TAX ISSUES FOR U.S. EXPATS: U.S. AND SWISS PERSPECTIVE

THE U.S. PERSPECTIVE

SUPSI

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Agenda

- Overview of U.S. Tax Residence
  - Who is a U.S. Tax resident
  - Exceptions
  - Treaty Benefits
- Relinquishing Green Card
  - Tax implications?
- Relinquishing U.S. Citizenship
  - Exceptions
- U.S. Taxation – Specific Issues
  - Sale of a U.S. Real Property Interest by Nonresidents
  - Sale of an interest in a U.S. Partnership by Nonresidents
  - Sale of U.S. Stocks by Nonresidents
  - Sale of Swiss Stocks by U.S. Citizens
  - Grants of Stock Options in Swiss Companies to U.S. Citizens
- U.S. Estate and Gift Tax
- Other Items to Consider If Your Client is U.S.

U.S. RESIDENCY RULES

U.S. Resident

- A U.S. Citizen
- A non-U.S. citizen that holds a “Green Card”
- A non-U.S. citizen that meets the “Substantial Presence Test”

The Substantial Presence Test

- At least 31 days of presence in the current year

Plus

- 183 days or more during a 3-year period, based on a weighted average formula
- The formula counts:
  - 100% of the days of presence in the current year, and
  - 1/3 of the days of presence in the first year before the current year, and
  - 1/6 of the days of presence in the second year before the current year
- Rule of thumb: keep days to 120 or less
- Part days count, except for presence for less than 24 hours in transit between two places outside the U.S

The Closer Connection Exception

- An individual who meets the Substantial Presence Test can still be treated as a nonresident alien if he:
  - Was present in the U.S. for less than 183 days during the year,
  - Had a closer connection during the year to a foreign country than to the U.S.,
  - Maintained a tax home in that foreign country during the entire year, and
  - Had not taken steps toward, and did not have an application pending for, lawful permanent resident status (Green Card)
- Must timely file Form 8840, Closer Connection Exception Statement for Aliens

Closer Connection Determination

- A facts and circumstances determination that includes, but is not limited to, the following:
  - The country of residence designated on forms and documents,
  - The location of a permanent home
  - Where family members are located,
  - The location of personal belongings (car/s, furniture, clothing, and jewelry),
  - Current social, political, cultural, or religious affiliations,
  - Business activities (other than those that constitute an individual's tax home),
  - The jurisdiction that issued a driver's license,
  - The jurisdiction where an individual votes, and
  - Charitable organizations to which contribution are made

Other Exceptions

- Medical Exception:
  - Do not count days of presence if unable to leave the U.S. because of a medical condition that is developed while are in the U.S.
  - Special relief for COVID-19 available for those who intended to leave but were unable due to COVID-19 travel disruption. Up to 60 days (beginning on or after February 1, 2020 and ending on or before April 1, 2020)
- Student Exception:
  - A student temporarily present in the U.S. under an "F," "J," "M," or "Q" visa, who substantially complies with the requirements of the visa
  - A teacher or trainee, including research positions, temporarily present in the U.S. under a "J" or "Q" visa, who substantially complies with the requirements of the visa
  - Limitations apply on the number of years an individual can be an exempt individual under these rules
- Must file Form 8843, Statement for Exempt Individuals and Individuals With a Medical Condition

Treaty Tie-Breaker

- Available for dual residents under domestic laws of the U.S. and a treaty country
- The tie breaker tests are applied in the order they appear:
    1. The existence and location of a permanent home
    2. Center of vital interests;
    3. Habitual abode; and
    4. Nationality
- Once residency determined, no need to continue
- If an individual remains a resident of both countries after the 4th test - the individual may apply for a mutual agreement procedure of the competent authorities

GREEN CARD AND THE EXIT TAX

Green Card

- A Green Card holder is a U.S. tax resident no matter where he lives
- Until:
  - Voluntarily turn in green card to U.S.C.I.S. and renounce U.S. immigrant status
  - Have immigrant status administratively revoked by U.S.C.I.S., or
  - Have immigrant status judicially revoked by a U.S. federal court

Giving Up Green Card

- As long as the individual is not a “Long-Term Resident,” no problem
- Long Term Residency obtained after holding the GC for 8 years out of the 15 years ending with the year of relinquishment
- Years in which treaty tie-breaker was invoked to claim non-U.S. residence do not count
- But be careful: invoking the treaty tie-breaker triggers the same tax consequences as relinquishment of the GC

Covered Expatriate

- A Long-Term Resident may be a “Covered Expatriate” if meets one of the following tests:
  - Net Worth Test - $2,000,000 or more on the date of expatriation,
  - Average Tax Liability - over $171,000 (indexed for inflation) in average for the five tax years before the year of expatriation, or
  - Tax Noncompliance - noncompliance with tax obligations for any period in the five tax years before the expatriation year. Certification under penalty of perjury is required

Giving Up GC as a Covered Expatriate

- Exit Tax:
  - A mark-to-market regime
  - All property of a covered expatriate is deemed sold for F.M.V. on the day before the expatriation date
  - Tax is due. Can be deferred if agreement reached with the I.R.S., and interest is imposed
- Succession Tax:
  - Tax will be imposed on U.S. persons receiving gifts or bequests
  - Regardless of whether the property transferred was acquired by the covered expatriate before or after expatriation

RELINQUISHING U.S. CITIZENSHIP

Giving Up U.S. Citizenship

- Exit Tax and Succession Tax if Covered Expatriate
- Unless:
  - Done before the age of 18½ years; but only if:
    - Was never a resident of the U.S., or
    - If treated as resident under the Substantial Presence Test - for not more than 10 years before the renunciation
  - Done by a dual citizen by birth; but only if:
    - Was a resident under the Substantial Presence Test for no more than 10 of the last 15 years
    - Will continue to be a citizen of that foreign country after renunciation, and
    - That foreign country would tax him as a resident
- The exceptions override the net worth and average tax liability tests but not the tax compliance test

U.S. TAXATION - SPECIFIC ISSUES

U.S. Taxation of Nonresidents

- Only taxed on U.S. Source income
- Fixed, Determinable, Annual or Periodic Income (F.D.A.P.)
  - Interest, dividends, royalties, rents, etc.
  - Taxed at a flat 30% gross withholding unless reduced/eliminated by treaty
- Effectively Connected Income (E.C.I.)
  - U.S. trade or business or U.S. P.E. (if treaty country)
  - Taxed at normal graduated rates on a net basis
  - Requires U.S. tax filing to be eligible for the deductions

Taxation of U.S. Real Property

- Sale of U.S. Real Property Interest (U.S.R.P.I.) by a nonresident is subject to special withholding under F.I.R.P.T.A.
  - Withholding by the buyer
  - 15% of sales price
  - Reduced withholding (or elimination) available if applied timely
- U.S.R.P.I. includes:
  - Direct and indirect interest in real property located in the U.S. (land, houses, condominiums)
  - Interest in a U.S. Real Property Holding Company (U.S.R.P.H.C.)
    - A domestic corporation if at any time during the five-year period preceding the sale of its stock the F.M.V. of the USRPI held by it is at least 50% of the F.M.V. of the corporation

Sale of a Partnership Interest

- Includes interest in U.S. L.L.C.'s
- If the partnership is engaged in a U.S. trade or business, taxed to the extent of the E.C.I. resulting from a deemed sale by the partnership of all of its assets
- Tax collected through 10% withholding
- Withholding imposed on the "amount realized"
- May result in greater withholding than the cash received

Sale U.S. Stocks and Swiss Stocks

- Source of gain determined based on residency of the seller
  - A U.S. resident for these purposes means a citizen or resident who does not have a tax home in a foreign country
  - Foreign or U.S. office material participation may alter the source
  - Treaty may alter the source
- Generally, nonresident selling U.S. stock (not U.S.R.P.H.C.) is not subject to U.S. tax
- Generally, U.S. resident selling Swiss stock is subject to U.S. tax and is not eligible for foreign tax credit
  - Only foreign source income is eligible for F.T.C.
- U.S. citizen living in Switzerland likely not treated as U.S. resident for purposes of the source rule thus generate foreign source gain and eligible for F.T.C.

Relief From Double Taxation

- Treaty benefits available for residents of a country; U.S. citizens who are subject to the “forait tax regime” are generally not treated as Swiss residents because they are not liable for tax on the same basis as other Swiss residents
- U.S. citizens who can benefit from the treaty may have double taxation alleviated on U.S. source income not otherwise eligible for F.T.C. under domestic law
- For purposing of determining U.S. foreign tax credits, Article 23, subparagraph 3(c) deems income from U.S. source that is taxed in Switzerland to be from Swiss sources to the extent necessary to avoid double taxation
- The amount that must be resourced depends on the amount of Swiss tax for which the U.S. citizen is claiming a U.S. foreign tax credit
- The amount available for credit is reduced by the amount of the U.S. source tax

Stock Options

- Qualified Stock Option:
  - No tax on the grant, vesting or exercise
  - Tax on the sale on the excess of the selling price over the exercise price
  - Capital gain treatment if holding period met The exercise is generally not taxable
- Non-Qualified Stock Option:
  - Most Swiss options likely to be N.Q.
  - No tax is imposed on grant, unless the option has an ascertainable value (generally, when traded)
  - Tax can be imposed in each of the vesting years if the exercise price is lower than the F.M.V. at the grant
  - Tax on exercise on the excess of the F.M.V. over the exercise price
  - Tax on the sale on excess of selling price over F.M.V. at the exercise

ESTATE AND GIFT TAX

Estate Tax

- Imposed on world-wide assets for U.S. domicile individuals
- Domicile looks to subjective intent to return to an individual's "true home"
- U.S. citizens are always domicile in the U.S.
- For non-U.S. citizens, domicile determination is difficult and seeks to determine intent as indicated by actions
  - Immigration status as evidence of intent?
  - I.R.S. argued both sides and court ruled that even if in violation of terms of visa, a decedent can develop required intent
- For non-U.S. domicile – U.S. estate tax imposed only on U.S. situs assets

Estate Tax

- Imposed on the F.M.V. of the property
- 40% flat rate (the first $1 million is subject to graduated rates resulting in $345,000 in taxes)
- U.S. domiciled individuals allowed a lifetime credit to transfer up to $11.58 million of wealth during life or at death
  - If also domiciled in Switzerland, the U.S. will generally provide credit against Swiss estate tax paid on Swiss situs assets
- Non-U.S. domiciled individuals allowed credit that shields $60,000 of value
  - Treaty with Switzerland allows Swiss domiciled a credit against U.S. estate tax liability that is based on the lifetime exemption amount available to U.S. domiciled, but only in proportion to U.S. assets
- Estate Treaty may change the situs of assets
  - The Swiss treaty does not
- Step up in basis to F.M.V. for recipient of inheritance

Gift Tax

- Imposed on the donor if the donor is a U.S. domicile
  - Gifts from covered expatriate are subject to tax by a U.S. donee
- For non-U.S. domiciled - imposed only on gift of tangible assets located in the U.S.
  - Jewelry
  - Art
  - Real property
  - Cash versus wires
  - Condo versus Co-op
- Swiss treaty does not apply to gifts

Gift Tax

- Imposed on the F.M.V. of the gift
- 40% flat rate
- Lifetime credit for U.S. domiciled may be used during life
- Annual amounts allowed
  - $15,000 per person
  - $157,000 to non-U.S. citizen spouse
  - Unlimited to U.S. citizen spouse
- No lifetime credit for non-U.S. domicile individuals
- Example of intangible assets:
  - Wire transfer
  - Shares in a U.S. corporation
  - Co Op shares?
  - Interest in a partnership?

OTHER ITEMS TO CONSIDER FOR U.S. CLIENTS

Considerations for U.S. Clients

- U.S. tax compliance even if no U.S. income
  - Form 1040, U.S. Individual Income Tax Return
  - Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
  - Other international forms resulting form ownership of foreign financial assets or accounts
    - F.B.A.R.
    - Form 8938 for financial asset with total value a threshold amount
- Ownership of non-U.S. corporations
  - Controlled foreign corporation?
  - Passive foreign investment company?
- F.A.T.C.A.
  - Disclosed by financial institutions

Important Notice

This presentation is not intended to be legal advice. Reading these materials does not create an attorney-client relationship. The outcome of each case stands on its own merits.

Tax issues for US expats: US and Swiss perspective

THE SWISS PERSPECTIVE

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Tax issues for US expats: the Swiss perspective

The Swiss perspective: main features

1. the definition of tax residence

2. the 'limited' world wide taxation principle

3. inheritance and gift tax

4. practical cases: the taxation of US 'luggage' (stock option, RSU, dividends, capital gain, real estate property, IRA, pension income, trust)

5. Other considerations

Please note that we are referring to a broad definition of US expats, including US citizens and ex green card holder. All the US tax consequences will be out of scope of these slides

Tax issues for US expats: the Swiss perspective

1) the Swiss perspective: the definition of tax residence

- According to art. 3 of the Federal Law on Income Tax, an individual is considered having tax domicile (i.e. tax residency) in Switzerland if he stays, without relevant interruptions, for at least:
  - 30 days in case of working activity in Switzerland
  - 90 days in case of no working activity in Switzerland

→ Temporarily absences don't interrupt the period

→ Staying in Switzerland just for study or healthcare purposes doesn't trigger the 'domicile' definition even if the individual stays more than 30/90 days

→ Subject to a different provision of the tax treaty, the right to tax begins – provided the requested period of time is met - the day of the arrival in Switzerland

Tax issues for US expats: the Swiss perspective

1) the Swiss perspective: the definition of tax residence

- The definition of residence in the US-Swiss tax treaty prevails on the Swiss definition, having a relevant consequence on the Swiss right to tax for the immigration year especially.

Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:
1. he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests);
2. if the State in which he has his centre of vital interests cannot be determined, or if he has no permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
3. if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
4. if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

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Tax issues for US expats: the Swiss perspective

2) the Swiss perspective: the ‘limited’ world wide taxation principle

- The worldwide taxation principle (art. 6, par. 1 LIFD) is a bit revised in Switzerland as Swiss taxation – for income tax as well as wealth tax – does not cover foreign real estate and fixed place of business abroad
- The (main) Swiss method to avoid international double taxation is named ‘exemption with progression’, as these foreign income and asset are not taxable in Switzerland but they count in order to determine the relevant tax rate applicable to the taxable income/assets. Worldwide income and asset have to be disclosed in the tax return in order to tax the taxable elements properly
- This is the main domestic method to avoid international double taxation, but with reference to specific income (such as dividend, interest, royalties,..) a tax credit is granted instead of the exemption method. In other terms, foreign dividends, interests (…) are taxable ordinarily but a tax credit is granted in order to eliminate/mitigate the double taxation
- Capital gains obtained by the disposal of private assets are tax exempt, regardless of where the assets are located. Capital gain arising from the selling of Swiss estate property are taxed according to Cantonal rules.

Tax issues for US expats: the Swiss perspective

3) the Swiss perspective: inheritance and gift tax

- Inheritance and gift tax are regulated by cantonal laws, therefore rules may change according to the residence of persons involved and to the situs of immovable property/fixed place of business
- There is no an inheritance/gift tax at federal level
- Spouses, parents, grandparents and descendants (including adopted children) in the direct line are exempt from inheritance and gift taxes (in Canton Ticino and in almost all Cantons)

The rates depend on the degree of relationship and on the amount received:

- siblings: 5.95% to 15.5%;
- nephews, nieces, children of half siblings, stepparents: 7.735% to 18.5%;
- grand-nephews and nieces, cousins, brothers and sisters-in-law, parents-in-law: 10.71% to 27%; and
- others: 17.85% to 41%.

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3) the Swiss perspective: inheritance (IHT) and gift tax

Territoriality principle of inheritance and gift tax (Canton Ticino) – in absence of tax treaty

Residence of de cuius	Residence of the beneficiary	Taxation
Switzerland	Switzerland or abroad	Swiss IHT applies
Abroad	Switzerland	-
Abroad (but with Swiss real estate)	Switzerland or abroad	Swiss IHT applies

Residence of the donor	Residence of the beneficiary	Taxation
Switzerland	Switzerland or abroad	Swiss gift tax applies
Abroad	Switzerland	Swiss gift tax applies
Abroad (but with Swiss real estate)	Switzerland or abroad	Swiss gift tax applies

4) Practical cases: the taxation of US 'luggage':

- **stock options** of US corporation exercised in Switzerland (after a requested vesting period) but assigned during a previous working activity in USA

→ as a general rule the difference between the strike price (if any) and the market value of the shares is considered employment income ruled by art. 15 on the US-Swiss tax treaty. Switzerland has no right to tax employment income provided that the employment activity was performed in the USA. However, this income is relevant in order to determine the tax rate applicable to the taxable income ('exemption with progression').

- **RSU** of US Corporation exercised in Switzerland (after a requested vesting period) but assigned during a previous working activity in USA

→ RSU (Restricted Stock Units, which represent basically a right to received shares) are treated as stock options according to the tax circular n. 34 of the Federal Tax Authority. Therefore, the gain arising from the exercise of the RSU is considered employment income and therefore taxed in the source of State only (USA). In Switzerland, the exemption with progression method will apply

Tax issues for US expats: the Swiss perspective

4) Practical cases: the taxation of US 'luggage':

- **Dividends** arising from US (listed) corporation and credited in a Swiss bank

→ Dividends are taxed at source with a comprehensive withholding tax of 30% (15%+15%). This withholding tax could be credited/refund by specific forms to be completed and filed properly. Dividends from minority shareholdings (<10%) are fully taxable in the hands of the Swiss taxpayer at the marginal rate. In case of substantial participation (>10%) only the 70% of the dividend is taxable at the marginal rate too.

- **Capital gain** arising from the selling of US shares

→ Provided that the individual is disposing his private assets and he is not performing a trading/professional activity, capital gains arising from the selling of US shares (listed or not) is tax exempt in Switzerland. This principle is valid also with reference to the shares acquired through the exercise of stock options/RSU. Evidence of the gain event has to be indicated in the tax return

4) Practical cases: the taxation of US ‘luggage’:

- **Real estate** property in USA

→ This is the typical example where the exemption with progression method applies, both for income tax and for wealth tax, if the real estate property is held directly by a Swiss individual. However, if the property is held through structure (ex LLC, trust…), it is necessary to analyse how this structure is treated in Switzerland for tax purposes (i.e. tax transparent or not). US and Swiss interpretation of these structures could create tax disadvantages.

- **IRA** (Individual Retirement Account)

→ This is a pension scheme common in USA, similar to the Swiss 3’ pillar. However, considering that there is no a specific exemption for wealth tax purposes, the value of the IRA at 31.12 is subject to wealth tax. Distributions from IRA account are considered as pension income according to technical explanation to art. 18 of the tax treaty and therefore this income is taxable in country of residence (Switzerland). In case of capital liquidation of IRA, a mitigation method applies and the capital liquidation is tax at the same rate of that should apply in case of annuity income.

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Tax issues for US expats: the Swiss perspective

4) Practical cases: the taxation of US 'luggage':

- **Pensions** in consideration of a past employment in USA

→ As a general rule and subject to art. 1, par. 2 of the tax treaty, according to art. 18 of the treaty pensions and other similar remuneration beneficially derived by a resident in Switzerland in consideration of past employment performed in USA shall be taxable only in Switzerland. However, if the pensions is in consideration of a past employment in the 'public sector' (es. federal administration, state or political subdivision or local authority), the income shall be taxable only in USA and Switzerland will exempt (with progression) that income.

- **Trusts** (set up in USA or elsewhere)

→ Switzerland has no a domestic trust law but the Hague Convention on trust has been ratified, therefore foreign trusts are well recognized. For tax purposes, trust is never subject to tax but taxation of trust assets and income generated within the trust will be in hands of the Swiss settlor (in case of discretionary trust or revocable basically) or in the hands of the Swiss beneficiary/ies (in case fixed interest trust). In case of the so called 'pre immigration trust (i.e. trust set up by a non resident settlor) substantial tax advantages could be obtained.

5) Other considerations

- Forfeit regime: individuals moving to Switzerland, provided that certain conditions are met, can opt for the favourable forfeit regime instead of the ordinary regime. According to this regime, foreign income are taxed on a forfeit basis, with a minimum taxable income of CHF 400’000 for EU citizens or CHF 750’000 for non EU citizens
- In addition to the income tax treaty, between USA and Switzerland an inheritance tax treaty is in force
- Before moving to Switzerland an accurate tax ‘check-up’ is recommended in order to review the current wealth structuring

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