**Guidelines** 05/23

# EXPANSION INTO THE USA: DOS AND DON'TS FROM A TAX POINT OF VIEW

The USA has its peculiarities in many ways, and this is also true of its tax system. If you are not aware of certain tax pitfalls, unexpected complications may arise in the course of an expansion into the USA.

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These guidelines show what measures should be taken in relation to the US enterprise – in particular with start-ups – and to the employees, and also what should not be done. The income tax consequences for employees working in the USA are also explained. However, the Guidelines are only intended to provide an overview and they are no substitute for (primarily American) expert tax advice.

## A. Expansion into the USA

### *1. Start of the US Project*

It is the nature of the game that an entry into the US market is associated with high entrepreneurial risks. In order to minimize these risks and to keep the costs as low as possible, it is common not to set up a US company at the time of the entry into the market unless required. Typically, employees in Switzerland contact potential customers in the USA and then travel to the USA to meet them. This approach makes sense from a business point of view. However, from a tax point of view there are certain aspects that need to be taken into consideration.

### *2. Sales by a Swiss company*

In order to evaluate whether a US company is advisable, the Swiss company should first evaluate whether its activities in the USA will constitute a permanent establishment from a US tax perspective. A US permanent establishment may be avoided by addressing the following:

- Contracts entered into by the Swiss company should be signed in Switzerland, and not in the USA;
- The company should not maintain any business premises in the USA;
- Executive employees should not negotiate contracts or conduct business in the USA.

To the extent these principles are not adhered to, the business activities performed in the US might more likely be regarded as creating a permanent establishment by the Swiss company under American law. The consequences of this could be (inter alia) that the Swiss company would have to file a US corporate tax return and pay corporate income taxes in the USA on income associated with its US permanent establishment.
Even if the Swiss company does not have a US permanent establishment as a result of its American activities, certain obligations and liability risks must be borne in mind. For example, when a transferred employee of the Swiss company becomes liable to tax in the United States on his US sourced income, the Swiss employing company may likely have joint liability for the US income tax due on it. Moreover, the company is obliged to apply the US payroll accounting system as well as the US wage withholding procedure. If this is not complied with, fines could result.

### *3. Incorporation of a US subsidiary*

In situations where the activities of the Swiss company will likely result in the creation of a US permanent establishment, the incorporation of a US subsidiary company is generally recommended. The proper time for establishing a US subsidiary company is typically when the extent of the US business activities would result in a US permanent establishment such as when the Swiss company will have a US sales office, a US marketing office or similar office in the USA or when the activities of its Swiss employees in the United States would create a US permanent establishment (e.g., regularly negotiating and execution of commercial contracts in the United States).

### *4. Dos and Don'ts*

| **Sales by Swiss Company / No U.S. Permanent Establishment** | **Incorporation of a US Company** |
|---|---|
| **Dos** | |
| • Conclusion of contracts in CH<br>• Operational business solely outside USA | • Proactive communication with a US tax adviser<br>• Separation of SwissCo and USCo |
| **Don'ts** | |
| • US employees<br>• Conclusion of contract in USA<br>• Business premises in USA | • Activity of Swiss employees in USCo |

## B. US Income Tax for Employees

### *1. US Income Tax*

The USA levies income tax on the worldwide income (including capital gains) of its citizens and non-US nationals classified as US tax residents ("resident aliens"). This is accompanied by the obligation to disclose all sources of income and all financial accounts. By contrast, non-resident foreign tax-payers ("non-resident aliens") only have to declare their income generated in the USA ("US source income" and excluding most capital gain). For Swiss employees, entrepreneurs and shareholders in US companies who either perform activities in the USA for a Swiss company or work for a US subsidiary, the resident alien status is thus something to evaluate. US tax resident aliens are firstly foreign US citizens and holders of a permanent resident card, a "green card". Non US persons who are present in the USA without a green card are evaluated as to whether they are US tax resident aliens based on the application of the substantial presence test.

### *2. Substantial Presence Test*

The substantial presence test is used for non US citizen individuals to differentiate between the resident alien and non-resident alien US tax status. It analyses the duration of the individual's stay in the USA during the current "testing" year and also during a period of two years leading up to the testing year. Specifically, the US tax residency threshold under the substantial presence test is exceeded if an individual equals or exceeds 183 days of US presence over a 3-years period, which includes the relevant calendar year and the previous two years. For this purpose, the actual days are counted as follows: all the days in the current year, 1/3 of the days in the first year before the current year and 1/6 of the days in the second year before the current year. Based on this system, individuals who spend an average 121 (actual) or more days per year in the USA will, after several years, be classified as US tax resident aliens under the test. In this regard, resident aliens should note that not only working days spent in the USA are considered to be "US days", but all days (also holidays, travel days etc.). The days of arrival in and departure from the USA are counted as well. Days on which the individual is sick can in principle be discounted, provided the sickness makes it impossible to leave the USA.

| **Substantial Presence Test** | |
|---|---|
| US days in the relevant tax period | |
| + | 1/3 of the US days in the period one year before the relevant period |
| + | 1/6 of the US days in the period two years before the relevant period |
| **>** | **183 days (ø 121 days in all three periods)** |

### *3. An Exception to Every Rule*

There are some cases that the substantial presence test does not cover. Employees/entrepreneurs frequently work in two or more locations and accordingly spend a lot of time in several different places. There are two exceptions to the substantial presence test in such cases. In order to claim these exceptions, information about the taxpayer's personal circumstances must be disclosed to the authorities, which can involve considerable administrative work.

### *3.1 Closer Connection Test*

Where a taxpayer meets the US substantial presence test, but less than 183 actual days are spent in the USA in the test year, the conditions for the US domestic "closer connection exception" should be considered. If the closer connection test is applicable, the foreign non-US person can possibly take the position he is not a US tax resident alien. Two things must be shown for the closer connection test:

- a "tax home" outside the USA (i.e., in Switzerland), and
- a closer connection to this tax home than to the USA.

The tax home is defined as the taxpayer's place of business or work. This is not always easy to determine, in particular when the taxpayer works mainly in two places. The following circumstances are taken into consideration:

- the total time that is normally spent by the taxpayer in each of the two places;
- the level of the taxpayer's business activities in both places;
- the significance of the income in both places.

If the taxpayer has such a tax home outside the USA, he must also show and substantiate that he has a closer connection to this tax home. When judging this, the taxpayer's personal circumstances are of great importance. Factors such as e.g. the place normally declared in forms as the residence, the place of the permanent home and family, of personal effects, of social, cultural, political or religious affiliations, the country in which the driving license is issued and where the individual has voting rights, are included. If the US tax authority comes to the conclusion that there is a tax home in Switzerland and that there is a closer connection to it, then the taxpayer will basically be classed as a non-resident alien.

### *3.2 Treaty Tie Breaker Test*

The second exception to becoming a US tax resident alien is the so-called treaty tie breaker test, which is based on art. 4 of the double taxation treaty between Switzerland and the USA (the "DTT"). Where the taxpayer is classified according to local law as a tax resident both in Switzerland and in the USA (resident alien), this exception is intended to prevent him from having an unlimited liability to taxation in both states. Unlike the closer connection exception, the treaty tie breaker exception can apply to taxpayers who are present in the USA for more than 183 days in the relevant year.

# «WHEN BUSINESS PREMISES ARE NEEDED IN THE USA, A US SUBSIDIARY SHOUD BE SET UP.»

When determining in which country the employee/entrepreneur is subject to unlimited tax liability, the following criteria are applied, in the order given below. If a criterion is fulfilled in both countries, then the matter is decided according to the next criterion. Where the criterion is only met in one country, then the taxpayer is subject to unlimited tax liability in that country.

1) The availability of a permanent home in Switzerland or the USA;

2) The place where the center of vital interests (employment and social ties) is, in Switzerland or in the USA;

3) The place of the individual's habitual abode, in Switzerland or in the USA;

4) The state of which the individual is a national;

5) Should none of the criteria be relevant and if the taxpayer has dual (Swiss-US) nationality, the tax authorities of the USA and Switzerland must settle the ques-tion by mutual agreement.

Individuals who work in the USA and keep their center of vital interests in Switzerland can in principle also claim the treaty tie breaker test if they stay in the USA for longer periods.

### *4. Dos and Don'ts*

| **Taxation of the Employees/Entrepreneurs in the USA** | |
|---|---|
| **Dos** | **Don'ts** |
| • Keep track of the time spent in the USA;<br>• If possible, limit the time spent in the USA to a maximum of 121 days per year | • Give up the permanent home in Switzerland;<br>• Transfer the center of vital interests to the USA |

### *5. Overview*

| **Number of US Days** | **US Status** | **Tax consequences in USA** |
|---|---|---|
| Less than 121 US days on average over a three years period | Non-resident alien | Taxation of US sourced income subject to Article 15 tax treaty protection; capital gains excluded |
| More than 121 US days on average over a three years period; but less than 183 U.S. days in the relevant tested tax year | Resident alien | Taxation of worldwide income, including capital gains |
| | If closer connection to Switzerland: non-resident alien | Taxation of US sourced income subject to possible Art 15 treaty protection, capital gains excluded |
| More than 183 US days in the relevant tested tax year | Resident alien | Taxation of worldwide income, including capital gains |
| | If Treaty Tie Breaker Test: non-resident alien | Taxation of US sourced income subject to possible treaty protection, capital gains excluded |

***6. Taxation as a Non-Resident Alien***

Non-resident aliens have to declare their US sourced income for tax purposes in the USA. The salary paid by a Swiss employer for work performed in the USA is also caught by this, provided that it amounts to more than USD 3,000 in the respective year. There is also an exception to this rule (based on art. 15 of the DTT). According to Article 15 protection under the tax treaty, the US sourced income can be taxed only in Switzerland if:

- The employee is present in the USA for a period of less than 183 days during every possible twelve-month period that commences or ends in the year concerned. This means that on every day of the year concerned a calculation has to be made for the six months going forward and the six months going back in time; not more than 183 days should be spent in the USA during the resulting one-year period;

- The salary is paid and borne by a Swiss employer; AND

- The salary is not paid or borne by a US permanent establishment (of the Swiss employer).

The significant advantage of the classification as a non-resident alien is (in particular with start-ups) that capital gains are tax-free in Switzerland and the sale of an enterprise is therefore in principle not taxed. For a non-resident alien, capital gains are not taxable in the USA, whereas for resident aliens they would be taxable.

***7. Employee stock options***

It is also recommended to tread carefully when employee stock options are granted. There is a threat of prohibitive taxation, in particular where options are granted at less than their fair market value, which could be taxable in the USA. Generally, a US tax advisor should be involved, especially with respect to employee stock options, wherever there is a possibility of US taxation.

## C. Summary

***To sum up:***

- A US subsidiary should be set up at the latest when business premises in the USA are needed;

- If the employee/entrepreneur is present in the USA on an average of not more than 121 days per year and keeps the center of his vital interests in Switzerland, he is in principle only subject to no (see tax treaty Article 15 analysis) or limited taxation in the USA and thus his private capital gains should not be taxable in the USA;

- If the employee/entrepreneur spends more that these 121 days in the USA, he should in principle not become subject to taxation of his worldwide income in the USA if he can claim one of the exceptions (closer connection test; treaty tie breaker test).

Caution: These guidelines only give an overview of the current legal position (May 2023) and are no substitute for (primarily American) expert tax advice.

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