The **tax treatment** of real estate **company** shares in **international contexts**

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The ownership and transfer of shares in real estate companies, whether onerous or gratuitous, give rise to interesting and sometimes complex issues, particularly in international contexts. We will first examine the concept of real estate company (REC) under Swiss law and then review certain Swiss taxes and the specifics of their application in certain international settings.

Concept of a real estate company

Swiss law does not recognise a particular form of REC as is the case in some countries. In principle, they are constituted in the form of an Ltd or an LLC. The concept of a real estate company is in fact a concept of tax law that was developed in the context of transfer taxes and the taxation of real estate gains. According to the Federal Supreme Court, a company is qualified as a real estate company when its purpose or actual activity consists mainly or exclusively in the acquisition, holding, management and sale of real estate. If the real estate is only the physical support of an industrial or commercial operation, it is not a real estate company but an operating company. The main criterion for qualifying a company as an REC is its statutory purpose (or the activity it actually pursues). However, our High Court specified that each case must be examined individually taking into account all the circumstances, a single criterion not being sufficient (ATF 2C_643/2017, recital 2.4). The following elements must also be taken into account:

- The market value of the buildings must in principle represent 2/3 of the market value of the company's total assets;
- 2/3 of the profit must come from "real estate" activities (e.g. rentals).

It should be noted that these are not cumulative criteria but indicators that must be weighted (SCHWAB Anne-Christine, Notion de société immobilière, RDAF 2019 II p. 317).

Transfer tax

Transfer tax is a tax on the transfer of real estate as such, regardless of whether or not a gain is realised. It is an indirect tax that has not been harmonised at the federal level, so that its treatment varies greatly from one canton to another. In all cantons, the transfer tax is in principle payable by the purchaser of the property. It is calculated on the basis of the purchase price and is generally levied at a rate between 1 and 3%.

The transfer of shares in a real estate company gives rise to the levying of transfer duties in some cantons, the intention being to tax the economic transfer of real estate as well. It should be noted that such transfers can only give rise to transfer duties in a canton if the real estate is located there, regardless of where the real estate company is based.

Some cantonal legislations impose transfer taxes on all transfers of shares in an REC, even for the transfer of a minority shareholding. Other cantons limit such taxation to transfers of majority shareholdings, and some cantons do not levy any transfer tax on transfers of shares in an REC.

The Federal Court has recently had to decide an interesting case on transfer taxes concerning the canton of Valais (ATF 2C_643/2017). In this case, a Maltese company had acquired all the shares of a Swiss company holding apartments, all located in Valais. The Valais tax authority considered that the Swiss company should be qualified as an REC and, on the basis of Valais law, levied transfer tax on the transfer of the shares. The Maltese company contested this classification, arguing that, from the point of view of the Federal Law of 16 December 1983 on the acquisition of real estate by persons abroad (LFAIE), the cantonal authority confirmed that the transfer was not subject to authorisation, precisely because the activity of the Swiss company was qualified as a hotel activity (cf. art. 2 para. 2 let. a LFAIE and art. 3 OAIE). If the competent authority had come to the conclusion that it was an REC without hotel activities, the transfer would have been subject to authorisation under the LFAIE and such authorisation would probably not have been granted. In other words, the company criticised the State of Valais for qualifying the company differently depending on whether it applied the LFAIE or the tax law concerning transfer tax. The Federal Court dismissed this argument by stating that the decision regarding the LFAIE status of the company has no binding effect on the Valais tax authorities with regard to the levying of transfer tax. The two laws (tax law and LFAIE) serve different purposes: transfer duties aim to tax the transfer of real estate, whereas the LFAIE aims to limit the acquisition of real estate by persons abroad in order to prevent foreign control over Swiss soil (above-mentioned decision, recital 8.3). From the point of view of transfer tax law, the question is whether the transfer of the shares in the REC is equivalent to a transfer of the real estate itself or whether the aim is to transfer a business (a hotel). In contrast to the LFAIE, the tax law does not take into account the way in which the real estate is used, but attaches importance to the purpose of

the company. In this case, the lower court found that the company's purpose in its articles of incorporation was that of a "classic" REC, that the building was registered as "residential property", and that the furniture and equipment were not typical of hotel facilities but rather the amenities of a luxury chalet. It also noted that more than two-thirds of the company's assets consisted of real estate and that rental income accounted for more than two-thirds of the profit. Finally, the company's commercial activity consisted mainly of renting out holiday homes, with hotel services as such being relegated to the background (above-mentioned decision, points 4.1-4-3). The Court therefore confirmed that the company was an REC and that the transfer tax was due.

Income and wealth tax

The individual taxpayer, domiciled in Switzerland, holding shares in a Swiss or foreign real estate company is liable for income tax on the distributions received from the REC and for wealth tax on the value of the shares. Indeed, for income and wealth tax purposes, shares in an REC are considered as moveable property. This implies that the real estate income generated by the REC is not directly attributable to the shareholder but is taxed as profit in the REC – provided that the REC is not treated as transparent under the law of its state of incorporation. Some double taxation agreements (DTA) provide for special rules concerning the taxation of shares in an REC and their income. This is the case, for example, in the DTA between Switzerland and France concerning French *sociétés civiles immobilière* (SCI). These are in principle fiscally transparent and the DTA provides in its Article 6 paragraph 2 subparagraph 2 that income from the ownership of shares in a company treated as real estate for tax purposes under the domestic legislation of the State in question is only taxable in that State. In other words, income from French SCIs, which are treated as transparent, is considered as real estate income and therefore taxed only in France. The Convention makes a similar provision for wealth tax levied on shares in SCIs. Indeed, according to article 24 paragraph 1 subparagraph 2 DTA CH-FR, the wealth constituted by shares of a company whose assets are mainly composed, directly or indirectly, of real estate situated in a Contracting State is taxable in that State. This means that, in principle, shares in SCIs are subject to wealth tax in France and therefore exempted (exemption with progression) in Switzerland. However, can Switzerland still tax the wealth represented by French SCI shares if it is not taxed in France? This is the question on which the Vaud Cantonal Court recently ruled (Decision of the Court of Administrative and Public Law of the Vaud Cantonal Court of 1st April 2021 (FI.2020.0109)).

French wealth tax on real estate assets is only due in France from a threshold of EUR 1,300,000, so that it is possible that a taxpayer holding real estate assets in France (e.g. shares in a SCI) for a total amount below this threshold is not taxed on the assets in France. Art. 25 let. B DTA CH-FR specifies that income and assets that are only taxable in France under the DTA are exempt from taxation in Switzerland (exemption with progression). However, the same provision specifies that this exemption only applies to income or wealth arising from SCIs in particular, after justification of their taxation in France. The possibility for Switzerland to tax the wealth constituted by shares of a French SCI depends on whether these shares have been subject to French wealth tax on real estate or not. If the answer is no, Switzerland is perfectly entitled to tax the value of these shares. The same reasoning cannot be applied to the income of French SCIs, as this is in principle taxed in France and must therefore be exempted in Switzerland pursuant to Art. 25 B 1 DTA CH-FR. This can lead to the peculiar and counter-intuitive situation where the real estate income of an SCI is only taxable in France, while the assets constituted by the shares of the same SCI are taxable in Switzerland. In the above-mentioned decision FI.2020.0109, the Vaud Cantonal Court confirmed this approach, although it should be noted that the case has been referred to the Federal Court, which has not yet given a ruling.

Inheritance and gift tax

Inheritance and gift taxes have not been harmonised at the federal level and are only levied by the cantons and municipalities. Most cantons and municipalities do not levy inheritance and gift taxes on transfers in direct descending lines or between spouses. If they are levied on transfers of movable property, they are charged in the canton of the donor's domicile or the last domicile of the deceased, regardless of the domicile of the heirs. Real estate is subject to tax at the place where it is located, regardless of the domicile of the donor/deceased or the domicile of the donee/heir. However, the practice of the cantons when REC shares are transferred gifted inter vivos or by devolution of the estate is that they are considered as movable property and taxed as such. This has an impact on taxation because the share of an REC (Swiss or foreign) is included in the movable property taxable in the canton of the donor/deceased's domicile, whereas real estate located outside the canton is not taxable there.

If, for example, a person domiciled in the canton of Valais were to give his son shares in an REC holding real estate in the canton of Vaud, no gift tax would be due either in the canton of Valais or in the canton of Vaud, since the canton of Valais does not tax gifts in direct line and the canton of Vaud is not competent to tax the transfer. If, in the same constellation, the object of the donation is the real estate property located in the canton of Vaud that the donor held directly, then the canton of Vaud would tax the donation, since donations in direct line are taxed there and the location of the gifted property leads to the taxation in the canton of Vaud.

It should also be noted that in international situations, some countries may treat an REC as transparent, considering it to be real property, and tax it as well. Many countries also tax the transfer of movable property located there. Finally, some countries tax gifts/inheritance at the domicile of the donee/heir. There is therefore a high risk of double taxation in international situations and Switzerland has concluded only a few double taxation agreements on inheritance tax and none on gift tax. In many cases, double taxation remains.

In conclusion, indirect real estate holding can be interesting from a tax point of view, but in international situations one should be prudent and carefully analyse the possible consequences of holding or transferring of shares in an REC. ■