US-UK ARTICLE SERIES

Busting myths when it comes to gifts!

The US and the UK are separated by the vast and tumultuous waters of the Atlantic Ocean. Those with connections to both countries will often find themselves rowing against the tide between two very different and complex regimes. With the right specialist advice, they can navigate the cross-border challenges safely and make the best use of planning opportunities.

Understand the issues, avoid the traps, and discover ways to plan ahead in our Navigating the Atlantic series for US-connected clients.

GIFTING

In this instalment, we bust some of the common myths when it comes to gifting and compare the tax implications of gifting in the US and the UK.

MYTH 1: GIFTS TO MY SPOUSE WILL ALWAYS PASS FREE OF TAX

It is a common misconception that gifts to spouses and civil partners are completely exempt from transfer taxes in both jurisdictions. However, such gifts may be taxable where there is a mismatch in the tax status of the donor (the person making the gift) and the donee (the person receiving the gift).

UK

In the UK, there is generally an unlimited exemption from inheritance tax ("**IHT**") on gifts between spouses and civil partners. However, where assets pass from a UK domiciled (or deemed domiciled) spouse to a non-UK domiciled spouse, the exemption is limited to just £325,000. Gifts in excess of this will be subject to tax in the same way as gifts made to any other individual.

There is an option for the non-UK domiciled recipient spouse to elect to be treated as domiciled for IHT purposes (in order to access the unlimited exemption) but this would also have the effect of bringing their non-UK assets within the scope of IHT, which may not be desirable. This will need to be considered carefully, on a case-by-case basis.

US

In the US, there is also an unlimited marital deduction from gift and estate tax on transfers to spouses in most cases. However, this will not be available where the donee spouse is not a US citizen. In that scenario, tax-free transfers in lifetime are limited to $175,000 annually (in 2023). In order to access the marital deduction from estate tax on death, assets have to be left to the non-US spouse in a special type of marital trust, known as a "QDOT".

BUSTING MYTHS WHEN IT COMES TO GIFTS!

MYTH 2: GIFTS TO CHARITY WILL ALWAYS PASS FREE OF TAX

UK

In the UK, in order for a gift to charity to qualify for the charitable exemption from IHT, the recipient entity must not only be operating for 'charitable purposes' (as defined in UK legislation), but it must also be registered as a charity in a country of the UK, EU or EEA. Critically, this means that a gift to a US charity will not qualify for the exemption, no matter how worthy the charitable cause. Lifetime transfers to non-qualifying charities can trigger immediate IHT charges (as well as charges to UK capital gains tax on assets gifted *in specie*, as discussed below).

US

While the US imposes equivalent geographical limitations for income tax purposes (i.e. a charitable gift must be made to a US organisation to qualify for relief), this limit does not apply for US estate tax purposes where charitable bequests are made by US citizens and domiciliaries. Non-US citizens/ domiciliaries, however, must leave US situs property to a US organisation to qualify for the US estate tax charitable deduction.

MYTH 3: GIFTS OF APPRECIATED ASSETS WILL NOT TRIGGER CAPITAL GAINS TAX

US

In the US, gratuitous transfers of appreciated assets will not constitute chargeable disposals for US income tax purposes – i.e. any in-built capital gain will not be crystallised on such transfers. Instead, the donor's base cost in the assets will be "carried over" to the donee and will be used to compute the gains realised on the eventual disposal of the assets by them.

UK

One might assume that the same will be the case in the UK, but that assumption would be incorrect. In the UK, with certain limited exceptions, a gift of an asset will be a chargeable disposal for capital gains tax purposes. If chargeable gains are triggered in the UK but not in the US on the same event, this can give rise to a risk of double taxation because the mismatch in treatment can cause a loss of relief under the US-UK double tax treaty. Advice should be sought on aligning the treatment in both countries to maximise relief.

MYTH 4: GIFTS WILL ALWAYS PASS FREE OF TAX IF I SURVIVE FOR SEVEN YEARS

UK

In the UK, outright lifetime gifts to individuals will generally be subject to the 'potentially exempt transfer' ("**PET**") regime. This means they will pass out of the donor's estate free of IHT if the donor survives the gift by seven years or more. If the donor survives the gift by more than three years but less than seven, the gifted sum will be subject to IHT on the donor's death, but at a reduced rate. The PET regime can be extremely advantageous for individuals who can afford to make substantial lifetime gifts, as there are no limits on the amount that can be given away to the next generation tax-free under this regime.

US

However, those who are subject to US gift and estate tax will be limited in their lifetime giving, as there is no equivalent to the PET regime in the US. Instead, US citizens and domiciliaries are broadly limited to making annual gifts to (any number of) individuals of up to $17,000 (in 2023) and otherwise eating into their lifetime exclusion amount of $12.92 million. Gifts in excess of these amounts are typically subject to immediate US gift tax at a rate of 40%, which is likely to be prohibitive in most cases.

"IT IS CLEAR THAT GIFTING IS AN AREA THAT CAN CAUSE SIGNIFICANT DIFFICULTIES FOR INDIVIDUALS WITH TAX CONNECTIONS IN THE US AND THE UK."

BUSTING MYTHS WHEN IT COMES TO GIFTS!

MYTH 5: I CAN MAKE GIFTS INTO TRUST UP TO THE AVAILABLE US GIFT AND ESTATE TAX LIFETIME EXCLUSION AMOUNT WITHOUT INCURRING TAX

US

It is common planning for US citizens and domiciliaries to make substantial lifetime transfers of assets into trust. By doing so, they can potentially remove assets (and any future growth on those assets) from their estates for US estate tax purposes. Provided the value of the assets transferred falls within their lifetime exclusion amount for gift and estate tax, this can be done without triggering tax.

UK

By contrast, in the UK, transfers of assets into trust are immediately subject to IHT (subject to available exemptions or reliefs). IHT is charged at a rate of 20% to the extent that the value of the assets transferred exceeds the donor's available 'nil rate band' of up to £325,000. This IHT charge will be "topped up" to a maximum of 40% in the event that the donor dies within five years of the transfer. For UK domiciled (or deemed domiciled) individuals, this will be relevant to transfers of any assets, worldwide. For non-UK domiciled individuals, this will apply to transfers of UK assets only. Where it is relevant, this IHT charge will generally prohibit lifetime planning using trusts.

CONTACT US

It is clear that gifting is an area that can cause significant difficulties for individuals with tax connections in the US and the UK. It is extremely important that advice is taken from advisors with an understanding of how the two legal systems interact; ideally before any action is taken.

Disclaimer: The members of our US/UK team are admitted to practise in England and Wales and cannot advise on foreign law. Comments made in this article relating to US tax and legal matters reflect the authors' understanding of the US position, based on experience of advising on US-connected matters. The circumstances of each case vary, and this article should not be relied upon in place of specific legal advice.

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