

**TWO COUNTRIES SEPARATED
BY A COMMON LANGUAGE:**

**US/UK ESTATE PLANNING
WITH TRUSTS**



TWO COUNTRIES SEPARATED BY A COMMON LANGUAGE: US/UK ESTATE PLANNING WITH TRUSTS

Collyer Bristow is highly experienced in acting for HNW/UHNW individuals with a US element to their affairs.

This document outlines how the UK may have a different tax treatment of US living trusts and how the UK concept of domicile may give rise to UK tax in unexpected ways.

I. US LIVING TRUSTS

Living trusts are a common US estate planning tool that can be highly UK tax-inefficient for UK resident grantors, trustees or beneficiaries. This is because, for UK purposes, these trusts do not necessarily share the same 'transparent' US tax treatment.

Key for UK purposes is whether the living trust can be characterised as a 'bare trust' (i.e. merely a nominee arrangement). In such circumstances their UK tax treatment generally mirrors the US treatment. On the grantor's death the recipient individual(s) simply receive(s) an inheritance as if it came directly from the grantor directly, along with a step-up in basis for the inherited assets for UK capital gains tax purposes.

However, the UK authorities are increasingly concluding that living trusts should be taxed as substantive settlements instead. If the trust is not UK resident (determined by the residency of its trustees), then a UK resident beneficiary may pay UK capital gains tax upon receipt of a distribution based on the amount of realised but undistributed capital gains within the trust during its lifetime.

The criteria upon which that UK characterisation is assessed derives largely from the relationship between the grantor and the role of the trustee. Those criteria draw inspiration from the Uniform Trust Code, which we understand codifies the nature of this relationship for US purposes.

One aspect of living trusts that commonly complicates matters are those relating to the grantor's capacity. Frequently, upon the loss of the grantor's capacity the trustees assume greater control. This can be problematic for the UK characterisation unless reviewed and assessed carefully, because in those circumstances the trust inevitably looks more like a substantive settlement.

Taking appropriate advice can minimise the risk of adverse UK tax for UK residents on distributions from living trusts. In fact, used carefully, trusts after the grantor's death can be highly UK tax-efficient for UK residents and/or domiciliaries.

2. LOSING UK DOMICILE STATUS

For UK persons relocating to the US, they should not carry out US estate planning without having first taken advice on whether they remain UK domiciled or deemed UK domiciled.

An individual will only cease to be UK domiciled once they have given up their permanent or indefinite intention to remain in the UK. This may be as soon as they arrive in the US, but equally the UK authorities may say that the individual remains UK domiciled long after their arrival since the individual is still most closely connected to the UK.

Even after the individual has lost their UK domicile, they will remain deemed UK domiciled for a further three calendar years. However, if the individual had been a UK resident for more than 15 UK tax years, they will also remain deemed

UK domiciled for UK inheritance tax purposes until they have been non-UK resident for three consecutive UK tax years and don't also return to the UK for six complete tax years in total. UK persons should therefore not assume that they have left the UK tax net the moment they leave the UK.

This is significant because a UK domiciliary or deemed UK domiciliary will remain liable to UK inheritance tax on their worldwide assets, subject to any relief under the US/UK capital taxes treaty. Therefore, the transfer of assets into trust, irrespective of the situs of those assets, may trigger an immediate UK inheritance tax charge. This may even apply to living trusts, even though they don't give rise to a corresponding US gift tax liability.

3. RETURNING UK DOMICILIARIES

For individuals returning to the UK after significant time spent in the US, if they were born in the UK with a UK 'domicile of origin' then they will become exposed to UK taxation on a worldwide basis within the first two UK tax years of their resumption of UK residence.

For these individuals it is crucial that UK tax advice is taken, and any pre-return planning is completed, in the UK tax year prior to their return

(i.e. by 5 April). Upon their return, 'formerly domiciled residents' will find their worldwide income and capital gains exposed to UK tax as they arise, their worldwide estates exposed to inheritance tax and any trusts settled while they were abroad will be brought within the UK inheritance tax regime for trusts. Taking steps to avoid this dramatic and upfront exposure to UK taxation can thus be of paramount importance.

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