PRO RENOVA

Newsletter 02

EDITORIAL

In addition to acknowledging the welcome suppression of the fiscal case law known as "Dumont", this newsletter is also a chance to take an overall look at the tax treatment applicable to work on property resulting in a capital gain, maintenance work, and the way in which they are distinguished. I often have occasion to lament an increase in the tax burden, or hindrances encountered to the work required to maintain and renovate properties, so I am extremely pleased about this rare act of simplification and encouragement.

Nevertheless, the field of tax remains a favoured area for the introduction of subtle and even confused distinctions, and this is also a chance to recall that, for the moment, work to improve energy efficiency is treated, on the fiscal level, as maintenance work (fully deductible). However, the situation could change, hence the interest in taking an overall look at the situation, which will enable each owner to take measures, if necessary, and to undertake any work in full knowledge of the facts and according to a suitable time schedule ; what is currently valid may not necessarily be so in two years' time.

Thierry Barbier-Mueller
Chief Executive Officer of the SPG Group

Abolition of the Dumont practice

With the adoption of new federal regulations, the Parliament and the Federal Council have put an end to a controversial tax practice arising out of the 1973 decision of the Federal Supreme Court in the "Dumont case". The purpose of the change is to eliminate tax obstacles that discourage owners from carrying out renovation work on new acquisitions. This recent amendment of the law is intended to make the cost of renovating recently acquired properties totally tax deductible in so far as the work is confined to maintenance, even where this has been neglected by the previous owner. This new situation, which is particularly favourable for taxpayers, took effect on 1 January 2010 at federal level and also in certain cantons, including Geneva. It will be extended to the whole of Switzerland by 1 January 2012 at the latest.

The origin of the Dumont practice

The Dumont practice dates back to a celebrated case brought before the Federal Supreme Court in which the tax department refused to allow the taxpayer to deduct from income the costs incurred in renovating a dwelling house acquired the previous year. In its decision of 15 June 1973, the Supreme Court reversed its previous case-law and upheld the position of the tax department. The federal judges came to the conclusion that when a building whose maintenance has been neglected by its previous owner is renovated by the purchaser shortly after acquisition, the cost of such work must in principle be considered as expenses incurred for the improvement of the property (non-deductible) and not as maintenance costs (deductible).

In stating its grounds at the time, the Federal Supreme Court recalled that only the maintenance costs of properties were deductible from income, these being defined as expenses incurred with a view to maintaining or restoring the value of the property, in contrast to expenses connected with its acquisition or improvement.

In a reversal of case-law, the Federal Supreme Court held that this definition could no longer be based solely on a technical aspect, but must take into consideration the economic dimension arising from the connection between the state of maintenance of the property and its intrinsic value. When a property enters into the possession of the taxpayer, it represents a certain value which depends in particular on its state of repair. Certain costs, technically described as maintenance expenses – for example, the overhaul of the roof or the facades – will have the economic effect of increasing the value of the property in relation to what it was at the time of purchase. Thus, the Supreme Court came to the conclusion that the cost of the work undertaken immediately after acquisition could not in general be deducted in as much as it contributes an increased value.

In support of its new economic assessment of maintenance costs, the Federal Supreme Court had held that this rule was consistent with the principle of equality of treatment, because any solution to the contrary would amount to unequal treatment between a purchaser who bought a house in poor condition and renovated it, and a purchaser who bought it only after it had been renovated by the previous owner. Though both buyers spent the same amount of money to become the owners of an asset of the same value after renovation, only the former could deduct the costs of the renovation undertaken.

The development of the case-law and its interpretation by the tax authorities led to the so-called Dumont practice, the general principle of which consists in refusing the deduction of the costs of renovation undertaken during the five years following the acquisition of a property whose maintenance has been neglected. The practice has been applied in ways which differed considerably from one canton to an-other, for example with regard to

the definition of a "neglected" property. Whereas certain cantons took as their reference point the age of the property, generally between 15 and 30 years, others favoured the assessment of any disproportion between the cost of the work and the acquisition price (between 5% and 25%). Others, such as Basel-Landschaft, Schaffhausen and Thurgovia, simply waived the application of the practice.

Abrogation of the Dumont practice

Over the years, many people called for the abrogation of the Dumont practice, not only because of the disparities in its implementation at cantonal level but also because of the resulting inequality of treatment between old and new owners. These reactions finally led to a parliamentary initiative being introduced in 2004 by national councillor Philipp Müller, proposing a limitation of the Dumont practice by recommending reducing the five-year period to two years and an objective definition of the term "neglected property" (i.e. when the cost of renovation work exceeds 20% of the purchase price during the first two years).

The parliamentary debates concluded that the practice should be purely and simply abrogated, at least at federal level. It was acknowledged that abrogation was justified, in the first place, as a measure to promote accession to ownership, as well as a contribution towards well maintained buildings in general and administrative simplification. With regard to the question of equality of treatment, the parliament judged that it was necessary to take into consideration the financial risk assumed by the purchaser of a badly maintained property, the scale of renovation work often being unknown at the time of acquisition.

In any event, parliament took the view that the constitutional principle tending to favour accession to ownership should take precedence over the equality between new owners of properties not maintained to the same standard. Thus, the draft law provided initially for an abrogation of the Dumont practice at federal level and left it up to the cantons to choose between upholding or abrogating it.

However, harmonisation of the direct taxes of the cantons and the Confederation and the concern to simplify inter-cantonal tax law led the Federal Council to abolish this practice at both federal and cantonal levels.

Practical consequences

The first consequence of the abrogation of the Dumont practice will be that taxpayers who own private properties can now, at federal level, deduct all the renovation costs. This means that all costs incurred for this purpose will be deductible as maintenance costs, irrespective of whether or not the property was bought during the previous five years.

This amendment of the law entered into force on 1 January 2010 and became applicable immediately as regards direct federal tax. The cantons have a period of two years, i.e. until 1 January 2012, to amend their legislation to this effect. Certain cantons, including Geneva, have already begun to make the necessary modifications.

The new provisions of the law enshrine a technical rather than an economic approach to the description of renovation costs. Having said that, it is important to bear in mind that it is only the costs relating to the renovation of a property that are deductible, while any other costs involving an increase in value will continue to be treated as non-deductible investment costs. It is thus essential for any new owner to draw a clear distinction between purely renovation work on the one hand and work resulting in an increase in the value of the property on the other. Though the latter may not be deductible from income, it can still be taken into consideration, when the property is sold, within the framework of the tax on real-estate profit and gain.

The abrogation of the Dumont practice also means that expenses incurred for the purpose of saving energy and the protection of the environment are now 100% tax deductible. In order to encourage property owners to make investments in favour of the environment, such costs are in principle deductible in just the same way as maintenance costs, even if they result in an increase in the value of the property. Hitherto, while the Dumont practice was still in force, added-value costs of this kind incurred during the five years following acquisition were only 50% deductible. Now, however, energy saving and environmental protection costs are completely tax deductible from the date of the acquisition of the property concerned.

Nevertheless, it will be important to pay close attention to the parliamentary debates on the popular initiative entitled "Security of housing in retirement" and a counter-proposal concerning the taxation of private ownership of housing. These bills are aimed in particular at the removal of tax on rental value, which will probably result in a restriction on real-estate deductibles as well as the creation of more targeted incentives to invest in the fields of energy saving and protection of the environment. With regard to real-estate deductibles, the aim is to remove the possibility of maintenance costs and renovation costs being deducted for a newly acquired property. In principle, however, this would not concern rented properties held as private assets or properties forming part of business assets. As regards environmentally friendly measures, the idea would be to limit deductions to expenses which comply with specific energy and ecological requirements and no longer to subsidise windfall effects, i.e. granting a tax deduction for a measure that the taxpayer would have taken in any event.

To conclude, the abrogation of the Dumont practice should be given a warm welcome by recent and future purchasers of real estate, with regard to the deduction of both renovation costs and environmental expenses. However, this new situation may not last for very long, depending on the outcome of the bills currently being debated in the Federal Parliament. With this in mind, taxpayers will need to weigh up whether this is the right moment to proceed with renovation and work resulting in greater respect for the environment. ■

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