# The end (of the tax year) is nigh

International Tax Personal tax

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*David Treitel* travels through American tax planning as 2016 draws to a close

### Key Points

### What is the issue?

Americans are taxed globally. The US tax year on 31 December is now quite close.

### What does it mean to me?

Clients may need to pay UK tax by or realise losses by 31 December 2016.

### What can I take away?

For an American, UK and US tax planning need to take place together to get the best result for each client.

## The tax year ends

US election in November? Had you heard? Thinking about tax for the American in the UK, does the election matter? Perhaps. Is it the only thing on the agenda? Probably not. With the US tax year end approaching on 31 December, Sterling having fallen significantly against the dollar this year and non-dom changes here in the UK on the horizon next year there are many practical steps to be addressed over the weeks ahead for any American client.

Observing from this side of the Atlantic, America seems to be on a journey today to somewhere new and indefinable; with strident slogans talking of ‘Making America Great Again’, ‘Stronger Together’ and ‘Build The Wall’. Whatever side of the political divide you inhabit, the journey for Americans in the UK is frequently equally divided; with tax seemingly over-complicated by having to deal with both US and UK sets of rules.

## Who is a US resident?

Best to start at the beginning. Under US law a US person is always US resident, and therefore always subject to tax by the US. All US citizens, residents (individuals who are not citizens, but become resident under the substantial presence test) and green card holders (permanent residents) are US persons. Everyone born in the United States (except for a child of a diplomat) is automatically a US citizen. Citizenship can also be acquired through naturalization. Additionally, someone born abroad to one or both US citizen parents may have inherited US citizenship under a complex set of what are known as ‘transmission’ rules.

Examining a passport may not provide sufficient clues to decide if an individual is, or is not, a US person. Someone with a British passport listing New York City as the place of birth will have an unambiguous United States place of birth, so will almost always be a US person. A passport listing the place of birth as Greenwich might mean that the client was born in London or, alternatively, in Greenwich, Connecticut, USA. (A British passport states only the town or city of birth, but not the country.)

Citizenship can be removed only by relinquishment (by performing a relinquishing act, such as an oath of allegiance to the Queen with the specific intention of relinquishing US citizenship) or by renunciation; requiring an oath before a US consular officer. As the United States has citizenship based tax residence rules, knowing if a client is or might be a US citizen is always vital.

## 31 December 2016 – a magical date?

All individuals who are US persons are required to file annual US tax returns reporting worldwide income and gains once total income exceeds a ‘filing threshold’, which depends on marital status. This year the filing threshold can be as low as, for example, $4,050 for a married taxpayer not filing a joint tax return. Filing an annual tax return is compulsory, even if there is no US tax payable.

The US tax year is the calendar year, with any tax due to be paid by 15 April of the following year. Both the tax return and the FBAR (Report of Bank and Foreign Financial Accounts) for individuals living outside the US are due to be filed by 15 June (the filing, but not the payment, date can be extended initially to 15 October and on a second request to 15 December).

In addition to returns reporting income and gains, US persons are required to file informational returns disclosing ownership and interests in non-US bank and financial accounts, assets, companies, partnerships, trusts and other entities.

Because of the US tax year-end, December is always a deadline month for Americans in the UK. For individuals requiring sufficient foreign tax credits on their US returns, it can be vital to arrange for UK tax to be paid to HMRC by 31 December. This year, for example, many people advanced dividend distributions to a date before 6 April 2016. If paid to a US person in these circumstances, it will frequently be best for any 2015/16 UK higher rate liability to be paid to HMRC by 31 December 2016 to avoid a mismatch in foreign tax credits. Equally, a US person in the UK who made substantial capital gains during 2016 may want to review whether it is prudent to pay CGT for 2016/17 to HMRC by 31 December 2016 so that there are sufficient foreign tax credits to be claimed on the 2016 US tax return.

US individuals who have made capital gains during 2016 might also want to review their investment portfolios with the aim of crystallising losses before 31 December to reduce US tax on any overall gains. Indeed, the sharp decline in Sterling over recent months might yield an advantage for some people from a US tax perspective, because gains on Sterling assets realised today will be much lower than at the start of 2016 once converted into US dollars. Consequently, this might be a good time for many Americans in the UK to sell investments that might not be ‘US tax friendly’; such as most UK unit trusts, investment trusts and OEICs (these are generally unsuitable for US persons from a tax perspective, because of the anti-avoidance ‘Passive Foreign Investment Company’ rules). While exploiting the fall in the Pound to save tax might appear an unconventional piece of tax advice, many Americans in the UK have historically held investments directly and within ISAs and Junior ISAs without adequate consideration of US tax consequences. Cleaning these up at a lower US tax cost might well be a good option.

For anyone thinking of renouncing US citizenship this year who might earlier in the year have had assets valued above the expatriation tax threshold of $2 million, the fall in the Pound might also make it simpler to avoid any expatriation tax. Conversely, some people will be worse off. For example, anyone repaying the capital on a Sterling mortgage after 23 June 2016 will inevitably find a need to recognise a taxable foreign currency gain on their 2016 US tax return because the Pound will have been stronger when the mortgage commenced.

## Non-dom changes?

From 6 April 2017 an individual who has been a UK tax resident for 15 or more of the past 20 UK tax years will be treated as deemed domiciled in the UK for UK income tax, CGT and inheritance tax. The same rule will apply to returning UK domiciliaries. As a consequence, many US persons in the UK will currently be updating their financial planning with these changes in mind.

For the purposes of calculating UK CGT, this new regime will permit someone who becomes deemed domiciled on 6 April 2017 to elect to re-base assets held on that date (which were owned on 8 July 2015). However, this election will have no effect on the US tax position. As a consequence, US tax could still be payable on future gains. For any American in this position, it will become even more important to look at the global tax position including reviewing when and how to take losses, as US tax may still be payable even if there is no CGT in the UK.

It is also proposed that during the 2017/18 tax year that any UK resident non-UK domiciled individual will be able to separate out (or cleanse) mixed funds between income, gains and clean capital. However, this is currently expected only to be permitted for assets held in cash, meaning that many UK resident non-UK domiciliaries might want be thinking of selling assets purchased with mixed funds. For anyone in this position who is also a US person, any gain on selling assets that is intended to allow mixed funds to be cleansed might result in a US tax charge. This is likely to make it tougher for some to reach a decision as to how best to deal with mixed funds.

# FATCA reporting

Many individuals in the UK are finding that financial institutions are collecting increasingly large volumes of data about their customers to ensure that the financial institution can provide adequate FATCA reporting. The next reporting deadline for institutions will be 31 May 2017. Any US person in the UK who is not yet up to date in the US in the filing of US tax and information returns should, as a consequence, be thinking of getting US filing up to date before this reporting date. This deadline is going to be particularly important for anyone who has received a 'FATCA letter' from their bank or financial institution during 2016, but has prevaricated in replying, because one has to assume that personal details will inevitably be passed to the IRS during 2017.

Thankfully for anyone in this position, the IRS have clear processes in place to help people catch up where US returns have never been filed, filing has lapsed, or returns that have been filed have incorrectly omitted foreign income. Under US law until a return has been filed for any year, the statute of limitations remains open for that year. On this basis, the law might suggest that every unfiled return should be completed today. Given, however, that there is frequently little or no tax involved for someone living overseas, the IRS currently offer 'Streamlined Filing Compliance Procedures', which are a simplified process for US taxpayers who have not filed complete returns in recent years and who have non-US income and assets. In most circumstances for someone in the UK this should result in no penalties (the IRS reserve the right not to accept taxpayers into the streamlined procedures, but in practice have accepted the vast majority of submissions). Because the streamlined procedures are usually penalty free, this offer from the IRS is arguably more attractive than the equivalent HMRC 'Worldwide Disclosure Facility'; albeit that some individuals in the UK may find themselves needing to use both sets of disclosure regimes if reporting of income and gains offshore has been incomplete or non-existent in both jurisdictions.

# US election?

It seems impossible to follow the news today without hearing about Trump and Clinton. Their tax policies are indeed as radically different as their personalities. The Trump tax plan proposes consolidating the seven individual US tax brackets that currently exist into three; with a top rate set at 33% (compared to 39.6% today) on taxable incomes above $112,500 (for single filers) and $225,000 (for married filing joint filers). It also includes abolishing the Alternative Minimum Tax and the 3.8% Net Investment Income Tax and increasing the standard deduction to $15,000 for a single person and $30,000 for married filing joint filers; but eliminating the personal exemption. Consistent with many other Republicans, Trump's plan includes abolishing the estate tax (which currently has an exclusion of $5.45 million, so already only affects a minority of estates). This plan also includes allowing substantial deductions for the costs of childcare. For anyone running a business, Trump proposes a substantial reduction in the corporate tax rate from the current 35% to 15%.

Clinton's tax proposals focus on tax increases for the wealthiest Americans; including a 4% 'Fair Share Surcharge' for taxable income above $5 million; thus creating a new top bracket of 43.6%. Those with taxable income above $1 million a year would pay a minimum 30% rate. The capital gains rate on assets held between 1 year and 6 years would be increased, especially noticeable for assets held under 2 years. The estate tax exemption would be reduced to $3.5 million and the rate increased from 40% to 45%. Clinton also proposes that single estates worth $500 million or more (or $1 billion from a couple) will instead be subject to a special and markedly higher 65% estate tax rate.

Both sets of policies look and feel quite different. Even after the election no-one will know until well into next year precisely what legislation might eventually result. Thinking about these policies for the American in the UK leads therefore to two clear conclusions. Firstly, if something is worth doing now, such as realising capital losses or paying UK tax by 31 December 2016, the election result will not alter that choice. Secondly, if the non-dom changes from April 2017 could affect the UK position, it might help to accelerate any UK focused planning so that any re-structuring is reviewed and indeed possibly takes place before 31 December 2016.

## Conclusion

What have we learnt from this journey? All US persons worldwide are charged to US tax, and returns are mandatory even when there is no tax payable. While there seems to be a great deal of noise about the US election, in practice being US tax compliant and planning for the US tax year-end and the UKs non-dom changes should proceed in any case. The direction of travel is clear, Americans in the UK will continue to find life and tax overly complicated. Neither political party in the United States is signalling that they are brave enough to change that part of the system.