NEWSLETTER N° 23

Editorial

Note to the reader: this publication is an update of Newsletter N° 22, which was published about 2 years ago.

Experience is generally a precious asset when it comes to structuring one's real estate investments; but we still need to be wary of being held back by preconceived ideas which are no longer necessarily current.

For decades, it was taken for granted, in informed professional circles, that it was better "not to touch the real estate companies", a source of complications and almost prohibitive tax costs (which tax costs were set to increase again). Curiously, it is rather the opposite that has occurred in recent years: the taxation of public limited companies (is it necessary to mention that a real estate company is simply a public limited company? etc.) has been significantly reduced, and now it is no longer really obvious to conclude that it is necessarily preferable, for example, to own and operate a rental building "en nom" (as a private individual) rather than as a real estate company. Especially since the real estate company has its own advantages: discretion, ease of transfer and absence of personal liability. We should add that the future cut in the tax rate for corporate earnings, which has already been accepted in the canton of Vaud and which is under discussion in Geneva, will significantly improve the result of the comparison in favour of real estate companies.

So: real estate ownership as an individual or as a real estate company? The fact that the answer to this question is not really so obvious any longer makes it that much more interesting, and it is what led us to devote this newsletter (updated as of Spring 2016) to some of the tax aspects – principally – of this issue.

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CEO of the SPG Group

Taxation of real estate investments*

The tax impacts connected with ownership of investment real estate, as opposed to real estate occupied by the investor, differ depending on the legal form selected for the real estate investment. The objective of this study is to outline the differences between the two principal methods of owning real property, viz. ownership as an individual and ownership as a real estate company, by evaluating the tax advantages of one form rather than another.

The type of investor aimed at by the following considerations is a non-professional investor, domiciled in Geneva or the canton of Vaud, whose residential-type investment real estate is located in the canton of domicile.

It is appropriate to note that the considerations that follow approach the situation from a generalist viewpoint and that, in a specific case, other factors might influence the tax treatment of the type of real estate ownership, in particular the size of the investments, the professional and financial situation of the investor, etc.

As a reminder, a real estate company is deemed to be any corporate entity whose principal activity is the construction, operation, purchase or sale of real property.

In practice, most often it is public limited companies which are characterised by their activity, which consists exclusively or principally of deriving an economic profit from the increase in the value of the real estate they own, or from its use as a safe or profitable capital investment. The manner in which the profit in question is made, whether it is by using the real estate, transfer of ownership thereof, renting out or leasing the real estate or building on it, is not important in this regard.

As opposed to operating real estate, investment real estate is defined as that which is not used in the exercise of a part of the company's commercial or industrial activity, and therefore, in particular, of the let building generating rental income.

1. Differentiated taxation based on the method of holding the investment real estate

1.1 At the time of purchase

1.1.1 Purchase as an individual

Any natural person who purchases real estate located in the canton of Geneva must pay registration fees, totalling 3% of the purchase value of the real estate, with no possibility of deducting mortgage debts. The emoluments of the Land Register (0.25%) and the notarial professional fees and costs are added to these registration fees.

In the canton of Vaud, these fees, called transfer fees, amount to a maximum of 3.3% of the purchase value, with it being specified that the rate may vary based on the municipality where the real estate is located. The notarial professional fees and costs are also added.

1.1.2 Real estate company

As a preliminary matter, one has to draw a distinction between taxation related to the establishment of a real estate company (i), and the tax charge related to the purchase of shares of an existing real estate company (ii).

(i) Establishment of a real estate company

An investor who purchases real estate and has it held by a real estate company does not acquire the real estate directly, but becomes an owner of the shares of the company which is registered as the owner in the Land Register.

When a real estate company having the form of a public limited company is established, the minimum share capital totals CHF 100,000.00. The minimum capital to be paid up initially is CHF 50,000.00. A federal tax is due on the establishment of participation rights in the form of shares, called stamp duty. Stamp duty is due only if the payments by shareholders exceed the amount of CHF 1,000,000.00, and it totals 1% of the total amount paid by the subscribers of shares, but at least on the par value of the shares. ▸▸

To that are added the registration or transfer fees levied in the same manner as at the time of purchase of real estate as an individual [see above, section 1.1.1], which the company shall pay, and the notary's professional fees and emoluments upon establishment of the company.

In other words, the establishment of a company to purchase real estate does not have any consequence fundamentally different from when a purchase is made as an individual.

(ii) Purchase of shares in a real estate company

On the other hand, if the real estate is already held by a real estate company the shares of which are transferred, from the point of view of the purchaser, the transfer of shares of real estate joint stock companies is not subject to registration or transfer fees, unless the purchase is made by notarial deed, which is rare in practice. To the extent that there is no change of owner in the Land Register, no emoluments are payable to the Land Register either.

1.2 During holding

1.2.1 As an individual

Very schematically, from the perspective of holding investment real estate, since the real property is assumed to be rented out, the taxable base constitutes rents collected, minus the expenses and costs of maintaining the real estate.

This real estate income is added to the other taxable income of the owner and is taxable at the rates applicable to all of the owner's income (a maximum of approximately 45% in Geneva and 41.5% in the canton of Vaud).

In addition to income tax, the owner must pay wealth tax, corresponding to a maximum of about 1% of the tax value of the real property. In practice, for rental properties, it is an amount corresponding to the capitalised rents[1].

It must be specified that the tax laws of Geneva and Vaud introduced what is called a "tax shield", applicable since 1 January 2009 for the canton of Vaud and since 1 January 2011 for the canton of Geneva. According to the new provisions, the cantonal and municipal income and wealth taxes shall not exceed a total of 60% of the taxable total net income of the taxpayer. For this calculation, the net return on the wealth is set at least at 1% of the net wealth[2]. The Geneva supplementary real estate tax, totalling 0.1% of the gross tax value of the real estate, is added to these taxes, with no tax allowance.

In the canton of Vaud, the real estate tax is a municipal tax owed by the owner, the rate of which may vary depending on the municipality where the real estate in question is located. The rate may not in any case exceed 0.15% of the tax assessment of the real estate.

The municipalities of Vaud may, in addition, levy a tax on rents equal to 3% at the maximum of the rents related to real estate located on their territory. This tax is paid by the tenant.

1.2.2 Real estate company

(i) Taxation of the real estate company

The net profit (schematically rents minus commercially-justified expenses) of the real estate company is taxed first at the level of the legal entity at a rate of approximately 24% at the maximum in the canton of Geneva and 22% at the maximum[3] in the canton of Vaud (including federal, cantonal and municipal taxes).

With respect to taxation of the equity assets of the company, they are taxable at the cantonal and municipal levels at a rate of the order of 0.45% for the canton of Geneva and 0.3% for the canton of Vaud.

The Geneva supplementary real estate tax is added to these taxes, totalling 0.2% of the gross value of the real estate, if it is owned by companies that are exclusively real estate companies.

In the canton of Vaud, legal entities are subject to a supplementary annual tax of 0.15% on the tax value of the real estate they own.

(ii) Taxation of the shareholder

When the profit is distributed to the shareholder in the form of a dividend, the payment is subject to withholding tax at the rate of 35%. This tax is reimbursable when the shareholder is domiciled in Switzerland and declares the dividend.

On the other hand, dividends are taxed at the level of the income tax due by the shareholder. However, only 60% of the 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 allowance applies both at the federal tax level and at the level of the Geneva cantonal tax. In Vaud, the reduction is not as high, because the dividends are taxable at 70%.

With respect to wealth tax, the value of the shares will be subject to the maximum annual tax of 1%, subject to the effects of the tax shield mentioned above [see above, section 1.2.1].

See table below.

[1] Articles 50 subparagraph a LIPP/GE (Loi sur l'imposition des personnes physique/Genève) [Law on Taxation of Natural Persons/Geneva] and 2 paragraphs 1 and 3 of the Law on Real Estate Tax Assessment (LEFI/VD).
[2] Articles 60 LIPP/GE and 8 paragraph 3 of the Law on Municipal Taxes (LICom/VD).
[3] Rates with respect to the 2015 tax year.

COMPARISON BETWEEN GENEVA AND VAUD [according to 1.2.2 (ii)]

Taxation of dividends Geneva

Company Pre-tax profit Tax on profit Profit remaining (fully distributed)	CHF 200,000 CHF 48,000 CHF 152,000	
Shareholder (holding more than 10% of the share capital of the company)	CHF	Max. rate
Taxable income	(60%) 91,200	45%
Income tax	**41,040**	45%
Disposable income	110,960	
Total tax charge	44.52%	

Taxation of dividends Vaud

Company Pre-tax profit Tax on profit Profit remaining (fully distributed)	CHF 200,000 CHF 44,000 CHF 156,000	
Shareholder (holding more than 10% of the share capital of the company)	CHF	Max. rate
Taxable income	(70%)* 109,200	41.5%
Income tax	**45,318**	41.5%
Disposable income	110,682	
Total tax charge	44.66%	

**In the calculations made, there is no distinction made between the cantonal tax allowance (70%) and the federal tax allowance (60%)*

1.3 At the time of transfer of ownership

1.3.1 As an individual

(i) Sale of the real estate

The sale of real estate which is a part of the private wealth of an individual is not subject to income tax, provided that and as long as the activities of the transferor of ownership of the real estate do not allow the transferor to be re-qualified as a professional merchant. The courts and tax authorities have developed a number of indexes in order to determine the cases in which the management of the assets by the owner of the assets exceeds ordinary private management, which is not taxable. These criteria, which are not cumulative, include a high frequency of operations, benefiting from particular knowledge in the real estate field, a systematic and planned manner of proceeding, a short period of ownership, use of foreign funds, etc.

On the other hand, the sale of real estate against payment entails the collection of a special cantonal tax on real estate profits and gains, levied on the capital gain realised. The taxable profit is determined on the difference between the sale value and the purchase value.

The tax rate in Geneva is calculated based on a degressive scale taking into account the length of time for which the real estate has been owned. For a holding period of less than two years, the tax rate is 50%, and it decreases based on the number of years of ownership until it reaches 0% in the case of ownership for more than twenty-five years.

In the canton of Vaud, the tax rates are also set based on a degressive scale, ranging from 30% for a period of ownership of less than one year and decreasing to 7% from twenty-four years of holding or more. When the owner occupied the real estate personally for a certain time, these years of occupancy count double when determining the tax rate.

When the property sold is investment real estate, partial or total reimbursement of the tax when another replacement property is purchased (re-investment) is not permitted.

(ii) Transfer of the real estate by inheritance or donation

If the real estate is transferred by inheritance or donation, the special capital gains tax is deferred, both in Geneva and Vaud, in the sense that the tax is not collected when the property is transferred, in other words at the time of the owner's death or at the time of the donation, but at the time of the next taxable transfer, when the heir(s) or donee(s) sell(s) the real estate.

However, at the time of the death or donation, special taxes on inheritances and donations are levied, the rate of which depends on the amount transferred and on the kinship relationship between the deceased and his/her heirs and between the donor and the donee. In the canton of Geneva, if the deceased or donor was not subject to lump-sum taxation according to any of the last three taxation decisions, the transmissions to the spouse or direct-line descendants are exempted from these taxes. In the canton of Vaud, there is total exemption for the surviving spouse, but not for the children.

1.3.2 Real estate company

(i) Sale of shares of the real estate company

Sale by the shareholder of shares in a real estate company also entails collection, at the cantonal level only, of the tax on real estate profits and gains. The gain subject to taxation corresponds to the difference between the sale value of the shares and their purchase value. The tax rate is identical to the rate applicable to natural persons that own the real estate in their name [see above, section 1.3.1(i)].

(ii) Transfer of shares in the real estate company by inheritance or donation

In the event of gift or inheritance, the same rules as those described above are applicable to any shareholder who inherits or receives shares in a real estate company as a donation [see above, section 1.3.1 (ii)].

(iii) Sale of the real estate by the real estate company

If the real estate is sold by the real estate company itself, the gain realised will be subject, not to tax on real estate profits and capital gains, but to the tax on profits, at the ordinary rate (22 to 24%).

Normally, the taxable profit is determined by the difference between the selling price and the book value of the real estate in the balance sheet.

It is to be noted that in Geneva, the tax on real estate profits and capital gains as described above is levied as a guarantee to ensure payment of tax on profits.

When the gain made from the sale of the real estate by the company is distributed in the form of dividends to the shareholder that holds the shares as part of his private wealth, only 60% of the payments are taxable at federal level and in the canton of Geneva and 70% in the canton of Vaud.

(iv) Liquidation of the real estate company

Tax treatment of the profit from liquidation follows the same principles as those applicable to the

COMPARISON BETWEEN GENEVA AND VAUD [according to 1.3.3]

Tax comparison at the time of divestment
Real estate located in canton of Geneva

Sale by the real estate company (Distribution of ordinary dividends or from liquidation)		Sale as an individual or sale of shares in the real estate company (Capital gain of private wealth)		
Company Pre-tax profit Tax on profit Profit remaining (fully distributed)	**CHF** 200,000 48,000 152,000	**Investor** Real estate gain Taxable gain (100%)		**CHF** 200,000 200,000
Shareholder (holding more than 10% of the share capital of the company)		**Taxes on real estate profits and capital gains** (based on holding period)		
Taxable income (60% of CHF 150,000)	91,200	Less than 2 years	100,000	50%
		From 2 to 3 years	80,000	40%
Income tax (Max. rate: 45%)	**41,040**	From 4 to 5 years	60,000	30%
		From 6 to 7 years	40,000	20%
Disposable income	110,960	From 8 to 9 years	30,000	15%
		From 10 to 24 years	20,000	10%
Max. total tax charge (irresp. of holding period)	**Rate** 42.52%	More than 25 years	0	0%

Tax comparison at the time of divestment
Real estate located in canton of Vaud

Sale by the real estate company (Distribution of ordinary dividends or from liquidation)		Sale as an individual or sale of shares in the real estate company (Capital gain of private wealth)		
Company Pre-tax profit Tax on profit Profit remaining (fully distributed)	**CHF** 200,000 44,000 156,000	**Investor** Real estate gain Taxable gain (100%)		**CHF** 200,000 200,000
Shareholder (holding more than 10% of the share capital of the company)		**Taxes on real estate profits capital gains** (based on holding period)		
Taxable income (70% of CHF 152,000)	109,200	Less than 2 years	54,000 - 60,000	27 to 30%
		From 2 to 3 years	44,000 - 48,000	22 to 24%
Income tax (Max. rate: 41.5%)	**45,318**	From 4 to 5 years	36,000 - 40,000	18 to 20%
		From 6 to 7 years	32,000 - 34,000	16 to 17%
Disposable income	110,682	From 8 to 9 years	30,000	15%
		From 10 to 24 years	14,000 - 28,000	7 to 14%
Max. total tax charge (irresp. of holding period)	**Rate** 44.66%	More than 25 years	14,000	7%

distribution of dividends resulting from a real estate sale [see above, section 1.3.2 (iii)]. In the determination of the taxable profit from liquidation, the difference between the market value of the real estate and its book value is, however, taxable; this is what is called realisation of latent reserves.

The liquidation surplus paid to the shareholder is subject to income tax or, as applicable, to withholding tax at the rate of 35%. This tax is reimbursed when the shareholder is a Swiss resident and reports this income.

1.3.3 Tax comparison

See table below.

2. Plan to reform Geneva real estate taxation and corporate taxation

2.1 Re-valuation of the Geneva housing stock

The tax values of real estate in Geneva are currently determined based on the value of the real estate on the purchase date, which is increased periodically according to the index published by the Geneva Tax Administration. Due to the significant and constant increase in real estate prices, this assessment method has led to unequal treatment between owners who purchased their real estate some time ago (and the tax value of which, even when increased, is clearly less than the market price) and new owners, for whom the tax value corresponds to the recent purchase price.

In order to attempt to correct this situation, a procedure to re-assess the Geneva housing stock, taking into account a weighted market value, is being established. This new valuation method might take effect on 1 January 2017.

2.2 Reduction of tax rate on profit

The draft corporate taxation reform III provides for an end to preferential taxation regimes at both federal and cantonal levels. The implementation of this reform would entail a loss of fiscal attractiveness for the cantons and a risk that the companies affected may relocate abroad.

In order to limit the risk of tax losses inherent in relocations, the canton of Geneva has announced the plan to reduce the ordinary tax rate on profits from 24% to 13%. As for the canton of Vaud, tax on profits would be reduced to 13.8%.

See table below.

3. Conclusions

In light of the above discussions, a comparison of the tax burden related to the two main forms of real estate ownership appears to be essential prior to the real estate purchase itself. The specific elements of each case must be understood and analysed for this purpose.

We have seen that it is more advantageous from a tax point of view for an investor who intends to own real estate for a relatively long period to own it as an individual or to own it through a real estate company and to sell the shares in the company, rather than to sell the real estate through the real estate company and then liquidate it, considering the degressive scales of taxation of real estate profits and capital gains. Planning how and when the real estate is to be sold is thus an important factor when deciding on the method of ownership.

**Update of newsletter No. 22 written by Mr Christian Lau of the Ducrest Heggli Avocats LLC Law Firm*

COMPARISON BETWEEN GENEVA AND VAUD [according to 2.2]

Tax comparison at the time of divestment
Real estate located in the canton of Geneva

Sale by the real estate company If reduction of taxation on profit to 13% (Distribution of ordinary dividends or from liquidation)		Sale as an individual or sale of shares in the real estate company (Capital gain of private wealth)		
Company	**CHF**	**Investor**		**CHF**
Pre-tax profit	200,000	Real estate gain		200,000
Tax on profit	26,000	Taxable gain (100%)		200,000
Profit remaining (fully distributed)	174,000			
Shareholder (holding more than 10% of the share capital of the company)		**Taxes on real estate profits and capital gains** (based on holding period)		
Taxable income (60% of CHF 174,000)	104,400	Less than 2 years	100,000	50%
		From 2 to 3 years	80,000	40%
Income tax (Max. rate: 45%)	**46,980**	From 4 to 5 years	60,000	30%
		From 6 to 7 years	40,000	20%
Disposable income	127,020	From 8 to 9 years	30,000	15%
		From 10 to 24 years	20,000	10%
Max. total tax charge (irresp. of holding period)	**Rate** 36.5%	More than 25 years	0	0%

Tax comparison at the time of divestment
Real estate located in the canton of Vaud

Sale by the real estate company If reduction of taxation on profit to 13.8% (Distribution of ordinary dividends or from liquidation)		Sale as an individual or sale of shares in the real estate company (Capital gain of private wealth)		
Company	**CHF**	**Investor**		**CHF**
Pre-tax profit	200,000	Real estate gain		200,000
Tax on profit	27,600	Taxable gain (100%)		200,000
Profit remaining (fully distributed)	172,400			
Shareholder (holding more than 10% of the share capital of the company)		**Taxes on real estate profits and capital gains** (based on holding period)		
Taxable income (70% of CHF 172,400)	120,680	Less than 2 years	54,000 - 60,000	27 to 30%
		From 2 to 3 years	44,000 - 48,000	22 to 24%
Income tax (Max. rate: 41.5%)	**50,082**	From 4 to 5 years	36,000 - 40,000	18 to 20%
		From 6 to 7 years	32,000 - 34,000	16 to 17%
Disposable income	122,320	From 8 to 9 years	30,000	15%
		From 10 to 24 years	14,000 - 28,000	7 to 14%
Max. total tax charge (irresp. of holding period)	**Rate** 38.84%	More than 25 years	14,000	7%

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