

## Lump sum taxation

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As the Portuguese government has decided to abolish the NHR status and the non-domiciled resident status is to be replaced by a totally unattractive regime in the United Kingdom, the attractive countries in Europe for high-net-worth individuals are essentially Andorra, Spain, Italy, Luxembourg, Greece, Malta and Switzerland.



Except for cantons such as Schwyz, where tax rates are very low, Switzerland is only attractive to wealthy foreigners if they benefit from expenditure bases taxation, also known as lump sum taxation. We therefore feel it is important to recall how this legally defined and politically sustainable system works, taking into account the comments made by the Swiss Federal Audit Office in its Report on the “supervision of direct federal tax, expenditure-based taxation” of 30 May 2022 hereafter: the Audit.

Lump sum taxation allows foreign nationals who meet certain conditions to be taxed in Switzerland not on their income and wealth, but on their expenses.

Lump-sum taxation is rooted in Swiss tradition. It originated in the canton of Vaud in 1862 and was introduced in Geneva in 1928. It has existed at federal level since 1934. This system of taxation went through a period of turbulence that began on 8 February 2009, when the people of Zurich decided in a referendum, by a majority of 52.9%, to abolish this form of taxation in their canton from 1st January 2010. This period ended on 30 November 2014, when around 60% of the Swiss population rejected an initiative aimed in particular at abolishing lump-sum taxation

throughout the country. In the meantime, the conditions for lump-sum taxation were tightened by Parliament on 28 September 2012, a legislative reform that came into force on 1st January 2016 for new arrivals and on 1st January 2021 for taxpayers already benefiting from this system.

### Lump-sum taxation conditions

Taxpayers wishing to elect for lump-sum taxation must meet the following conditions:

- a) Only taxpayers who are not Swiss nationals can qualify for lump-sum taxation. This rule excludes from the circle of potential beneficiaries Swiss nationals, dual nationals who hold both Swiss and foreign nationalities, and foreign nationals who acquire Swiss nationality.
- b) Only persons who are taxed for the first time on an unlimited basis in Switzerland or after an absence of at least ten years may be granted lump-sum taxation. However, the Federal Tax Administration (FTA) has specified in section 2.3 of its Circular No. 44 of 24 July 2018 that this requirement does not apply to lump-sum taxpayers who leave Switzerland and decide to return to benefit from this system again before a period of ten years.

- c) One of the conditions of lump-sum taxation is that the taxpayer who wishes to benefit from it must not be gainfully employed in Switzerland. According to the FTA, “a person who is gainfully employed in Switzerland in a principal or secondary occupation of any kind whatsoever and who derives income therefrom, in Switzerland or abroad, is not entitled to lump-sum taxation. This is particularly the case for artists, scientists, inventors, sportsmen and women and members of boards of directors who are personally gainfully employed in Switzerland” (para. 2.3 of Circular No. 44). This means that a lump-sum taxpayer may not engage in any gainful activity in Switzerland, either as an employee of a Swiss or foreign company or as a self-employed person. On the other hand, they may carry out any non-remunerated activity in Switzerland or abroad, as well as any lucrative activity abroad either as an employee or as a self-employed person. Furthermore, a lump-sum taxpayer has the right to manage his private assets by investing them in Switzerland or abroad. These investments may be remunerated, for example, in the form of interest, dividends or capital gains. However, care must be taken to ensure that the management of private assets does not become an independent gainful activity within the meaning of Swiss law.

Two points are worth highlighting. Firstly, some cantons are very restrictive when it comes to gainful employment abroad. Indeed, some of them do not accept a lump-sum taxpayer holding an executive salaried position outside Switzerland. Secondly, a recurring question which divides the legal doctrine and on which there is no case law from the Federal Court is whether a lump-sum taxpayer can be a director of a Swiss company. In its Audit, the Swiss Federal Audit Office mentions that in August 2021, the Federal Tax Administration informed the cantons of the conditions which, in its opinion, allow a lump-sum taxpayer to be a member of the board of directors of a Swiss company. According to the FTA, the following cumulative conditions must be met: 'No remuneration is granted in cash or in kind for any activity. However, compensation for expenses incurred (effective or appropriate flat-rate) is permitted, since these do not represent income from a dependent or independent gainful activity; the director ('corporate body' position) does not also manage the company's affairs; the company's effective activity is limited to the management of the assets contributed by the director to the company or serves to monitor the privately invested capital' (Audit, 3.2). As a matter of caution, we personally recommend that lump-sum taxpayers should not hold a directorship in a Swiss company unless they have obtained prior approval from the tax authorities of the canton in question. It should be stressed that cantonal practices vary widely.

### Calculation of the tax due by the taxpayer

The basic principle is that instead of paying tax on income and wealth, the lump-sum payer pays tax calculated on the basis of expenditure.

The first step is for taxpayers to complete a form listing their annual expenses and those of their dependants.

Once this amount is determined, it is important to note that it may not in any case be lower than two thresholds. First, the amount of expenses must not be less than seven times the annual rent or rental value of the taxpayer's property, and for those staying in either a hotel or a retirement home, not less than three times the annual cost of board and lodging. Furthermore, in all cases, this sum must not be less than CHF 434,700 for federal tax and an amount deter-

mined by each canton for cantonal and communal taxes (this minimum amount is CHF 467,800 in Geneva, CHF 450,800 in the canton of Vaud and CHF 250,000 in the canton of Valais).

Finally, it is up to the cantons, using a method of their choice, to impose a wealth tax on the taxpayer's assets, on a flat-rate basis. For example, the cantons of Geneva and Vaud have simply chosen to increase by 10% the amount on which the taxpayer is taxed in application of the principles mentioned above.

In practical terms, this means that a married couple taxed on the minimum amounts will pay an annual sum of around CHF 161,600 in Lausanne, around CHF 159,900 in Geneva and around CHF 105,500 in Verbier.

### Control calculation

Once the tax due by the taxpayer has been calculated, this amount is compared each year with an amount calculated on a certain number of items. It is important to emphasise that once this control calculation has been made between the tax due on expenditure and the tax due on the items taken into account for this calculation, only the higher of the two amounts is due. The two amounts are not cumulative.

The elements to be taken into consideration for the control calculation are as follows:

- 1) The taxpayer's real estate assets located in Switzerland and income thereof.
- 2) Movable property in Switzerland and income thereof.
- 3) Movable capital held in Switzerland, including debts secured by the pledge of a property and income thereof.
- 4) Copyrights, patents and similar rights being used in Switzerland and income thereof.
- 5) Swiss-source pensions and annuities.
- 6) Income for which the taxpayer claims partial or total relief from foreign tax under a double taxation treaty concluded by Switzerland.

We emphasise that the lump-sum taxpayer must give their banker the necessary instructions to ensure that the amount of tax calculated on the items taken into consideration for the control calculation does not result in higher tax than the amount they pay on their expenses.

### Lump-sum taxation and double taxation treaties

In principle, lump-sum taxpayers may benefit from double taxation agreements without any particular restrictions. However, the application of a number of them raises particular questions.

Firstly, the treaties concluded by Switzerland with Germany, Austria, Belgium, Canada, the United States, Italy and Norway provide for a system known as "modified lump-sum taxation". A lump-sum taxpayer who wishes to benefit from one of the aforementioned double taxation agreements must declare and be taxed in Switzerland on all income arising in the State in question, provided that the agreement grants Switzerland the right to tax. It is important to emphasise that this income will be treated in the same way as that taken into consideration for the control calculation. In other words, a lump-sum taxpayer wishing to benefit from one of the double taxation treaties providing for the system of "modified lump-sum taxation" who is obliged to declare the aforementioned income will not see the amount of his tax increase on condition that, when added to the elements to be taken into account in the control calculation, they do not give rise to a tax higher than that calculated on his expenditure.

Secondly, the double taxation agreement between Switzerland and France has been the subject of much discussion, not least by us. The current situation can be summarised as follows. Since 1 January 2013, the French Directorate General of Public Finances has taken the view that lump-sum taxpayers may no longer benefit from the Franco-Swiss treaty. This position is not shared by the Swiss tax authorities. For example, the cantonal administrations of Geneva and Vaud consider that a lump-sum taxpayer benefits from this agreement provided that the expenditure base on which he is taxed in application of the principles mentioned above is increased by 10% for the calculation of cantonal, communal and federal taxes.

### Conclusion

Contrary to widespread belief, the lump-sum taxation system is subject to strict rules, both in the legal provisions and in their application. As a result, we can only recommend that lump-sum taxpayers seek expert tax advice and assistance in completing their tax returns. ■