ISSUE 6: AUGUST 2017

Knightsbridge Wealth

technical news

For professionals working with international clients

Demand surges for International Wealth Management

The demand for international wealth management is going from strength to strength, as the asset base of high net worth individuals hits new heights. The global value of high net worth individuals' assets is set to surpass US$100 trillion by 2025, based on current growth trends. This is four times the level seen in just 2006.

While the Asia-Pacific region is likely to be a key driver in this growth as it sees more rapid economic expansion, Europe will remain a key market. The population of high net worth individuals in Europe increased by 4.8% in 2015, with 4.2 million individuals collectively holding US$13.6 trillion in assets.

Whilst this growth in wealth is creating opportunity, a cocktail of increasingly complex regulation and tax legislation across jurisdictions has emerged and scrutiny on tax avoidance schemes is creating challenges and the need for flexible, transparent solutions. This is having a significant impact on the wealth structuring strategies employed by high net worth investors, and their appointed representatives.

At the same time as the size and wealth of the population of high net worth individuals are increasing, the needs of high net worth individuals are also changing. Family structures and businesses are increasingly international, operating across multiple borders. For instance, it's not unusual for a high net worth family to have children in school in one country, live in another jurisdiction, with a business in a third – and potentially plan to retire in another country altogether. With this level of mobility, it's not a surprise that in 2016, US$10 trillion in private wealth was booked across borders.

Global regulations continue to evolve and consequently, individual tax and legal requirements will change according to each jurisdiction. In the UK, for instance, April brings with it a change to the way many resident non-domiciled individuals are taxed. This dynamic is creating stronger demand than ever for specialists who are well versed in cross-border wealth planning, as well as the need for increasingly flexible wealth and inheritance planning solutions.

As the wealth and number of high net worth families grow, so too will the amount of assets being transferred to the next generation. While we are seeing first-generation entrepreneurs considering how to pass on their wealth, we are also witnessing a burgeoning number of high net worth baby boomers in the US, and second and third-generation wealth creators in the Asia-Pacific region. The amount of wealth changing hands is startling. Wealth-X and NFP's 'Preparing for Tomorrow: A Report on Family Wealth Transfer' estimates that in excess of US$30 trillion of assets will be transferred over the next 30 years alone.

Inheritance and succession planning, therefore, is the top priority for many high and ultra-high net worth individuals when seeking financial planning support.

Governments are taking a closer view on the level of wealth moving across borders, and the level of wealth being passed on to younger generations. As they do so, reporting requirements and the need for transparency are growing. Alongside an increased regulatory compliance burden, this is bringing increased scrutiny on the finances of high and ultra-high net worth individuals. In the UK, for instance, the government's Public Accounts Committee has recently criticised HMRC for failing to pursue the wealthiest taxpayers.

In this environment, wealth planning solutions must not only be transparent, but established within the legal and fiscal regimes in which they are to be utilised.

Knightsbridge Wealth works with a number of providers offering solutions that bring a degree of flexibility and simplicity to an increasingly complex market. Awareness of the benefits of such schemes will inevitably grow.

All change for taxation for UK's 'non-doms'

Brexit is not the only potential source of change and uncertainty on the horizon for high net worth clients. In fact, the way UK resident non-domiciled individuals (RNDs) are taxed is now becoming increasingly complex. This is driving many to reconsider their current wealth structures and tax planning, and those who are not yet aware of the current or proposed rules run the risk of being caught out by a change in their status and having to face the negative consequences.

Since the summer of 2015, the government has been consulting on a raft of new rules affecting the tax status of RNDs. A further consultation response was published in December, confirming the majority of the changes outlined in the Autumn Statement last year, and draft legislation was published earlier this year.

Perhaps the biggest of the changes announced is an end to permanent non-domiciled status. Under the new rules, originally due to come into force on 6 April 2017, individuals who have been resident for 15 of the last 20 years would be treated as domiciled within the UK. Additionally, returning domiciliaries would be taxed as UK-resident domiciliaries while in the UK.

The announcement of the 8 June general election left insufficient time for adequate scrutiny of the new legislation and, as a result, the changes were omitted from the Finance Bill 2017. While it is widely anticipated that, bar a change of government, the core changes will still come into force, it is not currently known whether they would have an effective date of 6 April 2017 or be postponed to 2018. Given the possibility that the rules will be treated as effective from the beginning of the current tax year, clients will need to plan with both the current and proposed regimes in mind.

A change to domicile status on this scale would have significant implications for many high net worth individuals residing in the UK, especially if until now they have chosen to be taxed on the remittance basis. Under the proposed rules, for RNDs resident for 15 of the last 20 years, this would no longer be possible. Instead, they would be taxed on an arising basis on their income and capital gains, which could result in a significantly higher UK tax burden.

The changes announced did not come without any cushion from the government, however. It would have been a significant and unexpected shock for those seeing an end to their permanent non-domiciled status to also face capital gains taxes on their assets relating to their entire residency in the UK. A transitional arrangement was included, which would allow the rebasing of certain foreign assets of an individual becoming deemed UK domiciled on the date on which the new rules came into effect. Provided assets met certain criteria, such as having been owned since last year's Budget in March, they would automatically be rebased to their market value at 5 April (originally 5 April 2017), and capital gains from this point on would be subject to tax.

Further leeway was also announced by the government to allow RNDs to cleanse assets that may have unexpected UK tax liabilities. The proposed new rules introduced a window of two tax years (originally 2017/18 & 2018/19) for non-doms to reorganise 'mixed funds' – funds that, for example, include foreign income and gains, as well as the initial capital. This opportunity would allow individuals to segregate the income and gain elements from the initial 'clean' capital, keeping the income and gain elements off shore, and thereby not subject to UK taxation. This, too, was not without qualification. Cleansing would need to involve a transfer between accounts and would not be available to a returning domiciliary. In addition, the individual in question would need to have used the remittance basis prior to the introduction of the rule.

As the rules surrounding remittance-based taxation become increasingly complex and costly for individuals to navigate, it is spurring increased numbers of clients to revisit their current planning and wealth structures. Without doing so, the increased tax burden may make it too costly for many non-doms to remain in the UK.

With no remittance basis election required on a life assurance contract, this vehicle is due to become an increasingly attractive solution. Furthermore, the status of life assurance policies would not change under the rules as announced, allowing clients to continue to benefit from tax deferral. In fact, a consultation in 2016

reaffirmed that the 5% tax-deferred withdrawal allowance remains a key component of life policy taxation.

Alongside established tax benefits, life policies are portable across multiple jurisdictions, being firmly embedded into the tax and legal systems of the UK, US and EU. They allow greater flexibility for high net worth individuals, should they relocate.

Even under the new rules, trusts would be expected to remain a key strut of cross-border wealth structuring for non-doms in the UK, often in conjunction with life assurance. Other than for returning domiciliaries, trusts formed prior to an individual being deemed UK domiciled would retain some protection from tax on foreign income and gains if benefits weren't distributed, although such trust protections would be lost if, for example, additions were made to the trust by a deemed domiciled settlor. Trusts would also continue to play a central part in inheritance tax planning structures.

In contrast to the UK, trusts are not recognised or are treated unfavourably in many other jurisdictions. In such cases, a directly held life assurance policy alone can be preferable. However, in the UK, life assurance policies are set to continue to act as a complement to trust arrangements, providing additional protection against some of the trust-specific pitfalls that may arise as and when the changes described here are eventually introduced.

The changes announced by the UK government won't come as a surprise to many RNDs and their advisers. RND taxation has been a subject of constant change over the years, particularly since 2008. What is clear is that the treatment of RNDs and their taxation is becoming an ever more complex issue and, regardless of the election outcome, more change is likely. This means flexible, simple and compliant solutions such as life assurance, that are well established in the UK tax system, will become even more important to UK RNDs to help future-proof their financial arrangements.

Summary of Key Changes
Permanent non-domiciled status ends
Those resident for 15 out of 20 years treated as domiciled for all taxes
Returning domiciliaries taxed as UK resident while in the UK
Opportunity to cleanse mixed funds over two years
Automatic rebasing rights available to those becoming deemed domiciled on the date of introduction of new rules
Inheritance Tax for non doms holding UK residential property indirectly
5% tax deferred allowance for life assurance wrappers continues
Trust protections subject to tax on distributions and tainting

The Special Relationship : Taxation of US citizens in UK

The UK's special relationship with the US has been the subject of media scrutiny of late, following the inauguration of President Trump and his ongoing interactions with Prime Minister Theresa May.

The two countries' relationship is not just political. As advisers are well aware, the US is one of only two countries that has citizenship-based taxation, meaning it imposes income tax on US citizens and green card holders living abroad. To try to prevent US persons residing in the UK from being taxed twice on their income and gains, the countries share a double taxation agreement.

While a seemingly straightforward concept for US persons living in the UK, this arrangement doesn't prevent onerous and complicated reporting requirements, nor does it fully account for the complex way certain income is taxed in the US.

For instance, a US person in the UK may need to file annual federal tax returns, paying tax on income from worldwide assets. They will also need to report non-US accounts on reporting returns, such as FinCEN 114 and IRS Form 8938, to name just two. Meanwhile, they must also submit UK returns for UK income and gains, or even worldwide income and gains, if the resident is being taxed on an arising basis. This is not to mention the added complexity of the US tax year being based on the calendar and the UK tax year running from April to April. This complexity has significant implications for cross-border wealth strategies and tax planning.

Alongside complicated reporting, US high net worth individuals living in the UK may find they do not have sufficient investment flexibility to match their wealth strategies.

Advisers servicing American clients outside the US are typically careful to ensure that investment vehicles are designed with the relevant

US tax considerations in mind, to avoid generating significant tax liabilities and complications. To this end, the advisers may avoid certain non-US investment funds (which may be treated as passive foreign investment companies for US tax purposes), and European-issued life insurance (for fear that it may not qualify for favourable tax treatment in the US). The cost of 'foregoing' otherwise suitable investments is difficult to quantify, but it is nevertheless incurred by US expatriates across the world.

On the other side of the coin, using wealth planning solutions common in the US, but less well known in the UK, can cause similar complications.

Therefore, the challenge in managing wealth of US persons in the UK is how to comply with these difficult obligations, simplify the process of reporting, and provide the flexibility to meet their needs – all while achieving as much tax efficiency as possible.

Carefully designed dual compliant solutions are a crucial part of this approach. Generally, by their nature, such solutions would qualify as either life insurance or as an annuity for US purposes, while simultaneously meeting the requirements for life insurance in the holder's country of residence, such as the UK. This treatment in two jurisdictions brings with it considerable tax and reporting advantages, removing much of the concern about double taxation, and how assets are treated under the tax treaty between the UK and US.

With this type of solution, an individual does not own the underlying assets, but pays a premium to the issuer, which in turn would invest it according to a broad investment strategy selected by the contract holder. This allows a policyholder to benefit from exposure from a wider spectrum of investments than would otherwise be available to a direct investor. From a reporting perspective, this also brings benefits. While the policy's existence needs to be reported, there would be, for instance, no K-1s relating to underlying investments, significantly reducing this administrative burden.

A dual compliant policy allows income tax deferral in both the US and the UK. This immediately removes many of the tax reporting issues we have discussed. As there is no UK or US tax liability during the accumulation phase, this solution is especially attractive to investors who do not need continuous access to the policy value.

It is not just a one-way street, as UK high net worth individuals often relocate to the US. A dual compliant solution works both ways – bringing with it tangible tax benefits to those looking to move to America, alongside streamlined reporting.

Firstly, because the policy will benefit from tax deferral, the policyholder is only taxed at a time when benefits emerge, allowing the holder to move country and return without needing to change the policy. Secondly, UK individuals using such a solution can benefit from time apportionment relief, which reduces the taxable gain if the policyholder was non-UK tax resident for part of the holding period.

In practice, this means an individual can take out a policy in the UK, relocate to the US, surrender upon returning to the UK and only face UK taxation on a proportion of the overall gain reflecting the period of UK tax residence.

Ultimately, dual compliant solutions allow individuals and their advisers to focus their efforts and attention on long-term financial and succession planning, rather than the detail of cross-jurisdiction tax compliance and exposure.

Contact us

If you require further information about our services and how we can assist your clients, then please call us or send us an email about how and when we can contact you.

+44 (0)20 7407 3032

info@knightsbridgewealth.co.uk
www.knightsbridgewealth.co.uk

Knightsbridge Wealth Ltd
45 Pont Street
London
SW1X 0BD
United Kingdom