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Three Key Pre-Immigration Strategies for Swiss Families Moving to the USA

Hello!

Congratulations on your upcoming move to the USA. We are excited for you.

We understand that you are busy getting organized for your transatlantic move and we want to help you with a bit of helpful information.

Our goal here is to share with you three financial pre-immigration strategies that could help you reduce the financial cost of your US relocation and be smart about your US taxes during your time in the USA.

Are you ready?

Great! Let's get started.

Tip #1: Your Swiss home. What to do with it?

If you own a home in Switzerland, this is likely a question that you have pondered about: what you should with it? If you do not own a home in Switzerland, this strategy does not apply to you, but our strategy #2 may be helpful instead.

Understanding what to do about their Swiss home requires exploring the different options: Sell it? Rent it? Leave it empty for visits back home during the year?

In an ideal world, many Swiss expats would like to have the ability to keep their Swiss home empty and available to them for visits to Switzerland to see friends and family. You may be in this group.

This option has the advantage of convenience, but it can be a costly proposition. Does the USA offer any tax incentives that can make this option more affordable?

If you have a mortgage on your home, the answer is YES.

How does this work?

Under US tax rules, a mortgage interest deduction is allowed as an itemized deduction for a primary home and a second home. Your US home would be your primary home and your home in Switzerland, your second home.

There are some limitations though, so it's important to understand them:

- You need to claim itemized deductions on your US tax return.
- You can only deduct the portion of the mortgage interests that apply to balances of $750,000 or lower. If the mortgage balance is higher $750,000, the interest expense attributed to the excess mortgage balance is not deductible.
- You cannot not rent your vacation home if you want to claim the mortgage interest deduction as an itemized deduction.

Speaking of renting your home, what happens if you do? This is a second option that would allow you to offset all or part of the expenses of keeping your Swiss home during your US assignment.

What are the consequences of converting your Swiss home into a rental property?

- You will need to report the rental activity in the USA and Switzerland, as both countries will tax it. This means that you will need to continue to file tax returns in Switzerland.

- Switzerland has the first right of taxation as the country where the property is located, and the USA will impose a second layer of tax as your country of tax residence.
- The USA will allow a foreign credit for the income tax paid in Switzerland on the rental profit. The purpose of the foreign tax credit is to prevent double taxation.
- If, while being a US resident, you sell the home that you converted to rental at a gain while you are a US tax resident, capital gains tax and depreciation recapture may apply.
- Capital gains tax may be avoided if the home is sold within three years of moving to the USA under a rule known as the "primary residence exemption".

What is the primary residence exemption?

It is a rule that allows to exclude $250,000 (or $500,000 for a married couple selling a home owned jointly) of capital gains from US taxation if certain requirements are met.

What are those requirements?

- Your Swiss home was your primary residence for at least two consecutive years before moving to the USA,
- You sell your home within three of not using it as a primary residence

Let's look at this in more detail:

  - The home must have been your primary residence for at least two out of the last five years before the sale.
  - The exemption is limited to $250,000 per owner. Spouses can exclude $500,000 of gain if the home was owned by both.

Important considerations:

- If you had a mortgage on your property, you may have to recognize a foreign exchange gain if the US dollar appreciated against the Swiss franc during the mortgage holding period.
- If you sell your Swiss home BEFORE you become a US tax resident, neither the sale nor the cancellation of the Swiss mortgage is US taxable.
- If you sell the Swiss home AFTER it has been rented for three years or more, the home will no longer be eligible for the $250,000/$500,000 gains exemption.

STRETEGY: The USA provides tax incentives for home ownership that may reduce the cost of continuing to own a Swiss second home during your time as a US resident. There is also a potential capital gains limited exemption that may apply if you sell your Swiss home within three years of moving to the USA. By understanding these tax rules and applying them to your situation and goals, you can minimize the US tax impact of continuing to own a Swiss home during your US residency.

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TIP #2: Your Swiss Pensions. What to do with them?

If you are a participant in a Pillar 2 and/or a Pillar 3 pension, another issue you will need to consider is what to do with these accounts.

Should you cash them out, as permitted after de-registration in Switzerland? Or should you keep them? And if you keep them, how?

There are three considerations you need to weigh as you evaluate which is the best option for you:

1. The United States does not recognize your Pillar 2 and Pillar 3 accounts are qualified retirement accounts. This means that your Pillar 2 and Pillar 3 accounts do not benefit from US:
    a. Tax Deferral
    b. Tax Free Rollover
    c. Tax Deductible Contributions
2. Any contributions that you made into your Pillar 2 and Pillar 3 accounts before becoming a US tax person have no cost basis for US purposes.
3. Distributions from Pillar 2 and 3 accounts are taxable events for US tax purposes, as well as for Swiss tax purposes.
4. Unlike Switzerland, the USA does not tax Pillar 2 and 3 distributions at favorable rates capital distribution rates. Regular rates based on ordinary income tax brackets apply instead. Consequently, US tax on Pillar 2 and 3 distributions is usually higher than the Swiss tax on the same distribution.

Let’s break down these three points further:

1. Since Pillar 2 and Pillar 3 are not recognized by the USA as qualified pensions, these accounts do not enjoy the tax privileges they receive in Switzerland, and they will generally be taxed in the USA as follows:
    a. The growth, interest or other income earned in the account will be taxed every year as either ordinary income or PFIC income (refer to our blog for additional information on PFICs)
    b. If you move your Pillar 2 or Pillar 3 to a different financial institution or to a different account within the same institution, this transfer is a reportable event for US tax purposes that can result in potentially significant income tax owed at the federal and at the state level, depending on your state of US residency.

2. If you were not a US tax person before moving to the USA, any contributions that you made to your Pillar 2 and 3 accounts have a no cost basis for US tax purposes, making distributions and transfers fully taxable.
   THE FULL TAXATION OF YOUR SWISS PENSIONS CAN BE VERY COSTLY.

3. Since Switzerland taxes lump sum distributions of Swiss pensions as capital distributions at preferential rates, the tax imposed by the USA on the same distribution constitutes a second layer of taxation. The USA will recognize the tax paid to Switzerland on this distribution and provide a tax credit against the US tax owed. However, since the USA will tax the distribution at ordinary tax rates, in most cases, there will be additional US tax owed on the distributions.
   Additionally, some US states will also tax foreign pension distributions based on their own rules for the taxation of their residents. New York and California are examples of two states that tax foreign pension distributions. Texas and Florida are examples of states that do not.

STRATEGY: Since the US does not confer the same tax advantages to Swiss pensions as are provided by the Swiss government, it is very important to be aware of the implications for your situation. Carefully planning the timing of any transfer or distribution of Swiss pension accounts that also considers your circumstances and financial needs, can help avoid costly US tax consequences. By planning to transfer or distribute your accounts before becoming a US tax resident, or by avoiding making rollovers during your period of tax residency you can save significant amounts in unexpected taxes.

Tip #3: Your Swiss investment account. What to do with it?

If you have a Swiss investment account, you need to be aware of the following consequences of owning a Swiss investment account while a US resident:

- Your Swiss bank may decide not to keep you as a client once you become a US tax resident. Your change of status from a Swiss tax person to a US tax person imposes certain reporting requirements on your Swiss bank under FATCA (Foreign Account Tax Compliance Act). These requirements may include automatically reporting your account to the IRS if your balance meets a specific threshold.
- FATCA also imposes foreign account reporting requirements on you as an individual for owning Swiss accounts as a US resident. Additionally, you will likely need to file an FBAR, another foreign account reporting form, every year. The penalties for failure to report either the FATCA Form 8938 or FBAR Form FinCEN 114 when the filing thresholds are met can be severe, so understanding and meeting these requirements is critical.
- If your investment account is invested in Swiss mutual funds, ETFs or other forms of pooled investments funds, these funds are likely be considered PFICs for US tax purposes once you become a US resident. PFICs have extensive reporting requirements and are generally taxed at higher tax rates than equivalent US funds. Switching the investments to US funds or individual shares of publicly traded companies can avoid PFIC tax consequences. If the switch is made before US tax residence begins, capital gains tax consequences can also be avoided.
- You will need annual reports on dividends, interest and capital gains realized in your Swiss investment accounts translated into US dollars to properly report your investment income on your US tax return.
- The USA does not impose a stamp tax on investment trades. Trades are generally cost free and investment accounts are generally not subject to custody fees in the USA. Lower US investment costs and higher US fund liquidity may allow you to grow your investment savings faster in the USA than in Switzerland.

STRATEGY: Depending on your expected length of stay in the USA and your personal circumstances, it may be beneficial to you to move your investments to the USA during your US tax residency. If you decide to make this change, doing so before your US tax residency begins can also avoid prevent triggering US taxable capital gains. Investing in the USA can also reduce your risk of PFIC exposure, reduce investment costs and make your annual US tax reporting easier, as US banks and brokers are required to provide annual investment income reports to their investors, formatted for easy US tax reporting.

In conclusion, understanding the tax consequences of owning a Swiss home, Swiss pensions, and Swiss investment accounts as a US tax resident can help you make informed decisions that fit with your personal goals and situation while helping you reduce your taxes and continue to grow your wealth faster and more efficiently.

We hope you found this guide helpful and wish you a fantastic experience in the USA!

If you have additional questions, do not hesitate to contact us at info@swissamericanwealthadvisors.com or by phone at +1.610.668.1829 (USA) or +41.44.557.39.00 (Switzerland). We have helped many families in your situation and would be delighted to have the opportunity to work with yours.

Congratulations on your opportunity and best of luck!

Swiss American Wealth Advisors

Marina Hernandez, EA, CFP® and Jeffrey Haindl CFA, CFP® are Investment Adviser Representatives with Dynamic Wealth Advisors dba Swiss American Wealth Advisors. All investment advisory services are offered through Dynamic Wealth Advisors. Ms. Hernandez is the owner and principal of MHTax and offers tax preparation services through this entity. This is considered an outside business activity for Ms. Hernandez and is separate and apart from her activities as an investment advisor representative with Dynamic Wealth Advisors.