



FINEST PROPERTIES

Superior Living in Switzerland

NEWSLETTER

N°3



Editorial

Thanks to certain show business stars, the subject of this Newsletter is even more topical than we had expected... Although Switzerland does not have to be ashamed of this instrument of tax competition – remember that Belgium, Great Britain and Luxembourg, all members of the European Union, have also made great efforts to offer attractive taxation to high net-worth individuals – it is nevertheless true that the system of lump-sum taxation in our country does satisfy specific rules. We thought it would be useful to briefly recall those rules for the benefit of the circle of partners and customers of SPG Finest Properties and Christie's Great Estates.

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EXPLANATION OF TAXATION ACCORDING TO EXPENDITURE OR LUMP-SUM TAXATION

by Prof. Dr. Xavier Oberson and M^e Fouad Sayegh*

The Swiss tax system offers foreigners wishing to take up residence in Switzerland an alternative method of taxation to the traditional system of taxing wealth and global income. Taxation according to expenditure, commonly called the tax package, is based on the taxpayer's standard of living. It is characterized in particular by the fact that the taxpayers who benefit from it do not, in principle, have to declare their income and wealth, subject to some exceptions which will be mentioned below. This type of taxation is currently offered to about 3,600 people all over Switzerland and appears to be particularly attractive at the international level.

Conditions for benefiting from taxation according to expenditure

It is important to note, as a preliminary point, that the cardinal principles that govern taxation according to expenditure are entirely enshrined in law. The general rules are uniform throughout the country, although it should be pointed out that the rates of taxation vary from canton to canton. Some of them actually prove particularly favourable for attracting taxpayers assessed by means of the tax package. It appears that

nearly 90% of those benefiting from the tax package reside in the cantons of Geneva, Graubünden, Ticino, Vaud and Valais.

The tax package is still reserved mainly for foreign nationals, as Swiss citizens may only take advantage of it for a limited period of one year. It should be pointed out in this regard that the agreement concluded between Switzerland and the European Union relating to free movement of persons, which came into force on July 1, 2002, now offers European nationals wishing to settle in Switzerland without being economically active there a fast-track and simplified procedure for obtaining a residence permit. In contrast, the conditions that have to be met by non-Europeans to obtain a residence permit are proving to be increasingly strict.

Only persons settling in Switzerland for the first time or after an absence of at least ten years may in fact apply for taxation according to expenditure.

Finally, lump-sum taxation requires that the taxpayer must not be economically active in Switzerland. The Federal Tax Administration considers that a person is economically active in the country as

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soon as he or she engages in an income-generating main or subsidiary occupation, in Switzerland or abroad. In practice, it is not always easy to define the stage at which the limit of economic activity is crossed and the interpretation of this rule may vary considerably from canton to canton.

Calculating the lump sum (tax base)

The straight lump sum

Tax according to expenditure is calculated on the basis of the taxpayer's standard of living and is levied according to the ordinary tax scales. This method of taxation thus differs from the conventional taxation system by the elements used as a basis for calculating the tax (tax base).

In lieu of the taxpayer's income and wealth, it is then necessary to define his/her taxable expenditure, which is usually designated by the term "straight lump sum". It consists of the annual expenses incurred by his/her standard of living and that of his/her dependants. Standard of living is made up mainly of expenses incurred for accommodation, food, clothing, leisure activities, travel, vehicles, insurance and taxes.

In addition, the expenditure used as a base may not be lower than five times the annual rent applicable to the property occupied by the taxpayer. If the latter owns his/her accommodation, it is the rental value that will be determining.

The application of certain double-taxation agreements to which Switzerland is a party may involve some additional constraints on the way in which the amount of the straight lump sum is fixed. By way of an example, a taxpayer wishing to benefit from the double-taxation agreement concluded with France will have to accept an increase of the lump sum of about 30%.

The straight lump sum is fixed in overall terms by mutual agreement between the tax administration and the taxpayer, taking into account the above elements. Only this amount will be declared to the tax authorities, subject to the principles governing the mixed lump sum and the modified lump sum (cf. below). This agreement is often formalized by a lump-sum agreement the validity of which may, according to the canton, be for a limited time. When it expires, the lump sum must then be renewed and adapted to the circumstances, as the case may be.

The mixed lump sum

The tax administration proceeds each year to make a verification calculation concerning certain elements designated in the law. The purpose is to make a comparison between, on the one hand, the tax calculated on the basis of the straight lump sum and the tax that would normally be due on these elements, on the other; finally it retains only the highest amount of tax. Calculation of the mixed lump sum is based on all the taxpayer's elements of Swiss origin as well as on certain items of income of foreign origin.

The items of wealth and income of Swiss origin comprise in particular transferable and real-estate assets located in Switzerland and the return on them, income deriving from copyright or patents exploited in Switzerland, or pensions paid from Switzerland. It should be pointed out that shares and bonds whose debtors are domiciled in Switzerland must also be taken into consideration.

The second category of elements comprises what is termed income covered by a double-taxation agreement. This is income of foreign origin (dividends, interest, fees, etc.) which has been taxed at source and on which the taxpayer requests that a partial or total tax exemption be granted

pursuant to a double-taxation agreement. It is important to point out here that the taxpayer is still free not to declare this foreign income subject to the express condition that he/she does not request that the agreement be applied. There are in fact situations in which it is more advantageous to pay the full foreign withholding tax, but to avoid taxation in Switzerland on the basis of the mixed lump sum.

The modified lump sum

Some countries have a tendency not to recognize the status of Swiss residents in the case of taxpayers who are taxed according to expenditure. Thus in order to benefit from certain double-taxation agreements concluded by Switzerland, the taxpayer having a lump-sum arrangement has to subject all his/her income from the country in question to ordinary taxation in Switzerland. The countries concerned are Austria, Belgium, Canada, Germany, Italy, Norway and the United States.

Steps to be taken

For a person wishing to come and settle in Switzerland as a lump-sum taxpayer, the first step will be to carefully study the appropriateness of such a method of taxation, taking into account his/her personal situation and wealth, in particular the origin of his/her income, as well as the nature and location of his assets.

If taxation according to expenditure is deemed favourable, it will next be necessary to actually choose the property that will constitute the person's new domicile. The competent fiscal authorities will then have to be approached to start negotiating the lump sum. At the same time one will be able to embark on the procedures that have to be completed with the immigration authorities in order to apply for a residence permit ■

Document également disponible en français.

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