THE *FORFAIT* TAX REGIME IN SWITZERLAND – A VENERABLE ALTERNATIVE

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INTRODUCTION

For decades, Switzerland has had a favorable regime in place for non-Swiss nationals. Known as the "*forfait* taxation regime," the special rules allow foreign nationals relocating to Switzerland to pay tax on their worldwide expenditures, subject to an annual minimal base payment.

The forfait taxation regime is often mentioned as being comparable to the U.K. and Irish non-domiciled ("Non-Dom") tax regimes. However, when coupled with other advantages of the Swiss tax system, the forfait taxation regime is thought by many tax advisers to be more advantageous on several counts. First, it has a long history and is expected to continue as a result of a Federal referendum in 2014. In addition, there is usually no inheritance tax on transfers between spouses and to descendants.

Forfait taxation is available in most cantons, including Geneva, Vaud, Berne, Schwyz, Zug, and Grison in particular. However, Zurich and Basel have abolished the regime in recent years. While the prognosis for the forfait taxation regime is good, certain changes are anticipated. For example, the forfait legislation will be subject to somewhat increased thresholds from 2016 on, as discussed later in this article. Nonetheless, the basic principles will remain unaltered.

ELIGIBILITY

The forfait taxation regime is available to foreign nationals taking up tax residence in Switzerland for the first time. It is also available to returning (non-Swiss) residents who have resided outside of Switzerland for at least 10 years. Dual citizens do not qualify if one of the nationalities is Swiss.

Although the regime was originally aimed at wealthy foreigners retiring in Switzerland, there has never been a minimum age. However, to claim the benefit of the forfait taxation regime, an eligible individual must not exercise any paid work in Switzerland. This covers work as an employee and as a self-employed individual. Because this limitation pertains to work performed in Switzerland, work activity wholly performed abroad is permitted. This suggests that the individual must commute to an office outside of Switzerland, and consequently, tax may be imposed in the country where personal services are performed.

Beginning in 2016, both spouses must fulfil all the above criteria. Until then, the non-Swiss spouse in a mixed nationality couple could indeed apply for a forfait. That is no longer an option.

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CALCULATION OF TAX

Forfait taxation is based on one of three tax bases: (i) the taxpayer's worldwide living expenses, (ii) the control computation, or (iii) the minimum amount. Whichever base produces the highest amount is the tax base that will be used. Ordinary tax rates are applied to the base that is chosen.

The forfait tax base corresponds to the cost of maintaining a family. Cantons have considerable leeway in determining the practical aspects of what is included. In broad terms, living expenses include the cost of accommodation, general living, cars, aircraft, yachts, housekeeping, and personnel costs for all individuals financially supported by the taxpayer. This amount is computed by multiplying the rent paid for the living premises of the individual by a factor, which typically is a seven-times multiplier.

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Once the forfait tax base is computed, the so-called control calculation or shadow calculation must be taken into account. The control calculation includes in taxable income all items of Swiss-source income such as dividends from Swiss shares, royalties or interest from Swiss sources, and Swiss real property rental income. A portfolio of non-Swiss shares held and managed by a Swiss bank is excluded from the control computation. In addition, income for which treaty benefits are claimed must also be included. Treaty-protected income typically includes non-Swiss dividends and royalties subject to a withholding tax in the source country. This allows a taxpayer claiming the benefit of the forfait taxation regime to benefit from reduced withholding tax abroad.

Finally, a minimum amount of income is computed. From 2016 on, the minimum tax base is CHF 400,000 and a taxpayer's overall wealth will be taken into account. Cantonal practices are expected to vary considerably in this respect.

By way of example, a taxpayer with a monthly rent of CHF 5,000 will have a tax base of CHF 420,000 (*i.e.*, CHF 5,000 x 12 months x a multiplier of 7) based on living costs. With a monthly rent of CHF 3,500, the tax base will be (i) the minimum amount of CHF 400,000, as the living expense calculation (CHF 3,500 x 12 months x a multiplier of 7 = CHF 294,000) is below minimum of CHF 400,000, or (ii) the control amount based on Swiss-source income (such as dividends, interest, royalties, rental income) and income for which treaty benefits are claimed (*e.g.*, non-Swiss dividends). Tax payable is calculated by application of the ordinary progressive tax rates to the agreed tax base.

CANTONAL AND COMMUNAL RATES VARY

Switzerland, despite its relatively modest size, has 26 cantons that are further subdivided into approximately 2350 local communes. Tax is levied at Federal, cantonal, and communal levels. A forfait is negotiated with the cantonal authority, and the tax base to which ordinary tax rates apply is determined in those negotiations.

In Switzerland, the rates vary by canton and commune. The overall maximum tax rate will generally be between 25% and 45%, depending on the canton and commune in which the individual resides.

To illustrate, a married taxpayer with two children and a tax base of CHF 600,000 would pay tax approximately in Geneva, Lausanne, Gstaad, and Klosters as follows (with wealth tax not yet taken into consideration).

Place of Residence	Approx. Tax Payable
Geneva	CHF 225,000
Lausanne	CHF 225,000
Gstaad	CHF 200,000
Klosters	CHF 180,000

Given the wide range of applicable tax rates in Switzerland, there is considerable scope for "geographical tax planning." Although there is a statute harmonizing taxes among cantons, there are considerable differences in how the authorities apply the law in practice. Cantons and communes have strongly differing tax rates. Consequently, if an individual lives on a cantonal or communal border, the tax rates can vary significantly on each side.

Often, the sophistication of the canton and commune is balanced against the applicable tax rate. As a rule of thumb, remote cantons offer reduced taxes. If all that matters is the need to pay as little tax as possible, an individual will look at the communes with the lowest rates and the most favorable local practices regarding the tax base. Inheritance tax is also imposed at the cantonal level and varies significantly among the cantons.

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Typically, a client will have an idea of where he wants to live (in the city, mountains, or somewhere in between) and the adviser will then make a few suggestions. The choice is to a limited extent narrowed by the fact that a few cantons have abolished the regime – most notably Zurich.

APPLICATION OF TAX TREATY WITHHOLDING TAX RATES

As mentioned above, any income for which treaty benefits are claimed will be included in the so-called control calculation. In addition, some income tax treaties will not accept a forfait taxpayer as tax resident if the income from that country benefits from the forfait tax regime. In particular, the income tax treaties with Germany, Belgium, Norway, Italy, Austria, Canada, the U.S., and France provide that benefits are dependent on full Swiss taxation of income that is sourced in those countries. Not all treaty provisions are identical, and in particularly, in relation to France there is uncertainty in practice as to the treatment of French-source income.

With regard to each of the foregoing countries, treaty tax benefits are applied to a Swiss resident on a per-country basis only if all items of income from that country are reported on a Swiss tax return and taxed under Swiss rules generally applicable to Swiss residents. As a result, the entire income of the individual derived from a given country within this group must be included in the alternative computation of the tax base. Swiss tax is computed on the sum of the designated Swiss income and the income from those countries. Again, the tax is the greater of the tax on the consumption base or the control base. Consequently, if the consumption base exceeds the sum of the control base and the treaty-country income, the tax on the consumption base is applicable.

INHERITANCE TAX

Earlier this year, Switzerland held a national referendum regarding the imposition of inheritance tax on the Federal level at a uniform rate of 20%. Over 70% of the voters disapproved of the proposal. Inheritance tax remains a matter for the cantons to decide.

All cantons offer full spousal exemption. In the vast majority, both lifetime and death transfers to descendants are not subject to tax. Vaud levies inheritance tax on transfers to children, and so does Geneva if the deceased is subject to the forfait taxation regime. Registered same sex partners are exempt, too.

Transfers to unrelated donees or heirs may be subject to gift tax or inheritance tax imposed at rates of up to around 40% (depending on the canton).

The canton of Schwyz (which is German speaking) has no inheritance tax whatsoever.

SOCIAL SECURITY TAX

Forfait taxpayers under the age of 65 are subject to social security contributions. Depending on an individual's wealth, the contribution may amount to as much as CHF 24,000 plus an approximate 5% administrative cost per person.

GRANDFATHERED PROVISIONS

The new rules, which will come into force from January 1, 2016, will not fundamentally alter the application of the forfait taxation regime. Instead, they will essentially codify what has been practice in many cantons for some time. The new rules contain the following provisions:

- They provide for a minimum tax base at the Federal level of CHF 400,000 or seven times the actual or deemed rent.
- They provide that an applicant's overall wealth must be taken into account.
- They require that both spouses must fulfill the criteria for eligibility. (Consequently, mixed-couple forfaits involving Swiss and foreign nationals will no longer be permitted.)

Existing forfait rulings will remain valid for a transition period of five years.

OBTAINING A FORFAIT

Obtaining the forfait is usually less of an issue than immigration, especially for non-E.U. nationals. Once the residence canton and commune of choice have been identified, an eligible individual typically approaches the local cantonal tax authorities. Such authorities are competent to grant a forfait ruling.

When discussing a forfait with the cantonal tax authorities, information on an individual's worldwide living expenses and an approximation of wealth must be provided. The level of detail requested by the authorities varies greatly between cantons. If the relevant information is provided in a forthright manner, a ruling may be issued within two weeks.

IMMIGRATION RULES

The relevant criterion is nationality; the relevant distinction is between E.U. and non-E.U. nationals. Nationals of the 28 E.U. member countries are entitled to a residence permit, provided they are in a position to finance their living expenses and take out valid health insurance within three months from immigration.

The procedure is somewhat more burdensome for a non-E.U. national. Such individuals must either (i) be able to demonstrate a particular connection to Switzerland, such as childhood or holidays regularly spent in Switzerland, family members resident in Switzerland, or education in Switzerland; (ii) be over 55 years old; or (iii) qualify for a "statutory exemption." Statutory exemptions may cover individuals with cultural backgrounds or who make fiscal investments. The latter is essentially comparable to what is often called an "investor visa" in other countries.

Non-E.U. nationals may also seek a permit for education or medical reasons, but that would be relevant in a forfait tax context only if the stay were for an extended period.

An applicant's family will normally be granted the right to accompany the visa applicant.

FORCED HEIRSHIP RULES

Foreign nationals may provide for their estates to be governed by the law of their nationality, thus getting around the Swiss forced heirship rules. In some instances, it will be necessary to consider the E.U. Succession Regulation, a full discussion of which is outside the scope of this article.

PURCHASES OF REAL PROPERTY

The right to purchasing real estate is independent of an individual's tax status. The same rules apply to forfait and ordinary taxpayers. E.U./E.F.T.A. nationals who are Swiss resident are not subject to any restrictions limiting the right to own real property. A so-called Lex Koller-permit will be required, however, for the acquisition of a holiday home by nonresidents.

Non-E.U./E.F.T.A. nationals with a permanent residence permit ("C permit") are not subject to Lex Koller-restrictions either. Non-E.U./E.F.T.A. nationals with an ordinary residence permit ("B permit") are entitled to purchase their primary homes without a

Lex Koller-permit. The purchase of a second home such as a holiday home requires the issuance of a Lex Koller-permit.

A holiday apartment passed on by family inheritance will not be subject to the Lex Koller-permit requirement.

In addition, there is so-called second home legislation that applies regardless of Swiss, E.U./E.F.T.A., or other nationality. This legislation restricts the quota of holiday homes in to 20% per commune.

CONCLUSION

In conclusion, Switzerland's venerable forfait taxation regime is alive and will remain so in the future. For the right individual, who lives in a canton and commune with favorable rules, the forfait remains an excellent alternative to Non-Dom status in the U.K. – all the more so for long-term Non-Doms affected by new rules in the U.K. limiting Non-Dom taxation to 15 years.