

Tax: what are the consequences for owners, domiciled in Switzerland, of property located abroad?

Becoming the owner of a second home abroad may represent the realisation of a dream. Inheriting the superb abode of an uncle in America you did not even know existed may appear a wonderful surprise, on the surface. Yet, these situations may have totally unexpected and detrimental tax consequences. However, there are some advantages in the system.

1 Introduction

According to the Swiss tax system, taxpayers must indicate their total income and assets in their tax return, irrespective of whether such elements originate in Switzerland or abroad. However, in order to avoid double taxation, foreign-source elements are exempt from tax in Switzerland but taken into account only to calculate the rate of tax to apply to the assets and income (exemption with progression method). It is this method which is used for real estate assets located abroad, which are already taxed in the country in which they are situated. Yet, in practice, this solution is far from perfect and can lead to surprising, or even frankly inadequate results. Nevertheless, some nice surprises exist. Here is an analysis of this often misunderstood topic.

2 Taxation of properties in general

Properties are subject to a wealth tax based on a fiscal value, calculated more or less generously, depending on the canton. The Canton of Basel, for example, uses values 2.6 times lower than the average cantonal value, whereas those in the Canton of Neuchâtel are 20% higher. As regards income tax, property income corresponds to rental

or, in the case of actual occupancy by the owner, rental value, which may be defined economically as the income in kind generated from the enjoyment of the property by its owner. For the calculation of net income, the owner is entitled to deduct actual upkeep costs or claim a lump-sum reduction, generally 20% of gross income. Once again, some cantons are more flexible than others: for example, the Canton of Geneva grants a fairly liberal authorisation to deduct gardening costs. What is more, since no canton applies a limit to the upkeep costs which may be deducted, the real estate return may be negative, generating a significant or even dramatic reduction in total taxable income (in the event of comprehensive renovation, for example).

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In the event of tax liabilities in several cantons, any excess charges (charges higher than income) in

one canton must be offset by the other cantons. Therefore, this means that, globally, no deduction is lost. However, as we shall see, the situation becomes more complicated for properties held abroad.

3 Calculating the fiscal value of properties located abroad

When calculating the fiscal value of a property located abroad, approaches in the various cantons differ somewhat. In the Canton of Geneva, for example, the fiscal value corresponds to the purchase price, at the historical rate on the date of purchase. In the Canton of Vaud, this same value is reduced by 20%. In Neuchâtel, a 20% reduction is also granted, but it is the average rate for the year of purchase which is taken into account for the conversion into Swiss francs.

4 Calculating the rental value of properties located abroad

In order to determine the tax in Switzerland, if the property is occupied by the owner, it is essential to calculate the rental value referred to above, irrespective of whether the property is located in Switzerland or abroad. The main problem linked to this question for properties located abroad is the fact that few countries are familiar with this system (as is the case for France, Spain and Denmark in particular). One again there is no standard practice at cantonal level. In Geneva, if no foreign value is available (and it's therefore often the case), the value will correspond to 4,5% of the fiscal value of the real estate, without any deduction of upkeep costs.

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This practice may therefore penalise the owners. However, when such an official value is available, it may prove advantageous, since these values are often lower than in Switzerland (as is the case in France, for example). Most of the other cantons

(such as Vaud) calculate Swiss and foreign rental values in the same way, based on different parameters, especially the living area and the date of construction.

5 Consideration of upkeep costs

Apart from in cases where the net rental value of the property located abroad is calculated as a lump sum (see the 4.5% rule used in Geneva, figure 4 above), taxpayers are entitled to a deduction, whether a lump sum or for actual upkeep costs incurred.

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What is more, even in cases where the upkeep costs for a property abroad comfortable exceed the value of the property itself, these costs are taken into account for taxation in Switzerland. However, as we shall see below, there are certain flaws in the system for calculating tax (see figure 8 below).

6 Debts and interest liabilities

Debts and interest liabilities connected with properties located abroad are recognised in the same way as for properties located in Switzerland. It should also be noted that taxpayers domiciled in Switzerland are required to declare not only all their worldwide assets, but also all their worldwide debts, whether mortgages or unsecured, and the associated interest liabilities.

7 International division of net wealth and net income for taxation

The exemption with progression method (see figure 1 above) used to prevent double taxation requires that net property income and wealth be precisely divided between Switzerland and abroad. Within the context of the international divisions established by the authorities, while the upkeep costs are divided subjectively (with the costs

allotted to the property for which they were accrued), it is a different story for debts and interest liabilities, which are divided in proportion to the local gross assets.

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This means that, depending on the circumstances, a mortgage taken out for a property in Switzerland may be virtually non-deductible. Since interest liabilities are processed in the same way as debts, Swiss taxable income will be affected to the same extent. For example, this could be the case for a taxpayer, with debts on a property in Switzerland, who inherits a high-value property abroad. The taxpayer would then see the majority of the Swiss debt and interests transferred abroad. The same situation would apply to a new buyer of a second home abroad, purchased using their own cash resources. This system is even more problematic, since taxable income abroad is often insufficient to offset the duly divided interest liabilities and the deductible upkeep costs. There is then the question of how to take into account negative surpluses abroad (linked to the upkeep costs and excess interest liabilities) when calculating tax in Switzerland.

8 Handling negative surpluses abroad

According to para. 3 of article 6 of the LIFD (Federal Direct Taxation Law), for properties in particular, *'[...] losses suffered abroad may be taken into consideration in Switzerland only when determining the rate of tax'*. This therefore means that, unlike the inter-cantonal procedures (see end of figure 2), in the case of negative surpluses abroad on a property, the said excesses are not 'repatriated' to Switzerland, which would reduce the Swiss tax base (i.e. what is actually taxed in Switzerland). In such hypotheses, only the rate of tax is affected. Even if, in the most extreme (yet still realistic) hypothesis that the negative surpluses should reduce overall income to CHF 0.00 (with the rate of tax consequently also totalling 0%), the impact on tax is appreciable, which is not the case when income taxed in

Switzerland is greater than the taxpayer's actual ability to pay the tax. In fact, if, as we have shown, interest liabilities and upkeep costs actually paid by taxpayers are not deducted from their tax base because they have been artificially allocated abroad, their ability to pay is clearly impaired. In international terms, this situation may be considered equivalent to actual double taxation of income. In a judgement issued in 2014 (ATF 140 II 157), the Federal Court nevertheless ruled in favour of maintaining this system, judging in particular that the unconditional exemption for

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properties located abroad was an exception to the ability-to-pay principle. The Federal Court also ruled that an international situation cannot be compared to an inter-cantonal situation, since the taxation of second homes is guaranteed in Switzerland by a sufficiently high rental value, which is not necessarily the case abroad.

9 Conclusion

This analysis of the Swiss tax system thus shows that becoming the owner of a property abroad could prove more expensive than it appears, amazing though this may seem. 'Deduction losses', linked, in particular, to the principle of objective division of debts, are regrettable. Moreover, the obvious inequality of treatment between second home owners in Switzerland and those with a property abroad is flagrant. These two reasons (among others) should be enough to persuade the legislator to change the law.

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Despite this, there is currently no project to

support this. However, it must be acknowledged that the rules in force enable a certain optimisation of the tax liability in Switzerland since, even if this only affects the rate of tax, the unlimited deductibility of property upkeep costs, including for properties located abroad, may at least enable taxpayers to reduce their income rate of tax in Switzerland dramatically. It may thus prove extremely wise to remember to list and claim this type of deduction when filing a tax return.

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