EDITORIAL

Experience is generally a valuable asset when it comes to structuring your real estate investments; one must be careful not to fall into the trap of preconceived ideas that may no longer be relevant.

For decades, it was taken for granted—within informed professional circles—that it was better 'not to touch real estate companies (REC)', a source of complications and quasi-prohibitive tax burdens which were only bound to increase further.

Curiously, almost the exact opposite has been true in recent years: the tax levied on public limited companies (is it necessary to remind ourselves that a REC is nothing more than a Plc...?) has been significantly reduced, and it is no longer quite so clear whether it's preferable, for example, to own and operate a rental property in one's own name or via an REC. Especially since a REC offers advantages of its own: discretion, easily transferable, no personal liability. It should be added that the lower corporate income tax rate introduced within the framework of the January 2020 tax reforms significantly tips the results of our comparison in favour of RECs.

So: real estate held in one's own name or under an REC? The fact the answer to this question is no longer clear makes it all the more interesting, and has prompted us to devote this newsletter to the matter, by way of an update.

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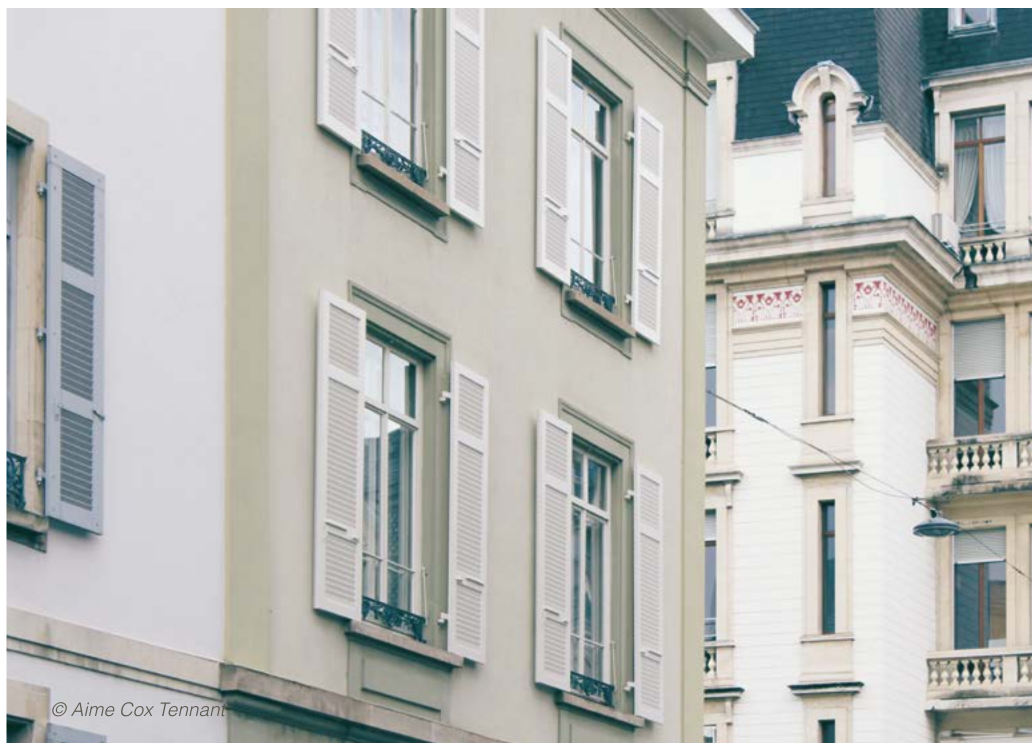
TAXATION ON REAL ESTATE INVESTMENTS*

The tax burden associated with the ownership of investment property, as opposed to property inhabited by the investor, varies according to the legal status chosen for said real estate investment. The aim of this study is to identify the differences between the two main ways of owning property—namely, holding property in one's own name, or under a real estate company—by assessing the tax advantages of each type over the other. The investor profile contemplated by the following considerations is that of an amateur investor located in Geneva or within the canton of Vaud, whose residential investment property is located within the canton of residency.

It should be noted that the following points approach the matter from a broad perspective and, in specific cases, other factors may influence the tax treatment of the given type of property ownership, in particular the amount of investments, the professional and financial context of the investor, etc. As a reminder, any legal person whose main activity is the construction, running, buying or selling of real estate is considered to be a real estate company.

In practice, this usually means public limited companies that are characterised by their activity, which consists exclusively or mainly of obtaining an economic profit from the increase in value of the real estate they own, or from its use as capital investment. The manner in which this profit is made, whether from the use, disposal, rental or leasing of the building, or even the construction of buildings, is irrelevant in this respect. As opposed to commercial properties, an investment property is understood to be one that is not used to conduct part of the company's business or industrial activity and thus, specifically, is a rental property which generates rental income.



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1. DIFFERENTIATED TAXATION DEPENDING ON HOW THE INVESTMENT PROPERTY IS HELD

1.1 At the time of purchase

1.1.1 Purchase under one's own name

Any natural person purchasing a property located in the canton of Geneva must pay registration fees, amounting to 3% of the property purchase price, without the possibility of deducting mortgage debts. Added to these registration fees are Land Registry fees (0.25%) as well as those of the notary.

Within the Canton of Vaud, these fees—known as transfer fees—amount to a maximum of 3.3% of the purchase price; the tax may vary depending on the town where the property is located. The notary fees are additional to this.

1.1.2 Real estate company

First off, it is important to distinguish between tax related to the creation of a real estate company (i), and the tax burden related to the acquisition of shares in an already existing real estate company (ii).

(i) Creating a real estate company

An investor who purchases a property and holds it under a real estate company does not directly acquire the property; rather, they become the owner of shares in the company which is itself registered as the owner on the Land Registry.

When creating a real estate company set up as a public limited company, the minimum share capital required is CHF 100,000.–. The minimum capital to be paid initially is CHF 50,000.–. For tax reasons, a minimum capital of around 20% of the property's value is normally required. A federal tax is levied on the creation of participatory rights in the form of shares, called Stamp Duty. Stamp Duty is only due where the payments of shareholders exceed the sum of CHF 1,000,000.–, and amounts to 1% of the sum paid by the subscribers of the shares, but no less than the par value of the shares. Added to this are the registration or transfer fees levied in the same way as on a property purchased in one's own name [see above, figure 1.1.1], which the company must pay, as well as the notary fees and those stemming from the company's incorporation. In other words, creating a company to purchase a property has no fundamentally different consequences to purchasing it in one's own name.

(ii) Acquisition of shares in a real estate company

On the other hand, if the property is held by a real estate company whose shares are transferred, from the point of view of the purchaser, this transfer of shares in public limited real estate companies is not subject to registration or transfer fees, unless the share purchase agreement is notarised, which in practice is rare. Insofar as there has been no change of owner on the Land Registry, there are also no fees levied in favour of the Land Registry.

1.2 When holding property

1.2.1 In your own name

Schematically, from the perspective of holding an investment property, said property being assumed to be rented out, the tax base is calculated on the rents collected, minus maintenance charges and expenses.

This real estate income is added to any other taxable income accruing to the owner and is taxable at the rates applied to the full sum of income (a maximum of around 45% in Geneva and 41.5% within Vaud canton).

On top of income tax, the owner is required to pay wealth tax, equivalent to a maximum of around 1% of the tax value of the property within the canton of Geneva. In Vaud canton, this rate also depends on the municipality; however the rate imposed by the canton and municipality must not exceed 1% of net worth. For rental properties, this is in practice an amount equivalent to rental equity[1].

COMPARISON BETWEEN GENEVA AND VAUD [as per 1.2.2 (ii)]

Taxation of dividends

	Geneva		Vaud	
Company Pre-tax profit Corporate income tax Remaining profit (fully distributed)	CHF 200,000.– CHF 27,980.– CHF 172,020.–		CHF 200,000.– CHF 27,580.– CHF 172,420.–	
Shareholder (holding more than 10% of the company's share capital)	**CHF**	**Rate**	**CHF**	**Rate**
Taxable income	120,414.–	70%	120,694.–	70%
Income tax	**54,186.–**	45%	**50,088.–**	41.5%
Disposable income	117,834.–		122,332.–	
Annual overall tax burden	**41.08%**		**38.83%**	

It should be noted that the tax laws in Geneva and Vaud have introduced what is known as a 'tax shield', applicable from 1 January 2009 in the Canton of Vaud and from 1 January 2011 in the Canton of Geneva. According to these provisions, cantonal and municipal taxes on income and wealth may not exceed a total of 60% of a taxpayer's global net taxable income. For this calculation, the net return on assets is set at a minimum of 1% of net wealth[2]. In addition to these taxes is the Geneva Real Estate tax, amounting to 0.1% of the property's gross tax value, without allowance. Within the canton of Vaud, Real Estate tax is a municipal tax payable by the owner, the rate of which may depend on which municipality the property is located in. The rate must not in any case exceed 0.15% of the property's tax estimate.

The municipalities of Vaud may also levy a rental tax equivalent to a maximum of 3% of the rents collected on properties located within their territory. This tax is generally borne by the tenant.

1.2.2 Real estate company

(i) Taxation of real estate companies

The real estate company's net profit (roughly, rent minus commercially justified expenses) is initially taxed at the level of the legal person, at a rate—before the tax reform—of a maximum of 24% within Geneva, and a maximum of 22% in the canton of Vaud (inclusive of federal, cantonal and municipal taxes). In 2020, this rate fell to 13.99% in Geneva. It decreased to 13.79% in the Canton of Vaud in 2019.

Furthermore, certain tax rules must be followed with regard to the level of a company's equity capital and the deductibility of interest on any shareholder loans. Moreover, the property may be subject to tax-eligible depreciation expenses. This is the taxation of the company's own capital equity, which is taxable at the cantonal and municipal level at a rate of around 0.45% in the canton of Geneva and 0.3% in the canton of Vaud. Both cantons have had a mechanism to reduce tax on equity capital in accordance with the tax due on profits since the tax reform came into force.

Added to these taxes is the additional Geneva Real Estate tax, amounting to 0.2% of the gross property value, if they belong to companies dedicated exclusively to real estate. Within the canton of Vaud, legal entities are subject to a top-up tax of 0.15% on the tax value of the properties they own.

(ii) Shareholder taxation

When profits are distributed to shareholders in the form of dividends, said payments are subject to withholding tax at a rate of 35%. This tax is refundable when the shareholder is domiciled in Switzerland and the dividend is declared.

In contrast, dividends are taxed at the level of the income tax applied to the shareholder. Nevertheless, only 70% of any dividends are taken into account in the tax base if the shareholder holds at least 10% of the real estate company's share capital. This rate of tax relief applies to both federal taxes and the Geneva cantonal taxes. On the Vaud side, this mitigation is lower, with dividends being taxable up to 70%. Within the framework of the tax reform, this rate was increased to 70% within the canton of Geneva for direct federal tax in 2020, while it remains at 70% within the canton of Vaud.

In the case of wealth tax, the share value shall be subject to annual taxation at a maximum rate of around 1%, subject to any effects of the tax shield mentioned above [see above, figure 1.2.1].

See table 'Comparison between Geneva and Vaud [as per 1.2.2 (ii)]'.

1.3 Upon disposal

1.3.1 In one's own name

(i) Sale of property

The sale of a privately owned property incurs no income tax as long as no activities of the vendor within the sphere of real estate allow for their reclassification as a real estate professional. Courts and tax authorities have developed a number of indices for the purpose of determining cases where the management of assets by their owner goes beyond mere private management. Amongst these criteria, which are not cumulative, is a high frequency of transactions, leveraging of specialist knowledge within the real estate field, a systematic and organised manner of operating, a short ownership term, use of foreign funds, etc. Meanwhile, the disposal of a property against payment incurs the collection of a special cantonal tax on real estate profits and capital gains, levied on the realised gains. Taxable profit is determined on the difference between the property's disposal value and acquisition value. In Geneva, this tax rate is calculated on a sliding scale, taking into account the length of ownership of the property. For holding periods of less than ten years, the tax rate is 50%, and this decreases in line with the number of years of ownership until reaching 0% in the case of being held for over twenty-five years.

Within the canton of Vaud, the tax rate is likewise set on a sliding scale, ranging from 30% for a period of ownership of less than one year and decreasing to 7% after twenty-four years of holding. Where the owner has personally occupied the property for a certain period of time, these years of occupation count for double when calculating the tax rate. Where the property sold is an investment property, the partial or total refund of tax upon purchasing a new replacement property (reinvestment) shall not be applicable.

(ii) Transfer of the property by inheritance or gifts

In the case of transferring a property by inheritance or gifts, the special taxation on capital gains is deferred both in Geneva and Vaud, in the sense that the tax is not collected at the time of transferring the property, i.e. upon the death of the owner or its gifting, but rather at the time of the next taxable transfer, when the inheritor(s) or gift recipient(s) dispose of the property.

However, in the event of death or donation, the special inheritance taxes or taxes on donations are withheld in an amount determined by the sum that is transferred and the relationship between the deceased and his or her heirs or between the donor and the recipient. In the canton of Geneva, if the deceased or the donor was not taxed in accordance with the lump-sum system during any of the three previous tax assessments, the refunds to the spouse or direct descendants are exempted from these taxes. In the canton of Vaud, the exemption is complete for the surviving spouse, but not for the children. However, the tax rate in the latter case is minimal.

[1] *Article 50 (a) LIPP / GE and 2 paragraphs 1 and 3 of the Real Estate Tax Assessment Act (LEFI/VD).*
[2] *Articles 60 LIPP / GE and 8 paragraph 3 of the Law on Municipal Taxes (LICom / VD).*

COMPARISON BETWEEN GENEVA AND VAUD [according to 1.3.3]

Tax comparison at divestment

	Property located within the canton of Geneva				Property located within the canton of Vaud			
	Sale by the REC (distribution of ordinary or liquidation dividends)	**Sale in one's own name or sale of the REC shares** (capital gains from private wealth)			**Sale by the REC** (distribution of ordinary or liquidation dividends)	**Sale in one's own name or sale of the REC shares** (capital gains from private wealth)		
Company Pre-tax profit Income tax Remaining profit (fully distributed)	CHF 200,000.– CHF 27,980.– CHF 172,020.–				CHF 200,000.– CHF 27,580.– CHF 172,420.–			
Investor Capital gains Taxable gains (100%)		CHF 200,000.– CHF 200,000.–				CHF 200,000.– CHF 200,000.–		
Shareholder (holding more than 10% of the company's share capital)		**Real estate income and capital gains tax** (depending on length of holding)			**Shareholder** (holding more than 10% of the company's share capital)	**Real estate income and capital gains tax** (depending on length of holding)		
Taxable income (70%)	CHF 120,414.–	< 2 years	CHF 100,000.–	50%	CHF 120,694.–	< 2 years	from CHF 54,000.– to CHF 60,000.–	27 to 30%
		From 2 to 3 yrs	CHF 80,000.–	40%		From 2 to 3 yrs	from CHF 44,000.– to CHF 48,000.–	22 to 24%
Income tax (Maximum rate: 45%)	**CHF 54,186.–**	From 4 to 5 yrs	CHF 60,000.–	30%	**CHF 50,088.–**	From 4 to 5 yrs	from CHF 36,000.– to CHF 40,000.–	18 to 20%
		From 6 to 7 yrs	CHF 40,000.–	20%		From 6 to 7 yrs	from CHF 32,000.– to CHF 34,000.–	16 to 17%
Disposable income	CHF 117,834.–	From 8 to 9 yrs	CHF 30,000.–	15%	CHF 122,332.–	From 8 to 9 yrs	CHF 30,000.–	15%
		From 10 to 24 yrs	CHF 20,000.–	10%		From 10 to 24 yrs	from CHF 14,000.– to CHF 28,000.–	7 to 14%
Maximum overall tax burden (regardless of length of holding)	Rate 41.08%	> 25 years	CHF 0.–	0%	Rate 38.83%	> 25 years	CHF 14,000.–	7%

1.3.2 Real estate company

(i) Sale of real estate company shares

Disposal by a shareholder of the shares in a real estate company likewise incurs, only on a cantonal level, the collection of a special tax on real estate profits and capital gains. The capital gains subject to this tax equal the difference between the disposal value of the shares and their acquisition value. The tax rate is the same as that applicable to natural persons who own the property in their own name [see above, fig.1.3.1 (i)].

(ii) Transferring shares in a real estate company by inheritance or gifting

In the case of gifting or inheritance, the same rules as those described above are applicable to any shareholder who inherits or is gifted shares in a real estate company [see above, figure 1.3.1 (ii)].

(iii) Sale of property by the real estate company

If the property is sold by the real estate company itself, any real estate profits and capital gains shall be subject not only to capital gains tax but also to income tax, at the ordinary rate (13.99% in Geneva or 13.79% in the canton of Vaud).
Normally, taxable profit is determined by the difference between the sales price and the book value of the property shown on the income statement. It should be noted that in Geneva, capital gains tax on properties as described above is levied as a security to ensure payment of the income tax. When the capital gains from the sale of the property by the real estate company are distributed by way of dividends to shareholders who hold the shares in their private assets, only 70% of the payments are taxable at a federal level and within the canton of Geneva in 2020, and likewise at 70% in Vaud.

(iv) Liquidating the real estate company

The tax treatment of liquidation proceeds follows the same principles as those that apply to the distribution of dividends resulting from the sale of property [see above, figure 1.3.2 (iii)].
In determining taxable liquidation proceeds, the difference between the property's market value and its carrying value is, however, taxable; this is known as the realisation of inner reserves.
Any liquidation surplus paid to the shareholder is subject to income tax (respectively to the withholding tax at a rate of 35%. This latter tax is refunded where the shareholder is a Swiss resident and declares this income).

1.3.3 Tax comparison

See tables 'Comparison between Geneva and Vaud [as per 1.3.3]'.

2. REASSESSING GENEVA REAL ESTATE

To determine a property's tax value—a determining factor for wealth tax and top-up property tax—the tax authorities apply rent capitalisation. The canton of Geneva has set the capitalisation rates used to calculate the tax value of rental properties in the 2020 tax year (see table with 2019 comparison). Capitalisation rates for the 2020 tax year incur a decrease in the wealth tax and top-up property tax levied on property owners in the fourth and fifth categories; only the second category displays stagnation, whereas for the first and third categories, the 2019 capitalisation rates incur an increase.

3. CONCLUSIONS

In light of the above developments, a comparison of the tax burdens stemming from the two main types of property ownership would seem to be an essential step prior to acquisition of a property itself. The specific factors of each case must be understood and analysed for this purpose.

*Update of the publication written by Carl Heggli of Ducrest Heggli Avocats LLC in 2016

Capitalisation rate on rental properties in Geneva for the 2019 and 2020 tax years

Categories	2019	2020
a) Residential buildings	3.91%	4.05%
b) HBM, HLM, HCM, and HM[1] properties	5.35%	5.35%
c) Commercial and other rental properties located in zone 1	3.04%	3.25%
d) Commercial and other rental properties located in zone 2	4.01%	3.86%
e) Commercial and other rental properties located in other zones	4.54%	4.50%

[1] *HBM, HLM, HCM, and HM = different forms of subsidised housing in Switzerland*

ABOUT

The Société Privée De Gérance (SPG) in Geneva and Rytz & Cie in the canton of Vaud form an integrated group, the SPG-Rytz group, operating in the main Lake Geneva region markets of Geneva, Nyon and Lausanne. Our mission is to create value for our clients by offering a full range of complementary and specialist real estate services: from investment and valuation research and advice, to management, brokerage and project management. The group boasts a Property Sales and Valuations department, specialising in the search for, valuation and sale of all types of property, commercial premises and land; it also consults on optimising property portfolios and offers a comprehensive, high added-value service.

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