SPG FINEST PROPERTIES
CHRISTIE'S
INTERNATIONAL REAL ESTATE

Available in two languages: English and French

NEWSLETTER N°9

Editorial

In the history of lump sum taxation, there will be a period before and a period after 30 November 2014. Indeed, that was the day when the Swiss people validated lump sum taxation, or more precisely, voted to uphold it. Two initiatives aimed at abolishing it, one federal and one in the Canton of Geneva, were clearly rejected by the electorate. The federal law of 28 September 2012 will therefore come into effect on 1 January 2016. This introduces many new features relating to authorisation to pay tax on a lump sum basis, which is why it struck us as relevant to present the changes concisely in this newsletter. A five-year transitional period is also planned before this law takes effect for those who already benefit from lump sum taxation.

Thanks to this new model, the lump sum system of taxation will undoubtedly have a sounder legal basis. But we cannot help thinking that Switzerland is lagging behind the times: lump sum taxation only affects a limited "target group" (wealthy retired or semi-retired people). However, the example of countries as diverse as Belgium, Portugal or the United Kingdom shows that what we really need is a new, different tax instrument, to attract a younger, more active "fiscal clientele", who already have established business credentials, but who are in an earlier stage of their working life. Opening up this debate would mean – at last – moving from reactivity to proactivity, from management of the status quo to the dynamic offensive to lay the foundations of future prosperity!

It is even more appropriate since the number of lump sum taxpayers, which was already not very high – we are only talking about 5382 people in 2014 for the whole of Switzerland – went down by 252 in two years, or –4.5%

Thierry Barbier-Mueller
CEO

LUMP SUM TAXATION: NEW IMPETUS?

The date of 30 November 2014 marks a turning point in the history of Swiss lump sum taxation. It is the day when the Swiss people were invited to cast their vote on the federal popular initiative which proposed the abolition of lump sum taxation. On the same day, the people of Geneva were to decide on the cantonal popular initiative which also aimed at abolishing this tax system at cantonal level. These two initiatives were resoundingly defeated, thus conveying a powerful signal from the Swiss people and from virtually all the cantons in support of lump sum taxation and its continued application.

So the population decided to keep and consolidate this institution, which has its origins in the canton of Vaud in 1862, making it a part of the Swiss tax system for more than 150 years. It is highly appreciated by wealthy people who wish to move to Switzerland, and as a tax method, it is often advantageous from several viewpoints. Under certain conditions, it replaces the ordinary income and wealth taxes by a lump sum of tax calculated on the basis of certain expenditure.

The referendum of 30 November 2014 allows the entry into force of the new federal law of 28 September 2012, which will take effect from 1 January 2016. We will see together below what measures were taken by the legislator to consolidate the future of lump sum taxation.

1 *Challenge to and changes in the lump sum taxation system*

In recent years, taxation based on expenditure has aroused controversy, both at federal and cantonal level. Some criticised this regime as a privilege that no longer has any reason to exist, while others see it as an economic promotion regime that is essential at a time of fierce international competition in this field.

Many cantonal popular initiatives have been put forward with the aim of amending or abolishing this type of taxation. In 2009, Zurich was the first canton to eliminate lump sum taxation at cantonal level, followed by the cantons of Appenzell Ausserrhoden, Schaffhausen, Basel-Stadt and Basel-Landschaft. Other cantons, such as Thurgau, St. Gallen, Lucerne, Berne and Nidwald decided to tighten up their legislation without abolishing this system. The canton of Geneva, in the recent referendum held at the end of November 2014, voted massively in favour of keeping this tax regime.

The federal referendum of 30 November 2014 put an end to a long period of uncertainty. By this vote rejecting the federal popular initiative on the abolition of lump sum taxation, the Swiss people showed that it gave its unreserved support for the very principle of taxation based on expenditure. It should be pointed out that all the cantons, with the exception of Schaffhausen, rejected the federal initiative, whereas the lump sum taxation system is only particularly present in four cantons (75% of people paying lump sum taxation reside in the cantons of Vaud, Valais, Ticino and Geneva). This vote probably put an end to the wave of cantonal referenda on the subject.

2 *New features*

On 28 September 2012, the Parliament adopted the federal law on taxation based on expenditure with a view to providing firmer foundations to the lump sum taxation system. As we will see below, there are many new features. They mainly concern the general conditions for granting lump sum taxation, the introduction of a minimum expenditure threshold, the revaluation of the coefficient of the rental value or the annual rent or the obligation for the cantons to determine how taxation based on expenditure will cover wealth tax.

3 *General conditions for granting*

Until now, the lump sum system was not reserved for foreign nationals, and Swiss citizens could benefit from it but only for a period limited to one year. From 1 January 2016, the lump sum taxation system will be reserved exclusively for foreign nationals. We believe that the impact of this change in practice will be minimal.

The other conditions in order to be eligible for this mode of taxation will be kept. Apart from not holding Swiss nationality, it will be necessary to have no professional activity in Switzerland, and be taking up residence for the first time in Switzerland, or for those who have previously been subject to unlimited taxation in Switzerland, be returning to Switzerland after a minimum of ten years' absence.

Finally, for couples, both spouses will have to fulfil the conditions for granting the lump sum taxation. The question of whether "mixed" lump sums will continue - consisting of taxing only one of the spouses according to their expenditure, and the other according to the ordinary system - remains controversial in our opinion.

4 *Raising the threshold of expenditure*

For direct federal taxes, a new minimum expenditure threshold has been introduced, so that the lump sum taxation system is more acceptable to public opinion. In future, the taxable base will have to be at least CHF 400,000.–. We point out that this amount corresponds to the taxable base on which tax is calculated at the standard income tax rates.

Until now, there had been no legal requirement in this regard. However, the introduction of this minimum amount will not involve major changes for those applying for lump sum taxation and moving to the cantons of Geneva and Vaud, because these cantons almost stopped accepting lump sums with a lower taxable base many years ago.

Moreover, according to the new law, the cantons will also be required to introduce an equivalent threshold, for an amount that they are free to set, for the calculation of the cantonal and municipal tax. Two trends are now emerging for those cantons which have already decided on the question: some have adopted a minimum of CHF 400,000.– while others have adopted CHF 600,000.–. In Geneva, whereas by law the minimum legal amount of expenditure is currently CHF 300,000.–, it would appear that the canton is heading towards a new threshold of CHF 600,000.–.

Although this is already standard practice in very many cantons, it should be emphasised that it is the overall expenditure of the taxpayer, both in Switzerland and abroad, which must be taken into consideration. That could have the advantage of clarifying the situation and harmonising cantonal practices where necessary.

5 *Increase by a multiple of the rental value or the annual rent*

To bring lump sum taxation into line with the current economic reality, the federal legislator has decided, in addition to the new threshold introduced, to increase the minimum base for calculation of annual expenditure. At present, the amount of expenditure must not be less than five times the annual rent or rental value, or double the annual price of full board for people living in a hotel or similar institution. Pursuant to the legislative amendment introduced, these multiples will be increased to seven times the annual rent or rental value, or three times the annual price for board and lodging. By way of example, when a lump sum taxpayer renting an apartment for a monthly rent of CHF 7000.– cannot be taxed on expenditure less than CHF 420,000.– (CHF 7000.– x 12 x 5), this amount will, in future, be CHF 588,000.– (CHF 7000.– x 12 x 7).

6 *New wealth tax component*

This is probably the most important new feature brought in by the legislative change, although it has received little media coverage. The cantons will be obliged to regulate explicitly in their cantonal law the way in which the wealth tax (in addition to income tax) will have to be paid in the context of lump sum taxation. However, they will be free to define how wealth tax should be included, and retain complete discretion as to the method.

Among the various cantons, the majority trend, even if it is not unanimous, is moving towards a multiple of expenditure, usually set at a coefficient of twenty. For example, a taxpayer with a lump sum of CHF 500,000.– would be liable, in addition to income tax, to wealth tax calculated at the standard rates, on a notional wealth of CHF 10 million (CHF 500,000.– x 20).

The canton of Geneva, like the canton of Vaud, has not yet formally decided how to include the wealth tax in the lump sum taxation system. In Geneva, two solutions were envisaged: either to determine the taxable wealth by a multiple of expenditure, or to increase the taxable income by a certain percentage. Finally, it was the second alternative that was adopted in the counter-proposal, which was ultimately rejected by the people of Geneva last November, proposing to increase the amount of the expenditure by 10%. Thus an annual expenditure worldwide of CHF 500,000.– would give rise to a lump sum of CHF 550,000.–. Of course, there is no way of predicting whether, when the Grand Council of Geneva comes to implement the federal law at cantonal level in 2016, the same solution will be put to the people. That being the case, the measure chosen must take account of the specific features of the canton, particularly its rate of wealth tax.

7 *Transitional period*

The new law will apply to all new arrivals from 1 January 2016. On the other hand, persons already taxed under the lump sum system at that date will benefit from a transitional period. The transitional period provided by the new legislation is five years, both for the direct federal tax and for the cantonal tax. That period will expire on 31 December 2020, so that the new law will apply to all persons subject to lump sum taxation as from 1 January 2021.

Therefore, it is interesting to note that persons who move to Switzerland before 1 January 2016 will only be subject to the new minima as from 1 January 2021. Therefore, in our opinion, there is an obvious window of opportunity to be seized by people planning to transfer their residence to Switzerland in the near future.

8 *Conclusion*

In view of the controversy stirred up by lump sum taxation, amendments and adjustments were necessary. The result which emerges from the new law is the fruit of a typically Swiss compromise, both between parties of the Left and Right, and between urban and rural cantons. It is true that these new measures could increase the tax burden connected with the lump sum, but that seemed necessary or even indispensable, in order to uphold this tax system and ensure its continued survival. As regards the federal vote on 30 November 2014, it removed the uncertainty that has applied in recent years concerning lump sum taxation, and given new impetus to this model of taxation by providing it with a firmer legal basis. In this way, Switzerland has enhanced its attractiveness for wealthy individuals.

Now it will be necessary to keep a careful eye on the legislative process at cantonal level to find out how the new federal law is implemented by the cantons. The period leading up to the entry into force of the new law on 1 January 2016 will also have to be watched. If the five-year transitional period should enable people already subject to lump sum taxation to prepare for these changes, one can already wonder about the potential influx of new lump sum taxpayers before 31 December 2015 with a view to benefiting from the more favourable conditions during the transitional period.

*by Fouad Sayegh, LL.M and Gregory Clerc, LLM.

Fouad Sayegh, Oberson Lawyers, Attorney at the Geneva and New York Bar, LL.M. International financial law (New York University School of Law); and
Gregory Clerc, Oberson Lawyers, Attorney at the Geneva Bar.

Replaces newsletters Nos 3 and 7

June 2015 / 400 copies / © SPG 2015 / All rights reserved