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News Analysis: Another Look at Swiss Lump Sum Taxation

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COUNTRY DIGEST

NEWS ANALYSIS

Another Look at Swiss Lump Sum Taxation

Switzerland's Federal Council recently issued a draft bill amending the Federal Direct Tax Act and the Federal Tax Harmonization Act to establish a new framework for the lump sum tax regime. The draft bill was approved by the Swiss parliament, and the amending law was published on September 28, 2012. (For prior coverage, see *Tax Notes Int'l*, Oct. 29, 2012, p. 461, *Doc 2012-21770*, or *2012 WTD 205-6*.)

On October 19, however, a left-wing committee collected the necessary signatures to force a nationwide vote on the revocation of the lump sum tax at the federal level. The date of the referendum will be set following parliamentary debate and will likely be in two to three years.

History of the Lump Sum Tax

Foreign nationals taking up residence in Switzerland may opt for the country's lump sum tax regime, under which tax rates are based on the cost of living. This special tax regime has been part of the Swiss tax system for decades and can be traced back to 1862, when the canton of Vaud introduced a special tax on the income and wealth of foreign nationals who were not employed in Switzerland. In 1928 the canton of Geneva introduced the cantonal lump sum tax, and since 1934 the tax has also applied on the federal level.

In 1948 the cantons that had lump sum tax systems agreed to apply uniform rules, which were set forth in an intercantonal tax agreement. Other cantons also decided to opt for lump sum taxation. Uniform rules were adopted on the federal level on December 14, 1990, when they were inserted into the Federal Direct Tax Act (article 14) and the Federal Tax Harmonization Act (article 6). While the harmonized rules under the federal framework apply to lump sum tax regimes at the cantonal level, the cantons still have considerable freedom, so cantonal rules on the lump sum tax regime still vary from one canton to another.

Since the regime was introduced at the federal level in December 1990, lump sum tax payers have added, in aggregate, approximately CHF 1.4 billion (about $1.8 million) to the budget and have created 22,500 jobs as a result of their spending in Switzerland. In 2010 alone, approximately 5,445 Swiss taxpayers who were subject to lump sum taxation paid CHF 668 million (about $798 million) in taxes.

Other Considerations

However, the tax regime has been criticized since its beginning, particularly by cantons that have relatively little experience with the tax. The main issue of contention is whether the regime violates the constitutional principle of equal treatment in taxation by failing to take into consideration the economic capacity of a taxpayer and because of its availability to foreigners, but not to Swiss nationals.

Since the canton of Zurich decided to abolish (through a referendum) its lump sum tax regime as of January 1, 2010, the federal lump sum tax framework has come under increasing pressure. Voters in the canton of Schaffhausen abolished lump sum taxation on the cantonal level in 2012, and the two cantons of Basel and the canton of Appenzell Outer-Rhodes will abolish it on the cantonal level as of January 2014.

However, voters in the cantons of Berne, Lucerne, Thurgau, St. Gallen, and Glarus have decided to maintain the cantonal lump sum tax. The vote is still pending in the cantons of Geneva, Nidwalden, and Ticino.

The Federal Council does not intend to abolish the lump sum tax regime at the federal level, but it wants to increase the assessment basis in the Federal Direct Tax Act and the Federal Tax Harmonization Act to make the tax regime more acceptable to Swiss residents. The Federal Council views the regime as enhancing Switzerland's attractiveness to foreigners who do not pursue business activity in the country.

Differences Under the New Law

Under the current law, lump sum taxation is available to foreigners and Swiss citizens who become resident in Switzerland for the first time or after at least 10 years outside the country. Although under the new law, Swiss citizens would no longer be eligible for the lump sum regime, under the current law, Swiss citizens are eligible for only one year of lump sum taxation.

The lump sum tax is generally calculated based on the taxpayer's total annual cost of living. Under the current law, the minimum cost of living is computed as five times the rent paid by the taxpayer or, for homeowners, five times the annual rental value of their homes.

Under the new law, for both the direct federal tax and the cantonal tax, the multiplier of the rent or rental value would be raised from five to seven, and a lower assessment base limit of CHF 400,000 (about $424,000) per year would be added for the federal tax. The cantons would be free to define the lower limit for their cantonal taxes.

There has been some legal uncertainty about the definition of cost of living. According to a circular letter of the Federal Tax Administration, lump sum taxation is based on the cost of living in Switzerland and abroad, but the law takes into account only the taxpayers' living expenses in Switzerland. The new law clarifies that the assessment base takes into consideration both the Swiss and the foreign cost of living.

Lump sum taxation will be available to married couples only if each spouse satisfies all the eligibility requirements. Under the current law, only one spouse must meet those conditions. The new law makes no changes to the applicable general tax rates, but the recently introduced tax reduction for parents (DBG 214 II *bis*) would not apply.

The cantons would be responsible for taking account of the wealth tax for purposes of the lump sum tax.

Individuals under the lump sum regime could apply the regime under the current rules for five years, after which they would have to meet the new criteria.

Final Comments

Under a separate measure unrelated to the lump sum tax bill, unemployed persons will be subject to higher social security contribution rates as of January 1, 2012. This will affect lump sum tax payers because they are classified as unemployed in Switzerland.

The new lump sum law is also subject to an optional referendum, which will be held if the signatures of 50,000 voters are collected within 100 days from September 28. A referendum to block the new law is unlikely, and it is expected to enter into force on January 1, 2014. ◆

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