SPECIAL REPORT

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How U.S. Citizenship-Based Taxation Affects International Double Taxation

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In this report, Mazur examines the interplay between Swiss and U.S. taxation of U.S. citizens residing in Switzerland and the potential for complicated tax burdens.

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Introduction

A double taxation conflict between two OECD members concerning an individual taxpayer can usually be resolved through the application of a double tax treaty that, based on the OECD Model Tax Convention on Income and on Capital,[1] sets out the rules for the avoidance or mitigation of double taxation by basing its scope on a taxpayer's residence.[2]

While the OECD model convention uses residence as the nexus for full tax liability,[3] the U.S. tax system applies a taxation-by-citizenship principle regardless of the taxpayer's residence. This is achieved by including the saving clause in U.S. tax treaties, which permits the United States to tax residents of other contracting countries who are U.S. citizens.[4]

The U.S. drew heavily on the OECD model convention when drafting the United States Model Income Tax Convention,[5] one of the major differences being the taxation-by-citizenship principle. However, as demonstrated in this report, double tax relief for U.S. citizens under the U.S. model convention (on which the Switzerland-U.S. double tax treaty[6] is based) is less efficient than for taxpayers from other countries under the

[1] OECD, "2017 OECD Model Tax Convention on Income and on Capital," at para. 1 (Nov. 22, 2017). The OECD model convention's influence extends beyond OECD member states; numerous nonmember countries have adopted its framework or based their bilateral tax treaties substantially on its provisions.

[2] *Id.* at I-8, para. 18.

[3] *Id.* at C(4)-1, para. 2.

[4] U.S. Treasury Department, "Technical Explanation of the United States Model Income Tax Convention," at 7 (Sept. 20, 1996).

[5] Treasury Department, "United States Model Income Tax Convention of September 20, 1996," at art. 1 (Sept. 20, 1996).

[6] Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation With Respect to Taxes on Income (Oct. 2, 1996).

OECD model convention. To illustrate the challenges the citizenship nexus poses for U.S. citizens residing outside the United States, this report focuses on Swiss residents holding U.S. citizenship.

U.S. Citizens in Switzerland

For the nearly 32,000 U.S. citizens residing in Switzerland, including around 16,000 American-Swiss dual nationals and another 16,000 holding solely a U.S. passport, taxation is a complex issue.[7] Swiss-resident U.S. citizens make up 0.35 percent of the Swiss population, and therefore the topic of Swiss-U.S. double taxation and its mitigation is quite prevalent.

Many U.S. citizens living in Switzerland are expatriates, highly skilled workers with substantial income who must file tax returns annually in both countries. Many others are entrepreneurs who conduct business in both countries or have established European operations based in Switzerland.

The issue is not limited to Switzerland. According to the Association of Americans Resident Overseas, approximately 5.4 million U.S. citizens live abroad.[8] As outlined in this report, U.S. citizens living abroad face double taxation because of the conflict between the U.S. taxation-by-citizenship principle and the residence-based taxation applied by most other countries. These individuals are taxed in the United States (nexus of citizenship) and in their country of residence (nexus of residence).

The Citizenship Nexus in Practice

The United States applies a tax regime that links tax liability solely to U.S. citizenship under U.S. nationality law. Notably, U.S. tax citizenship does not require possession of a valid U.S. passport, Social Security number, or state voter registration. While most U.S. citizens living abroad are fully aware of their tax obligations, a significant minority — often termed "accidental citizens" — comprises individuals born in the United States to parents temporarily residing there as students, scholars, or employees of multinational corporations.[9] These individuals typically maintain minimal connection to the United States and may be unaware of their obligation to pay U.S. taxes — a situation that is not satisfactory for either them or the IRS.

Tax Obligations in the United States

Unlimited Tax Liability

The Internal Revenue Code imposes tax on the taxable income of every individual who is a citizen or resident of the United States. [10] The unlimited tax liability of U.S. citizens derives not from the wording of section 1 alone, but also from Treasury regulations, which reflect the long-standing principle that the United States has authority to impose income taxation based solely on citizenship, regardless of the individual's place of residence.[11] This principle was affirmed by the Supreme Court in *Cook*, which established that "the native citizen who is taxed may have domicile, and the property from which his income is derived may have situs, in a foreign country, and the tax be legal, the government having power to impose the tax."[12]

Consequently, U.S. citizens residing abroad are subject to unlimited tax obligations in the United States, irrespective of any tax liabilities they incur in their country of residence. This regime applies to all U.S. citizens, including those who possess dual or multiple nationalities. These individuals are treated the same as other U.S. tax residents, and their income tax liability applies to worldwide income.

Section 61(a) provides a comprehensive definition of gross income as "all income from whatever source derived," with very few categories excluded from the tax base. Sections 101-140 outline specific exclusions from gross income, but generally, almost all income

[7] Swiss Federal Statistical Office, "Nearly 32,000 American Citizens Living in Switzerland Eligible to Vote on 8 November 2022" (Nov. 8, 2022).

[8] Doris L. Speer, "How Many Americans Live Abroad?" Association of Americans Resident Overseas (last updated Oct. 2024).

[9] Bernard Schneider, "The End of Taxation Without End: A New Tax Regime for U.S. Expatriates," 32 *Va. Tax Rev.* 1, 7 (2012).

[10] Reg. section 1.1-1(c).

[11] See Schneider, *supra* note 9, at 3-5 (describing the historical development of the principle of taxation by citizenship since the Civil War and confirming that that principle is deeply entrenched in U.S. tax law and has been consistently applied since the 19th century).

[12] *Cook v. Tait*, 265 U.S. 47 (1924).

categories are subject to U.S. tax. This includes income derived from assets located outside the United States, such as interests in foreign corporations, foreign business activities, employment abroad, or foreign real estate holdings, regardless of the taxpayer's domicile.

The primary tax burden for a U.S. individual arises from federal income tax. This discussion is therefore limited to federal tax obligations and does not address income taxes that may be levied by individual states.[13]

Mitigation of Double Taxation

The IRC provides two mechanisms for mitigating double taxation of foreign-source income: the foreign earned income exclusion (FEIE) and the foreign tax credit.

The FEIE allows U.S. citizens living abroad to exclude a specified amount of foreign earned income, as well as a housing cost amount, from their U.S. taxable income.[14] The exclusion applies to foreign earned income, such as wages, salaries, professional fees, and other compensation for personal services rendered abroad.[15] It does not apply to other income categories, such as capital gains or fixed or determinable annual or periodic income. For 2026 the exclusion amount (adjusted for inflation) is $132,900.[16]

The FEIE is available to U.S. citizens whose tax home is in a foreign country and who satisfy either the bona fide residence test (residence for an uninterrupted period including an entire tax year) or the physical presence test (presence for at least 330 full days during any 12-month period).[17]

The FTC allows taxpayers to credit foreign taxes paid or accrued against the taxpayer's U.S. tax liability on foreign-source income.[18] The credit is designed to offset U.S. tax that would otherwise be payable on the same income, independently of any double tax treaty.

The FTC limitation is calculated as the taxpayer's pre-credit U.S. tax liability multiplied by a ratio (not exceeding one), in which the numerator is the taxpayer's foreign-source taxable income and the denominator is the taxpayer's worldwide taxable income for the year[19]:

$$\text{FTC limitation} = \begin{array}{c}\text{Pre-credit}\\ \text{U.S. tax}\\ \text{liability}\end{array} \times \frac{\text{Foreign-source taxable income}}{\text{Worldwide taxable income}}$$

FTCs not used because of this limitation may be carried back one year or carried forward for 10 years.[20]

The FTC is available to both U.S. citizens and U.S. residents.[21]

Tax Liability in Switzerland

Unlimited Tax Liability

According to the Swiss Federal Direct Tax Act, individuals are subject to unlimited taxation based on their personal liability if they establish a tax domicile or residence in Switzerland.[22] This status is triggered by staying in Switzerland for at least 30 days while employed there or for at least 90 days without employment.[23]

Unlimited tax liability does not depend on an individual's citizenship. The sole relevant factor is the establishment of tax domicile or residence in Switzerland. Consequently, foreign nationals with Swiss tax residence are fully liable for Swiss income tax on their worldwide income. Conversely, Swiss nationals without Swiss tax residence do not have unlimited tax liability; they are taxed only on income derived from Swiss real property or self-employment activities conducted in Switzerland.

Income tax in Switzerland is levied at three levels: federal, cantonal, and municipal. Federal income tax applies uniformly nationwide at progressive rates, with a maximum marginal rate of 11.5 percent. Cantonal and municipal taxes

[13] States that impose income tax generally cease doing so once the relevant residency ties have been properly severed.

[14] Section 911(a)

[15] Section 911(d)(2)(A)

[16] Section 911(b)(2)(D); Notice 2026-25, 2026-17 IRB 836.

[17] Section 911(d)(1)(A).

[18] Section 901.

[19] Section 904(a).

[20] Section 904(c).

[21] Section 901(b).

[22] Bundesgesetz über die direkte Bundessteuer, at art. 3(1)-(2).

[23] *Id.* at art. 3(3).

vary by jurisdiction; municipalities apply tax multipliers within frameworks established by their respective cantons, and both are structured as progressive taxes. Because of this three-tiered system, effective tax rates vary significantly across jurisdictions, with combined marginal rates ranging from approximately 19 percent (Freienbach) to 43 percent (Geneva).[24] These regional variations materially affect subsequent tax calculations.

Mitigation of Double Taxation

Switzerland provides relief for foreign withholding taxes through a lump sum tax credit[25] (*Pauschale Steueranrechnung/imputation forfaitaire d'impôt*), which permits relief for foreign withholding taxes on certain income categories. An FTC is allowed to the extent that the affected foreign income is both taxable in Switzerland and has been subjected to a qualifying foreign withholding tax in the source country. The allowable credit is capped at the maximum rate stipulated in the applicable double taxation treaty.

Eligibility for Switzerland's lump sum tax credit is restricted to specific income categories: dividends, interest, royalties, service fees, and pensions or annuities.[26] Other items, including capital gains, do not qualify.[27]

The structure of Switzerland's lump sum tax credit system aligns with the approach recommended by the OECD model tax convention. Under this model, the country of residence retains the right to tax its residents on their worldwide income, while the source country may impose a withholding tax on certain categories of income paid to residents of the first state. The source country, however, is obligated by the double tax treaty to reduce its withholding tax rates to a treaty-specified maximum for qualifying residents. In turn, the country of residence (Switzerland) is responsible for granting relief from international double taxation, which it commonly does through the lump sum tax credit mechanism.

The Swiss lump sum tax credit is a standardized amount based on treaty limits, regardless of excess taxation suffered abroad or the full complexity of local tax systems. This streamlined approach simplifies compliance for taxpayers but can lead to over- or under-relief in atypical situations.

Under the Switzerland-U.S. tax treaty, the lump sum tax credit for U.S.-source dividends is capped at 15 percent, reflecting the treaty's residual withholding rate for those payments.[28] There is no FTC available on other income categories, such as interest, royalties, or compensation for services, because the treaty allocates exclusive or primary taxing rights for these items to the country of residence rather than the source country.[29]

As will be discussed later, the application of the lump sum tax credit under the Switzerland-U.S. tax treaty can lead to certain mismatches and limitations.

Switzerland-U.S. Tax Treaty

Swiss Double Tax Treaty Policy

Switzerland, as a matter of policy, largely follows the OECD model convention in its extensive network of double tax treaties. This means residence is the primary nexus that triggers unlimited tax liability, and the rules for allocating tax are built on this principle. Residency in one or both contracting states is a prerequisite for a natural person to fall within the treaty's scope. Residency also identifies the state that, because of its particularly close relationship with the taxpayer, can exercise unlimited tax jurisdiction under the treaty. The country of residence is contrasted with the source country, which has limited taxation rights under the treaty's allocation rules.[30]

[24] Taxbooks GmbH, "Einkommenssteuerbelastung in den Kantonen" (last visited Sept. 11, 2026) (in German).

[25] Verordnung über die Anrechnung ausländischer Quellensteuern.

[26] *Id.* at art. 1(2).

[27] Private capital gains are generally exempt from taxation in Switzerland; accordingly, a lump sum tax credit would not be available even if the Swiss ordinance contemplated it, because the maximum creditable amount would be zero.

[28] Switzerland-U.S. Double Taxation Treaty, *supra* note 6, at art. 10(2)(b).

[29] *Id.* at arts. 11(1), 12(1), 14(1), 15(1), and 18(1).

[30] Moritz Seiler, "Ansässigkeit," *Internationales Steuerrecht der Schweiz* 61 (2023).

Switzerland has not interposed the saving clause introduced in 2017 to the OECD model convention, thus preserving the right of a contracting state to tax its residents irrespective of other treaty provisions, unless excluded by specific exceptions.[31]

Of the two principal methods for avoiding double taxation (the tax credit method and the tax exemption method),[32] Switzerland has generally adopted the tax exemption method — specifically, the "exemption with progression" approach. Under this system, income allocable to a foreign country is exempt from Swiss taxation but is included in determining the applicable Swiss tax rate for progression purposes.

For passive income such as dividends, interest, and royalties, Switzerland applies the lump sum tax credit method, which provides relief for nonrecoverable foreign withholding taxes up to the treaty-specified maximum rate.

U.S. Double Tax Treaty Policy — Saving Clause

The foundation of U.S. double tax treaty policy is reflected in the U.S. model convention.[33] Building on residence as the primary taxation nexus, a key element of this policy is the saving clause, contained in the model convention's article 1(4). The saving clause permits the United States to tax the worldwide income of its residents and citizens in accordance with the general rules of the IRC, notwithstanding any treaty provisions to the contrary (including section 894(a)).[34] The saving clause also extends to former citizens and former long-term residents, who may be taxed under U.S. law notwithstanding the treaty.

To relieve double taxation the FEIE and FTC. These instruments are, however, applicable because of the domestic law, regardless of the applicability of a double tax treaty.

By applying the saving clause in connection with the FTC (which is applicable under domestic law and whose application is confirmed in the treaty), the United States aims to subject income earned by U.S. citizens to the higher tax rate of both treaty countries, with relief allocated in accordance with treaty provisions.

The U.S. tax treaty framework operates through a combination of the saving clause and the credit method. The former preserves U.S. taxing jurisdiction over its citizens and residents notwithstanding treaty limitations, while the latter, applied under U.S. domestic law and confirmed in treaty provisions, permits U.S. taxpayers to offset foreign taxes paid against their U.S. tax liability on the same income.

While treaties with some other countries (e.g., Italy, Japan, and Belgium) contain saving clauses that are technically reciprocal in form, allowing each country to tax its own citizens, in practical terms, only the United States applies citizenship-based taxation. Other countries generally do not tax nonresident citizens on their worldwide income, so reciprocity exists only theoretically.

Citizenship vs. Residence-Based Taxation: Context

U.S. citizens residing in Switzerland face potential double taxation on worldwide income. This income must be reported in tax returns filed in both jurisdictions. Limited relief is available under U.S. law through the FEIE; additional relief is available through the FTC system in the United States and the lump sum tax credit in Switzerland.

Citizens of other treaty-partner countries benefit from the residence-based taxation principle embedded in most double tax treaties. Even in the absence of a treaty, many jurisdictions limit their taxation rights to income derived from

[31] OECD, *supra* note 1, at art. 1, para. 3; Peter Hongler, "Funktionsweise der DBA," *Internationales Steuerrecht der Schweiz* 19 (2023). It should be noted that the saving clause in the OECD model convention has a different scope and purpose from that of the U.S. tax treaties. Whereas the U.S. saving clause is designed to preserve the United States' right to tax its citizens and residents as if the treaty had not come into effect, the relevant provisions in the OECD model convention primarily serve to prevent treaty abuse and to clarify that a contracting state is generally not restricted from taxing its own residents, except to the extent that specific provisions of the convention provide otherwise.

[32] OECD, *supra* note 1, at arts. 23a-23b.

[33] U.S. Model Tax Convention, supra note 6. The most recent version of the U.S. Model Income Tax Convention was released in 2016, Treasury Department, "United States Model Income Tax Convention" (Feb. 17, 2016).

[34] Treasury, *supra* note 4, at 8.

real property located within their territory, income from work performed within their territory, or income from business activities conducted within their territory.

Switzerland Double Taxation Agreement

A common way to alleviate double taxation is a double tax treaty. The double taxation agreement between the United States and Switzerland is designed to prevent or reduce double taxation of income and profits.[35]

The structure of the treaty broadly follows the OECD model convention. However, because of the specific features of U.S. tax law, it contains numerous materially significant deviations and special provisions, some already present in earlier agreements and consistent with current U.S. treaty practice. Many of these special provisions are closely linked to the U.S. saving clause. Considering that clause, the treaty requires provisions — particularly regarding personal scope, residence, and relief from double taxation — that deviate from those usually found in Swiss DTAs.[36]

Saving Clause

Article 1 of the Switzerland-U.S. double tax treaty contains the standard residence-based scope rule, overlaid with the U.S. saving clause and its exceptions. According to article 1(1), the treaty applies to persons who are residents of one or both contracting states. However, article 1(2) contains the saving clause, under which the United States reserves the right, notwithstanding any provision of the treaty, to tax its residents and citizens (including certain former citizens) as provided under its internal laws. Article 1(3)(a) and (b) then provide specific exceptions to this saving clause, particularly for provisions dealing with certain gains, relief from double taxation, nondiscrimination, and the mutual agreement procedure.

In practical terms, the saving clause means that the United States may, in principle, tax a U.S. citizen or resident as if the treaty had not come into effect, except when an express exception in article 1(3) applies. For example, if a Swiss resident performed independent personal services in the United States and the income was not attributable to a fixed base in the United States, article 14 would normally prevent the United States from taxing that income; however, if that Swiss resident was also a U.S. citizen, the saving clause permits the United States to include that remuneration in the citizen's worldwide income and tax it under normal IRC rules (i.e., without regard to section 894(a), which governs the tax treatment of income subject to a U.S. tax treaty).

For purposes of the saving clause, "residence" is determined under article 4. Thus, if an individual who is not a U.S. citizen is a resident of the United States under domestic law and also a resident of Switzerland under Swiss law, but is treated as a resident of Switzerland under the article 4 tie-breaker (for example, because their permanent home is in Switzerland), that individual is treated as a resident of Switzerland for purposes of the saving clause and may not be taxed by the United States in a manner inconsistent with the treaty. Such an individual is still treated as a U.S. resident for other U.S. tax purposes (e.g., in determining under section 957 whether a foreign corporation is a controlled foreign corporation, shares held by that individual are treated as held by a U.S. resident, potentially causing other U.S. persons to be U.S. shareholders with current subpart F inclusions).[37]

The saving clause extends to former citizens. Under article 1(2), the United States reserves the right to tax former U.S. citizens. Under current law (section 877A), a former citizen or long-term resident is subject to the expatriation tax if classified as a covered expatriate. An individual is a covered expatriate if, on the expatriation date, any of the following apply: (a) their net worth is $2 million or more, (b) their average annual net U.S. income tax liability for the five preceding tax years exceeds the inflation-adjusted threshold ($211,000 for 2026), or (c) they fail to certify full tax compliance for the preceding five years. Unlike

[35]Switzerland-U.S. tax treaty, *supra* note 6. This treaty replaced an earlier treaty from 1951, drafted before the first OECD model convention was published in draft form in 1963.

[36]Botschaft über ein Doppelbesteuerungsabkommen mit den Vereinigten Staaten von Amerika, BBl 1997 II 1086.

[37]Reg. section 301.7701(b)-7(a)(3).

the former section 877 regime, which imposed an alternative tax for up to 10 years, section 877A applies a one-time mark-to-market deemed sale of worldwide assets, with gains above an exclusion amount ($910,000 for 2026) taxed at capital gains rates.[38]

While in many U.S. treaties the saving clause is reciprocal, Swiss tax policy does not call for that treatment, so the provision was made unilateral, affecting only U.S. taxing rights.

Relief From Double Taxation in Switzerland

Article 23 of the Switzerland-U.S. treaty addresses the elimination of double taxation. It sets out the methods each contracting state must apply to relieve its residents from double taxation on income that may lawfully be taxed in both countries.

Switzerland generally applies an exemption-with-progression method: Income that, under the treaty, is taxed in the United States is exempt from Swiss tax but is taken into account when determining the applicable Swiss tax rate (article 23(1)(a)). The exemption applies to active income. For dividends, interest, and royalties that may be taxed in the United States under articles 10, 11, or 12, Switzerland instead grants, at the taxpayer's request, relief by way of a lump sum tax credit equal to the treaty-rate withholding tax (article 23(1)(b)).[39].

Interest, however, is generally exempt from source-state taxation under article 11, meaning no U.S. withholding applies even if the interest is not subject to the interest portfolio exemption; accordingly, no lump sum credit is available for interest in Switzerland. As a result, other categories of income subject to taxation in the United States, including employment and self-employment income, are exempt from Swiss taxation, subject to the exceptions noted below.

Under article 23(1)(c), Switzerland is not obliged to credit U.S. withholding tax at the full 30 percent domestic rate that may be levied in certain cases under articles 10(2) and 11(6). Examples include dividends from a U.S. real estate investment trust when the Swiss-resident recipient holds an interest of 10 percent or more, or "contingent interest" that does not qualify for the portfolio interest exemption under section 871(h) or 881(c).[40] Similarly, no credit is available when the United States does not grant full treaty relief because the Swiss recipient fails the limitation-on-benefits test under article 22. In both situations, Switzerland is required only to allow a deduction of the U.S. tax from the gross amount of the relevant income; that income is thus taxed in Switzerland on a net basis.[41]

Gains from the alienation of U.S. real property, including gains from shares in a "U.S. real property holding company" under article 13(2), are exempt from Swiss tax only if the Swiss resident can demonstrate that the United States has in fact exercised its taxing right over those gains.[42]

Income taxable in the United States is generally not taxed in Switzerland because of the application of the exemption method under article 23(1). An exception arises when the Swiss resident is also a U.S. citizen.

By virtue of the saving clause (article 1(2)), the United States taxes its citizens on worldwide income at ordinary progressive rates. If article 23(1) were applied without modification, this U.S.-source income, being "subject to taxation" in the United States, would be exempt from Swiss tax. That outcome would be inconsistent with Swiss treaty policy, which allocates taxing rights based on domicile. Article 23(3) therefore modifies the result: It provides that U.S.-source income of a U.S. citizen resident in Switzerland remains taxable in Switzerland as if the individual did not possess U.S. citizenship, thus allowing for a standard application of the lump sum credit of 15 percent in case of dividend income, even though the U.S. tax may be higher (20 percent for qualified dividends, or up to 37 percent for other

[38] Treasury, *supra* note 4, at art. 1, para. 2; Notice 2009-45, 2009-22 IRB 1047 (setting forth guidance on covered expatriate thresholds and inflation adjustments).

[39] Treasury Department, "Department of the Treasury Technical Explanation of the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation With Respect to Taxes on Income Signed at Washington on October 2, 1996 and the Protocol Signed at Washington on October 2, 1996," at art. 23, para. 1.

[40] Switzerland-U.S. tax treaty, *supra* note 6, at art. 23(1)(c).

[41] *Id.* at art. 23(1)(d). Finally, article 23(1)(d) specifically regulates the relief that Switzerland grants for U.S. Social Security pensions (see article 19(4)), an income category not analyzed in this report.

[42] *Id.* at art. 13, para. 2.

dividends). Regarding interest or royalty income, Switzerland is not required to grant relief to Swiss-resident U.S. citizens.[43] At the same time, paragraph 3 requires the United States to allow an FTC for Swiss income taxes paid on that income.[44]

Because U.S. law ordinarily does not permit an FTC for taxes on U.S.-source income (section 901), the treaty expressly provides that, for purposes of the U.S. FTCs, the relevant income is deemed to arise from Swiss sources.[45]

To offer a practical example: A non-U.S.-citizen resident of Switzerland receiving U.S.-source dividends benefits from the treaty withholding rate of 15 percent (article 10(2)(b)). A U.S. citizen resident in Switzerland, by contrast, is subject, under the saving clause, to ordinary U.S. tax on qualified dividends (currently 20 percent) or to ordinary income tax. Under article 23(3), Switzerland taxes that dividend as if the recipient were not a U.S. citizen and applies the lump sum tax credit, which the United States allows a credit for by treating the dividend as Swiss-source income.

Relief in the United States (Article 23(2))

The United States applies the credit method: It grants U.S. residents and citizens a credit for Swiss income taxes paid on income that is also subject to U.S. tax.[46] This provision confirms that Swiss taxes to which the treaty applies — namely, federal, cantonal, and communal taxes on income — qualify as creditable foreign taxes for purposes of the U.S. FTC.[47]

The FTC provided for in article 23(2) is directly linked to U.S. domestic legislation, particularly section 901-908.[48] In practice, this means:

- the credit against U.S. tax is generally limited to the amount of U.S. tax attributable to net foreign-source income within the relevant FTC limitation category;
- the dollar amount of the credit is determined in accordance with U.S. currency translation rules; and[49]
- income that is treated as U.S. source under domestic law, or that falls outside the applicable limitation category, may not generate a usable credit, potentially resulting in residual double taxation.

It should be noted that the U.S. system generously allows excess FTCs to be carried back one year or carried forward up to 10 years, which can be advantageous if the taxpayer's foreign-source income or U.S. tax liability fluctuates from year to year.

Compliance is relatively complex, requiring detailed forms (e.g., Form 1116) and careful tracking of creditable foreign taxes.

Re-Sourcing of U.S.-Source Income (Article 23(3))

The Switzerland-U.S. tax treaty contains a highly specific mechanism in article 23(3) tailored to address the interplay between the saving clause and the Swiss-U.S. treaty relief provisions. In case of U.S.-source income, this mechanism follows the "three bite approach"[50]: The source country (here, the United States) takes its "first bite at the apple" by taxing U.S.-source income up to the treaty rate; second, the residence country grants a credit for that notional sourcecountry tax; and only third does the United States allow an FTC for additional foreign tax, with any residual U.S. tax remaining if the U.S. rate exceeds the partner's rate.

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[43] Treasury, *supra* note 39, at art. 23, para. 3.

[44] Switzerland-U.S. tax treaty, *supra* note 6, at art. 23(3).

[45] Under the 1951 treaty (Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, 2 U.S.T. 1751 (May 24, 1951)), Switzerland was required, when taxing U.S. citizens resident in Switzerland, to exclude from the tax base all U.S.-source income covered by the treaty, taking that income into account solely to determine the applicable tax rate (exemption with progression). Aside from the fact that the 1951 convention was antiquated and did not reflect current OECD or U.S. treaty standards, it can be assumed that the lack of Swiss taxation of U.S.-source income of U.S. citizens — and the higher treaty withholding rates on dividends — were the main motives for Switzerland to conclude a new agreement.

[46] Switzerland-U.S. tax treaty, *supra* note 6, at art. 23.

[47] An important Swiss tax not covered by the treaty is the net wealth tax (Vermögessteuer or impôt sur la fortune) (*see* Switzerland-U.S. tax treaty, *supra* note 6, at art. 2(2)(a).

[48] *Id.* at art. 23. The wording of article 23, paragraph 2 follows the wording of the 1977 U.S. model convention, Treasury Department, "Model Income Tax Treaty" (May 17, 1977). *See also* Swiss American-Chamber of Commerce, *Swiss-U.S. Income Tax Treaty: Convention between the United States of America and Switzerland for the avoidance of double taxation with respect to taxes on income, signed on October 2, 1996*, at 285 (2004).

[49] Switzerland-U.S. tax treaty, *supra* note 6, at art. 23 para. 2.

[50] IRS, "Form 1116-Certain Income Re-Sourced by Treaty" (last updated Oct. 16, 2025).

Article 23(3) provides special rules for the tax treatment of income derived from U.S. sources by U.S. citizens who are resident in Switzerland. As described above, Switzerland is permitted to treat the income of those persons for treaty relief purposes as if they were not U.S. citizens and therefore need not provide full relief for the U.S. tax imposed on them, thereby limiting the tax credit to the applicable treaty rates. Article 23(3)(c) contains rules required to allocate some of the income to Switzerland to allow the FTC on that income. The amount tied to Switzerland is limited to the extent necessary to avoid double taxation under article 23(3)(b) (i.e., to reduce the residual U.S. tax to the amount of tax credit granted by Switzerland). The result is partial re-sourcing and is more limited than the full re-sourcing provided for in the U.S. model tax convention.[51]

The application of this mechanism is illustrated in the technical explanation of the treaty through schematic numerical examples that show how the re-sourcing rule and the U.S. FTC computation operate for U.S.-source income of U.S. citizens who are Swiss tax residents.[52] These examples demonstrate the coordination between Switzerland's lump sum tax credit method and the U.S. FTC rules and show that, in the described cases, the combined tax burden equals the higher of the ETRs of the two countries. According to the technical explanation, for a U.S. FTC to be allowed for the full amount of Swiss tax, an appropriate portion of the income must be re-sourced to Switzerland, the quantity of which depends on the amount of Swiss tax for which the U.S. citizen seeks to claim a U.S. FTC.

As will be shown later in this report, this mechanism functions smoothly and as intended so long as the Swiss rules on privileged taxation of dividends from qualifying participations (participation relief/partial taxation) do not apply. The treaty and its technical explanation were drafted and negotiated in the 1990s, before the introduction of partial taxation of dividends from qualifying participations in Switzerland.[53] It was also drafted before the preferential tax rate for qualified dividends was introduced in 2003.[54]

Nondiscrimination

It should be analyzed whether the saving clause is discriminatory, since it can result in a higher overall tax burden for U.S. citizens who are Swiss tax residents than for Swiss nationals taxed exclusively in Switzerland. Article 24 of the Switzerland-U.S. treaty contains a clause whose main purpose is to eliminate discrimination in specified circumstances. A standard treaty nondiscrimination provision establishes that, for tax purposes, discrimination on the grounds of nationality is prohibited and that, subject to reciprocity, nationals of a contracting state may not be treated less favorably in the other contracting state than nationals of that other state who are in the same circumstances.[55]

Article 24(1) of the Switzerland-U.S. tax treaty provides that nationals of one contracting state shall not be subjected in the other contracting state to any taxation or connected requirements that are other or more burdensome than those imposed on nationals of that other state in the same circumstances. To safeguard the saving clause, however, the same paragraph specifies that, for purposes of U.S. income taxation, U.S. nationals who are not resident in the United States are not considered to be in the same circumstances as Swiss nationals who are not resident in the United States. The treaty thus makes explicit that the nondiscrimination rule does not apply to U.S. citizenship-based taxation in this context.

[51] U.S. Model Tax Convention, *supra* note 5, at art. 23(3).

[52] Treasury, *supra* note 39, at art. 23, para. 3.

[53] The preferential treatment was introduced in 2009; *see* Bundesgesetz über die Verbesserung der steuerlichen Rahmenbedigungen für unternehmerische Tätigkeiten und Investitionen (Unternehmenssteuerreformgesetz II).

[54] Jobs and Growth Tax Relief Reconciliation Act of 2003, at section 302 (providing a preferential tax rate for qualified dividends, effective for dividends paid after Dec. 31, 2002).

[55] OECD, *supra* note 1, at C(24)-2, para. 5.

Table 1. Taxation of A: Swiss-Source Employment Income

Jurisdiction	Income	Tax Rate	Tax Calculated	Tax Credit	Net Tax Payable
Switzerland	$300,000	40%	$120,000	-	$120,000
United States	$300,000	37%	$111,000	$111,000	0

Practical Examples

The following examples illustrate the impact of the saving clause under the Switzerland-U.S. tax treaty. The scenarios focus on different income categories and how the taxing rights of both jurisdictions are coordinated in each case. Taxpayers A and B are U.S. citizens. A is resident in Zurich and faces an effective ordinary income tax rate of 40 percent, while dividends from qualifying participations (i.e., participations of at least 10 percent) are taxed at a reduced rate of 25 percent. B is resident in Wollerau and faces an effective ordinary income tax rate of 20 percent, with dividends from qualifying participations taxed at 12 percent.

Employment Income

A and B each have a taxable employment income of $300,000.

Swiss-Source Employment Income

Employment income is Swiss-sourced when a Swiss resident performs the work in Switzerland. In this situation, the resourcing rule in article 23(3) is not needed because the income is already treated as foreign-sourced for U.S. tax purposes, and the general FTC rules apply. Employment income of $300,000 is fully taxable in Switzerland.

Taxation of A

- The applicable Swiss tax rate is 40 percent, resulting in a Swiss tax expense of $120,000.
- No FTC applies in Switzerland.
- The same $300,000 of employment income is also taxable in the United States at a rate of 37 percent, producing a U.S. tax liability of $111,000 before the FTC.
- The United States applies the FTC to avoid double taxation of foreign-source income. For employment income, the U.S. tax liability of $111,000 is fully offset by the Swiss tax of $120,000 because the FTC cannot exceed the portion of U.S. tax attributable to the foreign income.
- This results in no residual U.S. tax on employment income after allowing for the FTC.
- The net tax expense for A on $300,000 of employment income is equal to the Swiss tax paid ($120,000).
- The final tax burden thus matches that of a Swiss taxpayer who does not have U.S. citizenship, and A is effectively subject to the higher Swiss rate.
- Whether a carryback or carryover of the excess $9,000 should be available is open to debate. On the one hand, it can be argued that because the treaty allows income to be re-sourced only "to the extent necessary to avoid double taxation," no excess credit arises in the first place. On the other hand, one may contend that the general FTC rules apply independently of the treaty, so IRC section 904(c) governs carrybacks and carryforwards, and the treaty language should affect only the computation of re-sourced income, not the availability of carryback and carryover.[56] It is assumed that the code provisions apply. (See Table 1.)

Taxation of B

- The applicable tax rate is 20 percent, resulting in a Swiss tax expense of $60,000.
- No FTC applies in Switzerland.
- The same $300,000 of employment income is also taxable in the United States at a rate of 37 percent, producing a gross U.S. tax liability of $111,000 before the FTC.
- The United States applies the FTC to avoid double taxation on foreign-source income. For employment income, the U.S. tax liability of $111,000 is reduced by the Swiss tax of $60,000 paid because the FTC cannot

[56]Treasury, *supra* note 39, at art. 23, para. 3.

Table 2. Taxation of B: Swiss-Source Employment Income

Jurisdiction	Income	Tax Rate	Tax Calculated	Tax Credit	Net Tax Payable
Switzerland	$300,000	20%	$60,000	-	$60,000
United States	$300,000	37%	$111,000	$60,000	$51,000

Table 3. Taxation of A: U.S.-Source Employment Income

Jurisdiction	Income	Tax Rate	Tax Calculated	Tax Credit	Net Tax Payable
Switzerland	$300,000	40%	$120,000	-	$120,000
United States	$300,000	37%	$111,000	$111,000	-

exceed the portion of U.S. tax attributable to the foreign income. The $60,000 FTC is applied directly against the U.S. tax liability, reducing it to $51,000.
- The net tax expense of B on $300,000 of employment income is equal to the U.S. tax paid ($111,000).
- The final tax burden equals that of a U.S. taxpayer, and B does not benefit from the lower Swiss tax rate. (See Table 2.)

U.S.-Source Employment Income

In rare instances, employment income can be treated as U.S. source — for example, when work is physically performed in the United States and is therefore U.S. source under domestic law, while in Switzerland, because of the individual's Swiss tax residence and main place of employment, the income is not exempt. Although this is an exceptional and hypothetical scenario, it is useful to illustrate how the FTC would operate in conjunction with article 23(3) of the Switzerland-U.S. tax treaty.

Taxation of A

- The applicable Swiss tax rate is 40 percent, resulting in a Swiss tax expense of $120,000. No FTC applies in Switzerland.
- The same $300,000 of employment income is also taxable in the United States at a rate of 37 percent, producing a gross U.S. tax liability of $111,000 before the FTC.
- The United States applies the FTC to the portion of income that is re-sourced under article 23(3), noting that re-sourcing is allowed only "to the extent necessary to avoid double taxation."

$$\textit{Resourced income} = \frac{\text{Swiss tax eligible for credit}}{\text{Applicable U.S. tax rate}} = \frac{\$120{,}000}{0.37} = \$300{,}000$$

- The FTC calculated on the re-sourced income is limited to the lower amount of Swiss tax paid ($120,000) and the U.S. tax attributable to the re-sourced income ($111,000).
- Accordingly, the U.S. tax liability of $111,000 is fully offset by the Swiss tax because the FTC cannot exceed the U.S. tax attributable to the foreign (re-sourced) income.
- The net tax expense for A on $300,000 of employment income is therefore equal to the Swiss tax paid ($120,000).
- The final tax burden matches that of a Swiss taxpayer without U.S. citizenship; A is effectively subject to the higher Swiss rate.
- A carryback or a carryover of the excess amount of $9,000 should be possible. (See Table 3.)

Taxation of B

- The applicable Swiss tax rate is 20 percent, resulting in a Swiss tax expense of $60,000. No FTC applies in Switzerland.
- The same $300,000 of employment income is also taxable in the United States at a rate of 37 percent, producing a gross U.S. tax liability of $111,000 before the FTC.
- The United States applies the FTC to the portion of income that is re-sourced under

Table 4. Taxation of B: U.S.-Source Employment Income

Jurisdiction	Income	Tax Rate	Tax Calculated	Tax Credit	Net Tax Payable
Switzerland	$300,000	20%	$60,000	-	$60,000
United States	$300,000	37%	$111,000	$60,000	$51,000

article 23(3), noting that re-sourcing is allowed only "to the extent necessary to avoid double taxation."

$$\textit{Resourced income} = \frac{\text{Swiss tax eligible for credit}}{\text{Applicable U.S. tax rate}} = \frac{\$120{,}000}{0.37} = \$300{,}000$$

The FTC calculated on the re-sourced income is limited to the lower amount of Swiss tax paid ($60,000) and the U.S. tax attributable to the re-sourced income ($111,000).

- The U.S. tax liability ($111,000) is reduced by the Swiss tax paid ($60,000), reducing it to $51,000.
- The net tax expense of B on $300,000 of employment income is equal to the U.S. tax paid ($111,000).
- The final tax burden equals that of a U.S. taxpayer, and B does not benefit from the lower Swiss tax rate. (See Table 4.)

U.S.-Source Dividends

Portfolio Dividends

A and B each receive dividends of $300,000 from their U.S. portfolio investments. The dividends are qualified dividends from a U.S. perspective.

Taxation of A

- The applicable Swiss tax rate is 40 percent, resulting in a Swiss tax expense of $120,000.
- Switzerland grants a lump sum tax credit of 15 percent (the treaty rate) — i.e., $45,000 — which can be offset against the Swiss tax liability, leaving a net Swiss tax of $75,000.
- The same $300,000 of dividend income is also taxable in the United States at a qualified dividend rate of 20 percent, producing a gross U.S. tax liability of $60,000 before FTC.
- Under article 23(3), the United States first preserves its 15 percent source-country entitlement ($45,000) under article 10(2)(b), so only the remaining 5 percent U.S. tax ($15,000) is "available for credit."[57]
- The re-sourcing is limited "to the extent necessary to avoid double taxation."

$$\textit{Resourced income} = \frac{\text{Swiss tax eligible for credit}}{\text{Applicable U.S. tax rate}} = \frac{\$15{,}000}{0.2} = \$75{,}000$$

The United States applies the FTC to the portion of income that is re-sourced under article 23(3), and the FTC is limited to the U.S. tax attributable to the re-sourced income — i.e., $15,000.

- Accordingly, the U.S. tax liability of $60,000 is reduced by an FTC of $15,000 and amounts to $45,000.
- The net tax expense for A on $300,000 of dividend income is $120,000, which corresponds to the 40 percent Swiss rate.
- The final tax burden thus equals that of a Swiss taxpayer who does not have U.S. citizenship, and A is effectively subject to the higher Swiss rate.
- A carryback or a carryover of the excess amount of $15,000 should be possible. (See Table 5.)

[57] *Id.* at art. 23(3).

Table 5. Taxation of A: Portfolio Dividends

Jurisdiction	Income	Tax Rate	Tax Calculated	Tax Credit	Net Tax Payable
Switzerland	$300,000	40%	$120,000	$45,000	$75,000
United States	$300,000	20%	$60,000	$15,000	$45,000

Table 6. Taxation of B: Portfolio Dividends

Jurisdiction	Income	Tax Rate	Tax Calculated	Tax Credit	Net Tax Payable
Switzerland	$300,000	20%	$60,000	$45,000	$15,000
United States	$300,000	20%	$60,000	$15,000	$45,000

Taxation of B

- The applicable Swiss tax rate is 20 percent, resulting in a Swiss tax expense of $60,000.
- Switzerland grants a lump sum tax credit of 15 percent (the treaty rate) — i.e., $45,000 — which can be offset against the Swiss tax liability, leaving a net Swiss tax of $15,000.
- The same $300,000 of dividend income is also taxable in the United States at a qualified dividend rate of 20 percent, producing a gross U.S. tax liability of $60,000 before FTC.
- Under article 23(3), the United States first preserves its 15 percent source-country entitlement ($45,000) under article 10(2)(b), so only the remaining 5 percent U.S. tax ($15,000) is "available for credit."
- The re-sourcing is limited "to the extent necessary to avoid double taxation."

$$\textit{Resourced income} = \frac{\text{Swiss tax eligible for credit}}{\text{Applicable U.S. tax rate}} = \frac{\$15{,}000}{0.2} = \$75{,}000$$

The United States applies the FTC to the portion of income that is re-sourced under article 23(3), and the FTC is limited to the U.S. tax attributable to the re-sourced income ($15,000).

- Accordingly, the U.S. tax liability of $60,000 is reduced by an FTC of $15,000 and amounts to $45,000.
- The net tax expense for A on $300,000 of dividend income is equal to the Swiss tax due before credit ($60,000).
- The final tax burden thus equals that of a Swiss taxpayer who does not have U.S. citizenship and also that of a U.S. taxpayer.
- No excess is available for carryover. (See Table 6.)

Dividends From Qualifying Participations

A and B each receive dividends of $300,000 from a U.S. corporation in which they hold a 15 percent interest. The dividends are qualified dividends for U.S. tax purposes and dividends from a qualifying participation for Swiss tax purposes.[58]

Taxation of A

- The applicable Swiss tax rate is 25 percent, resulting in a Swiss tax expense of $75,000.
- Under the lump sum tax credit system, the 15 percent treaty rate ($45,000) is effectively reduced in line with the reduced Swiss dividend taxation, so a credit of $25,000 is allowed. The net Swiss tax liability is therefore $50,000.

[58]Dividends from qualifying participations (i.e., from holdings of at least 10 percent in a Swiss or foreign company) benefit from a tax reduction of 30 percent at the federal level and of 30-50 percent at the cantonal and municipal levels. Bundesgesetz über die direkte Bundessteuer [DBG] Dec. 14, 1990, SR 642.11, at art. 20, para. 1bis; Bundesgesetz über die Harmonisierung der direkten Steuern der Kantone und Gemeinden [StHG] Dec. 14, 1990, SR 642.14, at art. 7, para. 1.

Table 7. Taxation of A: Dividends From Qualifying Participants

Jurisdiction	Income	Tax Rate	Tax Calculated	Tax Credit	Net Tax Payable
Switzerland	$300,000	25%	$75,000	$25,000	$50,000
United States	$300,000	20%	$60,000	$15,000	$45,000

- The same $300,000 of dividend income is also taxable in the United States at a qualified dividend rate of 20 percent, producing a gross U.S. tax liability of $60,000 before FTC.
- Under article 23(3), the United States first preserves its 15 percent source-country entitlement under article 10(2)(b) ($45,000), leaving 5 percent U.S. tax ($15,000) "available for credit."
- The re-sourcing is limited "to the extent necessary to avoid double taxation."

$$\textit{Resourced income} = \frac{\text{Swiss tax eligible for credit}}{\text{Applicable U.S. tax rate}} = \frac{\$15{,}000}{0.2} = \$75{,}000$$

The United States applies the FTC to the portion of income that is re-sourced under article 23(3); the FTC is limited to the U.S. tax attributable to the re-sourced income ($15,000).[59]

- Accordingly, the U.S. tax liability of $60,000 is reduced by an FTC of $15,000 and amounts to $45,000.
- The combined tax burden for A on the $300,000 dividend is $50,000 (Swiss) plus $45,000 (United States) — i.e., $95,000, which is higher than the Swiss tax due before credit. This total exceeds the burden that would be borne by a Swiss resident who is not a U.S. citizen and is also higher than the $60,000 paid by a U.S. resident taxed solely at the 20 percent qualified dividend rate.
- A carryback or a carryover of the excess amount of $35,000 should be possible and may partially mitigate the negative tax consequences. (See Table 7.)

Taxation of B

- The applicable Swiss tax rate is 12 percent, resulting in a Swiss tax expense of $36,000.
- Under the lump sum tax credit system, the 15 percent treaty rate ($45,000) is effectively reduced in line with the reduced Swiss dividend taxation, so a credit of $25,000 is allowed. The net Swiss tax liability is therefore $11,000.
- The same $300,000 of dividend income is also taxable in the United States at a qualified dividend rate of 20 percent, producing a gross U.S. tax liability of $60,000 before FTC.
- The United States applies the FTC on the re-sourced income. For this purpose, a notional U.S. tax of 15 percent is deducted from the U.S. tax liability of 20 percent, resulting in a tax amount eligible for credit of $15,000.[60]
- Under article 23(3), the United States first preserves its 15 percent source-country entitlement ($45,000) under article 10(2)(b), leaving 5 percent U.S. tax ($15,000) "available for credit."
- The re-sourcing is limited "to the extent necessary to avoid double taxation."

$$\textit{Resourced income} = \frac{\text{Swiss tax eligible for credit}}{\text{Applicable U.S. tax rate}} = \frac{\$15{,}000}{0.2} = \$75{,}000$$

The United States applies the FTC to the portion of income that is re-sourced under article 23(3); the FTC is limited to the U.S. tax

[59]Treasury, *supra* note 39, at art. 23(3).

[60]*Id.*

Table 8. Taxation of B: Dividends From Qualifying Participants

Jurisdiction	Income	Tax Rate	Tax Calculated	Tax Credit	Net Tax Payable
Switzerland	$300,000	12%	$36,000	$25,000	$11,000
United States	$300,000	20%	$60,000	$15,000	$45,000

attributable to the re-sourced income — i.e., $15,000.[61]

- Accordingly, the U.S. tax liability of $60,000 is reduced by an FTC of $15,000 and amounts to $45,000.
- The combined tax burden for B on the $300,000 dividend is $11,000 (Swiss) plus $45,000 (United States) — i.e., $56,000, which is higher than the Swiss tax due before but lower than the $60,000 paid by a U.S. resident taxed at the 20 percent qualified dividend rate.
- No excess amount is available for carryover. (See Table 8.)

The Three-Bite System and Its Shortcomings

As demonstrated above, in the case of U.S.-source dividends from qualifying participations, the mechanism for eliminating double taxation envisaged in the Switzerland-U.S. tax treaty does not operate as intended. Instead of ensuring that the taxpayer bears the higher of the tax rates applicable in the two states, the lack of coordination between the Swiss lump sum tax credit and the limitations on resourcing U.S.-source income for U.S. FTC purposes produces an unfortunate outcome: The overall tax burden for the taxpayer exceeds the tax borne by other Swiss or U.S. residents with the same amount of taxable income.

The cause of this distortion can be traced to two structural shortcomings that do not fully take into account the specific position of Swissresident taxpayers who are subject to the saving clause: (i) the reduction of the Swiss lump sum credit, and (ii) the saving clause resulting in a partial double taxation of U.S. citizens resident in Switzerland.

Swiss Lump Sum Reduction

The Swiss lump sum tax credit is reduced to mirror the lower taxation of dividends from qualifying participations. Consequently, the credited amount is lower than the treaty rate of 15 percent. This result reflects the logic of the lump sum tax credit: Only fully taxable income entitles a taxpayer to a credit, and, in the case of privileged taxation, it is reduced. This result, nevertheless, is not in line with the intention of the Switzerland-U.S. treaty. While the result may be correct from a Swiss tax perspective and not be challenged for taxpayers who are not U.S. citizens, it overlooks the double taxation it may impose on Swiss taxpayers subject to the saving clause. This one-sided measure costs the taxpayer a portion of the 15 percent tax credit. In the example illustrated in Table 7, only 55.5 percent of the lump sum credit of 15 percent is granted. As a result, instead of a tax credit of $45,000 (15 percent of the dividend received), the taxpayer is granted only a tax credit of $20,000. The benefit of the partial dividend taxation is thus significantly diminished.

This outcome is not discriminatory as such because Switzerland considers only its own tax position and does not take into account the U.S. income taxation of Swiss taxpayers who are U.S. citizens, other than relying on the residual 15 percent tax on U.S.-source dividends.

Saving Clause

As noted above, article 23(3) of the treaty and the corresponding technical explanation were developed in the 1990s, before Switzerland introduced the partial taxation regime for dividends from qualifying participations, and before the United States adopted the preferential regime for qualified dividends. The socalled threebite approach, which is a treaty coordination mechanism for tax and FTCs when a U.S. citizen is resident in a treaty partner jurisdiction — and

[61] *Id.*

thus a direct consequence of the saving clause — is not capable of reflecting all the specificities of each state's domestic law, and is therefore prone to fail in certain cases.

Paragraph 3(b) of article 23(3) is intended to eliminate potential double taxation that may arise because subparagraph 3(a) allows Switzerland not to grant full relief for U.S. tax imposed on U.S. citizens resident in Switzerland. Under subparagraph 3(b), the United States grants a credit for Swiss income tax paid or accrued after the application of subparagraph 3(a) and undertakes, in doing so, not to reduce its tax below the amount taken into account by Switzerland when applying subparagraph 3(a).[62] In substance, this means that the United States should, at a minimum, refrain from taxing an amount corresponding to the Swiss lump sum tax credit. In a standard case, this amount will correspond to 15 percent of the gross dividend; however, when Switzerland reduces the FTC (for example, because of privileged or partial taxation of dividends), the U.S. tax should be reduced accordingly to a rate below 15 percent, thereby allowing for a higher re-sourcing amount and a higher FTC.

The fact is that the United States does not tax below the amount equivalent to 15 percent of the dividend amount, and not the amount that is considered in Switzerland under article 23(3)(a). Instead, based on the three-bite approach, the United States applies the residual tax rate of 15 percent to U.S.-source dividends as the first bite and, assuming that Switzerland credited 15 percent to the taxpayer, deducts the residual tax amount from the U.S. tax available for credit, resulting in a reduction of the re-sourced amount that does not reflect the fact that the Swiss tax credit does not correspond to the U.S. residual tax rate. As a result, the carefully designed, coordinated approach to tax credits and re-sourcing rules in the treaty fails in the case of privileged taxation, leading to double taxation of these taxpayers.

While one can argue that the taxpayer benefits from lower tax rates in both countries, this result is not satisfactory or equitable because U.S. citizen taxpayers suffer double taxation that taxpayers in comparable circumstances are not subject to if they are not U.S. citizens.

Section 904(b)

The Swiss rules reducing the amount of creditable foreign tax are mirrored by a reduction of the FTC amount for certain categories of foreign-source income foreseen in the IRC. Section 904(b)(2) provides for a reduction of the FTC, factoring in a capital gain tax rate differential to compensate for the lower rate of long-term capital gains. While the rule clearly applies to capital gains, it must be analyzed whether it applies to qualified dividends, since they are taxed at the same rates as net capital gains.

According to section 1(h)(11), the term "net capital gain" means "net capital gain (determined without regard to this paragraph) increased by qualified dividend income," whereby the term "qualified dividend income" means "dividends received during the taxable year from domestic corporations and qualified foreign corporations."[63] Hence, section 1(h)(11) effectively subjects qualified dividend income to the preferential tax rates applicable to net capital gain. However, this provision applies solely in the context of the maximum capital gains rate under section 1(h). This limitation can be directly derived from the structure and language of section 1(h) and by the fact that qualified dividends are subject to rules governed by the dividend and corporate distribution provisions in subchapter C (sections 301-316) and are listed separately in the gross income rules in section 61.

A clarification of this point can be found in reg. section 1.904(b)-1, which states that if there is a capital gain rate differential (i.e., longterm capital gains are taxed at preferential rates), capital gains included in foreign-source taxable income must be reduced by the "rate differential portion" for FTC limitation purposes. Qualified dividend income taxed at preferential rates is treated similarly: Taxpayers must make a rate differential adjustment to qualified dividend income corresponding to the capital gain rate

[62] *Id.* at art. 23(3).

[63] A qualified foreign corporation is defined in section 1(h)(11)(c)).

differential adjustment, unless an exception (e.g., the small-amount election) applies.[64]

Consequently, in practice, the ETR borne by a U.S. taxpayer resident in Switzerland who receives U.S.-source dividends from a qualifying participation may be even higher than shown above because of the application of section 904(b).

Conclusion

The examples shown in the Taxation of A regarding dividends from qualifying participations show that changes in tax laws after the entry into force of the Switzerland-U.S. tax treaty, together with the technical explanations, led to an unintended lack of coordination in the mechanism for the avoidance of double taxation under article 23. Instead of ensuring that the taxpayer pays the higher of tax rates applicable in both countries, the lack of coordination between the lump sum tax credit in Switzerland and the application of the saving clause and of the three-bite system lead to an unfortunate result: The total tax burden suffered by the taxpayer is higher than the tax payable by other Swiss or U.S. tax residents with exactly the same income. As illustrated in the admittedly schematic calculations above, the FTC is generally well designed to mitigate the double taxation that may arise from applying the saving clause under the Switzerland-U.S. tax treaty. When applied in conjunction with the treaty, the FTC is intended to reduce, though not entirely eliminate, instances of double taxation. As demonstrated in the examples, its practical effect is to raise the total tax burden to the higher applicable rate of either the United States or Switzerland. This outcome results from the FTC being a nonrefundable credit for foreign taxes, meaning that no credit is granted for foreign taxes exceeding the U.S. level of taxation on a given category of income.[65]

For U.S. citizens residing in Switzerland, the tax credit mechanism under the treaty operates similarly to the credit method: The taxpayer bears the higher of the two jurisdictions' tax rates. Although these taxpayers are not in the same position as other Swiss tax residents or individuals subject only to U.S. taxation, the treaty was specifically designed to ensure that the jurisdiction with the higher tax rate captures the residual tax. This outcome is consistent with both the OECD model convention and the U.S. model convention, aligns with the credit method, and does not constitute discrimination under the nondiscrimination article.

Nevertheless, because the credit mechanism under the Switzerland-U.S. tax treaty effectively limits the U.S. FTC to the amount necessary to avoid double taxation, it shows shortcomings in certain situations — for example, when U.S.-source dividends benefit from a lower tax rate (and a lower amount of tax credit) because they are derived from a qualifying participation.

Although the FTC is a unilateral U.S. measure to alleviate international double taxation and is not subject to the rules of U.S. double tax treaties, it is limited to the amount of the taxpayer's compulsory foreign tax liability, taking into account any treaty-based reduction of that liability.[66] The same limitation applies to income treated as Swiss source because it is re-sourced under article 23(3) of the Switzerland-U.S. tax treaty, since that income is still subject to the general FTC limitation rules in section 904, including the separate limitation category for treaty re-sourced income.[67]

Another shortcoming that is worth mentioning is the application of the carryover (and carryback) rules. Under the general rules, any excess foreign tax for a given year may be carried back one year and carried forward up to 10 years, but only to the extent that there is excess limitation in the same separate category in those other years. As indicated by the calculation examples above, the operation of these carryover rules in the specific context of the Switzerland-U.S. treaty is not expressly regulated in the treaty text or technical explanation.

Nevertheless, assuming that the general carryover rules apply, their practical effect is often

[64] Reg. section 1.904(e) provides that qualified dividend income subject to preferential rates is subject to a rate differential adjustment in a manner analogous to the adjustment for capital gains when computing the FTC limitation.

[65] Schneider, *supra* note 9, at 19.

[66] Reg. section 1.9012(e)(5); IRS, "Reduced Foreign Taxes Under Treaty Provisions," Practice Unit INT-P-063 (Mar. 20, 2025).

[67] Section 904(d)(6).

rather illusory, not only in cases in which the Swiss ETR exceeds the applicable U.S. rate so that the annual FTC limitation produces an excess amount year after year, but also in situations in which double taxation is only partially mitigated because of the FTC shortcomings described above. In these circumstances, taxpayers may accumulate significant excess FTCs with little realistic prospect of using them in other years, despite the formal availability of carryback and carryforward relief.

Finally — and this is intentional — the Switzerland-U.S. treaty does not provide relief for all taxes levied on Swiss taxpayers. It grants relief for income taxes, including cantonal real estate gains tax, when treated as an income tax, but it does not cover cantonal and communal wealth taxes. Although Swiss wealth taxes function in practice as a substitute for a capital gains tax on privately held assets, they are imposed on net wealth and therefore fall outside the treaty's scope.[68]

In sum, the above analysis suggests that, for U.S. citizens resident in Switzerland, the interaction between citizenship-based taxation, the saving clause, the Swiss lump sum credit, and the FTC may result in imperfect relief from double taxation. ■

[68] Rev. Rul 70-464, 1970-2 C.B. 152; Schneider, *supra* note 9, at 19 (confirming that since the Zurich Vermoegenssteuer is a tax levied annually as a percentage of the market value of the fortune of the taxpayer, such tax is not an income tax and, hence, is not a creditable tax under section 901 of the Code. However, it is further held that the Zurich Vermoegenssteuer which is allocable to the stocks and bonds owned by the taxpayer (which are held for the production of income within the meaning of section 212 of the Code) is a deductible tax under section 164 of the Code.)