Tax Residency of Individuals: Switzerland

STEP Israel Annual Conference
Tel Aviv, June 20, 2017

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Agenda

Swiss Domestic Law
- Types of Tax Liability
- Tax Residency Nexus
- Consequences of Tax Residency

Cross-Border Situations
- Impact of DTT
- Swiss Court Practice

Aspects Relevant for Private Clients with Swiss Nexus
- Swiss Lump-Sum Taxation
- Taxation of Foundations and Trusts
# Agenda

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## Aspects Relevant for Private Clients with Swiss Nexus
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- Taxation of Foundations and Trusts
## Swiss domestic law
### Types of tax liability

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<th><strong>Economical Nexus</strong></th>
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<td>Unlimited tax liability</td>
<td>Limited tax liability</td>
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<td><strong>Connection elements</strong></td>
<td>- Domicile</td>
<td>- Real Estate</td>
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<td>- Habitual residence</td>
<td>- Employment / Board Membership / Artist or</td>
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<td>Sportsperson's activity</td>
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<td><strong>Legal basis (domestic)</strong></td>
<td>Art. 3 DFTA</td>
<td>Art. 4 and 5 DFTA</td>
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<td><strong>Attribution of taxation</strong></td>
<td>Tie breaker clause (Art. 4 DTT-IL)</td>
<td>Various treaty clauses, e.g. Art. 6 / 15 / 16</td>
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<tr>
<td><strong>Method to levy tax</strong></td>
<td>• Rule: Ordinary taxation, i.e. typically annual tax</td>
<td>DTT-IL</td>
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<tr>
<td></td>
<td>return</td>
<td></td>
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<tr>
<td></td>
<td>• Exception: simplified method for non-Swiss citizens</td>
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<tr>
<td></td>
<td>without professional activity: lump-sum taxation</td>
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<td>(forfeit; cf. Slides below)</td>
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<tr>
<td></td>
<td>Source tax (withholding tax) on specific income</td>
<td></td>
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<tr>
<td></td>
<td>streams</td>
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**Legal Bases**

Federal Act on Direct Taxes dated 14 December 1990, publ. In SR 641.11 ("DFTA")

Federal Act on Harmonization of Taxes dated 14 December 1990, publ. In SR 642.14 ("FTHA")

Cantonal tax legislation

Double taxation treaties, e.g. Art. 4 of the Convention between Switzerland and Israel for the avoidance of double taxation with respect to taxes on income and property (publ. in SR 672.944.91, "DTT-IL")
Swiss domestic law
Sources for unlimited tax liability

All "types" of Swiss tax residency lead to the same result from a Swiss domestic tax perspective:

**unlimited tax liability**
(cf. slide 10)
Swiss domestic law

Unlimited tax liability due to operation of law

Minors

Art. 3 para. 2 DFTA in connection with Art. 25 CC

domicile derived from domicile of parents

Individuals under guardianship

Art. 3 para. 2 DFTA in connection with Art. 26 CC

domicile at the seat of the competent agency for the protection of adults
Swiss domestic law
Unlimited tax liability due to elected domicile (1/2)

Art. 3 Direct Federal Tax Act

1. (...) 

2. For tax purposes, a person has his/her domicile in Switzerland if he/she resides within the territory with the intent of permanently staying in the country or if the federal laws assign a special legal domicile.

3. (...) 

4. (...) 

5. (...) 

1. **Physical presence**
   - temporary interruption of the stay is not harmful (less than 2 years)

2. **Intention to stay permanently**
   - accommodation (overnight stays; rented/owned)
   - manifestation of the taxpayers will in **objective, external facts**; declarations of intent are neither necessary nor sufficient for the establishment of a domicile.
     - registration with the police is only a weak manifestation of the intention to remain permanently
     - motives for electing a certain domicile are irrelevant
   - Stay should not be of merely temporary nature
     - also temporary stays can fulfill the requirement of permanence (minimum duration of 1 year)
Swiss domestic law
Unlimited tax liability due to elected domicile (2/2)

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<th>Category</th>
<th>Typically…</th>
<th>Swiss approach (practice)</th>
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<td>Singles</td>
<td>Work in A, have (small) appartment in A, have family in B and return to B regularly</td>
<td>Center of vital interests in A if they are older than 30 and / or have worked in A for 5 years</td>
</tr>
<tr>
<td>Concubinage</td>
<td>Cf. Single; partner living with them in A</td>
<td>Center of vital interests in A if they live there with a partner</td>
</tr>
<tr>
<td>Married couples</td>
<td>Spouse / family live in B; individual works in A where he/she has (small) appartment</td>
<td>Center of vital interests typically with family if regular returns to family; Spouses may exceptionally have separate tax domiciles Special case: executives.</td>
</tr>
</tbody>
</table>
Swiss domestic law
Unlimited tax liability due to habitual residence

Art. 3 Direct Federal Tax Act

1. (…)
2. (…)
3. A person has a place of residence in Switzerland if he/she, irrespective of temporary interruptions,
a) resides within the territory for at least 30 days and exercises an employment or
b) resides within the territory for at least 90 days and does not exercise an employment.
4. (…)
5. Individual persons are, based on their personal affiliation, liable to taxation in their place of origin, if they are domiciled in a foreign country and are there, with respect to an employment at the state or another public institute, wholly or partially exempted from income taxation. If a person is a national of more than one country, he/she is liable to taxation in the country, the nationality of which he received last. If he/she has no Swiss nationality, he/she is taxable at the domicile or at the domicile of the employer. Tax liability extends to spouses and children within the meaning of Art. 9.
**Swiss domestic law**

**Consequences of unlimited tax liability**

<table>
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<th>Tax</th>
<th>Object</th>
<th>Tax Rate</th>
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| **Income Tax** (federal, cantonal, communal) | Taxation of worldwide income  
• Employment income  
• Investment income  
• Pension income  
• Etc. Exemptions:  
  • Based on Swiss domestic law (e.g., private capital gains; real estate abroad)  
  • Based on DTT | Progressive tax rates with significant differences between cantons and between communes within same cantons*  
• Zug: 22.9%  
• Zurich: 40.0%  
• Geneva: 45.0%  
• Vaud: 41.5% |
| **Wealth Tax** (cantonal, communal)      | Worldwide wealth, except real estate and business abroad.             | Progressive tax rate with moderate differences between communes in same cantons*  
• Zug: 0.28%  
• Zurich: 0.66%  
• Geneva: 1.01%  
• Vaud: 0.79% |
| **Inheritance and Gift Tax** (cantonal)  | • Object: Gifts and successions of CH residents  
  (except SZ, OW and, in certain situations, LU) and real estate in CH  
  • Recipient is tax liable in canton of decedent’s / donor’s (last) domicile / situs canton of real estate | Depending on canton |

**AEOI**: starting January 2018 (CH-Israel: January 2019)

* Assumptions: tax rates 2017, not married, no church affiliation, no children

**Topic to keep in mind**: Place of effective management of closely held / underlying companies in structures
Swiss domestic law
Formal aspects: tax filings and technicalities

Art. 8 Direct Federal Tax Act

1. A person is liable to tax starting from the day on which he/she establishes a domicile or habitual residence in Switzerland for tax purposes, or on which he/she receives taxable values.

2. A person ceases to be subject to tax liability on the day of his/her death, his/her departure from Switzerland or with the disappearance of values taxable in Switzerland.

Start of unlimited tax liability

• Establishment of domicile or habitual residence / departure from Switzerland or demise
• Pro rata temporis if start or end of unlimited tax liability during tax year

Annual tax returns

• Have to be filed in the canton where the taxpayer is resident at the end of the respective tax period
• Married couples file jointly
• Also tax returns for individuals under the lump-sum regime
• Official filing dates vary from canton to canton

Social security status

• Contributions as employees (board members) vs. self-employed
• Individuals without professional activity and below retirement age: contributions of up to CHF 24’000 p.a.
Swiss domestic law
Formal aspects: residence permits

EU-Citizen: mere formality
Non-EU-Citizen: typically lump-sum taxation decisive

Residence permits without gainful activity – EU/EFTA citizens
Residence permits (without gainful activity) are granted to EU/EFTA citizens (e.g., Cyprus citizens), if they can prove that they:

- have adequate financial means (typically > CHF 1 mio.) for themselves and their families;
- have comprehensive health insurance coverage.

Residence permits without gainful activity – Non EU/EFTA citizens
- Eligible: i.a., individuals of specific "economical interest" to relevant canton
  - Relevant for lump-sum taxation candidates
  - To be further discussed with cantonal authorities: availability of favourable regime due to age of candidate
- Right to enter and reside for applicant and spouse / children
- Further requirements:
  - Sufficient health insurance
  - Formal requirements (request)
- Relocation, i.e. transfer of domicile (center of vital interests, incl. a certain physical presence) to Switzerland
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## Cross-Border Situations
- Impact of DTT
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## Aspects Relevant for Private Clients with Swiss Nexus
- Swiss Lump-Sum Taxation
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## Cross-border situations
Impact and specialties of double tax conventions

### Limitation of the personal scope of DTT
- lump-sum taxation
- members of diplomatic missions
- treaty abuse

### Attribution of tax residency
- Tie breaker clause
- Priority order permanent abode – center of vital interests – physical presence – citizenship – competent authority agreement

### DTT Switzerland – Israel
- Art. 5 of Protocol to DTT-IL: subject to tax clause aiming, in particular, at Israeli tax regime for new immigrants (cf. Below)
- Availability of tax residency certificates

### DTT Switzerland – Canada
- Modified lump-sum taxation required for recognition of Swiss tax residency in cases of lump-sum taxation

### DTT Switzerland – US
- Tax credit mechanism applied typically for US citizens subject to US taxation on their worldwide income
- Modified lump-sum taxation required for recognition of Swiss tax residency in cases of lump-sum taxation
Cross-border situations
Examples and court practice (1/5)

VGer ZH, 21.11.2011, StE 2011 B 11.1 Nr.17 = Locher et al., DBA-D, B 4.2 Nr.37

Facts

• Couple stayed for 1 1/2 years in different foreign countries
• Afterwards they bought a house in France
• They still owned a house in Switzerland where they stayed from time to time
• Husband was a member of the administrative board of a Swiss company under his control

− The court ruled that the house in Switzerland and the administrative board mandate are of subordinate importance.
− Giving up the center of vital interests at one place does not mean that all ties to the country need to be cut entirely

➢ Center of vital interests NOT in Switzerland!
Cross-border situations
Examples and court practice (2/5)


Facts

• 30 year old taxpayer
• Worked for 3 years in Saudi Arabia for a Swiss employer
• Established social contacts in Saudi Arabia and met his partner there
• Spent approx. 69 days per fiscal year in Switzerland
• Kept his rental apartment in Thurgau
• Did not maintain social contacts in Switzerland

- Fact that he kept apartment is not sufficient to speak against change of domicile

➢ Center of vital interests NOT in Switzerland
Cross-border situations
Examples and court practice (3/5)

BGer, 18.01.2011, "C 472/2010, E.2.3 and 3.4.3=StE 2011 A 32 Nr. 17 =StR 2011, 425

Facts

• Taxpayer was the CFO of an association
• For 3 years, he spent 80% of employment in Singapore
• Lived in an apartment in Singapore
• Kept rental apartment in CH

– Individual could not demonstrate substantial personal relations in Singapore outweighing relations to Switzerland.

➢ Center of vital interests in Switzerland!
Cross-border situations
Examples and court practice (4/5)

BGer, 19.01.2015, 2C_335/2014, 2C_336/2014, E.5.2)

Facts

• Taxpayer was a professor who was the director of an institute at a Rumanian university
• Salary paid by University of Fribourg
• He returned monthly to wife in Switzerland and also during holidays

- The personal relations to Switzerland outweighed the professional relation to Rumania

➢ Center of vital interests in Switzerland
Cross-border situations
Examples and court practice (5/5)

30.09.2012

Worked in Switzerland where he contributed to pension plans

Moved to Israel (Aliyah) 10 years special tax regime

Pension benefits

Source taxation on pension payment

August 2013

Generally

• Subject to tax clause in article 5 of Protocol to DTT-IL:

"It is understood that, as long as income derived by a resident of Israel from sources within Switzerland is, under the law in force in Israel, subject to tax in Israel only by reference to the amount which is received in Israel, and not by reference to the full amount thereof, or such income is exempted from tax in Israel, the exemption from, or reduction in rate of Swiss tax provided for (with or without conditions) by any article of the Convention shall apply only to the portion of that income which is received in Israel or otherwise subject to tax in Israel".

• Purpose of subject to tax clauses = avoidance of double non-taxation

BGE 143 II 65

• Taxpayer profited from a tax exemption in Israel
• Taxpayer could not demonstrate that the capital benefits he received were subject to tax in Israel
• Reimbursement of the Swiss source tax on pension payment is, therefore, not possible under the DTT-IL
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Private clients with Swiss nexus
Swiss lump-sum taxation: overview

**Taxation**

- Lump-sum as basis for taxation, application of ordinary tax rates
- Cantons and communes have to raise income and wealth tax

**General principles**

- Attractive alternative to ordinary income and net wealth taxation based on worldwide net income and wealth: lump-sum taxation is based on the *worldwide expense* of the tax-payer
- Tax regime available and frequently used i.a. in the canton of Valais

**Eligible persons**

- Individuals without Swiss citizenship
- In case of married couples, both partners must fulfill the requirements
- Unlimited liability to Swiss taxation for the first time or interruption of 10 years
- *No gainful employment in Switzerland*
  - The managing of own assets is usually not considered as a gainful employment up to a certain extent
  - The activity as a board director is generally not allowed in Switzerland; whether the activity (employed or self-employed) is allowed outside of Switzerland depends on cantonal practice.
  - Determination on a case-by-case basis necessary
Private clients with Swiss nexus
Swiss lump-sum taxation: sample

Highest tax burden resulting of following four categories for tax basis:

- **Living expenses**
  - Rent apartment Switzerland or costs of privately owned estate
  - Furnish, decoration etc.
  - Travel and holidays
  - Housekeepers
  - Food, beverage & others
  - Health & personal care
  - Insurances
  - Donations, contributions

- **Rent / rental value**
  - 7 times annual rent (in case property is rented) or rental value (if property is owned).
  
  \[ \text{E.g.: rent for apartment: CHF 3'500 p.m. / CHF 42'000 p.a., } 7 = 294'000 \]

- **Control calculation**
  - Income from Swiss sources, e.g. Swiss real estate, bank accounts
  - Treaty protected income
  - For wealth tax: Value of Swiss assets

- **Minimum tax basis**
  - Depending on canton
  - Economic interest for non-EU citizens to be eligible for permit

- **Taxable income** based on the above assumption: CHF 500’000.
  - This lump-sum, in principle, covers an equal amount of income within the control calculation

- **Taxable wealth**: CHF 500’000 * cantonal multiplier
Private clients with Swiss nexus
Taxation of foundations

Foundations

| Establishment | • Contributions from living persons are subject to gift tax; contributions cause mortis are subject to inheritance tax
|              | • Tax exemption (federal, cantonal & community level) for foundations with a charitable purpose \(\rightarrow\) ruling necessary |
| Current Taxation | • Taxed as separate legal entities |
| Distributions to beneficiaries | • In general, depending on the purpose of the foundation and the Canton in charge, subject to income or gift tax |
| Dissolution | • Depending on foundation deed |
### Taxation of trusts

**Private clients with Swiss nexus**

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<th>Revocable trust</th>
<th>Irrevocable fixed interest trust</th>
<th>Irrevocable discretionary trust*</th>
</tr>
</thead>
</table>
| **Legal basis**        | • No formal legal basis  
                          | • Recommended: tax ruling (ideally prior to relocation* / planning) |
| **Establishment**      | • no tax consequences  | • gift tax  | • gift tax |
| **Ongoing taxation**   | • assets attributed to settlor  | • assets attributed to beneficiary  | Assets neither attributed to Settlor nor Beneficiary |
| **Distributions to beneficiaries** | • gift tax (except where settlor = beneficiary)  | • Generally subject to income tax  
                          | • Capital gains and repayment tax free  | • Generally subject to income tax  
                          | [tax free repayment of contributed capital]  |
| **Dissolution**        | • If assets flow to beneficiaries, typically gift tax  | • In general subject to income tax  
                          | • capital gains and repayment tax free  | • In general subject to income tax  
                          | • tax free repayment of capital that was subject to gift tax |

* If Settlor is resident in Switzerland at the time of establishment of the trust, the tax consequences resemble the ones of a revocable trust.
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