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Expansion into the USA: Do's 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, annoying complications may arise in the course of an expansion into the USA. 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 USA Project

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

2. Sales by a Swiss company

First and foremost, the Swiss company must avoid its activity in the USA being classified by the American tax authorities as a permanent establishment. The following precautions should be taken:

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

Where these principles are not adhered to, the US business might be regarded as a permanent establishment under American law. The consequences of this could be (inter alia) that the Swiss company would have to file a tax return in the USA and pay corporate income tax there.

Even if the Swiss company does not have a permanent establishment as a result of its American activities, certain obligations and liability risks must be borne in mind: where an employee of the Swiss company becomes liable to tax in the USA on his US income, the company has 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 done, there is a threat that fines may be payable.

3. Incorporation of a US subsidiary

Before a permanent establishment in the United States is created, the incorporation of a US subsidiary company is recommended. The right time for this is when the extent of the US business activities makes it necessary to have a sales office, marketing office or similar office in the USA.

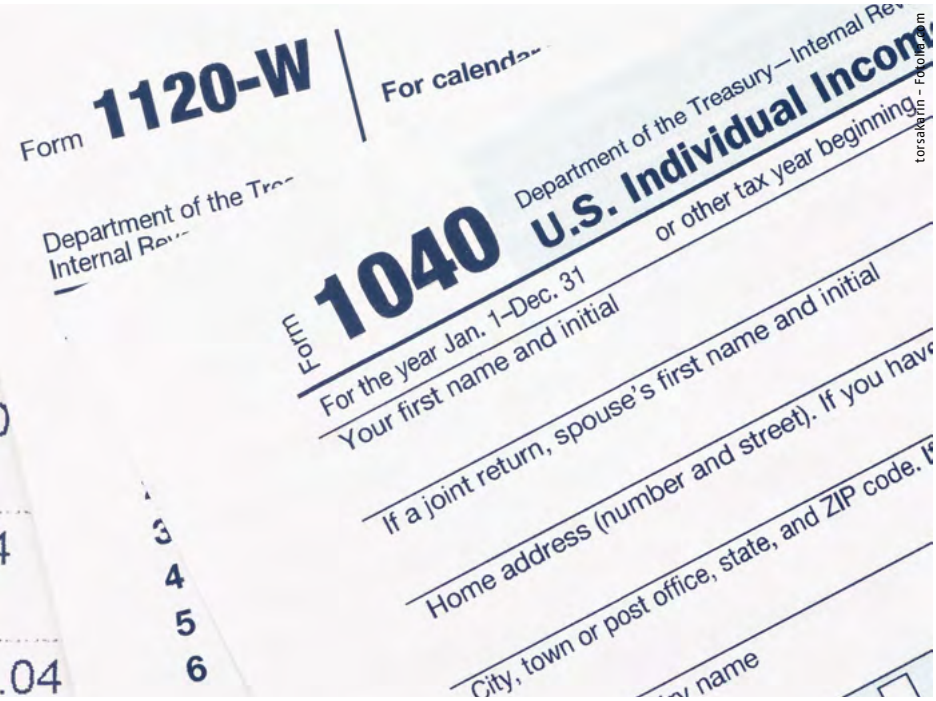
4. Do's and Don'ts

Sales by Swiss Company / No U.S. Permanent Establishment	Incorporation of a US Company
Do's: • Conclusion of contract in CH • Operational business solely outside USA	**Do's:** • Proactive communication with a US tax adviser • Separation of SwissCo and USCo
Don'ts: • US employees • Conclusion of contract in USA • US business premises	**Don'ts:** • 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-U.S. nationals classified as U.S. 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 taxpayers ("non-resident aliens") only have to declare their income generated in the USA (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 be avoided. Resident aliens are firstly foreign U.S. citizens and holders of a permanent resident card, a "green card". Persons who are present in the USA without having a green card may be given resident alien status based on the substantial presence test.



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2. Substantial Presence Test

The substantial presence test is used for individuals to differentiate between resident alien and non-resident alien status. It analyzes the duration of the individual's stay in the USA during one year and/or during a period of several years. The test is met when an individual is present in the USA during more than 183 days in a 3-year 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, persons who have spent an average of more than 121 days per year in the USA are included as resident aliens under the test. In this connection, resident aliens must note that it is not only working days spent in the USA that are considered to be "U.S. days", but all days (also holidays, travel days etc.). The days of arrival in and departure from the USA are likewise counted here. Days on which the individual is sick can in principle be discounted, as long as the sickness makes it impossible to leave the USA.

Substantial Presence Test

	U.S. days in the relevant tax period
+	1/3 of the U.S. days in the period one year before the relevant period
+	1/6 of the U.S. 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 which the substantial presence test does not catch. 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. This can involve considerable administrative work.

a. Closer Connection Test

Where a taxpayer meets the substantial presence test but under 183 days are spent in the USA in

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the test year, the conditions for the U.S. domestic "closer connection exception" should be considered. 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. It is not always easy to determine this, in particular when the taxpayer works mainly in two places. The following circumstances are taken into consideration:

- The total time which 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 show 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 given in forms as the residence, the place of the permanent home and the family, of personal effects, of social, cultural, political or religious affiliations, the country of the driving license and of the voting rights, are included. Where the U.S. tax authority comes to the conclusion that there is a tax home in Switzerland and that there is a closer connection to it, then taxpayer will basically be classed as a non-resident alien.

b. Treaty Tie Breaker Test

The second exception 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 classed according to the local law as 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. The exception can also apply to taxpayers who are present in the USA on more than 183 days in the relevant year. 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 his habitual abode, in Switzerland or in the USA;
4. The state of which he is a national;
5. Should none of the criteria be relevant and if the taxpayer has dual (Swiss-U.S.) nationality, the tax authorities of the USA and Switzerland must settle the question by mutual agreement.

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

4. Do's and Don'ts

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

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5. Overview

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

6. Taxation as a Non-Resident Alien

Non-resident aliens have to declare their U.S. source income for tax 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 this, the U.S. source income can be taxed 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;
- The salary is not paid or borne by a U.S. permanent establishment.

The significant advantage of 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 necessary 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. A U.S. tax adviser should generally be involved, and especially with respect to employee stock options, wherever there is a possibility of U.S. taxation.

C. Summary

To sum up:

- A U.S. 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 average for not more than 121 days per year and he keeps the center of his vital interests in Switzerland, he is in principle only subject to limited taxation in the USA and thus his private capital gains are not taxable in the USA;
- If he spends more that these 121 days in the USA, he can in principle avoid taxation of his worldwide income if he can claim one of the exemptions (closer connection test; treaty tie breaker test).

Caution: These guidelines only give an overview of the current legal position (March 2021) and are no substitute for (primarily American) expert tax advice.

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