

Executive summary

If you are a US citizen and your spouse or civil partner is not you need to ensure you have appropriate estate planning in place to avoid your heirs getting an unexpected tax bill following your death. In this guide we consider the estate tax issues that mixed US/UK couples face and some potential solutions.

US/UK TAX SERIES: ESTATE PLANNING ISSUES FOR US/UK COUPLES

A mixed US/UK marriage or civil partnership¹ – where one of the couple is a US citizen and the other is not, or one is UK domiciled or deemed domiciled and the other is not – can cause significant tax issues if the correct planning is not put in place.

US ESTATE & GIFT TAX

US citizens are subject to US estate and gift tax on transfers of their worldwide assets (regardless of whether they are living in the US or not), but benefit from a lifetime estate and gift tax exemption of US\$11.4m (set to increase with inflation until 2026 when the exemption will return to US\$5m, indexed for inflation).

Outright gifts from a US citizen to their US citizen spouse, during life or on death, and transfers to properly structured trusts, are fully exempt from US gift and estate tax (although the trust may be subject to US estate tax on the surviving spouse's death). Gifts made by a US citizen to their non-US citizen spouse will not benefit from this unlimited marital deduction unless made through a US qualified domestic trust (a 'QDOT'). A QDOT allows for deferral of US estate or gift tax until the non-US citizen spouse receives a distribution of capital from the trust, or the death of the non-US citizen spouse. The marital deduction only applies where couples are legally married.

A non-US citizen who is resident in the US (for US estate tax and gift tax purposes) is subject to US estate and gift tax on their worldwide assets, but benefits from the same lifetime estate/gift tax exemption as a US citizen. The test of 'residence' for US estate and gift tax purposes is different from the test of residence for US income tax purposes.

Individuals who are neither US citizens nor US resident for US estate and gift tax purposes are only subject to US

estate and gift tax on US assets – they are entitled to a lifetime gift/estate tax exemption of just US\$60,000.

US estate and gift tax is imposed at graduated rates up to US\$1m and at a flat rate of 40% above that threshold.

UK INHERITANCE TAX

An individual who is domiciled or deemed domiciled in the UK (regardless of where they are resident) is subject to UK inheritance tax (IHT) on their worldwide assets.

An individual who is non-UK domiciled (and is not deemed domiciled in the UK) is only liable to UK IHT on their UK assets. However, UK assets held indirectly - through a non-UK company - will not generally be subject to UK IHT. This is because what the individual owns is a non-UK asset (the shares in the non-UK company) and not the UK asset. However, where the non-UK company holds an interest in UK residential property, or a loan related to UK residential property, the shares will be subject to UK IHT.

Gifts made by an individual to their spouse/civil partner during their lifetime or on death are, generally, exempt from UK IHT, unless the donor spouse/civil partner is UK domiciled/deemed domiciled and the recipient spouse/civil partner is non-UK domiciled/not deemed domiciled, in which case the exemption is limited to £325,000.

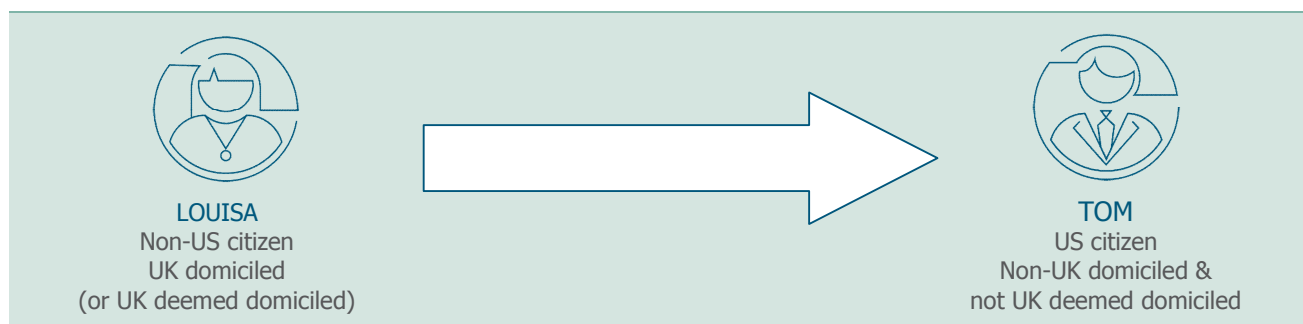
Gifts made by an individual, during their lifetime, to another individual only give rise to a charge to UK IHT if the donor dies within seven years of the date of the gift.

Gifts of non-UK assets made by a non-UK domiciled (and not deemed domiciled) individual are free of UK IHT.

On death the first slice of a person's taxable estate is charged at 0%. This 'nil rate band' is currently £325,000. Over this amount IHT is charged at 40%.

¹ The US allows for same-sex marriage. In England same-sex couples may marry or enter into a civil partnership; currently mixed-sex couples can marry but not enter into a civil partnership (this is due to change on 31 December 2019).

MARRIES COUPLES/CIVIL PARTNERS



US tax position	UK tax position
<ul style="list-style-type: none"> > Gifts of non-US assets made to Tom during life or on death will not be subject to US gift/estate tax; gifts of US assets will benefit from the US unlimited marital deduction and will not be subject to US gift/estate tax > Assets which pass to Tom will form part of his estate and be subject to US estate tax on his death (subject to his lifetime US estate/gift tax exemption of US\$11.4m in 2019) > No US capital gains tax on a gift of US assets to Tom 	<ul style="list-style-type: none"> > Gifts made to Tom during Louisa's life will not be subject to UK IHT provided Louisa does not die within seven years of the date of the gift > Gifts made to Tom on Louisa's death, or within the seven years before her death, will be subject to UK IHT if the value of the assets passing to Tom exceed £325,000 (plus any part of Louisa's nil rate band (of £325,000) that has not already been used) > No UK capital gains tax on gifts between spouses/civil partners

Solution

- > As far as possible Louisa should make gifts to Tom (and/or any children) more than seven years before her death.
- > If Tom and Louisa are living in the UK Tom will become UK deemed domiciled after having been UK resident for 15 UK tax years and the full spouse/civil partner exemption from UK IHT will then apply to gifts from Louisa to Tom (whether made during life or on her death). If Louisa dies before Tom becomes UK deemed domiciled, Tom could elect to be treated as UK domiciled so that the full spouse exemption would apply. However, if Tom made such an election he would then be subject to UK IHT on his worldwide estate until such time as he has been non-UK resident for four UK tax years.
- > If Tom is still a US citizen at the time of his death his whole estate will be subject to US estate tax so the couple should consider structuring any gifts from Louisa to avoid increasing Tom's taxable estate for US purposes.
- > Taking out insurance to pay out a lump sum on death to pay any UK IHT (or US estate duty) due is also an option.

US PERSONS TAKING OUT LIFE INSURANCE

Where an individual's estate is likely to be illiquid, or they do not want the assets passing to their heirs to be diminished by taxes payable as a result of their death they may take out insurance to pay a lump sum on their death to pay any tax due.

Death benefits paid out on a life insurance policy purchased by a US citizen (or US resident/domiciliary) on their own life will be subject to US estate tax if the proceeds are paid into the deceased's estate or the deceased is the owner of the policy. For this reason the policy is often transferred to an irrevocable trust. However, the US person must survive the transfer of the policy into trust by three years and not have any control over the trust or the distribution of the policy proceeds, in order for the proceeds to be outside their estate for US estate tax purposes. These issues can be avoided if the US person funds the trust with cash and the trust then purchases the life insurance policy.

From a UK perspective, writing a life insurance policy in trust for your heirs using the insurance company's

standard trust form is usually sufficient to prevent the proceeds being subject to UK IHT on your death.

US EXECUTORSHIP TRAP

It is not unusual to want your surviving spouse/civil partner, or another family member, to administer your estate following your death. However, where that individual is a US citizen you should seek advice.

If you appoint a US citizen as the executor and trustee of your estate under your will you need to ensure that the will contains a 'general limitations on powers' clause prohibiting the US citizen, as trustee of the will trust, from exercising certain powers. In particular, the US citizen must not have power to distribute any portion of the trust fund to themselves, or anyone for whom they are financially responsible (such as their minor children) unless it is, for example, for education. If the correct wording is not included the entire value of the will trust could be considered part of the trustee's estate for US estate tax purposes, even if they cannot benefit from the trust.

MARRIES COUPLES/CIVIL PARTNERS

US tax position	UK tax position
<ul style="list-style-type: none"> > Gifts made to Louisa during life or on death do not benefit from the US marital deduction and so will be subject to US estate tax. As no UK IHT will be due until Louisa's death the US/UK estate tax double tax treaty does not help as the taxing point is different. > Gifts of up to US\$155,000 (current gift tax annual exclusion) can be made to Louisa each year free of tax – any gifts in excess of this are not exempt, and will be taxable gifts using up all or part of Tom's lifetime estate/gift tax exemption (US\$11.4 million in 2019) > No US capital gains tax on a gift of assets to Louisa 	<ul style="list-style-type: none"> > Gifts made to Louisa during life or on death will benefit from the spouse/civil partner exemption from UK IHT > Spouse/civil partner exemption from UK IHT will apply on death whether Tom leaves his assets outright to Louisa or in a life interest trust for her > No UK capital gains tax on gifts between spouses/civil partners
<p>Solution</p> <ul style="list-style-type: none"> > Provide for Tom's assets to pass into a US qualified domestic trust (a 'QDOT') on his death rather than to Louisa absolutely – if the QDOT is structured properly the assets passing into the QDOT will qualify for the US marital deduction on Tom's death. The charge to US estate tax on the value of Tom's estate will be deferred until distributions of capital are made from the QDOT to Louisa and the remainder would be taxed on Louisa's death. A QDOT must meet certain conditions, including that it must have at least one US trustee. > It would be possible to draft a QDOT for Louisa, set up under the terms of Tom's will, so that the assets passing into the QDOT qualify for the spouse/civil partner exemption from UK IHT. 	

This is a general guide only and is not a substitute for specific legal and tax advice.



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Building a successful business is a lifetime's investment. We will help you protect your legacy, now and for your successors.

Personal & Family WEALTH

Substantial wealth, substantial risks. We will help you protect and pass on your personal wealth.

PRIVATE WEALTH INSTITUTIONS

Advising the industry that advises the wealthy, you can rely on us as your trusted legal partner.

EXPERTISE

- > Dispute resolution > Divorce > Family asset protection > Family businesses & family office > Fiduciaries
- > M&A and corporate finance > Philanthropy > Privacy & reputation protection > Private equity
- > Real estate – commercial & residential > Succession planning, wills & probate
- > Tax planning, disputes and compliance > US/UK planning > Wealth management institutions > Wealth structuring