Pension, Retirement Planning and Saving for Americans in Switzerland

3 March 2016
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## The Swiss three Pillar model - an overview

<table>
<thead>
<tr>
<th>Needs-oriented pensions</th>
<th>Pillar 1</th>
<th>Pillar 2</th>
<th>Pillar 3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>State pensions</td>
<td>Occupational benefits insurance</td>
<td>Private pensions</td>
</tr>
<tr>
<td></td>
<td>Mandatory</td>
<td>Voluntary</td>
<td>Voluntary</td>
</tr>
<tr>
<td></td>
<td>AHV/IV</td>
<td>Supplementary benefits (EL)</td>
<td>Mandatory benefits</td>
</tr>
<tr>
<td>Responsibility of the government</td>
<td>AHV/IV contributions</td>
<td>- Employer and employee: each 50%</td>
<td>- Self-employed persons and those not gainfully employed: 100% self-funded</td>
</tr>
<tr>
<td></td>
<td>EL contributions</td>
<td>Funded with federal and cantonal tax money</td>
<td>BVG/UVG</td>
</tr>
<tr>
<td>Retirement pension</td>
<td>Daily benefits</td>
<td>- Retirement pension/capital</td>
<td></td>
</tr>
<tr>
<td>Child’s pension</td>
<td>- Retirement pension/capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disability pension</td>
<td>- Retired person’s child’s pension</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disabled person’s child’s pension</td>
<td>- Disability pension</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Widow’s/widower’s pension</td>
<td>- Disabled person’s child’s pension</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Orphan’s pension</td>
<td>- Widow’s/widower’s pension</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Orphan’s pension</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
An overview of the issue

The Problem

U.S. citizens living and working in Switzerland are severely disadvantaged with regard to pension planning

**Swiss tax law**

Pillar 1 (AHV) and Pillar 2 (BVG)
- Employer contributions are not taxable and do not form part of gross salary
- Employee contributions to both the AHV and BVG are fully tax deductible

Pillar 3 (Säule 3a)
- Employee contribution to Säule 3a tax deductible up to 6,700 CHF p.a.

**United States tax law**

Pillar 1 (AHV)
- Employer contributions are (ordinary) taxable income and are added to gross salary
- Employee contributions not tax deductible and are added to gross salary
- Switzerland issues a "Certificate of Coverage" for an exemption from U.S. social security taxes

Pillar 2 (BVG)
- Employer contributions are (ordinary) taxable income and are added to gross salary
- Employee contributions not tax deductible and are added to gross salary

Pillar 3 (Säule 3a)
- Employee contributions not tax deductible and are added to gross salary
### US Tax treatment and results of each pillar

#### Pillar 1 (AHV)
- Government pension plan
- Status uncertain
- Most likely considered social security
- But possibly ordinary foreign financial account (conservative)

#### US Tax Treatment

- Income and capital gains (theoretically) taxable
- In practice, on retirement the pension payments are treated as taxable income

#### Pillar 2 (BVG)
- Considered an ordinary foreign financial account (conservative)
- No employer or employee contribution allowances/deductions

#### US Tax Treatment

- Income and capital gains (theoretically) taxable
- In practice:
  - Annuitisation: pension payments are treated as taxable income
  - Lump-sum payout: Lump sum treated as ordinary income for the year and taxed at the full marginal rate;
  - subject to;
  - amount of accumulated basis in the BVG

#### Pillar 3 (Säule 3a, 3b)
- Considered an ordinary foreign financial account (no doubts)
- No employer or employee contribution allowances/deductions

#### US Tax Treatment

- Income and capital gains taxable
- Considered an ordinary investment account
- No tax advantages whatsoever
- Real and potential disadvantages:
  - Various problems possible; PFICs, basis, interest tax charge, etc.
  - Ie., Not a good idea
## The traditional U.S. 401(k) plan

<table>
<thead>
<tr>
<th>Type of Plan</th>
<th>Last Date for Contribution</th>
<th>Maximum Contribution</th>
<th>Maximum Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified Plan:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Defined Contribution</td>
<td>Elective deferral: Due date of employer's return.</td>
<td>Employee contribution: Elective deferral up to <strong>$17,500</strong>, $23,000 if age 50 or over.</td>
<td>25% of all participants compensation, plus amount of elective deferrals made.</td>
</tr>
<tr>
<td></td>
<td>Employer contribution: Money Purchase or ProfitSharing: Due date of employer's return.</td>
<td>Employer contribution: Money Purchase: Smaller of <strong>$51,000</strong> or 100% of participants compensation. ProfitSharing: Smaller of $51,000 or 100% of participant's compensation.</td>
<td></td>
</tr>
</tbody>
</table>

- Quite generous
- ✗ Unfortunately Switzerland does not recognise the 401(k) plan
- ✗ So no deductible contributions possible
- ✗ And it's even (theoretically) subject to Swiss income and wealth tax
### Numerical example of first and second Pillar – AHV and BVG

#### Income

<table>
<thead>
<tr>
<th>Gross Annual Salary</th>
<th>160'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children and education allowance (2 children)</td>
<td>4'800</td>
</tr>
<tr>
<td>Other</td>
<td>0</td>
</tr>
</tbody>
</table>

**Total Compensation:** 164'800

#### Deductions

<table>
<thead>
<tr>
<th>Deduction</th>
<th>Amount</th>
<th>Rate</th>
<th>Subtotal</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st pillar pension contributions</td>
<td>160'000</td>
<td>5.05%</td>
<td>8'080</td>
</tr>
<tr>
<td>Unemployment insurance deduction</td>
<td>160'000</td>
<td>1.00%</td>
<td>1'600</td>
</tr>
<tr>
<td>2nd pillar pension contributions</td>
<td>160'000</td>
<td>5.00%</td>
<td>8'000</td>
</tr>
<tr>
<td>Non business accident insurance</td>
<td>160'000</td>
<td>1.12%</td>
<td>1'794</td>
</tr>
<tr>
<td>Sickness cover</td>
<td>160'000</td>
<td>0.90%</td>
<td>1'440</td>
</tr>
</tbody>
</table>

**Total deductions:** 20'914

<table>
<thead>
<tr>
<th>Deduction (Employer contributions)</th>
<th>Amount</th>
<th>Rate</th>
<th>Subtotal</th>
</tr>
</thead>
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<tr>
<td>1st pillar pension contributions</td>
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<td>0.90%</td>
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</tr>
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**Total employer benefits:** 20'914

#### Taxable Income

- **Swiss taxable income:** 143'886 CHF
- **Add back non tax exempt and non-deductible items:**
  - Pillar 1 (AHV) employer cont.: 8'080
  - Pillar 1 (AHV) employee cont.: 8'080
  - Pillar 2 (BVG) employer cont.: 8'000
  - Pillar 2 (BVG) employee cont.: 8'000

**U.S. taxable income (IRS rules):** 176'046 CHF

#### Difference between Swiss and U.S. taxable income

- **Swiss taxable income:** 143'886 CHF
- **U.S. taxable income:** 176'046 CHF
- **Difference:** 32'160 CHF
Worst case scenario – tax payable, vs.
Tax payable on just the Pillar 2

### In Total

<table>
<thead>
<tr>
<th>Tax payable to the United States on pension contributions</th>
<th>CHF</th>
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</thead>
<tbody>
<tr>
<td>Pillar 1 (AHV)</td>
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<tr>
<td>Employee contribution:</td>
<td>8,080</td>
</tr>
<tr>
<td>Employer contribution:</td>
<td>8,080</td>
</tr>
<tr>
<td>Pillar 2 (BVG)</td>
<td></td>
</tr>
<tr>
<td>Employee contribution:</td>
<td>8,000</td>
</tr>
<tr>
<td>Employer contribution:</td>
<td>8,000</td>
</tr>
<tr>
<td>Amount added back to US taxable income:</td>
<td>32,160</td>
</tr>
<tr>
<td>Tax payable at 28%</td>
<td>9,005</td>
</tr>
</tbody>
</table>

### Just the BVG

<table>
<thead>
<tr>
<th>Tax payable to the United States on Pillar 2 contributions</th>
<th>CHF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pillar 2 (BVG)</td>
<td></td>
</tr>
<tr>
<td>Employee contribution:</td>
<td>8,000</td>
</tr>
<tr>
<td>Employer contribution:</td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td>16,000</td>
</tr>
<tr>
<td>Tax payable at 28%</td>
<td>4,480</td>
</tr>
</tbody>
</table>
Assuming a "typical" 5% Employee : 10% Employer contribution

### In Total

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<td>16,000</td>
</tr>
<tr>
<td>Employer contribution</td>
<td>8,000</td>
</tr>
</tbody>
</table>

Amount added back to US taxable income: 40,160

Tax payable at 28%: 11,245

### Just the BVG

<table>
<thead>
<tr>
<th>Tax payable to the United States on Pillar 2 contributions</th>
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<tr>
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<tr>
<td>Employee contribution</td>
<td>16,000</td>
</tr>
<tr>
<td>Employer contribution</td>
<td>8,000</td>
</tr>
</tbody>
</table>

24,000

Tax payable at 28%: 6,720
Pillar 2 (BVG) example: Assuming no contributions were ever declared or taxed

**Scenario 1: Lump sum payout**
- 2 Million CHF lump-sum payout
- Taxed at 13.8% by Canton Zürich
  - 276,000 payable to Swiss authorities
- Taxed at 39.6% by IRS
  - 792,000 CHF payable to the IRS
  - Less: 276,000 to the Swiss
  - 516,000 CHF owed to IRS

**Scenario 2: Annuity**
- 2 Million CHF converted at 5.1%
- 102,000 CHF p.a. lifetime annual annuity (paid monthly)
- Taxed as ordinary income.
  - Result: Depends on personal retirement situation
    - Taxed at US marginal rate in retirement
      (Less any taxes paid to Switzerland)
- However, annuitisation *may* be treated as taxable event;
  - In which case → 792,000 CHF owed to IRS
The Situation

- Before 2010, mostly no-one aware of the problem (or ignored)
- Yes, some advisors were saying "Foreign pension plans are not "US qualified" plans"
  - therefore all contributions taxable
- Issue mostly ignored however

- Result: Many US Persons overseas have accumulated large tax liability
  - On what was thought to be low tax pension money

- Special circumstances - sometimes there are treaty positions to be taken
  - individual situations to be considered
- In many (most) cases however, no "Basis" was ever accumulated
- Pension "Pot" is therefore fully taxable under US rules on payout

What Changed?

- FATCA (The Foreign Tax Compliance Act) in 2010
- Automatic Information Exchange, transparency, disclosure, Reporting in ALL things financial
  - Environment has CHANGED
What to do?
The conservative approach

1. First and foremost - Seek competent tax advice
   - Make sure all pension plan contributions; Pillar 1, Pillar 2 and Pillar 3 are on the tax return
     - This builds "Basis" in the pension plan
     - “Basis" means the capital you originally paid in - this should NOT be taxable on payout
   - Make sure your CPA understands how everything is treated under US tax law
   - Growth (income and capital gains) is taxable
   - Make sure pension plans are included on the FBAR (FinCen form 114)

2. Set up alternative pension plan(s)
   - Make sure alternative plan is tax deferred under US tax law
     - i.e., whatever is paid in (after tax money) accumulates tax free until payout
   - Ensure it is safe
     - Security is paramount
   - Combine with estate planning
   - Consider Swiss tax rules (Wealth tax, taxation on income, etc.)
Example: The Malta trust retirement planning solution

What is it?
- Maltese Trust with underlying defined contribution pension plan
- Involves:
  - Set up as Malta trust under Maltese tax law
  - Qualifies as QROPS under UK tax law
  - Tax deferral under US tax law
  - **Swiss residence of plan owner** - consequences & treatment
- **Four** jurisdictions involved

Advantages
- Tax deferral
- Investment flexibility - no PFIC problems

Known potential issues
- Uncertainty – Four jurisdictions involved
- 30% of value can be paid out tax free under Malta / US tax treaty
  - And the rest?
- Surrender and early withdrawal charges & tax implications
- Annuitytisation rules uncertain
- Must be resident outside the USA
- Tax treatment in jurisdiction of residence (Switzerland, Asia, etc.)
- Assets located in Malta
**ONE Trust** is a Nevis Trust holding a U.S. tax compliant Variable Life Insurance Policy (DVA or VUL)

**How it works**
- Nevis Trust (Revocable or Irrevocable)
- Holding a US compliant Variable Universal Life Policy (Deferred Variable Annuity, Variable Universal Life)
- Liechtenstein Insurance Company
- Swiss Custodian Bank
- Swiss Asset Manager (SEC registered) - your choice of investment strategy
- Tax deferral: returns accumulate tax free
- Probably subject to Swiss wealth and income tax - exemption being applied for
- Lump sum payout remains within the trust
- Annuitisation – payments paid out by the trust
- Assets owned by the trust – can be adapted for estate planning purposes

- In the event of death of insured
  - Death benefit paid into the Trust
  - Trust pays to beneficiaries
Tax Planning, Estate Planning, etc. benefits of the Trust

- The Nevis Trust can be multi-purposed
- It is set up to be flexible
- Effective and cost-effective planning tool
  - Can pack other assets into the trust
- US tax compliant
  - Recognised planning strategy under US tax law
- Estate planning tool → beneficiaries of trust

✔ Tax savings
✔ Investment flexibility
✔ Asset protection
✔ Estate and succession planning
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