



## Welcome to the summer edition of Focus.

This year has already brought some important milestones in the firm's growth and development. Firstly, we are pleased to announce that, after seventeen years at Coldbath Square, we have now relocated to 236 Gray's Inn Road, just around the corner from our former home. We are very excited by this move as the new offices provide the space that we currently need and will enable the firm to continue to grow over the next five to ten years as we develop existing client practice areas and recruit more graduate trainees as well as experienced personnel.

Secondly, another landmark development is the opening of a Frank Hirth office in New York. Kevin Johnson will be joining the firm as an Associate Director and brings with him over twenty-five years experience of international tax as well as an existing practice. Kevin is based in New York and will be establishing a permanent Frank Hirth office out there for which we will be looking to recruit staff over the next few months. We are absolutely thrilled by this development, as it will enable us to better serve our existing client base.

In terms of internal promotions, we are pleased to announce that Paul Bolland and Jemma Baker joined the director group as Associate Directors as from 1 April 2008. Paul and Jemma have worked at Frank Hirth for thirteen and ten years respectively and their promotions reflect the firm's desire to grow from within, in tandem with recruiting appropriate professionals externally. David Hathaway has been promoted to Manager whilst the following join the management group as Assistant Managers – within the tax group, Adam Smith, Helen Griffiths,

Kristina Searle, Mary Waite,  
Stacie Richardson and

## Frank Hirth opens its New York office this month

Ursule Diankela; within the audit practice, Allison Hibbs; and within the administrative team, Carleen Dehaney, Charlotte Cooke and Lisa Usher. We wish everyone the best of luck with their new roles.

Still on the firm's news, we are sorry to announce that Jon Preston retired in May after five years with the firm following a long career with Arthur Andersen and more recently Deloitte & Touche. We thank Jon for everything he has contributed to the firm and wish him a very happy retirement.

Given the huge impact that the Finance Bill will have on our non-UK domiciliary clients as from 6 April 2008, we are obviously keeping a very close eye on the amendments that are being made to the proposed legislation by the various committees. The legislation is expected to be enacted at some date in July 2008 and, as at the date of publication, we are still waiting for the final legislation. In this edition of Focus, we have a detailed article setting out the amendments to the proposed legislation that have been made to the definition of UK tax residence and the taxation of offshore trusts for UK resident but non-UK domiciled settlors and beneficiaries.

Our second article covers the expatriation rules which are now in effect for US citizens expatriating from the US and long-term US residents (green-card holders who have filed US resident tax returns for at least eight out of the last fifteen consecutive tax years) who terminate their US residence by giving up their green-card or by virtue of taking a "treaty position" on a US tax return. Even though the US expatriation rules were completely revised as recently as June 2004, regular Focus readers will be aware that we have been warning of further changes in this area for 18 months now.

Finally, we are delighted to report that Paul Hocking completed his charity motorbike ride earlier this year. Paul rode a 2008 Ducati Desmosedici RR Moto GP replica bike from the factory in Bologna to the Moto GP track in Jerez in Southern Spain and then home to West London. He raised over £15,000 for Riders for Health. If you would like more information about this charity, then please visit [www.riders.org](http://www.riders.org) Well done Paul!

We hope you enjoy this edition of Focus and wish you all a great summer.

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# EXPATRIATION

We are no longer dealing in speculation. As we write, the long presaged mark to market exit tax applying to expatriating individuals has become a reality. Passed without dissent in both the House of Representatives and the Senate, the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 has been awaiting presidential signature. On 17 June 2008, President George W Bush signed the act into law. This is the effective date of the act. Ostensibly a package of benefits for serving military and their families, the revenue provisions of the act include the exit tax together with a number of other provisions affecting expatriating individuals.

These Revenue provisions in very similar form have been tacked onto different bills in recent times but previously the bills (for reasons other than the expatriation provisions) had not passed Congress. We discussed the last incarnation of the proposed legislation in last September's edition of Focus but as this is now the brave new world in which we live it is important to revisit the details of the legislation as they affect expatriating individuals from 17 June 2008.

## Who is Affected?

The new rules affect those referred to in the legislation as "covered expatriates". A "covered expatriate" is any person who relinquishes their US citizenship, or any long-term resident who ceases to be a US person and who falls within the existing definition of IRC 877. (In general, the term "long-term resident" means someone who has been a lawful permanent resident (green-card holder) during at least eight of the fifteen tax years ending in the year of expatriation.) So a "covered expatriate" is an expatriating individual meeting any of the following:

- Has a net worth of US\$2m or more.
- Has an average net US income tax liability of US\$139,000 for the five years prior to expatriation.
- Fails to certify that all US federal tax filing obligations have been complied with for the preceding five years.

If the above do not apply, then an individual can give up citizenship or long-term permanent residence without further consequences as an individual not considered to be expatriating for tax motivated reasons.

"Covered expatriate" is refined further in the newly enacted legislation by two exceptions that can apply if filing obligations have been complied with as above. These exceptions apply to:

- An individual who was from birth a national of the US and of another country; as long as such individual as of expatriation continues to be a citizen and a tax resident of that other country; and has been a resident of the US for not more than ten of the fifteen taxable years ending with the year of expatriation.
- An individual who relinquishes citizenship before reaching the age of 18½; as long as such individual has been a resident of the US for not more than ten of the fifteen taxable years ending with the year of expatriation.



## The Mark to Market Tax

All property of a covered expatriate shall be treated as sold at market value on the day before the date of expatriation. To the extent that the resulting gain exceeds US\$600,000 (for 2008, increasing by cost of living adjustment thereafter) it would then be subject to US taxation at the applicable rate for the character of the gain.

An election can be made to defer the payment of this tax until actual gain is realised. The tax can be deferred until the due date (without extension) for the return for the taxable year in which the property is sold or the gain otherwise realised. To make the election the taxpayer must irrevocably waive any right under any treaty of the US which might otherwise bring the gain out of charge to US tax. Interest will be assessed on any tax so deferred as if the election had not been made.

## Exceptions

Certain eligible deferred compensation arrangements are specifically exempt from the exit charge. In these cases the payor of any taxable payment to a covered expatriate would be obliged to withhold tax at a rate of 30% from the payment. Essentially the term eligible here refers to arrangements where the payor is a US person or is not a US person but elects to be treated as a US person for withholding purposes (and the election satisfies such requirements as the Treasury may stipulate).

All other deferred compensation arrangements are subject to the mark to market tax; the covered expatriate being deemed to have received a distribution of their entire interest under the plan on the day before their expatriation. (It should be noted that the definition of what constitutes a deferred compensation arrangement is drawn very widely, and includes, for example, interests in non US pension schemes.)

No penalty tax that might have applied for an early distribution will apply under these rules and appropriate adjustments will be made to future distributions from the plan to reflect the tax already paid.

Similar rules apply to certain "Specified Tax Deferred Accounts" that would include IRA, qualified tuition programs, Coverdell ESA, and Archer MSA.

Similar provisions also deal with interests in trusts. The mark to market tax does not apply to non-grantor trusts. Instead the trustee will be required to withhold 30% tax on distributions (to the extent these would be taxable if the individual continued to be a US taxpayer) made out of the trust to the covered expatriate as beneficiary. In addition, if the market value of the property distributed exceeds its basis, the trust would recognise a gain equal to the amount of the excess.

Grantor trusts are treated as look-through entities for US tax purposes with the grantor reporting all income items and deductions on his personal return. To the extent the covered expatriate is the owner of a grantor trust the mark to market rules will apply to the trust assets attributable to such individual.

## Covered Gifts and Bequests

The act imposes a tax on the recipient of a gift (lifetime) or bequest (upon death) made by a covered expatriate to any US citizen or resident taxpayer. The tax will be charged on the value of any gift in excess of \$12,000 (the annual gift exemption rising annually) at the highest marginal estate or gift tax applicable at the time of the gift.

Gifts to a US citizen spouse or to a qualified charity are exempt. The tax charged under these provisions will be reduced by any gift or estate tax paid to a foreign country in respect of the same gift or bequest.

This is probably the most egregious aspect of the “new” rules, imposing as it does a tax liability and reporting obligation on US persons who might have no reason to know if the person making the gift was a US citizen or green-card holder in a previous life.

It should be noted that there is nothing in the act to suggest that the US\$1 million lifetime gift exemption or the US\$2million estate tax exemption available to US persons applies under these provisions.

Gifts to US trusts are treated in the same way with the donee trust being charged the gift or estate tax. If the covered expatriate makes a gift to a foreign trust and such trust subsequently makes distribution, whether out of income or corpus, to a US beneficiary then the gift is treated as if made directly to that US citizen or resident and the recipient is charged to tax in the same way. (The foreign trust can elect to be treated as a US domestic trust for these purposes and satisfy the US tax liability as a domestic trust would be required to do.)

### Co-ordination with Existing Legislation

These new provisions will be added to the Internal Revenue Code as section 877A directly after the existing expatriation provisions of section 877. Section 877 is amended to add a final paragraph stating that 877 shall not apply to any individual whose expatriation date is on or after the date of enactment being 17 June 2008.

The current provisions of section 877 require an expatriated individual to continue filing US tax returns for ten years after expatriation. Under the new rules now enacted this continued filing requirement is removed and the expatriated individual is treated as a non-resident alien from the date of expatriation. This is of course at the potentially prohibitive cost of the mark to market tax.

It would be hoped that subsequent guidance or even changes in the law will limit the scope of the new rules to perhaps US situated accounts, or limit the charge to net worth at the time of expatriation. At present, the message has to be to seriously consider the consequences of renouncing your US citizenship, or surrendering your green-card; and please contact us before acting!

# Talk to us before considering renouncing your US citizenship or green-card

## 91 Day Tests

### Coming to the UK

This can be split in to two areas:

1. Short-term visitors (individuals visiting for only limited periods without any intention to remain for an extended period); and
2. Long-term visitors (individuals coming to the UK intending to remain indefinitely or for an extended period).

Short-term visitors will be regarded as resident if:

- a. They meet the 183 day test; or
- b. They visit the UK regularly and after four tax years their visits to the UK average 91 days or more a tax year. They will become resident from the start of the fifth tax year.

Long-term visitors will be regarded as resident in the UK from the day they arrive to the day they leave if they come to the UK for a specific purpose and remain in the UK for at least two years. If you also own accommodation in the UK upon arrival the same treatment will apply.

### Leaving the UK

If you leave the UK permanently you will be treated as remaining resident in the UK if:

- a. You were to satisfy the 183 day test; or
- b. Your visits to the UK average 91 days or more over the period of absence up to a maximum of four years.

For example, an individual leaves the UK permanently on 5 April 2006 and then spends 40 days in the UK in the next tax year ending 5 April 2007. That individual would not be resident in the 2006/07 tax year as the time was less than 183 days in that specific tax year and less than 91 days on average since they departed.

If the same person then spends 110 days in the 2007/08 tax year he would still be non-resident for UK tax purposes as he would have spent less than 183 days in the full tax year and less than 91 days on average ( $40 + 120 / 2 = 80$  days) over the two tax years since their departure.

The same individual spends another 120 days in the 2008/09 tax year. Using exactly the same principles as above, he would be resident in the UK for the 2008/09 tax year as although he had spent less than 183 days in the actual tax year, over the three year period since his departure, he would have spent on average greater than 91 days per tax year ( $40 + 120 + 120 / 3 = 93.33$  days).

## Split Year Treatment

A taxpayer is treated as resident in the UK for an *entire* tax year if he is resident in the UK for any part of the tax year. However, if he were to leave or arrive during the tax year it is possible, by concession, to split the tax year in which the permanent arrival or departure occurs. This basically splits the tax year in to two separate periods of residence and non-residence for UK tax purposes.

There are conditions to be met to obtain this concession but they are outside the scope of this current article.

## UK RESIDENCE RULES

HM Revenue & Customs (HMRC) have been looking at the residency rules and interpretation for some time now and given the voluminous amount of copy that has been issued on this recently we felt it would be helpful for our readers to receive some clarification on the rules as they currently stand. This article will only deal with physical residency in the UK and not the term ‘ordinary residence’.

At present there is no statutory definition for the term ‘residence’ within UK legislation and the definitions used in UK taxation are largely based on case law.

However, it has been confirmed that draft legislation on UK residence will be published by 31 December 2008.

### 183 Day Test

A taxpayer will always be resident in the UK if the number of days spent in the UK amount to 183 days or more. There is no exception to this rule.

Furthermore, long-term visitors will be regarded as resident in the UK from the day they arrive to the day they leave if they come to the UK for a purpose that means they will remain here for at least two years. The same treatment will apply if you own or lease accommodation in the UK in the year you arrive.

## Revenue Guidelines – IR20

HMRC guidelines in this area are set out in their booklet IR20 which was updated in April 2008. As a practice we have followed and used these guidelines when advising clients on their specific scenarios but recent cases have shown that HMRC are willing to rule against these guidelines. This has unfortunately led to uncertainty amongst advisers and their clients who rely upon this document.

However, HMRC have stated that they will still follow the guidelines issued within IR20 "fairly and consistently" but will "consider all the relevant evidence, including the pattern of presence in the UK and elsewhere..." to determine whether a person has left the UK or not and their residency status.

### All Change

HMRC had originally issued provisional legislation/guidelines that days entering and leaving the UK would now be counted as days in the UK to determine a taxpayer's residency.

HMRC have now stepped back from this rule and have changed the provisions to state that; *"As of April 2008, when deciding if an individual is resident in the UK for tax purposes, days will count if you are in the UK at midnight for residence test purposes."*

HMRC have therefore arrived at a halfway house between the previous rules (*excluding* days of arrival and departure) and the rule stated in the first paragraph above (*including* days of arrival and departure).

HMRC will still discount days spent in the UK due to exceptional circumstances beyond a taxpayer's control (e.g. illness of the taxpayer or an immediate member of his family) for short term visitors to the UK. But please note that the days discounted are only for those individuals that have spent less than 183 days in that tax year. If a person has spent more than 183 days in the tax year, including days due to exceptional circumstances beyond their control, these are not able to be excluded for the day count rule.

If you require any assistance with regards to the above please get in touch with your usual contact at Frank Hirth to discuss.



Prior to 6 April 2008, there was a parallel exemption (in section 87 TCGA 1992) for non-UK domiciled beneficiaries, including the settlor, to avoid the taxation of gains made by offshore trusts where these are matched to capital payments made to them. From 6 April 2008, a resident non-domiciled beneficiary will now pay tax on capital payments matched to trust gains where they are remitted to the UK. If the beneficiary is a remittance basis user then they will not be taxed where the capital payment has been left offshore.

As part of the changes, HMRC have clarified their position on the matching of capital payments to trust gains, as well as having introduced special rules for capital payments between 12 March 2008 ("Budget Day") and 5 April 2008. The new rules provide that payments are matched on a "last in, first out" basis, which inevitably means that it will be more difficult to match pre-6 April 2008 gains to avoid a capital gains tax liability and as such, the longer capital payments are left the greater the risk that pre-6 April 2008 gains are stranded.

Where any offshore trustees are minded to make capital distributions to UK resident beneficiaries, then there will be an inevitable increase in their administrative burden, including a requirement to calculate gains realised in accordance with UK capital gains tax rules, as well as an increased likelihood of registration and interaction with HMRC.

When the original draft legislation was published, HMRC announced that gains realised or accrued before 6 April 2008 would not be caught by the new rules. The new proposals do allow for a one-off election to be made to treat all of the assets as having been sold and re-acquired at their market value as at 6 April 2008, which effectively rebases the assets. The election does not realise a gain, rather when the asset is sold the gain is split between a pre-6 April and a post-5 April pool. To take advantage, the trustees must file the election with HMRC by 31 January following the first UK tax year in which a capital payment is made to a UK resident beneficiary or any part of the trust is transferred to a new trust.

The imposition of a capital gains tax charge to capital payments from offshore trusts will cause particular concern for US taxpayers and their ability to claim credit in either the UK or the US for taxes paid. Careful planning will be required to ensure that a doubling up of taxes is avoided.

The extension of the anti-avoidance provisions will mean that trustees of offshore settlements, as well as beneficiaries, will need to be more mindful of the increased scope to UK tax on remittances. Whilst the proposal for a notification scheme for trusts established by non-UK domiciled settlors has been set aside, HMRC have emphasised their intention to use the Self Assessment enquiry regime to establish whether entries on returns correctly reflect the income and gains assessable on them from the trust.

Despite the proposals, the offshore trust still represents an effective planning tool for non-UK domiciled taxpayers as it offers inheritance tax protection for "excluded property" settlements, as well as a limitation on tax on gains realised in the trust to occasions when the beneficiary receives a capital payment.

If you have any concerns and would like to discuss these changes, please get in touch with your usual contact at Frank Hirth.

## UK FINANCE ACTS

After extensive lobbying following the Pre-Budget Report, the proposals in the Finance Bill currently before Parliament represent a significant softening of the proposals on the definition of non-residence, as well as the taxation of non-UK domiciled taxpayers and their trust interests.

### Offshore Trusts – Taxation for UK Resident Settlers and Beneficiaries

The changes in the Finance Bill 2008 represent the Government's further reaction to the perceived use of offshore trusts for tax avoidance. Despite being left reassured that the legislation shall not be as punitive as was feared when the Pre-Budget Report was released in October 2007, it is clear that HMRC are now more focussed on offshore settlements and specifically, on their UK resident beneficiaries.

On a positive note, the exemption for non-UK domiciliaries from the anti-avoidance provisions (in section 86 TCGA 1992), which taxes gains realised by non-UK trusts on a UK resident settlor retaining an "interest" in the settlement, will still prevail. Happily, non-UK domiciled settlors are not chargeable to tax regardless of whether they choose to be remittance basis users.