. The same income is also reported and tax in the US, with credit for taxes paid in the UK to offset the tax due in the US. The difficulty comes if you want to spread your investment risk through a collective investment such as Unit Trusts (Mutual Fund) or ETFs. Both the US and UK taxes codes treat such investments in the other country to penal rates of tax and heavy compliance reporting. Other than a small number of specialists, most UK investment advisers are reluctant to make such investments on behalf of US citizens. The other potential trap is with a common tax advantaged investment scheme in the UK called the Share ISA (Individual Savings Account). This allows investment in stocks to be accumulated free of UK tax on dividends and capital gains. Unfortunately, the US Tax Code does not recognize this, and taxes dividends and capital gains within the ISA at the normal US rates, thus negating the tax advantage.

IF THIS LOOKS LIKE YOU CONTACT US FOR A CONFIDENTIAL REVIEW OF YOUR SITUATION, AND TO DEVELOP A PLAN TO MANAGE IT