Memorandum

From MLL Private Clients Team
Date Geneva / Zurich, 2 December 2014

Subject **Latest news on the Swiss lump sum tax regime**

The *forfait* reloaded!

- On 30 November 2014, the Swiss population voted by a vast majority against a popular initiative aiming at the abolition of the lump sum taxation, the so called forfait, with 59.2% of the population and 25 out of 26 Cantons saying a very clear and strong "No!" to the initiative. Swiss democracy has efficiently protected this special pragmatic tax regime which has gained a new legitimacy and is here to stay!

- Stricter conditions will apply as of 2016 for new forfaits but existing lump sum taxpayers will benefit from a five year transition period; their current agreement accordingly remaining in force until 2021.

- Foreigners contemplating to move to Switzerland under a lump sum tax regime are encouraged to obtain a forfait ruling before the end of 2015 to benefit from the current more flexible conditions for the next five years.

1. A short reminder: the current rules

A foreigner who takes up domicile in Switzerland or who returns to Switzerland after a period of more than 10 years may apply for a special lump sum tax ruling, provided the applicant has no gainful activity in Switzerland.

The ruling is an agreement with the local tax administration stating that the foreign individual will be taxed on the basis of his living expenses, instead of being assessed on his total worldwide income and wealth. It applies at the Federal, Cantonal and Municipal level. In other words, the resulting tax will not be based on the effective income derived by the taxpayer but on certain living expenses of the taxpayer and his family living with him.

The following criteria are taken into consideration in the granting of the ruling:

(i) The annual living expenses incurred by the taxpayer for himself and the members of his family and persons supported by him who are with him in Switzerland. For the purposes of determining the lump sum basis, the amount recognized by the administration as living expenses cannot be less than 5 times the annual rent paid for leased premises or 5 times the rental value of the house or apartment owned by the taxpayer;

(ii) Swiss Source Income, being the revenues from Swiss securities (dividends, interest, etc.), income from real estate located in Switzerland, Swiss pensions and revenues derived from copyrights, royalties or from similar rights exploited in Switzerland;

(iii) The value of the assets located in Switzerland;

(iv) Foreign source income (including dividends, interest, royalties, copyrights, etc.) when the taxpayer has requested the application of a double tax treaty.

The Swiss tax administration may perform every year a so-called "control calculation" in order to ascertain that the *forfait* based on the living expenses incurred in Switzerland is not less than the taxes due at the ordinary rate on the Swiss source income, Treaty Income and the wealth taxes payable for the assets located in Switzerland.

The lump sum taxation applies only as long as the above mentioned conditions are met.

The lump sum taxpayer pays an income tax on the amount of his agreed deemed expenses, the *forfait*, at the rate applicable in each Canton. By way of example, a lump sum taxpayer with a lump sum set at CHF 650'000 will approximately pay CHF 250'000 of taxes in 2014. Please note that the taxes can vary significantly from one Canton to the other, and even from one Municipality to the other; precise calculations based on the taxpayer's place of residence must therefore be made.

In addition, each adult included in the lump sum tax agreement is subject to the mandatory social contributions (retirement plan) which amount up to a maximum amount of CHF 24'000 per year until the legal age of retirement.

The lump sum taxation does not exonerate the taxpayer from his/her inheritance and gift tax liabilities. Most Cantons provide for an inheritance tax exemption for the children and spouse's share of the estate (for example Valais). In Geneva however, although the surviving spouse is exempted, there is a 6% tax when the estate passes to descendants. Likewise, in Vaud, the estate tax is of maximum 3,5% on the descendants' share.

2. The new rules

Following a certain political pressure against the lump sum taxation, which has been abolished in some Cantons like Zurich, the Swiss parliament enacted some new rules setting out some stricter conditions. The main changes will be:

(i) The minimum *forfait* threshold will be set at CHF 400,000 on the Federal level; and

(iii) The living expenses will be deemed to amount to a minimum of 7 times the rent of the property occupied by the taxpayer or, where the taxpayer owns his residence, of 7 times the rental value of his/her property.

It is worthwhile noting that in most cases, the rent or rental value will be deemed the key factor. Of course, this rent or rental value will vary substantially from one Canton to another, the more urban ones such as Geneva being more "expensive" than the ski resort and farmland ones, like the Canton of Valais or of Fribourg.

This being said, even the more rigid Cantons like Geneva have now also taken a strong view to protect and maintain the special *forfait* tax regime for a renewed term as the Geneva population was also asked to vote on 30 November 2014 on a separate initiative targeting the *forfait* locally: not only was this local initiative massively rejected, but so was the official Cantonal counteroffer, aiming to increase by a fair amount the conditions to obtain a *forfait* !

Last but not least, each Canton was granted a two year time period to adapt its own legislation accordingly. The stricter conditions will apply to any lump sum agreement negotiated after 1st January 2016. The lump sum agreement existing before the entry into force of the new conditions will remain valid for five years after this date that is until 2021. Taxpayers with an already existing *forfait* may wish to accordingly renew their lump sum tax agreement in 2015 to extend its benefit, even if in theory their *forfait* is not due to expire next year.

So, all in all, very good news for those who have moved or are contemplating to immigrate to Switzerland, with certainty and simple solutions once again re-established and guaranteed for many years to come!

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