**Recent developments concerning lump-sum taxation**

by

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Introduction

Lump-sum taxation – also known as expenditure-based taxation – allows foreign citizens to pay tax in Switzerland based on their expenditure rather than on their income and wealth. In order to benefit from this system, the taxpayer must not hold Swiss nationality, must have an unrestricted right to remain in Switzerland either for the first time or after an absence of ten years or more and must not be engaged in gainful activity in Switzerland.

This form of taxation has been stabilised and its continued existence has been assured over recent years both politically – in light of the Swiss people’s decision to reject an initiative seeking to abolish it on 30 November 2014 – and legally following its reform which was adopted by the Federal Assembly on 28 September 2012. The Federal Tax Administration (FTA) issued circular no. 44 entitled “Lump-sum taxation in relation to direct federal taxes” (Circular 44) on 24 July 2018 which replaces circular no. 9 of 3 December 1993 (Circular 9). This article aims to outline the main elements of this new circular which completes the reform of flat-rate taxation.

The main tenets of the reform of 28 September 2012 can be summarized in the following way. Firstly, the legal conditions for paying lump-sum taxation must be met by the two spouses living in the same household, which excludes the possibility of one of the two spouses being engaged in gainful activity in Switzerland and of a couple where one of the two spouses holds Swiss nationality from benefiting from this tax system. Secondly, the cantons are obliged to establish a minimum level of expenditure in their legislation with this being set at CHF 400,000 for the calculation of direct federal taxation. Furthermore, the taxpayer’s minimum amount of expenditure no longer has to be five times the rental value of the property occupied by the flat-rate taxpayer but seven times. Finally, whereas under the old law the amount paid in lump-sum taxation covered both tax on wealth as well as on income, it is now up to the cantons to tax the taxpayer’s wealth in a form which they are free to decide on. It is worth noting that these new provisions entered into force on 1 January 2016 for new arrivals but will only apply to taxpayers present in Switzerland before this date from 1 January 2021.

Conditions of eligibility for lump-sum taxation

While article 14 para. 2 of the Federal Act of 14 December 1990 on Direct Federal Taxation (DFTA) and article 6 para. 2 of the Federal Act of 14 December 1990 on the Harmonisation of Direct Taxation at Cantonal and Communal Levels (DTHA) are very clear on this point, the Federal Tax Administration (FTA) insists in sections 2.1 and 2.2 of Circular 44 that spouses living in the same household must meet both of the above-mentioned conditions in order to be eligible for lump-sum taxation. It expressly stipulates that no exception to this rule can be made from 1 January 2021.

One of the most sensitive issues politically and one of the most important practically is determining the exact scope of the provision according to which a flat-rate taxpayer cannot engage in gainful activity in Switzerland. Circular 44 stipulates the following in section 2.3: “Engaging in gainful activity, which excludes the right to flat-rate taxation, is where the person practices a main or auxiliary profession in Switzerland of any kind from which they receive an income in Switzerland or abroad. In particular, this applies to artists, scientists, inventors, sports people and Board of Directors members who are *personally* engaged in gainful activity in Switzerland.” In theory, this means that flat-rate taxpayers may not engage in any gainful activity on Swiss territory, neither as the employee of a Swiss or foreign company nor in a self-employed capacity. They may, however, carry out non-remunerated activity in Switzerland or abroad, as well as any kind of gainful activity outside of Switzerland, whether as an employee or in a self-employed capacity. A taxpayer opting for expenditure-based taxation is allowed to invest in Switzerland or abroad. Such investments may produce income by way of interest, dividends or capital gains. If the investment takes place in Switzerland, the taxpayer’s role must be limited to that of investor and must not effectively constitute gainful activity. The value of the Swiss investments and the revenue that they generate are covered by the control calculation which we will look at below. Particular attention should be paid to the opportunity for flat-rate taxpayers to engage in gainful activity abroad. Some cantonal tax administrations adopt a stricter approach than the law and the FTA and do not accept flat-rate taxpayers holding executive positions as employees abroad. They justify their position by contending that some of their activities are carried out in Switzerland as otherwise the Swiss domicile would be fictitious. Furthermore, in cases of gainful activity abroad in a self-employed capacity, the authorities are becoming increasingly vigilant in checking whether any element of the activity is exercised in Switzerland or whether the taxpayer’s domicile in Switzerland creates a centre of economic interest. A recurrent issue is establishing whether a flat-rate taxpayer may be the director of a Swiss company. With reference to the text of section 2.3 of the aforementioned Circular 44, the FTA does not exclude this possibility provided the taxpayer is either not personally engaged in any activity in Switzerland or the activity is not carried out for gainful purposes. It should be pointed out that some cantons adopt a more restrictive approach.

It is interesting to note that the content of Circular 44 on the notion of engaging in gainful activity in Switzerland is almost identical to that found in Circular 9 which it replaces. One difference is nevertheless worth highlighting. Whereas in 1993 the FTA stipulated that income meant revenue from gainful activity as an employee or in a self-employed capacity, in accordance with articles 17 and 18 DFTA respectively, it abandoned this specification in 2018. In our view, this can be interpreted as the FTA’s intention to cover all kinds of income, such as the reimbursement of expenses for example.

Finally, with regard to the requirement that a taxpayer wishing to benefit from flat-rate taxation must take domicile in Switzerland for the first time or after an absence of at least ten years, the FTA deems that an exception exists for persons subject to flat-rate taxation who leave Switzerland and wish to return. This latter group can return to Switzerland and take advantage of the flat-rate tax system again even if they have not resided abroad for a 10-year period.

The control calculation

Many people overlook the fact that flat-rate taxation is not restricted to the tax calculation on expenditure. Once federal, cantonal and communal tax has been calculated based on the taxpayer’s expenditure, these amounts must be compared each year with those amounts calculated based on the following elements with only the highest amount being due:

1. Real estate assets situated in Switzerland and revenues thereof;
2. Moveable objects situated in Switzerland and revenues thereof;
3. Movable capital situated in Switzerland including debts secured by the pledge of a property and the revenues thereof;
4. Copyrights, patents and similar rights being used in Switzerland and the revenues thereof;
5. Pensions, unearned income and annuities from Swiss sources;
6. Revenues for which the taxpayer requires either temporary or full foreign tax relief under a double taxation treaty entered into by Switzerland.

In its new circular, the FTA stipulated in section 3.3.4 that the taxpayer’s revenues of Swiss origin will be deemed “revenues from moveable capital situated in Switzerland.” To determine whether this is the case, the decisive factor for debt claim rights is whether the domicile or registered office of the debtor is located in Switzerland and in the case of participatory rights whether the registered office of the stock company or cooperative company in which the taxpayer holds a stake is located in Switzerland. The place where the participatory or debt claim rights are held and the currency in which they are denominated are not determining factors. For example, the value of shares in Nestlé, whose registered office is in Switzerland, and the revenues thereof are included in the control calculation regardless of whether the shares are part of a portfolio managed by a bank in Switzerland or abroad.

Conclusion

While Circular 44 includes a number of stipulations, its content is quite similar to that of Circular 9. We also wish to draw the reader’s attention to the fact that this only concerns direct federal tax. This means the cantons have a certain degree of room for manoeuvre, especially with regard to cantonal and communal taxes.