INTRODUCTION

The passage of Foreign Account Tax Compliance Act (FATCA) in 2010 ushers in a new era of global tax transparency that enables the IRS to aggressively pursue Americans with assets outside the United States that have either not been reported or not fully reported on U.S. tax returns. Media coverage of FATCA usually overlooks the fact that foreigners in America are also highly exposed to the government’s offshore dragnet. The FATCA regime of cross-border tax reporting is as likely to uncover unreported assets owned by foreigners resident in the U.S. (and hence U.S. taxable) as Americans with assets abroad.

Failure to understand the basic rules of U.S. tax compliance when it comes to cross-border investing can jeopardize an international family’s ability to successfully build wealth through effective investing and financial planning. At worst, it can expose taxpayers to costly and punitive tax penalties.

On the pages that follow, we summarize the top ten most common tax and investment mistakes made by foreigners in America:
1. **Failure to report investment income from assets held outside the United States**

Foreign nationals resident in the United States (with some exceptions) are subject to U.S. taxation on their world-wide income, just like U.S. citizens. Nevertheless, foreigners in America routinely fail to report foreign financial assets (usually acquired before coming to America). Waiting years or decades to fully report foreign assets is likely to result in large tax penalties and require expensive legal redress to become compliant.

2. **Failure to understand the implications of FATCA**

In 2010 the U.S. passed into law the Foreign Account Tax Compliance Act. FATCA creates a system of mandatory reporting by foreign banks and governments around the world on ALL U.S taxable persons (including foreigners resident in the United States) Before FATCA, failure to disclose non-U.S. assets and income was very rarely uncovered by the IRS. Now, however, FATCA provides tax transparency were previously there was none. Ignoring these issues is no longer a viable strategy.

3. **Allow tax complexity to deter investing and retirement planning.**

Many foreigners who come to America find themselves overwhelmed by the complexity of U.S. taxation. The frequent result is that they do not invest at all. This outcome preempts the savers from benefiting from the very consistent long-term growth of a well-diversified, efficiently managed investment portfolio. Every immigrant deserves the opportunity to have their money work as hard as they do. Invest the time to figure out the basics of investing and retirement planning and seek out good financial advisors.

4. **Failure to purge U.S. tax toxic investments BEFORE arriving in America**

When legacy foreign assets include pensions, mutual funds, business interests, trusts or cash-value insurance policies, severe complications often arise because of punitive tax rates and complex reporting rules that the U.S. tax code imposes on these foreign assets. Ideally, new residents of the United States should develop a plan to deal with these tax issues before arrival in the United States. Pernicious outcomes may be mitigated if the assets are reported properly from the begin-
Be aware that the best strategy is often to sell assets that are particularly U.S. tax toxic.

5. **Disregard U.S. Foreign Trust Reporting Rules**

Foreign trusts are particularly common tax time bombs that lurk undetected in the old country investment portfolios of many new arrivals to the United States. Many structures (including pension funds and family businesses) often meet the IRS definition of a foreign trust even though they are not commonly thought of as trusts. Unfortunately, many new Americans and new green card holders go years without properly reporting interests in foreign trusts, only to find out that cleaning up the problem is costly and time intensive. Where a U.S. taxable person has a beneficial interest in a foreign trust, the trust must provide a detailed accounting of its activities, or the beneficiary will be subject to punitive tax rates on distributions.

6. **Ignore Estate Tax Implications of Assets Retained in America After Returning Home.**

Foreigners in America who acquire U.S. assets and then leave the United States and continue to own those assets need to be aware of U.S. estates tax rules. The U.S. imposes estate tax (at rates rising to 40%) on U.S. assets (called “U.S. situs assets”) above a low $60,000 exemption threshold when those assets are owned by foreigners not resident in the United States (so-called “non-resident aliens”). The most common assets subject to this tax are real estate and U.S. stocks (see Investing and Financial Planning for Foreign Nationals in the U.S.). In some cases, this exemption is overridden by estate tax treaties the United States maintains with sixteen countries around the world. Where no applicable treaty exists, however, large potential estate tax burdens face non-resident aliens with U.S. situs assets.

7. **Cash Out of Retirement Account When Leaving the U.S.**

Many foreigners build up substantial U.S. retirement account (401ks, IRAs, etc.) balances during their working years in America. Deciding what to do with these accounts when they leave the U.S. can be a daunting task. Generally, high taxes and early withdrawal penalties will apply if the accounts are cashed in before retirement age (59 ½). Furthermore, U.S. retirement account investment options are often much better than investment options available back home. On the other hand, a U.S. retirement account is considered a “U.S. situs” asset, which means it will be subject to potentially substantial U.S. estate tax if the non-resident alien holder dies still owning the assets (see above). A strategic distribution plan should be adopted that optimizes for both income tax and estate tax.

8. **Failure to Make Proper Treaty Claims.**

Many foreigners who are subject to U.S. or foreign tax on investments held across borders can commonly reduce or eliminate the tax and withholding by making timely tax treaty claims on the basis of one of the sixty-eight tax treaties and eighteen estate tax treaties that the U.S. maintains with other countries. Unfortunately, taxes are often withheld because a timely election was not made and a tax paid was not recovered because the taxpayer and/or their tax adviser was not aware of the tax treaty provisions available.
9. Failure to recognize the benefits of leaving assets in U.S. investment accounts even when leaving.

In many cases, leaving financial assets in the United States may be a surprisingly advantageous option for non-Americans. Financial assets held by foreigners are not subject to U.S. capital gains tax. Dividends and interest will be subject to a withholding tax at a rate of up to 30% (usually reduced to 10% or 15% by treaty). This withholding tax, however, can usually be recovered as a tax credit in the country of residence. The net effect, therefore, is that investors, even after returning to their home country or to a third country can continue to benefit from the generally superior investment environment available in the United States. These investment advantages are substantial and include low fund and brokerage fees, greater range of investment options and greater market liquidity.

10. Become victims of tax and investment scams in the U.S. and abroad

Foreigners are often attractive targets for investment scams and “off-shore” tax avoidance schemes because they lack a basic understanding of the U.S. tax and investment landscape. There is no free lunch and risk-free, tax free investments opportunities do not exist. The reach of the IRS is long and the impunity of the scammers is unfortunately pervasive.

11. Failure to recognize the unique tax penalty imposed on foreigners investing in U.S. real estate

Direct ownership of real estate is subjects the foreign, non-resident investor to having to prepare annual federal income tax and state income tax filings. Furthermore, real estate holdings subject the foreign, non-resident to a more complicated tax regime – the Foreign Investment in Real Property Tax Act (FIRPTA), which creates complicated withholding requirements on the gross proceeds when a foreign, non-resident, a foreign trust, or even a foreign partnership sells U.S. real estate. Furthermore, foreign direct ownership of U.S. real estate will subject the non-resident’s estate to U.S. estate tax because real estate is a U.S. situs asset. A diversified portfolio of liquid securities not only provides superior investment outcomes, but also generally creates far fewer compliance, tax and probate issues.
Editor’s Note: We realize that our “top ten” mistakes list eleven mistakes. At the risk of excluding a mistake of which readers should be aware, we’re leaving eleven top-ten-worthy mistakes to avoid.

**Thun Financial Advisors Research** is the leading provider of financial planning research for cross-border and American expatriate investors. Based in Madison, Wisconsin, David Kuenzi and Thun Financial Advisors’ Research have been featured in the *Wall Street Journal, Emerging Money, Investment News, International Advisor, Financial Planning Magazine* and *Wealth Management* among other publications.

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