TRUST & ESTATE PLANNING

The debate surrounding Swiss lump sum taxation and the importance of the use of trusts

By Thomas Brunner

General taxation for individuals resident in Switzerland

Like many other countries, Switzerland generally taxes resident individuals on their worldwide income. The income is taxed at federal level, cantonal level and communal level. The cantons and their communes independently determine the tax rates within the constitutional principles. Wealth, gift and inheritance taxes are imposed on a cantonal and communal level, but not on a federal level.

Lump sum taxation for wealthy immigrants

Individuals who make Switzerland their country of residence for the first time, or individuals that have spent at least ten years outside of Switzerland before returning to Switzerland, may opt for lump sum taxation. There are approximately 5,400 foreigners benefiting from this special form of taxation in Switzerland. Lump sum taxation was first introduced by Canton Vaud in 1862 in order to establish a tax system to efficiently tax wealthy foreigners spending a fair amount of time in Switzerland and benefiting from the local Swiss infrastructures without contributing to their maintenance. What at the beginning was not intended to be a privilege has developed into an attractive option for wealthy individuals to reduce their tax burden significantly by taking up residence in Switzerland. A prerequisite to opt for lump sum taxation is to renounce any gainful activities in Switzerland and not become a Swiss national.

Thomas Brunner

With lump sum taxation, the payable tax is calculated by considering the expenditures of the individual such as the taxpayer's living expenses in Switzerland, the living expenses of the taxpayer's family and those of other persons the taxpayer supports. The taxable amount is calculated by multiplying the annual rental cost by five or the deemed rental value of the taxpayer's dwelling in Switzerland. The cantons may apply different calculation rates. In the past, the taxable amount was often calculated at less than CHF 250,000.00 (tax basis).

In practice, the taxable amount is negotiated with the tax authorities of the canton of domicile. As a general rule, foreign source income and assets held outside of Switzerland do not have to be declared. Swiss source income (income from real estate situated in Switzerland; income from movable assets situated in Switzerland; income from financial assets invested in Switzerland) is only relevant when it exceeds the calculated living expenses as mentioned above. In such a case, the tax rate will be based on the income from Swiss sources.

Pressure on lump sum taxation

The Swiss lump sum taxation regime has been subject to regular political debate in the past. Some consider it to be a disingenuous means to privilege wealthy taxpayers, which, from a legal point of view, contravenes the fundamental principles of equal treatment of all taxpayers and taxation based on economic capacity. Others see it as an instrument for enhancing Switzerland's appeal as a place of residence. The Federal Tax administration estimates that more than 22,000 jobs directly or indirectly derive from the lump sum taxation regime, particularly in more remote regions and mountain resorts.

Swiss itizens already voted on the abolition of lump sum taxation at cantonal/communal level in 10 of 26 cantons. Five of these ten cantons confirmed the continuation of lump sum taxation and citizens decided to abolish lump sum taxation in the other five cantons, namely Zurich, Basel-Landschaft, Basel-Stadt, Appenzell Ausserhoden and Schaffhausen. On 30 November 2014 Swiss citizens voted on adding a new clause to the federal constitution forbidding privileges for natural persons and therefore a total abolition of lump sum taxation in Switzerland across all three levels: federal, cantonal and communal. The result was that a clear majority of 59.2% of the voters wanted to maintain lump sum taxation.

The reasoning behind this solid result in favour of the continuation of lump sum taxation may be grounded in the Swiss parliament's endeavours to increase the calculation base from 2016 onward. The minimum tax base will be increased and shall be no less than seven times the annual rent paid or, for home owners, deemed rental value. The minimum tax base will not be less than CHF 400,000.00 for federal income tax purposes. The cantons will have to apply the same calculation method as the federation, but will remain flexible in determining the minimum tax base. Some cantons have already tightened their calculation methods.

Lump sum taxation will become more expensive for all those who were taxed on a basis below CHF 400,000.00 while for those who have less than CHF 12 million worth of assets, changing to the ordinary taxation system should be considered.

The use of trusts

For wealthy, new immigrants the establishment of trusts before coming to Switzerland has become ever more important. On the one hand, lump sum taxation does not cover gift and inheritance taxes. Therefore, the assets of a person whose last place of residence was Switzerland are exposed to these cantonal taxes that already exist. Additionally a popular people's initiative wants to establish a general Swiss gift and inheritance tax of 20% for wealthy persons with an estate of more than CHF 2 million. These taxes could be avoided by using trusts.

On the other hand, the proper structuring of assets by transferring them into a discretionary irrevocable trust may significantly reduce the tax burden of an immigrant in Switzerland when opting for ordinary taxation instead of lump sum taxation.

If, for example, a wealthy individual considers CHF 10 million or less as sufficient to live on in Switzerland, they may transfer all their assets exceeding CHF 10 million to a discretionary irrevocable trust and then emigrate to Switzerland. The assets in a proper structured discretionary and irrevocable trust and its generating income will not be taxed in Switzerland as long as no distributions are made to a person resident in Switzerland. The wealthy individual just pays taxes on his private assets, in this example amounting to less than CHF 10 million, and the generated income out of it. Depending on the investment strategy, the performance and the chosen place of residence, the payable annual tax can be much less than they would pay being taxed on a lump sum basis. Additionally, an ordinarily taxed individual is not restricted in pursuing any gainful activities in Switzerland contrary to an individual who is taxed on a lump sum basis. Profound advice regarding tax and estate planning, proper structuring of assets and investments is essential for a sustainable and longstanding benefit.

Please contact us with any questions or for advice.

GGI member firm
Swiss Trust Company Ltd.
Auditing & Accounting, Tax,
Advisory, Corporate Finance,
Fiduciary & Estate Planning
Zurich, Switzerland
Thomas Brunner
E: thomas.brunner@stg.ch
W: www.stg.ch