



SPECIAL REPORT

American Expat Investing: The 4 Keys to Success

Maxim Global Wealth Advisors has built a reputation as a premier wealth advisor to internationally-mobile U.S. Citizens who reside outside of the United States. Our professionals have specialized in advising American expats for many years, and with this report we would like to address some of the most common questions and concerns that we hear from our clients.

Our goal is to help American citizens living a global lifestyle to identify the most critical financial issues they face and to provide guidance in making wise investment decisions. While not all-inclusive, we hope this report can serve as a starting point for you on the road to a more efficient and profitable wealth management plan.

We have organized this report into the four critical financial areas for American expats, each of which we discuss in detail in the following pages.

- How do I handle my cash and banking needs while living abroad?
- How should I structure and manage my investment portfolio?
- How am I taxed by the United States and my resident country?
- How does real estate fit into my financial plan and what are some of the special considerations for an expat?

→ HOW DO I HANDLE MY CASH AND BANKING NEEDS WHILE LIVING ABROAD?

A simplified banking plan can make daily life much more manageable for American expats. We recommend expats maintain two primary bank accounts. The first should be a U.S.-based account with not only standard offerings such as credit and debit cards, but also convenient web features such as online check writing and money transfers. The second account should be opened at a local bank in the resident country. This account should be used for day-to-day living expenses and should normally hold a cash reserve to insure against a cash crunch (typically 3-6 months of living expenses will suffice).

Many foreign banks also offer U.S. dollar-denominated accounts, which are a terrific option for expats as they often simplify transfers and can sometimes reduce the cost of foreign exchange.

EXCHANGING CURRENCY

Currency exchange transactions aren't always as straight-forward as one might think. Ideally everyone could exchange currencies at the prevailing interbank rate – which is the listed rate that corresponds to the wholesale rate banks charge one another when trading large amounts. Individuals can rarely get this rate. Most are charged 2% to 3% above this rate when exchanging money and some can end up paying even more than that. Therefore, expats should limit the frequency of foreign exchange transactions by planning ahead for cash needs. When a transfer is necessary, it is always a good idea to shop around among different banks and investment companies. Independent FX trading firms can be another good alternative for large transfers, although we have not found them to be particularly price competitive with smaller transfers.

Ultimately, expats should not be afraid to ask for a better rate than what they are quoted, particularly if a large amount is being exchanged. It can be difficult to negotiate great rates on amounts below \$250,000, but on exchanges above \$1 million it is possible to receive at or near the interbank rate. Finding the best rate on transfers in between these levels often requires a fair amount of shopping around and negotiation.

Many expats forget that managing cash is about more than accessibility. A properly structured banking plan not only keeps cash easily accessible, but also saves what can end up being a significant amount of money on transaction fees.

→ HOW SHOULD I STRUCTURE AND MANAGE MY INVESTMENT PORTFOLIO?

It is our experience that American expats often find themselves pondering two very basic questions when it comes to managing their portfolios. Should I get an expert to help me? And if so, who?

Many American expats are quite financially savvy and will sometimes try to manage their own investments. But dealing with the complexities of administering their assets while living abroad and the need to consider things like currencies, regional exposure and taxes can make this a difficult and time-consuming burden. Additionally, every hour spent tending to financial matters is one less hour spent enjoying the rich experiences a foreign locale may have to offer. And living a global lifestyle often means traveling and not always being able to keep up with sometimes volatile markets. All these factors weigh on the decision about whether to seek expert advice or “go it alone.”

“GOING IT ALONE”

Should an expat decide to “go-it-alone”, the following tips should be considered when managing an investment portfolio.

American expats should maintain their investment assets in the U.S. brokerage system. This offers the benefits of stable regulatory oversight, SIPC account insurance and proper reporting of gains, losses and dividends for IRS purposes. Most investment funds located internationally or offshore do not report according to IRS standards and account holders can be penalized with higher tax rates in the U.S. In fact, many international financial institutions are beginning to decline and close investment accounts for U.S. citizens in recognition that they cannot provide appropriate tax reporting to the IRS.

Discount brokers in the U.S. are often a better option for expats than traditional Wall Street brokerage firms. This is because discount brokers offer excellent web account access and have good tools and reporting that will make it easier for Americans to administer their assets from abroad. Also, discount brokers provide an open-platform with a large selection of investment alternatives at very reasonable cost.

The selection of discount brokerage firms may be limited for some expats because not all discount brokerage firms will handle accounts from any country. The U.S. Department of Treasury restricts brokerage firms from working with residents in certain OFAC restricted countries. In addition to this list, many brokerage firms maintain their own list of approved countries. Ideally, it is best to open these accounts before moving abroad because brokerage firms often have greater flexibility when changing the address of a current client compared with opening a new client account. The end result is that American expats may need to shop around and look at more than one firm in order to find the best fit for their individual needs.

We would like to make special note of the various tax-advantaged savings programs offered around the world (such as a 401(k) in the U.S.). We recommend clients consider

taking advantage of these programs. However, it is important to consider the “worldwide” tax implications (both the US and the foreign country), especially if the plan is not a “qualified” plan for US tax purposes. Due to the complexities surrounding the current and future deductibility and/or taxation of such accounts, we recommend that you get advice from a qualified US tax advisor prior to participating in such a program.

SEEKING EXPERT ADVICE

If an expat does decide to seek expert financial advice, finding someone qualified to help them can be a major challenge. This is because there aren't many financial advisors out there who understand the complexities American expats face while living abroad.

In general, expats should seek out an investment advisor who either understands, or is willing to learn, the unique tax and investment implications American expats face. Fee-only investment advisors who operate in the U.S. as Registered Investment Advisors (RIA) are often a wise choice. These firms are regulated by the SEC and generally earn their compensation from asset-based advisory fees, not product commissions. This assures their objectivity and encourages the advisor to act in the best interests of clients.

KEY QUESTIONS TO ASK WHEN INTERVIEWING AN ADVISOR

- What services do you and your firm offer?
- In what type of client do you specialize?
- Is your firm subject to government regulation? By what agency?
- Are my investments held in insured accounts?
- What is your educational background, professional credentials and work experience?
- How are you compensated (commission, fee-based or combination)?
- Do the investments you recommend provide proper tax reporting to the IRS?

INVESTMENT PORTFOLIO DESIGN

One of the biggest challenges for wealthy American expats is how to structure their investment portfolios given that they perhaps do not know their ultimate retirement destination and currency.

One of the most common investment mistakes made by expats is investing with a bias toward the U.S. In fact, the U.S. represents only about 40% of the global stock market. More investors are starting to view the whole world as one market, favoring the U.S. less in their stock allocations. Many foreign economies are growing faster and are financially stronger than the U.S. By investing globally, you can gain a broader level of diversification as well as access to more attractive investment opportunities.

Ultimately, investors who live globally should invest globally. Stocks, real estate securities, bonds and cash form the foundation of a sound global investment portfolio. There are many different vehicles available to build an investment portfolio, but we recommend that investors primarily utilize investment funds which are based in the U.S.. This is because they are the best managed and most reasonably priced investment funds in the world, and the selection of investment alternatives is superior. One challenge for Americans living abroad is that most U.S. brokerage firms prohibit anyone with a foreign

address from purchasing U.S. mutual funds. Without going into great detail, this restriction is due to a legal technicality; but it can be overcome. It is possible to purchase U.S. investment funds while living abroad if help is sought from an advisor that understands how the rules work.

Diversifying the risk of significant currency swings should be a key element of any expat's investment strategy. This does not mean speculating on currency movements, as they are notoriously hard to predict and can move quickly in any direction. Expats should hold a combination of investments which are denominated in a broad mix of currencies so as to insulate them from the risk that fluctuations in foreign exchange rates will negatively affect their global buying power. This is of particular importance for expats who are not certain where they will spend the remainder of their working years or their retirement.

In the end, many expats who would rather not manage their own investments often do so because they can't find a trustworthy advisor who properly understands their unique situation. So regardless of whether expert advice is sought, or an expat chooses to go it alone, the basic investment principles outlined above will help all expats get the most out of their investment capital.

IS IT BENEFICIAL TO KEEP MY MONEY "OFFSHORE"?

- No, there is no tax benefit to keeping money "offshore" for law-abiding U.S. citizens
- There is frequently little or no regulation of offshore companies, so they often have misleading advertising and very high fees
- Most offshore programs use investment funds that are unregulated; gains from these funds often receive the highest possible tax in the U.S.
- Aggressive "offshore pension" marketers will lock up money and charge very high "surrender" charges if you want to get your money out
- Offshore investments which purport to be "retirement plans" are "non-qualified" and enjoy no tax advantages in either the U.S. or the country where you reside.

→ HOW AM I TAXED BY THE UNITED STATES AND MY RESIDENT COUNTRY?

When Americans move abroad, they are often uncertain what impact their move will have on their annual tax liability. Here are some important factors to consider.

First and foremost, the U.S. imposes taxes based on citizenship, not residence. This means all U.S. citizens, including expats, are required to file a tax return every year, regardless of where they reside.

One of the biggest misconceptions is that expats do not need to file if their income is below the “Foreign Earned Income Exclusion” amount (\$87,600 for 2008). Again, all U.S. citizens are required to file a tax return every year.

DOUBLE-TAXATION

Another concern for many expats is that they will be double-taxed on the income they earn – once by the U.S. and again by the government of the country in which they live. American expats need not worry. There is a system of exclusions and credits in place to

THE FOUR PILLARS AIMED AT HELPING AMERICAN EXPATS AVOID DOUBLE-TAXATION

- Foreign Earned Income Exclusion: Whereas the IRS normally taxes on world-wide income, expats may qualify to exclude a preset amount of foreign earnings from U.S. tax - \$87,600 for 2008
- Foreign Housing Exclusion: Expats may also be able to exclude or deduct from taxable income certain foreign housing expenses in excess of \$14,016 (but limited based on city of residence)
- Foreign Tax Credit – General Limitation: Generally a credit for foreign taxes paid on wages or other “earned” income
- Foreign Tax Credit – Passive: Generally a credit for foreign taxes paid on “passive” income such as interest, dividends and capital gains

avoid double taxation. The four pillars of this system are: the Foreign Earned Income Exclusion, the Foreign Housing Exclusion, the Foreign Tax Credit (General Limitation) and the Foreign Tax Credit (Passive). (See the insert box on this page for more details about these credits and exemptions.) Unused foreign tax credits can be carried back one year, and then forward 10 years.

The U.S. also has tax treaties with numerous foreign

countries that target the issue of double taxation. Most of these treaties stipulate that the country where the income originates has the “first” right to tax that income. An advisor who knows such treaties well can be beneficial because domestic laws in some countries may dictate that certain types of income are non-taxable. Some of these treaties also may grant foreign tax credits against income originated in the U.S.

REPORTING INCOME EARNED ABROAD

Many Americans wonder if they need to report income from outside the U.S. on their U.S. tax return. The answer is yes. The U.S. taxes “worldwide” income, applying the same criteria to various types of investment income – such as interest, dividends, and capital gains – as it would if the income were generated within the U.S. It is also important to report all bank accounts outside of the U.S. if the aggregate value of those accounts exceeded \$10,000 at any point in the tax year.

Certain investment income from outside of the U.S. can be problematic and have punitive or unfavorable tax implications. Income generated from Passive Foreign Investment Income; Controlled Foreign Corporations, Subpart F Income; Foreign Personal Holding Company Income and Foreign Partnership Income fall into this category.

FAMILY MATTERS AND TAXES

On a more personal note, living a global lifestyle is often linked with marriage to someone who is not a U.S. citizen or permanent resident. Americans often wonder what kind of impact this will have on their tax liability. First, it is important to determine if such a couple has “community” income or “separate” income in order to determine what to report on the U.S. tax return. Couples in this situation generally benefit the most from using the *Married Filing Separate* filing status. However, if the couple has children and the American provides over half of the support for the children, filing under the Head of Household status can be more beneficial.

Another key factor to consider is that the unlimited marital exemption on gifts and estate transfers does not apply when an American marries a person who is not a U.S. national or permanent resident.

These couples can also make a one-time election to file a joint return for the year of election and all future years. This can be beneficial if a (nonresident) spouse has very little income or if a (nonresident) spouse has income taxed in a very high tax bracket and the American spouse is taxed in a low tax bracket. This election can only be made once, and is valid for all future years unless revoked. Neither spouse can ever make the election again, so both the election and revocation need to be considered carefully.

Americans who live abroad and marry a nonresident should consider that they may, at some point, wish to return to the U.S. Those who wish to return with a nonresident alien spouse will need three years of U.S. tax returns to obtain a spousal visa.

Every person’s individual circumstances are unique and regulatory and tax regulations vary substantially by country. Therefore, it would be wise for expats, or those planning to embark on an expat experience, to seek out tax specialists to advise them.

→ HOW DOES REAL ESTATE FIT INTO MY FINANCIAL PLAN AND WHAT ARE SOME OF THE SPECIAL CONSIDERATIONS FOR AN EXPAT?

One of the first and most important decisions facing American expats is how to satisfy their housing needs while living abroad. This usually means coming to a decision about whether they should purchase a home overseas or rent.

RENTING VERSUS OWNERSHIP

Depending on the country, it is common for there to be a tax advantage to owning a home due to a mortgage interest deduction similar to that of the U.S. With many income tax structures being much higher than the U.S, this can be quite advantageous.

However, American expats can also receive a substantial tax benefit from the deduction of certain rental expenses while abroad. This special expat tax benefit can serve to diminish the overall appeal of home ownership. Many foreign countries impose significant transfer taxes on the buyers of real estate, which are often in addition to selling expenses borne by the buyer. Taken together, these costs can add anywhere from 10%-15% to the purchase price. This factor contributes to the trend in most foreign countries to staying in the same home for much longer than in the U.S.

American expats also face a little understood but potentially severe tax risk based on foreign currency exchange rates when buying and selling real property abroad. Because Americans must report all currency gains to the IRS, it is possible for American's to incur a significant tax liability due to either a capital gain on the sale of their home or an exchange rate gain on the retirement of their foreign mortgage debt. These outcomes can occur even if the homeowner actually suffered a net loss on the sale of the home. It should be said that during periods of either a weakening or strengthening dollar, American expats face a significant tax risk derived exclusively from exchange rate fluctuations when owning real estate assets abroad, especially if the purchase is financed with a foreign mortgage. This foreign exchange risk is amplified by the value of the home.

Many more Americans are adopting a more global lifestyle, and thus have a higher likelihood of moving around between different countries either for work or for personal reasons. Given this higher likelihood of mobility, expensive transfer costs and potentially higher tax bills on the sale of property serve to further lessen the appeal of home ownership abroad.

RETURNS ON REAL ESTATE AND ESTATE TAXES

When considering a residence from an investment perspective as part of an overall asset allocation strategy, it is important to understand that typically residential real estate has risen at about the rate of inflation over the long term. Obviously this is a generalization

and there will always be locations in which real estate returns are above average. While significant wealth has been created through home ownership, there are also considerable costs including transfer taxes, annual property taxes, mortgage interest and maintenance expenses which are often not considered when analyzing the investment return of home ownership. This is in addition to the time spent on home improvement, maintenance and management.

Estate taxes on real estate assets are another risk to Americans. Generally, real estate is a taxable asset in the country in which it is located. This can cause a situation where the real estate falls outside of your overall estate plan which leads to higher probate expenses and delays, and often higher estate taxes than anticipated. The ownership of any real estate asset should be considered independently by an estate planning expert in the country in which it is located.

PROCEED WITH CAUTION

Americans living abroad must consider the potential downside of home ownership along with the well-accepted benefits. In many cases, an expat lifestyle and tax status serve to make ownership a less obvious choice. In order to break even, we recommend that expats be prepared to own a foreign home for at least 5-7 years. In any event, purchasing a home that is reasonably priced and below one's maximum buying power would decrease potential risk associated with a short holding period and taxes from foreign exchange gains. Given the mobility of expats mentioned above and the potential tax pitfalls, the financial benefits of foreign home ownership are often diminished compared to those of people living in the U.S.

ABOUT MAXIM GLOBAL WEALTH ADVISORS

Maxim Global Wealth Advisors provides holistic wealth management solutions to internationally-mobile families with ongoing U.S. tax reporting. We specialize in investment management, tax strategies and financial consulting for American expatriates.

Maxim designs investment programs to communicate and comply fully with U.S. and international tax authorities, while focusing on optimizing the efficiency and coordination of assets in order to maximize returns and preserve capital.

Like you, we realize that there's more to life than money, but you've worked hard to get where you are and you want to be smart about your future. We can help.

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