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N E W S L E T T E R

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A tax-optimised asset and liabilities structure

Dear Sir or Madam,

Happy are those who are affluent, as material wealth contributes considerably to a positive attitude towards life. Is it now worth incurring debts in order to save on taxes? The answer to this question lies in a tax-optimised asset and liabilities structure.

The amount of tax payable depends on income and assets. If we deliberate whether we can save on taxes by incurring debts, then we disregard earning income. We analyse the assets, for example securities and real estate, which generate passive income. We also analyse liabilities, for example mortgages and loans, which create a negative income in the form of interest, which then reduces overall income. After that, we consider the issue whether it is worthwhile to incur debts and whether it makes sense to leave mortgages as they are instead of repaying them. What does not make any sense is to incur debts just for taxation's sake. Simply spending more than generated income just to avoid paying tax on assets makes no sense. Mind you, some people generally spend more money than they earn. However, that is a completely different issue.

Yet it must be noted in advance: only when assets have reached seven figures in Swiss Francs is it worth making considerations regarding taxes on assets, as these are marginal in the low regions. Thus can a considerable savings objective be achieved without incurring any significant tax consequences.

Interest on liabilities versus asset income
Anyone who is in debt, be it in the form of loans or consumer credits, can deduct debt interest from their income. Anyone who has assets, be it in the form of securities or real estate, is generating income liable to tax (for once we ignore negative interest).

Is it worthwhile taking up a loan (lombard credit) on your assets, for the purpose of purchasing securities?
Let us take a look at the implications of a change in assets, for example by taking up a loan amounting to CHF 1mn in order to purchase securities. In this particular case, the increase in securities by CHF 1mn leads to an increase in earnings from assets. Next to these tax-liable additional earnings, you have the additional debt interest which can be deducted from your taxes.

Interest-intensive asset investments
Let us first look at creating a conservative securities portfolio with high interest earnings. Always taking the fiscal framework into consideration, this will lead to earnings on interest, liable to tax. Should the amount of debt interest be equal to the generated return on assets, the tax consequences are nil. Should we have no success and generate less earnings on interest than debt interest, then we are losing money. We can deduct this loss, here the difference between interest receivable and interest payable, from our income. In total we have an increase in expenses even after tax which under the bottom line leads to a net reduced income.

Capital gains intensive asset investments
On the other hand, let us take a look at creating a securities portfolio with a high percentage in shares. Once again taking the fiscal framework into consideration, this will lead to tax-free capital gains or, as history has shown us, to tax-free capital losses. Here deducting debt interest will more immediately lead to tax savings than with interest-intensive asset investments.
Conclusion: Less income than with other methods and tax-free capital gains, but either positive or negative with corresponding risks.

Is it worthwhile increasing the mortgage to save on taxes?
In most situations, this is a less than ideal solution as you do not generate as much interest as the bank does. Of course we can come to a different evaluation once we have a higher return than our bank interest generates. However, then it is no longer a fiscal consideration, but rather a commercial evaluation. Thus increasing the mortgage is only then worthwhile if we generate a higher return with our investments than the bank does with its interests.

Conclusion I:
Thus we come to our core statement, that debts should first and foremost serve as a commercial basis for financing. Making debts for purely fiscal reasons is wide of the target.

Are there other ways to save on taxes (purchasing into the pension plan?)
Tax planning can have positive fiscal effects. Examples for this are either the purchase of a life insurance with a single premium or incurring bank liabilities. Once again taking the fiscal framework into consideration, purchasing such a life insurance will lead to either a tax-free or a tax-reduced insurance benefit.

The same applies to a leveraged purchase into a pension plan. We create an increase in pension assets whilst incurring debts with interest that can be deducted. However, this situation is highly complex.
Positive effects: reduced assets plus interest on invested capital.
Negative effects: interest payable reduced by tax advantage. Considering all the individual factors, a generalised statement cannot be made in this specific instance.

Does buying real estate lead to tax reductions?
Purchasing real estate replaces moveable assets and relevant earnings with immoveable property and relevant earnings, plus debt interest for the mortgage. In the first phase this will lead to a reduction in the tax burden. At a later stage, immoveable property and capital gains are balanced against each other, with property owners, generally speaking, slightly better off.

However, it must be pointed out here that there is a fiscal limit for the deduction of interest payable which absolutely needs to be considered. Thus immoveable property should never be purchased for fiscal reasons only; other considerations need to be taken into account.

Conclusion II:
For substantial tax savings, an individual analysis is required. Incurring debts does not necessarily lead to savings; only within the framework of an all-inclusive assessment might this be possible.

Kind regards
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