Swiss Lump-Sum Taxation: An Alternative Amidst Europe's Tax Reforms?

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I. Introduction

States have an interest in increasing their tax revenues while at the same time maintaining their fiscal attractiveness. Adjustments to taxation are often aimed at taxing wealthy individuals. However, excessive taxation can result in the departure of its wealthy citizens. For a country like Switzerland, adjustments in the European environment are therefore an opportunity to attract new wealthy taxpayers. Some state measures are presented below as an introduction to this article.

Several European states have recently implemented significant tax reforms. Norway, for instance, has introduced tax increases and stricter taxing rules in the recent past. Even with the departure of Norway, one cannot escape certain taxes. Because leaving Norway triggers a so-called exit tax, which is payable on unrealised capital gains from securities or shareholdings in legal entities. Previously, it was possible to avoid this tax, as it expired after five years and was no longer payable unless the shares were sold. Since November 2022, this exit tax is no longer limited in time, so that in the event of a share sale the exit tax of newly 37.84 % (increase of 2.64 %) must be paid.

These measures have resulted in many residents leaving Norway. Many of them have chosen Switzerland as their new place of residence. The reason for this is the Norwegian Ministry of Finance's reinterpretation of the double taxation agreement between Switzerland and Norway. If certain conditions are met, Norway recognizes a person as resident in Switzerland for tax purposes within the meaning of Article 4 of the double taxation agreement between Switzerland and Norway. Further details on this topic will be given in chapter III. "Modified lump-sum taxation and its advantages".

Significant tax adjustments are planned in the United Kingdom. Until now, people with non-dom status in the UK have benefited from being taxed at a flat rate, whereas foreign income was not taxed. Since 2017 a non-dom can no longer claim this status if he or she has been a UK resident for 15 out of the previous 20 years, or if certain other conditions apply. Like the previous government, the new government led by Keir Starmer plans to abolish the outdated non-dom regime and replace it with the new residence-based regime. The government will remove preferential tax treatment based on domicile status for all new foreign income and gains (FIG) that arise from 6 April 2025. To replace the remittance basis of tax, the government will introduce a residence-based regime, providing 100% relief on FIG for new arrivals to the UK in their first four years of tax residence, provided they have not been UK tax resident in any of the 10 consecutive years prior to their arrival. The new government also plans to close existing loopholes, for example by subjecting foreign assets held in trusts to the inheritance tax.

It is expected that UK faced an exodus of around 9'500 people with liquid assets of at least one million dollars in the past year. This would mean that twice as many millionaires would have left the UK as it was already the case in the year 2023. According to a study by the UBS the UK could lose almost one in six of its millionaires until 2028.

In the upcoming years Switzerland with its lump-sum taxation might be considered as an attractive alternative for wealthy individuals with tax residence in Italy too. The government of Italy decided

in August 2024 to double the flat tax applied on income earned abroad from EUR 100'000.00 to EUR 200'000.00. In Italy, the lump-sum tax is granted to wealthy foreigners or Italians who decide to take up residence in Italy after living abroad for at least nine years. The lump-sum covers all income and assets earned abroad.

The taxation of wealthy individuals is therefore undergoing a change in parts of Europe. These changes mark an opportunity to attract some of the emigrants to Switzerland. However, these opportunities are at risk due to a domestic legislative initiative. The so-called popular initiative "For a social climate policy - fairly financed through taxation (Initiative for a future)" - in short: inheritance tax initiative - provides for inheritances of over CHF 50 million to be subject to an inheritance tax of 50%. Although the initiative is predicted to have little chance of success, it is already prompting many wealthy individuals to leave Switzerland. Due to the growing uncertainty among wealthy residents, the Swiss Federal Council announced in August 2024, that it would reject an exit tax. Furthermore, the Swiss Federal Council confirmed in December 2024 that tax avoidance measures would not apply retroactively to the date on which the initiative was adopted, but only from the date on which the implementing provisions came into force. According to federal estimates, if the initiative were adopted, the lost revenue due to emigration would exceed the expected additional tax revenue, which is why a net loss would be expected.

II. Lump-sum taxation and its attraction

Foreign individuals relocating to Switzerland are in general subject to the same income and wealth taxes as Swiss residents. This principle is breach by lump-sum taxation, to which a foreigner who relocates to Switzerland has the right to request for. This internationally favorable taxation regime allows to be taxed according to the worldwide living expenses instead of the worldwide income and net wealth. Since lump-sum taxation keeps the effort of the asset valuation low, it is a simplified method of taxation and the effective tax burden might be very attractive for wealthy individuals. Currently, the lump-sum taxation can be claimed in all Swiss cantons except for Appenzell-Ausserrhoden, Basel-Landschaft, Basel-Stadt, Schaffhausen and Zurich.

Lump-sum taxation is only an option for non-Swiss citizens who are taking up residence in Switzerland for the first time or after an absence of at least ten years. In addition, these residents will not be permitted to perform any commercial activity (employed or self-employed) in Switzerland. This means that any commercial activity needs to be performed outside of Switzerland.

However, the criterion of the absence of gainful employment is to be understood restrictively but is not entirely uncontroversial. For example, the Swiss Federal Council has clarified that the activity as a member of the Board of Directors in Switzerland constitutes a dependent gainful activity if it is remunerated accordingly. As a result, lump-sum taxation is generally not permitted. Compensation is not only understood to mean a director's fee, bonus or similar, but also compensation paid to him or her by a third party such as a shareholder of the company. This provision also covers activities in which a member of the Board of Directors does not receive any compensation but is a shareholder of the company. In this case, however, it must be a significant shareholding that enables him or her to exert certain influence on the company and the waiver of the compensation must result in a significant increase in value. On the other hand, board activities are compatible with lump-sum taxation in certain constellations, inter alia if the activity is performed on an honorary basis or if the taxpayer is merely reimbursed for expenses to a reasonable extent.

The lump-sum taxation is also not precluded if the paid activity of a member of the Board of Directors takes place abroad. In the case of a Swiss joint-stock company, however, this would only be the case if the company would be actually administrated abroad and the member of the Board of Directors goes abroad to carry out its activities. However, the Swiss Federal Supreme Court has already ruled that a small-scaled activity in Switzerland does not preclude lump-sum taxation if the

gainful activity is otherwise carried out abroad. It must therefore be clarified on a case-by-case basis whether the respective activity sought precludes lump-sum taxation.

The taxable income for lump-sum tax purposes is determined on the worldwide annual living expenses of the taxpayer and its dependents. In any case, certain minimum amounts are taken into account as living expenses for the calculation of the flat-rate tax. The modalities of the taxation and the taxable income are usually negotiated with the tax authorities and confirmed by them with a legally binding tax ruling.

Swiss law requires that the amount of taxes based on the annual living expenses must be at least equal to the taxes according to ordinary rates of taxation calculated from the total gross value of assets located and invested in Switzerland, plus the income derived therefrom. For this purpose, the Swiss tax authorities compare the taxable income based on the worldwide annual living expenses with the revenue from Swiss sources on a yearly basis (by means of the so-called "control calculation", see also: III. Modified lump-sum taxation and its advantages). If the lump-sum taxes are lower under the control calculation than the tax on the above-mentioned elements of income and assets in Switzerland calculated at the ordinary rate, then the individual will be taxed based on the sum of the Swiss sourced income.

III. Modified lump-sum taxation and its advantages

Switzerland currently has double taxation agreements with over 100 countries. In general, foreign taxpayers benefiting from lump-sum taxation are deemed to be resident in Switzerland under the respective tax treaty and therefore can in principle benefit from the double taxation agreement and claim tax relief provided by the tax treaty.

However, with regard to the double taxation treaties with Belgium, Germany, Italy, Norway, Canada, Austria and the USA a taxpayer subject to lump-sum taxation is only considered as resident in Switzerland if certain requirements are met. These requirements are met if the taxpayer is treated as if all income, including the income from the respective state, are subject to ordinary taxation and the general income tax rates in Switzerland. The modified lump-sum taxation then enables the taxpayer to claim the flat-rate tax credit for the income originating from the respective state. This contrasts with individuals being subject to ordinary lump-sum taxation, who are in principle not entitled to the flat-rate tax credit of the base taxes remaining abroad. This makes the modified lump-sum taxation an attractive option for a person from one of these seven before mentioned states who consider relocating to Switzerland.

IV. Ordinary taxation and its benefits

1. Cantonal inheritance and gift tax

Being subject to lump-sum taxation does not exempt from the inheritance and gift tax. The inheritance and gift tax are levied at cantonal level only. Except for canton Schwyz and Obwalden, all cantons levy inheritance and/or gift taxes if the deceased or donor had been resident of the respective canton, or if real estate located in the canton is transferred. In all those cantons, spouses are exempt from inheritance and gift taxes. Most cantons also exempt direct descendants. Since the cantons are free to determine how the tax is to be levied, the progressively designed rates vary between the cantons and is multiplied by a factor depending on the relationship between the deceased respectively the donor and the recipient. It is important to note that this cantonal competence would continue to exist even if the inheritance tax initiative were to be adopted by the Swiss voters.

2. Income and wealth tax

In some cases, it may be more attractive for foreigners to be subject to ordinary taxation instead of lump-sum taxation, also due to the modified lump-sum taxation. The Swiss tax authorities leave the scope for flexible application of the lump-sum taxation open insofar as even a change from lump-sum taxation to ordinary taxation is accepted by the Swiss tax authorities. The ordinary income tax is levied on the worldwide income. However, revenues derived from business conducted abroad, from permanent establishments and from immovable property situated abroad are exempt and are considered only for the determination of the applicable personal income tax rate. Since the Swiss tax system is based on the principal of family taxation, the income of spouses and minor children is added together.

Individual tax rates are typically progressive, whereas a tax rate of 11.50% applies at the federal level for income above CHF 950'000.00. Since the cantons may set their own tax rates, the applicable cantonal tax rates can vary significantly. With a tax rate of 22.59%, the canton of Schwyz offers the most attractive income taxes in a cantonal comparison.

In addition to the low tax rates, all capital gains from the sale of private assets are generally tax-free from the federal and cantonal/communal level and might reduce in some cases the tax burden significantly. As an exception, gains realized on the sale of real estate or of majority stakes in real estate companies are subject to a separate cantonal real estate capital gains tax. Another special feature of the Swiss tax regime is that dividends of significant shareholders (10% or more) are subject to preferential taxation. Only 50% to 70% of the gross dividend - depending on the level (cantonal or federal) - is subject to ordinary income tax.

As stated, the wealth tax is based on the worldwide assets. Important exemptions apply to personal household items and to claims on pension funds and assets invested in recognized personal pension schemes. Since the cantonal wealth taxes are assessed on a net basis, various deductions can be claimed from the gross assets, which might reduce the taxable assets enormously.

Unlike the income tax, the wealth tax is only levied at the cantonal and municipal level. Every canton can set their own tax rates and therefore the maximum tax burden differs considerably. The tax rates are, especially compared to the raised wealth tax rates in other jurisdictions quite low. In addition, some cantons even grant an exemption amount.

V. Conclusion

In the face of tightening tax regimes across Europe, Switzerland remains a tax haven for high-net-worth individuals. Its flexible lump-sum taxation, coupled with low wealth and income tax rates, makes it an attractive alternative, despite potential domestic challenges such as the inheritance tax initiative.