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Tax Cuts and Jobs Act (TCJA) can heavily impact Swiss residents if they are considered as Section 958(a) shareholders

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U.S. taxpayers continue to analyze and adapt to the new international taxation regimes introduced by the Tax Cuts and Jobs Act (TCJA), including the Section 965 inclusion, global intangible low-taxed income (GILTI), foreign derived intangible income (FDII), and the base erosion anti-abuse tax (BEAT). The aim of this article is to highlight potential tax consequences for Swiss residents with US passports/green cards arising from the repeal of the downward attribution rules of Section 958(b)(4) of the US Internal Revenue Code (US IRC). The new US tax law modifies the attribution rules that apply for purposes of the anti-deferral rules of subpart F under US IRC. The second part of the article discusses potential planning solutions for mitigating the tax exposure arising from the repeal.

1. Swiss and US tax liability for US tax payers residing in Switzerland

In general, a US passport or green card holder with permanent residency in Switzerland is subject to an unlimited tax liability in Switzerland and the US and thus is required to file both a Swiss and a US tax return.

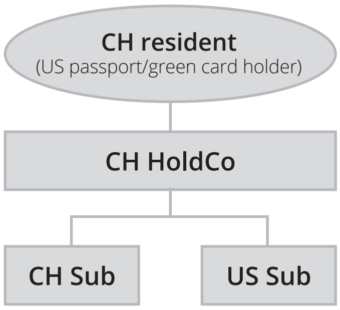
The US and Swiss tax liabilities are both based on the worldwide income of the individual. In the US, a taxpayer who meets certain requirements for working or living outside the US is allowed to exclude a certain amount of its foreign earned income from US tax. For the tax year 2018 (filing in 2019) the exclusion amount is $103,900. Moreover, the taxpayer can exclude or deduct certain foreign housing amounts, etc. Similarly, the Swiss tax liability is based on the individual's worldwide income. In Switzerland income from foreign businesses, foreign permanent establishments and on foreign real estate is excluded from taxation but is taken into account in determining the applicable (progressive) tax rates. As both countries levy taxes on the individual's worldwide income the resulting burden of double taxation can be eliminated based on the existing rules of the double tax treaty between Switzerland and the US. Taxes paid in Switzerland can be considered as a foreign tax credit against tax owed on the same income in the US.

One central driver of an individual's tax liability besides employment income is income from investments. The new tax rules resulting from TCJA significantly expands the types of income that certain US individuals must include in their annual tax returns.

2. Expanded inclusion rules for US tax purposes under TCJA

As a result of this expansion, a US taxpayer holding shares in a foreign company might become subject to annual income inclusions if the foreign company is considered a so-called "controlled foreign corporation" (a "CFC"). Moreover, the rules of the TCJA does not only lead to an expanded yearly inclusion of the CFC's current income but also to a one-time toll charge on the undistributed earnings of the CFC. In addition, a new tax (so-called „GILTI" tax) is imposed on the US shareholder who holds an interest in a CFC.

A CFC is defined as a foreign corporation that is more than 50 percent owned by 10 percent shareholders (by vote or value) that are US persons (US citizens, green card holders, other individuals that are treated as US residents as a result of their presence in the US, corporations, trusts, estates, and partnerships).



If for example a Swiss resident with a US passport/green card, holds a Swiss corporate parent company (CH HoldCo) which wholly owns a US subsidiary (US Sub) and a Swiss wholly owned subsidiary (CH Sub), under the new Section 958(b) attribution rules the 100 percent ownership in CH Sub will be attributed to US Sub, and CH Sub will be treated as a CFC. If the person however, owns less than 10 percent of CH HoldCo, then the shareholder is not considered a Section 958(a) shareholder of the CFC and hence not subject to the rules of income inclusion and GILTI taxation.

Under these new inclusion rules certain types of income of CH Sub, specifically the Subpart F and GILTI income, of this CFC have to be included in the tax return of the US person. Subpart F income particularly includes movable and passive investment income such as dividends, interest, rents and royalties, income received by a CFC from the purchase or sale of personal property involving a related person as well as income from the performance of services by or on behalf of a related person. THE GILTI tax however, also considers most types of operating and active income of the CFC.

3. Tax planning considerations

To potentially mitigate the negative tax consequences resulting from TCJA different tax planning alternatives could be considered. For examle, a foreign entity can make the so-called "check the box"-election on IRS Form 8832 for eligible entities (in Switzerland available for Swiss GmbH). With this election, the foreign subsidiary may be treated as a partnership for US tax purposes (if it has more than one owner), and not as a CFC. Alternatively, the foreign subsidiary might be elected to be treated as disregarded entity being separate from its owners from a US perspective. Because a "check-the-box" election applies only for US tax purposes, the election will not result in any tax consequences in the country of the CFC. Another alternative that may be considered is to convert the US subsidiary into a US branch of the foreign parent company in order to eliminate the US entity to which downward attribution applies. Both the election and the conversion into a branch is viewed as a deemed liquidation of the foreign company and potentially may trigger US tax consequences which is why a careful analysis is recommended.

US individual taxpayers who are subject to tax on GILTI may consider making the so called Section 962 eleetion. With this election, the individual shareholder is allowed to be taxed at a 21% corporate tax rate and can potentially claim foreign tax credits. However, the impact of the Section 962 election should be carefully analysed prior to making this election.

4. Summary

US persons that were not treated as US shareholders of CFCs in the past, need to review their structures in order to determine how the new downward attribution rules impact their set-up. If the person faces a significant US tax liability caused by the new rules he/her should consider whether a restructuring of the structure or the like could lead to a more favourable result. In any case changes in the structures or the tax treatment of entities always require a holistic analysis to ensure that no new risk arise.

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