Feeling pinch back home, U.S. retirees pursue the American Dream abroad

FINANCIAL ADVISOR, PERSONAL FINANCE, INVESTING, RETIREMENT, SPECIAL REPORTS, IN-DEPTH REPORTING, BUSINESS NEWS, INVESTING, RETIREMENT, INVESTING IN PUERTO RICO, DEFAULT, 401(K), JPMORGAN, TARGET DATE FUNDS, PERFORMANCE, RE-ENROLLMENT, PRIVATE EQUITY, PUBLIC PENSIONS, 401(K), PENSIONS, HIGH RATE OF RETURN, 401(K), RETIREMENT SAVINGS, RETIREMENT, RETIREE, EXPAT, EXPATRIOT, ABROAD, FOREIGN, INVESTMENT, LONG-TERM INVESTING, SPECIAL REPORTS, U.S. DOLLAR, BUSINESS NEWS

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CNBC.com | Wednesday, 20 Nov 2013 | 10:48 AM ET

Some five years ago Edd Staton and his wife, Cynthia, were living the American Dream in Las Vegas. But with the onset of the financial crisis in 2008, the Statons, like millions of other Americans, saw things take a dramatic turn for the worse.

Both lost good jobs due to corporate downsizing, and the value of their retirement portfolio plunged. As older Americans faced with grim employment prospects, the Statons did what a growing number of their counterparts are doing: They pulled up stakes and retired abroad, where many U.S. expatriates are finding that they can live a lot better on a lot less.

(*Read more*: Where Americans are retiring abroad)

In 2010 the Statons relocated to Cuenca, a fast-growing temperate city in the highlands of Ecuador that has become a haven for American retirees in recent years.

"Whether they have a million dollars in the bank or a hundred, many people retire abroad because they look at their future and realize it is probably not going to pan out the way they thought it would," said Edd Staton.

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Not long ago many Americans regarded the idea of retiring abroad—if they gave it any thought at all—as a somewhat wacky notion. However, the idea has quickly gained traction over the past five years, thanks in part to technological and other changes that have made it easier to relocate to a foreign country.

Anyone interested in buying a home in Costa Rica, for instance, can tap into a wealth of online information on the subject. What's more, expanded Internet access has made it easier for American expats to handle their affairs from virtually any corner of the world and stay in touch with friends and relatives in the U.S.

"In the last five years the notion of retiring abroad has become more of a mainstream idea in the U.S.," said Jennifer Stevens, executive editor of *International Living* magazine. "People who saw their nest eggs take a hit during the recession have been taking a hard look at their options."

However, the decision to retire abroad comes with plenty of practical considerations, beginning with picking the right place, said Stevens. Those thinking about it should take stock of their priorities and financial resources and narrow their options to a few places that appear to be a good fit, she said. Then they ought to test-drive one or more of those places.

"Rent a place for a few months, travel around, and see if you like a particular market," said Stevens. "You may find there are things you can't tolerate."

(Read more: Six feet under as a retirement plan?)

Determining whether you can stomach a life in rural Panama, for instance, is only half the battle. There are a number of other challenges associated with living abroad, from currency risk and navigating real estate purchases to staying tax-compliant in the U.S.

"One of the big considerations is where retirees keep their money," said David McKeegan, co-founder of Greenback Expat Tax Services.

Many Americans who relocate to a foreign country keep their financial accounts in the States, which can work either for or against them, depending on the value of the U.S. dollar relative to other currencies. "If they keep their accounts in the U.S.," McKeegan said, "they have to deal with currency fluctuations, and for those on a fixed income, that can make a big difference."

Moving retirement and other financial accounts overseas can come with a different set of hassles. Many foreign financial institutions have begun shunning American customers rather than dealing with the requirements of the Foreign Account Tax Compliance Act, passed by Congress in 2010 in an effort to curb offshore tax evasion by U.S. citizens through foreign banks, trusts and shell companies.

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Informally known as FATCA, the law essentially requires foreign banks and other financial institutions to disclose data on American clients with accounts containing at least $50,000, or to withhold 30 percent of the dividend, interest and other payments due to those clients and send that money to the Internal Revenue Service. Institutions that don't comply could face fines or be barred from doing business with American clients.

"A lot of banks are saying that requirements imposed by FATCA are too much of a hassle to deal with," said McKeegan. "They'd rather just lose customers than have to do the reporting to the IRS."

FATCA also imposes reporting requirements on many U.S. taxpayers living abroad. In general, married filers with foreign accounts exceeding $400,000 in value at the end of any given tax year (or more than $600,000 at any time during the tax year) must file a special form with their annual income-tax returns. Single taxpayers must file the form if the value of their foreign-account assets tops $200,000 at the end of a given tax year, or more than $300,000 at any time during the year.

The Department of the Treasury already requires that American expats fill out the Report of Foreign Bank and Financial Accounts form, known as FBAR, if they have more than $10,000 in non-U.S. financial accounts. Those who fail to comply with FATCA or FBAR requirements could face stiff penalties, including having to turn over a big chunk of their assets in overseas accounts to the IRS.

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"This is the year international banks will start to report on American citizens to the IRS, allowing the IRS to match that data with the information they get from U.S. citizens with overseas accounts," said certified financial planner Nick Hodges, founder of NCH Tax & Wealth Advisors. Hodges, also a CPA, specializes in working with Americans living abroad.

"What you don't want is a retiree on a limited budget to have to pay one of the penalties," Hodges said, for not meeting the requirements of the FATCA or FBAR.

Retiring abroad can also create certain headaches when it comes to estate taxes. Married couples, for instance, may find that they don't qualify for the $5 million federal estate-tax exclusion in the U.S. if one of them is a non-resident or a citizen of another country.

What's more, countries have different regulations when it comes to estates and taxation of retirement-account earnings. Experts say it behooves American expats to seek professional advice on taxes and inheritance rules in their adopted countries. They might also want to draft wills or trusts locally, because some countries don't recognize certain U.S. legal documents.

In order to minimize their U.S. tax burden and the hassles associated with disputing taxes from abroad, some retirees actually establish residence in no- or low-tax U.S. states—by voting there, obtaining a driver's license or filing a partial-year return, among other tactics—prior to moving.

"There are always tax issues when it comes to retiring abroad. U.S. citizens can never escape the tax man," said Tom Zachystal, a certified financial planner and founder and president of Individual Asset Management, which specializes in investment management and financial planning for American expats.

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If retirees opt to buy rather than rent property abroad, they may have their work cut out for them. Many foreign-property markets are a lot less transparent than their U.S. equivalent and thinly traded, especially for the types of high-end homes many foreign retirees tend to prefer. A beachfront condo that seems like a bargain by American standards may be very difficult to resell, given the limited pool of potential buyers for such property in many foreign locales.

"The kinds of checks and balances that we have in the U.S. often don't exist in other countries in terms of real estate purchases," said Stevens, who advises American buyers to seek legal representation from English-speaking local attorneys. Buyers should also ensure that their lawyers don't also represent sellers, a practice that is common in many foreign countries and can create conflicts of interest, she said.

In many foreign markets, particularly in parts of Latin America, real estate is commonly held inside corporations or trusts, which creates tax-compliance issues for Americans living abroad. Foreigners who fall in love with beachfront properties in Mexico have long had to use real estate trusts to buy them, because the country prohibits non-Mexicans from directly owning land within 31 miles of the coast and 62 miles of the nation's borders.

(Read more: Why 401(k) savers don't have enough to retire)

"The minute you buy real estate inside a corporation, it becomes a reportable event and must be shown on your U.S. tax return," said Hodges.

Many Americans try their hand at retiring abroad and decide it is not for them. Many others are quite content in their adopted countries, although some concede that the adjustment period can be rough.

"You come here with your Type A brain and certain expectations" about the way things ought to work, said Staton. "But you have to learn to go with the flow or go home."

Others caution that Americans should not retire abroad strictly for financial reasons. "The joy of going overseas is the adventure and the beautiful scenery," said Hodges. "If those are not the things that attract you, you'd be better off in the States."

"If you want to live cheaply, go visit the South in the U.S., where they speak English and you can shop at Wal-Mart," he said.

—*Anna Robaton, Special to CNBC.com*

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