

# Taxing Issues

*Welcome to our first in a series of articles for American in Britain. In this article we will concentrate on recent tax developments in the United States and United Kingdom*

## **GETTING TOUGH ON TAX HAVENS**

Earlier this month, President Obama laid out his plans for international tax reform. The stated goals of the tax reforms are to reduce the amount of taxes lost to tax havens.

In order to “get tough” on tax havens, the proposals include stricter reporting requirements for individuals and financial institutions. The aim is to crack down on perceived abuses of the system by Americans using tax havens to hide their wealth from US taxes. Offshore financial institutions with US clients will be coerced to join the Qualified Intermediary (QI) scheme. Under this programme, financial institutions enter into an agreement with the Internal Revenue Service (IRS) to share information about their US clients and to produce Form 1099s as any US financial institution would have to do. In order to meet the QI requirements, all commonly-controlled financial institutions will also have to be QIs.

Any financial institution not choosing to join the QI scheme will be assumed to be facilitating tax evasion. US financial institutions will be required to withhold between 20% and 30% on any US payments to customers of non-QI institutions.

In addition, any US person holding an account with a foreign institution which is not a QI, will be assumed to have enough funds in their accounts to require foreign bank account reports be filed. It will then be up to the US person to prove otherwise. Further, if the account holds a balance over \$200,000 at any point in the year, the failure to file would be deemed “wilful” meaning greater penalties and perhaps criminal charges. These proposals represent a drastic change in the legal presumptions. The new legal presumptions would shift the burden of proof from the IRS to individuals and foreign financial institutions to prove they were not sheltering income or aiding in tax evasion.

Both US investors and non-QIs would also be required to disclose transfers of money or property between the US investor and non-QI account, with an emphasis on transfers made by foreign entities on behalf of the US person.

In order to aid the IRS, the administration proposes to hire 800 IRS agents devoted to international tax enforcement as well as to extend the statute of limitations for investigations and to increase the penalties on US taxpayers failing to adequately disclose their offshore accounts.

This year’s Foreign Bank Account Reporting (FBAR) reports have to be made by 30 June 2009. Failure to meet the obligation to report annually foreign accounts over which an American citizen or resident has ownership or signature authority normally carries heavy penalties, even if any income earned in the accounts has been properly reported on their US tax return. But the IRS have just announced that individuals who are delinquent in their FBAR filings, but who have properly reported and paid tax on the income earned in the relevant accounts, will avoid

penalties if the filings are made no later than 23 September 2009.

In contrast, in the UK, HM Revenue & Customs (HMRC) had an Offshore Disclosure Amnesty programme two years ago in relation to any offshore bank accounts subject to payment of a fixed penalty. What is being described as the New Disclosure Opportunity is going to be run through to March 2010 with a strict timetable; further details are to be announced.

## **FUNDING UK LIFESTYLE**

The use of ‘foreign’ bank accounts is a central part of expatriate financial planning. For example, from time to time, you may want to draw on non-UK monies for UK spending; at the very least, there is some reassurance in having a safety net. As a result of the restricted way in which the UK taxed non-domiciles by allowing them to segregate their non-UK world from the gaze of HMRC, the UK has a sophisticated set of rules taxing the transfer of value into the UK. Every time a remittance of value is made to the UK, the question becomes what is being remitted; income, capital gains or capital? It is of vital importance to understand what you are bringing to the UK and how, or even if, it will be taxed.

The most effective tool is correctly structured bank accounts and the mantra must be it is never too late to start. For those individuals accepting UK tax on their worldwide income and gains, bringing non-UK income and gains to the UK that accumulated when they were not subjected to UK tax will still trigger a tax charge. For US taxpayers, particular care is required as this is a minefield for double taxation as you would have already been taxed on the income or gains, although the US/UK tax treaty cannot ride to the rescue.

## **US INVESTMENTS AND UK TAX**

As expected, the 2009 UK Budget has brought forward proposals dealing with offshore funds. As with most anti-avoidance, the introduction of the rules dealing with the taxation of funds where the income was not being substantially paid out was too widely drawn. One of the consequences of the changes in last year’s Finance Act was to highlight the UK’s taxation of US investments, such as the staple mainstay of the investment manager – the mutual fund.

It will come as no surprise that both the IRS and HMRC agree on the taxation of foreign investments, although they remain divided on how to do this. In the UK, HMRC retained a system of registration which has never been widely embraced, whilst the US expects the investment to be fiscally transparent with the intention of taxing the investor on the underlying income and gains. The Budget has

brought forward plans to redefine the scope of the investments caught within the definition of an offshore fund, which will hopefully step mutual funds outside the definition and match up UK and US treatment of income and gains.

#### **UK INVESTMENT PLANNING**

Making pension contributions was a basic planning tool for higher rate taxpayers to reduce their effective rate of tax in the UK whilst saving in a tax free environment for the future. For US citizens, payments into pensions also provided an excellent mechanism to utilise excess foreign tax credits on their US returns by bringing down their effective rate of UK tax. Under proposals brought forward in the Budget, the ability to make contributions has been severely curtailed.

The legislation comes in two parts – with tax relief being withdrawn in full from 6 April 2011, and anti-forestalling provisions designed to stop payments into pensions before the new rules bite. Under the anti-forestalling rules, if you earn more than £150,000 per annum and want to make payments into a pension scheme over and above your regular amounts,

either personally, through a salary sacrifice or through an employer's contribution, then tax relief will be severely curtailed.

For UK resident taxpayers, the ISA (Individual Savings Account) provides a tax beneficial platform for investment outside the scope to UK tax. Whilst in the ISA wrapper, income, gains and growth are exempt from UK tax. For US taxpayers, the tax free status is clearly not respected, although the wrapper may be appropriate to reduce the effective rate of UK tax on worldwide income and gains.

Currently, one can invest £7,200 into an ISA (of which a maximum of £3,600 can be in cash). From 6 October 2009, individuals over 50 will be able to invest £10,200 into an ISA (of which half - £5,100 - can be in cash). From 6 April 2010, the increase in the limits will apply to all taxpayers. It is clear that the more generous limits may attract increased interest in the ISA vehicle, although some care is required for US taxpayers. Many have been caught out by investing into US tax unfriendly assets, such as unit trusts. It is possible to achieve a tax saving for US individuals by ensuring that the investment does not offend US tax rules.

For further information on the above, or to discuss any other taxation issues, please contact Mark Walters, Managing Director of Tax for Frank Hirth, at 020 7833 3500 or [markw@frankhirth.com](mailto:markw@frankhirth.com) ■

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