

The Intricacies of Working with Cross-Border Clients

by Nancy Opiela

If you're one of the few professionals specializing in cross-border financial planning, it's not uncommon that you'll get a question along these lines from a colleague: "I have a foreign national client who has left some accounts back in his home country. That's not a problem, right?" In most cases, however, it could be a very big problem. And often there's planning that could be done before a client moves to the United States to ensure that there are no financial surprises.

We spoke with financial planners who work with clients who are citizens of foreign countries but live in the United States. In addition to illuminating a growing market niche, their stories may raise issues you'll want to explore with your clients who are not U.S. citizens. While tax laws and other government regulations differ from country to country, the planners we spoke with agree on one thing—crossing an international border without advance planning spells trouble.

As soon as you put one foot over the border and establish residency in the United States, you lose a lot of the planning opportunities, says Brian Wruk, CFP, of Transition Financial Advisors in Gilbert, Arizona. He has a dual CFP certificate in Canada and the United States and is a citizen of both countries. In fact, Wruk's such a believer in the importance of advance planning that Canadians about to move to the United States are the focus of his newly formed firm. He has worked with Canadians moving to the States to work for companies such as IBM, Hewlett Packard and Intel.

Explains Wruk, "I tell my clients, 'Imagine you are going to a dinner theater and the Internal Revenue Service is in the audience. You have one chance to set up the stage before you fling the curtains open. Once you step across the border and take up residency, the curtain flies open and the IRS sees whatever you have. Many people blindly move across the border and open the curtains before they realize that they could have taken advantage of a valuable planning opportunity. You have a chance before you leave Canada, before the curtain opens to set the stage to your advantage. That's what I help people do.'"

North of the Border

As you might expect, many foreign citizens who cross American borders, and end up working with American-based Certified Financial Planner professionals, come from Canada. Perhaps because Canada is a neighbor, most of these Canadian citizens assume they can move back and forth with relative freedom and ease. Explains Tom Connelly, CFP, of Keats, Connelly & Associates in Phoenix, Arizona, "People who come to see us *after* they move to the United States have cost themselves thousands of dollars. I had a call for a rep at a well-known broker/dealer and he had a Canadian with an RRSP (Canada's registered retirement savings plan) who wanted to bring it down here. His compliance people told him the client could roll the RRSP into an IRA in the United States. Thankfully, something told him to get a second opinion. The fact that that kind of advice is coming from the higher ups at a broker/dealer is terrifying."

Adds Connelly's partner, Robert Keats, CFP, "Often when a company transfers an employee to the United States from Canada, part of the deal will be to have the company accountant do the taxes the following year. That gives the individual being transferred a false sense of security. The tax return is completed long after the person has exited the country and it isn't necessarily done correctly. We've seen these firms make huge mistakes that cost the client a tremendous amount of money."

Keats, a dual citizen of Canada and the United States, literally wrote the book on cross-border planning. His *Border Guide*, a long-time bestseller in Canada, will be released in the United States later this year. But so prevalent are the questions from other planners that Keats, Connelly & Associates has formed a sister company—Cross-Border Tax and Accounting—to do limited-scope consulting projects. While the firm specializes in Canada-U.S. cross-border planning, it has the resources to do tax work and planning for other foreign nationals.

Canada-U.S. Tax Issues

Like Keats, Connelly and Wruk, Claudia Freeman, CFP, in the Institutional Trust area of Comerica Bank in Detroit,

Michigan, works with many Canadians. She brings a unique personal perspective to her work in an interesting cross-border niche. Born and raised in Chicago, she went to the University of Windsor in Ontario, Canada, where she met her husband-to-be, who is from Windsor. She has lived in Windsor for 25 years as a U.S. citizen and has worked on both sides of the border. At Comerica Bank, she administers 401(k) plans for a variety of companies and designs and delivers employee financial education.

Says Freeman, "I live in an area where the cross-border issues are prevalent for a lot of people. There are many people who live in Windsor and commute to the Detroit area to work. It's a very easy commute—just over half an hour. When I travel back and forth to work, it's amazing to see the increase in traffic over the years. More and more people are living in Canada and working in the United States. The free trade agreement loosened things up and there is such a demand for people in information systems, nursing and education. It's pretty easy now for Canadians to work in the United States. I couldn't say that ten years ago. You had to be able to prove that what you were doing couldn't be done by anyone else."

In fact, there are a number of Canadian citizens working at Freeman's bank. And questions from Canadians working in the United States are becoming increasingly common after her presentations for local companies. Questions fall along these lines: "I'm living in Canada and working in the United States. Should I contribute to the 401(k)? What are the tax implications?"

Freeman's answer? "It depends. Probably for a lot of people, no, but as with anything, you don't want to generalize. There are a number of factors to consider."

First, Freeman notes, if a Canadian resident contributes to a 401(k) in the United States, they don't get the tax deduction. "When filing the U.S. return, net income can be reported. But when filing the Canadian return, which they have to do because they reside in Canada, they have to report their gross income. Canada does not recognize a foreign pension plan. So you don't get the tax deduction. Of course, you get deferral on the earnings, and if your company matches contributions, you have that to gain. So sometimes it makes sense to contribute to the match to get the free money."

There's a second factor to consider, says Freeman: If the employee is living in Canada, he or she can contribute to Canada's RRSP. "It's very similar to an IRA other than the fact that you can put up to \$13,500 a year in if you don't belong to a pension plan. If you belong to a pension plan, then the amount is reduced using a formula based on particulars of your pension plan."

Freeman explains that if a Canadian resident participates in a pension plan or a defined benefit plan, 401(k), or 403(b), there's a box that's checked off on their W-2 form.

"As a Canadian working in the United States and reporting U.S. source income in Canada, you need to send a copy of the U.S. return and the W-2 with the Canadian form. The Canadian government sees that the box on the W-2 is checked and reduces what you can contribute to an RRSP by ten percent of your gross income. That may be harsh depending on what your pension is."

Freeman notes, however, that if the employee's company has a pension, the box will be checked whether or not he or she contributes to a 401(k). "In that case, because the amount you can contribute to an RRSP will be reduced, it may make sense to contribute to a 401(k). If you don't have a pension plan, the box won't be checked unless you contribute to a 401(k)—so then you have more of a decision to make," she explains. "The Canada-U.S. tax treaty tries to circumvent the problem of double taxation, but it doesn't hit every area. I think the 401(k) is one of those areas where there is a hole."

Robert Keats agrees with the importance of understanding RRSPs. "These accounts grow without any tax on current basis, and Canadians think they can cross the border and the United States is going to look at those retirement accounts the same way," explains Keats. "Sometimes, they could be down here 10 to 15 years before they decide they are going to draw on them. All of a sudden, there is this huge tax liability because in the United States they should have been paying taxes on the income in those accounts all along. The alternative is that they could use an election in the Canada-U.S. tax treaty to help them to defer the taxes."

If a client has an RRSP in Canada and moves to the United States, what should they do? Of course, it depends on the circumstances; however, says Keats, there are 10 or 11 reasons for taking your retirement account out if you are moving to the United States and maybe only one or two lesser reasons for leaving the account in Canada. "There are lots of techniques to get the assets out at the lowest possible tax rate. If you do the planning properly, you can get it out at pretty close to zero tax and set it up in the United States as a regular investment portfolio—or contribute it to a U.S. plan gradually over time. Use it to fund other accounts and get a tax deduction for it," he explains.

Another major tax mistake Canadians moving to the United States make, according to Keats, involves the Canadian deemed disposition tax. "Unlike the United States, Canada doesn't tax its citizens once they leave the country. However, there's an exit tax, the deemed disposition tax, and most people either fail to do the deemed disposition at all or fail to do it correctly and end up getting double-taxed."

Brian Wruk concurs. Without advance planning, people can be hit hard by the deemed distribution tax, says Wruk. "Recently, I worked with an employee of a company in Canada who had a relocation team show him around Phoenix. But they didn't pay any attention to his finances and as a result he owed \$60,000 in taxes to Canada. He was furious at the company."

Other Cross-Border Considerations

When talking about issues that can be addressed in advance, these planners say more attention should be paid to immigration planning. "Many people come over accepting a job offer and take a very short visa, one or two years and they end up being trapped," explains Keats. "They've invested in a house, their families get comfortable here and all of a sudden their visa expires and they can no longer work. Often, the company that sponsored them for the visa knows that and uses it as leverage to get the employee to do things they might not do otherwise—like working longer hours for less money. To protect our clients, we make sure that the immigration issues are negotiated up front. The ideal, of course, is to have a package that offers flexibility to either stay here or return to Canada."

Wruk also pays special attention to immigration strategies. "Sometimes the husband will get a job down here, and we need to try negotiating some type of visa for the spouse. I also go through the pros and cons of a move with client—is moving to the United States the right thing to do? How might the move affect the family?" There are customs issues to address. Wruk advises clients about what to do with their vehicle, for instance, and what they may bring across the border.

Wruk also gets involved with health care options. "The health care system is different and the ideal is for the client to be covered before the move because Canadian coverage ceases when you stop paying taxes. It's a socialistic medical care system in Canada, but maybe they are uninsurable in the United States."

Connelly notes that another area for concern is investment management. "It is really important to know clients' circumstances and goals before you recommend what to do with their assets," he explains. Maybe the client is going to live in the United States during the winter. Maybe they will live here until they retire and then move back to Canada. You have a certain amount of future liability stream that is going to be required in Canadian dollars. So you don't necessarily want to take their entire investment portfolio, bring it to the United States and put it in dollar-denominated investments. If you do that, you are indirectly and unknowingly speculating on the Canadian dollar. So it's really important to try to ballpark the liabilities. In some cases, that might be an argument to leave some money in Canada, or to buy Canadian securities in U.S. accounts."

Connelly also notes that planners should be aware that transaction costs and structured investment products in Canada are much more expensive than they are in the United States. "It's not uncommon in Canada to see the expense ratio at 2 percent on bond funds and emerging markets at 3 1/2 percent—and that's not considering the load. In Canada, a tremendous amount of your earnings get eaten up by expenses. If you are trading stocks and bonds, expenses are more like the 1970s were in the United States in terms of spreads and commissions. Over the long run, we can save our clients our fees, sometimes twice our fees, just saving transaction costs of the investment environment they'd been in."

South of the Border

Citizenship issues are also important for Mexican citizens south of the American border, according to Raoul Rodriguez-Walters of Harbor Asset Management in Portland, Oregon. Rodriguez-Walters, who also has an office in Mexico City, specializes in advance financial planning for Mexican citizens who wish to move to the United States. "It's a wide-open field with a lot of opportunity," he says.

Explains Rodriguez-Walters, "For those Mexican clients who go to the United States to work with the intent of coming back to Mexico, you want to delay the U.S. citizenship as long as possible. The first step is to avoid residency and after that, avoid long-term residency, longer than eight years, and then avoid citizenship because of the tax implications. There is some planning we can do here. For example, if you go to the States as a student, you are not considered a resident."

Rodriguez-Walters notes that the financial issues he deals with fall mostly into three categories—taxes, property ownership and estate planning. "Taxes are where the biggest hang-ups come," he says. "Mexico has no capital gains taxes for securities, but the United States does. If you are planning to purchase a house in the United States or fund college for your children, and the way you are going to do it is sell securities in Mexico, you don't want to be a U.S. resident when you do it. All of a sudden, you're subject to U.S. capital gains tax."

When it comes to property, Rodriguez-Walters stresses that if clients have property in Mexico, even if they don't live in Mexico, they should have a Mexican will. "Clients should not revoke their U.S. will, but there are ways to do a Mexican will so both wills are valid," he notes.

Another property-related issue that causes trouble for Mexicans living in the United States is rental property. Says Rodriguez-Walters, "If a client rents his Mexican property out while he is away, that is considered Mexican source income and is subject to Mexican income tax. That also goes for U.S. citizens who rent their properties in Mexico."

Finally, in the tax category, Rodriguez-Walters notes that many clients who have worked in the United States have questions about the Social Security they paid. "If they pay into the system and never become a citizen, then move back to Mexico to retire, they have a right to U.S. Social Security benefits. A lot of people do not realize that," he says.

As for estate planning, Rodriguez-Walters says Mexicans who have their children in the United States and then return to Mexico can run into problems with gifting to children and listing assets in their names. He explains, "There are certain arrangements in Mexico that are pretty common, but in the United States they are taxable. People don't realize the problem until their child is ready to go to college in the United States and draws on an account. That can cause problems if you don't have all your tax ducks lined up." He adds that reporting requirements for trusts are very complicated in Mexico.

Across the Sea

Barbara Steinmetz, CFP, of Steinmetz Financial Planning in Burlingame, California, never planned that cross-border planning would be an area of specialization. "It just kind of happened," she says. "The first foreign client who came to me was attracted by my tax background."

What resulted in Steinmetz getting more foreign-born clients—who come from such areas as the Netherlands, India and China—was her expertise in stock options offered at many of the nearby Silicon Valley companies with a number of foreign-born employees.

"Stock options are confusing even to people who are born here," says Steinmetz. "The average person can't understand the tax consequences, et cetera. Some companies bring in firms to explain them, but it's a difficult subject, particularly for employees who might have English as their second language."

In addition to giving advice on stock options, Steinmetz helps her clients with 401(k) decisions. "Often, the feeling is that the investment decisions are overwhelming, so the employee does nothing or contributes the bare minimum. That's not so different from American workers, but foreign nationals may not even understand what is being deducted on their pay stub. FICA may mean nothing to them," she explains.

In fact, Steinmetz has done 401(k) education programs for companies where the fact that foreign nationals were not

contributing to the plans caused them to become top-heavy. "Once all employees understood the benefits, the contribution levels increased," she says. "All of what we do is education. Our commitment to presenting information has to be that much stronger for those who have English as a second language."

Steinmetz notes that the number of foreign citizens she's worked with has changed her approach for all her clients. For example, she routinely asks if they are U.S. citizens. "I'm not here to check for green cards, but if a client is a foreign national working here, then that raises a group of concerns," she explains. "For example, do they have accounts outside the United States that are not held in dollars? If you are doing an overall financial plan, you have to know what's going on."

One major difference Steinmetz has noted between her foreign national clients and domestic U.S. citizen clients is that the foreign nationals are very concerned with sending "something back home to take care financially of the people they have left behind." Explains Steinmetz, "These clients share a great appreciation for the sacrifices their parents have made so that they could get an education and be in the position they are in now."

Steinmetz also notes that while many clients will insist that their stay in the United States is temporary and therefore resist purchasing a home, she finds that their plans often change. "They have children here and discover that life in the United States is not so bad," she says. "So when I hear younger people say they don't want to buy because it's temporary, my response is that it might not be—they may be here longer than they think. They can deduct mortgage interest on their tax return, so there's an advantage in getting into the real estate market."

Lessons for All

Clearly, cross-border clients require special planning expertise. Government regulations are constantly changing. In addition, there are the changes in the tax treaties between countries to deal with. An effective cross-border move also requires a head-start because often there is just one opportunity to take advantage of a particular planning strategy.

It's important, say the planners we spoke with, for planners to raise potential planning issues with clients who may be too wowed by an initial job offer to consider the specifics and future implications of a cross-border move. Says Claudia Freeman, "The exchange rate in the United States is so attractive that sometimes it stops people from doing the financial planning they might need before they take a job. The fact that the U.S. dollar is worth \$1.50 in Canada is probably all they see at first when they evaluate a job offer."

While a cross-border situation may present itself only a few times in your career, at least one of the issues illuminated here is worth addressing with all your clients, particularly those who may have lived and worked abroad. It's important, say cross-border planners, to ask all your clients if they have assets held outside the country. In addition to giving you a full picture of their net worth, it may flag areas where you need to seek the opinion of a cross-border planner.

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