International

Switzerland seen by a UK resident – what's there to consider from a HNWI perspective?

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Switzerland has, due to its political and economic stability, health, public and schooling infrastructure, multilingual charm, and central location within Europe, historically been one of the focus jurisdictions for UK HNW families for their investment and personal residency planning. Recent developments such as political changes in the UK as well as the challenges put up by Covoid-19 on individuals and governments, have shown a significant increase in interest also from UK based HNW families in investments into or even in relocation to Switzerland. The following article shall outline the key elements to be considered within the planning and implementation of investments or even relocation to Switzerland when looking at it from a UK perspective.

Investments into Switzerland

Swiss bank accounts and investments in companies are usually not problematic

Investments into Swiss companies or the opining of Swiss bank accounts by non-resident HNW families—directly or via their family offices—is typically subject to the customary KYC and anti-money-laundering checks on the level of the involved banks and counterparts but not per se restricted. Both the holding of Swiss bank accounts and the ownership in Swiss shares etc do not trigger a Swiss tax liability, except for the general Swiss withholding tax levied on certain interest and dividend income on a domestic level.

But restrictions and tax consequences apply in the area of Swiss real estate

The acquisition of Swiss real estate by non-Swiss citizens is restricted under the so-called "Lex Koller". Foreigners can acquire non-residential real estate (e.g. industrial real estate) as well as secondary homes (vacation homes) in specifically designated touristic areas of Switzerland. However, the acquisition of any other residential real estate by foreigners—directly or by way of an acquisition structure such as companies or trusts—is possible only if such non-Swiss citizen owners or beneficial owners in structures are permanent residents with their effective center of vital interest in Switzerland. In such case, there are deemed being Swiss. Whilst EU/EFTA citizens are required to hold a residence permit B or C, non-EU/EFTA citizens such as UK citizens are required to hold a C permit, which is typically available only after being a Swiss resident for 5 years and after being integrated sufficiently, this also including a certain level of local language skills. If a structure is used, such structure needs to be entirely Swiss controlled. The mere investment into Swiss residential real estate by non-residents is, therefore,

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generally limited to vacation homes in certain areas of Switzerland, to Swiss citizens residing in the UK and acquiring Swiss residential real estate, or to UK citizens inheriting Swiss real estate.

Where the acquisition of Swiss real estate by a UK citizen residing outside Switzerland is possible, Swiss tax consequences will need to be considered : —

- The ownership of Swiss real estate will trigger a limited tax liability in Switzerland from a domestic law perspective and the Swiss-UK double taxation treaty on income taxes confers taxation rights in such scenario on Switzerland. Accordingly, the non-Swiss resident owner will be required annually to file a Swiss tax return, so that income and wealth taxes can be levied on the Swiss tax value of the real estate as well as its deemed rental income, both under consideration of certain deductions for mortgages and mortgage interest as well as maintenance costs (depending from canton to canton).

- A sale of Swiss real estate will be subject to Swiss real estate capital gains taxation and, depending on the location within Switzerland, certain further levies such as transfer dues may be triggered.

- A transfer of Swiss real estate by way of a gift or inheritance will, within a deferral mechanism in the capital gains taxation system, primarily trigger inheritance or gift taxation. Inheritance and gift taxes are levied in all cantons except for Schwyz, Obwalden and, in certain scenarios, Lucerne. Cantonal legislation provides in most cases for an exemption from inheritance and gift taxation for transfers to spouses and direct descendants as well as recognized charities. However, in the absence of harmonization of the inheritance and gift tax regimes amongst Swiss cantons, and also because the—generally harmonized—real estate capital gains tax consequences and related levies vary considerably between cantons, it is recommended to review the specific local tax ramifications in each case individually.

Further to the Swiss tax aspects, it is also sensible to review how a Swiss piece of real estate would fit into an overall estate planning. There are often difficulties in using, and practically implementing, non-Swiss estate planning tools such as trusts and foreign wills in relation to Swiss assets, particularly Swiss real estate. Corresponding Swiss estate planning instruments regarding the Swiss assets may be a sensible approach to avoid problems later.

Relocation to Switzerland

The centre of vital interest—the importance of documenting this typically decisive element

Under Swiss law a person is resident in Switzerland for tax purposes if he or she has had an uninterrupted stay of at least 30 days in the country with professional activity or a stay of at least 90 days without professional activity, or if a person physically spends time in Switzerland and has the intention to stay here. As of the day a person has become tax resident of Switzerland, he or she will become subject to unlimited tax liability in Switzerland. This means that his or her worldwide income and wealth become subject to income tax at the federal, cantonal, and municipal levels, and to wealth tax on the cantonal and municipal levels. A key feature of Swiss tax legislation certainly consists in the exemption from capital gains realized within a person's moveable private wealth from income taxation.

In order to avoid double taxation where a person maintains a nexus to both Switzerland and the UK, the Swiss-UK income tax treaty provides, like the vast majority of double taxation treaties Switzerland has concluded, for a so-called tie-breaker clause allocating an individual's residence for tax purposes to the jurisdiction with which such person has the closer nexus due to his or her centre of vital interest. In view of the typically intense travel activities of HNWI and HNW family members, and also in view of an increasing appetite of tax authorities to litigate tax residency cases, it is not only recommended to review carefully with a local UK adviser which criteria need to be met to depart successfully from the UK, but it is generally recommended to be ready to evidence a person's centre of vital interest at least for a few years after a relocation to Switzerland by way of a diary as well as underlying expense documentation.

Residence permits for non-EU citizens—relevance of the lump-sum taxation regime

Since citizens of an EU/EFTA member state are entitled to take residence in Switzerland in most cases, obtaining a residence permit and relocating to Switzerland used to be a rather straightforward process and merely a formality for UK citizens prior to Brexit. Since Brexit, the possibilities for UK citizens to obtain a residence permit in Switzerland have been significantly restricted. As non-EU citizens, UK citizens who do not exercise a gainful activity in Switzerland and may not apply for a combined work and residency permit can relocate to Switzerland only if they are of retirement age and can demonstrate a close nexus to Switzerland or if they are of economic interest to a specific canton, typically based on a lump-sum taxation (forfeit) arrangement.

As an alternative to the ordinary regime of income and wealth taxation, most cantons provide taxpayers the option of being taxed on their worldwide living expenses by way of lump sum taxation. Although cantons Zurich, Basel-City, Basel-Country, Schaffhausen and Appenzell Ausserrhoden have abolished lump sum taxation on the cantonal level, it continues to be a possibility federally and in most other cantons.

Lump sum taxation is available only to persons who are not Swiss nationals, who do not exercise a professional activity in Switzerland and who have recently relocated to Switzerland or have not lived here during the past ten years. For married couples to qualify for the regime, both spouses must meet the requirements. Cantonal practices in relation to the requirements vary and it is recommended that applicants seek specific advice at their location of choice. In a lump sum regime, the income tax basis is determined by a tax ruling that must be obtained from the cantonal tax authorities, and is derived from the highest amount of the following figures : —

- The aggregate amount of the taxpayer's and his or her spouse's worldwide living expenses;
- The sevenfold of Swiss housing costs; or
- The so-called control calculation and the applicable cantonal and federal minimum amount.

The control calculation takes into account any income from Swiss sources (e.g. real estate investments, pensions, shareholdings etc.). The basis for wealth taxation is typically determined by the cantonal legislation applicable to taxable income. Both income and wealth taxes are levied at ordinary rates under the lump sum taxation regime.

Domestically, persons taxed under the lump sum taxation regime are considered to be Swiss tax residents, and are recognized as such in most other jurisdictions such as e.g. the UK. In order for the taxpayer to be recognized as a Swiss tax resident in the US and Germany, any US-sourced or German-sourced income would need to be fully taxed under a so-called modified lump sum taxation regime. Note, however, that the lump sum taxation regime does not apply to inheritance or gift taxation. As a result, wealth and succession planning structures, such as trusts and foundations, still require individual assessment for tax purposes. For such structures it would typically be appropriate to obtain a tax ruling from the competent cantonal tax authorities.

Pitfalls in connection with inheritance and gift taxation—despite the Swiss-UK double taxation treaty

Gift and inheritance taxes are levied at the cantonal and municipal level but not federally. Most cantons and some municipalities impose inheritance and gift taxes if one of the following applies : —

- The deceased or the donor had their (last) Swiss residence in that canton;
- The asset in issue is real estate located in the canton (cf. supra); or
- The asset in issue is a commercial asset that was transferred abroad from the canton.

Cantons Schwyz and Obwalden do not impose either inheritance or gift tax, and canton Lucerne does not impose gift tax.

While the cantonal and municipal legislation applicable to inheritance and gift taxes varies significantly, a key characteristic common to inheritance and gift tax in most cantons is that the liability to pay the tax falls on the recipient (i.e. the donee, heir or legatee). The applicable tax rates and tax-exempt amounts vary between the cantons and depend on the relationship between the deceased/donor and the heir/donee, which should be considered at the planning stage. The progressive nature of the tax rates must also be kept in mind. While transfers to a spouse are exempt from inheritance and gift tax in practically all cantons, transfers to direct descendants are taxable in some cantons (e.g. canton Vaud). There is a realistic risk that taxpayers are taxed more than once for inheritance and gifts because Switzerland has only concluded a handful of double taxation treaties on inheritance tax (e.g. with the UK, Germany and the US). To the extent that it has done so, the treaties are in any event not comprehensive and do not cover gift taxes. For example, the Swiss-UK inheritance tax treaty contains a tie-breaker-clause to determine a deceased’s last place of residence amongst Switzerland and the UK in case both the UK and a Swiss Canton consider a deceased as UK resident/domiciled and tied their respective inheritance tax consequences to this so that a double taxation situation arises. However, it is important to review each case specifically as e.g. UK inheritance taxation rights may continue to apply for a certain period even after a person’s relocation to Switzerland. Since, in such a scenario, Swiss forced heirship rules would, in principle, commence to apply as of the relocation date and since these rules provide for a forced heirship portion in favour of a deceased’s children, UK inheritance taxation may still be triggered even after a person has left the UK. Such exposure may be mitigated, e.g. by way of Swiss estate planning tools such as a formal waiver of the children on their forced heirship or a choice of law in favour of UK succession law, but it is key within a relocation process of HNWI or HNW family members to address these topics early on in the process.

Be mindful when trust structures are involved

In addition to double taxation aspects that may occur as a consequence of residence disputes or ongoing taxation rights, estate planning tools like trusts which are typically used in the UK should also be reviewed from a Swiss tax perspective prior to a relocation into Switzerland.

Switzerland does not have its own trust legislation but generally recognizes foreign trusts from a legal perspective. There is still no domestic case law to provide guidance on how a trust will be interpreted in the context of Swiss succession principles. As a result, the law in this area is quite uncertain. The Swiss forced heirship provisions would take precedence over any provisions of a trust or the laws applicable to that trust. Swiss estates involving trusts have the potential to become involved in complex and extensive litigation. It is, therefore, advisable to seek Swiss legal advice at an early stage of planning to prevent any conflicts between the provisions of the foreign trust and Swiss succession law. In the absence of any applicable legislation, the tax treatment of trusts in Switzerland is governed by a Circular Letter of the Swiss Federal Tax Administration. It distinguishes between the following types of trusts : —

- Revocable trusts : revocable trusts are typically held to be transparent structures from both the settlor's and the beneficiary's point of view;
- Irrevocable fixed-interest trusts; and
- Irrevocable discretionary trusts.

The settlor of an irrevocable discretionary trust is not liable for Swiss tax in respect of the trust assets if he was not resident in Switzerland at the time of settlement. In certain situations, this could continue to be the case even if the settlor becomes a Swiss resident after settlement. However, if the settlor was a Swiss resident at the time of settlement, the trust is, usually, disregarded for the purposes of Swiss tax law and the trust assets are attributed to the settlor personally.

If the trust is an irrevocable fixed interest trust, the beneficiaries are liable for wealth tax on the trust assets. Any foreign trusts' Swiss income, wealth, inheritance and gift tax treatment of a trust, therefore, requires closed attention, as the relevant Swiss practice of allocating taxation rights between settlors and beneficiaries typically depends on who has influence and control over the management of trust assets and their distribution. It is advisable to discuss the Swiss tax treatment of a trust with the competent Swiss tax authorities prior to a move, so that a tax ruling can be sought and amendments to the structure can be implemented prior to the relocation where necessary.

Furthermore, Swiss tax authorities have increased their interest in the place of effective management of underlying companies within trust structures. If such companies were to be held effectively managed in Switzerland, the company's tax domicile might be claimed to be in Switzerland too. It is, therefore, recommended carefully to review the governance structures within a trust structure within the context of a relocation to Switzerland, to ensure that not only the trust itself but also the trust assets are in shape before a nexus to Switzerland is established.

Outlook

Given the current challenges all around the world, it is hard to predict how the political, social and legal environment in Switzerland will develop over the next few years. Although public spending has increased, most of the cantons currently do not plan to increase taxes. To the contrary, most cantons are still reducing taxes, in particular corporate taxes to stimulate the economy. Further, interesting changes to the Swiss inheritance law have been approved by the parliament. The bill will increase the testator's freedom of disposition and will allow more flexibility for estate planning. The bill is intended to come into force as of January 2023 and is an important milestone in adapting Swiss inheritance law to new social developments and modern forms of living.