

Milne Legal Press Release

“U.S. Taxes Triggered when Swiss Invest in the U.S.”



Whether our Swiss Clientele¹ are interested in: (i) acquiring a vacation home in Miami or New York; (ii) starting an active trade or business in San Francisco or Chicago; or (iii) investing in United States (“U.S.”) corporate stocks or U.S. private equity deals, Milne Legal (“ML”) encourages each Swiss Person to evaluate the general U.S. tax laws highlighted in this Press Release, including the application of the U.S.- Swiss income tax treaty,² to see how such laws may affect their U.S. investment.

ML is dedicating this Press Release to its Swiss Clientele, both individuals and entities (e.g., an “Aktiengesellschaft” or as a “Societe Anonyme”),³ located throughout Switzerland, who have often asked ML to advise them on the U.S. taxes that may be triggered if they choose to invest in the U.S. in: (i) U.S. real estate; (ii) U.S. stocks and bonds; or (iii) a U.S. trade or business.

After evaluating the U.S. income tax impact on these U.S. investments, this Press Release will conclude by turning to the U.S. estate tax laws that may be triggered when a Swiss decedent passes away owning any U.S. situs assets. It will also address the possible application of the

¹ “Swiss”, as referred to in this Press Release, means a non-resident alien (“NRA”), as such term is defined in IRC §7701(b) who does not have U.S. citizenship, a green card, or meet the substantial presence test. Further, the term “Swiss Persons” or “Swiss Clientele” used throughout this Press Release means a person (e.g., a Swiss citizen, a Swiss resident, or an entity organized under the laws of Switzerland) who is not defined as a “U.S. Person” under Section 7701(30) of the Internal Revenue Code of 1986 (“IRC”).

² The Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, Signed at Washington on October 2, 1996, which can be found at: <https://www.irs.gov/pub/irs-trty/swiss.pdf>

³ Treas. Reg. § 301.7701-2(b)(8)(v) treats both an Aktiengesellschaft and a Societe Anonyme as a “per se” foreign corporation for U.S. federal income tax purposes.



U.S.-Swiss estate tax treaty that may be available to Swiss Persons to reduce or eliminate any U.S. estate tax obligations.⁴

I. General U.S. Tax Rules affecting Swiss Persons

Swiss Persons are only subject to U.S. taxes on two different types of income: (i) “passive income” from U.S. sources; or (ii) “business income” which is effectively connected with a trade or business in the U.S. (commonly referred to as “ECI”).

- A. Passive Income.** Swiss Persons are subject to a general 30% withholding tax (withheld by the U.S. payor) on gross income on fixed, determinable, annual, or periodic income (“FDAP Income”) from U.S. sources. FDAP Income includes interest, dividend, and rental income - often referred to as “passive” or “non-business” income. If applicable, the statutory “portfolio interest exemption” reduces the general 30% withholding tax on interest income to zero. There are other exceptions for “Bank Interest” and “short-term original issue discount” on debt obligations. The 30% U.S. tax withholding rate may also be reduced for certain types of FDAP Income under the U.S.-Swiss income tax treaty. In Part II. below, we will address how the U.S.-Swiss income tax treaty affects the general 30% withholding rate on FDAP income.
- B. Business Income.** Swiss Persons who carry on a trade or business through a “permanent establishment”⁵ in the U.S. are subject to the same graduated tax rates (e.g., up to 39.6% for individuals and up to 35% for corporations in 2016)⁶ and the same rules that apply to similarly situated U.S. Persons that operate a U.S. trade or business.

II. Swiss Persons Investing in U.S. Stocks and Bonds

When our Swiss Clientele invest in U.S. stocks and bonds (passive investments such as equity positions in Apple Inc., Facebook Inc., or Caterpillar Inc.) as part of their investment portfolio, they are subject to the general 30% withholding tax on the gross dividend or interest income that they receive on those investments, reduced by treaty. For Swiss Persons meeting the definition of “resident”⁷ under Article 4 of the U.S.-Swiss income tax treaty,

⁴ The United States-Switzerland Estate and Inheritance Tax Treaty (signed in 1951 and ratified in 1952).

⁵ “Permanent establishment” is defined under model income tax treaties as a “fixed place of business through which the business of an enterprise is wholly or partly carried on.” See Section 3 of this article for further information on what constitutes a permanent establishment under the U.S.-Swiss income tax treaty.

⁶ The tax rates that apply to effectively connected income are found in IRC § 1 and § 11.

⁷ Swiss tax counsel is essential to understand what constitutes residency in Switzerland for purposes of the income tax treaty.



Article 10 of the treaty reduces the general 30% withholding tax on dividends to either 5% or 15% (depending on the amount of voting stock directly held by the beneficial owner) and Article 11 reduces the withholding tax on interest income to 0%.⁸ The zero percent tax rate on interest income will not apply if the taxpayer carries on a business in the U.S. through a permanent establishment and the interest income is attributable to such permanent establishment.⁹

To be eligible to receive these reduced withholding rates under the treaty, Swiss Persons must be resident in Switzerland, must provide the withholding agent with a properly completed withholding certificate, e.g., a W-8BEN for individuals and a W-8BEN-E for entities,¹⁰ and such taxes, if any, must be satisfied through withholding. Assuming the U.S. tax has been satisfied through the withholding regime, the Swiss person is not required to file a U.S. income tax return.

III. Swiss Persons Investing in a U.S. Trade or Business

A Swiss Person that receives income “effectively connected” with a U.S. trade or business is subject to U.S. tax at the graduated rates that typically apply to U.S. persons (e.g., up to 39.6% for individuals and up to 35% for corporations in 2016).¹¹ However, the U.S.-Swiss income tax treaty only permits the U.S. to tax Swiss Persons on a U.S. trade or business that also constitutes a “permanent establishment” (“PE”) as defined under the treaty. Therefore, ML encourages any Swiss Person who has business contacts within the U.S. (e.g., travels to the United States on a regular basis) or who employs U.S. persons to evaluate whether such

⁸ See Article 10 and 11 of the Convention between the United States of America and the Swiss Confederation (October 2, 1996).

⁹ See Article 11 paragraph 3 of the income tax treaty between the United States of America and the Swiss Confederation (October 2, 1996).

¹⁰ In 2010, Congress passed the Hiring Incentives to Restore Employment Act of 2010, P. L. 111-147 (the HIRE Act), which added chapter 4 of Subtitle A (chapter 4) to the Code, consisting of sections 1471 through 1474 of the Code and commonly referred to as “FATCA” or “chapter 4”. Under chapter 4, participating foreign financial institutions (FFIs) and certain registered-deemed compliant FFIs are generally required to identify their U.S. account holders, regardless of whether a payment subject to withholding is made to the account. The IRS has published regulations that provide due diligence, withholding, and reporting rules for both U.S. withholding agents and FFIs under chapter 4.

An intergovernmental agreement (IGA), Model 2, between the United States and Switzerland took effect on June 30, 2014 (considered to be “In Force on June 2, 2014”) to facilitate the implementation of FACTA. The IGA can be found at: <https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>

¹¹ The tax rates that apply to effectively connected income are found in IRC § 1 and § 11.



business activities rise to the level of a PE under the U.S.-Swiss income tax treaty.

The U.S.-Swiss income tax treaty describes a PE as:

“a fixed place of business through which the business of an enterprise is wholly or partly carried on.”¹²

Despite having a “fixed place of business” in the U.S., the treaty states that the following will not constitute a permanent establishment: “the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, advertising, the supply of information, scientific research, or other activities which have a preparatory or auxiliary character.”¹³ The treaty defines “preparatory or auxiliary activities” as advertising activities or activities for the purpose of supplying information only.¹⁴

ML advises its Swiss Clientele to tread cautiously in their PE analysis when they engage “agents” who carry out business activities inside the U.S. on behalf of the Swiss firm. The activities of the agents can be imputed to the Swiss firm and cause the Swiss firm to have a PE, thereby subjecting the Swiss firm to U.S. tax. The treaty states the following:

“where a [dependent agent] is acting on behalf of an enterprise and has, and habitually exercises,¹⁵ in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise,

¹² See Article 5 of the income tax treaty between the United States of America and the Swiss Confederation (October 2, 1996). Article 5 provides examples of a PE such as the following: (a) a place of management; (b) a branch; (c) an office; (d) a factory; (e) a workshop; and (f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

¹³ See Article 5 (4)(e) of the Convention between the United States of America and the Swiss Confederation 1996.

¹⁴ Id.

¹⁵ The OECD Model, commentary on Article 5, states the following: “[T]he authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority “in that State,” even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise.”



unless the activities of such person are limited to those [that are preparatory or auxiliary] . . .”¹⁶

Swiss Persons should evaluate any potential agency relationship and its impact under the U.S.-Swiss income tax treaty prior to sending any agent into the U.S. to conduct any business activities on its behalf.

If a Swiss person is determined to have a PE in the U.S., then it will be taxed on any business profits that are “attributable” to the PE. The U.S. Model Treaty states that business profits that are attributable to the U.S. PE are those profits that “it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.”¹⁷

Although beyond the scope of this Press Release, Swiss business entities that have income which is effectively connected with a U.S. permanent establishment may also be subject to the U.S. “branch profits tax”.¹⁸ Therefore, Swiss entities which have ECI must also evaluate the impact of the branch profit tax under the U.S.-Swiss income tax treaty in order to arrive at the total U.S. tax obligation associated with their U.S. business activities.¹⁹

Finally, on a related subject, our Swiss clientele who make private equity investments by holding interests in U.S. partnerships (either directly or indirectly), must closely monitor whether the U.S. partnership has ECI. If the Swiss person receives an allocation of ECI from the U.S. partnership, then the U.S. partnership will be required to withhold U.S. tax on the ECI allocated to the foreign partner (at 39.6%) and the Swiss Person will be required to file a U.S. tax return with the U.S. Internal Revenue Service (“IRS”) to claim a refund for any overpayment of U.S. tax.²⁰

Most of our Swiss Clientele, for privacy purposes, prefer to structure their U.S. private equity investments through “blocker” entities (entities regarded as

¹⁶ See Article 5(5) of the Convention between the United States of America and the Swiss Confederation 1996.

¹⁷ See U.S. Treasury Department's Model Income Tax Convention of September 20, 1996, art. 7(2).

¹⁸ In addition to tax on ECI as discussed in this Press Release, foreign corporations may be subject to a branch profits tax (“Branch Profits Tax”) of up to 30% of its after-tax ECI. The Branch Profits Tax is a second level of tax that would be applied after the 35% tax on ECI earned by the foreign corporation, resulting in a cumulative tax as high as 54.5% on any ECI investment - if not otherwise reduced by treaty. For Swiss Corporations, Article 10 of the tax treaty between the United States and Switzerland reduces the general 30% Branch Profits Tax to 5%.

¹⁹ The branch profits tax is intended to treat a foreign entity's U.S. trade or business activities as if it were activities associated with a separate U.S. corporation subject to double taxation.

²⁰ IRC § 1446(a).



“corporations” for federal income tax purposes).²¹ By using blockers, our Swiss Clientele may avoid receiving ECI, and therefore, avoid the necessity of filing an individual US tax return. Note, however, that the “blocker” entity will still be required to file a U.S. tax return to report the allocation of ECI from the U.S. partnership.

Please visit ML’s homepage at: www.milnelegal.com and click on the link “News, Events, and Publications” for structure charts illustrating how a Swiss Person may chose to make these private equity investments in order to avoid triggering distributions of ECI.

IV. Swiss Persons Investing in U.S. Real Estate

Capital gains from the sale of U.S. property (e.g., U.S. stocks and bonds) generally do not constitute FDAP Income subject to the 30% withholding tax discussed above.²² This is welcomed news for our Swiss clientele because it means that any U.S.-source capital gains (e.g., gains from the sale of their investment portfolio), which is not effectively connected with a U.S. trade or business, is statutorily exempt from U.S. taxation.

A significant exception to the tax-exempt status of capital gains relates to capital gains derived from the sale of U.S. real property by a non-U.S. person (e.g., our Swiss Clientele). The Foreign Investment in Real Property Tax Act (“FIRPTA”) provides that a non- U.S. person that has any gain from the disposition of an interest in real property²³ located in the U.S. is deemed to be gain which is effectively connected with a U.S. trade or business subject to taxation as ECI.²⁴ This tax on U.S. real property interests continues to apply even if the U.S. real property interest is indirectly owned by the Swiss person through his or her ownership in a partnership.²⁵

²¹ The main goal of a “blocker” in any private equity investment is not to avoid the net income tax liability owed to the U.S.; that liability still exists and will be paid by the blocker (instead of by the Swiss Person or other foreign investors). The main objective of the blocker is to protect the Swiss Person, and any other non-U.S. investors who have chosen to invest in the blocker, from having to file U.S. income tax returns because of its indirect U.S. trade or business activities. The U.S. income tax filing obligations belongs to the blocker and not to the indirect foreign investors. Therefore, the corporation (whether US or non-US) is said to have “blocked” the foreign investors from their U.S. tax filing obligations and the foreign investors’ privacy is properly retained from the U.S. tax authorities.

²² See Treas. Reg. § 1.1441-2(b)(2)(i).

²³ FIRPTA also applies to the disposition of an interest in a domestic or foreign corporation that holds U.S. real property. For example, the disposition of the blocker corporation discussed in the previous section.

²⁴ IRC § 897(a).

²⁵ IRC § 897(g) and § 1446.



FIRPTA requires that purchasers withhold 15% (10% for dispositions before February 17, 2016) of the gross amount realized from the sale or exchange of a U.S. real property interest by a non-resident alien.²⁶

V. U.S. Estate Tax

Although it is not the primary purpose of this Press Release to discuss the impact of the U.S. estate tax on Swiss individuals, ML wishes to touch on the subject given its importance to the discussion above.

A non-U.S. decedent (i.e., a non-U.S. citizen who is also not a U.S. domiciliary at the time of his or her death) who dies owning property that has “situs” in the U.S. is subject to the U.S. estate tax on that property at rates up to 40%, unless reduced by treaty.²⁷

Common categories of U.S. situs assets include: (i) real property located in the U.S.;²⁸ (ii) tangible personal property physically located in the U.S. (including currency located in the U.S.);²⁹ and (iii) shares of corporations incorporated in the U.S.³⁰ By contrast, interests held in real estate located outside the U.S.³¹ and shares issued by corporations organized outside the U.S.³² are both examples of non-U.S. situs assets, not subject to U.S. estate tax.

Unlike U.S. decedents (i.e., U.S. citizens or persons who were “domiciled”³³ in the U.S. at the time of their death),³⁴ a non-U.S. decedent’s estate is not allowed

²⁶ IRC § 1445.

²⁷ IRC § 2201, 2103 and 2104.

²⁸ Treas. Reg. § 20.2104-1(a)(1).

²⁹ Treas. Reg. § 20.2104-1(a)(2).

³⁰ Treas. Reg. § 20.2104-1(a)(5).

³¹ Treas. Reg. § 20.2105-1(a)(1).

³² Treas. Reg. § 20.2105-1(f).

³³ Domicile, for U.S. estate and gift tax purposes, is a subjective test, based on many facts and circumstances. An individual is considered domiciled in the U.S. if the individual: (a) is living in the U.S. and has the intention to remain in the U.S. indefinitely; or (b) has lived in the U.S. with such an intention and has not formed the intention to remain indefinitely in another country. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile. As a result, determining domicile is quite subjective and is based on all the facts and circumstances of the individual in question. Such domiciliary factors include, but are not limited to, where the individual’s primary residence is located, where the individual carries on his family, social, religious, and business relations and activities.

³⁴ For U.S. decedents dying in 2016, the unified credit is USD 2,125,800, which may effectively exempt a taxable state of up to USD 5’450’000. As explained above, the unified credit is also available to exempt taxable gifts made by the decedent during his or her lifetime, and only that portion of the unified credit that has not been applied against lifetime taxable gifts may be applied against the estate tax upon the decedent’s death.



a unified credit against the estate tax. Instead, a non-U.S. decedent's estate is allowed a rather meaningless credit of USD 13'000, which will exempt only USD 60'000 of U.S.-situs assets from estate tax. There is no estate tax reporting obligation for non-U.S. decedents who pass away owning U.S.-situs assets below the 60'000 exemption.

Fortunately, for Swiss decedents (i.e., Swiss citizens who have their domicile in Switzerland), the U.S. has concluded only a handful of estate tax treaties, including a rather favorable estate tax treaty with Switzerland,³⁵ that may reduce the U.S. estate tax burden for Swiss decedents (i.e., non-U.S. citizens who were not domiciled in the U.S. at the time of his or her death) well beyond the general USD 60'000 exemption discussed above for other non-U.S. decedents.³⁶

For example, a Swiss decedent that dies in 2016 and has a worldwide estate valued at the time of his death of USD 10 million with USD 1 million of U.S. assets (i.e., USD 9 million of non-U.S. situs assets) would be entitled under the estate tax treaty to an exemption of USD 545'000 based on the following formula:

$$1'000'000/10'000'000 \times 5'450'000^{37} = 545'000$$

Therefore, the total amount of U.S. situs assets subject to the U.S. estate would be USD 455'000 (1'000'000 minus the treaty exemption of 545'000).

In addition, note that shares in a foreign corporation are not subject to U.S. estate tax since they are not treated as U.S.-situs assets. A common U.S. estate planning technique adopted by non-U.S. persons is to form two corporations: a U.S. corporate subsidiary and a foreign corporate parent. The U.S. corporate subsidiary is then funded with cash and purchases U.S.-situs assets. At the death of the non-U.S. shareholder of the foreign corporate parent, the shares of the foreign corporation are not subject to U.S. estate tax. Consequently, this structure may avoid the imposition of U.S. estate tax upon the death of the non- U.S. shareholder of the foreign corporate parent.

³⁵ See Article III of the United States-Switzerland Estate and Inheritance Tax Treaty (signed in 1951 and ratified in 1952).

³⁶ Article III of the U.S. – Switzerland estate tax treaty provides that the exemption is calculated as follows: "the United States shall allow a specific exemption which would be allowable under its law if the decedent had been domiciled in the United States in an amount not less than the proportion thereof which the value of the total property (both movable and immovable) subjected to its tax bears to the value of the total property (both movable and immovable) which would have been subjected to its tax if the decedent had been domiciled in the United States."

³⁷ The total unified credit available to U.S. decedents in 2016 was USD 5'450'000 (assuming no gifts were made during the taxpayer's lifetime that would reduce this amount).



In conclusion, with some advance planning, Swiss individuals owning U.S.-situated assets can take steps today through proper structuring and planning to minimize their exposure to any U.S. estate tax at the time of their death and/or ensure that they take full advantage of the exemption provided under the U.S.-Swiss estate tax treaty.

If the U.S. estate tax applies, the executor or administrator of a Swiss decedent's estate must file Form 706-NA with the IRS and Form 8833 to take the treaty-based tax position, if applicable. The due date for payment of the estate tax (and filing of the returns, if an extension is not otherwise filed) is nine months after the date of the decedent's death. If needed, the executor may claim an automatic six-month extension to file by filing Form 4768.

VI. Conclusion

Prior to making an investment in U.S. real estate, U.S. equities, or in a U.S. trade or business, ML encourages Swiss Persons to plan in advance, taking the above U.S. income and estate tax laws into consideration, in order to avoid any unnecessary tax surprises in the future.



Dustin Milne
Managing Partner

“ One of the most unfortunate outcomes we see in our tax practice is when Swiss individuals pass away owning direct equity investments in U.S. corporations or U.S. real estate, triggering U.S. estate tax obligations unbeknownst to them. Through proper estate planning techniques, this exposure to U.S. estate taxes could have been avoided.”

Mr. Dustin Milne has an international tax LL.M. degree from New York University School of Law and a Juris Doctorate degree from the University of Miami School of Law where he graduated Magna Cum Laude.

Mr. Milne may be contacted at: dustin.milne@milnelegal.com

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This Press Release reflects Milne Legal's interpretation of the IRC and Treasury Regulations thereunder as of the date of this article. Any subsequent changes to the U.S. tax laws discussed herein could affect the validity of the general conclusions or recommendations set forth by Milne Legal.

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