Continental thinking

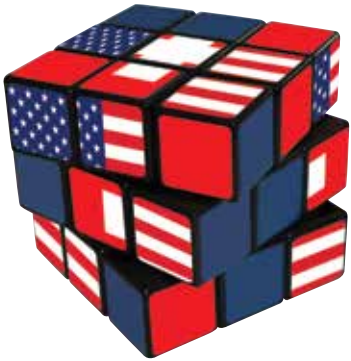
Flexible solutions for those facing a US/Swiss planning conundrum

withersworldwide

The majority of people understand the importance of having a will and estate plan to safeguard their family's future. However, unless the process is made easy and affordable, more often than not, making a will remains, perennially, on the 'to do' list. This is all the more likely when the variations are made more complicated because a member of the family is a US person.

In this brochure, to illustrate the complex issues that can arise in this area, we have provided a case study of what one might, at first sight, assume to be a straightforward situation. In fact, and as we show, it is anything but.

Withers advises clients on similar scenarios every day. We have seen virtually every tax and financial permutation affecting US clients living abroad or with other cross-border issues, and have developed tailored estate planning models to address those issues.



Our dedicated US tax and estate planning team in Switzerland has in-depth experience across all the issues that can arise, including

- International tax and wealth planning
- Pre-immigration tax planning
- Real estate acquisitions and dispositions
- Tax compliance, including voluntary disclosure
- Expatriation
- Trusts, foundations and family partnerships
- Charitable donations and lifetime gifts
- Wills
- Regulatory impacts, including FATCA

With the advice and support of local Swiss law firms, we are able to deliver an integrated suite of services, taking into account the combined impact of US/Swiss tax and inheritance laws. Having built up relationships over many years with leading law firms and professional advisers throughout Switzerland, Withers' Zurich and Geneva offices work as one to deliver focused, responsive cross-border solutions to US/Swiss families.

Our lawyers include native French, German and Italian language speakers, as well as lawyers who were born in Switzerland and others who have now made Switzerland their home. This combination enables our lawyers to have a full understanding of the cultural needs of US/Swiss families.

Integrated US/Swiss estate planning

Families are increasingly mobile and international. In the midst of this mobility, they often acquire real estate, business interests or other assets in numerous countries. This usually creates complex tax and estate planning issues for these families, often without them knowing.

Access to timely and integrated cross-border US tax and estate planning advice is therefore essential. By reducing tax exposure in the US, Switzerland and other relevant countries and providing mechanisms for sound succession and stewardship of family assets, smart planning can play a critical role in safeguarding the family's financial position and protecting wealth for future generations.

Strategic advice – from a single point of contact

With the advice and support of local Swiss law firms, Withers provides targeted, integrated advice to clients with US/Swiss tax and estate planning needs. We recognize the issues that need to be considered are always different and that every couple will have their own particular objectives. But, in our experience, it is always possible to create efficient and effective estate planning documents that 'work' in both the US and Switzerland.

Our approach means that clients benefit from having a single, highly experienced point of contact. As well as ensuring that issues are resolved as quickly and cost-effectively as possible, the integrated advice we provide is an essential strategic resource – ensuring that assets are protected tax-efficiently for the long term.

Because Withers has offices in Asia, the United States and Europe, our US tax and estate planning team has immediate access to bespoke advice on the cross-border issues that frequently arise.

About Withers

Withers is the first international law firm dedicated to meeting the legal needs of successful people and their families, businesses and philanthropic interests.

The firm has more than 700 members of staff, including over a 100 partners, with offices in London, Geneva, Zurich, Milan, Padua, New York, Greenwich, New Haven, Hong Kong, Singapore and the British Virgin Islands.

The firm's clients have interests in more than 80 countries and represent more than one-third of the Sunday Times Rich List, and a significant number of the Forbes and Hurun Rich Lists.

Case study – an everyday situation?

The family

Tim Butler is a US citizen who has lived in Zurich since the late 1980s having moved there following graduation from university in the US. Now aged 52, Tim is a pharmaceuticals executive based in Switzerland.

Tim is married to Anna, aged 38, who is a Swiss citizen, born and raised in Zurich. They met in Switzerland and have been married for about 10 years. They have two young children, Alexander and Alina, aged six and eight respectively, who were both born in Switzerland. Now that Anna is caring for the children, she no longer works. She has never held a green card.

Tim and Anna are happily settled in Zurich and plan to continue living in Switzerland for the foreseeable future. Tim is considering whether he should give up his US citizenship.

Their assets

Tim has investments worth approximately CHF 15m, including an investment portfolio which is run out of the US. Anna and Tim are the co-owners of their Zurich home, which they purchased with a mortgage of CHF 3m. After a little renovation the house is now worth about CHF 6m. They also own an apartment in New York City, with a value of about US$ 5m, as joint tenants with right of survivorship.

Anna's parents are comfortably well off. Or at least they were until they gifted the bulk of their CHF 10m of assets to Alexander and Alina, subject to a usufruct retained by them.

Tim's parents are both still alive and are living in the US. They have assets in the region of US$ 2m that they intend to leave to Tim and his two brothers.

Both Tim and Anna have low-value term life insurance policies – taken out when they took out their mortgage. Tim has recently taken out some whole life policies to provide for Anna and the children should something happen to him.

Neither of them have made a will. They both considered doing so when the children were born but have never managed to get around to it.

Their objectives

For Tim and Anna, the overriding priority is to secure the financial well-being of their family – as tax-efficiently as possible. They have heard about the ways in which US tax and regulation can impact the finances of people in their situation, including the drive by the US government to ensure that it receives the correct amount of tax from US persons living overseas. Tim has already considered expatriating from the US as a possible course of action, but the issues seem so complex that they have repeatedly postponed seeking advice.

Focusing on the issues

Tim and Anna consider themselves to have a simple situation. In our experience their situation is far from unusual, but – as can be seen from some of the issues identified – there are a number of complexities that lurk behind this apparently ordinary situation. They do, therefore, need early advice on tax and estate planning.

Set out below are some of the main areas on which Tim and Anna need to focus. The aim is to safeguard their family's financial well-being and prevent their hard-earned wealth from being unnecessarily depleted by avoidable taxation.

Swiss matrimonial property regimes

An initial issue to consider is whether Tim and Anna have entered into any type of matrimonial agreement concerning their respective rights in their property, as the type of matrimonial property regime applicable to the couple will be material in determining their US tax exposure.

Ownership of real estate

Americans married to non-US citizens often fall foul of US estate, gift and income tax laws unwittingly as a result of not seeking US tax advice before buying real estate with their spouse. Tim and Anna's situation is, in our experience, one of the most common problems.

Purchasing and owning a home as joint tenants with right of survivorship is very common between couples because when one spouse dies the other automatically owns the whole of the property, without the deceased spouse's interest passing to his or her estate or heirs. However, where one spouse is a US citizen and the other is not, a myriad of tax issues may arise.

US federal gift tax

When two Americans are married, they can simply transfer assets between them without triggering any US federal gift tax (there is an unlimited marital deduction for transfers to a US citizen spouse). This deduction does not apply to transfers to a non-US citizen spouse. Instead there is a limited annual exclusion.

As a result, when an American buys property jointly with his non-US citizen spouse, there might be gift tax implications on the initial purchase, or more likely on the later sale of the property. Any gift over and above the amount of the annual exclusion will be reportable in the US and the amount of the excess will absorb at least part of the US citizen's lifetime gift tax allowance. In circumstances where that allowance has already been fully absorbed, this will result in gift tax being payable.

US federal estate tax

If an American owns property with their non-US spouse as joint tenants with the right of survivorship, as does Tim with respect to the New York City apartment, the full fair market value (ie not just half) of the property is included in the American's taxable estate, except to the extent that the non-US spouse can show that he or she contributed to the purchase or to mortgage payments. As a result, US federal estate tax may apply to the entire value on the American's death.

Property bequeathed outright to a US citizen spouse qualifies for a full US federal estate tax marital deduction. However, property left to a non-US citizen spouse does not qualify for the deduction unless it is left in a special type of trust known as a Qualified Domestic Trust ('QDOT'). This trust can often be an essential tax-planning tool and should be considered, together with Swiss tax and legal implications, in US/Swiss estate planning scenarios.

Further, a person who is neither a tax resident nor citizen of the US (a non-US person), like Anna, is subject to US federal estate tax on US situs property, such as real estate and tangible personal property located in the US at the non-US person's time of death. So, absent appropriate planning, Anna's interest in the apartment and its contents will be subject to US estate tax on Anna's death.

Finally, with respect to life insurance, the proceeds of any policies owned by Tim will be subject to estate tax on his death absent good planning (eg the use of an irrevocable trust to hold the insurance policies).

US federal income tax

In the US, a single person generally can only exclude up to US$ 250,000 of capital gain from the sale of a main home. Consequently, Tim may find that, when he and Anna sell their home in Zurich, there could be substantial US tax on the gain.

This means that for US income tax purposes, it may be better for a couple to buy their non-US home in the non-US spouse's name. However, simply giving the property, or the

money to buy the property, to the non-US spouse could trigger US gift tax. An alternative might be to loan the non-US spouse the money (the US tax code allows such loans to be non-interest bearing). Care is needed to ensure that the IRS does not assert that the transfer is a gift.

Further, while non-US persons are generally exempt from tax on capital gains, there is an exception in the case of real property. As a consequence, Anna will be taxable in the US with respect to gains on the sale of the New York City apartment, potentially at a higher marginal rate than Tim.

Expatriating from the United States

Every year, many US citizens and green card holders renounce their citizenship or lawful permanent resident status. However, before expatriating, Tim needs to be aware of a number of issues affecting him and his children.

Under US tax law, certain US citizens and green card holders are subject to a special tax regime when they expatriate.

These individuals are referred to as ‘covered expatriates’. Generally, a covered expatriate is any US citizen or long-term green card holder (ie held a green card for eight years) who expatriates and either has a net worth of US$ 2m or more, exceeds a US income tax liability threshold or fails to certify that he has satisfied all US tax obligations for the previous five tax years. As Tim’s net worth exceeds US$ 2m, he would be considered a covered expatriate and thus would be subject to the special tax regime if he were to expatriate.

Under this special expatriation regime, Tim would be treated as if he sold all his assets when he expatriated and US taxes would be due on the gains from the deemed sales over the exemption amount. Further, Tim’s children (as US citizens) would be subject to tax at the applicable gift or estate tax rate when they received a gift or bequest from him. There are exceptions and planning methods that may enable people to avoid these harsh rules.

Leaving assets to US heirs

As Alina and Alexander are both US citizens, they too are subject to US tax law. This raises significant tax planning issues that must be addressed with respect to the wealth that will ultimately pass to them from their parents and grandparents.

There are numerous mechanisms and vehicles that can be utilized to transfer wealth from one generation to the next, including wills, trusts, usufructs, foundations and companies. A common vehicle used for tax-efficient US estate planning is the trust. Assets held in a

properly drafted trust for the benefit of US persons are not subject to US federal estate tax. However, if the trust has not been properly drafted, nearly half of all the assets could be unnecessarily lost to the US government – not just once, but at each successive generation.

It is usually advisable, where possible, that a trust set up to benefit US children should qualify as a so-called 'grantor trust' during the donor's lifetime. Grantor trusts are disregarded for federal income tax purposes, with any income, gains or losses attributed directly to the donor. After the donor's death, however, in the absent of other planning, a grantor trust would convert to a 'nongrantor' trust, which, if treated as a non-US trust, could then be subject to the confiscatory tax and interest charges under the US 'throwback' rules. These rules can cause virtually an entire distribution from a non-US trust to a US person to be payable to the US government in tax where the trust has previously accumulated income or gains.

Of course, careful consideration must be given to the Swiss tax implications of utilising trusts in this context.

Early advice is essential

The situation in which Tim and Anna find themselves is not unusual, and, as illustrated, the extent and complexity of the issues that can arise are extremely far-reaching.

For all individuals, irrespective of nationality, estate planning is an essential step. Central to this process is an up-to-date, tax-efficient will that accurately reflects one's wishes. At the same time, consideration should be given to related matters, including making lifetime gifts to dependants, ensuring pensions and life insurance are held in the most tax-efficient way, assessing ownership arrangements for jointly-held property and, where appropriate, the establishment of trusts.

Where US/Swiss couples are concerned, the combined effects of US and Swiss tax, matrimonial and inheritance laws must be taken into account at every stage. Provided this is done early, families can form a stable foundation for their future.

How we can help – next steps

Our US wealth planning team has helped thousands of clients create and sustain tax-efficient structures for protecting their wealth and their families' future prosperity.

If you believe that any of the issues we have identified in this brochure apply to your situation, or those of your clients, we recommend an early consultation with us where we can establish your circumstances and make recommendations for your future.

We know how important it is to be clear about fees and about the scope of the work to be done. For this reason, in most cases we can offer clients US/Swiss integrated estate planning documents for a fixed fee determined at the start of the engagement once we have an understanding of the client's particular needs.

If you require further information please contact us on

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