

the AMERICAN



£7.50

Interview: *A Strange Loop's* Michael R Jackson

Grands Prix In Cannes And Monaco

Inside Joe Biden's White House

My Lunch With The King

The Life And Legend Of Jim Brown

USWNT At The FIFA Women's World Cup

The Way We Were - Joe Kapp And Dave Wilcox



American Shows At
edinburgh
FRINGE



PHOTO ©ADAM NIR

Do You Have US Resident Trusts?

Nomaan Ilyas looks at the tax issues arising for UK resident beneficiaries of US resident trusts

A trust is a legal relationship where the rights are typically passed from the settlor to the beneficiary. It is a popular vehicle used by families as a useful method of protecting family wealth. Trusts can also be effective in providing protection from Inheritance/Estate Taxes and preserving wealth for future generations.

However, tax rules of the respective home jurisdictions to the settlors and beneficiaries of the trust must be taken into consideration due to the complexities that may arise; for example, when a UK resident is a beneficiary of a US trust.

Taxpayers may believe that if distributions from a US trust were primarily taxed in the US, there will be no UK tax liability due on the distributions. Unfortunately, this is not the case, as a UK resident beneficiary may also be liable to tax in the UK if a distribution was made to them.

Another common misconception is that if the beneficiary has reported their

distributions on their US tax return, there is no need to disclose their distributions on their UK tax return. However, under the US-UK Double Tax treaty, the UK can have the primary right to tax the UK resident beneficiary rather than the US and therefore the distributions may need to be disclosed and taxed on their UK tax return – they may be able to take a foreign tax credit for this on their US tax return.

We advise that beneficiaries who may have been receiving distributions over many years should review and regulate their position with HMRC should their tax affairs need to be corrected. As HMRC may charge penalties on previous unpaid tax liabilities, there is a possibility that these can be reduced through voluntary disclosures.

US trust with UK resident trustee

If you are the sole UK resident trustee of a family trust, your own personal trust, educational trust or a foundation or charity,

then you may make that trust UK resident by virtue of your own UK residence status – UK resident trusts pay UK tax on all income and gains usually at the very top rates as well as paying US tax (subject to tax treaties and foreign tax credit).

Care will need to be taken where there are one or more UK resident trustees as this can make the whole trust UK resident. If you are a trustee and live in the UK, it would be prudent to check the residence status of your trust.

Varying UK and US trust structures and treatment

Trusts drawn up under US laws do not always correspond with equivalent types under UK laws. We see numerous types of US trusts, Family Trusts, Annuity Trusts, Life Insurance Trusts, Revocable Living Trusts, Grantor Trusts, and Non-Grantor Trusts which all have different US tax treatments.

Determining how best to match a foreign

entity to UK law is key. As a starting point, is the trust even a trust at all under UK law? Is the trust a substantive trust or a bare trust? Is the trust an interest in possession or is it discretionary? These factors will change how the income is taxed in the UK.

Is the trust subject to the relevant property regime or a qualified interest in possession for inheritance and capital gains tax purposes? These questions can usually be answered upon review of the trust deed, which is the original document drawn up to create the trust and can help identify how the trust should be treated under UK tax laws.

Is a distribution deemed inheritance upon death?

In the US, a termination distribution from a trust on the death of an individual is usually from principal and therefore free of US tax.

Unfortunately, the same is not true in the UK. Whilst an inheritance directly from an individual's estate is free of tax, any 'inheritances' which derive from trust distributions will likely be 'matched' to the trust's accumulated gains and can be taxed at a rate up to 45%.

Interaction of UK and US tax credits

There are various issues that arise when

trying to organise tax credits between the UK and US. The key scenarios are as below:

1. US Income or Capital Gains Tax paid by the trustees is not available for offset against UK tax on distributions to the beneficiaries of the same income/gains.
2. The availability of tax credits can be counterintuitive. For example, there are instances where tax paid in the UK by a UK resident beneficiary may be available for offset against a grantor's US tax liability on the same income.
3. The timing of credits is important because of the differences in UK/US tax years. Planning should be undertaken to ensure that credit offset opportunities are not lost.

Income or Capital

How distributions are taxed depends on whether the payment is categorised as income or capital. Unless proven otherwise, HMRC will normally tax any distributions from US trusts as income, usually at the maximum income tax rate of 45% and in some cases, a foreign tax credit cannot be claimed for US tax.

Should the distribution payment be categorised as capital, trustees and UK resident beneficiaries are typically liable to capital gains tax on trust gains that are matched to the capital distribution.

Additionally, for each year capital gain distributions are deferred within a trust, the UK capital gains tax rate increases by 10% of headline rate to a maximum of 32%.

Other complications can arise where there may be a provision of trust property to the beneficiary at below market rate, for example use of a residential property or a loan.

Although some may be deterred from the idea of continuing to maintain US resident trusts due to their tax complexities; depending on the type of trust, UK resident beneficiaries may only be liable to tax when a distribution is made. It could be a case where paying tax on trust distributions is not as frequent as anticipated due to the main purpose of a trust being a vehicle to protect family wealth; therefore, it may remain a beneficial structure to utilise.

Evidently, this is a complex area of tax law and professional advice should be sought if you are either a beneficiary of a US trust or about to become one. ★

Nomaan Ilyas is Managing Director of Frontier Group, a firm of advisers specialising in US, UK and International Tax return preparation services and advice. You can contact him on 020 7332 2843, n.ilyas@frontier-fs.com, www.frontier-fs.com

