

TAXATION



Lump-sum taxation: the control calculation

Expenditure-based taxation, also known as lump-sum taxation, enables a foreign national, if he meets a certain number of conditions, to be taxed in Switzerland not on the basis of his income and wealth, but on the basis of his expenses and those of his dependents. The amount of these expenses may not be less than seven times the annual rent or rental value of the home occupied by the taxpayer and in any case not less than CHF 400,000 for the calculation of direct federal tax (hereinafter: DFT) and an amount that varies according to the canton (CHF 400,000 in the canton of Geneva, CHF 360,000 in the canton of Vaud and CHF 250,000 in the canton of Valais) for the purpose of cantonal and communal taxes (hereinafter: CCT).

Too often, taxpayers forget that once the tax replacing both federal income tax and cantonal and communal income and wealth taxes are calculated,

these amounts must be compared each year with those calculated on a certain number of elements. This operation is called a control calculation.

How the control calculation works

Before examining the elements to be taken into account for the control calculation, two remarks are in order. First, it should be noted that once the tax on the lump-sum and the tax on the basis of the control calculation have been calculated, only the higher of the two is due. These amounts are not cumulative. Secondly, since in Switzerland wealth tax is levied only by cantons and municipalities, only the income is taken into account for the control calculation for DFT purposes, whereas for the calculation of the CCT, not only the income but also the relevant wealth items have to be taken into account.



The gross items to be taken into account in the control calculation are as follows:

1. Real estate assets located in Switzerland and income thereof ;

For DFT purposes, the income from a property located in Switzerland and owned by a lump-sum taxpayer is taken into account for the control calculation, regardless of the canton in which it is located. It should be noted that in Switzerland, the owner pays a tax on the rental value even if he does not rent his property. As for the CCT, either the property is located in the canton where the lump-sum taxpayer is domiciled and in this case it is taken into account for the control calculation both for income and wealth tax purposes, or it is located in another canton and in this case it is not taken into account for the control calculation because the income and wealth taxes are due in that canton. In practice, this means that if a lump-sum taxpayer acquires a secondary residence in the canton where he is domiciled, the taxes related to this property, if they do not exceed those calculated on the amount of the expenditure and the other elements of the control calculation, will not increase his tax burden, whereas if he acquires it in another canton all the taxes related to this property will be due in that canton and will not be covered by the lump-sum taxation.

2. Movable assets located in Switzerland and income thereof.

In practice, this provision is mainly aimed at works of art and collectors' items.

3. Movable capital held in Switzerland, including debts secured by the pledge of a property and income thereof.

First, it should be noted that the term «movable capital held in Switzerland» used by the legislator is unfortunate insofar as, as the Federal Tax Administration (hereinafter: FTA) points out in section 3.3.4 of its Circular no. 44 of 24 July 2018 (hereinafter: Circular no. 44), the place where the capital is held is in no way decisive. Whether securities are deposited in a bank in Switzerland or abroad is of no consequence.

The only criterion for determining which securities and receivables, as well as their income, are relevant for the calculation of the control is the following. For debt claims, the domicile or registered office of the debtor. For shareholdings, the place of the registered office of the company or cooperative in which the lump-sum taxpayer has a stake. Only in cases where this domicile or registered office is in Switzerland will the amounts be taken into account for the control calculation (section 3.3.4 of

Circular no. 44). The only exception to this principle is the case where a lump-sum taxpayer has a claim against a debtor whose domicile or registered office is abroad, but this debt is secured by a pledge on a property located in Switzerland.

It is important to note that cash in any currency - and income thereof - deposited in a Swiss bank are part of the receivables taken into account for the control calculation. This is not the case if they are deposited in a bank abroad.

With a few exceptions, the income to be taken into account for the control calculation is that which is subject to withholding tax in Switzerland. If this income is declared - which is a legal obligation - the lump-sum taxpayer will be able to reclaim it, regardless of whether the amount of tax due is based on the lump-sum or on the control calculation.

It should be reminded that in Switzerland capital gains on private assets are not taxable. This means that if a lump-sum investor makes capital gains on Swiss securities, the value of the latter will be taken into account for the calculation of wealth tax, but the income in the form of capital gains will not be taxed.

4. Copyrights, patents and similar rights being used in Switzerland and the income thereof.
5. Pensions and annuities from Swiss sources.
6. Income for which the taxpayer claims either partial or full tax relief under the provisions of a double taxation treaty entered into by Switzerland.

This situation arises when a lump-sum taxpayer receives income from a State that levies a tax, for example a withholding tax, for which he can claim full or partial relief under a double taxation treaty between that State and Switzerland. The income in

this context is mainly dividends, interest, royalties, annuities and pensions. A typical case is a lump-sum taxpayer who receives a dividend of say, 100, from a country with a withholding tax rate of 35% which, under the double taxation agreement, could be reduced to 20%. In such a situation, the taxpayer has the following choice: either he declines to make use of the double taxation agreement and to claim the full or partial tax relief and, consequently, he is not obliged to declare the income in Switzerland as part of the control calculation. In such a case, the income has no effect on the lump-sum taxpayer's taxes in Switzerland. The other choice would be to claim full or partial tax relief pursuant to the double taxation agreement. In this case, he is obliged to declare this income, which is taken into account in the control calculation. It is therefore up to the lump-sum taxpayer to decide on a case-by-case basis whether it is financially preferable to pay the tax abroad or to claim full or partial tax relief and to include it in the control calculation.

The FTA specifies that the decisive criterion is not that the taxpayer has taken steps to obtain the benefits of a double taxation agreement, but simply the fact that he has been exempted from foreign taxation under the agreement. This is the case, for example, when a foreign State waives taxation of a retirement pension not on the basis of an official certificate or a specific request, but simply on the basis of the creditor's address in Switzerland (section 3.3.4 of Circular No. 44).

Only the cases where taxes of the source state are fully or partially offset by virtue of the double taxation agreement are taken into account for the control calculation. The application of such a double taxation agreement to determine the competent state to tax income has no effect on the control calculation. For example, the application of a treaty to determine that real estate income is taxed in the State where the real estate is located or that director's fees are taxed in the State of the company's seat does not have the effect that such real estate income

or director's fees should be taken into account in the control calculation.

Finally, it is important to note that the treaties concluded by Switzerland and Austria, Belgium, Canada, Germany, Italy, Norway and the United States provide for a special system known as «modified lump-sum taxation». According to these treaties, a lump-sum taxpayer who wishes to benefit from the double taxation treaty must declare and be taxed in Switzerland at the federal, cantonal and municipal levels on all income from the state in question, provided that the treaty grants the taxing right to Switzerland. For example, a lump-sum taxpayer wishing to benefit from the Swiss-Belgian treaty must declare and be taxed in Switzerland on a Belgian-source dividend, but not on a director's fee paid by a Belgian company. The former must be taxed in Switzerland while the latter must be taxed in Belgium. This income is treated in the same way as the income relevant for the control calculation. In other words, a lump-sum taxpayer wishing to benefit from one of the above-mentioned double taxation treaties, and who is obliged to declare the above-mentioned income will not see his taxes increase provided that, when added to the elements to be taken into account in the control calculation, it does not generate a higher tax burden than that calculated on his lump-sum.

Conclusion

In conclusion, we would like to highlight the following points. Firstly, even if the result of the comparison between the two amounts of tax to be paid is that the amount calculated on the elements included in the control calculation is lower, the taxpayer is nevertheless obliged to declare these elements each year in his tax return. Secondly, subject to a few special cases, it is relatively easy to avoid taxation on the basis of the control calculation provided that the necessary instructions are given to the banker. Finally, it is important to be very careful about the use of double taxation treaties. ■