

American Expat Tax Saving Strategies

It is important for U.S. citizens abroad to ensure compliance with relevant tax codes when making investments.

The 'expat life' has numerous advantages, but a drawback to being an American expatriate is remaining subject to the U.S. tax code, which reaches across borders and requires U.S. citizens to pay taxes no matter where they live. While there are a number of ways to reduce the amount owed, it is important to minimize risks and ensure compliance.

The Wrong Way

The desire to get their tax bill as low as possible is where some Americans take a drastic wrong turn. Some unscrupulous sellers of offshore products and services tell Americans that the IRS will not know about money held in offshore 'tax havens' unless they tell the IRS themselves. The idea is that the IRS cannot tax or come after money they are unaware of. Salesmen explain that tax havens have a vested interest in keeping client information confidential.

However, governments around the world are sharing more and more information each day and a number of tax havens that have upheld strict client privacy laws for years are finally beginning to release information. If an American controls financial accounts outside the U.S. with aggregate value greater than US\$10,000 at any point during the year, Treasury Department Form 90-22.1 must be filed. The government is recognizing that the most politically acceptable way to raise

tax receipts is to increase compliance with existing laws. Keeping quiet about money held offshore and hoping for the best is not a "tax-saving strategy," but only increases the risk of serious civil and criminal penalties.

Further, tax treatment of offshore investments varies, and a number of offshore strategies designed to save taxes ironically could increase tax exposure. For example, if the IRS considers a tax-saving strategy to be a Passive Foreign Investment Company (PFIC); investors will face punitive taxation.

A Better Way

For Americans that want to cut their tax bill in legal, efficient, and cost-effective ways, a three-tiered investment approach is recommended: invest in tax efficient investments, manage them well, and hold them in the appropriate types of accounts.

Tax Efficient Investments

The primary goal of investing is not to save money on taxes and fees, but to make money. Fortunately, the most attractive investments in terms of risk-adjusted returns also happen to be the most cost-effective and tax-efficient. A diversified portfolio of index funds lowers overall risk and provides better long-term returns than the majority of actively managed funds.

Managed Well

Regardless of which stocks or funds are chosen, trading in and out of them based on where you think the market is headed is not a good idea. Higher trading activity leads to higher transaction costs (including taxes), and countless studies show that market timing is counterproductive over the long-run. Trading should be based on your personal situation, along with periodic rebalancing, which realigns the portfolio with the appropriate level of risk and


encourages buying low and selling high.

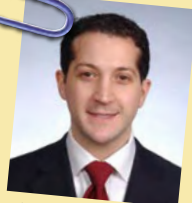
Held in the Appropriate Account

Investors can further reduce their tax bill by making sure investments are held in the appropriate account from a tax perspective. As an example, real estate investment trusts (REITs) are best held in tax advantaged accounts like an IRA. This allows you to avoid unfavorable tax treatment on nonqualified dividends. As another example, low dividend growth stocks are well suited for taxable brokerage accounts because stocks are not taxed until gains are realized or dividends are distributed.

Better Off Onshore

Should you do what you can to reduce your tax bill? Yes. As an American, does that include moving money offshore? Not usually. There can be good reasons to open an account outside the U.S., such as minimizing currency risk for upcoming expenses. However, if the primary goal is reducing taxes, the vast majority of Americans are better served keeping money in the U.S. Mass marketed offshore solutions sold by unregulated salesmen are best avoided, although customized offshore strategies created by professionals can make sense for some high-net worth individuals. But for most people, the costs outweigh potential benefits.

U.S. tax law is taking an increasingly tough stance on Americans with money offshore in the form of extra filing requirements, tax treatment of those assets, and penalties for non-compliance. Using the tax minimization strategies outlined above with money in the U.S., American expats can benefit from lower taxes, generally lower product and service fees, SIPC protection, more transparent and regulated financial markets, and less onerous tax filing requirements - all without worrying about a call or letter from the IRS. 



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