Confiscatory taxation and the tax shield mechanism

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Switzerland is one of the few countries with a net wealth tax. It is levied by the cantons and municipalities and has the potential effect that the taxpayer is forced to use his capital to be able to pay tax. The Federal Court has repeatedly stated that the constitutional guarantee of property protects taxpayers from confiscatory taxation. Our High Court has refrained from setting a rate at which taxation would be considered confiscatory, but specified that each case must be examined individually, taking into account – among other things – the tax rate, the total tax burden, the duration of the taxation, and the accumulation of various taxes.

Several cantons have introduced a ‘tax shield’ system to ensure that their taxation cannot be considered confiscatory. In essence, the tax shield has the effect of imposing a maximum percentage that must not be exceeded by the combined cantonal and communal income and wealth tax. We will examine the systems put in place by the cantons of Vaud, Geneva, Bern and Valais. We will illustrate each system with the following simplified example: a taxpayer with a taxable wealth of CHF 100,000,000, net income from assets of CHF 700,000 and other net income of CHF 200,000. The tax shield system has no impact on direct federal taxes, so we will not take it into account in the following calculations.

nton of Vaud

According to article 8 p ragraph 3 of the V ud law on communal taxes (LICom-VD), the cantonal and communal tax on income and wealth cannot exceed 60% of the net taxable income. For the calculation, the net income deriving from assets may not be lower than 1%. This means that if the taxpayer has little income, the tax authorities will only accept a reduction in taxation to an amount corresponding to 0.6% of the taxpayer's wealth.

Cantonal and municipal tax rate on wealth 0.8%.
Cantonal and municipal income tax rate 30%.

Cantonal and communal (ICC) wealth tax (CHF 100,000,000*0.8%)	800,000
ICC income (CHF 900,000*30%)	270,000
Total ICC without tax shield	**1,070,000**
118% of net taxable income	

Calculation of the tax shield

Minimum income (= 1% of net assets) as this amount is higher than the net taxable income, it is taken into account	1'000'000
The maximum tax is 60% of this amount	600,000
Total ICC after application of the tax shield	**600,000**

i.e. a tax reduction of CHF 470,000

Canton of Geneva

Geneva has a similar system to the canton of Vaud. According to article 60 of the Geneva law on the taxation of individuals (LIPP-GE), cantonal and communal taxes on wealth and income may not exceed a total of 60% of net taxable income. For the calculation, the net return on assets is set at least at l% of the net assets.

Cantonal and municipal tax rate on wealth 1%.
Cantonal and municipal income tax rate 33.5%.

Cantonal and communal wealth tax (CHF 100,000,000*1%)	1,000,000
ICC income (CHF 900,000*33.5%)	301,500
Total ICC without tax shield	**1,301,500**
145% of net taxable income	

Calculation of the tax shield

Minimum income (= 1% of net assets) as this amount is higher than the net taxable income, it is taken into account	1,000,000
Insufficient return on assets (CHF 1,000,000-700,000)	300,000
Net taxable income (CHF 700,000+200,000)	900,000
Income taken into account for the calculation of the tax shield	1,200,000
The maximum tax is 60% of this amount	720,000
Total ICC after application of the tax shield	**720,000**

i.e. a tax reduction of CHF 581,500

Canton of Bern

The Bernese tax shield differs from the two systems described above in that it does not provide for a theoretical minimum return on assets in the calculation and only affects wealth tax. According to Article 66 of the Bernese Tax Act (LI-BE), the cantonal, communal and parish wealth tax th t is higher than 25% of the incoming deriving from the taxable assetsis reduced to this rate, but to maximum of 2.4‰ of the taxable wealth. In other words, if the wealth generates returns, these returns cannot be taxed at more than 25% and if the wealth does not generate returns, the capit l cannot be taxed at more than 2.4‰.

Cantonal and municipal tax rate on wealth 0.58%.
Cantonal and municipal income tax rate 29.9%.

Cantonal and communal wealth tax (CHF 100,000,000*0.58%)	580,000
ICC income (CHF 900,000*29.9%)	269,100
Total ICC without tax shield	**849,100**
94.3% of net taxable income	

Calculation of the tax shield

Maximum taxation of returns on assets (25% of CHF 700,000)	175,000
Minimum taxation of assets (2.4‰ of CHF 100,000,000)	240,000
The highest of these amounts is the maximum wealth tax	240,000
Total ICC after application of the tax shield (CHF 240,000+269,100)	**509,100**

i.e. a tax reduction of CHF 340,000

Canton of Val is

Valais has a system similar to th t of the canton of Bern. According to article 2 of the Valais cantonal ordinance concerning the determination of the confiscatory nature of wealth tax, taxpayers whose cantonal and communal taxes on wealth and on the net return on wealth exceed 20% of the net taxable income are entitled to a tax reduction. The reduction corresponds to the difference between the above-mentioned taxes and 50% of the net return on assets, with a minimum taxation corresponding to half of the tax on assets that must remain in all cases.

Since this system has no theoretical minimum return on assets, it allows the taxpayer's wealth tax to be reduced by half in the absence of income.

Cantonal and municipal tax rate on wealth 0.63%.
Cantonal and municipal income tax rate 25%.

Cantonal and communal wealth tax (CHF 100,000,000*0.63%)	630,000
ICC income (CHF 900,000*25%)	225,000
Total ICC without tax shield	**855,000**
95% of net taxable income	

Calculation of the tax shield

Income tax on the return on assets (CHF 700,000*25%)	175,000
Wealth tax	630,000
	805,000
./. 50% of the return on assets (CHF 700,000/2)	350,000
Tax reduction (1st calculation)	455'000
Maximum reduction (50% of wealth tax)	315,000
Total ICC after application of the tax shield (CHF 855,000-315,000)	**540,000**

i.e. a tax reduction of CHF 315,000

In light of the simplified examples above, we see that the tax shields system's impact in Geneva and Vaud is in some cases limited by the fact that they provide for a theoretical minimum return on assets to be taken into consideration. The Bernese and Valais tax shield systems allow for a significant reduction in wealth tax when the taxpayer has little to no income. The systems of the latter two cantons are therefore more favourable to tax planning that enables the tax shield to be particularly effective. ■