TAX LAW BRIEFING

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Lump sum taxation

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Despite some headwinds, Switzerland still offers foreigners the possibility of paying tax essentially based on their living expenses rather than their actual income. This option is referred to as 'lump sum taxation'. In comparison with other privileged tax regimes for high net worth individuals such as the UK "resident but not domiciled" taxation, lump sum taxation – subject to certain conditions – offers attractive tax planning opportunities.

Recently, lump sum taxation has been the subject matter of various legislative proposals and changes. For instance, the minimum tax base will increase from 2016. Further, in five German-speaking cantons (Zurich, Schaffhausen, Appenzell Ausser Rhoden, Basel-City and Basel-Land), the regime of lump sum taxation was abolished while at Federal level and in the canton of Geneva a vote with the same purpose is about to held. In the cantons of Saint-Gall, Lucerne and, more recently, Berne and Obwalden, initiatives aiming at abolishing the regime were rejected.

Although lump sum taxation has come under discussion, in particular in certain regions of German-speaking Switzerland, it should be noted that this regime has not been confronted with fierce political opposition in French-speaking Switzerland and that it enjoys full support of the Swiss Federal Council. Even though the conditions for granting lump sum taxation will be tightened from 2016 (cf. sec. III below) this regime still allows for favourable solutions in a number of cases.

Currently, there are approximately 5'400 foreigners benefiting from lump sum taxation, the majority living around the Lake of Geneva in the cantons of Vaud and Geneva. Other popular places are situated in the cantons of Valais and Ticino.

I. Who is entitled to lump sum taxation?

Foreign nationals taking up tax residence in Switzerland may benefit from lump sum taxation if and as long as they do not exercise any gainful occupation in this country (neither as an employee nor self-employed).

II. How is the tax calculated under current law?

Lump sum taxation is based on the living expenses of the taxpayer and his/her dependents he/she cares for irrespective of where these costs arise. This includes in particular: accommodation, food and clothing; education, culture and leisure; cars, aircrafts and yachts; housekeeping and personnel.

In practice, it is often difficult to determine a verifiable amount of living expenses which is why the amount of rent paid or a deemed rental value of owned property are frequently used for calculating the tax base. In any case, living expenses have to equal at least five times the rent paid or the deemed rental value or, respectively, at least double the costs for lodging. Finally, the results obtained pursuant to these methods have to be opposed to the taxpayer's income earned from Swiss sources (such as dividend, interest, royalties, rental income, etc., so-called 'shadow or control calculation') and to the income for which the taxpayer seeks tax treaty protection (so-called 'modified lump sum taxation').

The highest of these three amounts ((i) actual living expenses, (ii) multiple of rent paid/letting value/ lodging expenditures, or (iii) result of the shadow/control calculation) will be used as assessment basis for the lump sum taxation. Significant differences persist among the cantons, in particular regarding the taking into account of a tax payer's wealth. Certain cantons have established minimum thresholds for either the tax base or the tax revenue due.

III. How is the tax calculated under new law (applicable from 2016)?

The changes in the legal basis will be applicable from 2016 and cause substantial modifications:

1. Increase of the minimum tax base: for both federal and cantonal income tax purposes, the new tax base shall equal at least seven times the rent paid deemed rental value or, respectively, at least three times lodging expenditures.
2. Specific minimum amount of taxable income: for federal income tax, the (minimum) taxable income shall amount to CHF 400'000. The cantons have to set thresholds for minimum taxable income too but are flexible in determining the relevant amounts. It is highly likely that the cantons of Vaud and Geneva, for instance, will set the minimum threshold at CHF 400'000 as well.

Therefore, the following four amounts have to be taken into consideration in future:

a. living expenses incurred within and outside of Switzerland,
b. seven times accommodation costs (or three times lodging expenditures),
c. the gross amount of the shadow/control calculation,
d. the new minimum tax base of CHF 400'000 for federal income tax and respective thresholds for cantonal income tax purposes.

The highest amount will serve as tax base.

3. No longer lump sum taxation for "mixed couples": both spouses will have to be foreign nationals and, separately, meet the eligibility criteria. At present, mixed nationality couples may, for the non-Swiss spouse, apply for lump sum taxation.
4. Consideration of wealth: Cantons have to take into account wealth as well but are free to determine the respective methods. The authorities of Vaud and Geneva have not yet clarified their preferred route because to this day individuals subject to lump sum taxation have not been taxed on their wealth.
5. The transitional period regarding the new law for existing lump sum taxation agreements is five years.

IV. What is the procedure for obtaining lump sum tax status?

- First, the prospective lump sum taxpayer typically takes up effective tax residence in Switzerland and secures Swiss accommodation (whether as tenant or owner). Purchase agreements may be subject to the condition that a valid residence permit is issued.
- Lump sum taxation has to be negotiated with the competent cantonal authorities which will then eventually confirm the arrangement by way of tax ruling. It is for the applicant to demonstrate that he/she fulfills the conditions to benefit from the lump sum taxation.
- New arrivals have to obtain a residence permit.
- Furthermore, new arrivals will become liable to contributions to the mandatory old-age and survivors insurance ("AHV") until they reach the ordinary pension age. The amount of wealth and the amount of twenty times the pension income serve as a base for computing the contributions. Since 1 January 2013, the annual maximum contribution amounts to CHF 24'000 plus approximately 5% of this amount for administrative costs.

V. What else is to be taken into consideration?

Some jurisdictions impose exit taxes on individuals giving up their current residence and moving abroad. Therefore, we recommend seeking advice from a tax advisor of the exit country as to the tax consequences prior to moving to Switzerland.

Once granted, the lump sum taxation will generally stay in place but may be subject to adjustment on material changes in the taxpayer's financial circumstances or expire altogether if he takes up Swiss nationality, gives up residency in Switzerland or takes up gainful activity (independent or employed) in Switzerland.

In Switzerland, taxes may be levied at federal, cantonal and communal level. Tax rates may vary significantly between cantons and communities. It is thus advisable to compare the different tax burdens before choosing the place of residence.

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