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NEWSLETTER

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Withdrawal of capital from the pension fund – attention, misunderstanding!

Dear Sir or Madam,

With Swiss pension funds, bearing certain restrictions in mind, you may choose to either draw your pension plan savings as a life-long annuity, or as a one-off lump sum payment. Additionally, capital payment enjoys certain tax privileges and allows for interesting tax planning opportunities. Since 2006, a blocking period of three years for each voluntary payment into a pension fund has been in place for drawing a lump sum.

However, the regulations for this blocking period open the door for misunderstandings. We have had a number of cases in which insured persons who had planned to draw a lump sum had, shortly before reaching retirement age, made voluntary payments, and had even asked their pension fund whether this was permissible. The answer they received may have been correct, but it was an answer to the wrong question. The consequences of this misunderstanding ensued when they drew the lump sum, with the tax administration starting a supplementary tax procedure and cancelling the deduction granted at payment, and charging full taxes.

To ensure this does not happen to you, we would like to shed some light on this issue: there are two different regulations regarding this blocking period which are easily mixed up.

Regulation according to occupational pension law
The federal Occupation Pension Act (BVG) stipulates in Art. 79b, section 3 that benefits resulting from a voluntary contribution (and only those) may not be drawn as a lump sum within a period of three years. Let us assume that you have pension plan savings of CHF 500’000 in your pension fund account, and you make an additional voluntary payment of CHF 20’000 the year before your retirement. In this situation the pension fund is entitled to pay out CHF 500’000 as a lump sum, whereas only the CHF 20’000 needs to be converted into a life-long pension.

The regulation according to tax law
Tax law, however, takes a step further here. After each voluntary contribution payment, the blocking period applies to all capital withdrawals for the next three years. Therefore, the tax authorities assume a tax circumvention if a lump sum is drawn within those three years, and consequently they will cancel the deduction granted at payment. In return, the corresponding share of the lump sum will not be taxed (again). However,

as the tax rates on drawing a lump sum are privileged and thus considerably lower than the regular rates granted on the deduction, there will be rather painful additional payments that will also include late interest. In 2010 the Federal Supreme Court had been dealing with such a case, and fully supported the tax authorities' application of this regulation.

The misunderstanding arises from the fact that pension funds are primarily focused to comply with BVG regulations, and, if at all, only incidentally see themselves giving tax advice. If they receive an inquiry by an insured person about the legitimacy of voluntary payments and drawing lump sums, then they only answer from a BVG point of view. The insured person inquiring, on the other hand, would like to optimise his or her taxes and has little interest in what the pension fund is allowed to do. The answer to the question about the first regulation is understood by the insured as answer to the second regulation.

In a summary assessment from a fiscal point of view it needs to be noted that, should you plan to receive your pension capital as lump sum, in a period of three years prior to retirement (or prior to an early withdrawal for other reasons), no voluntary contributions are possible.

Should you require advice regarding pension or tax planning, including planning in an international context, then the artax experts are at your disposal.

Kind regards
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