Managing US Pension Accounts for non-US Residents

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If you have worked in the United States it is likely that you have paid into a US pension account such as an IRA (Individual Retirement Account) or a 401k (an occupational pension plan). The question arises as to what should be done with such an account once you give up US residency.

There are three alternatives: You can transfer it to another pension account, you can distribute the money, or you can leave it in the current account.

In an ideal world you would have complete cross-border portability for your US pension account such that you could transfer the funds without tax consequences to an equivalent account in your new country of residency. Unfortunately US tax regulations typically do not allow such transfers. While you can sometimes transfer from one type of US plan to another without tax consequences (such as from a 401k to an IRA), it is usually not possible to transfer from a US plan to a non-US plan; with the possible exception of some specially structured corporate pension plans. A transfer from a US pension plan to a non-US plan would typically be deemed a distribution for US tax purposes.

This brings us to the second option: You could distribute the funds in your US pension plan and do what you like with the proceeds. US pension plans are quite flexible in terms of allowing access to one's funds, unlike pension accounts in many other countries that may allow only limited lump-sum withdrawals with the remaining funds used to purchase an annuity or available only to be drawn down over the account-holder's lifetime. You can access any or all of the funds in a US IRA at any time. If you have a 401k account from a former employer, this can be transferred to an IRA ("rolled over" in the vernacular), whereupon the funds can be accessed as above. Other types of US plans, such as deferred compensation plans or defined benefit plans are less flexible.

The downside of distributing the funds in your pension plan are that you lose the tax-deferral benefits, which may be substantial over time, and the distributed funds may be subject to taxes and possibly penalties for early withdrawal if you are under age 59 ½.

The third option is to leave the account as is, to be accessed as the need arises in retirement or otherwise, once early withdrawal penalties no longer apply. This is the best option for many people but the issue that non-US residents often face is that their US pension plan administrator may not be willing to deal with them now that they no longer live in the United States. Many brokerage firms will insist that you close your account once you no longer have a US address; or they may allow you to retain the account but will not allow management of the investments – in effect freezing your pension. If you are facing such a situation, you should know that there are a few firms, such as ours, that specialize in cross-border issues and can accommodate you.

Apart from the administrative issues faced by leaving the account as is, another concern may be currency risk. Typically US pension accounts are invested mostly in US Dollar denominated investments, but if you reside outside the US you may

eventually spend the funds in another currency. This can introduce significant currency risk in addition to the investment risk you may already be assuming. For example, someone with a US-based retirement account who moved to Europe ten years ago and is now contemplating spending his US Dollar denominated pension account in Euros would find that the USD has weakened by over 30% against the Euro over this time period, resulting in a 30% loss in purchasing power for him. If the money was to be spent in Canadian Dollars it would be almost a 40% loss and in Australian Dollars it would be over a 50% loss.

Clearly it is important to consider currency risk if you may eventually be spending your pension funds in a currency different from that in which they are invested. Many US brokerage firms and investment advisors do not consider this and maintain only a minimal allocation to non-US investments. Also, typically pension accounts such as 401ks only offer very limited non-US investment options so it may be to your benefit to terminate such plans once you are no longer a US resident and move the money to an IRA where it can be better diversified globally.

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