

# EDITORIAL

'In this world nothing can be said to be certain, except death and taxes,' wrote Benjamin Franklin. This would seem to suggest that taxation might be a topic worthy of regular published commentary! The lump-sum tax (the tax on living expenses), which applies to some 5,000 foreigners residing in Switzerland without engaging in any money-making activities in our country, is calculated based on the taxpayer's annual expenditures. While the number of individuals benefitting from lump-sum taxation is on the decline, the tax revenues, approaching a thousand million francs, are on the increase for the Confederation, the cantons and the municipalities involved. In 2014, by a wide majority, the people and the cantons reaffirmed their desire to maintain lump-sum taxation, a time-honoured pragmatic institution. Following modifications to the law, which went into effect in 2016, the lump-sum tax eligibility requirements and calculation basis were made stricter for new taxpayers, making it less appealing than it was previously. Meanwhile, those who began benefitting from the system prior to January 1, 2016 will avail of a 5-year transitional period, i.e. until 2021, before the new conditions will apply to them. In 2018, the Federal Tax Administration published a bulletin with useful information on the application of the new system, clarifying the new eligibility requirements and new calculation basis, specifically with regard to the tax base, the increase in the rent multiplier or rental values from five to seven times, and the fact that wealth will now be taken into consideration in the calculations. These are the topics that will be addressed in this publication.



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## LUMP-SUM TAXATION, A 150-YEAR-OLD INNOVATION

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### INTRODUCTION

Several years ago, Italy and Portugal, symbols of unabashed tax competition, introduced new tax systems with the specific goal of attracting wealthy taxpayers, while France and Germany openly declared their desire to reinforce their tax appeal to benefit from Brexit. In this environment, lump-sum taxation, an old institution, unchanging in appearance, has served as a precursor. In 1862, the canton of Vaud became the first to implement an alternative tax scheme that would apply to certain foreign taxpayers. Even at that time, there existed a political objective to reinforce the appeal of the canton in the eyes of taxpayers whose resources could have a favourable impact on the local economy. In order to accomplish this, the canton of Vaud designed a system in which the taxpayers in question would not be taxed on their income but rather on their expenses. Thus lump-sum taxation was born. This idea was propagated throughout the country in 1935, undergoing various

modifications and clarifications over time in keeping with changes in the legislative climate. The new bulletin concerning the tax on living expenses, published on July 24, 2018 by the Federal Tax Administration, constitutes the most recent of these clarifications. It is the result of the modifications to the legal provisions governing lump-sum taxation that were approved by voters in 2014 and that went into effect in 2016.

### LEGAL FRAMEWORK AND EXPLANATIONS

The tax that is calculated in the lump-sum taxation system employs the same schedules as standard taxes. However, the formulae are not applied to income but rather to the taxpayer's annual living expenses. These annual expenses must correspond, at a minimum, to the highest of the following: the rent multiplier, the rental value or the price of the pension allocated to food and shelter; revenue originating from Swiss sources; or a fixed

amount (CHF 400,000 in federal taxes, plus the currently effective cantonal tax, which varies from one canton to another).

A wealth tax component is added on top of this amount. Each canton is free to define the manner in which it wishes to proceed in this respect, for example, by increasing the amount of the expense or by calculating a wealth tax on a multiple of the expense.

Furthermore, certain elements of wealth or income may have an impact on the taxpayer's annual tax burden. This is particularly true in the case of revenue originating from Swiss sources or when the taxpayer has requested that a double taxation agreement be applied.

## IN 1862, THE CANTON OF VAUD BECAME THE FIRST TO IMPLEMENT LUMP-SUM TAXATION.

The lump-sum tax is exclusively reserved for foreign nationals who do not engage in any money-making activities in Switzerland. Furthermore, those who benefit from lump-sum taxation must be taking up residence in our country for the first time or, in the case of those who have already resided in the country, must be returning after an absence of at least ten years.

The cantons maintain a very narrow margin of wiggle room in the application of these rules. With the exception of the minimum fixed amount of expenses and the way in which the wealth tax is levied, the federal and cantonal regulations are identical. However, the interpretation of these rules may vary from one canton to the next. Therefore, the July 24, 2018 Federal Tax Administration bulletin is not binding to the

cantonal administrations. Nevertheless, in practice, it serves as a reference, and the elements it deals with will be followed a priori by the cantonal administrations.

### NEW ELEMENTS AND CLARIFICATIONS

The bulletin provides supplemental clarifications on the modifications regarding the eligibility requirements and calculation basis of the lump-sum tax.

In terms of the conditions for eligibility, the most significant difference has to do with the criterion of Swiss nationality. Until now, some cantons have allowed couples to benefit from lump-sum taxation even if one spouse is Swiss, as long as the couple fulfils all of the other requirements. Other cantons developed a separate filing protocol in which the foreign spouse is subject to lump-sum taxation, while the Swiss spouse is subject to standard taxation. The first of these practices is considered to be incompatible with the new law. Therefore, Swiss taxpayers married to foreigners may no longer benefit from the tax on living expenses, even if the other conditions have been met. On the other hand, the question as to whether or not the second of these practices can still be applicable will, no doubt, lead to controversy. The bulletin excludes it, as the legal text appears to leave some margin for interpretation in favour of applying the lump-sum tax separately to the foreign spouse. Finally, the bulletin explicitly clarifies that lump-sum taxpayers may leave Switzerland and later resume their residency without being subject to the ten-year hiatus established for

taxpayers who have engaged in some kind of money-making activity in the country.

With regard to the calculation basis of the tax on expenses, it is somewhat amplified by the bulletin. The concept of expense now includes amounts paid on behalf of the taxpayer's spouse and dependent children, even when the latter of these reside abroad. The fees and contributions paid into the social security system are also included. Finally, non-recurring fees, such as large donations, are not generally taken into account. However, even here, the concepts of 'non-recurring fees' and 'large donations' remain imprecise.

### CONCLUSION

Often considered to be a tightening of the regulations governing the tax on expenses, the new rules reflect the adaptation of lump-sum taxation to the current legislative climate. An adaptation to the challenges that vary with the times, which may be one of the reasons behind the lasting success of this institution. It is in this context that the new bulletin from the Federal Tax Administration provides useful details and clarifications, both on the new conditions for eligibility and on the scope of the calculation basis. If these details and clarifications are sometimes debatable, taxpayers will keep in mind the possibility of calling them into question and thereby reinforcing their legitimacy.

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