



## **American Expat Tax Saving Strategies**

The 'expat life' has numerous advantages, but a drawback to being an American expatriate is remaining subject to the US tax code. The US tax code reaches across borders, taxing us regardless of where we call home. The law requires us to pay taxes, but there are a number of ways to minimize the amount owed.

### **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 '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.

Governments around the world are sharing more and more information every day. A number of tax havens which prided themselves on strict client privacy laws that withstood wars and pressure from powerful states are finally cracking under the pressure. Some countries which withstood outside pressure have been undermined by rogue employees - for example [when a bank clerk in Lichtenstein sold a DVD](#) of client information to German, British and American authorities.

If an American controls financial accounts outside the US whose aggregate value is greater than \$10,000 at any point during the year – they must file a [Treasury Department Form 90-22.1](#). With an out of control deficit and the stigma attached to tax hikes, the government recognizes 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,' as this exposes you to the risk of serious civil and criminal penalties.

Tax treatment of offshore investments varies, and a number of offshore strategies designed to save taxes ironically increase your tax bill. For example, if the IRS considers your tax-saving strategy to be a Passive Foreign Investment Company (PFIC), allocated gains and excess distributions are taxed as income at the highest rate applicable. In addition, deferred tax liabilities are treated as an underpayment of tax. It's generally a good idea to get a written opinion from a CPA if your primary goal in moving assets offshore is to lower your tax bill.

### **A Better Way**

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

### ***Tax Efficient Investments...***

The primary goal of investing is not to save money on taxes and fees. The primary goal of investing is 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. Some foreign index funds can also provide diversification away from the US dollar.

### ***Managed Well...***

Regardless of what stocks or funds you invest in, 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 these types of strategies do not work for anyone over the long run. Trading should be based on your personal situation, along with periodic rebalancing. Rebalancing realigns the portfolio with the appropriate level of risk, and encourages buying low and selling high when the natural urge is to do the exact opposite. Other examples of strategies to reduce your tax bill include selling securities on the basis of highest in/first out, and tax loss harvesting with similar but not identical securities.

### ***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 non-qualified 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 US – for example to minimize currency risk for upcoming expenses. However, if your primary goal is to lower your tax bill, the vast majority of Americans are better served keeping money in the US rather than moving it to a tax haven. Mass marketed offshore solutions sold by unregulated salesmen are best avoided. Customized offshore strategies created by highly skilled professionals can make sense for some high net worth individuals, but for most people the costs outweigh potential benefits.

US 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. Fortunately, there are a number of effective ways to decrease your tax bill with money in the US. Americans living abroad without any ties to an address in the US can open an account with US-based brokerages that are set up for it, for example the foreign branches of Charles Schwab and E\*Trade.

Using the tax minimization strategies outlined above with money in the US, 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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