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## Saving taxes with real estate?

Dear Ladies and Gentlemen,

Real estate property that is either lived-in or let can have considerable tax consequences in Switzerland. Below we are outlining the principles of taxation of real estate both in Switzerland and abroad and also show possible optimisation measures.

### **Income tax**

#### Rent and lease income

Anybody letting property and thus making revenue through this needs to declare this as income. Taxed are rent and lease income that are billed to the tenants or leaseholders without billing associated costs.

#### Imputed rental value

If property is either used by the owner or not let then the imputed rental value is taxed as income. The imputed rental value corresponds to about 60-70% of the amount that the owner would earn in case the property was let or what the tenant would pay. Calculating imputed rental value differs from canton to canton and is in general between 4% and 7% of the tax value of the property. The canton of Basel-Stadt applies a calculation of around 4% in case of cantonal tax and 4.6% in case of direct federal tax.

#### Deduction of maintenance costs

Maintenance costs for property either in Switzerland or abroad can be deducted, but only costs contributing to helping maintain value are allowed to be used for deduction from income tax. Among these are costs for repair work, equivalently replacing furnishings and installations, plus costs for paint work, building insurance premiums and a number of service (repair) agreements. Costs for energy saving measures are subject to separate tax regulations. Although de facto raising the value of a property, expenditures for additional thermal insulation, for example, can be deducted as value-maintaining costs. Equally, installing a solar heating system to replace an existing heating system can be deducted from income tax, but only in case this had not already been installed when those properties were newly built.

Maintenance costs that actually raise the value of a property cannot be deducted from income tax; however, when selling the property you are allowed to deduct these specific costs from property gains tax. Such costs include initial installation or value-raising replacement of furnishings or fittings. Operational costs such as water, electricity, gas and waste disposal plus any extension to the property cannot be deducted.

Each year, the owners are entitled to freely choose whether they would like to have the actual costs for maintenance and renovations or a flat charge deducted.

By early planning of extensive renovation work and concentration of ensuing costs to either one or two taxation periods, in hand with full exploitation of flat-rate deduction in other tax periods you will be able to fully optimise your entire tax burden. We would like to suggest that you arrange a prior meeting with a tax consultant.

### Mortgage and loan interest rates

The amount of debt interest depends on the actual mortgage and any possible loan plus their interest rates. You are entitled to deduct these interest rates from your tax declaration, but they considerably reduce your income. Increased mortgage rates may contribute to a tax relief, nevertheless they disproportionately reduce your assets and should thus, from a fiscal point of view, be avoided.

### **Wealth tax**

#### Tax value for let or leased property in Basel-Stadt

Capitalisation, and the method to determine tax value differ from canton to canton. In the canton of Basel-Stadt, the annual capitalised rent and lease revenue (without associated costs) is regarded as tax value. Capitalisation rate is 6.50%, and tax value is calculated as follows:

$$\frac{(\text{rent or lease value}) \times 100}{6.50\%} = \text{tax value}$$

The same goes for real estate property outside Basel-Stadt.

#### Tax value of owner-occupied property in Basel-Stadt

Owner-occupied property or property neither let nor leased, situated in Basel-Stadt, is assessed at real value. With an evaluation order the tax authority of Basel-Stadt determines the tax value. For owner-occupied property outside the canton of Basel-Stadt both the previous tax value and additionally the external tax value (e.g. official value, land register value) need to be declared. After 10 years at the latest or after extensive rebuilding work the tax authority will again determine the value of the property. In case of properties abroad, the tax value is determined either via the tax value abroad or by purchase price.

### **Do persons subject to tax in Switzerland need to declare overseas property both abroad and in Switzerland?**

Switzerland requires declaration of income and assets worldwide. Properties abroad may not be taxed directly in Switzerland, but they are used to determine the tax rate. Income and assets are divided up, via international tax allocation, among the countries that are affected. Tax rates are determined on the basis of the income generated worldwide. Below we are using a very simplified example to illustrate this:

	Switzerland	Abroad	Total
Earned income	100'000	-	100'000
Deductions Switzerland	-25'000	-	-25'000
Rental Income	-	10'000	10'000
Maintenance costs	-	-3'000	-3'000
<b>Total</b>	<b>75'000</b>	<b>7'000</b>	<b>82'000</b>

In the example above, the income generated worldwide is CHF 82'000. This amount is relevant for the determination of the tax rate that subsequently will be used on the taxable income of CHF 75'000 generated in Switzerland. The income generated abroad amounting to CHF 7'000 will not be taxed in Switzerland. Depending on mortgage payments, a property abroad can also lead to a tax rate reduction. Abroad, local tax laws are applicable; depending on country, income generated worldwide can but does not need to be considered to determine tax rate(s).

#### In case of non-declaration

In such a case, we recommend submitting voluntary, non-punishable declaration. If the tax authority is not yet aware of the property abroad, you just have to pay supplementary taxes and, where applicable, interest on arrears for the last 10 years. A fine will not be issued. Please note you can make a voluntary, non-punishable declaration only once.

#### **Excursus: financing home ownership**

According to a publication by the Federal Statistical Office (BFS), home ownership in Switzerland stands at around 37%, the lowest in all of Western Europe. Not only is this due to higher property prices, at purchase power parity, in Switzerland, but also due to a rather restrictive tendency in issuing mortgages in Switzerland.

When issuing mortgages, banks require that at least 20% of the purchase price is financed via "equity". On top of that, since 2010 at least 10% of the purchase price needs be financed via "actual equity", i.e. assets accumulated through voluntary savings and not through pension plan savings. Restrictions for Swiss banks for issuing mortgages had been increased during the last few years and are going to be made even more severe than they already are in the next few years. In the future, amortisation of mortgages needs to reach up to 2/3 of the actual capital. Previously amortisation of mortgages had been possible up to 80% of the original capital. So far banks are still accepting the pledging of vested pension capital from a pension fund as equity; however, there are plans among certain political groups to further reduce the option of prepayments for home ownership.

Kind regards

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