Real estate companies – a renewed attractiveness?

With the entry into force of the Federal Act on Direct Federal Taxes (FDTA), the Federal legislator – followed by many cantons which amended their tax laws in its wake – introduced the facilitated liquidation of real estate companies (REC) under favourable tax conditions, which should have made the use of such companies obsolete. Furthermore, following the recent abolition of bearer shares, the use of a limited company in order to preserve the complete anonymity of the shareholder is no longer possible. However, real estate companies have some advantages, particularly in terms of estate planning and taxation. On the latter point, with the entry into force of the recent fiscal reforms, real estate companies have potentially become more attractive, as we will illustrate with an example. In this article, we will analyse the tax issues under the tax legislation of the canton of Vaud. The authors would like to point out that there are major differences between the cantons in terms of tax laws, so that any real estate transaction should first be analysed under the tax provisions applicable in the canton(s) affected by the transaction.

Tax advantages and drawbacks

There are two ways of owning real estate in Switzerland. Either the owner acquires a property in his own name and holds it directly, or he may acquire it through a real estate company, in which case the ownership is indirect. As we shall see, there are major differences in the taxes generated by property ownership depending on whether it is held directly or indirectly.

There are essentially three stages in which taxes are levied on property ownership. Firstly, when a property is acquired, a transfer tax is due if the ownership changes in the land register. This tax, which amounts to approximately 3.3% of the sale price of the property in the canton of Vaud, is not levied if an REC shares are sold, as the company remains the owner of the property[1].

During the period of ownership of the property, rental income is subject to income tax (max. rate: 41.5%) or corporate income tax (max. rate: 13.79%) and the value of the property is subject to wealth tax (max. rate: approx. 0.79%) or, in some cases, capital tax[2]. A property tax is also levied, at a rate of 0.15% of the fiscal value of the property, regardless of the type of ownership. For real estate held by an REC, there is a supplementary property tax of 0.1% of the tax value of the property. The shares of an REC are subject to wealth tax for the shareholder. Any distributions that he receives

[1] This is not the case in all cantons
[2] Capital tax is fully deductible from the corporate income tax in the canton of Vaud.

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from the company are subject to income tax[3]. In this sense, the real estate returns are subject to double taxation: first within the company for corporate income tax, and then for the shareholder for income tax. However, if the shareholder holds more than 10% of the shares of the company, such distributions benefit from a 30% tax reduction. Furthermore, the shareholder may well decide that the company will not to pay out any dividends. By doing so, he limits his taxable income, which potentially allows him to benefit from the cantonal tax shield[4]. This is not possible for a person holding a property directly, as the rental income accrues to him as soon as he receives it and enters directly into his taxable income, greatly limiting any application of the tax shield. Furthermore, if an owner sells his property to an REC that he owns, he can set up a vendor loan, which the company can repay to him tax-free. The amount of the loan will however be subject to wealth tax for the shareholder.

At the time of the sale of the property, real estate gains tax is levied regardless of whether the property is held directly or indirectly. If the shares of an REC are sold, the real estate gains tax is levied taking into account the value of the property and not the sale price for the shares. In the canton of Vaud, the rate is degressive depending on the length of time the owner has owned the property. The minimum rate of 7% is reached after a holding period of 24 years[5]. It should also be noted that an REC that sells its property may have to be liquidated, which would generate not only a tax on the liquidation profit within the company but also an income tax for the shareholder on the possible liquidation dividend.

It should be borne in mind that buyers are sometimes reluctant to acquire shares in an REC rather than the property directly. In this regard, a property owner who aims to sell his property may be inspired to retain direct ownership rather than to form an REC.

Illustration with an example

Let's take the case of a taxpayer subject to the maximum tax rate, who acquired a property in 1996 at a price of CHF 8,000,000. The tax value of the property has recently been revised and amounts to CHF 7,000,000. The net rental income is CHF 480,000. In 2021, the taxpayer forms an REC, to which he sells the property for CHF 12,000,000 and sets up a vendor loan for CHF 11,900,000.

The sale of the property to the REC gives rise to real estate gains tax of CHF 280,000 and trans-

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[3] Such distributions are subject to a 35% withholding tax, which Swiss tax resident can fully reclaim. Non-residents can only reclaim withholding tax if the applicable double tax treaty so provides.

[4] The tax shield aims to ensure that cantonal and communal taxes on income and wealth are not confiscatory. To this end, it limits these taxes to a maximum amount of 60% of taxable income. For the calculation, the taxable income may not be less than 1% of taxable wealth.

[5] The period is 12 years if the owner occupies the property himself.

fer taxes (payable by the REC) of CHF 396,000, i.e. a total tax burden of CHF 676,000 as "transfer costs".

The difference in the annual tax burden between direct and indirect ownership can be estimated as follows:

	Direct	Indirect
Income tax	199'200	
Corporate income tax		66'192
Property tax	10'500	10'500
Suppl. property tax		7'000
Profit after tax	270'300	396'308
Total financial gain		**126'008**

In our example, the transfer cost related to the sale of the property to the REC is recovered in a little more than 5 years, insofar as the annual tax savings can be estimated at ca. CHF 126'008. In addition, the taxpayer will be able to receive for about 30 years substantial amounts as reimbursement of the vendor loan, all tax free. As these reimbursements are not considered income, they would not prevent him from benefiting from the tax shield if the conditions for its application are otherwise met.

The transaction in this example is only economically relevant if the owner of the property has no intention of selling the property in the short or medium term. If the property or the shares of the REC were to be sold within a short period of time, the tax on real estate gains would be very high and would potentially wipe out any benefits of the transaction. Therefore, such a transaction should be part of a long-term planning.

Other advantages of indirect ownership through an REC

It should also be noted that the transfer of assets by way of inheritance can be greatly facilitated if a real estate company is used instead of directly owning a property. Indeed, it is much easier to divide shares of a real estate company among one's heirs than to transfer portions of a property to them. Furthermore, once the heirs are shareholders in a real estate company, strategic decisions for the maintenance and/or development of a property are taken by a simple majority at a general meeting, whereas if they hold the property directly, such decisions must in principle be taken unanimously.

Conclusion

Indirect ownership of real estate through an REC enables a strategy to be implemented as to the return on investment, e.g. through the tax free repayment of a vendor loan or the choice of the amounts of dividends to be distributed as well as the tax periods in which such distributions take place. The combination of these factors with the recently reduced corporate income tax rate, the tax reduction on distributions from qualifying holdings and the possibility of benefiting from the tax shield can be particularly advantageous for the shareholder of an REC. It may be worthwhile for real estate owners to examine the possibility of transferring their real estate assets to an REC, not only for tax reasons but also for estate planning. It should however be borne in mind that owners holding real estate in an REC sometimes find it difficult to sell the company's shares, as some buyers prefer to acquire a property directly. ■