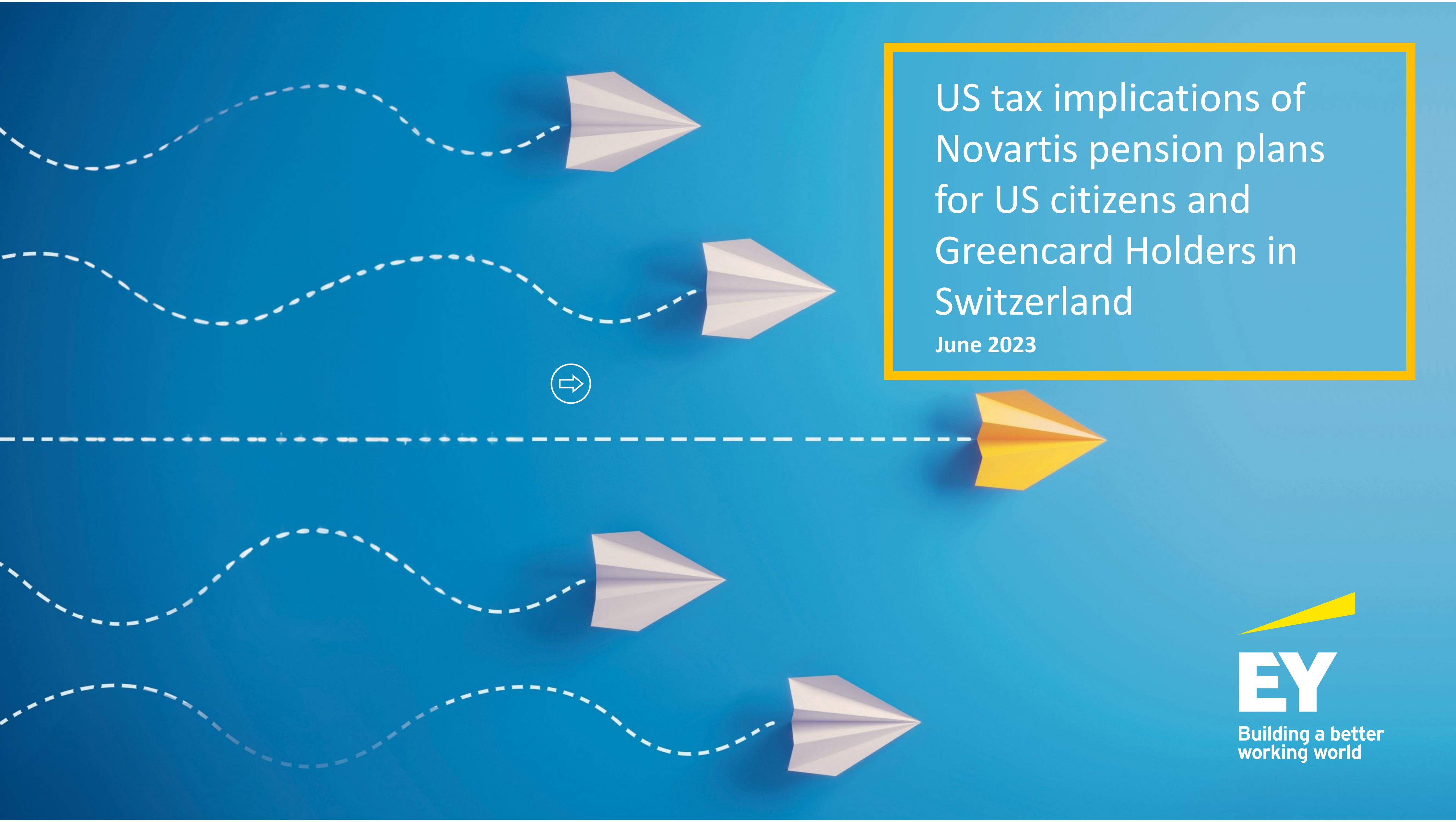

US tax implications of Novartis pension plans for US citizens and Greencard Holders in Switzerland

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Overview of Swiss pension system

The Swiss social security system is based on a three-pillar system as follows:

- **1st pillar:** This mandatory social security system (old-age and survivors' insurance). Pensions are based on premiums paid and on the number of years worked. Benefits generally satisfy minimum living requirements.
- **2nd pillar:** Company pension plans. These benefit plans complement the benefits of the 1st pillar and are compulsory for employees subject to the old-age and survivors' insurance.
- **3rd pillar:** The third pillar represents an additional voluntary savings plan for individuals to meet their further retirement needs.

Pillar 1	Pillar 2	Pillar 3
• State pension	• Occupational pension	• Private Pension

Overview of Swiss pension system

	Pillar 1		Pillar 2			Pillar 3a	
	State plans - mandatory		***Employer plans - mandatory***			***Private savings - voluntary***	
	Contribution	**Distribution**	**Contribution**	**Buy-Back**	**Distribution**	**Contribution**	**Distribution**
Overview	Employee and employer contribution Legal % applied on income earned and withheld via payroll	Can be taken only after reaching retirement age – annuity payment only	Employee & employer contributions Min. legal rate based on age % of insured salary and withheld via payroll	Additional volunteer employee contributions / Novartis pension administrator can advise on your limits for pension buy-back	Can be taken: 1) Retirement age 2) De-registration from Switzerland 3) Purchase of Swiss property for primary use 4) Starting a business Lump sum or annuity payment, typically combination of both	Voluntary personal pension scheme (via bank or insurance company)	Can be taken: 1) Retirement age 2) De-registration from Switzerland 3) Purchase of Swiss property 4) Starting a business Typically lump sum payment
Swiss Taxation	Employee contributions: Deductible Employer contributions: Not taxable	Taxable at distribution as regular income	Employee contributions: Deductible Employer contributions: Not taxable	Deductible	Taxable at distribution Lump sum taxed at reduced rate and annuity payment taxed as regular income	Employee contributions: Deductible up to CHF 7'056 (for 2023)	Taxable at distribution Lump sum payment taxed at reduced rate
US Taxation (US citizen / GC Holder)	Not deductible against US taxable income	Not taxable at distribution	Employee contributions: <u>NOT</u> Deductible Employer contributions: <u>Taxable</u> Additional US tax implications, i.e. 8938)	Employee contributions: <u>NOT</u> Deductible Employer contributions: <u>Taxable</u>	Only the distribution in excess of amounts already taxed is taxable	Employee contributions: <u>NOT</u> Deductible Employer contributions: <u>Taxable</u> Additional US tax implications, i.e. PFIC, 8938	Only the distribution in excess of amounts already taxed is taxable

US tax implications for Swiss pensions

Swiss pension funds do not meet the US definition of a "qualified retirement plan" (e.g. plan is vested and funded). As a result, participation, i.e. contributions, distributions, earnings, could trigger US taxation.

US citizens and Greencard holders do not qualify for US tax relief under the US-Swiss income tax treaty

Employee contributions to Swiss pension plans	Generally not deductible
Employer contributions to Swiss pension plans	Generally taxable
Earnings on pension	Generally taxable
Distributions from Swiss pension plans	Generally taxable (less basis already taxed which represents 'investment in the contract')

US tax implications for Swiss pensions

In the US, taxation ultimately is based on US residency status:

US tax residents *(US citizens, GC holders, US resident aliens)*	Taxed on worldwide income
US nonresidents	Taxed on US source income only

US marginal tax rates
(as of June 2023)

- **Federal: 10%-37% depending on income level**
- **State: vary by state**

***Note: the above references income tax only**

US taxation - Considerations for a US citizen or resident locally employed in Switzerland

Individuals who are US tax residents & Swiss tax residents are subject to two separate tax regimes:

1. US – citizenship / green card holder
2. Switzerland – employment in Switzerland

Cash flow consideration for pension participation

- Timing of taxation of the pension may create cash flow challenges
- US will tax at time of contribution, whereas Switzerland will tax at time of distribution

US taxation of contributions – US citizens and GC Holders

- Employer contributions to Pillar 2 are taxable
- Unlike 401k contributions, employee contributions to Pillar 2 are not deductible from taxable income
- Tax contributions create US tax basis in the pension plan
  - Tracking tax basis is critically important to determine the taxable amount of an eventual pension plan distribution

Employer contributions	Employee contributions	Earnings
Taxable	Not deductible	Taxable

Example - Taxable compensation

	Switzerland	US	Comments
Base salary	125,000	125,000	
Social security contributions	(6,000)		Swiss social / Local Swiss employee
Swiss pension contribution – **employee**	(8,000)	--	Deductible in Switzerland only
Swiss pension contribution – **employer**	--	10,000	Nondeductible / taxable in the US
Risk component	--	--	Not taxable in either country
Taxable compensation	**111,000**	**135,000**	

US taxation of earnings (Pillar 2 plans)

Earnings

- Taxation applies for “highly compensated” employees (HCEs)
  - Defined by the IRS as having received compensation in the preceding year more than $135,000 (if the preceding year is 2022)
  - Taxation would differ if not highly compensated
- Yearly growth in the Swiss pension fund is taxable for US tax residents (HCEs)
- If an individual becomes resident in a given year (e.g. obtains Greencard) after already participating in the plan, they may be required to recognize accumulated earnings from prior years.
- Any earnings reported and taxed on a US tax return should be tracked

  as part of the tax basis

Tax basis (Pillar 2 plans)

Tax basis

- Previous employer contributions which were previously taxed in the US
- Any employee contributions previously taxed in the US
- Taxable distributions will be reduced by tax basis at the time of taxation

Note: The term “tax basis” is being to reflect an employee’s “investment in the contract”

Tax Basis

- Employer contributions previously taxed in US
- Employee contributions previously taxed in US
- Earnings/account growth

Taxation of pension distribution or movement to blocked account

US tax impact

- a distribution from the Novartis Swiss Employer Pension Plan (including a transfer of the Swiss pension funds into a Swiss blocked account) will result in US tax for a US tax resident at the time of distribution
  - The distribution amount less “US tax basis” will be taxed as US income tax rates (37% highest marginal rate as of 2023 tax year) plus state taxes (if applicable)
  - US tax basis in the pension plan will reduce the taxable distribution. US tax basis is defined as:
    - Previous employer pension contributions to pension fund that were previously taxed in the US
    - Any employee contribution previously taxed in the US
    - Any earnings previously taxed in the US

Taxation of pension distribution or movement to blocked account

Swiss tax impact:

- Cash payout: entire distribution subject to tax at reduced rate vs income tax rate (5-15%)
- Rollover to a blocked account: No taxation

How to avoid double taxation?

- Swiss source tax could be either credited against the US tax on the US tax return OR claimed as a refund from Switzerland (for non-resident of Switzerland)

Distributions: annuity

Annuity

- US: to the extent the distribution exceeds tax basis, the payment will be taxable at ordinary rates for US tax residents / GC holders
  - Cannot be rolled into a qualified US retirement plan, IRA, etc.
- Switzerland:
  - Residents are taxed at ordinary income tax rates
  - Nonresidents not taxed if in the US at time of distribution – exclusion under US/Swiss Treaty

	Switzerland	US
Annuity withdrawal	50,000	50,000
Basis in pension	0	(45,000)
Taxable portion of pension annuity	50,000	5,000

Distributions: lump sum distributions

Lump sum withdrawal – at retirement

- US: the amount exceeding basis is taxed at ordinary income tax rates
- Switzerland: applies a reduced rate for lump-sum pension payments ranging from 5%-15%
  - Residents: taxed at the reduced rate of the canton of residence
  - Nonresidents: taxes will be withheld at reduced rate but of the canton where the fund is registered

	Switzerland	US
Lump sum withdrawal	450,000	450,000
Basis in pension	0	(440,000)
Taxable portion of pension withdrawal	450,000	10,000

Distributions: before retirement

US

- the amount exceeding basis is taxable in the US at ordinary income tax rates

Switzerland: taxable in Switzerland if fully distributed

- Ability to claim credit on the US return for Swiss taxes paid on pension distribution to prevent double taxation assuming you are a resident of Switzerland

In Switzerland there may be an option to move the pension funds to a blocked account

- No Swiss income tax until funds are fully distributed
- Earnings continue to be taxed in the US

Swiss Pension buy-backs

Swiss pension buy-backs are available in Switzerland in an effort to reduce Swiss tax

- **WARNING - A buy-back could have adverse tax consequences for a US taxpayer / US citizen or green card holder**
  - **Foreign tax credit availability decreases with reduced Swiss tax**
  - **US tax could be accelerated on Swiss pension contributions resulting in cash flow issues for taxpayer**

EXAMPLE	No buyback	With buyback
Taxable income	200,000	200,000
Pension buy-back		50,000
Taxable basis	200,000	150,000
Swiss taxes	57,000	40,000
Swiss tax savings		17,000
Taxable income	200,000	200,000
US tax (before FTC)	70,000	70,000
Foreign tax credit (FTC)	(57,000)	(40,000)
Final US tax	13,000	30,000

Other US tax reporting obligations

Participation in a Swiss pension (Pillars 2 & 3 and blocked accounts) may trigger other tax reporting obligations in the US:

- **Report of Foreign Bank & Financial Accounts (FBAR) -** US residents having financial interest in (or signature authority over) at least one financial account located outside of the US are required to file an FBAR **if the aggregate value of all foreign financial accounts exceeded $10,000** at any time during the calendar year to be reported.
  - The FBAR due date is April 15th annually with an automatic extension through October 15th
  - The definition of foreign financial account is very broad and includes foreign pensions
  - This form is informational only (no payment due)
- **Reporting of Specified Foreign Financial Assets – Form 8938 -** A US resident with an interest in a "specified foreign financial asset" during the taxable year, must attach Form 8938 along with the tax return, if the aggregate value of all such assets exceeds specific thresholds.
  - The definition of a specified foreign financial asset includes foreign pensions
  - The form is included with the annual US income tax return

Additional Pillar 3 considerations

Pilar 3 investments may have US tax implications

- Passive Foreign Investment Company (PFIC)
  - Foreign-based mutual funds are often classified as PFIC
  - PFIC's are subject to complex US tax guidelines
  - Form 8621 will be required with your US tax return if you have invested in a PFIC
  - Gains and distributions from a PFIC are taxed at US ordinary tax rates as opposed to the more favorable capital gains tax rate
- Foreign Trust / Form 3520-A reporting obligations
  - US citizens and residents who own a foreign trust (full or part owners) must file Form 3520-A by March 15, 2023
  - The requirement to file will not be automatically extended with the extension of time to file your US tax return
  - Informational only / no payment due
  - Filed separately from your tax return

Questions

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