SKYBOUND
WEALTH MANAGEMENT

ISA Guide for UK Expats resident in the USA

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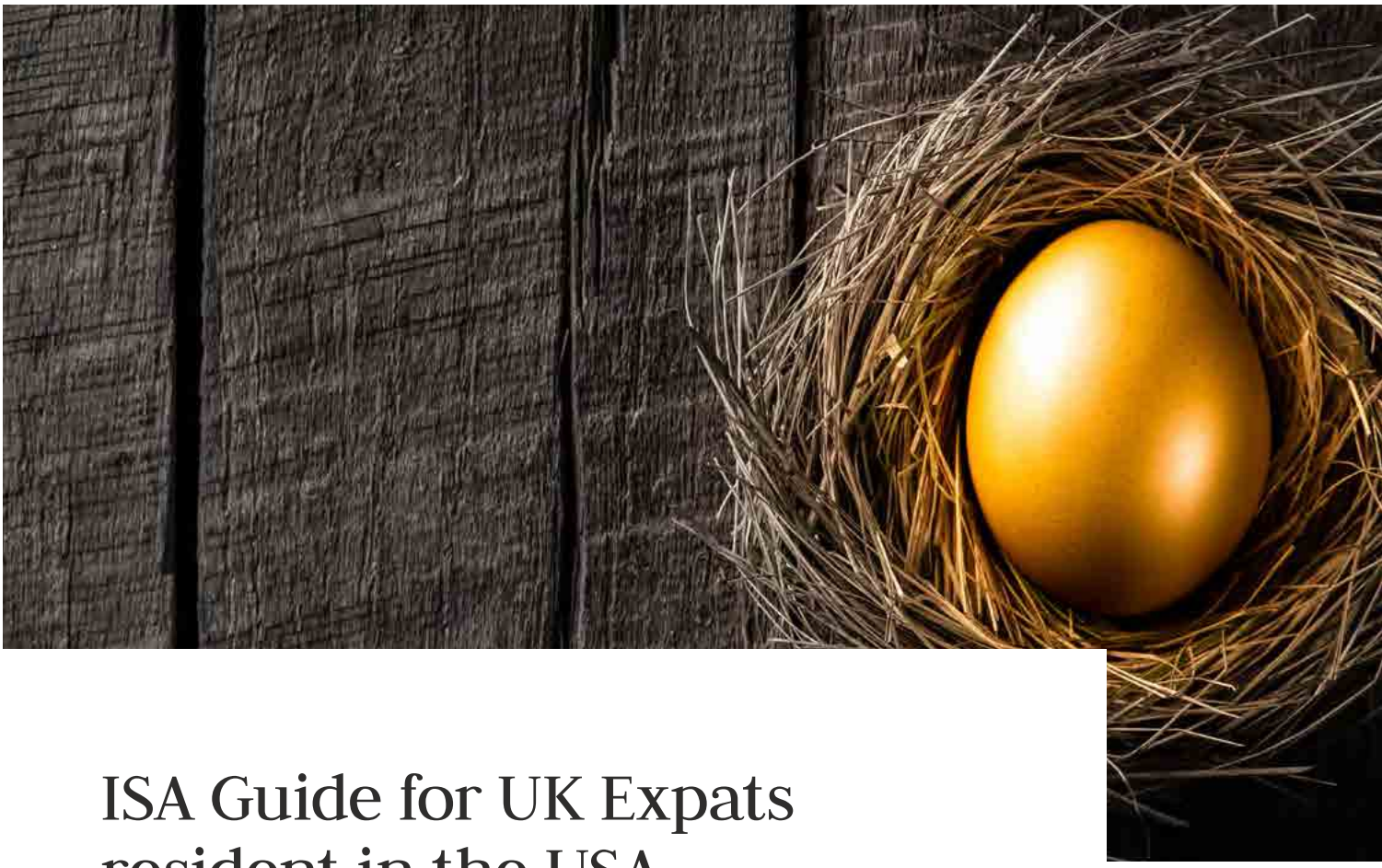


ISA Guide for UK Expats resident in the USA

In the UK, one of the most common tax efficient savings tools is an Individual Savings Account (ISA for short).

An ISA is an investment account domiciled in the UK that lets you build savings from UK employment income to provide tax free growth and income in the UK. ISAs come in various types but the two most common are Cash ISAs and Stock ISAs.

UK tax residents can contribute up to £20,000 each UK tax year with no age restrictions.

There is no limit to the amount that can be built up in the UK and ISA investments will form part of your estate for Inheritance Tax purposes.

There are no age restrictions on withdrawals, and you can take funds out at any time without losing UK tax benefits (except as noted below for Lifetime ISAs).

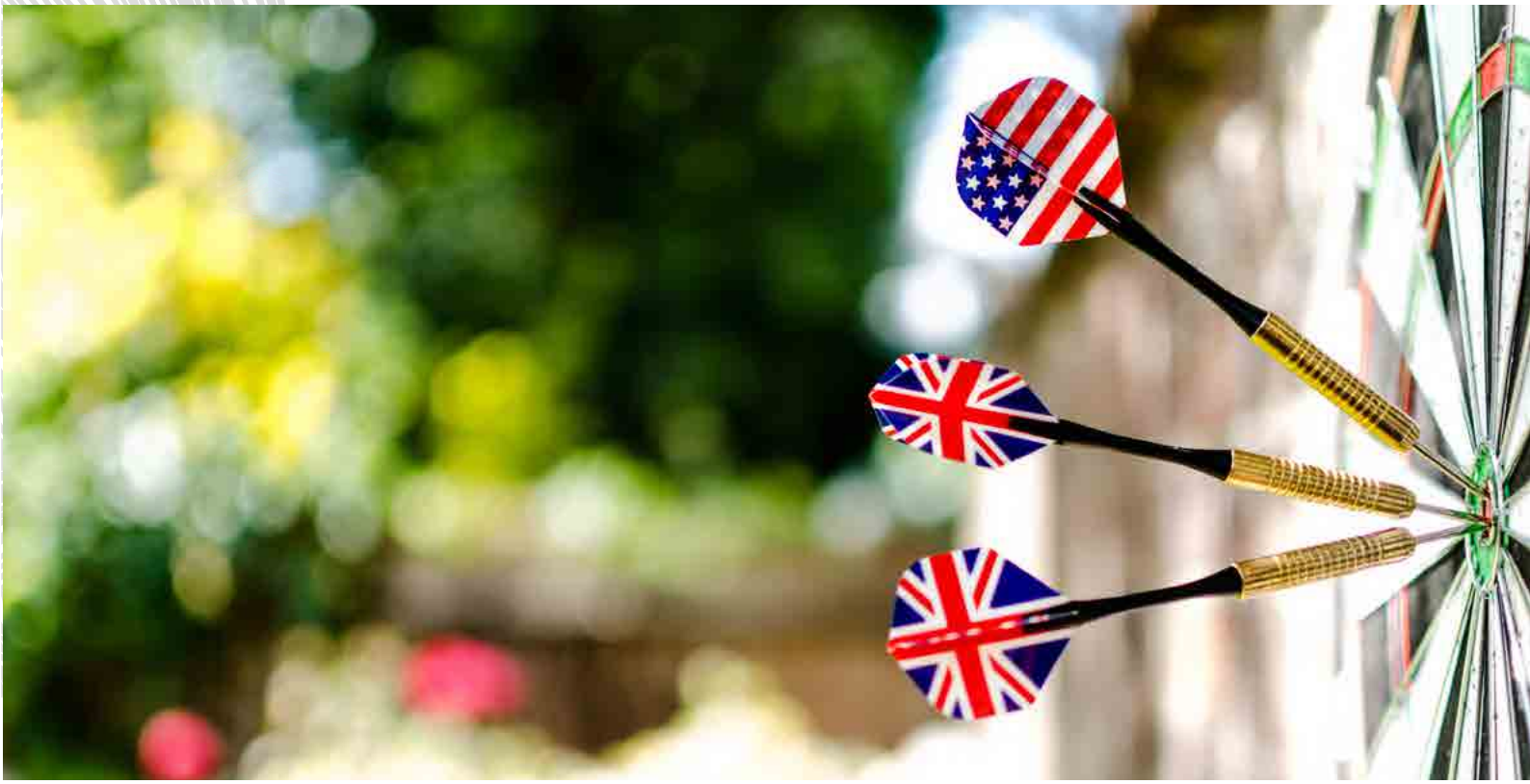
Lifetime ISAs are slightly different in that you need to be between the age of 18 and 40 to open a lifetime ISA and you can put in up to £4000 a year until you are 50. The government will add 25% per year (up to a max of £1000). Withdrawals are restricted and unauthorised withdrawals will lead to a 25% penalty (to allow the government to recoup the bonus) as will a transfer from a Lifetime ISA to a different ISA.

Withdrawals are allowed if:

1) Funds are used to buy your first home
2) If you are aged 60 or over or;
3) If you are terminally ill, with less than 12 months to live.

With some exceptions you can generally transfer your Individual Savings Account (ISA) from one provider to another at any time. One exception is that if you transfer cash and assets from a Lifetime ISA to a different ISA before the age of 60, you'll have to pay a withdrawal fee of 25%.

Whilst ISAs are generally a good investment vehicle, once you leave the UK behind, there's a strong chance they may no longer be the best option. In the next section of this e-guide, we look at how residing in the US affects the suitability of your UK ISAs.



Do all these features apply to a US resident holding ISAs?

NO. If you are non-UK tax domiciled, you cannot contribute to an ISA (unless you're a Crown employee working overseas or their spouse or civil partner). You can start contributing if you return to the UK.

An ISA whilst often being an important part of retirement planning, it is not a pension, so it does not come under the UK/US tax treaty. ISAs are not recognized by the IRS so neither capital gains or income from ISAs, are tax free.

If your ISAs contain mutual funds the IRS is likely to consider these to be a Passive Foreign Investment Company (PFIC) and the income/capital gain is automatically taxed at the maximum tax rate normally reserved for only the highest earners. **This tax rate is currently at (August 2022) 37%.**

Are individual shares held within ISAs taxable in the USA on sale or disposition?

Yes, they are taxable however they are subject to regular capital gains and not the PFIC rules therefore up to 20% rather than the 37 percent for holding mutual funds within the ISAs.

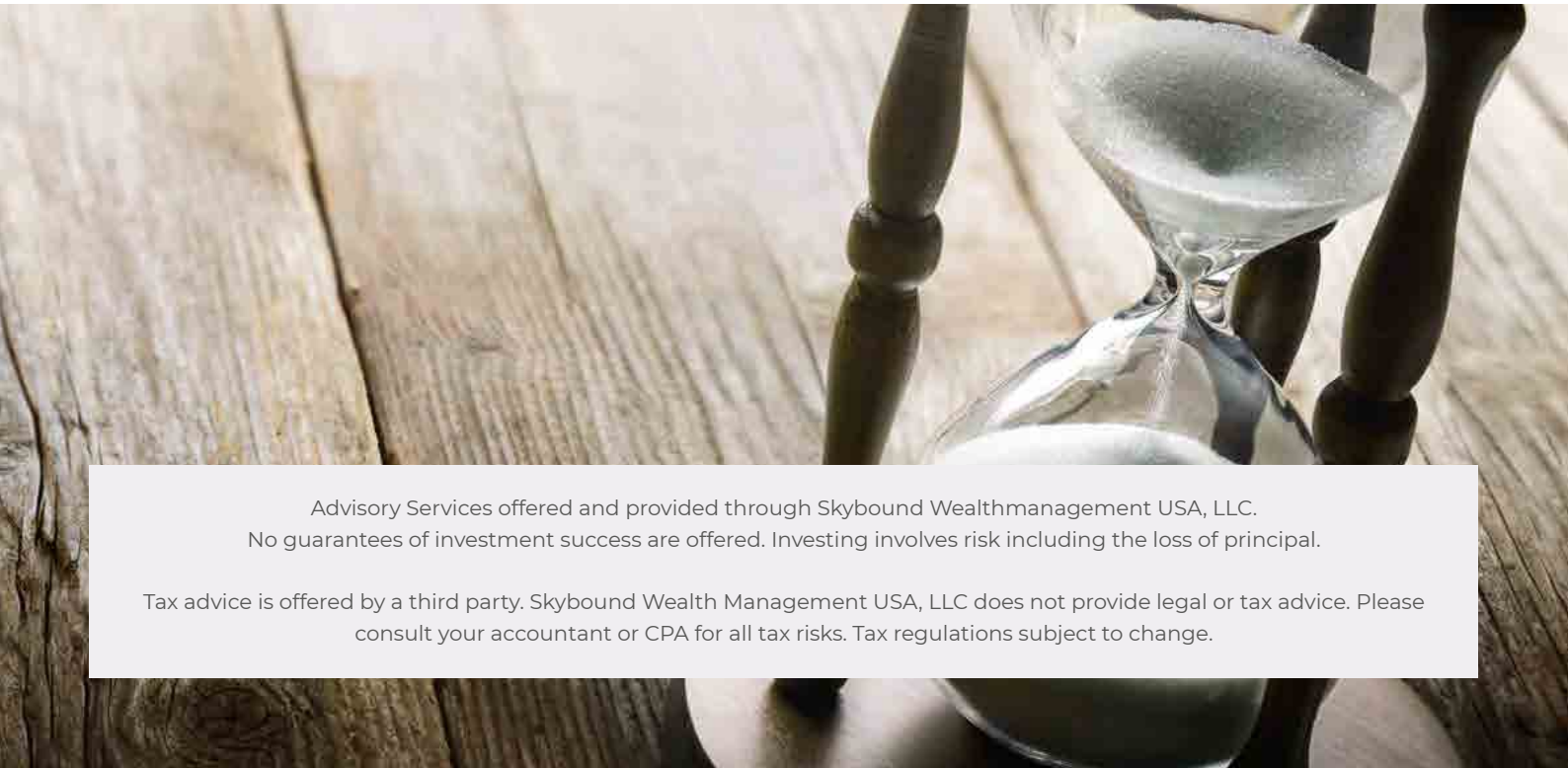
Is now a good time to consider organising my ISAs?

Potentially, yes. If planning to stay in the US permanently further gains may be subject to US federal income tax. The idea is to take control of your tax liability now to potentially reduce liabilities in the future.

Your potential tax liability is a function both of exchange rates and asset prices. Given the course of exchange rates and the markets over the last 10 years, it's fairly safe to say that at the beginning of this year, you may have been sitting on some sizeable gains. Since January though, both exchange rates and asset prices have cheapened substantially in dollar terms.

Under that scenario, it may make sense to realize gains in your ISA and roll the proceeds into one of any number of tax-deferred, USD denominated vehicles (eg. Roth IRA, Annuities).

It's likely that when you set up your ISA, the GBP/USD exchange rate was higher than it is right now. When one looks back over the last 10 years, the rate was as high as 1.71 in mid-2014, and as low as 1.14 in March of 2020. From a tax perspective, taking a lower gain now may make sense. We strongly recommend taking both tax (from an International CPA) and investment advice analysis from a US advisor experienced in this field.



How would I benefit by taking action on my ISA investments now? Why not just wait until I need them?

By disposing of GBP denominated mutual funds, investments could then be repurposed towards compliant, and potentially more tax friendly investments.

Are any of my other U.K. assets/accounts also subject to this penalty?

Yes, old brokerage/unit trust investment accounts/endowments in the U.K are subject to the penalty tax, but again single equities are fine and subject to normal U.S. capital gains rules. The only exception is if the assets are in a U.K. registered pension scheme (SIPP, defined contribution, defined benefit plan). Other accounts could also benefit from the same example used above because of the depreciation of Sterling and the resultant lower USD capital gain.

In what circumstance should I keep my ISAs?

If returning to the UK, ISAs could still provide valuable benefits, however those retaining green card/citizenship will still likely be subject to US taxation. If your intention is to return to the U.K., rebalancing can trigger the U.S. penalty tax so professional advice and careful ongoing management is needed to not fall foul of the rules.

ISA Reporting.

If you hold foreign assets of more than £10,000 then you will need to complete a Foreign Bank and Financial Accounts Report (FBAR), (Form FinCEN 114). There are various other reporting forms that you may need to complete, and we strongly recommend speaking to a CPA specialising in international tax and accounting. Depending on what is held within the ISA, compliant reporting can be very expensive and onerous and is another significant reason to not hold ISAs if you intend to stay in the US.

Other filings that may be relevant depending on your circumstances are:

Form 8938(Specified Foreign Financial assets)

ISA Form 3520(Gift inheritance/trust distribution)

PFIC form 8621 (Passive Foreign Investment Company)

What if I am Out of Compliance?

If you are out of FBAR compliance, the penalties can be severe. Therefore, you may consider entering the IRS offshore voluntary disclosure/tax amnesty before it is too late. Always take tax advice from an experienced International CPA. Many former UK residents unknowingly run afoul of US reporting requirements and an experienced US CPA is best equipped to get you back onside while hopefully reducing or eliminating any possible penalties.

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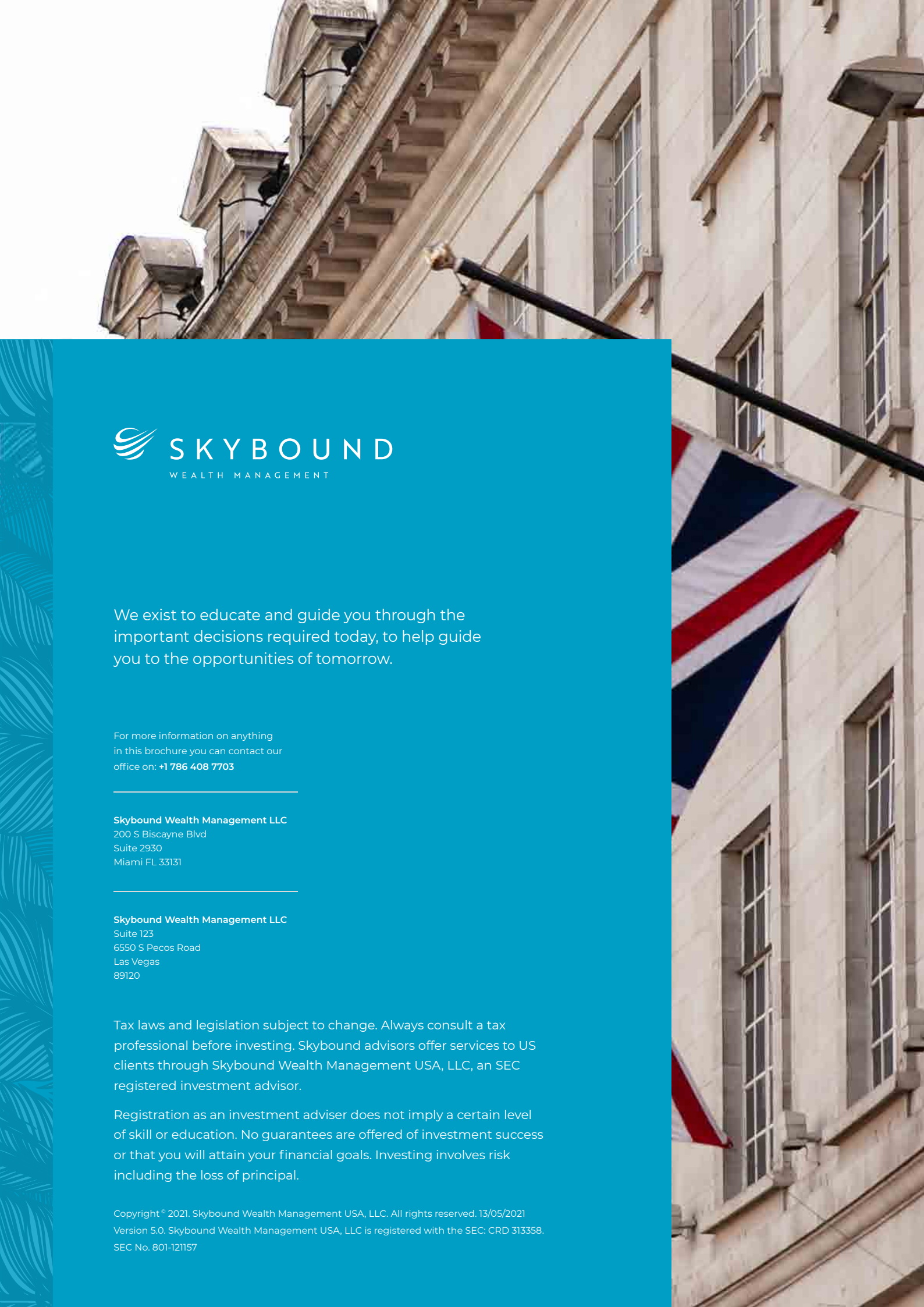

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We exist to educate and guide you through the important decisions required today, to help guide you to the opportunities of tomorrow.

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