



Lump sum taxation in Switzerland

How does it work?

Who can benefit from it?

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1. A globally unsecure economic environment

The general tendencies in recent years in the areas of taxation, the banking industry as well as the general state of public finances in Europe are increasingly considered worrisome by many. We have witnessed the introduction of new rules on financial transparency and exchange of information and a proliferation of new regulations and compliance requirements. Tax increases loom on the horizon in numerous countries and inflation is hitting record-highs. Various countries are seeing social unrests. Governments are looking for new ways to levy higher taxes. The OECD countries are introducing minimum corporate tax rates in order to reduce international tax competition. On a regular basis, the media are reporting various types of “leaks” that expose confidential information of private individuals to the public domain. The COVID-19 pandemic and especially the war in Ukraine have exposed how fragile our world is.

In addition, a perceived mobilisation of the public opinion against “the rich” as well as mounting concerns over the incessant growth of public debt levels in the wake of the recent pandemic have increased the general uncertainty for many wealthy individuals.

With all these developments in mind, many families across the globe are seeking to put backup plans in place. Many are even already willing to “vote with their feet” and are seeking to establish their domicile in a new country. These people are generally looking for safety, stability, predictability, privacy and, of course, moderate levels of taxation.

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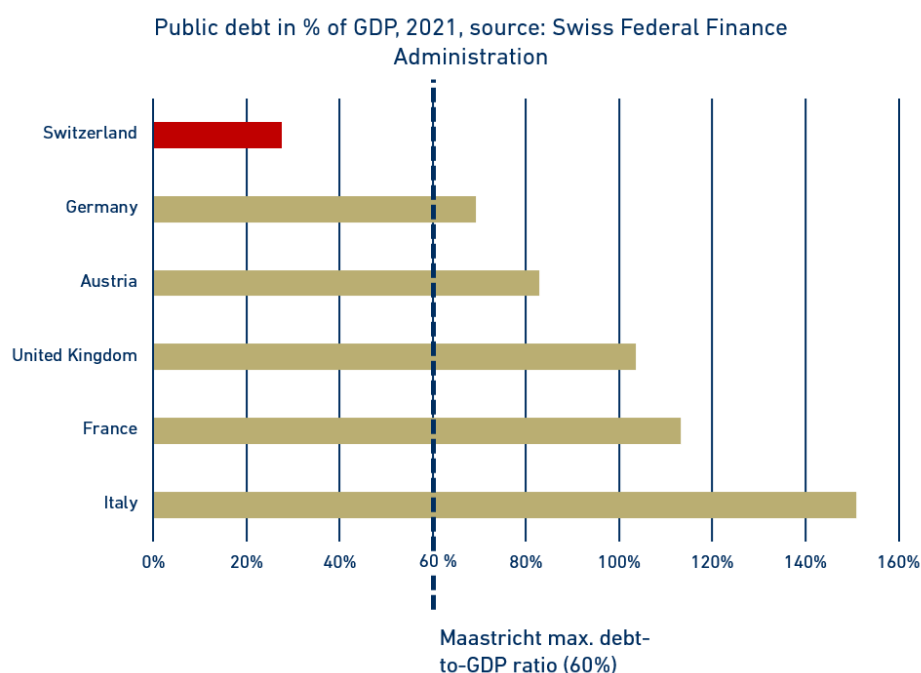
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2. What does Switzerland have to offer?

Notably, Switzerland has had its share of many of the aforementioned developments (especially in the banking and corporate tax areas). Yet, the willingness and ability of the relevant political actors to maintain the traditional attractiveness for wealthy individuals and to remain a reliable partner has probably never been stronger. Be it the upholding of traditional lump sum taxation for private individuals in most Swiss cantons (almost 60% in favour) or be it the rejection by a large majority (71%) of the voters of a new general 20% estate and gift tax which would have especially penalized direct descendants (who generally benefit from full tax exemption): Swiss voters have systematically and consistently refused to approve invasive proposals that were aimed at increasing the tax burden on the wealthy. Corporate tax rates also follow the general downward trend.

Switzerland is composed of 26 cantons (“states”), which are financially autonomous. The cantons are in charge of their own budget, and they set their own tax rates. As a consequence, there is a robust tax competition among the cantons and there are notable differences in the respective tax rates.

The taxpayer-friendly environment is however not only ensured by an attractive framework of tax rules, but also through the fact that, unlike in the neighbouring countries, the ratio of public debt to GDP in Switzerland was continuously reduced (!) over the last years. It is now as low as 28% (the Maastricht debt limit being set at 60%). Arguably, public debt is in the end nothing else than postponed taxation. Thus, the moderate level of Swiss public debt should ensure that the country will be able to maintain its attractiveness for taxpayers for years to come.



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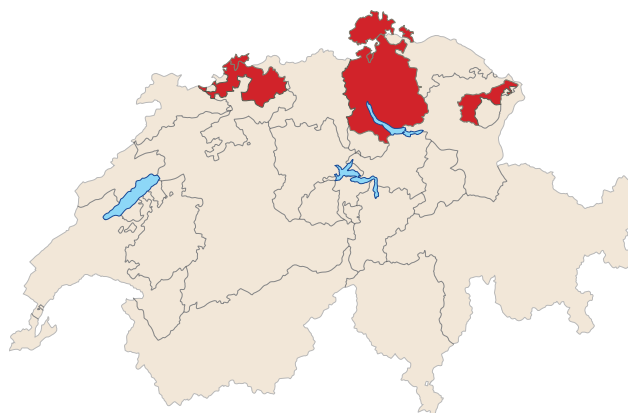
The tax authorities deliver a legally binding tax ruling to the taxpayer that confirms the modalities of taxation.

3. How does lump sum taxation work?

3.1. Background

Lump sum taxation has traditionally benefitted foreigners who were willing to settle down in Switzerland without pursuing a professional activity. Since the 19th century, Swiss cantons have been offering these types of tax rules to foreigners. Lump sum taxation has the advantage of being a simple and very competitive mode of taxation for individuals who meet certain requirements. Swiss federal law describes the basic conditions that need to be met by an individual in order to apply for this beneficial tax regime. Lump sum taxation is available to foreign nationals who have their tax domicile in Switzerland if they are not exercising any professional activity in the country and if they have not been Swiss tax residents during the ten previous years.

Currently, lump sum taxation is available in the entire country, except in the cantons of Zurich, Schaffhausen, Appenzell-Ausserrhoden, Basel-Stadt and Basel-Landschaft (in red on the map). In 2018, 4'557 persons were taxed under the lump sum rules in Switzerland. Most of them lived in the cantons of Vaud, Valais, Geneva, and Ticino.



3.2. Why lump sum taxation?

In essence, lump-sum taxation is an alternative and simplified method for determining the taxable income and wealth of foreign nationals who are tax domiciled in Switzerland and who are not exercising any professional activity in the country. The tax is levied on a deemed income (the "lump sum") that derives from the annual cost of living (see below, Sect. 3.4). As a result, the effective tax burden can be extremely attractive.

The specific modalities are pre-discussed with the tax authorities of the canton where the applicant wishes to live. On that basis, the tax authorities deliver a legally binding tax ruling to the taxpayer that confirms the modalities of taxation. As a positive side effect, the costs of annual tax compliance are generally much more limited than they would be otherwise.

3.3. Who can benefit from lump taxation?

Any non-Swiss nationals who establish their Swiss tax residence for the first time can request to be taxed on a lump sum basis. As explained, the lump sum tax regime precludes the taxpayer from exercising any professional activity in Switzerland. This means that any professional activity needs to be physically performed abroad. Private management of one's own personal wealth is permitted.

To a rather limited extent and subject to confirmation by the tax authorities, Swiss board memberships may be tolerated.

In the case of married or registered couples, both spouses need to meet the respective requirements.

3.4. How is the taxable income established?

As a starting point, the taxable income is determined on the basis of the total annual living expenditure (which will serve as a "deemed taxable income") or of a multiple (7x) of the annual rental costs of the taxpayer and his dependents. For federal tax purposes the minimum taxable income must be at least CHF 400'000. For cantonal tax purposes the tax base may be lower in some instances.

The amount in question is usually confirmed by way of negotiations with the authorities, on a case-by-case basis. Therefore, the authorities expect to receive all relevant information on the applicant's personal and financial situation. This information is kept absolutely confidential. Personal wealth management structures (trusts, companies, etc.) should be addressed in these discussions with the tax authorities.

The following is typically part of the qualifying personal living expenditures:

- + Food and clothing
- + Housing
- + Personal staff
- + Education and culture
- + Travelling and vacation
- + Health care
- + Costs of vehicles (cars, boats, planes etc.) or animals (e.g. horses)
- + Foreign taxes
- + Other costs

Total = Taxable income ("lump sum", taxed at ordinary income tax rate)

On a going forward basis, the tax authorities generally accept to levy taxes on the basis of the agreed lump sum, as long as the taxpayer's general situation does not change.

The taxable income is determined on the basis of the total annual living expenditure.

In Switzerland, there is no capital gains tax on privately held shares or other securities.

3.5. Control Calculation

Swiss laws require that the taxable income based on the annual expenditures (see above) be at least as high as the sum of the individual's Swiss-sourced income. For this purpose, a parallel "Control Calculation" must be made. The Control Calculation especially includes income from Swiss real property and from other assets located in Switzerland (including financial assets), Swiss intellectual property and Swiss pensions. Foreign-sourced income for which benefits from Swiss double tax treaties were requested is also included.

If the income under the Control calculation is higher than the lump sum determined based on the annual expenditures, the former will be the basis for the income tax.

In Switzerland, there is no capital gains tax on privately held shares or other securities. Therefore, as an example, a gain (or a loss) derived from the sale of shares in a Swiss or foreign company is tax-free and thus not relevant (and is not taken into account in the Control Calculation).

Capital gains derived from the sale of Swiss real property will however be subject to taxation (see below Sect. 3.7.3).

3.6. Double tax treaties

Switzerland has a very broad double tax treaty network. In order to be applicable to lump sum taxpayers, certain double tax treaties concluded by Switzerland provide for certain specific additional requirements, if a Swiss tax resident is taxed on a lump sum basis. Currently these countries are: Austria, Belgium, Canada, France, Germany, Italy, Norway and the United States.

In essence, lump sum-taxed individuals need to include the income from these countries in their Swiss tax base in order to benefit from treaty benefits ("modified lump sum taxation").

Certain double tax treaties concluded by Switzerland provide for certain specific additional requirements.

3.7. What are the other Swiss taxes due by individuals who are subject to lump sum taxation?

3.7.1. Wealth tax

In addition to income taxes, there is a wealth tax payable in every canton (the tax basis is also determined on a lump sum basis). The cantons follow varying approaches to determine the wealth tax base in the case of lump sum taxation: A frequent method is to multiply the taxable income with the factor 20. Thus, if a lump sum taxed person has a taxable income of CHF 1 m, the taxable wealth would amount to CHF 20 m. The applicable annual tax rates vary between 0.1% and 1%.

3.7.2. Withholding tax

Dividends paid by Swiss companies are subject to Swiss withholding tax (WHT, rate of 35%). Swiss tax residents (including persons who are taxed on a lump sum basis) are entitled to a refund or credit of the WHT against their Swiss income taxes. Such income will however be included in the taxable income (lump sum) or in the Control Calculation.

Most cantons have abolished gift and inheritance taxes on transfers between spouses and to direct descendants.

Switzerland has a very low VAT standard rate of currently 7.7%.

3.7.3. Real estate capital gains tax

Gains derived from the sale of Swiss real estate are subject to a separate real estate capital gains tax. The tax rates in the case of short-time ownership can be very high (60% in certain places) and it goes down to usually about 20% in the case of long-term ownership. If a primary home is sold prior to acquiring a new one, the proceeds reinvested are entirely tax exempt.

3.7.4. Social security

Persons domiciled in Switzerland are subject to the Swiss social security system. They are liable to pay social security contributions and will need to have private health insurance coverage with a Swiss insurance carrier. The social security contributions payable by lump sum taxed persons depend on the size of their wealth (the maximum amount is currently roughly CHF 25'000 per year and per person).

3.7.5. Gift and inheritance taxes

Gift and inheritance taxes are only levied by the cantons. Being taxed on a lump sum basis does in principle not exempt an individual from gift and inheritance taxes. Schwyz and Obwalden have however abolished them altogether while Lucerne only levies an inheritance tax.

Most cantons have abolished gift and inheritance taxes on transfers between spouses and to direct descendants. For these reasons gift and inheritance taxes are usually not a major concern to families. The taxation of other transfers depends on the degree of family relationship and may be subject to higher gift and inheritance taxes. Transfers made to Swiss charities are usually tax-exempt. Some cantons also exempt transfers to foreign charities under certain conditions.

In Geneva, transfers from a person who is or has been subject to lump sum taxation in an assessment for one of the three years prior to the gift or to death will be subject to a gift or inheritance tax, even if the beneficiary is a child or the spouse. In Vaud, persons who are taxed on a lump sum basis (and certain other foreigners) are subject to lower gift and inheritance taxes than individuals who are subject to ordinary taxation. Some communities in the canton of Lucerne levy a low inheritance tax on transfers to descendants.

3.7.6. Value added tax

Switzerland has a very low VAT standard rate of 7.7% (the current rates in the European Union range between 17% and 27%).

A lump sum tax ruling is often the gateway to a Swiss residence permit.

Persons who are taxed on a lump sum basis and who live in Switzerland can acquire Swiss residential property.

3.8. Is there a difference between EU/EFTA and Non-EU/EFTA nationals?

The conditions for non-EU/EFTA nationals are frequently more restrictive than for EU/EFTA nationals. The tax authorities expect higher tax revenues from non-EU/EFTA nationals in order to satisfy an "economic or fiscal interest". Based on an economic or fiscal interest, immigration authorities will deliver the relevant immigration permits. For this very reason, lump sum taxation has always also been a popular immigration planning tool for citizens from countries that would otherwise need to observe stricter immigration rules into Switzerland ("third country nationals"). The obtention of a lump sum tax ruling is often the gateway to a Swiss residence permit.

3.9. What about the acquisition of Swiss residential real estate by persons taxed on a lump sum basis?

The acquisition of Swiss residential real estate by non-Swiss citizens is subject to several restrictions (known as "Lex Koller"). However, EU/EFTA citizens who have their domicile in Switzerland can freely acquire Swiss residential real estate. Non-EU/EFTA citizens who have a short-term residence permit "B" are allowed to purchase a residential property if they use it as their primary domicile. Non-EU/EFTA citizens who have a long-term residence permit "C" and who have a Swiss domicile can acquire Swiss residential real estate without restrictions. Thus, persons who are taxed on a lump sum basis and who live in Switzerland can in principle acquire Swiss residential property.

4. Example of calculation

Assume Taxpayer T owns worldwide assets of CHF 500m. His annual income is CHF 10m. Further assume Canton X has accepted that T's annual cost of living amount to CHF 1m. Canton X determines T's taxable wealth by multiplying his taxable income with a factor of 20. Thus, on a lump sum basis, T's taxable income will amount to CHF 1m and his taxable wealth will amount to CHF 20m. Also assume that the ordinary income tax rate in Canton X is 20% (combined federal, cantonal and communal) and the annual wealth tax rate is 0.5%. T's annual personal taxes will amount to an income tax of CHF 200k (20% of 1m) plus a wealth tax of CHF 100k (0.5% of 20m). In addition, he will also need to pay social security contributions of roughly CHF 25k per year. In total, he will be paying CHF 325k per year. If he had been subject to ordinary taxation, he would have had to pay an income tax of CHF 2m (20% of 10m) and a wealth tax of CHF 2.5m (0.5% of 500m) plus social security of CHF 25k, totaling in taxes of CHF 4.525m.

The relationship between taxpayers, tax advisors and tax authorities is generally characterized by a culture of discussion and mutual trust as well as by predictability and stability.

5. What is the general attitude of the Swiss tax authorities?

The Swiss tax authorities have a sophisticated advance tax ruling practice that has been in place for many decades. The relationship between taxpayers, tax advisors and tax authorities is generally characterized by a culture of discussion and mutual trust as well as by predictability and stability.

The Swiss tax authorities consider taxpayers as their „clients“. They are well aware of the importance of being economically attractive and of being welcoming to potential taxpayers. As a consequence, it is common practice to approach the tax authorities in the context of major transactions, or prior to the implementation of wealth planning instruments (be it through gifts, the settlements of trusts, the establishment of foundations, etc.). The ruling system is also fully available to individuals who are taxed on a lump sum basis.

6. What is the procedure to request lump sum taxation?

- (1) Identify the canton of interest for a potential tax residence
- (2) Provide information to the cantonal tax authorities regarding:
 - a. Personal and family situation (sometimes required: extract from police records at current domicile)
 - b. Financial information: types of income, movable and immovable property, trusts, wealth structures, worldwide costs of living, etc.
 - c. Written and signed confirmation:
 - i. that the applicant has never been a Swiss tax resident so far;
 - ii. that he or she will not be carrying out any professional activity in Switzerland; and
 - iii. that he or she is not a Swiss national
- (3) Submission of a tax ruling request determining the taxable income and taxable wealth (it usually takes about approximately 3 to 4 weeks until it is granted)
- (4) After ruling approval, submission of immigration permit request with immigration authorities (duration of approximately 1 month)

Please do not hesitate to contact us should you have any questions.



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