

Novartis Swiss Employer Pension Plan

Taxation – US/Swiss Income Tax

17 October 2013

Pension Seminar



www.pensionskassen-novartis.ch

EY

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Agenda

US/Swiss Taxation

- ▶ US IRS Circular 230
- ▶ US and Swiss Domestic tax law - Overview
- ▶ Double tax avoidance
- ▶ US/Swiss pension taxation - US/Swiss income Tax Treaty
- ▶ US/Swiss pension taxation - Domestic tax law
- ▶ Swiss Pension - Overview
- ▶ Example 1: US to Switzerland
- ▶ Example 2: Switzerland to US
- ▶ Example 3: Switzerland Cross border
- ▶ Disclaimer

IRS Circular 230 Disclaimer

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Domestic Tax Law – US

United States : Taxation is based on US residency status

- ▶ **US Tax residents (as below)** - generally subject to tax on world-wide income
 - US Citizens
 - US Green Card Holders and
 - US Resident Aliens (based on days of presence in the US)

- ▶ **US Nonresidents** – generally subject to tax on US sourced income only

Domestic Tax Law – Switzerland

Switzerland: Taxation is based on Swiss residency status

- ▶ **Swiss Tax residents** – generally subject to tax on world-wide income (and wealth)

- ▶ **Swiss Nonresidents** – generally subject to tax on employment income on Swiss workdays

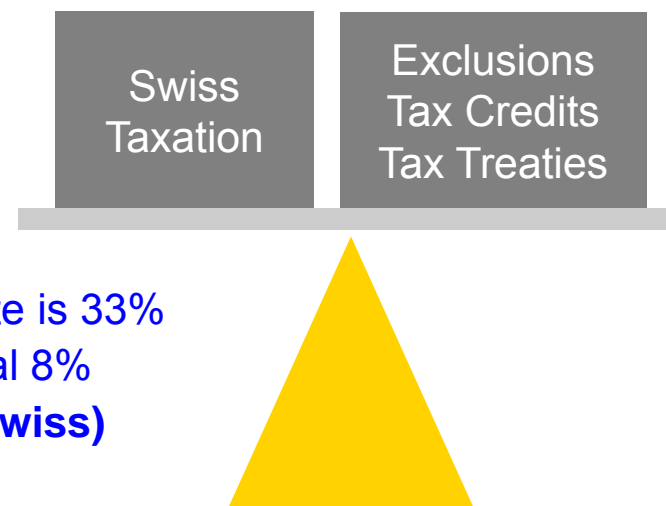
The Big Picture as a local hire in Switzerland

US Tax Resident and Swiss Tax Resident

- ▶ Subject to two taxation regimes because:
 - ▶ Employment in Switzerland
 - ▶ US Citizen / Green Card Holder

Seems that there is double taxation?

- ▶ US tax system allows exclusions, tax credits and tax treaties which mitigates double taxation
- ▶ Effectively pay the higher tax of the two systems



Example

- ▶ Swiss Effective tax rate is 25%, U.S. effective tax rate is 33%
- ▶ Swiss receives 25% of the tax, U.S. receives residual 8%
- ▶ **Overall Tax Burden: still 33% (higher of U.S. or Swiss)**

US/Swiss Income Tax Treaty – Pension Article

Switzerland - United States Income Tax Treaty (1996)

- ▶ Article 18, “Pensions and Annuities” provides for taxation where individual is considered tax resident
- ▶ “Tax residency” is normally determined under Article 4
- ▶ US tax residents would normally be tax resident in the US by default and may have an additional tax residency in the non-US country based on the country’s domestic tax laws
- ▶ Very important to note here is that determination of residency to a country is normally complex and may differ based on each person’s individual circumstance and the treaty rules

US/Swiss Income Tax Treaty – Pension Article (Contd.)

Article 18

Pensions and annuities

1. Subject to the provisions of Article 19 (Government service and social security), pensions and other similar remuneration beneficially derived by a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

Article 4

Resident

1. For the purposes of this Convention, the term "resident of a Contracting State" means:
 - (a) any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, nationality, place of management, place of incorporation, or any other criterion of a similar nature, except that a United States citizen or alien lawfully admitted for permanent residence (a "green card" holder) who is not a resident of Switzerland by virtue of this paragraph or paragraph 5 shall be considered to be a resident of the United States only if such person has a substantial presence, permanent home or habitual abode in the United States; if, however, such person is also a resident of Switzerland under this paragraph, such person also will be treated as a United States resident under this paragraph and such person's status shall be determined under paragraph 3;

Pension Taxation – US

United States

Swiss Pension contributions – Employee and Employer

- ▶ Novartis Swiss employer pension fund is not considered “qualified” under US law
- ▶ Therefore, both employee and employer contributions are US taxable on the way into the plan
- ▶ The taxed contributions creates a US tax 'basis' in the pension plan

Pension Distributions

- ▶ A distribution from the Novartis Swiss Employer Pension Plan (and indeed a transfer into a Swiss blocked account from the plan), results in US tax for a US citizen or green card holder at the time of distribution.
- ▶ The distribution is taxable to the extent that the amount received is in excess of the US tax 'basis'. The basis is the amount of employer and employee pension contributions that have already been taxed by the US on the way into the pension plan.

Pension Taxation – Swiss

Switzerland

Swiss Pension contributions – Employee and Employer

- ▶ Employee contributes 0.5% to 10.9% (dependent on age, excl. Management Pension Fund) of the insured salary (employment income minus coordination amount of CHF 24,570)
- ▶ The employer contributes double of employee contributions
- ▶ The employee contributions are withheld by employer and are deductible for Swiss tax purposes
- ▶ The employer contributions are not Swiss taxable on the way into the plan

Pension Taxation – Swiss (Contd.)

Switzerland

Pension Distributions

- ▶ Distributions from Pillar 2 can only be made when you –
 - ▶ reach retirement age,
 - ▶ leave/de-register from Switzerland,
 - ▶ purchase a property in Switzerland for own use (primary home) or
 - ▶ start a business (self-employed)

- ▶ If you leave Switzerland, pillar 2 pension can be paid out to you and will be subject to beneficial tax rates.

- ▶ If you move to a EU or EFTA State and you are subject to mandatory old age pension insurance in that state only contributions in excess of the legally required (over mandatory part) can be withdrawn.

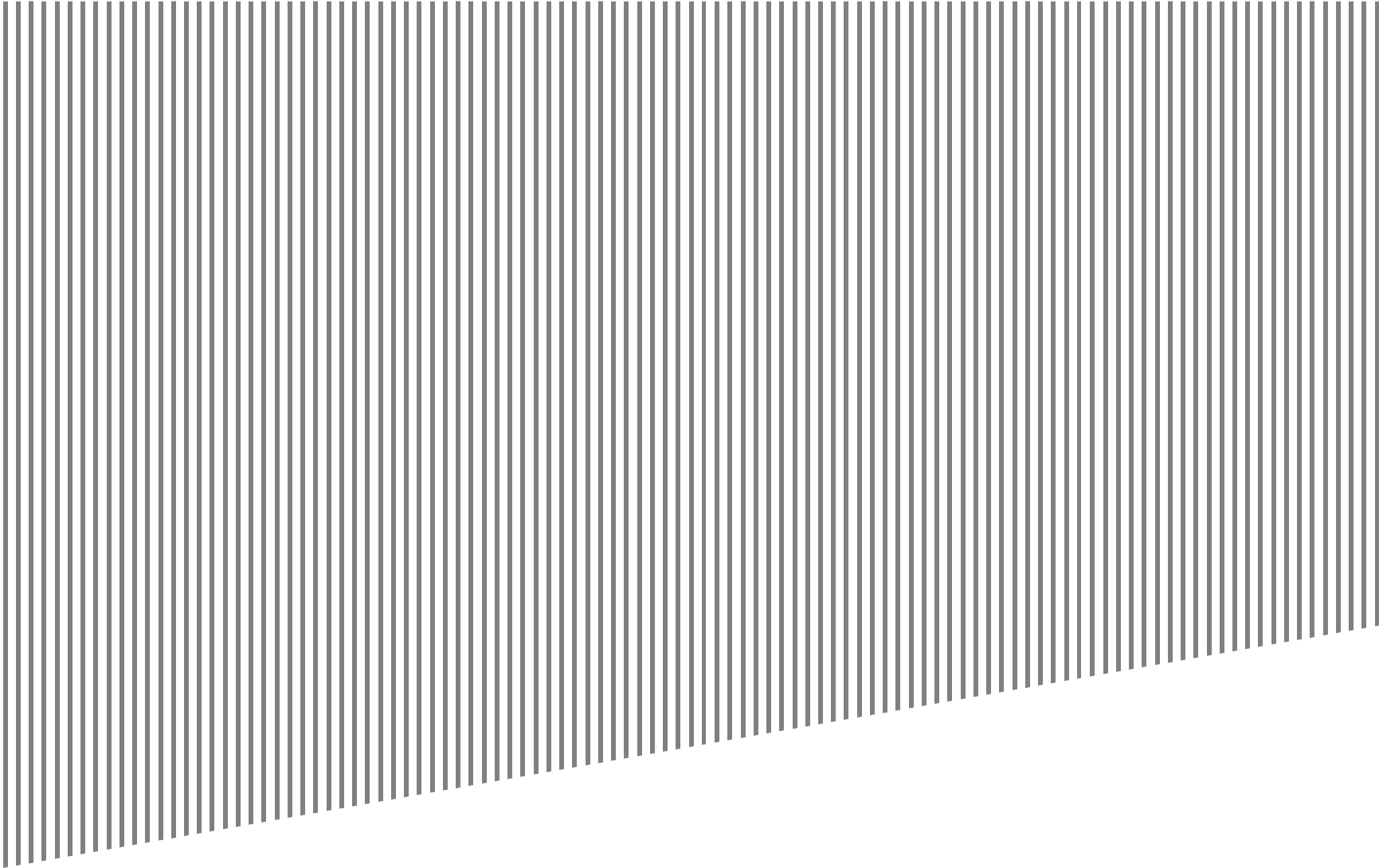
CH Social Security - Overview

	Pillar 1		Pillar 2			Pillar 3a	
	Mandatory state insurance (AHV/IV/EO)		Company pension Fund (partly mandatory based on Swiss Pension Act, BVG)			Voluntary private savings	
	<i>Secures existence</i>		<i>Confirming standard of living</i>			<i>Additional needs</i>	
	Contribution	Distribution	Contribution	Buy-Back	Distribution	Contribution	Distribution
Description	<ul style="list-style-type: none"> - Basic Swiss social security withheld at source. - AHV is 5.15% of gross salary, uncapped and includes the state pension (total 10.3% parity paid by employee and Novartis) - ALV or unemployment insurance (UI) is 1.1% up to CHF 126,000, and 0.5% between CHF 126,001 and CHF 315,000 for 2013 	<ul style="list-style-type: none"> - Distributions can be taken only after you reach retirement age. - You would need to submit your AHV card (keep it safe until then). Exception: if you are returning to a non-treaty country, pillar 1 benefits may be paid out to you after leaving/de-registering from Switzerland. 	<ul style="list-style-type: none"> - E'ee contributes 0.5% - 10.9% (dependent on age , excl. Management Pension Fund) of the insured salary (employment income minus coordination amount of CHF 24,570 for 2013). - Special rates apply to income above CHF 220'000. - Withholding at source. - Novartis contributes double e'ee contributions. 	<ul style="list-style-type: none"> - Additional voluntary e'ee contributions to pillar 2 (filling missing years of contributions back to age 25). - If you have never belonged to a Swiss occupational benefits scheme, the annual sum of contributions is capped at 20% per year of the "respective insured remuneration", for the first 5 years. - 3 year blocking period applies. - Novartis pension administration can advise on your limits for pension buy-back. 	<ul style="list-style-type: none"> - Distributions can be taken only upon (1) retirement age, (2) de-registration from Switzerland, (3) purchase of a Swiss property for own use (primary home) , and (4) starting a business. - If you leave Switzerland, the vested benefits can be paid out to you and will be subject to beneficial tax rates. - If you move to a EU or EFTA State and you are subject to mandatory old age pension insurance there, only contributions in excess of legally required can be withdrawn. 	<ul style="list-style-type: none"> - Voluntary, personal pension scheme (via bank or insurance company). 	<ul style="list-style-type: none"> - Distributions can be taken only upon (1) retirement age, (2) de-registration from Switzerland, (3) purchase of a Swiss property, and (4) starting a business. - Distributions are subject to beneficial tax rates in Switzerland.

CH Social Security – Overview (Contd.)

Pillar 1		Pillar 2			Pillar 3a		
Mandatory state insurance (AHV/IV/EO)		Company pension Fund (partly mandatory based on Swiss Pension Act, BVG)			Voluntary private savings		
<i>Secures existence</i>		<i>Confirming standard of living</i>			<i>Additional needs</i>		
Contribution	Distribution	Contribution	Buy-Back	Distribution	Contribution	Distribution	
Swiss Taxation	- AHV & ALV both deductible against Swiss taxable income.	- Taxable at distribution.	- E'ee contributions deductible	- E'ee contributions deductible (exception for Swiss non-residents possible) - If you move cantons, buy-back may not be fully deductible (as losses from one canton to another cannot not be carried over).	- Taxable at distribution.	- E'ee contributions are tax-deductible up to CHF 6'739 (2013) per annum	- Taxable at distribution.
US Taxation	- Not deductible against US taxable income	- Not taxable at distribution.	- E'ee contributions <u>not</u> deductible	- E'ee contributions <u>not</u> deductible - E'er contributions <u>taxable</u> <i>N.B. Swiss tax savings vs US tax impact - tax calculations could be run for planning.</i>	- Only the distribution in excess of amounts already taxed (i.e. only the growth in the fund), is taxable at distribution.	- E'ee contributions <u>not</u> deductible - E'er contributions <u>taxable</u> <i>- N.B. Potential PFIC issues!</i>	- Only the distribution in excess of amounts already taxed (i.e. only the growth in the fund), is taxable at distribution.

Practical Examples



Example 1: US to CH

Facts:

US citizen/US green card holder

Local hire move from US to Switzerland

Assumed annual gross salary of CHF 180,000

Assumed no US state tax residency as a Swiss local hire

Scenario A: Cash flow under Novartis Swiss pension fund

Scenario B: Cash flow under US 401k

Example 1: US to CH (Contd.)

Joe Smith						EXAMPLE 1	
						Scenario A	
Place of residency:	Basel-Stadt						
Marital status:	Married						
Number of children:	0						
Swiss Church membership:	none						
Analysis: Full Year Swiss Local Hire - Target Cash							
CHF 1 = USD	1.05						
Tax calculation				SWITZERLAND - Actual Return		USA - Federal Actual Return	
				Swiss Full Year Local Hire			
Income				CHF		USD	
Annual Base Salary				100'000		105'000	
Others				80'000		84'000	
Total Direct Compensation at Target		(A)		180'000		189'000	
EmployEE Swiss Pension Contributions				8'170			
EmployER Swiss Pension Contributions		(B)		16'341		17'158	
Swiss AHV social security (5.15%)				9'270			
Swiss ALV unemployment insurance 2013 (First CHF 126'000 @ 1.1%, remaining up to CHF 315'000 @				1'656			
Swiss Deductions		(C)		19'096			
Total Estimated Taxable Income				160'904	(A)-(C)	206'158	(A)+(B)
Lump Sum Deductions				Swiss Federal and Cantonal Tax		US Federal Tax	
Business expenses (Swiss)	Standard/Itemized Deduction			4'700	4'000	-12'200	
Insurance premiums (Swiss)	Exemptions (Federal/State)			3'500	4'000	-7'800	
Deduction for married couples and children (Swiss)				2'600	35'000	0	
Total Lump Sum Deductions				10'800	43'000	-20'000	
Taxable Income				150'104	117'904	186'158	
Income Tax Liability				CHF 32'603		\$39'590	

Example 1: US to CH (Contd.)

Less Swiss Tax Liability taken as credit on US return (Limited to US Tax liability)						\$34'233		
			Residual US Federal Tax Liability (USD)			\$5'357		
			US State Income Tax Liability			5'357		
			Swiss Tax Income Liability in USD			34'233		
			Overall Tax Liability in USD (Swiss + US)	(E)		39'590		
			Swiss Social Security (AHV/ALV) in USD			11'472	51'062	
			Swiss Employee Pension Contributions in USD			8'579		
			Total deductions	(F)		20'051		
			Net Salary Cash	(A)-(E)-(F)		129'359		
			Employee and Employer Swiss Pension Contributions			25'737		
			Net Salary Cash + Pension Contributions			155'096		

Post-tax basis in Swiss Pension - US tax paid year on year, therefore no tax due on these amounts at distribution. Only US taxable on pension fund growth.

Summary: Higher US tax costs due to Swiss pension contributions being US taxable. However, pension pay outs are typically more under Swiss pension plan versus the US 401k.

Note: There is a possibility of lowering the rate of pension contribution by 2%. Such a change of the contribution scale is possible on a monthly basis. Get in touch with your Novartis Swiss Pension Fund Advisor.

Example 1: US to CH (Contd.)

Joe Smith				EXAMPLE 1
				Scenario B
Place of residency:	USA, New Jersey			
Marital status:	Married			
Number of children:	0			
Analysis: Full Year US, NJ, Resident - Target Cash				
		TARGET		
Tax calculation		USA - Federal Actual Return	USA - State Actual Return	
Income		USD	USD	
Annual Base Salary		105'000	105'000	
Others		84'000	84'000	
Total Direct Compensation at Target		189'000	189'000	
US 401(k) Deduction		-17'500	-	
Total Estimated Taxable Income		171'500	189'000	
		US Federal Tax	US State	
State Tax taken as itemized deduction		-12'200	-	
Exemptions (Federal/NJ)		-7'800	-2'000	
		-20'000	-2'000	
Taxable Income		151'500	187'000	
Income Tax Liability		29'886	7'869	

Example 1: US to CH (Contd.)

Total Tax liability (Fed and State)			37'754	
US Social Security			7'049	
US Medicare @ 1.45%			2'741	
Additional Medicare Tax @ 0.9%			-	47'544
401(k)			17'500	
Total deductions	(B)		65'044	
Net Salary Cash	(A)-(B)		123'955.70	
Employer Pension Contribution (assume 1:1)			17'500	
Employee Contribution to 401(k)			17'500	
Total US Pension Contribution			35'000	Untaxed - taxed at distribution
Estimated US tax on pension at distribution			11'900	
Net Salary Cash + Pension Contributions			147'056	

Summary:

- ▶ Even though Scenario B shows lower tax costs, the pension pay out is higher under Scenario A
- ▶ Each individual situation may differ

Example 2: CH to US

Facts:

Swiss Citizen

No additional US citizenship or US green card

Local hire move from Switzerland to US

Taxation : Refer the Swiss/US Income Tax Treaty

Scenario 1: Resident for tax in US

- ▶ 100% distribution subject to Swiss lower withholding tax rates on the pension distribution
- ▶ 100% distribution subject to US taxes at ordinary income rates – since no previous US tax “basis” created in the fund
- ▶ Credit given on the US tax return for Swiss taxes withheld
- ▶ Likely residual US taxes still owed
- ▶ Note – State taxes may apply additionally!

Example 2: CH to US (Contd.)

Facts:

Swiss Citizen

No additional US citizenship and no US green card holder

Local hire move from Switzerland to US

Taxation : Refer the US/Swiss Income Tax Treaty

Scenario 2: Non-resident for tax in the US

- ▶ 100% distribution subject to Swiss lower withholding tax rates on the pension distribution
- ▶ 100% distribution is non-US source and therefore, not subject to US taxation

Example 2: CH to US (Contd..)

Moving to the US? KEEP IN MIND!!

- ▶ *Novartis Swiss employer pension fund pays out at the end of the month the Swiss employment contract ends*
- ▶ *Pension fund requires at least two weeks advance notice **and five workdays after the due date** to release the funds (esp. if Pension Fund 2 investment holdings are involved)*
- ▶ *Reach out to your personal tax advisor before moving to the US – at least two months before the move*
- ▶ *Possibility of moving the pension to a Swiss “blocked” account prior to leaving Switzerland. US and Swiss tax interplay is complex and depends on various factors like residency, days of presence, point of registration, etc. Other US tax implications/reporting requirements may also apply.*
- ▶ *Additional US filing forms may be triggered for non-US investments held*

Example 3: Swiss ‘Daily’ Cross-Border

Facts:

German citizen

US green card holder

Employment contract in Switzerland

Tax resident in Germany

Note: rules differ for weekly cross-Border

Highlights

- ▶ Swiss income tax at 4.5% on gross salary
- ▶ 100% income subject to Swiss social security (if threshold of 25% of work/remuneration in the country of residence is not exceeded – per EU regulation)
- ▶ 100% income subject to German income tax + credit for Swiss income tax given
- ▶ **100% income subject to US income tax + credit for German income tax after Swiss credits given**

Example 3: Swiss 'Daily' Cross-Border (Contd.)

- ▶ For the US tax return, specifically for pension taxation, we need to look at the US tax treaty with the country that the taxpayer is determined to be tax resident of.
- ▶ Here, since tax resident in Germany, the US/Germany income tax treaty will apply

Calculation:

Description	<i>All amounts in same currency</i>			
	Switzerland	Germany	US	Total
Gross Salary	250'000	-	-	250'000
Approximate Income Tax Rate	4.5%	36%	33%	
Income Tax Liability	11'250	90'000	82'500	
Less: Tax Credits	-	-11'250	-78'750	
Net Tax Liability	11'250	78'750	-	90'000
Swiss Social security	29'481	-	-	29'481

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Questions



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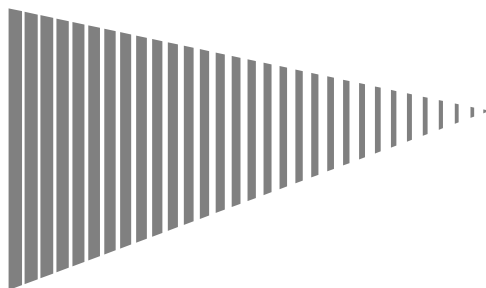
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Thank you



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