Switzerland offers a number of attractions to clients seeking a new home. Christian H Kälin outlines the potential tax benefits of Switzerland, how clients can obtain these benefits and the pitfalls and restrictions.
remains unaffected by these changes, it is possible for all EU citizens who can show sufficient financial means to become resident and benefit from lump-sum taxation in all cantons throughout Switzerland.

Under the lump-sum taxation regime, the Swiss tax authorities generally require the assessment of a minimum taxable income of at least five times the annual rental payments for the apartment or house in which the foreigner will reside in Switzerland. In all cantons, certain minima apply and in some cantons these minima are higher for non-EU citizens than for EU citizens (even though there is no legal basis for such a distinction). In case of owned property, the annual rental value is taken as the basis for this calculation. If taxed on this basis, clients are not asked to declare their worldwide income or assets, which offers wealthy individuals and families considerable privacy for their financial affairs. The amount of tax effectively payable, however, must exceed the income tax that would be due on certain expenses in Switzerland. It must also exceed the tax that would be due on Swiss source income as well as income for which a partial or total reduction of foreign taxes is requested by virtue of an international tax treaty.

The modified lump-sum tax
In several tax treaties concluded by Switzerland, including those with Belgium, France and Germany, it has been agreed to limit treaty benefits to foreign source income that is taxed in Switzerland at the regular tax rates. Because these treaty clauses would normally exclude people who are taxed under a lump-sum arrangement, a modified lump-sum taxation has been introduced. Under this, the income derived from the respective treaty country will be included in the broader tax base as assessed annually. For the tax authorities to determine the correct tax rates at which the foreign source income should be taxed, the total worldwide income would have to be taken into account. If the worldwide income is not declared, however, the highest tax rates apply on the respective foreign-source income for which treaty relief is sought.

Limited or no gift and inheritance taxes
Besides offering unique lump-sum taxation that effectively caps the income and net wealth tax for qualifying foreign citizens, Switzerland has no federal inheritance or gift taxes. Instead, the cantons levy inheritance and gift taxes in their own competence, which means there are 25 different inheritance and gift tax regimes, while the Canton of Schwyz dispenses entirely with inheritance or gift taxes. Many cantons do not levy inheritance taxes between spouses or between parents and children, or levy only a very...
modest tax of below 10 percent for descendants. According to the cantonal inheritance and gift tax laws, the relevant cantons are competent to levy these taxes on property situated in the canton and on the worldwide estate of deceased people or donors who had their last domicile in that canton. Heirs and recipients of gifts are not taxed in Switzerland.

Where inheritance and gift taxes apply, there is usually a progressive scale depending on the relationship and size of the donated property or estate. The highest tax rates apply to gifts and inheritances between those who are not related to each other and in such cases tax rates may reach up to about 50 percent in certain cantons. It is therefore also important to pay attention to the applicable cantonal gift and estate taxes when choosing the place of residence in Switzerland.

Depending on the circumstances, it may be necessary to take international tax issues into consideration. For example, while in many cantons there will be no tax liability for spouses and close relatives, it may nevertheless be desirable in some cases to pay a very small percentage of gift or inheritance taxes to prevent the home country of the deceased, donor, heirs or recipients from assuming jurisdiction to tax the estate or gift.

Moreover, some Swiss inheritance and gift tax treaties provide for some important exceptions to the general rule that Switzerland is competent to levy inheritance and gift taxes on the worldwide estate of deceased persons or donors who had their last domicile in Switzerland.

For instance, the treaty with Germany generally grants that country a competing, unrestricted right of taxation if the deceased, having lived at least five out of the last 10 years in Germany before giving up his or her German residence, had moved to Switzerland during the last five years prior to his or her death. Foreign domestic tax rules need to be taken into consideration as well. In Germany, for instance, heirs or recipients who are resident there are subject to German inheritance taxes regardless of the last domicile of the deceased.

Irrespective of such special issues, however, the absence of inheritance and gift taxes, or the very low tax rates, naturally provide interesting possibilities for succession planning. Swiss international private law also allows foreign individuals who live in Switzerland to choose whether to apply the inheritance law of Switzerland or of their country of origin, a situation that offers further flexibility for estate planning.

Trusts in Switzerland and the use of pre-immigration trusts

Being a civil law country, trusts are essentially unknown in Swiss law, which provides for fiduciary agreements and foundations but not for trust arrangements. As a result, considerable legal uncertainty surrounds foreign trusts with some connection to Switzerland, for instance in the form of a Swiss trustee, trust assets located in Switzerland, Swiss resident beneficiaries or settlors. This uncertainty exists over both the taxation and legal recognition of trust agreements, although the latter will significantly improve now Switzerland has ratified the Hague Convention on the Law Applicable to Trusts and their Recognition.

Because Switzerland is one of the most important private banking centres in the world, trusts are however well known to Swiss bankers, fiduciaries and lawyers who service international private clients and they have been in use in Switzerland for quite a long time. Even the Swiss tax authorities have become somewhat familiar with trusts and several cantons have established...
principles for the tax rules to be applied to trusts linked to Switzerland.

As an increasing number of wealthy foreign citizens are moving their residence to Switzerland, particular questions have arisen with regard to the treatment of trusts that they had established prior to moving to the country or trusts established while they are resident in Switzerland.

Essentially, two issues need to be considered. The first relates to the legal recognition of trusts. Switzerland has ratified the Hague Convention that deals with the recognition of trusts, even though this does not fully address all legal uncertainties existing for trusts with a Swiss connection. In the meantime, lawyers and courts - as well as those involved in trusts - have to live with the fact that it will take some time until the Swiss courts and litigators get used to the new era.

The second issue relates to the tax treatment of trusts. The tax authorities in a number of cantons, such as Zurich and Vaud, have developed principles on how they tax trusts and those involved in trust arrangements, such as beneficiaries, settlors and trustees. These principles are not consistent, however, and considerable differences exist throughout Switzerland over the tax treatment of trusts. The Federal Tax Administration is working on a Circular that will answer some of the tax questions but may create further headaches for practitioners depending on the final position taken by the tax authorities.

Great care must therefore be taken in drafting the trust deed before a trust with a Swiss connection is established or before a foreign national moves to Switzerland if he or she is in some way connected to a trust, for example as a settlor or beneficiary. In most cases, it is also essential to discuss and obtain a tax ruling from the local tax authorities where the client intends to reside.

### Acquisition of Swiss property

Swiss property has been in high demand by foreign investors for a long time. As a result, Switzerland has restricted the right of such acquisitions for decades. This has even led to a widespread belief that non-Swiss citizens are not permitted to purchase Swiss property. The reality, however, is quite different.

It is correct that, in principle, all non-resident foreign citizens who wish to acquire Swiss residential property must obtain prior approval. Such approval is difficult to obtain. A foreign individual may be authorised to purchase a holiday home in a place designated by the respective cantonal authorities as a holiday resort. But every authorisation must be deducted from the annual quota assigned to the cantons by the federal government for holiday homes and hotel condominium units. The cantons and communes may also apply their own restrictions, which may be even more stringent.

Holiday homes and hotel condominium units may only be acquired by individuals under their own name, and under no circumstances by a company. These restrictions also mean that tax and estate planning options for Swiss holiday homes owned by foreign individuals are limited.

Foreign citizens who hold a Swiss residence permit, however, can now acquire property easily. In fact, since 1997, foreign citizens holding a Swiss residence permit may purchase a reasonably sized house or apartment for their personal use with no further need to seek prior approval. Even if they subsequently leave the country, they are not forced to sell again and can therefore keep their property.

As financially independent EU citizens will easily be able to obtain a Swiss residence permit, they also gain the right to acquire Swiss residential property. If they are resident in Switzerland, they can acquire as much property of any kind as they like in the same way as Swiss citizens can.

While these provisions concern only residential property, the acquisition of commercial property by foreign individuals (including entities) is no longer restricted. As a result, there is ample scope for tax planning by investors wishing to invest in Swiss commercial property.

### Tax rulings are essential with regard to trusts

Swiss law fails to stipulate clear taxation rules for trusts. They are consequently subject to general taxation rules that can lead to inappropriate results and, as these rules differ between cantons, a wide range of scenarios exist for the taxation of trusts. The creation of a trust may lead to gift and estate taxes, which may in certain situations even be levied again later on in distribution. Wealth and income taxes could be levied from the beneficiaries, trustees or settlors, depending on the trust deed and the opinion of the responsible tax authorities.

While these uncertainties over the taxation of trusts make it difficult to gain an overview, Switzerland fortunately allows tax scenarios to be submitted to the authorities to obtain tax rulings. Individuals and families who live outside Switzerland but who intend to establish their residence in Switzerland have a further advantage; the cantonal authorities are usually quite flexible and willing to grant a favourable tax ruling because they are interested in attracting wealthy foreign residents – and new tax payers.