CREDIT SUISSE

Relocation in Switzerland: Tax Treatment

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Special Tax for Foreigners Who Are Not Engaged in Gainful Employment or Business

1. Introduction

Anyone who takes up their main residence in Switzerland for the first time, or after having left Switzerland for at least 10 years, without engaging in gainful employment or business in the country, may choose to pay either ordinary income tax or expenditure-based tax. In both cases, the individual concerned will pay all three of federal, cantonal, and municipal taxes. The choice of canton and municipality of residence may have a greater or lesser impact on the annual tax burden. Swiss nationals are eligible to opt for expenditure-based tax only for the tax period of their arrival. Foreign nationals, however, are also eligible to opt for expenditure-based tax in subsequent tax periods. With respect to ordinary income tax, taxpayers must declare all of their worldwide assets and income, i.e. both Swiss and in other countries, since Switzerland has the authority to tax those assets and income, without prejudice to international double taxation agreements (DTAs) executed by Switzerland.

Whether such agreements apply or not, it is also important to note that, with respect to the fact that individuals are wholly subject thereto, the Direct Federal Taxation Act[1] specifically exempts companies, permanent establishments and foreign real estate from the tax base[2]. A number of cantons, including Vaud, Valais, Fribourg, Jura, and Neuchâtel, have incorporated that provision into their tax laws.

However, those factors are taken into account to determine the tax rate and may also have an impact on taxable income and assets in the international breakdown of liabilities and interest payable[3]. If foreigners choose to pay expenditure-based tax, however, they will nevertheless have to file a tax return – even though it may not be fully comprehensive – specifying some or all of their income and assets depending on their personal situation.

In addition, regardless of the type of tax selected, a foreigner who is less than 65 years old (or less than 64 years old for women) without gainful employment or business must register with a Swiss social security fund (AHV/AVS) and pay an annual contribution of up to CHF 10,000.

2. Obtaining a Temporary or Permanent Residence Permit

Individuals who are not Swiss nationals may take up residence in Switzerland only if they are issued temporary or permanent residence permits that allow them to legally reside in the country. The requirements to be met for obtaining such permits vary depending on whether or not the individual is a national of the EU (European Union) or EFTA (European Free Trade Association).

2.1 EU/EFTA Nationals

The Agreement between Switzerland and both the EU and the EFTA on the Free Movement of Persons, which has been effective since June 1, 2002, is what now governs the issuance of residency authorizations for nationals of the member states.

According to Article 24 of Appendix 1 to the Agreement, EU or EFTA nationals, as well as the members of their families, who are not engaged in gainful employment or business, may be issued a renewable five-year residence permit provided that they can show the authorities evidence that they have sufficient means for themselves and the members of their families to prevent any of them from having to claim social welfare benefits during the time of residence. In addition, they must certify that they have health and accident insurance coverage.

Permanent residence permits (C Permits) for EU/EFTA nationals will be issued for an unlimited duration after an uninterrupted period of five years' residence in Switzerland.

2.2 Nationals of Countries not in the EU/EFTA

With respect to nationals other than those of the EU/EFTA, the Federal Ordinance of October 6, 1986 (BVO/OLE) limiting the number of foreigners provides that only persons aged over 55 who can provide evidence of close ties with Switzerland and have sufficient means may apply for a residence permit for an individual without gainful employment or business.

It should also be noted that the interpretation of these requirements has become much more restrictive since the Agreement on the Free Movement of Persons became effective on June 1, 2002.

With respect to nationals of other countries, a temporary (B) residence permit is generally issued for no more than one year, and may be renewed every year, but only depending on the quotas set every year.

Such nationals of other countries may, in principle, be issued a permanent (C) residence permit after an uninterrupted period of 10 years' residence.

3. Acquisition of Real Estate in Switzerland

The acquisition of real estate in Switzerland by non-Swiss nationals is limited and, in principle, subject to authorization[4]. EU/EFTA nationals may freely acquire any real estate provided that they are in fact resident in Switzerland and have a valid residence permit at the time that they request a transfer of ownership on the real estate register.

It should also be noted that foreigners resident in Switzerland who are not EU or EFTA nationals or who do not have a permanent (C) residence permit will be subject to authorization, except to acquire their main dwelling.

1 Article 6, para. 1 of the Federal Law on Direct Federal Taxation.
2 Used to calculate the tax.
3 For international purposes, an unabsorbed surplus of interest payable attributable to the country where real property is located is not deducted from Swiss taxable income, unlike the rule for the inter-cantonal breakdown.
4 Federal Law on Acquisition of Real Estate by Persons Resident Abroad (LFAIE).

4. Expenditure-Based Tax

Expenditure-based tax, also called "special tax for foreigners who do not engage in gainful employment or business" or "flat-rate tax," is a particular type of assessment tax which Switzerland has had for over 50 years. It is an excellent way for foreigners without gainful employment or business who want to settle in Switzerland to optimize their assets, provided that they reorganize their family estate domestically and internationally in an appropriate manner.

4.1 Legal Foundations

The first foundation of the flat-rate tax was laid in the Agreement prohibiting tax arrangements executed on December 10, 1948[5], the purpose of which was to restrain tax competition among cantons and prevent some past abuses. The cantons of Fribourg and Neuchâtel had already signed the Agreement by 1949, while Vaud, Valais and Geneva did so only in the 1960s, and Jura in 1980.

Once the Agreement had become effective, the principle of taxing foreigners without gainful employment or business based on expenditure was recognized and became effective for both the Confederation and most Swiss cantons.

Except for one item[6], this type of tax was incorporated into the Federal Act on the Harmonization of Direct Cantonal Taxation and Direct Community Taxation[7], which became partially effective on January 1, 1993 and fully effective on January 1, 2001. It was also then incorporated into Article 14 of the Direct Federal Taxation Act on January 1, 1995.

All Swiss cantons have also incorporated this provision. However, during a recent referendum, the Canton of Zurich abolished this type of tax, with effect from January 2010.

4.2 Requirements for Eligibility for Expenditure-Based Tax

4.2.1 Nationality

Anyone who takes up residence or stays for a period in Switzerland for the first time or after having lived abroad for at least 10 years is eligible for flat-rate tax. For Swiss nationals (or dual nationals), such a tax will apply only to the tax period of their arrival. Foreign nationals, however, may be made eligible for expenditure-based tax for longer than that. In its Circular No. 9 of December 3, 1993, the Federal Tax Administration specified that a foreign national who meets the requirements may choose between expenditure-based and ordinary tax for each tax period. Although the legal provisions in Article 6 of the Federal Act on the Harmonization of Direct Cantonal Taxation and Direct Community Taxation and Article 14 of the Direct Federal Taxation Act are strictly identical, some cantons, including Geneva, refuse to allow an individual who has already paid ordinary tax to be subject to expenditure-based tax even though the individual meets all of the requirements. In the Canton of Geneva, only individuals arriving in Switzerland for the first time or after having lived abroad for at least 10 years are eligible for expenditure-based tax. That view is somewhat questionable since both statutes provide that foreign nationals are eligible for expenditure-based tax after the tax period of their arrival. In other words, for some cantons, foreigners must opt for expenditure-based tax as soon as they arrive in Switzerland if they want to continue to be eligible in the future. In other cantons, foreigners may choose, as they can for the direct federal tax – with the exception, naturally, of any cases of abuse.

For married couples, the Direct Federal Taxation Act provides that both spouses are eligible for expenditure-based tax, even if one of them is, or their children are, Swiss nationals, but provided that each spouse meets all of the other objective and subjective requirements[8] specified by law.

4.2.2 No Gainful Employment or Business

As provided in Article 14 of the Direct Federal Taxation Act and in Circular No. 9 of December 3, 1993, of the Federal Tax Administration, individuals who wish to be eligible for expenditure-based tax must not have had any gainful employment or business in Switzerland during the 10 years preceding their arrival. That provision is mitigated by some legal opinion, which deems that being engaged in gainful employment or business in Switzerland is not an obstacle to being eligible for expenditure-based tax provided that the individual has not been "wholly subject"[9] during the 10 years preceding arrival. In any case, such individuals must undertake not to engage in gainful employment or business in Switzerland after their arrival. The concept of gainful employment or business must be examined in the light of Swiss tax law and the related case law. On that basis, an individual is deemed to be engaged in gainful employment or business if receiving income as specified in Articles 17 or 18 of the Direct Federal Taxation Act. In particular, this is the case of artists or athletes who are personally engaged in gainful employment or business in Switzerland.

On the other hand, a foreign artist or athlete whose employment or business is exclusively abroad will be eligible for flat-rate tax.

According to some legal opinion and to the Federal Supreme Court[10], the actual location of the employment or business is the determining factor. As a result, an employee of a company headquartered in Switzerland but who works[11] only abroad will be eligible for flat-rate tax if the other requirements are met.

And finally, taxpayers who merely manage their own assets, either directly or through a legal entity, regardless of how the assets are administered, will not be considered to be engaging in gainful business.

Example 1:

Our assumption here is of a couple, the husband aged 65 and the wife aged 60. They have decided to live in a large apartment (in Verbier, in the Canton of Valais, or in Montreux, in the Canton of Vaud) for which the annual rent is CHF 50,000. The annual expenditure, and the related tax, is determined as follows:

Annual rent = CHF 50,000

Determination of expenditure = 5 x 50,000 = CHF 250,000

If resident in Verbier, Valais

Taxable income (flat rate basis)	CHF	250,000.00
Municipal tax	CHF	27,820.00
Cantonal tax	CHF	29,583.00
Direct federal tax	CHF	19,846.00
Total tax	**CHF**	**77,249.00**

The wife must also be registered with a social security fund (AHV/AVS) and pay an annual contribution of CHF 5,706.50 until her 64th birthday.

If resident in Montreux, Vaud

Taxable income (flat-rate basis min. as of 1.1.2009)	CHF	270,000.00
Municipal tax	CHF	19,323.00
Cantonal tax	CHF	41,821.00
Direct federal tax	CHF	22,446.00
Total tax	**CHF**	**83,590.00**

The wife must also be registered with a social security fund (AHV/AVS) and pay an annual contribution of CHF 6,470.00 until her 64th birthday.

5 RO 671.1 (Official Compilation of Federal Laws and Ordinances).
6 The criterion that foreign nationals should not have been born in Switzerland.
7 Article 6.

8 Circular No. 9 of the Federal Tax Administration of December 3, 1993.
9 Ordinary tax based on all of the taxpayer's worldwide assets (see section 1 above).
10 Ruling of the Federal Supreme Court of May 15, 2000, published in RDAG (Revue de Droit Adminsitrative et de Droit Fiscal) 2002, pp. 114–120.
11 That is, the employee, not the company.

4.3 Determination of Annual Expenditure

Expenditure-based tax is an alternative to income and wealth tax and is calculated on the basis of the taxpayer's spending. To determine that spending, the tax authorities base their calculation[12] on expenditure consistent with the lifestyle of the taxpayer and dependents in Switzerland. Such expenditure includes that for food, housing, clothing, culture, vacations, compensation of employees and domestics, etc. In all cases, the spending deemed to occur must be equal to at least five times the annual rent or rental value of the dwelling occupied by the taxpayer. For foreigners living in a hotel or in a room with board, the deemed spending must be equal to at least twice the annual charge for accommodation and board. In practice, the amount of spending is almost always calculated on the basis of rent or rental value.

With respect to the last point, some tax authorities do not determine rental values in compliance with the legal rules[13] and apply a percentage of the acquisition price or market value of the dwelling. This percentage is often higher than the ordinary rental value[14].

In addition, many German-speaking cantons tax hypothetical assets, which they calculate by multiplying the amount of spending by a given factor.

All cantons apply a minimum annual amount of spending, which may vary based on age. The younger the individual, the greater that minimum annual amount may be (for example, in the Canton of Vaud).

Certain cantons apply a minimum annual amount of spending to nationals of countries that are not members of the EU/EFTA that is higher than the amount for nationals of countries that are members.

Example 2:

The previous example showed that for annual expenditure of CHF 270,000 (Canton of Vaud) and CHF 250,000 (Canton of Valais), the tax was, respectively, CHF 83,590 and CHF 77,249.

Let us compare that with what would have to be paid if all of the above items were subject to ordinary tax. We shall assume the following securities portfolio:

Swiss equities: taxable value of CHF 5,000,000/ dividends of CHF 105,000

Swiss bonds: taxable value of CHF 4,000,000/ interest of CHF 185,000

	Montreux		Verbier	
Swiss assets:	CHF	9 million	CHF	9 million
Swiss income:	CHF	290,000.00	CHF	290,000.00
Annual expenditure:	CHF	270,000.00	CHF	250,000

i) Control calculation tax:

Municipal tax	CHF	91,225.00	CHF	62,394.00
Cantonal tax	CHF	42,150.00	CHF	68,120.00
Direct federal tax	CHF	25,046.00	CHF	25,046.00
Total tax	**CHF**	**158,421.00**	**CHF**	**155,560.00**

ii) Expenditure-based tax:

Municipal tax	CHF	19,323.00	CHF	27,820.00
Cantonal tax	CHF	41,821.00	CHF	29,583.00
Direct federal tax	CHF	22,446.00	CHF	19,846.00
Total tax	**CHF**	**83,590.00**	**CHF**	**77,249.00**
Total control calculation tax:	**CHF**	**158,421.00**	**CHF**	**155,560.00**

Given the items considered for the control calculation, the wife's AHV/AVS contribution would be CHF 10,100 (Canton of Vaud or Valais), rather than the CHF 5,706.50 (Valais) or CHF 6,470 (Vaud) in example 1.

4.4 Control Calculation

A foreigner who is taxed on an expenditure basis may not pay a tax amount lower than those calculated on all of the following:

a) Income and assets relating to real estate in Switzerland.

b) Income and assets relating to securities and valuables in Switzerland.

c) Income and assets relating to capital invested in Switzerland. Capital invested in Switzerland is understood to mean any security issued by an individual or legal entity resident in Switzerland. By way of example, a Nestlé share is a Swiss security, regardless of where it is held in safekeeping. Conversely, Royal Dutch shares are not considered to be securities investments in Switzerland, even if the shares are held in safekeeping in a Swiss bank. Consequently, the issuer's residence or headquarters is the determining factor. To take another example, an individual who holds shares in an investment fund issued by an entity based in London, but whose underlying assets are Swiss securities, is not considered to have a Swiss investment. Naturally, any cases of abuse, e.g. tax evasion, are excepted from the above.

d) Income generated in Switzerland from copyrights, patents and similar rights.

e) Income for which the taxpayer is eligible for a partial or total foreign tax credit in compliance with a Swiss double taxation agreement (DTA). The gross income items to be declared are income for which the taxpayer applies for a foreign partial or total tax credit by virtue of a Swiss double taxation agreement. However, the taxpayer may waive the benefits of such an agreement which he or she could apply for. If the taxpayer does so, such foreign income will not be taken into account for the control calculation, but foreign withholding tax will be unrecoverable.

An individual receiving income which is implicitly covered by a double taxation agreement and not subject to withholding tax, must declare such income for the control calculation. By way of example, let us take a French national who pays expenditure-based tax in Switzerland and who receives a pension from a private pension fund headquartered in France. According to the provisions of French law, such pensions are subject to a tax withheld by the pension fund. However, the pension fund may not have to do so if the beneficiary of the pension is a resident of a country with which France has executed a double taxation agreement under which the beneficiary's country of residence has tax authority. In that case, the DTA between France and Switzerland would apply, and the individual would have to declare the pension for the control calculation. The individual would, of course, have to fulfill the DTA's definition of resident[15].

With respect to the control calculation, only real estate maintenance expenses and those of asset management may be deducted from the above income. Interest payable may not.

12 Federal Council Ordinance of March 15, 1993, on expenditure-based tax with respect to direct federal tax.

13 Article. 7, para. 1 of the Federal Law on the Harmonization of Direct Cantonal Taxation and Direct Community Taxation, Article 21, para. 1 b of the Federal Law on Direct Federal Taxation.

14 See also a very interesting ruling of the Administrative Court of the Canton of Vaud dated December 20, 1999 [FI 93/0015], concerning this practice.

15 See section 5.3 below.

5. Expenditure-Based Tax from an International Standpoint

5.1 Administrative Formalities upon Departure before Arrival in Switzerland

When an individual changes residence, there are a few rules to follow to avoid certain traps. Since each country has its own laws, it is very difficult to make a list of everything which the individual should be aware of. Nevertheless, we strongly recommend that individuals wishing to take up residence in Switzerland make a clear "break" and move the focus of their vital interests from their former country of residence to the new one, i.e. Switzerland. It is not enough for them to just announce their departure and file their papers in the new country of residence; before that, they should be aware of each of the two countries' tax legislation.

They should then make sure that they will in fact be residents as defined in the DTAs between Switzerland and their former countries of residence so as to avoid any problem of double taxation. For instance, some countries, like the United States, tax all their nationals no matter where they are resident. Others apply what is known as a follow-up tax, to which their nationals will continue to be subject, under certain conditions, for a certain period of time after their departure. This is the case for Germany[16], Italy and Spain. Still others may levy an exit tax.

5.2 "Modified" Expenditure-Based Tax

In principle, a foreigner who pays Swiss expenditure-based tax cannot benefit from the double taxation agreements between Switzerland and Germany, Austria, Belgium, Italy, Norway, the United States and Canada, as those countries do not consider as residents individuals whose tax base does not include at least all Swiss income as well as that from the other contracting country. In order to benefit from one of those agreements, the individual must, for the calculation of the expenditure-based tax, declare all income from the countries concerned (and not only income subject to withholding tax) to the extent to which it is subject to Swiss tax and not exempted therefrom under the DTA.

In addition, the applicable tax rate must be the one for all worldwide income and assets. To simplify, the maximum rates (for federal, cantonal and municipal taxes) are usually applied, i.e. from 35% to 45% for the French-speaking cantons. In the case of income from the above countries, a flat rate tax credit may apply.

Let us also note that Article 4, para. 3 of the Ordinance of March 9, 2001 specifies that benefiting from the flat rate tax credit cannot reduce the Swiss expenditure-based tax.

5.3 Specifics for France

France does not recognize resident status for an individual who is taxed only on the basis of five times rental value[17]. In order to benefit from the double taxation agreement between Switzerland and France, it is therefore necessary to increase this amount by around a third[18].

5.4 Specifics for Germany

As mentioned above, an individual who pays expenditure-based tax in Switzerland must declare all Swiss and German income[19] in order to benefit from resident status as defined in the DTA between Switzerland and Germany.

However, German tax law has two provisions allowing the German tax authorities to continue to levy tax on their nationals even after they have moved abroad. The first provides that the tax authorities may tax their nationals' German income for 10 years after their departure. The DTA between Switzerland and Germany limits this period for income and wealth tax to five years[20], not counting the year of arrival. However, this partial exemption does not apply if a national becomes a Swiss resident in order to engage in gainful employment[21]. The second provision allows the German tax authorities to subject a German national to tax for an unlimited period if he or she resides abroad but maintains a permanent dwelling in Germany or usually lives in that dwelling for at least six months per calendar year[22].

Example 3:

Let us again take the case of our couple in example 1 for whom the tax authorities applied an amount of annual expenditure of CHF 250,000.00 on the basis of annual rent of CHF 50,000.00.

Annual rent = CHF 50,000

Determination of expenditure = 5 x 50,000 = CHF 250,000

Increase to benefit from the DTA = CHF 250,000.00 + 30% = CHF 325,000.00

If resident in Verbier, Valais

Taxable income (increased expenditure-based amount)	CHF	325,000.00
Municipal tax	CHF	37,570.00
Cantonal tax	CHF	40,551.00
Direct federal tax	CHF	29,596.00
Total tax	**CHF**	**107,717.00**

If resident in Montreux, Vaud

Taxable income (increased expenditure-based amount)	CHF	325,000.00
Municipal tax	CHF	24,543.00
Cantonal tax	CHF	53,117.00
Direct federal tax	CHF	29,596.00
Total tax	**CHF**	**107,256.00**

Because of the increased expenditure amount, the wife's annual AHV/AVS contribution would be CHF 7,979.00 instead of CHF 10,100.000 as in example 2 or CHF 5,706.50 (Valais)/CHF 6,470.00 (Vaud) as in example 1.

For a foreigner who is a Swiss resident, double taxation may be avoided in both of the above cases by offsetting the tax paid in Switzerland against the German tax

5.5 Specifics for Belgium

Belgium does not recognize resident status for individuals whose tax base does not include at least all Swiss and Belgian income[23]. As a result, such an individual subject to expenditure-based tax may benefit from the DTA between Switzerland and Belgium only if all of the above income is declared. If individuals do so and therefore have resident status, they may, under certain conditions, benefit from the DTA and recover some or all of the 25% Belgian withholding tax on dividends. It should be noted that Switzerland and Belgium have not signed a DTA with respect to inheritance and bequests.

5.6 Specifics for the United Kingdom

The double taxation agreement between Switzerland and the United Kingdom has several particularities, including its provisions on domicile and inheritance. UK law provides for specific distinctions between residence and domicile.

Individuals who are resident but not domiciled in the UK generally pay tax only on a remittance basis, i.e. on income repatriated into the country.

As a rule, these individuals cannot benefit from the DTA on Swiss income unless that income is repatriated to the United Kingdom[24]. Individuals who are both domiciled and resident in the UK will in principle have to pay tax on all of their assets unless a double taxation agreement applies.

16 See section 5.4 below.
17 Article 4, para. 6 b of the DTA between Switzerland and France.
18 This 30% increase is the result of an amicable agreement between the Swiss and French tax authorities.
19 Without prejudice to income that is explicitly attributable to Germany as defined in the DTA between Switzerland and Germany.
20 Article 4, para. 4 of the DTA between Switzerland and Germany.
21 Article 4, para. 4 of the DTA between Switzerland and Germany, provided that the employer and employee do not have a substantial direct or indirect financial interest in common, which is the case of the employee is also a shareholder of the company that employs him or her.
22 Article 4, para. 3 of the DTA between Switzerland and Germany.
23 Without prejudice to income that is explicitly attributable to Belgium as defined in the DTA between Switzerland and Belgium.
24 Xavier Oberson, Précis de droit fiscal international, p. 71, section 211.

With respect to inheritance, UK tax law makes a major distinction according to whether the deceased was a resident of Switzerland or the UK, or both. Even if the deceased had a civil and tax domicile only in Switzerland, the UK can, under both its own law and the DTA, levy inheritance tax on all securities and valuables, in particular the securities of UK companies, and real property located in the UK, i.e. in situs taxation.

Other countries also have particularities which an individual wishing to take up residence in Switzerland should take into account, but we cannot list them all in this paper.

6. Inheritance and Marital Property Planning

In addition to the tax issue, it should be borne in mind that taking up residence in Switzerland also has consequences with respect to inheritance and matrimonial regime law. These issues are too often overlooked, but they become very important if the legal system of the foreign national's country is quite different from Switzerland's and if spouses have not executed a marriage contract in the country where they were married.

Basically, the rules of Switzerland's Private International Law Act (PILA) provide for retroactive change of matrimonial regime, as they specify that if residence is transferred to Switzerland, Swiss law will apply retroactively to the marriage date[25]. In other words, spouses who have taken up residence in Switzerland and who have not executed a marriage contract will be subject to Swiss legal provisions requiring that all property acquired after marriage be shared. Given that change of marital property system, which the spouses are most often not aware of, there may be undesired fundamental changes in their relationship with respect to their assets.

Because of this, the spouses may, in a written agreement, rule out the retroactive application of Swiss law, or even decide to maintain the legal provisions that applied previously to their marital property system[26].

Taking up residence in Switzerland also has inheritance consequences. Foreigners who may have already made wills before arriving in Switzerland should make sure that their wills are in compliance with Swiss law.

This issue may be of particular importance if the foreigner's domestic law does not provide for obligatory heirs and if he or she has already made a will before arriving in Switzerland, since the PILA provides that the inheritance of a deceased whose last residence was in Switzerland will be probated in that country and will be subject to its laws[27]. However, unless they are Swiss dual nationals, foreign nationals may elect to have their domestic law apply to their wills or inheritance contracts.

As can be seen, taking up residence in Switzerland is liable to generate unsuspected legal conflicts with respect to both inheritance and matrimonial regimes.

Consequently, the issues of inheritance planning and matrimonial regime should be systematically examined and cannot be dissociated from the tax issue when changing residence.

Foreign nationals not only have a certain amount of latitude in providing for their successions, they can also benefit from a number of DTAs executed by Switzerland enabling them to avoid double inheritance tax.

Switzerland has executed 10 agreements enabling individuals to avoid double inheritance tax with the following countries: Germany, the United States, the United Kingdom, France, Austria, Denmark, Finland, Norway, Sweden and the Netherlands. None of them applies to tax on donations inter vivos. The DTAs with Germany and Sweden do, however, provide for the possibility of instituting an amicable proceeding with respect to bequests in the event of double taxation, although it should be remembered that in such a proceeding, the authorities are obliged only to exercise due care, not to achieve a given result.

Switzerland also offers tax advantages on transfers of assets for no consideration, i.e. bequests or inheritances. In Valais and Fribourg, as in some other cantons, there is no tax on inheritances or bequests if the transfer is in direct descent and to the surviving spouse. In Vaud, the tax rate is reduced by half for foreign nationals who have never been engaged in gainful employment or business in Switzerland[28]. This reduction is applied only for the portion of the estate which is fully subject to tax in the Canton of Vaud, without foreign participation under a double taxation agreement.

7. Trusts under Swiss Tax Law as Asset Planning Instruments

Although Switzerland recognized trusts when it ratified the Hague Convention of July 1, 1985 (which became effective on July 1, 2007), the tax issues have not been resolved as they are excluded from the scope of the Convention. However, the Convention has helped to strengthen legal certainty, in terms of civil law, with regard to foreign trusts in Switzerland.

Each canton remains autonomous in its tax treatment of trusts. In this respect, the Swiss Tax Conference issued a Circular designed to standardize taxation of the various parties involved in trust arrangements in Switzerland (Circular No. 30 of August 22, 2007). The Federal Tax Administration has indicated that it wants to apply this Circular to the federal direct tax and the advance tax.

The Circular defines the essential features of a trust: "The concept of trust describes a legal relationship with effect against third parties that originates when, based on a trust deed, the settlor transfers specific capital assets to one or more persons (trustee(s)), who is or are required to manage and use them pursuant to a goal determined in advance by the settlor in favor of one or more third parties (beneficiaries)."

Because a trust is not a legal entity, it is not as such subject to taxation and is, thus, "transparent." This raises the issue of the taxation of the settlor, trustee, and beneficiaries. Because the trustee holds the position of fiduciary, no element of income or capital of the trust property may be taxed on the trustee. The tax treatment of the settlor and the beneficiary depends on the nature of the trust.

From a Swiss tax perspective, the category of the trust determines whether the settlors have conclusively divested themselves of assets when the trust was established i.e. settlors must impoverish themselves in favor of another taxpayer, who is thereby enriched.

Revocable Trust

Under a revocable trust, settlors do not divest themselves of assets and there are no tax consequences when the trust is established. The settlor remains liable for tax on the assets and their income (at the settlor's tax residence). Distributions to the beneficiary or beneficiaries are then considered bequests, which are taxed according to cantonal law, taking into account the kinship between the settlor and the beneficiary.

Irrevocable Trust

Irrevocability is determined, for tax purposes, based on the criteria defined by the trust and it may be challenged if, for example, settlors appoint themselves as trustees or beneficiaries or reserve the right to revoke the appointment of a trustee or require the liquidation of the trust. Thus, even if a trust is referred to as irrevocable, it may be defined as revocable from a tax perspective. If the trust's irrevocability is accepted, the settlor's definitive divestment of assets is, by contrast, recognized.

25 Article 55 of the PILA.
26 Article 52 of the PILA.
27 Article 90, para. 1 of the PILA.
28 Article 36 – LMSD (Vaud's law concerning tax on inheritances and bequests).

Irrevocable fixed interest trust

In this type of trust, beneficiaries are deemed to be usufructuaries (usufruitiers) because the rights granted to them flow directly from the trust deed. The beneficiaries have a claim to the assets and the settlers impoverish themselves in favor of other taxpayers.

Creation of the trust is treated as a donation from the settlor to the beneficiary or beneficiaries, who may be subject to tax on the donations if the conditions defined by cantonal law are met (based on residence and kinship). The beneficiaries are taxed, in principle, on the income for the distributions they receive, as well as on the capital with respect to their share of the trust assets. However, if it can be proven that the distribution includes capital gains from private wealth or from initial trust capital, they will not be taxed.

Irrevocable discretionary trust

A distinction is made based on whether or not the settlor is a Swiss resident at the time the trust is created. If the settlor is a Swiss resident, the impoverishment is not recognized and the tax consequences are identical to those of a revocable trust. However, according to the Circular, the divestment may be allowed for foreigners subject to the expenditure-based tax "because in this case, only wealth in Switzerland and earnings from Swiss-based assets are taken into account for purposes of the calculation control." If the settlor is not a Swiss resident when the trust is created, it is considered a donation up to the amount of the trust capital not subject to tax in Switzerland. The trust assets are not taxable on the settlor, who has divested himself or herself of them, or on the beneficiary or beneficiaries, given that the latter rights are only expectations. Consequently, beneficiaries' distributions are subject to income tax only when paid or when a firm legal entitlement is obtained. If it can be proven that the distribution includes the initial trust capital, or that it does not involve income, the distribution is not taxed. However, if the trust's assets themselves may not be allocated to the beneficiary or beneficiaries, the distribution would not be exempt, partially or totally, from the capital gains tax on private wealth.

These are only the major points. As cantonal practices may vary, it is important to carefully examine all arrangements regarding trusts and their tax treatment and to confirm them.

Last, it is useful to note that a trust may not be created in order to reduce reserved portions when the settlor subjects his or her estate to a law that recognizes reserved portions (unless the obligatory heirs in question have accepted the reduction of the portion).

8. Conclusion

Although the expenditure-based tax system may at first seem easy to understand, the reader will soon grasp the fact that an apparently simple situation can very quickly become complicated unless all factors relevant to optimal estate planning are considered carefully. A foreign national taking up residence in Switzerland can select the best international distribution of his or her securities and valuables to avoid having to pay tax on more than the deemed expenditure, and also being subject to double taxation, which may in some cases be a substantial burden.

Our experts at Credit Suisse will be pleased to tell you about the various estate planning options if you are interested in transferring your residence to Switzerland.

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