A KMI report

For all our American Investors

[The below is from a US tax lawyer/client of KMI, who has kindly given this overview of an American's tax obligation when overseas. This advice is given in good faith but neither KMI or our client take any responsibility for the advice given below we recommend you always check out your personal circumstances before investing]

Many Americans think that moving overseas creates a complex tax situation for them in the States. But that doesn't have to be the case. Depending on your circumstances, you can keep your U.S. tax obligation (remember, it follows you anywhere in the world) straightforward.

In fact, if you're an American living or retiring outside the United States, you'll likely find that the annual tax return you file with the IRS is not any different from the one you filed before you took off for foreign shores. If you're retired on a pension or Social Security, earning interest and dividends from your investments, or drawing down on your 401(k) or IRA, your move to another country is a tax-neutral one as far as Uncle Sam is concerned. The only change you'll need to make to your U.S. federal return is the return address.

Remember, as a U.S. citizen, you're taxed on your worldwide income no matter where you live. This means that all of these income categories are taxed the same even if you retire overseas.

What if you own a rental property overseas? Not a big deal. Your U.S. return won't be much different than if that rental were located somewhere Stateside. Rental income, depreciation, and expense deductions are all treated the same from a U.S. tax point of view no matter the location of the property. You can even do a 1031 like-kind exchange of one foreign investment property for another, but that's a discussion for another time.

Your U.S. tax return gets more complicated when you start earning income outside the United States. The Foreign Earned Income Exclusion (FEIE) for 2009 is US$91,400 (it's US$91,500 for 2010). This means you can earn up to US$91,400 while living and working outside the U.S. and have it excluded from your U.S. taxes.

It's important to understand, however, that this exclusion doesn't apply to interest, dividends, or any other passive investment income, such as rental income. In other words, for the most part, most U.S. retirees abroad don't qualify for the FEIE. It's a big advantage for anyone living outside the States and earning income abroad...but that leaves most retirees out.

However, originally, the FEIE exclusion took your foreign-earned income off the top of your total taxable income, and your tax bracket was calculated using the reduced income total. If you had total earned income for the year of US$120,000, between the exclusion amount and other deductions, you may have had taxable income of, say, US$10,000. Originally, the IRS taxed on that US$10,000 at rates for US$10,000, meaning you enjoyed the lowest tax bracket.

However, a few years ago, the IRS changed how they make this calculation. Now, your tax bracket is figured before the exclusion is applied. That means that, now, if your total earned income is US$120,000, that's the tax bracket brought to bear. Bottom line, your US$10,000 of taxable income is now taxed at a much higher rate.

Here's another "overseas" tax complication to keep in mind if you're an American, even one residing in the United States: Uncle Sam wants to know about every non-U.S. financial account you hold if the total value of the accounts is US$10,000 or more.

This doesn't mean any individual account worth US$10,000 or more, as many people have tried to claim. US$1,000 in each of 10 accounts qualifies for the reporting, for example.

Many people don't like the idea of reporting their offshore financial accounts to the IRS, so they don't. This is a big mistake, and I strongly recommend you not make it. The penalties for not reporting offshore accounts are extremely high, and the IRS is aggressively going after people who aren't reporting them.

What qualifies as a financial account? A bank account, a brokerage account, effectively any account that holds cash or securities.

A safe deposit box where you store bearer bonds doesn't count as an account, but transporting the bonds personally from the United States to the country where the box is located does technically trigger the customs reporting requirement, both when you leave the United States and as you enter most other countries.

Note that the IRS reporting form asks you to detail offshore financial accounts...unless you hold 25 or more of them. In this case, you're asked simply to tick the appropriate box indicating that you've got the multiple accounts overseas. I'll leave you to draw your own conclusions from this.

All financial accounts must be reported...but real estate holdings need not be. No IRS reporting requirement exists for real property...unless you're earning rental income from it or until you sell it and realize a capital gain. Simply buying or holding a piece of real estate in another country isn't reportable, which is why I recommend non-U.S. real estate as an important part of any asset protection program.

One mistake people for whom not reporting to the IRS is an agenda make is holding the non-U.S. real estate in an offshore corporation. The offshore corporation *is* reportable to the IRS if it's a U.S.-controlled foreign corporation (that is, if it's owned by U.S. citizens). The reporting requirements for offshore corporations are beyond the scope of this Tax Day report, as they can get complicated. Suffice it to say that the financial statements—income statement and balance sheet—of a reportable foreign corporation are to be filed with the IRS each year