SWISS LUMP SUM TAX REGIME – BASED ON ANNUAL EXPENDITURES

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INTRODUCTION

Switzerland can be an attractive country of residence for foreign nationals not pursuing an economic activity in Switzerland.

Besides the ordinary income and wealth tax regime, Switzerland provides for advantageous tax regimes for expatriates (in terms of extensive deductible expenses related to the expatriation) and for high-net-worth individuals.

ORDINARY TAX REGIME

Under the ordinary Swiss tax regime, individuals having a domicile in Switzerland or residing in Switzerland are fully taxable on worldwide income and wealth.

An individual is domiciled in Switzerland for tax purposes if he or she is present in Switzerland with the intention of settling permanently in Switzerland. This generally occurs when an individual has both a physical presence in Switzerland and the intention to settle permanently in Switzerland. The intention must be clearly evident to third parties from the factual background. Consequently, domicile is the place where an individual's center of personal and business interests are located.

An individual is deemed to be resident for tax purposes in Switzerland if he or she is physically present in Switzerland without notable interruption during

- 30 days and carries on a lucrative activity in Switzerland, or
- 90 days without carrying on a lucrative activity in Switzerland.

A taxpayer who is a tax resident abroad and stays in Switzerland only for educational or medical purposes is not treated as a resident of Switzerland for tax purposes.

Under the ordinary tax system, resident taxpayers are liable for Swiss income, wealth, and inheritance taxes.

Income and wealth taxes are basically levied on worldwide net income at several levels that include the Swiss Federal, Cantonal, and Municipal governments. In comparison, worldwide net wealth is exempt from Swiss Federal tax.

Some Cantons provide a tax shelter (*bouclier iscal*), according to which the Cantonal and Municipal income and wealth taxes cannot exceed a certain percent-age of annual taxable income. The tax shelter is intended to eliminate the risk of confiscatory taxes for individuals having relatively low income, but significant taxable assets. To illustrate, the Cantonal and Municipal income and wealth taxes in Geneva

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are capped at 60% of the annual taxable income. On the other hand, Geneva considers a person to recognize deemed minimum income corresponding to 1% of net wealth.

FAVOURABLE LUMP SUM TAX REGIME

Individuals taking residence in Switzerland for the first time or after an absence of at least ten years, without carrying out a lucrative activity in Switzerland, may opt for the lump sum tax regime instead of the ordinary tax regime.

Under the lump sum tax regime, the taxable base is determined on the Swiss and foreign living expenses of the entire family. Included in the tax base are items such as

- Food and clothing
- Housing
- Cleaning and maintenance expenses
- Private personnel costs
- Travel and vacations
- Maintenance costs for horses
- Maintenance costs for automobiles, yachts, and aircraft
- Other living expenses

The total amount of annual expenditures constitutes the taxable base for lump sum taxpayers. That base is subject to the ordinary progressive income tax rates at Swiss Federal, Cantonal, and Municipal levels.

In addition to income tax, wealth tax is levied at Cantonal and Municipal levels based on total taxable wealth. In general, total taxable wealth is computed as a multiple of the taxable base for income tax purposes. That base is increased by a certain percentage and is subject to progressive wealth tax rates.

The lump sum tax regime is applicable to an individual only if requested in a written submission to the Cantonal tax authorities. Once the regime applies, an individual must report changes in facts that may have an impact on the taxable base.

Application Conditions

To apply the lump sum tax regime, the following conditions must be met:

- **Residency in Switzerland**
    - Establish residence in Switzerland for the first time or after an absence of 10 years
    - Physical presence on at least 90 days each year without notable interruption (fictive domicile does not give right to lump sum taxation)

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- Meeting the above two conditions affects only Swiss tax. It does not mean that a person is viewed to be a Swiss resident under all Swiss income tax treaties. For treaty purposes, the residence article of an applicable in a treaty must be reviewed. In several income tax treaties, Swiss resident individuals who elect the lump sum regime are not considered to be residents of Switzerland for treaty purposes unless regular Swiss tax is applied to income from sources in the treaty part-ner jurisdiction.

- **Prohibition to carry out any lucrative activity in/from Switzerland**
  - In principle, activity outside Switzerland is allowed.
  - However, in an age of remote working by entrepreneurs and executives, identifying the location of an activity may be difficult in certain circumstances. Where the location is blurred, the source of the income will be the decisive factor, rather than the place where the services take place.
  - Management of personal assets is allowed. Management may be carried out through a Swiss family office or a Swiss holding company, provided that the taxpayer is not classified as a securities or real estate dealer by the Swiss tax authorities.
- Not available for Swiss citizens

"The taxable base computed by reference to annual expenditures cannot be lower than a minimum taxable amount provided by the Swiss Federal and Cantonal tax acts."

Minimum Taxable Base

The taxable base computed by reference to annual expenditures cannot be lower than a minimum taxable amount provided by the Swiss Federal and Cantonal tax acts.

At the Swiss Federal level, the taxable base cannot be less than the highest of the following amounts:

- CHF 421,700 in 2023
- Seven times the annual deemed rental value of an individual's primary residence that is owned, or if not owned, the effective rent of the taxpayer's primary residence
- Three times the expenses for lodging (*e.g.*, hotel where an apartment is not leased) and food
- The comparative calculation, which is the sum of the following elements:
  - Swiss source income (on Swiss real estate, movable assets located in Switzerland, financial assets invested in Switzerland, Swiss pensions, Royalties on Swiss source copyright and patents, etc.)
  - Foreign source income for which application of a double tax treaty is requested by the taxpayer (*i.e.*, treaty-favored income)

The purpose of the comparative calculation made in the annual tax return is to verify that the annual tax liability of the lump sum taxpayer levied on the taxable base is not lower than the tax liability that would be levied on the elements of the

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comparative calculation. Only the maintenance expenses for property and ordinary bank charges paid for the management of movable assets can be deducted from the comparative calculation.

At the Cantonal level, each Canton is free to set its minimum taxable base, lump sum taxable wealth, or an increase of the initial taxable base for wealth tax purposes. Beginning in 2009, many Swiss-German Cantons, such as Zürich, Schaffhausen, Appenzell-Ausserrhoden, and Basel abolished the lump sum tax regime at the Cantonal level. Beginning in 2016, many other Cantons strengthened their lump sum regimes by introducing new provisions in line with Swiss Federal harmonization principles.

Cantons providing the lump sum tax regime, also provide for a minimum taxable base amounting to at least seven times the deemed rental value or effective rent paid for main residence, as well as for a comparative calculation considering not only income on Swiss assets but also related wealth. Regarding the minimum taxable base at the Cantonal level, thresholds vary significantly from one canton to another as do the rates. To illustrate:

- The Canton of Geneva provides a minimum taxable base of CHF 400,000, for wealth tax purposes the taxable base is increased by 10%.
- The Canton of Vaud provides a minimum taxable base of CHF 415,000, including the increase of 15% for wealth tax purposes.
- The Canton of Valais provides for a minimum taxable base of CHF 250,000. Lump sum wealth tax is levied on the taxable base multiplied by four. As a result, a lump sum taxpayer resident in Valais who can claim the minimum taxable base will be taxed at the Cantonal level on CHF 250,000 and at the Swiss Federal level on CHF 400,000 for income tax purposes. The minimum taxable wealth is CHF 1 million.
- The Cantons of Lucerne, St-Gallen, and Schwyz provide for a minimum tax-able base of CHF 600,000. The wealth tax is levied on 20 times the taxable base, amounting to CHF 12 million. Ordinary rates on income and wealth are lower in these Cantons than in Geneva and Vaud, where rates are among the highest.

Examples

Mr. A is not a Swiss citizen. He resides in Switzerland with members of his family. The family reports annual worldwide expenditures of CHF 500,000. Mr. A owns residential property in which he and his family reside. The deemed annual rental value of Mr. A's main place of residence is CHF 100,000, resulting in a taxable annual base of CHF 700 000 (CHF 100,000 × 7). In these facts, the taxable base for lump sum taxation is the deemed rental value of the main residence.

- In Geneva, the taxable base of CHF 700,000 is increased by 10%, *i.e.*, a total of CHF 770,000 subject to tax at the ordinary income tax rates, yielding an annual tax liability of approximately CHF 300,000.
- In Valais, the taxable base would be CHF 700,000 for income tax, which is multiplied by four, for wealth tax purposes, amounting to CHF 2.8 million. The annual tax liability would amount to approximately CHF 260,000.

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- In Schwyz, the taxable base would be CHF 700,000 for income tax purposes and CHF 14 million for wealth tax purposes. The annual tax liability would amount to approximately CHF 200,000.

The deemed rental value is determined by the Cantonal tax authorities and is primarily based on the value of the property. Therefore, the value itself may be significantly different from one canton to the other for the same category of property.

RESIDENCE PERMIT

Switzerland has specific rules regarding residence permits depending on whether the individual is a national of a Member State of the E.U. Under those rules, E.U. citizens must demonstrate sufficient means of subsistence to obtain a residence permit. In comparison, non-E.U. citizens can obtain a residence permit if it is in the fiscal interest for the Canton of residence.

A fiscal interest exists if the projected tax liability for the individual equals or exceeds a certain minimum amount. This amount varies from Canton to Canton. To illustrate:

- In the Cantons of Geneva and Vaud, the amount ranges between CHF 300,000 and CHF 350,000.
- In the Canton Schwyz, the amount is approximately CHF 500,000.
- In the Cantons of Valais, Zug, and Ticino, the amount is approximately CHF 270,000.

Note that the minimum tax amounts provided above are indicative of the amounts agreed based on negotiations with the competent tax authority on a case-by-case basis.

As a result of Brexit, U.K. nationals are considered to be non-E.U. nationals when applying for the Swiss lump sum tax regime. However, negotiated amount for U.K. nationals may be reduced in certain Cantons. To illustrate, in the Canton of Vaud, the tax liability is often between CHF 180,000 to CHF 200,000 for individuals above the age of 55 years.

TAX RESIDENCY AND DOUBLE TAX TREATIES

Switzerland has income tax treaties covering income taxes and net wealth taxes with around 100 countries. The income tax treaties with Germany, Austria, Belgium, Canada, the United States, Italy, and Norway do not recognize lump sum taxpayers as residents of Switzerland unless income arising in those countries are included in the comparative calculation. The treaty provisions are not identical. As a result, lump-sum tax agreements will vary depending on the country of origin of the income.

SWISS GIFT AND INHERITANCE TAXES

At the Cantonal level, gift and inheritance taxes are levied. Only the Canton of Schwyz has no gift or inheritance taxes.

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Cantons are free to set tax rates. Most Cantons have a low rate, if not a complete exemption, for gifts and inheritances between spouses and for donees, and heirs in direct blood line to the donor or decedent.

In some Cantons, lump sum taxpayers remain subject to gift and inheritance at a very reduced rate. Again, those Cantons provide for a full exemption for surviving spouse and for donees and heirs in direct line to the donor or decedent.

PRE-IMMIGRATION ESTATE TAX PLANNING

Pre-immigration tax planning is necessary to mitigate Swiss gift and inheritance taxes. The creation of a foreign trust or foundation often is an efficient solution for estate tax planning purposes. A Luxembourg *Société de gestion de patrimoine familial* ("S.P.F.") is popularly used, also. In certain cases, the use of a Swiss holding company may be an option to consider for Swiss tax residents with foreign assets.

Trusts and Foundations

The Swiss foundation is exclusively used for charitable purposes. In case of a non-charitable foundation, any distribution from the foundation to a beneficiary would be characterized as a gift to an unrelated party and may be subject to gift or inheritance tax at the highest possible rate, generally between 40 to 50%.

The tax treatment of a settlor of a trust depends on whether the trust is irrevocable. As a general principle, a revocable trust is treated as transparent under Swiss tax law. This means that the settlor continues to be treated as the owner of the asset. A Federal Tax Circular on Trusts describes the circumstances in which a trust is considered to be non-transparent. When a trust is non-transparent, the establishment of a trust is immediately subject to gift tax. When transparent, there is no gift tax at formation, but inheritance tax is imposed at the conclusion of life. The guidance in the Federal Tax Circular should result in similar treatment at the Cantonal level, as a result of harmonized practice between Swiss Federal and Cantonal tax rules.

For an individual anticipating a move to Switzerland, the establishment of an irrevocable trust yields gift and estate tax benefits when the settlor can demonstrate two facts:

- Assets were transferred irrevocably to the trust or foundation before becoming a Swiss tax resident.
- The trust (or the foundation) is not transparent.

A trust is transparent where the settlor retains any of the following rights or powers:

- The right to be a beneficiary of the trust
- The right to revoke or appoint a trustee
- The right to designate new beneficiaries
- The right to replace a protector having powers similar to those of the trustee
- The right to amend the trust deed or to have it amended
- The right to revoke or liquidate the trust
- A veto power against the trustee's decisions regarding the assets

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An advanced tax ruling confirming the non-transparency of the trust or foundation is highly recommended before migrating to Switzerland.

Corporate Structures

In certain cases, the use of a Swiss holding company may be an option to consider for Swiss tax residents with foreign assets. A Swiss holding company enjoys the benefit of participation relief for qualifying dividends and capital gains, or full participation exemption if it is a pure holding company. It also enjoys a full credit for Swiss withholding tax on dividend payments to Swiss residents, and access to the broad Swiss treaty network. Dividends to Swiss substantial interest shareholders are partially exempt from income tax.

A Luxembourg *Société de gestion de patrimoine familial* ("S.P.F.") is also a structure with some popularity.

PRACTICAL ASPECTS

Social Security Contributions

Swiss lump sum taxpayers also need to contribute to the Swiss Social Security until they reach the age of 65 years for men or 64 years for women. In 2025, contributions will be required for both men and women until the age of 65 years is reached. The exact amount of contribution will depend on the taxable base confirmed by the tax authorities under the lump sum tax regime.

Private International Law

Before migrating, it is important to verify the Swiss civil law aspects and consequences for the family such as matrimonial law and accuracy of any prenuptial agreement, the applicable inheritance law, and the need to update any existing will.

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CONCLUSION

Switzerland provides for a very attractive lump sum tax regime for H.N.W.I. and U.H.N.W.I., which is not based on worldwide income and wealth but determined on the annual expenditures of the family and therefore corresponds to the family standard of living.

Compared to other countries with similar regimes, the significant advantage of Swit-zerland resides in its political and economic stability. Whether COVID-19, the war in Ukraine, and energy availability and prices, Switzerland has demonstrated a certain pragmatism and avoided social demonstrations.

Switzerland is also a leader in innovation and technology, fosters a liberal economic system, maintains close ties to other markets, supports an excellent education and health care system, has outstanding infrastructure, and a high quality of life. But most importantly, it allows a U.H.N.W.I. to be taxed on their annual expenditures subject to a written approval of the Cantonal tax authorities, instead of ordinary worldwide income and wealth taxes.

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