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The Swiss Lex Koller remains in force

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On 13 November 2013 the Swiss Federal Council published its additional report on the Swiss Federal Act on Acquisition of Real Estate by Persons Abroad (the so-called Lex Koller). The Lex Koller restricts the acquisition of Swiss residential and other non-commercial real estate by foreign (non-Swiss) persons. While the Swiss government recommended to the Swiss Parliament in its report of 4 July 2007 to repeal the Lex Koller in its entirety, following a u-turn it is now recommending to maintain the Lex Koller.

In 2007 the Swiss government considered the risk of foreign infiltration to be marginal and, therefore, recommended the repeal of the Lex Koller. However, the financial crisis of 2008 and the economic developments since then resulted in fundamental changes and although protective zoning plan measures have been introduced in 2011, it is now widely recognised that the Lex Koller is the only effective measure to reduce demand for Swiss residential properties. A repeal of the Lex Koller could foster additional demand for residential properties, in particular in the centres of Zurich and Geneva, therefore increasing the risk for a real estate bubble in these regions. Enhanced investments by foreign investors in Swiss real estate could also lead to an appreciation of the Swiss franc which would further damage the Swiss export industry. Therefore, the Lex Koller will be maintained. Against this background, this article examines:

- The liberalisation of the Lex Koller over time.
- The significance of Lex Koller for transactions.
- When the Lex Koller rules apply.

LIBERALISATION OF THE LEX KOLLER OVER TIME

Since its inception in 1983 the Lex Koller has been considerably liberalised in several steps to allow foreigners to invest in Switzerland's real estate market:

- In 1997, the Swiss commercial real estate market, including the mortgage loan financing market, was opened to foreign investors. Any premises on which commercial activities are carried out are now excluded from the authorisation requirements of the Lex Koller. This is regardless of whether the real estate is used directly by the foreign investor or whether it is rented or leased by the foreign investor to a third party for pure investment purposes (provided that the third party uses the leased premises for commercial purposes).
- In 2002, and due to the Swiss bilateral agreements with the EU, the principle was introduced that EU/EFTA nationals with a permanent residence in Switzerland are to be treated like Swiss nationals.
- Since 2005, shares in residential property investment corporations listed on a Swiss stock exchange can be purchased by foreign investors without an authorisation. However, if such an investment corporation is controlled by foreigners, it still needs an authorisation for the acquisition of new residential properties.

As a consequence, the acquisition of business premises by foreign nationals is, as a rule, not restricted under the Lex Koller. In contrast, the residential real estate market remains heavily restricted.

SIGNIFICANCE OF LEX KOLLER FOR TRANSACTIONS

The Lex Koller applies to both asset deals and share deals, that is, independent of whether the transaction is structured as, among others:

- A straight sale/acquisition.
- Indirect acquisition by way of acquiring the shares of an entity holding such real estate.
- Exchange of real estate.
- Gift.
- Acquisition of assets and liabilities of a business, or the restructuring of an existing entity by way of merger, demerger, asset transfer and so on.

In asset and share deals, a transaction within the scope of the Lex Koller can only enter into effect after the Lex Koller authorisation has been granted:

- If such a transaction is completed without applying for an authorisation or before the authorisation has been granted, the transaction becomes null and void.
- To the extent the contract has already been fulfilled, the parties can claim back their payments made.
- The authorities must correct the unlawful situation by having the entry in the real estate registry revoked, or by forcing the buyer to sell the property.

In practice, the parties to a planned transaction can often not conclusively decide whether the transaction is subject to the Lex Koller. In these cases, the buyer has to file a request for a ruling with the competent authority, before entering into the transaction.

The following summary of the Lex Koller rules highlights that, in certain cases, finding a suitable deal structure may decide whether a transaction is possible at all.

WHEN THE LEX KOLLER RULES APPLY

Real estate transactions are subject to the Lex Koller if both:

- The acquirer (or the beneficial owner of the acquiring entity) is a person abroad within the meaning of the Lex Koller.
- The acquisition object qualifies both with regard to its use (non-commercial) and type of right to be acquired (transaction) as real estate within the meaning of the Lex Koller.

Person abroad

Individual persons. The Lex Koller defines individual persons abroad as being either:

- Individuals resident or domiciled abroad.

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- Individuals living (as a temporary resident) in Switzerland, but who are neither nationals of EU/EFTA member states nor holders of a valid permanent residence permit (the C permit).

Legal entities. Legal entities are considered persons abroad if they are either:

- Domiciled abroad (irrespective of whether they are controlled by persons abroad).
- Controlled by persons abroad.

Control of a legal entity by persons abroad can be exercised by different means, and is assumed by law if persons abroad either:

- Hold (or control, whether directly or indirectly) more than one-third of the entity's equity capital or voting rights.
- Provide significant amounts of debt capital to the entity. The relevant amount of debt capital triggering foreign control depends on the balance sheet structure of the entity. It is equal to at least 50% of the difference between the company's assets and its debts with respect to persons that are not subject to the Lex Koller.

Real estate subject to the Lex Koller

Non-commercial use. The Lex Koller requires persons abroad to obtain a permit from the relevant authorities to acquire Swiss real estate, unless the real estate serves as a permanent business establishment for the exercise of an economic activity. Economic activities in the sense of the Lex Koller include industrial production, trading or service activities.

Exceptions. Real estate relating to a permanent business establishment can, as an exception, include residential property, for example if:

- The residential property is necessary for the business, such as a caretaker's flat.
- A separation from the business is impossible or unreasonable.
- The residential property is mandatory due to housing unit quotas under planning or zoning regulations.

However, the mere building, sale or rental of residential property does not qualify as an economic activity in the sense of the Lex Koller.

Further:

- Persons abroad can purchase commercial real estate with land reserves without a permit, as long as the land reserves do not exceed one-third of the property surface.
- Land for development purposes can be acquired by persons abroad, provided construction works on buildings to be used for economic activities begin within about one year.
- A person abroad can acquire residential property by way of acquisition of, or a merger with, a company whose main business purpose is not the acquisition, holding and sale of residential property, and provided the value of the residential property is less than 30% of the company's assets.

Any real estate not qualifying as commercial real estate as described above is subject to authorisation, unless another specific exemption is available.

Authorisations to acquire residential property are available to acquire a holiday home or serviced flat. Such real estate must be in an area designated by the cantonal authorities as a holiday resort.

The cantons and tourist municipalities can implement their own restrictions. They may decide to:

- Ban authorisations for a specific location.
- Permit acquisitions of condominiums only, and only up to a certain quota.
- Limit the annual number of authorisations.
- Only permit the purchase of residences that are already foreign-owned.

In practical terms, persons abroad can only acquire second homes in designated tourist areas, mainly in the areas adjacent to the Alps and in certain parts around Lake Geneva.

Real estate transactions subject to the Lex Koller. Besides the direct purchase of real estate, the Lex Koller also covers transactions which give persons abroad de facto control over real estate, for example through:

- Leaseholds.
- Granting and exercise of a right of purchase.
- Right of first refusal or a right of repurchase.
- Granting of financing.

The term "acquisition of real estate" therefore also includes the acquisition by way of:

- Joint ownership or co-ownership (including condominium ownership).
- Leasehold, occupancy or usufruct rights to real estate.
- Most importantly, the acquisition of shares (including non-voting shares) in a legal entity, of an interest in a company without legal personality (such as a partnership) or of a unit of an investment vehicle (including investment funds) whose de facto purpose is the acquisition of real estate.

However, the acquisition of shares listed on a stock exchange in Switzerland or investment fund units if they are regularly traded, even if such trading is off-exchange, does not trigger the obligation to obtain a Lex Koller authorisation. Therefore, the purchase of a single share in an unlisted company involved solely or substantially in acquiring or holding residential property or dealing therein requires prior authorisation under the Lex Koller.

A long-term lease with unusual contractual terms may also be subject to the authorisation requirement under the Lex Koller. Examples of such terms are:

- The one off-payment of the rent in advance or the waiving of consent to fundamental architectural alterations.
- The linking of a rental contract to a loan agreement with offsetting of rent against interest on the loan.
- The financing of the purchase or development of the real estate in excess of the usual lending limit applied by Swiss banks.
- A construction ban and similar ownership restrictions on neighbouring land.

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- *Norm SIA 118, Allgemeine Bedingungen für Bauarbeiten, neu aufgelegt, in: "CH-D Wirtschaft", Bauwirtschaft, Dezember 2013.*
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Recent publications.

- *"Legal hurdles related to the acquisition of real estate in Switzerland by foreign investors", Zuger Steuerpraxis 2011.*
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