US citizens living in Switzerland: which tax and estate planning issues should you be mindful of

The USA exercises personal tax jurisdiction on the basis of citizenship and immigration status. US citizens and Green Card holders therefore remain liable to US taxation wherever they live. As a result of this distinguishing feature of the US tax system, they are potentially exposed to international double taxation. Understanding these issues and seeking holistic advice help mitigating tax leakage.

Many people assume that their US tax obligations simply stop once they leave the US and become tax resident in another country. Not so! To help you understand the US tax implications for an American or green card holder living abroad, I have compiled some common questions we are regularly asked by individuals who have just relocated to Switzerland from the United States. And I have with me today my colleague Tran Luong who is best placed to address them.

Hugues Salomé: Suppose I am a US citizen and my spouse is a US green card holder. We both live and work in Switzerland. Do we still need to file a US federal return since we no longer live in the US?

Tran Luong: Yes, absolutely. US citizens and lawful permanent residents (green card holders) remain liable for tax on their worldwide income for US federal income tax purposes even when they live outside the US. You must continue to file a US federal return annually, and watch out, because this may include several new forms and disclosures you've not seen in the past. FinCEN Form 114, commonly known as the FBAR (Report of Foreign Bank and Financial Accounts), is a good example.

Do we still need to file any state income tax returns?

TL: This question needs the classic "it depends" response! State filing requirements vary considerably from state to state as each state has its own income tax law. Generally, if you have permanently relocated to Switzerland and taken proper steps to change your permanent domicile to Switzerland, you would expect to break state tax residence. However, non-resident doesn't mean non-taxable: you may still be subject to state tax as a non-resident on income derived from sources within the state such as deferred compensation, partnership income and/or rental income.

Now that we are living outside of the US, what is our US filing deadline? Can we extend it?

US taxpayers must generally file their annual US federal and state income tax returns by 15 April following the end of the tax year. US citizens and green card holders residing outside the US on 15 April get an automatic two-month extension to file by 15 June without needing to submit any special forms. If more time is needed, they can apply for an additional extension to 15 October. A discretionary extension to 15 December can also be requested although the IRS have the right to reject that request.

But, be aware: a valid extension does not protect you against all penalty and interest assessments. We recommend our clients to have a draft prepared as a way to estimate whether an advance payment of an anticipated balance should be made, even if they know they cannot file their tax return before 15 June.

US citizens should be mindful about the US "transfer tax" for any gifts they make during their lifetime or upon their death to any party, including a trust, a partnership or a corporation?

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Since we are filing a US federal tax return because of our US status, does that mean we are paying tax twice or are double taxed?
As a US citizen or green card holder living in Switzerland, some, or all, of your income may be subject to income tax in both countries. It would be subject to double tax if the story ended there. To offset this risk, the US allows a credit to be claimed for Swiss tax on non-US-sourced income. The credit is limited to the amount of US tax related to the non-US sourced income. Be careful though, the Swiss tax must meet the US definition of an income tax or tax paid in lieu of income tax in order for it to be eligible. Swiss church tax, wealth tax and value-added tax do not meet the criteria.

What about US citizens benefiting from the lump sum taxation regime in Switzerland?
Although double taxation can be mitigated by claiming a tax credit for income tax paid to a foreign jurisdiction, not all types of foreign tax qualify for such a credit. The Swiss lump-sum taxation regime is considered by the US as a voluntary income tax calculated by reference to a taxpayer's standard of living and not based on a person's actual annual income. Tax paid under the regime, therefore, does not qualify as an income tax credit from a US standpoint and would not be creditable on the US tax return. However, the tax treaty signed between the US and Switzerland would allow Swiss lump-sum taxpayers to qualify for the credit if they elect to be subject to the generally imposed Swiss income taxes on all US source income.

What type of income is subject to US tax but not Swiss tax?
Some common examples are:
- Net gain on the sale of assets held for investment
- US rental property
- Annual Swiss pension plan contributions and earnings

How are capital gains taxed in the US?
The rate of US capital gains tax depends on the type of asset and the length of time you hold it. The holding period begins on the day a property is acquired or ownership changes and ends when it is disposed of or title transfers. Gains in respect to assets held for less than 12 months, are defined as short-term gains and are taxed as ordinary income, subject to the progressive tax rates running between 10% and 37% depending on a taxpayer's overall taxable income. Long-term gains, are assets held for more than 12 months, and are subject to tax at a flat rate of either 0%, 15% or 20%.

What is the net investment income tax I see on my US federal income tax return?
Net investment income tax (NIIT) has been in effect since 1 January 2013. It is an additional tax of 3.8% applicable to an individual's net investment income. NIIT is only applicable when a taxpayer's adjusted gross income exceeds a certain threshold ($250,000 for joint filers, $200,000 for single filers, and $125,000 for married individuals filing separately). Be aware, the NIIT cannot be offset by foreign tax credits.

Why is my Swiss pension plan subject to US tax? Aren't pension plans supposed to be a tax deferred savings program?
Generally, a pension plan allows a taxpayer to defer savings to accumulate tax-free growth until retirement or distribution. But, Swiss pension plans, such as Pillar 2 and Pillar 3, are not "qualified retirement plans" for US tax purposes. Unless the US-Switzerland treaty says otherwise in the future, Swiss pension contributions and associated income or growth are subject to US federal tax annually. The concept sounds easy, but the mechanism can be quite complex. Participation in a Swiss pension plan may be beneficial from a Swiss perspective but not as favorable when you also have a US filing obligation. So, take care, plan with both your Swiss and US taxes in mind. We would always recommend seeking individual advice on this matter.

Now, the next logical question we are often asked is "what happens upon distribution of my pension if my contributions and growth have been taxed by the US already?" But that's probably a question for a whole other article because, as you might have guessed, it gets very complicated!

What about succession planning? What should US citizens living in Switzerland be mindful of?
US citizens should be mindful about the US "transfer tax" for any gifts they make during their lifetime or upon their death to any party, including a trust, a partnership or a corporation. Generally, inter-vivo gifts made by US citizens are subject to US gift tax if the value of the gifted assets exceeds the annual tax-free threshold. The tax-free gift threshold is $17,000 per recipient in 2023 and is adjusted annually for inflation. Not to make things more complicated, the US also assess an estate tax (also known as the "death tax") on the value of the worldwide assets owned by US citizens at the time of death, which exceeds the lifetime exemption amount, set at $12.92 million in 2023. Unless further legislation is enacted, the lifetime exemption amount will be reduced by approximately one-half at the end of 2025 (i.e. reduced to $6.2 million per individual as of 1 January 2026).

Please note that the lifetime exemption amount can also be used to exempt gift tax applicable on any taxable transfer before death. When an individual makes a gift exceeding the annual exclusion of $17,000, he or she can either pay the gift tax on the excess amount or apply for a lifetime exemption credit. However, each time an individual applies for the lifetime exemption credit, the amount used is subtracted from the lifetime exemption credit, leaving less credit to shelter estate tax at the time of death. With the lifetime exemption to be cut in half in about two and a half years, US citizens with estate valued at above $6 million worldwide should contemplate using their exemption partially or entirely before that date. Many people may put off any succession planning on the basis that they have several years to address it, but by starting now that same planning can be done with potentially less risk. The US estate tax is a political football, with the current administration saying that they are going to eliminate it altogether. I think there's little chance of that happening; however, one never knows until the actual legislation is proposed and passed.

Closing remarks from Hugues Salomé

Head of Private Clients at KPMG

Thank you very much! This has been really insightful. Your comments emphasize the importance of addressing the situation of US persons living abroad in a holistic fashion. Due to their citizenship or status as Green Card holders, these individuals are inevitably exposed to the succession and tax rules of more than one jurisdiction. Understanding how this set of rules interplays is key to avoid double taxation but also lengthy and painful legal proceedings upon demise. In that respect, practical experience is also key and our Swiss-based US Tax and Legal team works on such cases on a daily basis.

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