Addressing Critical Questions for International Families with U.S. interests

ABERDOUR INVESTMENTS

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About Aberdour Investments

Independent,

Fee Only,

Fiduciary,

Advice.

Financial Planning & Asset Management

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I have lived the journey of moving to the U.S. navigating everything from learning new vocabulary and establishing credit to business ownership, gaining green card status and ultimately citizenship.

It isn't an easy journey - the challenges of managing finances across borders are real.

My hope for this eBook is to serve as an introductory guide to the obstacles and issues most global families will experience as they arrive, settle and then perhaps leave the U.S.

About me:

- Born in Edinburgh, Scotland Chris Saxton emigrated to the U.S. in 2004 with his wife ultimately becoming dual citizens in 2018
- Chris worked as an engineer designing jet engines for Rolls Royce before taking the opportunity of a lifetime to move to the U.S. They have lived in Arizona, California and Minnesota.
- In 2016 he graduated with his MBA from the University of St. Thomas with a focus in finance, starting Aberdour Investments in 2019.
- Chris, Jo, their two daughters and Mungo the Cairn Terrier live in Shoreview, Minnesota

Contents

An introduction to financial concerns for globally oriented families

Globally oriented families experience unique and complicated questions with regards to their financial situation and the potentially fluid nature of their country of residence.

This guide is intended to be an introduction to the types of financial issues globally mobile families experience. These include:

- Relocation, ex-pat assignments & immigration
- Banking, currencies and cash management
- Real Estate - both residences & for investment purposes
- Taxation in the United States & abroad
- Entrepreneurialism & business ownership
- Investments & asset allocation
- Retirement planning
- Estate planning

Chapter 1
Who are we able to serve?

1. Who are we able to serve?

- We specialize in catering to globally mobile families with financial ties to the United States, whether they are citizens or residents of the country or simply have assets located here.
- A sizeable global community of people exists throughout the world who have financial affairs in the United States and at least one other country.
- The majority of this community consists of international knowledge workers and other middle and senior-management professionals, typically employed by larger corporations.

1. Who are we able to serve?

Example of who might benefit: Andrea

- Andrea, an English marketing executive employed by a prominent London-based company, is initially relocated to the Hong Kong office before being later transferred to the U.S. headquarters.
- She marries a Chinese man and they have two children.
- Throughout their journey, they open various accounts and investments in both England, Hong Kong and the U.S.
- They embark on the process of obtaining green card status, with the aspiration of providing their children with education at U.S. universities.

1. Who are we able to serve?

Example of who might benefit: Neill

- A highly skilled computer programmer employed by Google DeepMind, London engages in research for his Ph.D taking him to Brazil, where he marries a Brazilian national.
- Ultimately they establish residence in Silicon Valley, intending to make the U.S. their permanent home.
- Throughout this journey they accumulate various assets, bank accounts, retirement funds, properties, and even business interests.
- Extremely busy with his professional endeavors, he may not have dedicated sufficient time to focus on managing these assets and planning for the future.
- Consequently, he may encounter challenges of unknown financial hurdles, navigating a complex legal, financial, and regulatory landscape, and dealing with a scarcity of comprehensive sources of information.

Chapter 2
U.S. Tax Status & Residency

2. U.S. Tax Status & Residency

There are three types of cross-border families when it comes to U.S. tax status.

1. Foreign nationals in the U.S.
2. American citizens & permanent residents living abroad
3. Foreign nationals with assets in the U.S.

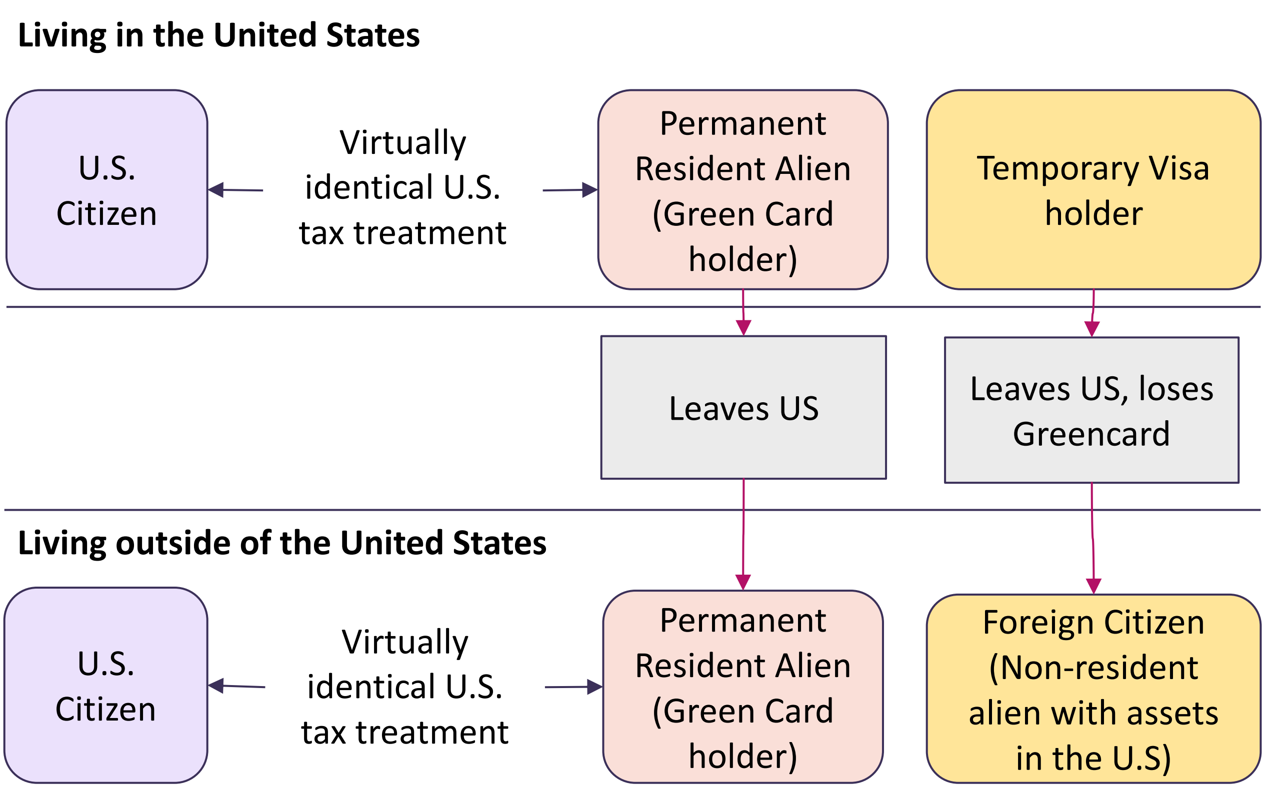
The intricacies of cross-border taxation

Professionals engaged in cross-border activities encounter a highly intricate tax landscape. The United States stands out as the sole major nation that imposes taxes on all its citizens and tax residents based on their global income and assets, irrespective of their current residency status in the U.S.

Furthermore, tax laws are evolving swiftly, leading to increased transparency in the reporting of foreign assets.

2. U.S. Tax Status & Residency

The common thread between U.S. citizens moving abroad or foreign nationals moving to the U.S. and even becoming citizens is the fact that there will be assets in more than one country and thereby subject to more than one set of laws and regulations.



Chapter 3
Challenges of the Regulatory Landscape

3. Challenges of the Regulatory Landscape

The unequal nature of tax regimes & reach

- Most countries tax on residency

  i.e. If you are living and working in Germany then you will be taxed in Germany

- The United States is unique among major nations in taxing the worldwide income of all its citizens and residents, irrespective of their current place of residence.
- Fortunately, an intricate system of foreign tax credits ensures little or no double taxation.

Recommending against secretive offshore wealth strategies

- FATCA (Foreign Account Tax Compliance Act)

  1st phase required non-US companies to report if their clients are U.S. citizens or tax residents

- While there is a broad range of complex offshore wealth strategies available, adhering to U.S. tax law reveals that only a limited number of these are practical and low-risk.

Chapter 4
401(k) issues for Global Families

4. 401(k) issues for Global Families

Almost everyone should capitalize on the tax-deferred benefits that 401(k) plans offer.

Do my 401(k) benefits stay with me?

- In most cases, the tax advantages of a 401(k) will accompany you, regardless of your future destination, be it returning home or moving to a third country.
- However, there are some countries where this is not explicitly supported by legal provisions.
- International tax laws are likely to undergo changes over time.
- The accounts themselves remain within the jurisdiction of the United States.

4. 401(k) issues for Global Families

Is it necessary to file a U.S. tax return if I have a 401(k)?

- The answer hinges on your individual circumstances, but in many instances, the response is no.
- The United States imposes taxes on all its citizens and residents for their global income, regardless of their location in the world.
- If you maintain U.S. citizenship or permanent residency (Green Card), you are required to file a U.S. tax return, irrespective of your place of residence.

How are distributions from the 401(k) taxed?

- At some point, you will commence withdrawing from your 401(k), either voluntarily or due to Required Minimum Distributions (RMDs).
- Typically, the IRS issues a 1099-R, expecting a tax return to be filed.
- For U.S. citizens and tax residents residing in the U.S., the process is relatively straightforward. Distributions from qualified retirement accounts are taxed as ordinary income for both federal and state purposes. These distributions are added to any earned income, investment income, or other taxable pension income.

4. 401(k) issues for Global Families

What if you withdraw money while living abroad?

- In such cases, the situation can become significantly more complicated for expatriates.
- Most countries have a tax treaty with the U.S. that governs which country has the primary right to tax pension payments and qualified account distributions.
- Generally, the country in which you currently reside will have the first right to tax.

If you are a non-resident living outside of the United States:

- It is probable that you will be taxed on your withdrawals, including distributions from 401(k) and IRA accounts, in the country of your current residence.
- However, it is also likely that the U.S. institution holding the account will withhold some tax to be remitted to the IRS for potential taxes owed.
- If you are living abroad and are a U.S. citizen or tax resident, the distributions typically need to be reported as income in both the U.S. and your resident country.
- You will receive a 1099-R from the account custodian - the IRS expects your return to reflect that income. It is your responsibility to report the taxable distribution to your country of residence.

4. 401(k) issues for Global Families

What if you withdraw money while living abroad? (cont.)

If you are a non-resident living outside of the United States:

- If the foreign country asserts the primary right to tax that distribution, a foreign tax credit could be utilized in the U.S. to prevent double taxation of the income.
- It is crucial to seek expert advice within your resident country or the country where you expect to reside when you commence taking distributions, as each tax treaty is unique.

Tax withholdings on distributions for non-residents:

- The institution holding your account is likely to withhold taxes for potential U.S. tax obligations before disbursing the funds to you.
- Most types of U.S. source income paid to a foreign person are subject to a mandatory withholding of 30%.
- It's worth noting that many U.S. institutions may over-withhold tax on distributions, even when presented with evidence that a country's specific treaty calls for a lower rate.

4. 401(k) issues for Global Families

What if you withdraw money while living abroad? (continued)

How do foreign residents recover U.S. withholding tax?

- Due to uncertainty regarding the appropriate withholding tax for payments to non-residents, individuals are addressing this challenge through two distinct approaches:

  1. The more correct method involves foreign residents reporting "pension income" to their resident country and paying taxes on it. Subsequently, these individuals can file a non-resident tax return in the U.S. to reclaim the withheld taxes.

  2. The alternative scenario, while more common, is less correct. In this case, foreign residents receiving 401(k) and IRA distributions may not report this income in their resident country since taxes were already withheld in the U.S. It's possible that a local tax advisor might also determine that no further reporting is necessary.

- However, this second scenario is likely not the correct tax treatment and could pose long-term issues. Many foreign countries may retroactively investigate improper reporting over several years. While amended U.S. returns can be filed, they are typically only allowed a potential refund for the prior three tax years. For years preceding that period, individuals might find themselves effectively paying double tax.

4. 401(k) issues for Global Families

Contributions to IRA accounts while residing abroad:

- For U.S. citizens and tax residents living internationally, there is often significant confusion regarding whether they should contribute to their pretax savings plans, such as IRAs, in the U.S. In many cases, it is advisable to refrain from making such contributions.
- Individuals working abroad on short-term foreign assignments may operate under an expatriate agreement, remaining on the company's U.S. payroll and being fully insulated from the effects of foreign taxation (a tax-equalized contract). In these instances, it is generally acceptable for the individual to contribute to their 401(k) plan throughout the assignment period.
- However, U.S. citizens and tax residents working abroad on a local contract, using a local payroll system, or in a self-employed capacity, will not have access to a U.S. 401(k) system. In most cases, they should avoid making pre-tax contributions to U.S. savings plans like IRAs due to the risk of paying taxes in a foreign country on earned income and potentially facing taxation again later in life when withdrawing funds from their pre-tax IRA.

Chapter 5
Foreign Pensions, Retirement Plans, & other Savings Accounts

5. Foreign Pensions, Retirement Plans, & other Savings Accounts

Global countries offer a diverse array of retirement plans.

- Many successful foreign professionals fully participate in U.S.-based retirement plans such as 401(k)s, IRAs, and Roth IRAs, a practice generally advisable due to the associated tax savings and other incentives.
- However, U.S. citizens and residents working abroad are faced with the decision of whether to participate in tax-advantaged foreign retirement plans.

The U.S. Tax Treatment of Foreign Retirement Plans is Frequently Unclear.

- The U.S. does not universally recognize the qualified status of most foreign retirement plans.
- Most tax treaties lack clarity on how different foreign pension programs and employer-based retirement plans will be assessed from a U.S. perspective.
- Most tax advisors might assume tax-deferred status for these retirement plans and treat them similarly to qualified U.S. plans when filing U.S. tax returns, this treatment is typically incorrect.
- Future increases in cross-border information sharing between countries may bring new attention to this area.

5. Foreign Pensions, Retirement Plans, & other Savings Accounts

Contributions by U.S. citizens and residents to foreign plans

- We typically recommend individuals participate in these plans if they are planning to be abroad for a few years,
  - However, they need to be willing to handle the increased complexity associated with such participation.
- Contributions to these plans are seldom tax-deductible with the IRS, but working within a country with higher tax rates than the U.S. could result in tax savings, possibly even benefiting from an employer matching.
- Thanks to foreign tax credits and exclusions from U.S. taxation, foreign retirement contributions often effectively escape taxation in the U.S., even though they are reported on a U.S. tax return.
- When residing in a foreign country and contributing to a foreign pension plan without taking a U.S tax deduction, it is crucial to carefully track these contributions.
  - Upon eventual distribution of the retirement funds, tax will only be levied on the growth in the account, not on the original contributions.

5. Foreign Pensions, Retirement Plans, & other Savings Accounts

Contributions by U.S. citizens and residents to foreign plans

- This strategy involves taking the deduction at the higher tax rate in a foreign country, covering any "net" U.S. tax with foreign tax credits. Later in retirement, the individual can distribute the money in the U.S. without paying tax on the original contributions, as they were after-tax for U.S. purposes.

Investing Inside a Foreign Retirement Account

- In the past, numerous international retirement plans were characterized by inefficiency and subpar performance, frequently constructed within the infrastructure of insurance firms, significantly elevating plan expenses.
- Additionally, the investment options available within these foreign plans often consisted of poorly performing proprietary funds. A more preferable scenario involves "open architecture," where high-quality investments from various managers are offered based on their merits rather than the provider.
- Fortunately, in the last decade, there has been a positive shift, with several foreign retirement plans now structured like 401(k)s. These plans provide high-quality investment choices, including indexed funds with low fees.

Chapter 6
Roth IRAs & Roth 401(k)s

6. Roth IRAs & Roth 401(k)s

- Roth IRAs and Roth 401(k)s are valuable retirement savings vehicles in the U.S.
- They enable individuals to make post-tax contributions to an account that grows tax-free throughout their lifetime and often into the lifetime of their heirs.
- For instance, in a Roth IRA scenario, if you invest $100,000 and it grows to $400,000 after 20 years, both the initial $100,000 and the $300,000 gain are tax-free. This is particularly appealing compared to traditional 401(k) plans.

How to get money into a Roth IRA

- Getting money into a Roth IRA can be challenging as annual contribution limits are relatively small, and individuals with higher incomes may not be eligible to contribute at all.
- More recently, employer plans have started incorporating Roth 401(k) options, allowing for larger contributions as they match regular 401(k) limits. Those with higher incomes should carefully weigh the decision to pay up to 50% income tax in exchange for tax-free growth for life, considering that the immediate tax deferral of a traditional 401(k) may be more advantageous.
- Tax-deferred IRA accounts can be "converted" into Roth IRAs, requiring individuals to pay income tax upfront in exchange for tax-free growth in the future.

6. Roth IRAs & Roth 401(k)s

Foreign implications of Roth IRAs and Roth 401(k)s

- While the basic 401(k) structure (tax-deferred salary deferral) is well known around the world, the Roth structure is relatively new – as such few foreign governments have yet agreed to reciprocally honor this very generous tax-free account structure.
- For individuals planning to live in a foreign country later in life, there is substantial risk as most countries may not recognize the tax-free structure of Roth accounts.
- For a foreign citizen coming to the U.S. with plans to stay for life, the risks associated with a Roth structure are considerably lower.

Chapter 7
529 plans for Educational Savings

7. 529 plans for Educational Savings

- U.S. 529 plans share similarities with Roth IRA plans as they generally allow after-tax contributions into an account structure that provides tax-free growth, given that eventual distributions are used for qualified education purposes.
- These funds can be utilized for the beneficiary of the account, and it's easy to change the beneficiary from one child to another.
- This modern investment vehicle varies from state to state, with some offering a more cost-efficient structure and a wider range of investment options.

Start contributions when they are young

- To maximize the benefits of a 529 account, it's advisable to start contributions when your children are very young. Waiting until they are 14 or 15 may not yield significant tax-free growth over just a few years.

7. 529 plans for Educational Savings

Caution for Foreign Residents

- Similar to concerns with Roth plans, Educational 529 accounts are generally not recognized by other countries.
- If you plan to leave the U.S. before your child reaches university age, the funds in your 529 account may not be eligible for tax-free distribution, as your child won't be attending an accredited U.S. university (or a foreign affiliate of a U.S. university).
- In such cases, funds left in this account would need to be withdrawn and be subject to taxes and penalties.
- Seeking knowledgeable advice is crucial but challenging to find. It's important to seek expert advice within your resident country, considering that tax treaties between the U.S. and individual countries are all unique.