Pension, Retirement Planning and Saving for Americans in Switzerland

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The Swiss three Pillar model - an overview

<table>
<tr><th colspan="6">Needs-oriented pensions</th></tr>
<tr><th colspan="2">Pillar 1</th><th colspan="2">Pillar 2</th><th colspan="2">Pillar 3</th></tr>
<tr><th colspan="2">State pensions</th><th colspan="2">Occupational benefits insurance</th><th colspan="2">Private pensions</th></tr>
<tr><th colspan="3">Mandatory</th><th colspan="3">Voluntary</th></tr>
<tr><td>AHV/IV</td><td>Supplementary benefits (EL)</td><td>Mandatory benefits BVG/UVG</td><td>Extra-mandatory benefits</td><td>Tied pension (Pillar 3a)</td><td>Flexible pension (Pillar 3b)</td></tr>
<tr><td colspan="2">Responsibility of the government</td><td colspan="2">Responsibility of the employer</td><td colspan="2">Responsibility of the individual</td></tr>
<tr><td colspan="2">■ AHV/IV contributions
– Employer and employee: each 50%
– Self-employed persons and those not gainfully employed: 100% self-funded
■ EL contributions
Funded with federal and cantonal tax money</td><td colspan="2">■ UVG contributions
– Employer: Occupational accidents
– Employee: Non-occupational accidents
■ BVG contributions
– Employer and employee: Employer contributions must equal at least the total contributions of all employees
– Self-employed persons: 100% self-funded</td><td colspan="2">100% self-funded (to close individual pension gaps)</td></tr>
<tr><td colspan="2">■ Retirement pension
■ Child's pension
■ Disability pension
■ Disabled person's child's pension
■ Widow's/widower's pension
■ Orphan's pension</td><td colspan="2">■ Daily benefits
■ Retirement pension/capital
■ Retired person's child's pension
■ Disability pension
■ Disabled person's child's pension
■ Widow's/widower's pension
■ Orphan's pension</td><td colspan="2">■ Insurance or banking solution
■ Any other savings and assets</td></tr>
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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)

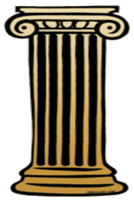
- Employer contributions are (ordinary) taxable income and are added to gross salary
- Employee contributions not tax deductible and are added to gross salary

Pillar 3 (Säule 3a)

- Employee contributions not tax deductible and are added to gross salary

US Tax treatment and results of each pillar

US Tax Treatment | Result



Pillar 1 (AHV)

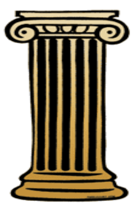
US Tax Treatment
- Government pension plan
- Status uncertain
- Most likely considered social security
- But possibly ordinary foreign financial account (conservative)

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

Pillar 2 (BVG)

US Tax Treatment
- Considered an ordinary foreign financial account (conservative)
- No employer or employee contribution allowances/deductions

Result
- 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)

US Tax Treatment
- Considered an ordinary foreign financial account (no doubts)
- No employer or employee contribution allowances/deductions

Result
- Income and capital gains taxable
- Considered an ordinary investment account
- No tax advantages whatsever
- 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

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

- ✓ 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

US Citizen Employee resident in Switzerland	Switzerland - CHF		
Income	**Amount**	**Rate**	**Total**
Gross Annual Salary	160'000		160'000
Childrens and education allowance (2 children)	4'800		4'800
Other	0		0
		Total Compensation:	**164'800**

Deductions	Employee contributions (deducted)				(Employer contributions)		
	Amount	**Rate**	**Subtotal**				
1st pillar pension contributions	160'000	**5.05%**	8'080	**No US deduction**	**5.05%**	8'080	**No US deduction**
Unemployment insurance deduction	160'000	1.00%	1'600		1.00%	1'600	
2nd pillar pension contributions	160'000	**5.00%**	8'000	**No US deduction**	**5.00%**	8'000	**No US deduction**
Non business accident insurance	160'000	1.121%	1'794		1.121%	1'794	
Sickness cover	160'000	0.90%	1'440		0.90%	1'440	
		Total deductions:	**20'914**		**Total employer benefits:**	**20'914**	
		Swiss taxable income:	**143'886**				

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**

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

Tax payable to the United States on pension contributions		CHF
Pillar 1 (AHV)	Employee contribution:	8,080
	Employer contribution:	8,080
Pillar 2 (BVG)	Employee contribution:	8,000
	Employer contribution:	8,000
	Amount added back to US taxable income:	**32,160**
	Tax payable at 28%	**9,005**

Just the BVG

Tax payable to the United States on Pillar 2 contributions		CHF
Pillar 2 (BVG)	Employee contribution:	8,000
	Employer contribution:	8,000
		16,000
	Tax payable at 28%	**4,480**

Assuming a "typical" 5% Employee : 10% Employer contribution

In Total

Tax payable to the United States on pension contributions		CHF
Pillar 1 (AHV)	Employee contribution:	8,080
	Employer contribution:	8,080
Pillar 2 (BVG)	Employee contribution:	16,000
	Employer contribution:	8,000
	Amount added back to US taxable income:	**40,160**
	Tax payable at 28%	**11,245**

Just the BVG

Tax payable to the United States on Pillar 2 contributions		CHF
Pillar 2 (BVG)	Employee contribution:	16,000
	Employer contribution:	8,000
		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: Annuitisation

- 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

Situation and Practice

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

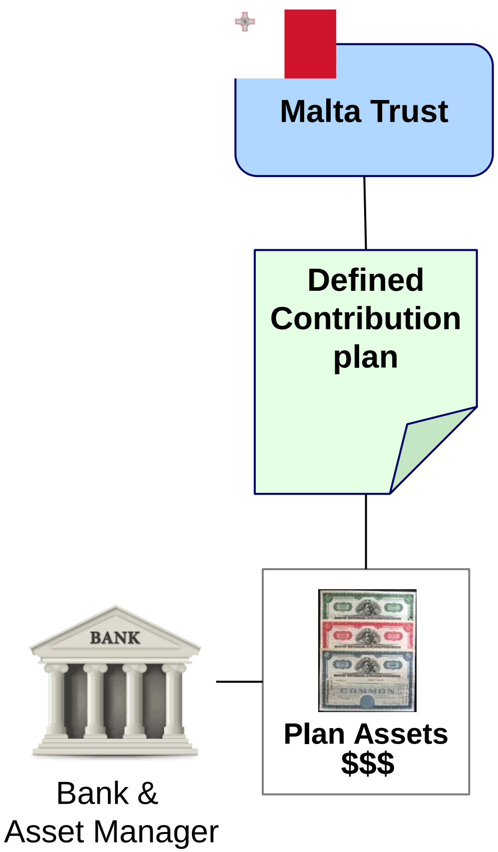
1. First and foremost - Seek competent tax advice

- 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

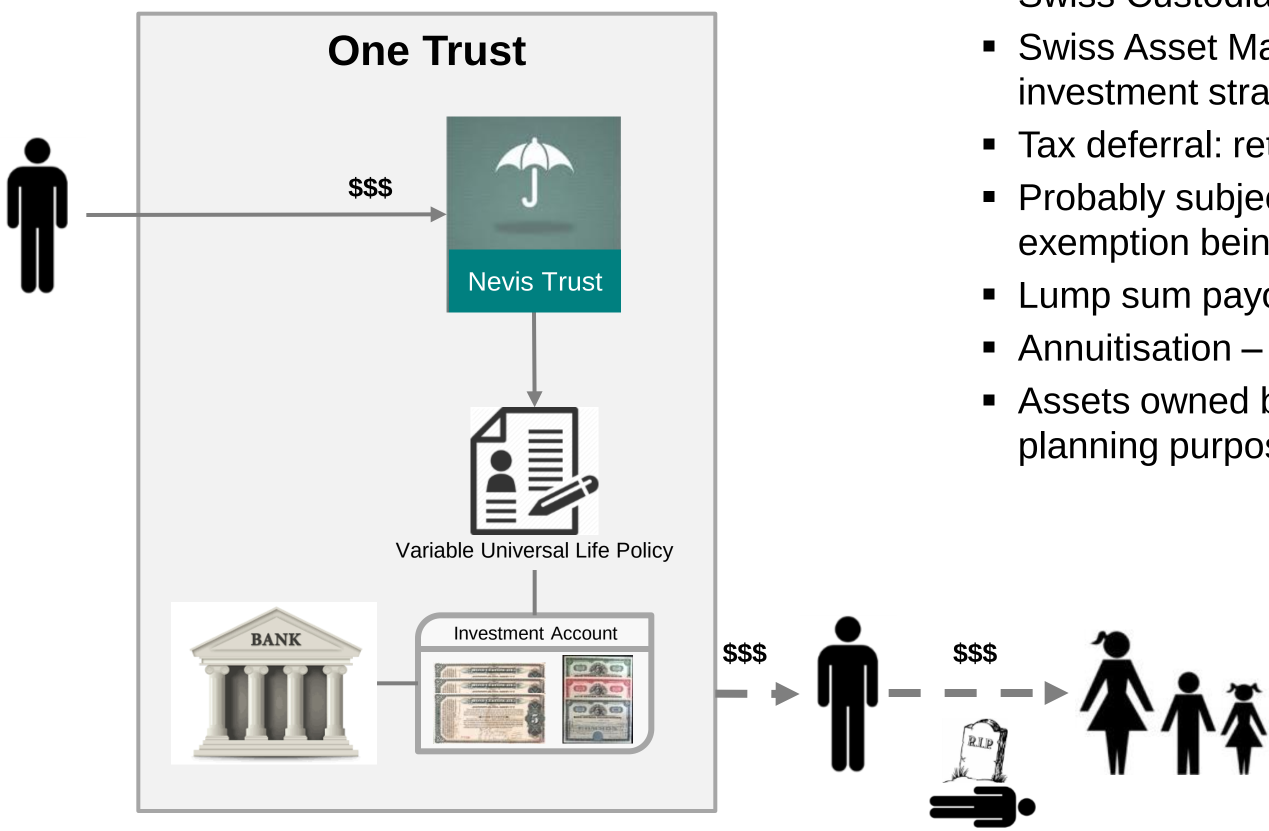
- Uncertainty – Four jurisdictions involved
- 30% of value can be paid out tax free under Malta / US tax treaty
  - And the rest?
- Surrender and early withdrawal charges & tax implications
- Annuitisation rules uncertain
- Must be resident outside the USA
- Tax treatment in jurisdiction of residence (Switzerland, Asia, etc.)
- Assets located in Malta

One good solution - ONE Trust

ONE Trust is a Nevis Trust holding a U.S. tax compliant Variable Life Insurance Policy (DVA or VUL)

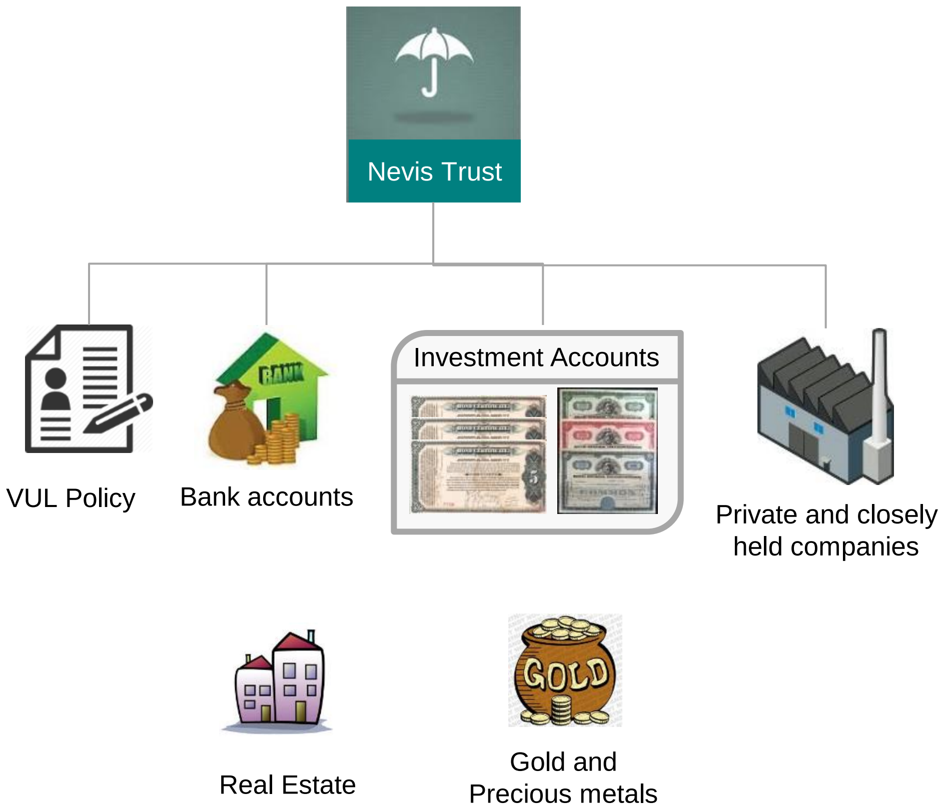
How it works

- 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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