

EXPENDITURE TAXATION

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NATURE OF EXPENDITURE TAXATION

Preliminary Remarks

Under certain conditions, Swiss tax law offers the taxpayer the possibility to opt for so-called taxation according to expenditure, also referred to as expenditure taxation or lump-sum taxation,¹ instead of the ordinary income or wealth (net worth) taxation.²

Expenditure taxation is levied not on the taxpayer's income and assets but on living expenses³ in Switzerland.⁴ The main advantage of this type of taxation is that the

* The author thanks Jan Kleiner, lic iur, Zurich, for his contribution to this article. The author also wishes to thank Danielle Wenger, lic iur, Attorney at Law, Tax Expert, Zurich, and Nicola Benz, LLB Hons, Attorney at Law, Zurich, for critical review of and valuable comments on this article. In addition, the author thanks Eva Wettstein, Zurich, for indexing and proofreading. Originally published in *Aktuelle Juristische Praxis* 2/2007, *Die Aufwandbesteuerung*, pp 156 et seq. Translation by LT LAWTANK GmbH, Fribourg.

¹ The terms 'taxation according to expenditure' or 'expenditure taxation' best capture the nature of this type of taxation, although the 'lump sum taxation' designation has always been used. G Wilhelm, 'L'imposition des étrangers d'après la dépense', *StR* 1998, 74.

² Eidgenössische Steuerverwaltung, Informationsstelle für Steuerfragen (ESTV-Aufwandbesteuerung): Steuerinformationen. Teil E, Steuerbegriffe. Die Besteuerung nach dem Aufwand, Bern 2003, 1; F Richner, 'Pauschalbesteuerung', *ZStP* 2000, 1. According to media reports, there are currently approx. 3,200 taxpayers who are taxed according to living expenditure, with the majority of these taxpayers living in the cantons of Geneva, Grisons, Vaud, Valais and Ticino; *NZZ*, 17 Feb. 2006, available at www.nzz.ch/2006/02/17/zh/articleDL7YY.html.

³ M Bernasconi, *Die Pauschalbesteuerung*. Translated from the Italian, Zurich 1983, 1; P Locher, 'Kommentar zum DBG'. Bundesgesetz über die direkte Bundessteuer. Part I, Art 1-48 DBG, Allgemeine Bestimmungen, Besteuerung der natürlichen Personen, Therwil 2001, n 1 (Art 14 DBG); X Oberson, *Droit fiscal Suisse*, Geneva/Basle/Munich 2002, § 6, n 59.

⁴ Including living expenses of dependent persons living in Switzerland; ESTV-Aufwandbesteuerung (fn 2), 8; Locher (fn 3), n (Art 14 DBG); Oberson (fn 3), § 6, n 61; F Richner, W Frei, S Kaufmann, *Handkommentar zum DBG*, Zurich 2003, n 3 (Art 14 DBG) refer, with reference to M Rose (ed), *Konsumorientierte Neuordnung des Steuersystems*, Heidelberg 1991, to a 'consumption-orientated taxation system'. See also FTrib, judgment of 15.5.2000, *StE* 2001, fo 29.1, n 6 (also published in n 70, 575 ff), para 2 (a)).

basis of assessment diminishes⁵ as a consequence of the ordinary tax rate only being applied to a portion of the taxpayer's worldwide income and assets.⁶ The result is a regular and significant reduction in the individual tax burden.⁷

Taxation based on expenditure involves a simplified assessment procedure.⁸ The tax authorities base their assessment on criteria as set out below and carry out a control valuation (*Kontrollrechnung*) on the basis of domestic source income and domestic assets.⁹

IMPORTANT DISTINCTIONS

Tax Agreements

Case-law of the Federal Tribunal¹⁰ defines a tax agreement as a set of rules governing an actual one-off or recurrent case not covered by statute, and specifying the nature, scope or settlement conditions of the tax liability.¹¹ If a tax agreement is concluded, the competent authority issues a corresponding decision after conferring with the taxpayer.¹² The distinguishing feature of tax agreements is that the

⁵ And not due to a reduction in the tax rate; M Koch and M Heeb, 'Der Zuzug in die Schweiz: Vorzüge der Pauschalbesteuerung nutzen', *Praxis Internationale Steuerberatung* 2000, 116; Oberson (fn 3), § 6 N 57; Richner (fn 2), 1; Richner, Frei and Kaufmann (fn 4), n 5 (Art 14 DBG); see also M Zweifel, P Athanas, (ed) (StHG-Bearbeiter): *Kommentar zum Schweizerischen Steuerrecht I/1*, Basle 2002; StHG-Zwahlen, n 1 (Art 6 StHG), who sees in expenditure taxation 'a legally based determination of an assessment basis supported by a control method'. A similar view is expressed by E Höhn and R Waldburger, *Steuerrecht. Vol I. Grundlagen-Grundbegriffe-Steuerarten. Interkantonales und Internationales Steuerrecht. Steuerverfahrens- und Steuerstrafrecht*, Bern/Stuttgart/Vienna 2001, § 14 n 172. The Zurich Tax Appeal Commission I considers expenditure taxation to be a 'special tax, which - in contrast to expenditure taxation according to § 29 StG - does not take account of the concept of income contained in §§ 19 to 27 StG'; Zurich Tax Appeal Commission I, decision of 16.12.1991, StE 1992, fo 29.1 n 3.

⁶ Oberson (fn 3), § 6, n 59; Richner (fn 2), 1; Richner, Frei and Kaufmann (fn 4), n 5 (Art 14 DBG). See also Zurich Tax Appeal Commission I, decision of 16.12.1991, StE 1992, fo 29.1 n 3.

⁷ E Känzig, *Die eidgenössische Wehrsteuer (Direkte Bundessteuer)*, Basle 1982, n 1 (Art 18^{bis} BdBSt); Koch and Heeb (fn 5), 116; Richner (fn 2), 1; see also Bernasconi (fn 3), 1.

⁸ ESTV-Aufwandbesteuerung (fn 2), 1; P Hinny, *Die bilateralen Verträge und ihre Auswirkungen auf unser Steuerrecht; sind Pauschalbesteuerung und Quellensteuer weiterhin zulässig?*, ST 2000, 1147, 1153; Koch and Heeb (fn 5), 116. See also Känzig (fn 7), n 1 (Art 18^{bis} BdBSt).

⁹ ESTV-Aufwandbesteuerung (fn 2), 1.

¹⁰ BGE 101 Ia 92 ff, 98.

¹¹ FTrib, unpublished decision of 23.1.2004 (2A.52/2003), with references; BGE 101 Ia 92 ff, 98.

¹² Eidgenössische Steuerverwaltung, Informationsstelle für Steuerfragen (ESTV-Konkordat): *Steuerinformationen. Teil A, Allgemeine Angaben. Das interkantonale Konkordat über den Ausschluss von Steuerabkommen vom 10. Dezember 1948*, Bern 1998, 6.

taxpayer is no longer assessed and taxed according to the generally applicable statutory rules; the authorities, acting in cooperation with the taxpayer, agree to a new regime, which is case-specific.¹³ Tax agreements are problematic in respect of the fundamental principles of equality before the law and equal taxation.¹⁴ They are prohibited in the area of federal direct tax for lack of a statutory basis.¹⁵ They are likewise prohibited at the cantonal level pursuant to the intercantonal convention on the exclusion of tax agreements.^{16,17}

In contrast, taxation according to expenditure is provided for by statute at both the federal and cantonal levels.¹⁸

Tax Reliefs and Tax Exemptions

Tax reliefs and tax exemptions governed by statute and general statutory tax reliefs in favour of entire classes of taxpayers do not constitute tax agreements in the sense described above.¹⁹ Given their statutory basis, they do not pose a problem in respect of the principle of equal treatment of taxpayers before the law.

Agreements Reached During an Assessment Procedure

Nor do agreements concluded between taxpayers and the authorities during an assessment procedure constitute prohibited tax agreements. Such cases do not constitute a departure from the statutory regime, but rather involve a procedural understanding between the authorities and taxpayers.²⁰

¹³ ESTV-Konkordat (fn 12), 6.

¹⁴ ESTV-Aufwandbesteuerung (fn 2), 2.

¹⁵ BGE 121 II 273 ff, 279.

¹⁶ Convention between the Cantons of the Swiss Confederation on the Exclusion of Tax Agreements of 10.12.1948, SR 671.1.

¹⁷ Article 1 para 1:

‘The cantons undertake henceforth not to conclude any tax agreements with taxpayers and not to make use of any right provided for by statute or decree to conclude such agreements’.

See also ESTV-Konkordat (fn 12), 1 ff, 6 f

¹⁸ Locher (fn 3), n 5 (Art 14 DBG), with references, suggests that there are still certain resemblances between (authorised) expenditure taxation and (unauthorised) tax agreements; namely when the criteria for the assessment basis are open to negotiation or when an arrangement is made for a period of several years. See also Hinny (fn 8), 1153; M Bauer-Balmelli and S Maas, *Aufwandbesteuerung und englisches Konzept des Steuerstatus, ‘Resident but not domiciled’ – ein Vergleich*, zsis Monatsflash 6/2006 (available at www.zsis.ch).

¹⁹ ESTV-Konkordat (fn 12), 6 f As examples of statutory tax ‘privileges’, the tax liability exemptions under Art 56 DBG are worth mentioning.

²⁰ ESTV-Konkordat (fn 12), 7; Richner, Frei and Kaufmann (fn 4), n 18 (Art 14 DBG) with references.

The Problem and Justification of Taxation According to Expenditure

The issue of expenditure taxation is the subject of some political debate.²¹ There is a widespread view that it is a disingenuous means of privileging wealthy taxpayers.²² From a legal point of view it is argued that it contravenes the fundamental principles of equality before the law,²³ commonality of tax, and taxation based on economic performance.^{24, 25}

The issue of whether to maintain or abolish expenditure taxation should be debated chiefly at the political level.²⁶ This being said, from a legal perspective²⁷, one cannot deny that the concerns expressed about taxation based on economic performance²⁸ are justified to some degree.^{29, 30}

²¹ Bernasconi (fn 3), 1; ESTV-Aufwandbesteuerung (fn 2), 1; H Grüninger, *Steuerrechtliche Entwicklungen*, SZW 2003, 18 StHG-Zwahlen (fn 5), n 4 (Art 6 StHG). The message of the Federal Council in respect of DBG and StHG also refers to the fact that expenditure taxation meets with 'approval as well as refusal'. Message DBG/StHG, 51. See also the initiative submitted to parliament on 3.10.2003 by Leutenegger Oberholzer, member of the National Council, for the abolition of expenditure taxation, and the National Council debate of 6.10.2005 in this respect (document 03.458n by Leutenegger Oberholzer. Expenditure taxation; Abolition), available at www.parlament.ch/afs/data/d/bericht/2003/d_bericht_n_k10_0_20030458_0_20040913.htm (initiative and commission report) on the transcripts of National Council debates (document 03.458 Parliamentary Initiative Leutenegger Oberholzer Susanne. Expenditure taxation. Abolition.), available at www.parlament.ch/ab/frameset/d/n/4709/208488/d_n_4709_208488_208596.htm.

²² ESTV-Aufwandbesteuerung (fn 2), 1; see also Bernasconi (fn 3), 1.

²³ Article 8 BV.

²⁴ See also Art 127 para 2 BV.

²⁵ Richner (fn 2), 5; Richner, Frei and Kaufmann (fn 4), n 1 (Art 14 DBG); the Zurich Tax Appeal Commission I (Decision of 16.12.1991, StE 1992, fo 29.1 n 3) is also of the opinion that expenditure taxation is 'clearly in contradiction to the ordinary net worth taxation applied in Switzerland and the concept of taxation according to ability to pay'. Regarding the constitutionality of expenditure taxation see also M Beusch, *Aufwandbesteuerung - Privileg für reiche Ausländer oder aus praktischen Gründen gebotene Art der Ermessensveranlagung?* zsis Monatsflash 10/2005 (available at www.zsis.ch), section 3.

²⁶ See the National Council debate of 6.10.2005 (document 03.458 Parliamentary Initiative Leutenegger Oberholzer Susanne. Expenditure taxation. Abolition.) available at www.parlament.ch/ab/frameset/d/n/4709/208488/d_n_4709_208488_208596.htm.

²⁷ First, it should be mentioned that in respect of federal direct tax, expenditure taxation is governed by a federal law, the constitutionality of which cannot be reviewed due to the provision of Art 191 Federal Constitution (BV), which confers binding force on federal statutes. This, however, does not apply to cantonal laws, where an in-depth debate is called for on this issue. See also Richner, Frei and Kaufmann (fn 4), n 2 (Art 14 DBG).

²⁸ It only seems justified on practical grounds. See in this respect P Locher, *Praktikabilität im Steuerrecht (unter besonderer Berücksichtigung des materiellen Rechts der direkten Steuern)*, publication commemorating the 65th birthday of Ernst Höhn, Bern 1995, 189 ff, 195.

²⁹ This is less the case when the issue is examined from the perspective of equality before the law; see in respect of permissibility of legislative discrimination against nationals BGE 129 II 249 ff

Ultimately, values need to be weighed up politically. The promotion of economic development is a major factor.³¹ The possibility of being taxed according to living expenses rather than worldwide income and assets is a sufficient reason for a significant number of wealthy foreigners to move their domicile to Switzerland.^{32, 33} This benefits local businesses, such as the building sector, the handicraft and retail trades, tourism, lawyers and the services sector as a whole, not least the banking sector, which has substantial assets under management.³⁴ State tax revenue also increases as a result of taxes being levied according to expenditure and – depending on cantonal regulations – in cases of succession³⁵ involving wealthy foreigners domiciled in Switzerland, or gifts.³⁶ It is therefore not surprising that many other countries have adopted similar models, with the UK example of ‘Taxation on Remittance Basis’ and ‘Resident but not Domiciled’ tax status being particularly well known, but also including Luxembourg, Belgium, Monaco, Ireland and Liechtenstein.³⁷

The political debate revolves around the question of ‘whether or not Switzerland intends to retain such taxpayers in the future’.³⁸ If expenditure taxation were abolished, one should not expect taxpayers subject to this form of taxation to simply pay taxes under the ordinary regime; they are much more likely to leave Switzerland. Tax revenues would be lower, not higher, as a result.³⁹ The attractiveness of Switzerland as a location and the competitive position of

³⁰ Bernasconi (fn 3), 1; F Richner, W Frei, B Weber and H Brüttsch, *Kurzkomentar zum Zürcher Steuergesetz*, Zurich 1997, n 2 (§ 31 StG-ZH), who see in expenditure taxation a breach of the principle of taxation according to ability to pay.

³¹ Richner (fn 2), 6; on the economic significance also StHG-Zwahlen (fn 5), n 3 (Art 6 StHG).

³² Or to another country with similar tax treatment.

³³ Bernasconi (fn 3), 1; Höhn and Waldburger (fn 5), § 14 n 172. See also Wilhelm (fn 1), 74, for whom expenditure taxation represents ‘an excellent means of organising their tax and estate situation at an international level’. Under the old regime, residence permits were granted mainly to persons wishing to spend their latter years in Switzerland.

³⁴ See in detail Bernasconi (fn 3), 1 f; see also the remarks of National Council member Baader during the National Council debate on expenditure taxation (debate transcript, document 03.458 Parliamentary Initiative Leutenegger Oberholzer Susanne. Expenditure taxation. Abolition.), available at www.parlament.ch/ab/frameset/d/n/4709/208488/d_n_4709_208488_208596.htm.

³⁵ Although rare in practice.

³⁶ Bernasconi (fn 3), 2.

³⁷ Bauer-Balmelli and Maas (fn 18), n 6.

³⁸ See also the remarks of National Council member Baader during the National Council debate on expenditure taxation (debate transcript, document 03.458 Parliamentary Initiative Leutenegger Oberholzer Susanne. Expenditure taxation. Abolition.), available at www.parlament.ch/ab/frameset/d/n/4709/208488/d_n_4709_208488_208596.htm.

³⁹ Remarks of National Council member Baader during the abovementioned National Council debates (see also fn 38).

Switzerland on tax when compared to the rest of Europe or internationally, an issue the country cannot ignore, would thus both be affected.⁴⁰

In view of the above, it is likely that expenditure taxation, an institution that has been firmly anchored in the Swiss tax landscape for decades⁴¹ and that was maintained in the course of tax harmonisation,⁴² will continue to remain possible in the near future.⁴³

LEGAL BASIS

Historical background

Under the constitution, the cantons are free to set up their own tax systems.⁴⁴ As a result, tax laws have always varied from one canton to another. This has led to the cantons having very different regulations regarding tax exemptions or tax agreements. In the past there was a widespread possibility of concluding tax agreements in different cantons⁴⁵. In light of the serious concerns raised⁴⁶ regarding respect for the fundamental principles of equality and security before the law, an intercantonal convention on the exclusion of tax agreements was concluded on 10 December 1948.⁴⁷ In addition to prohibiting the conclusion of tax agreements, the convention provides for a range of permitted tax reliefs, inter alia, taxation based on expenditure.⁴⁸ In order to bring federal legislation into line with the provisions of the convention on lump sum taxation, the Federal Council issued a decree on 11 October 1949 introducing a new Art 18^{bis}⁴⁹ to the then still valid resolution of the

⁴⁰ StHG-Zwahlen (fn 5), n 2 (Art 6 StHG) Richner, Frei and Kaufmann (fn 4), n 2 (Art 14 DBG).

⁴¹ Richner, Frei and Kaufmann (fn 4), 2 (Art 14 DBG); Wilhelm (fn 1), 74.

⁴² Wilhelm (fn 1), 74.

⁴³ See fn 21; Reference is made to the cantonal initiative of the people of Zurich entitled 'An end to tax privileges for foreign millionaires' supported by the Alternative List, for the abolition of expenditure taxation.

⁴⁴ ESTV-Konkordat (fn 12), 1.

⁴⁵ ESTV-Konkordat (fn 12), 1; see the concept of tax agreements as described above.

⁴⁶ There is also the problem of the increasingly, fierce competition amongst the cantons to win wealthy taxpayers, which has led to well-off individuals taking advantage of the situation to obtain favours. ESTV-Aufwandbesteuerung (fn 2), 2; Wilhelm (fn 1), 74.

⁴⁷ Wilhelm (fn 1), 74.

⁴⁸ Article 1 para 3 (a) of the convention.

⁴⁹ Article 18^{bis} BdBSt:

¹ The taxpayers under Art 3 para 1 (a) or (c) who do not have Swiss nationality and are neither engaged nor have ever been engaged in gainful occupation in Switzerland can pay a lump sum tax instead of income tax. This right is conferred on Swiss nationals who were not taxable under Art 3 para 1 in the last

Federal Council regarding wealth (or net worth) taxation (BDBSt). The current regulations were thus modelled on the intercantonal convention on the exclusion of tax agreements and Art 18^{bis} BDBSt.⁵⁰

Applicable Statutory Basis

Numerous cantons made use, at times in different ways, of the possibility offered to them to provide for tax reliefs, including in the form of lump sum taxation.⁵¹ The variations between the cantonal regulations should be reduced in the course of the tax harmonisation process.⁵² Article 6 of the tax harmonisation law (StHG) obliges cantons to accord natural persons the right, in certain circumstances, to pay tax according to expenditure⁵³ instead of income or wealth tax, at least up to the end of

10 years due to absence and who take up domicile or residence in Switzerland without engaging in gainful occupation, up to the end of the calendar year following their return.

⁵⁰ See also message DBG/StHG, 51.

⁵¹ ESTV-Aufwandbesteuerung (fn 2), 2; Richner (fn 2), 3.

⁵² ESTV-Aufwandbesteuerung (fn 2), 2; Richner (fn 2), 3.

⁵³ See the cantonal regulations: Canton of Aargau: § 24 StG-AG and § 5 of the decree for the implementation of the tax statute StGV (SAR 651.111), and the explanatory note on expenditure taxation published by the tax authority of the Canton of Aargau; Canton of Appenzell, Outer Rhoden: Art 16 StG-AR and Art 6 of the tax law implementation decree (Steuerverordnung, BGS 621.111); Canton of Appenzell, Inner Rhoden Art 17 StG-AI and the decision of 5.12.2000 of the commission in respect of the tax law and tax decree; Canton of Basle-Land: § 10^{bis} StG-BL; Canton of Basle-City: Art 14 StG-BS, explanatory note 'expenditure taxation' of the tax administration of the Canton of Basle-City; Canton of Bern: Art 16 StG-BE and decree on expenditure taxation VBA (BSG 661.312.21); Canton of Fribourg: Art 14 StG-FR and resolution of 20.3.2001 on expenditure taxation (SGF 631.31); Canton of Geneva: Art 14 StG-GE and Art 1 to 6 RALIPP I; Canton of Glarus: Art 13 StG-GL; Canton of Grisons: Art 14 f StG-GR; Canton of Jura: Art 31 para 5 StG-JU and the decree on expenditure valuation for the lump sum taxation of non-Swiss taxpayers (RSJ 641.312.21); Canton of Lucerne: § 21 StG-LU and § 7 of the tax decree of the Canton of Lucerne (SRL 621); Canton of Neuchâtel: Art 16 StG-NE; Canton of Nidwalden: Art 16 StG-NW and cantonal and communal tax law implementation decree (tax decree, NGS 521.11); Canton of Obwalden: Art 16 StG-OW and implementation provisions on expenditure taxation of 30.5.1995 and 20.3.2001 (GDB 641.417); Canton of Schaffhausen: Art 15 StG-SH and § 9 of the decree on direct taxes (SHR 641.111); Canton of Schwyz: § 15 StG-SZ and the relevant explanatory note of the cantonal tax authority; Canton of Solothurn: § 20 StG-SO and tax decree n 18 on expenditure taxation (BGS 614.159.18); Canton of St. Gallen: Art 28 ff StG-SG and Art 9 of the tax decree (SGS 811.11); Canton of Ticino: Art 13 StG-TI and Art 1 of the regulation of the taxation law (RL 10.2.1.1.1); Canton of Thurgau: § 17a StG-TG and decree of the Governing Council on the state and communal tax law of 10.11.1992 (TGS 640.11); Canton of Uri: Art 18 para 4 StG-UR and the regulation on expenditure taxation of 17.5.2005; Canton of Vaud: Art 18 StG-VD; Canton of Valais: Art 11 StG-VS and the resolution of the Governing Council on lump sum taxation of 30.9.1992; Canton of Zug: § 14 StG-ZG and § 4 of the tax law decree (BGS 632.11); Canton of Zurich: § 13 StG-ZH and directive of the cantonal tax authority on expenditure taxation of 28.7.1999.

the current tax period.⁵⁴ The deadline for adapting cantonal tax laws⁵⁵ expired on 1 January 2001.⁵⁶

An essentially identical⁵⁷ provision exists at the federal level under Art 14 of the Direct Federal Tax Act (DBG), which provides for the possibility of taxation based on expenditure under certain conditions. Article 14 para 2 DBG contains – in contrast to the provision of the StHG – a mandatory provision stating that foreigners have the ‘ongoing’ right to lump sum taxation if all the conditions are met.⁵⁸ To further specify the details and conditions governing expenditure taxation in relation to direct federal tax, the Federal Council issued a corresponding implementing decree on 15 March 1993.⁵⁹

CONDITIONS FOR EXPENDITURE TAXATION

General Remarks

If a person meets all the conditions for expenditure taxation, they have a legal right to be taxed accordingly.⁶⁰ The competent tax authorities do not have any discretion in this respect.⁶¹ On the other hand, there is no obligation to apply expenditure taxation to a person who satisfies all the requirements.⁶² A person may decline to exercise their right to be taxed under this regime, in which case they will be taxed

⁵⁴ See Art 6 para 1 StHG. This means (or meant) for cantons whose tax laws already contained provisions on expenditure taxation that the form provided for by Art 6 StHG had to be implemented by 2001; ESTV-Aufwandbesteuerung (fn 2), 3; see also Richner (fn 2), 3.

⁵⁵ ESTV-Aufwandbesteuerung (fn 2), 3.

⁵⁶ However cantons were left free to decide whether or not to apply expenditure taxation to non-Swiss nationals for an unlimited period. See Art 6 para 2 StHG. ESTV-Aufwandbesteuerung (fn 2), 3.

⁵⁷ ESTV-Aufwandbesteuerung (fn 2), 3.

⁵⁸ Art 14 para 2 DBG:

‘If such persons are not Swiss nationals, they may also have the ongoing right to expenditure taxation.’

ESTV-Aufwandbesteuerung (fn 2), 3.

⁵⁹ Expenditure taxation decree in respect of federal tax of 15.3.1993, SR 642.123 (henceforth Decree of the Federal Council on Expenditure Taxation). See also Art 14 para 4 DBG.

⁶⁰ Richner, Frei and Kaufmann (fn 4), n 4 (Art 14 DBG); StHG-Zwahlen (fn 5), n 6 (Art 6 StHG).

⁶¹ StHG-Zwahlen (fn 5), n 6 (Art 6 StHG).

⁶² ESTV-Aufwandbesteuerung (fn 2), 5; Höhn and Waldburger (fn 5), § 14 n 173; Wilhelm (fn 1), 75. It should be noted that a taxpayer taxed according to expenditure is still required to make social security repayments. The minimum amount is CHF 445.00 per year, the maximum amount is CHF 10,100.00 per year.

on an ordinary assessment basis.⁶³ However, if the conditions are not wholly met, expenditure taxation is not possible.⁶⁴

Below the requirements that taxpayers must satisfy in order to be eligible for expenditure taxation are detailed:

Subjective Conditions

Possibly entitled persons

According to the wording of Art 6 StHG and Art 14 DBG, expenditure taxation is available only to natural persons.⁶⁵ The lump-sum taxation of legal persons is not provided for.⁶⁶ The context and systematic order of the provisions governing taxation according to expenditure indicate that business partnerships are not taxable on this basis either.⁶⁷ Thus the claim to have tax liability assessed on an expenditure basis may be brought by private individuals only.⁶⁸

Tax residence and domicile status

In order to come under Switzerland's tax regime, individuals wishing to be taxed according to their living expenses must meet the ordinary subjective conditions for taxability in Switzerland.⁶⁹ They must acquire tax domicile or residence status in Switzerland.⁷⁰

Taking up domicile or residence

⁶³ Although the right to decline lump sum taxation may be exercised in respect of every tax period; Locher (fn 3), n 4 (Art 14 DBG); StHG-Zwahlen (fn 5), n 6 (Art 6 StHG).

⁶⁴ Bernasconi (fn 3), 9; Eidgenössische Steuerverwaltung, Hauptabteilung Direkte Bundessteuer (ESTV-Kreisschreiben): Kreisschreiben Nr. 9. Verordnung über die Besteuerung nach dem Aufwand bei der direkten Bundessteuer, Bern 1993, 1; Locher (fn 3), n 7 (Art 14 DBG).

⁶⁵ ESTV-Aufwandbesteuerung (fn 2), 4; Koch and Heeb (fn 5), 117; Richner (fn 2), 7; StHG-Zwahlen (fn 5), n 7 (Art 6 StHG).

⁶⁶ StHG-Zwahlen (fn 5), n 7 (Art 6 StHG).

⁶⁷ StHG-Zwahlen (fn 5), n 7 (Art 6 StHG).

⁶⁸ A natural person who is a member of a business partnership abroad and is a resident of Switzerland may opt for expenditure taxation providing they satisfy the remaining conditions, particularly the absence of any gainful occupation in Switzerland; see below and StHG-Zwahlen (fn 5), n 7 (Art 6 StHG).

⁶⁹ StHG-Zwahlen (fn 5), n 15 (Art 6 StHG).

⁷⁰ See Art 3 para 1 StHG.

Expenditure taxation is only available to persons taking up domicile or residence in Switzerland for the first time or following a 10-year absence.⁷¹

Not every form of presence in Switzerland constitutes grounds for exclusion from expenditure taxation. This regime is excluded only if the person's presence in the country constitutes a tax residence or domicile in Switzerland.

Gainful occupation

The key requirement for the permissibility of expenditure taxation is that the taxable person does not engage in any gainful occupation.⁷² Gainful occupation is any main activity or part-time occupation⁷³ that is exercised for the purpose of earning an income,⁷⁴ whether in an independent capacity or as an employee.⁷⁵

The activity must be remunerated to qualify as gainful.^{76,77} There must be a pecuniary gain.⁷⁸ This is lacking if a wage is to be qualified as compensation for costs or in the case of work performed in a wholly voluntary capacity.⁷⁹ The concept of gainful occupation further includes a quantitative aspect – a few business calls made from a private domicile in Switzerland do not suffice.⁸⁰

Understanding the phraseology of the DBG and StHG, which state that no gainful occupation is permitted 'here', is trickier.⁸¹ Repeatedly, according to the case-law of

⁷¹ Art 14 para 1 DBG; Art 6 para 1 StHG; ESTV-Kreisschreiben (fn 65), 1; StHG-Zwahlen (fn 5), n 18 (Art 6 StHG).

⁷² Art 14 para 1 DBG; Art 6 para 1 StHG; StHG-Zwahlen (fn 5), n 19 (Art 6 StHG) BGE 87 I 376 ff

⁷³ FTrib, judgment of 15.5.2000, StE 2001, fo 29.1, n 6 (also published in ASA n 70, 572 ff). Commentary on this judgment by Grüniger (fn 21), 26 ff; Bernasconi (fn 3), 10.

⁷⁴ Bernasconi (fn 3), 10; ESTV-Kreisschreiben (fn 64), 2; ESTV-Aufwandbesteuerung (fn 2), 5; StHG-Zwahlen (fn 5), n 21 (Art 6 StHG).

⁷⁵ StHG-Zwahlen (fn 5), n 21 (Art 6 StHG).

⁷⁶ Richner, Frei and Kaufmann (fn 4), n 11 (Art14 DBG).

⁷⁷ In this respect the Federal Tribunal held, in a judgment of 1948, that a non-Swiss national who is a member of a board of directors and receives a fixed remuneration, emoluments, allowance, etc., is gainfully occupied and has no right to expenditure taxation; ASA n 17, 391 ff

⁷⁸ StHG-Zwahlen (fn 5), n 21 (Art 6 StHG).

⁷⁹ StHG-Zwahlen (fn 5), n 21 (Art 6 StHG). See also Bernasconi (fn 3), 11, who argues that an activity exercised in an honorary capacity and generating income of up to CHF 12,000 should not be treated as gainful occupation. Income up to this amount in my view constitutes remuneration for out-of-pocket expenses; it is however difficult to define a clear limit in terms of the amount of income that would be required to qualify as gainful occupation. See also Richner, Frei and Kaufmann (fn 4), n 12 (Art14 DBG).

⁸⁰ FTrib, judgment of 15.5.2000, StE 2001, fo 29.1 n 6, b.

⁸¹ See StHG-Zwahlen (fn 5), n 19 (Art 6 StHG).

the high courts,⁸² the applicant must not be engaged in any professional activity on Swiss soil, that is to say within the geographical area of Switzerland.^{83, 84} The burden of proof lies with the competent tax authorities.⁸⁵ This means that a taxpayer applying for expenditure taxation may not physically engage in gainful activity in Switzerland;⁸⁶ otherwise the possibility of expenditure taxation is excluded. It is immaterial whether or not the professional activity is related to the Swiss economy.⁸⁷ The whereabouts of the domicile/registered office of the employer or the 'value' assigned to the work are equally of no importance.⁸⁸ The decisive criterion is physical presence. In contrast, gainful employment abroad does not preclude taxation according to expenditure, irrespective of whether the employer is foreign or Swiss.⁸⁹

There is some dispute as to whether weight should be given to the fact that a person has been previously engaged in gainful occupation in Switzerland. In the opinion of the author, expenditure taxation is not ruled out merely because the taxpayer previously pursued a gainful occupation in Switzerland – even if this was within the last 10 years.⁹⁰ This view is supported by a comparison of the phraseology of Art 18^{bis} BdBSt and that of Art 14 DBG and Art 6 StHG: whereas the former provision expressly requires that the taxable subject in question 'neither engages in *nor has ever engaged in* any gainful occupation in Switzerland', the DBG and StHG provisions are milder insofar as they merely require that the person 'is not engaged in any gainful

⁸² FTrib, judgment of 15.9.1961, ASA n 30, 366 ff; FTrib, judgment of 15.5.2000, StE 2001, fo 29.1 n 6, b.

⁸³ StHG-Zwahlen (fn 5), n 19 (Art 6 StHG), with references.

⁸⁴ FTrib, judgment of 15.9.1961, ASA n 30, 366 ff, 368; FTrib, judgment of 15.5.2000, StE 2001, fo 29.1 n 6, a.

⁸⁵ FTrib, judgment of 15.5.2000, StE 2001, fo 29.1, n 6, b (also published in ASA n 70, 575 ff). BGE 121 II 257 ff, 266; FTrib, judgment of 15.9.1961, ASA n 62, 720 ff, 720.

⁸⁶ StHG-Zwahlen (fn 5), n 19 (Art 6 StHG), with references.

⁸⁷ FTrib, judgment of 15.9.1961, ASA n 30, 366 ff, 368 f (BGE 87 I 376 ff).

⁸⁸ P Locher, Einführung in das internationale Steuerrecht der Schweiz, Bern 2005, 418. In the same vein is StHG-Zwahlen (fn 5), n 19 (Art 6 StHG). Bernasconi (fn 3), 12, holds the opposing view that writers or scientists who carry out the 'intellectual part' of their work in Switzerland, only to commercialize it abroad, should be entitled to expenditure taxation, providing they do not have premises in Switzerland nor any employees. In my opinion this view cannot be followed. The place where the work is actually performed should be the decisive factor.

⁸⁹ Bernasconi (fn 3), 10; FTrib, judgment of 15.5.2000, StE 2001, fo 29.1, n 6 (also published in ASA n 70, 575 ff). A business traveller who travels exclusively abroad and does not use their Swiss domicile for any business, but only for personal relations can be taxed according to expenditure. Känzig (fn 7), n 3 (Art 18^{bis} BdBSt) opposes this, but without giving reasons, ESTV-Aufwandbesteuerung (fn 2), 5; also Bernasconi (fn 3), 10.

⁹⁰ See, however, ESTV-Kreisschreiben (fn 64), 1; likewise Richner, Frei and Kaufmann (fn 4), n 7 (Art 14 DBG); Locher (fn 3), n 6 (Art 14 DBG).

occupation here'.⁹¹ One can assume from the above that if the intent of the drafters of these provisions had been to further consider a previous gainful occupation, irrespective of duration, as an obstacle to expenditure taxation, they would have maintained the statute's original, more restrictive wording.

A previous gainful occupation becomes of relevance in cases where, combined with a lengthy period of residence in Switzerland, it has triggered a tax residence in the last ten years.⁹² This causes the possibility of expenditure taxation to fall away because the requirement that a domicile or residence be established *for the first time* or after a *period of absence of at least 10 years*⁹³ is not met.

To summarise, where a person has been previously gainfully occupied in Switzerland, one must first ascertain whether this was the case in the last ten years and, if so, whether the person's presence in Switzerland as a result of the gainful occupation has triggered a tax residence or domicile. Where this is the case, then the possibility of being taxed according to living expenses falls away.

The absence of a gainful occupation has further implications outside tax law: Non-EU foreign nationals under 55 years of age are granted a regular residence permit only if they are eligible for a work permit.⁹⁴ This is somewhat in contradiction to expenditure taxation requirements.⁹⁵ In practice,⁹⁶ however, it is possible to circumvent this discrepancy by, for example, taking up employment in Switzerland with a newly formed company which carries out all its activities exclusively

⁹¹ For this reason the reference in Richner, Frei and Kaufmann (fn 4), n 7 (Art 14 DBG) to BGE 87 I 376 ff (ASA n 30, 366 ff) is not sufficient to hold that Art 18^{bis} BdBSt formed the basis of this decision.

⁹² See Art 3 para 3 StHG.

⁹³ With regards the concept of absence, see above, section 'Taking up domicile or residence'.

⁹⁴ Article 34 BVO; see also Locher (fn 3), n 7 (Art 14 DBG); There remains otherwise only the exception under Art 36 BVO, which provides that residence permits may be granted to other foreign nationals not engaged in gainful occupation where important grounds render this necessary. In some cantons tax interests constitute such grounds. Where this is the case, additional requirements must be met. According to the Federal Office for Migration directives and explanations relating to the arrival, residence and labour market (ANAG-Weisungen), Bern, May 2006, para 555, the foreign national applicant must provide evidence of relations with Switzerland (Swiss ancestors, school, study or training in Switzerland, previous long or repeated stays), demonstrate that they are based in Switzerland, that they intend to spend at least six months of a calendar year in Switzerland, will only engage in gainful occupation abroad and will limit the extent of such gainful occupation.

⁹⁵ See Grüniger (fn 21), 26 ff.

⁹⁶ See also FTrib, judgment of 15.5.2000, StE 2001, fo 29.1, n 6 (also published in ASA n 70, 575 ff).

abroad.⁹⁷ This type of gainful occupation, which is not physically carried on in Switzerland, is not incompatible with expenditure taxation.⁹⁸

A contrario, persons who are *actively* engaged in gainful activity in Switzerland are excluded from expenditure taxation even where their work does not translate into anything tangible in Switzerland.⁹⁹ So when directors,¹⁰⁰ sportsmen,¹⁰¹ musicians, composers, artists,¹⁰² inventors, etc. perform their activity – albeit with no tangible ‘results’ – in Switzerland, the possibility of expenditure taxation is lost.¹⁰³

Swiss nationals and foreign nationals; dual nationals

As a general rule, both Swiss nationals and foreign nationals can elect to be taxed according to expenditure. However, there are differences in the length of the tax period authorised under this regime.¹⁰⁴

⁹⁷ StHG-Zwahlen (fn 5), n 20 (Art 6 StHG) This very scenario formed the basis of the above judgment of 15.5.2000, StE 2001, fo 29.1, n 6 (also published in ASA n 70, 575 ff).

⁹⁸ FTrib, judgment of 15.5.2000, StE 2001, fo 29.1, n 6 (also published in ASA n 70, 575 ff); StHG-Zwahlen (fn 5), n 20 (Art 6 StHG).

⁹⁹ StHG-Zwahlen (fn 5), n 22 to Art 6 StHG.

¹⁰⁰ According to Bernasconi (fn 3), the partners of a Swiss partnership limited by shares who only earn interest in proportion to their share contributions and take a share in profits should not be treated as gainfully occupied. This opinion should be followed if the position of partner does not involve any professional activity; however, as soon as any gainful occupation is carried out – for example by a partner with unlimited liability – expenditure taxation is ruled out. On this subject see Bernasconi (fn 3), 11.

¹⁰¹ See S Hürlimann, *Professioneller Sport und Steuern. Grundsätzliches aus nationaler und internationaler Sicht*, CaS 2004, 199 ff, 207 f.

¹⁰² Bernasconi (fn 3) argues that artists who make an isolated appearance in Switzerland and donate their earnings to charitable organisations should not be treated as having a gainful occupation. This is true because this type of scenario is comparable to an honorary activity. However, checking or ascertaining how often a person may carry out such activity in Switzerland, and verifying that the proceeds actually go to the charitable organisation, is not so easy in practice. To solve this problem, it should be required of an artist who wishes to make such an appearance in Switzerland to provide evidence that a) the activity is carried out on a limited basis and b) that all proceeds are donated to a charitable organisation. On this subject Bernasconi (fn 3), 11; Also P Agner, A Digeronimo, H-J Neuhaus, G Steinmann, *Kommentar zum Gesetz über die direkte Bundessteuer. Ergänzungsband*, Zürich 2000, n 5 (Art 14 DBG).

¹⁰³ ESTV-Kreisschreiben (fn 65), 2; StHG-Zwahlen (fn 5), n 22 (Art 6 StHG).

¹⁰⁴ ESTV-Kreisschreiben (fn 65), 1; ESTV-Aufwandbesteuerung (fn 2), 4 f; Locher (fn 3), n 6 (Art 14 DBG); as suggested by Richner, Frei and Kaufmann (fn 4), n 15 (Art 14 DBG), this differentiation raises concerns regarding equality before the law. Inequality before the law cannot be justified by the fact that it is more difficult to ascertain the income and assets of foreigners; one fails to see why such difficulties should cease to exist in respect of a national returning to Switzerland and not in respect of foreigners. On this whole subject, see above, but in particular see fn 29 and BGE 129 II 249 ff as regards the permissibility of intended legislative discrimination against Swiss nationals.

Swiss citizens are eligible only, but even so, on their return to Switzerland, insofar as they meet the remaining conditions, to elect to be taxed according to expenditure up until the end of the current tax period.¹⁰⁵ The following applies to non-Swiss nationals: in the area of federal direct tax, the mandatory rule of Art 14 paragraph 2 DBG allows for expenditure taxation not only during the current tax period, but also after its expiry – for an unlimited time period.^{106, 107} The rules of the StHG and of the DBG differ in this respect: Art 6 para 2 StHG is a discretionary provision,¹⁰⁸ which means that the cantons are free to determine whether or not to grant expenditure taxation to foreign nationals following the expiry of the current tax period.¹⁰⁹ This is no longer relevant, however, given that all the cantons have since enacted tax laws that make provision for the possibility of foreign nationals to apply for expenditure taxation for an unlimited time period.¹¹⁰

Persons in possession of another nationality in addition to Swiss citizenship do not qualify as foreign nationals within the meaning of Art 14 DBG and Art 6 StHG.¹¹¹ They must conform to the rules applicable to Swiss nationals who have returned to Switzerland.¹¹²

Married couples and children

The question of whether in the case of a married couple both spouses have to meet the requirements for expenditure taxation in order to be entitled to this regime

¹⁰⁵ ESTV-Kreisschreiben (fn 65), 2; Locher (fn 3), n 8 (Art 14 DBG); StHG-Zwahlen (fn 5), n 12 (Art 6 StHG).

¹⁰⁶ See below on termination of the right to expenditure taxation. Hinny (fn 8) refers to the relationship between these regulations and the bilateral agreements with the EU, particularly the agreement on the free movement of persons. According to this agreement placing nationals at a disadvantage with respect to EU nationals (so-called discrimination against nationals) is prohibited. Only gainfully employed persons may rely on the prohibition of discrimination against nationals, that is to say precisely those persons who are excluded from expenditure taxation. Only those persons who may by way of an exception rely on the equal treatment of nationals without being engaged in gainful occupation (not gainfully employed family members of a person having the right to freedom of movement) could thus be taxed according to expenditure based on the prohibition of discrimination against nationals. However, this would only include the children under the age of 21 or the dependents of gainfully occupied persons. See on this topic Hinny (fn 8), 1152 ff.

¹⁰⁷ According to the phraseology of Art 14 DBG and Art 6 StHG ('If such persons are not Swiss nationals [...]') these remarks should apply equally to foreign nationals and stateless persons. See also Höhn and Waldburger (fn 5), § 14 n 173.

¹⁰⁸ Article 6 para 2 StHG: 'If such persons are not Swiss nationals they may also have the ongoing right to expenditure taxation'.

¹⁰⁹ ESTV-Aufwandbesteuerung (fn 2), 6; Richner (fn 2), 3.

¹¹⁰ ESTV-Aufwandbesteuerung (fn 2), 6; Grüniger (fn 21), 25.

¹¹¹ StHG-Zwahlen (fn 5), n 14 (Art 6 StHG).

¹¹² Bernasconi (fn 3), 10; Locher (fn 3), n 8 (Art 14 DBG).

requires closer examination.¹¹³ As a rule, individuals are subject to Switzerland's tax sovereignty only if they personally meet the subjective requirements.¹¹⁴ This means that in the case of a married couple, the conditions governing for example domicile or residence¹¹⁵ must be met by both spouses individually.¹¹⁶ Where one of the spouses fails to meet the subjective conditions for taxability in Switzerland, both spouses cannot be taxed in this country.¹¹⁷

With regard to the individual subjective conditions for expenditure taxation, it is necessary to examine whether, in the case of only one of the spouses meeting all the conditions, the other may also be eligible.¹¹⁸ The fundamental principle of family taxation,¹¹⁹ which guarantees that a family be taxed according to its ability to pay,¹²⁰ requires an assessment based on multiple criteria.¹²¹ Despite such joint assessment, each spouse is treated as an individual taxpayer¹²² with an equal participation in the assessment procedure.¹²³ Considering that expenditure taxation is none other than a particular form of assessment and that, in the case of a married couple, the assessment basis is determined separately for each spouse, it then follows that the requirements must be met by each spouse individually.¹²⁴ Where a separate assessment basis is determined for each spouse, a separate method is also used. It is therefore necessary to examine in each individual case whether the conditions for establishing an assessment basis according to living expenses are met. This allows for only one of the spouses to meet the requirements. He/she may then elect to be taxed according to his/her living expenses. In such case the assessment basis of the qualifying spouse is determined according to living expenditure, whereas a separate

¹¹³ StHG-Zwahlen (fn 5), n 8 (Art 6 StHG).

¹¹⁴ See Art 3 para 3 StHG.

¹¹⁵ StHG-Zwahlen (fn 5), n 16 (Art 6 StHG).

¹¹⁶ The same applies to children who are under parental authority; StHG-Zwahlen (fn 5), n 16 (Art 6 StHG).

¹¹⁷ StHG-Zwahlen (fn 5), n 8 (Art 6 StHG).

¹¹⁸ StHG-Zwahlen (fn 5), n 8 (Art 6 StHG).

¹¹⁹ Article 9 DBG and Art 3 para 3 StHG; see in this respect M Zweifel and P Athanas, (ed) (DBG-Bearbeiter): Kommentar zum Schweizerischen Steuerrecht I/2a, Basle 2000; DBG-Greminger, n 1 ff (Art 9 DBG).

¹²⁰ By adding or consolidating the income of spouses (who are not separated); See DBG-Greminger (fn 119), n 2 (Art 9 DBG).

¹²¹ StHG-Zwahlen (fn 5), n 9 (Art 6 StHG).

¹²² See DBG-Greminger (fn 119), n 3 (Art 9 DBG), with references.

¹²³ According to Zwahlen, this multiple criteria model (fn 5) takes into account the basic idea that both spouses must meet the subjective and objective conditions independently in order to be taxable under Swiss law; StHG-Zwahlen (fn 5), n 9 (Art 6 StHG).

¹²⁴ Locher (fn 3), n 6 (Art 14 DBG).

determination is made for the assessment basis of the other spouse.¹²⁵ Thus the fulfilment of all the requirements by one of the spouses does not entitle them both to expenditure taxation.

According to Art 3 para 3 StHG and Art 9 para 2 DBG, the same applies to a child whose returns on assets are attributed to the holder of the parental authority.¹²⁶ If the child meets all the conditions for expenditure taxation it can opt for this regime and if it elects to do so, this is counted as a criterion in the assessment basis of the parents in accordance with the corresponding rules of expenditure taxation regarding the object of assessment.¹²⁷

Given the scope of expenditure taxation,¹²⁸ as defined by the Federal Tax Administration Circular on Expenditure Taxation, and the rules applicable to married couples, the following case scenario should be considered an exception: where only one of the spouses or only the children have Swiss nationality, and in the event of all the remaining conditions being met, both spouses are entitled to expenditure taxation in the same capacity as foreign nationals.¹²⁹ In my opinion there is little justification for this exception in practice.

Objective Conditions

Preliminary remarks

The DBG and StHG not only govern the subjective conditions for taxation according to expenditure, and hence the circle of beneficiaries, but also the extent of the authorised tax relief. Expenditure taxation must satisfy certain minimum requirements.¹³⁰ In particular, the tax liability of a person taxed according to living expenses must not be less than the amount that person would normally pay under ordinary taxation on income or assets on their moveable and immovable assets located in Switzerland¹³¹ and the income generated from these assets.¹³²

¹²⁵ StHG-Zwahlen (fn 5), n 9 (Art 6 StHG); see DBG-Zwahlen (fn 119), n 8 (Art 14 DBG); see also Bernasconi (fn 3), 12; for a different opinion see: Locher (fn 3), n 6 (Art 14 DBG); Richner, Frei and Kaufmann (fn 4), n 8 (Art 14 DBG).

¹²⁶ StHG-Zwahlen (fn 5), n 10 (Art 6 StHG).

¹²⁷ StHG-Zwahlen (fn 5), n 10 (Art 6 StHG).

¹²⁸ ESTV-Kreisschreiben (fn 64), 2. Several cantons, such as Aargau, Basle-City, St. Gallen, Schwyz and Zurich, have similar rules; various other cantons mention in their tax-related rules or directives that the ESTV-Kreisschreiben 'should be applied accordingly'.

¹²⁹ Agner, Digeronimo, Neuhaus and Steinmann (fn 102), n 5 (Art 14 DBG); ESTV-Kreisschreiben (fn 64), 2; Locher (fn 3), n 8 (Art 14 DBG).

¹³⁰ ESTV-Aufwandbesteuerung (fn 2), 8.

¹³¹ Asset values are only important in respect of the control valuation with regard to cantonal taxes, given that the confederation does not have a wealth tax; in this respect see below.

Basis of assessment

Introductory remarks

The basis of assessment for expenditure taxation is the living expenditure of the taxpayer and the taxpayer's family members.¹³³ For expenditure taxation purposes, family membership is not based on family relationships. To qualify, a person must be a dependent of the taxpayer¹³⁴ and live in Switzerland.¹³⁵ Thus any person residing in the family circle of the taxpayer is considered a relevant family member, not only spouse and children.¹³⁶

The aggregate amount of the annual living expenses paid by the taxpayer for himself or herself and the persons mentioned above qualifies as taxable expenditure.¹³⁷ There is some discussion as to whether this calculation should be limited to money spent in Switzerland or extended to include expenses incurred abroad.¹³⁸ Neither the StHG, the DBG nor the Decree of the Federal Council on Expenditure Taxation address this question. In a 1971 decision of the Federal Supreme Court, expenditure was held to comprise all expenses incurred in Switzerland and abroad.¹³⁹

Living expenses

According to the circular issued by the tax administration and the decree on expenditure taxation, living expenditure comprises all of the following:¹⁴⁰

- subsistence and clothing expenses;

¹³² ESTV-Aufwandbesteuerung (fn 2), 8.

¹³³ Article 14 para 3 DBG: see Art 6 para 3 StHG; Bernasconi (fn 3), 13; Höhn/Waldburger (fn 5), § 14 n 174; Locher (fn 3), n 15 (Art 14 DBG); Richner (fn 2), 10; Wilhelm (fn 1), 77. StHG-Zwahlen (fn 5), n 24 (Art 6 StHG).

¹³⁴ Bernasconi (fn 3), 13; Locher (fn 3), n 15 (Art 14 DBG); Richner (fn 2), 10; StHG-Zwahlen (fn 5), n 24 (Art 6 StHG).

¹³⁵ See Decree of the Federal Council on Expenditure Taxation, Art 1.

¹³⁶ StHG-Zwahlen (fn 5), n 24 (Art 6 StHG).

¹³⁷ Locher (fn 3), n 16 (Art 14 DBG).

¹³⁸ Locher (fn 3), n 16 (Art 14 DBG, adds to this value local and foreign source expenses (likewise P Agner, B Jung and G Steinmann, Kommentar zum Gesetz über die direkte Bundessteuer, Zurich 1995, n 3 (Art 14 DBG); Bernasconi (fn 3), 15; ESTV-Kreisschreiben (fn 64), 3; Känzig (fn 7), n 7 (Art 18^{bis} BdBSt), whereas Zwahlen (fn 5) expressly excludes expenses incurred abroad; StHG-Zwahlen (fn 5), n 24 (Art 6 StHG); likewise Richner, Frei and Kaufmann (fn 4), n 26 (Art 14 DBG).

¹³⁹ FTrib, unpublished judgment of 15.10.1971 (A 117/71), cited by Bernasconi (fn 3), 14.

¹⁴⁰ ESTV-Kreisschreiben (fn 64), 3; see also ESTV-Aufwandbesteuerung (fn 2), 8.

- accommodation expenses, including expenses for heating, cleaning, garden maintenance, etc;
- all expenses (cash remuneration and benefits in kind) for the taxpayer's staff;
- expenditure on education, entertainment, sport, etc;
- expenses for travelling, holidays, health, etc;
- upkeep costs of expensive domestic animals (horses, etc);
- maintenance and operating costs of automobiles, motorboats, yachts, planes, etc;
- all other living costs, including direct taxes.¹⁴¹

Out-of-pocket living expenses of the spouse and dependent children, provided they live in Switzerland, are also treated as taxable expenses.

The Decree of the Federal Council on Expenditure Taxation provides for further conditions in relation to direct taxes the total calculated living expenses must meet a minimum aggregate expenditure level.¹⁴² Pursuant to Art 1 para 1 of this decree, the total living expenditure must be equivalent to at least five times¹⁴³ the rent¹⁴⁴ or the rental value of the lived-in area of a house¹⁴⁵ owned and occupied by the taxpayer.¹⁴⁶ In all other cases living costs must be at least double the board and

¹⁴¹ Agner, Jung and Steinmann (fn 138), n 3 (Art 14 DBG); ESTV-Aufwandbesteuerung (fn 2), 8.

¹⁴² Richner (fn 2), 11; StHG-Zwahlen (fn 5), n 27 (Art 6 StHG).

¹⁴³ Höhn and Waldburger (fn 5), § 14 n 174, refer to the fact that underlying this reference amount is the notion that housing costs account for some 20% of the entire living expenditure. See also Bernasconi (fn 3), 15.

¹⁴⁴ The annual rent does not include accessory charges. If the rented flat or house belongs to a (natural or legal) person to whom the taxpayer is close, an amount equivalent to that which an independent third party would pay is taken into account; Bernasconi (fn 3), 19; Richner, Frei and Kaufmann (fn 4), n 29 (Art 14 DBG); StHG-Zwahlen (fn 5), n 28 (Art 6 StHG). See also ESTV-Kreisschreiben (fn 64), 4, and Richner (fn 2), 11, which refer only to subtracting heating costs from the annual rent paid.

¹⁴⁵ If the taxpayer lives in their own house or apartment, the rental value is equal to what the taxpayer would have paid in rent for a similar dwelling in a similar area. Deductions for under-use are, in the opinion of the Federal Tax Administration, excluded. ESTV-Kreisschreiben (fn 64), 4. However, StHG-Zwahlen (fn 5), n 29 (Art 6 StHG) holds the opposing view that the assessment basis on which a person taxed according to expenditure will be taxed should be assessed according to the same basic rules as any other taxpayer (which would allow for deductions for under-use). See also Richner (fn 2), 11 f.

¹⁴⁶ If a person is using more than one property in Switzerland, the question arises as to which of the different rents should be considered for the determination of the minimum amount. The Federal Tax Administration (ESTV-Kreisschreiben (fn 64), 4) requires that the highest rent always be taken into

lodging expenditure.¹⁴⁷ At the cantonal level there are some variations regarding this minimum requirement – the majority of cantons follow the requirements imposed in relation to federal direct tax.¹⁴⁸

account. Zwahlen (StHG-Zwahlen (fn 5), n 28 (Art 6 StHG) however holds the view that this ‘purely fiscal approach’ ignores the fact that the ordinary subjective criteria should be also taken into account in the context of expenditure taxation. This means that the tax residence should be the deciding factor; as a result, the rent on the property where the taxpayer spends most time is the deciding factor. For completeness it should be mentioned that the rent paid on all the accommodation used is taken into consideration in the determination of living expenditure. Bernasconi (fn 3), 15; ESTV-Kreisschreiben (fn 64), 4.

¹⁴⁷ Annual board and lodging costs correspond to all costs incurred by the taxpayer for accommodation and board in hotels, boarding houses, etc, including costs for beverages, heating, service, etc. ESTV-Kreisschreiben (fn 64), 4. See also Wilhelm on the topic (fn 1), 77.

¹⁴⁸ The Canton of Aargau requires five times the rent or rental value, or double the board and lodging costs, as at federal level; the Canton of Appenzell Outer Rhoden requires (by reference to the Federal Decree on Expenditure Taxation) five times the rent or rental value, or double the board and lodging costs; the Canton of Appenzell Inner Rhoden requires (by reference to the Federal Decree on Expenditure Taxation) five times the rent or rental value, or double the board and lodging costs; the Canton of Basle-Land requires (by reference to the Federal Decree on Expenditure Taxation) five times the rent or rental value, or double the board and lodging costs; the Canton of Basle-City requires five times the rent or rental value, or double the board and lodging costs, as at federal level; in the Canton of Bern expenditure taxation must be based on five times the rent or rental value, double the board and lodging costs or the wealth tax according to the official values of plots of land of the canton (Art 1 (a-c) of the expenditure taxation decree [VBA, BSG 661.312.21]); the Canton of Fribourg requires (by reference to the ESTV-Kreisschreiben) five times the rent or rental value, or double the board and lodging costs (according to the cantonal tax authority); the Canton of Geneva in principle requires a minimum value of CHF 300,000. (Oberson (fn 3), § 6, n 61; see Art 1 para 3 RALIPP I); the figure of five times the rent or rental value may also be relevant (if this amount is higher) and in cases where the taxpayer does not live in a house or flat that they finance themselves, so can the sum of double the board and lodging costs as well as three quarters of the board and lodging costs, as a so-called ‘family charge’ (Art 1 para 2 (b) RALIPP I); in the Canton of Glarus, according to the cantonal tax administration, the minimum tax liability is CHF 80,000. In the Canton of Grisons the lowest limit is, as at federal level, five times the rent or rental value of owned property; however, there is a minimum tax liability of CHF 75,000 for federal, cantonal and communal taxes or CHF 80,000 including church membership (according to the director of the cantonal tax authority); the Canton of Jura requires six to eight times the rent or rental value or twice or three times the board and lodging costs (Art 2 of the decree on the valuation of the assessment basis for lump sum taxation in respect of foreign taxpayers, RSJ 641.312.21); the Canton of Lucerne requires, as at federal level, five times the rent or rental value or double the board and lodging costs (explanatory note of the tax administration of the Canton of Lucerne on expenditure taxation, available at www.steuern.lu.ch); the Canton of Neuchâtel requires, as at federal level, five times the rent or rental value or double the board and lodging costs (Art 5 of the Regulation concerning the implementation of the direct tax law [RELCdir, RSN 631.01]); the Canton of Nidwalden requires (by reference to the Federal Decree on Expenditure Taxation) five times the rent or rental value, or double the board and lodging costs; the Canton of Obwalden requires (by reference to the Federal Decree on Expenditure Taxation) five times the rent or rental value, or double the board and lodging costs; the Canton of Schaffhausen requires (by reference to the Federal Decree on Expenditure Taxation) five times the rent or rental value, or double the board and lodging costs (§ 9 of the decree on direct tax, SHR 641.111); the Canton of Schwyz requires a minimum tax sum of CHF 90,000, comprising all cantonal income and wealth taxes and federal direct tax; however, if the tax calculated on the basis of five times the rent or rental value

So, the taxpayer must submit two amounts for every tax period for the purpose of determining the basis of assessment:¹⁴⁹ the actual annual living expenditure and the rent, rental value or annual board and lodging expenditure, multiplied by the relevant factor. Subject to verification that it complies with the required minimum value, the result shall constitute the assessment basis.

Control valuation

Introductory remarks

According to express statutory regulation,¹⁵⁰ the assessment basis as calculated according to the above method – whether it is the sum of living expenses or a multiple of the rent, rental value or board and lodging costs – is subject to a control valuation.^{151,152} The expenditure tax is set against the taxable amount normally due

or double the board and lodging costs is higher, this amount will be taxed. See the relevant explanatory note of the cantonal tax authority available at www.sz.ch/steuern/Aktuell/Pauschalbesteuerung.html. In addition, according to § 15 para 2 StG-SZ, the Governing Council reserves the right to increase the minimum requirements; the Canton of St. Gallen requires (by reference to the Federal Decree on Expenditure Taxation) five times the rent or rental value, or double the board and lodging costs (Art 9 of the tax decree of the Canton of St. Gallen); the Canton of Solothurn requires (by reference to the Federal Decree on Expenditure Taxation) five times the rent or rental value, or double the board and lodging costs (§ 2 of the tax decree n 18, expenditure taxation, BGS 614.159.18); the Canton of Ticino requires five times the rent or rental value or double the board and lodging costs, whereby the Governing Council ('Consiglio Di Stato') can determine minimum requirements (Art 1 of the regulation of the taxation law, RL 10.2.1.1.1); the Canton of Thurgau requires five times the rent or rental value or double the board and lodging costs (§ 1a of the decree of the Governing Council on the state and communal tax law, TGS 640.11); the Canton of Uri requires five times the rent or rental value or double the board and lodging costs (Art 2 of the regulation on expenditure taxation, RB 3.2213); the Canton of Vaud (Art 18 para 1 LI-VD) requires five times the rent or rental value; see administrative tribunal of the Canton of Vaud, decision of 20.12.1999, StE 2000 fo 29.1 no 4: 'the income subject to the special tax is determined according to living expenditure and should be at least five times the rental value of the accommodation of the taxpayer'. The Canton of Obwalden also requires a multiple of five: see Art 1 para 1 (a) of the implementing provisions on expenditure taxation. The Canton of Valais requires five times the rent or rental value or double the board and lodging costs whereby a resolution of the Governing Council provides for a special rate (resolution of 30.9.1992 on lump sum taxation, 642.105); the Canton of Zug requires five times the rent or rental value or board and lodging costs (§ 4 of the tax law decree, BGS 632.11); in the Canton of Zurich, if the person subject to expenditure taxation lives in rented or owned property, the minimum tax amount is five times the rent chargeable to third parties plus a taxable income of CHF 350,000 and wealth of CHF 7,000,000 (Grüninger (fn 21), 25).

Finally, the tax administrations can determine minimum amounts not defined in the tax rules and regulations.

¹⁴⁹ ESTV-Kreisschreiben (fn 64), 4; Locher (fn 3), n 19 (Art 14 DBG).

¹⁵⁰ Article 14 para 3 DBG, Art 6 para 3 StHG; see also Art 1 para 2 and Art 2 of the Decree of the Federal Council on Expenditure Taxation.

¹⁵¹ On this subject Bernasconi (fn 3), 19 ff; ESTV-Kreisschreiben (fn 64), 4 f; ESTV-Aufwandbesteuerung (fn 2), 10 f; Locher (fn 3), n 20 (Art 14 DBG); Oberson (fn 3), § 6, n 59; Richner (fn 2), 12 ff; Richner, Frei

under ordinary taxation on source income and – at the cantonal level – domestic assets. Where a person is entitled to relief under a double taxation treaty, the foreign source income and asset values are included in this calculation.¹⁵³ The expenditure tax must not be less than the tax that would normally be chargeable on the gross aggregate of these elements as computed by reference to the ordinary rate.¹⁵⁴ If it drops below this value, the expenditure tax is levied on the basis of the control valuation result.¹⁵⁵

Below is a description of how the control valuation is to be performed.

Control valuation criteria in respect of direct federal tax

All the following criteria used in defining income form the basis for the control valuation, irrespective of whether they are directly attributable to the taxpayer or the taxpayer's dependents.¹⁵⁶

Income on immoveable assets located in Switzerland: The first criterion listed in Art 14 para 3 (a) DBG is income from immoveable assets¹⁵⁷ located in Switzerland.¹⁵⁸ In respect of federal direct tax, reference is made to Art 21 para 1 DBG.^{159,160} In respect

and Kaufmann (fn 4), n 34 ff (Art14 DBG); Wilhelm (fn 1), 77 f; DBG-Zwahlen (fn 119), n 31 ff (Art 9 DBG); StHG-Zwahlen (fn 5), n 32 ff (Art 6 StHG). See also Zurich Tax Appeal Commission I, decision of 16.12.1991, StE 1992, fo 29.1 n 3.

¹⁵² StHG-Zwahlen (fn 5), n 32 (Art 6 StHG).

¹⁵³ ESTV-Aufwandbesteuerung (fn 2), 10.

¹⁵⁴ This means that other assets located abroad and the income derived therefrom nevertheless benefit from 'preferential treatment'; ESTV-Aufwandbesteuerung (fn 2), 10.

¹⁵⁵ Art 14 para 3 DBG, Art 6 para 3 StHG; see also Richner, Frei and Kaufmann (fn 4), n 34 (Art14 DBG); StHG-Zwahlen (fn 5), n 32 (Art 6 StHG).

¹⁵⁶ Thus the aggregate gross income of the taxpayer and spouse and dependent children living in Switzerland are counted. Richner, Frei and Kaufmann (fn 4), n 35 (Art 14 DBG); StHG-Zwahlen (fn 5), n 32 (Art 6 StHG).

¹⁵⁷ Article 14 para 3 (a) DBG.

¹⁵⁸ On the one hand the relevant statutory provisions expressly provide that only income from assets in Switzerland should be taken into consideration in the control valuation, while on the other hand this results from international tax law; DBG-Zwahlen (fn 119), n 32 (Art 14 DBG). StHG-Zwahlen (fn 5), n 33 (Art 6 StHG).

¹⁵⁹ Article 21 para 1 DBG:

¹Income on immovable assets is taxable, in particular:

- a) any income from a lease, lease of land, usufruct or any other usage;
- b) the rental value of land or a portion of land which is available to the taxpayer for personal use under a property right or usage right (free of charge);
- c) income from building contracts;
- d) income from the exploitation of gravel, sand and other flooring materials.

of cantonal income tax, the only income taken into account is the income generated from assets located in the canton of domicile, in order to avoid double taxation with regard to any other canton in which assets are located.¹⁶¹

Income on a chattel located in Switzerland: A chattel¹⁶² is understood to mean any moveable property.¹⁶³ Taxable income generated by a chattel mainly comprises the income accruing to the taxpayer from an actual lease to a third party.¹⁶⁴ Further, the moveable property must have been made available in Switzerland for use by third parties.¹⁶⁵ Income accruing from a lease on a chattel abroad for example is not counted in the control valuation.¹⁶⁶

Income on moveable financial assets located in Switzerland, including income from mortgage notes: It is not exactly clear which earnings are covered by Art 14 para 3 (c) DBG.¹⁶⁷ The key is determining the circumstances in which financial assets are to be treated as 'located in Switzerland'. In my opinion, and with a view to promoting a coherent system of tax law, one can refer in this respect to the Federal Law on Withholding Tax.¹⁶⁸ Withholding tax applies, inter alia, to income from moveable financial assets where the related investment is made through a 'local'. Thus, for the purposes of the control valuation, capital invested using the services of a 'local' can be treated as financial assets 'in Switzerland' by reference to Art 9 VStG.¹⁶⁹ This means that all interest, returns, profits and other income¹⁷⁰ from the following financial assets must be taken into account in the control valuation:

- bonds, serial bonds, serial annuities and debt ledger entries issued or recorded by a local;¹⁷¹

¹⁶⁰ Richner, Frei and Kaufmann (fn 4), n 38 (Art14 DBG).

¹⁶¹ Income from assets which are located outside the canton of domicile are subject to ordinary taxation in the canton of domicile; StHG-Zwahlen (fn 5), n 33 (Art 6 StHG).

¹⁶² Article 14 para 3 (b) DBG.

¹⁶³ Article 713 ZGB. These are primarily all moveable physical objects; however, the law also includes natural forms that have been brought under control; H Honsell, N P Vogt and T Geiser (ed) (BasK-Bearbeiter): Basler Kommentar zum Schweizerischen Privatrecht. Zivilgesetzbuch II. Art 457-977 ZGB, Art 1-61 SchlT ZGB, Basle/Geneva/Munich 2003; BasK-Schwander, n 2 (Art 713 ZGB).

¹⁶⁴ StHG-Reich (fn 5), n 39 (Art 7 StHG); StHG-Zwahlen (fn 5), n 34 (Art 6 StHG).

¹⁶⁵ Richner, Frei and Kaufmann (fn 4), n 39 (Art14 DBG); StHG-ZWAHLEN (fn 5), n 34 (Art 6 StHG).

¹⁶⁶ Richner, Frei and Kaufmann (fn 4), n 39 (Art14 DBG); StHG-ZWAHLEN (fn 5), n 34 (Art 6 StHG).

¹⁶⁷ Richner, Frei and Kaufmann (fn 4), n 40 (Art 14 DBG).

¹⁶⁸ Federal Law on Withholding Tax of 13.10.1965 (VStG, SR 642.21).

¹⁶⁹ Also ESTV-Aufwandbesteuerung (fn 2), 10 fn 9; DBG-Zwahlen (fn 119), n 35 (Art 14 DBG); StHG-Zwahlen (fn 5), n 34 (Art 6 StHG). In my opinion, (in end effect) also Richner (fn 2), 13; Richner, Frei and Kaufmann (fn 4), n 40 (Art 14 DBG).

¹⁷⁰ See Art 4 para 1 VStG.

¹⁷¹ See Art 4 para 1 (a) VStG.

- shares, participations in limited liability companies, participations in corporations, participation certificates and profit-sharing certificates issued by a local;¹⁷²
- shares in investment funds or similar shares issued by a local or by a local acting together with a foreigner;¹⁷³
- client assets with local banks and savings banks.¹⁷⁴

Locals are all natural or legal persons having their domicile, permanent residence or registered office in Switzerland, or registered as a company in the local register of commerce. Legal persons or corporate entities not having legal personality that are actually managed in Switzerland and carrying out business activity here are also treated as locals, even where their registered office is abroad.¹⁷⁵

Income from receivables or assets guaranteed by mortgages on land in Switzerland or the pledging of Swiss mortgage notes is also counted in the control valuation.¹⁷⁶

Securities may also be transferred as a chattel to third parties against payment. The proceeds of sale qualify as income from a chattel according to Art 14 para 3 (b) DBG and are counted as such in the control valuation.¹⁷⁷ Capital gains, however, are not counted in the control valuation, as they are not considered taxable income.¹⁷⁸

Income from copyrights, patents and similar rights exploited in Switzerland: Intellectual property rights¹⁷⁹ are treated as exploited in Switzerland where the user has a registered office or domicile in Switzerland for the purpose of exploiting such rights¹⁸⁰ or a corresponding intangible asset is used on the Swiss market.¹⁸¹

¹⁷² See Art 4 para 1 (b) VStG. The whereabouts of securities in respect of receivables in respect of relevant claims, participations or assets is of no relevance; StHG-Zwahlen (fn 5), n 36 (Art 6 StHG).

¹⁷³ See Art 4 para 1 (c) VStG.

¹⁷⁴ See Art 4 para 1 (d) VStG.

¹⁷⁵ See in this respect Art 9 VStG.

¹⁷⁶ ESTV-Aufwandbesteuerung (fn 2), 10 fn 9; StHG-Zwahlen (fn 5), n 37 (Art 6 StHG).

¹⁷⁷ See DBG-Zwahlen (fn 119), n 34 (Art 14 DBG) and StHG-Zwahlen (fn 5), n 34 (Art 6 StHG), which refer to the fact that the 'basic right' for such a transfer must lie abroad for any related income to be left out of the control valuation.

¹⁷⁸ Richner, Frei and Kaufmann (fn 4), n 40 (Art 14 DBG).

¹⁷⁹ Art 14 para 3 (d) DBG.

¹⁸⁰ Or where the taxpayer has business premises in Switzerland from which the activity is performed. Richner, Frei and Kaufmann (fn 4), n 41 (Art 14 DBG); DBG-Zwahlen (fn 119), n 38 (Art 14 DBG). StHG-Zwahlen (fn 5), n 39 (Art 6 StHG).

¹⁸¹ Accordingly income from intangible assets placed on foreign markets is not counted in the control valuation. DBG-Zwahlen (fn 119), n 38 (Art 14 DBG). StHG-Zwahlen (fn 5), n 39 (Art 6 StHG).

*Retirement benefits, annuities and pensions from Swiss sources: 'Swiss source'*¹⁸² retirement benefits, annuities and pensions arise where long-term benefits are provided by an obligor whose registered office is in Switzerland.^{183,184} Annuities from private insurance,¹⁸⁵ alimonies, annuities or any similar benefits, where the obligor is domiciled in Switzerland, are treated in the same way.¹⁸⁶

Income on which the taxpayer claims full or partial relief in respect of foreign tax under a double taxation agreement concluded by Switzerland: As a rule, income from foreign sources¹⁸⁷ is included in the control valuation only where the taxpayer claims full or partial relief in respect of foreign tax under a double taxation agreement concluded by Switzerland.¹⁸⁸ The idea behind this rule is that the taxpayer should not- as a result of expenditure taxation in Switzerland - derive unreasonable advantages from such relief.¹⁸⁹ It is sufficient for foreign tax on foreign source income to be fully or partially eliminated under an agreement - even where such tax is withheld at source or levied under the ordinary taxation procedure.¹⁹⁰

Income on which a foreign tax relief or refund may be claimed includes earnings, pensions, annuities, dividends, interest and royalties¹⁹¹ from all countries with which Switzerland has concluded a double taxation agreement.¹⁹² Given that the control valuation is carried out on the basis of gross value, it should first be clarified

¹⁸² Art 14 para 3 (e) DBG.

¹⁸³ Or by an obligor providing services from its business premises in Switzerland Richner, Frei and Kaufmann (fn 4), n 41 (Art 14 DBG).

¹⁸⁴ DBG-Zwahlen (fn 119), n 39 (Art 14 DBG). StHG-Zwahlen (fn 5), n 40 (Art 6 StHG).

¹⁸⁵ Richner, Frei and Kaufmann (fn 4), n 41 (Art 14 DBG).

¹⁸⁶ DBG-Zwahlen (fn 119), n 39 (Art 14 DBG); StHG-Zwahlen (fn 5), n 40 (Art 6 StHG).

¹⁸⁷ Article 14 para 3 (f) DBG. See on the subject in detail ESTV-Kreisschreiben (fn 64), 5 f; Richner, Frei and Kaufmann (fn 4), n 45 (Art 14 DBG); see also Känzig (fn 7), n 9 ff (Art 18^{bis} BdBSt).

¹⁸⁸ ESTV-Kreisschreiben (fn 64), 5; Höhn and Waldburger (fn 5), para 14 n 175; Locher (fn 3), n 27 (Art 14 DBG); Richner (fn 2), 13; Richner, Frei and Kaufmann (fn 4), n 45 (Art 14 DBG); Wilhelm (fn 1), 78. DBG-Zwahlen (fn 119), n 40 (Art 14 DBG). StHG-Zwahlen (fn 5), n 41 (Art 6 StHG).

¹⁸⁹ It should be noted that in certain cantons, tax on income for which the taxpayer claims relief under an agreement is calculated at a scaled rate. ESTV-Aufwandbesteuerung (fn 2), 11.

¹⁹⁰ This is for example the case where a foreign state declines to tax a pension under a treaty signed with Switzerland in cases of limited tax liability; ESTV-Kreisschreiben (fn 64), 5.

¹⁹¹ According to the circular letter (*Kreisschreiben*) of the Federal Tax Administration on expenditure taxation, royalties are 'any portion of funds paid for usage or right of usage in respect of copyright on literary, artistic or scientific work, including cinematographic films and films or recordings for radio and television, of patents, marks, models, plans, formulae or processes or for usage or right of usage in respect of industrial, commercial or scientific equipment or for the communication of industrial, commercial or scientific research'. ESTV-Kreisschreiben (fn 64), 5.

¹⁹² ESTV-Kreisschreiben (fn 64), 5; ESTV-Aufwandbesteuerung (fn 2), 11; see also Richner (fn 2), 14.

what is meant by gross value in respect of foreign income. Gross value means the net value less the non-reclaimable portion of the foreign tax.¹⁹³

Insofar as a taxpayer claims protection from a double taxation agreement (this is a right, not an obligation)¹⁹⁴ the corresponding foreign source income is counted in the control valuation.¹⁹⁵ Where the taxpayer declines to claim relief, the income is not counted.¹⁹⁶ This means that the taxpayer can choose if they wish to have income from country A or B counted, and if they wish to claim relief in respect of dividends from company X but not in respect of dividends from company Y, for example.¹⁹⁷

The taxpayer must always specify in their tax return whether or not they have claimed relief for the current tax period. If so, for verification purposes the taxpayer must declare in their tax return all foreign source income for each country that is taxable principally in Switzerland.¹⁹⁸

Control valuation criteria in respect of cantonal and communal tax

At the cantonal and communal levels, the control valuation takes account of both income and assets.¹⁹⁹ The cantonal and communal tax must be at least equal to the tax that would be levied at the ordinary rate on the aggregate gross amount:²⁰⁰

- of immoveable assets located in Switzerland (that is, in the relevant canton) and income from these assets;²⁰¹

¹⁹³ The following example (from Richner (fn 2), 14) serves to demonstrate this: Dutch shares are liable for tax at source at 25%. Taxpayers taxed according to expenditure in Switzerland can claim a reduction of the Dutch source tax based on the Dutch double taxation treaty in a reclaim procedure from 25% to 15% (10% reduction). Based on the claim under the double taxation treaty, the income from the Dutch shares counts as 85% of its value in the control valuation.

See on the subject in detail ESTV-Kreisschreiben (fn 64), 5; ESTV-Aufwandbesteuerung (fn 2), 11; Richner (fn 2), 14; Richner, Frei and Kaufmann (fn 4), n 46 (Art 14 DBG).

¹⁹⁴ Richner (fn 2), 14.

¹⁹⁵ Richner (fn 2), 14.

¹⁹⁶ Richner, Frei and Kaufmann (fn 4), n 47 (Art14 DBG).

¹⁹⁷ Richner (fn 2), 14; Richner, Frei and Kaufmann (fn 4), n 47 (Art14 DBG).

¹⁹⁸ DBG-Zwahlen (fn 119), n 40 (Art 14 DBG); StHG-Zwahlen (fn 5), n 41 (Art 6 StHG).

¹⁹⁹ See the explanatory note 'expenditure taxation' of the tax administration of the Canton of Aargau (available at www.steuern.ag.ch), 2.

²⁰⁰ See Art 6 para 3 StHG.

²⁰¹ See Art 6 para 3 (a) StHG. In respect of cantonal and communal tax, the only portion of wealth counted in the control valuation is that located in the canton of domicile; StHG-Zwahlen (fn 5), n 33 (Art 6 StHG). However, the basic difference in the control valuation with respect to the federal tax is that (as is generally the case as regards the control valuation in respect of cantonal and communal tax) not only is the income from all asset values taken into account, but the asset value itself (the gross amount, which excludes a deduction for debts on this amount).

- of a chattel located in Switzerland (that is, in the relevant canton) and related income;²⁰²
- of the moveable financial assets invested in Switzerland, including mortgage notes and related income;²⁰³
- of intellectual property rights exploited in Switzerland and related income;²⁰⁴
- Swiss source retirement benefits, annuities and pensions;²⁰⁵
- income on which the taxpayer claims full or partial relief in respect of foreign tax under a double taxation agreement concluded by Switzerland.²⁰⁶

Deductions

In respect of federal tax²⁰⁷ and, generally speaking, cantonal taxation, no social security deductions can be made.²⁰⁸ Real estate maintenance costs²⁰⁹ according to Art 32 DBG and the corresponding decree,²¹⁰ and general management costs related to securities and assets generating taxable income,²¹¹ may be claimed as deductions in respect of the control valuation.²¹² Deductions of other business outlays, as well as other deductions, in particular for debt interest, annuities and long-term liabilities, are excluded.²¹³

²⁰² Art 6 para 3 (b) StHG.

²⁰³ Art 6 para 3 (c) StHG.

²⁰⁴ Art 6 para 3 (d) StHG. See also Richner (fn 2), 16.

²⁰⁵ Art 6 para 3 (e) StHG.

²⁰⁶ Art 6 para 3 (f) StHG.

²⁰⁷ Deductions in this respect are governed by Art 2 of the Decree of the Federal Council on Expenditure Taxation.

²⁰⁸ Art 3 Decree of the Federal Council on Expenditure Taxation; Höhn and Waldburger (fn 5), Art 14 n 175. See also ESTV-Kreisschreiben (fn 64), 4; Känzig (fn 7), n 7 (Art 18^{bis} BdBSt); Locher (fn 3), n 19 (Art 14 DBG); Richner, Frei and Kaufmann (fn 4), n 27 (Art 14 DBG).

²⁰⁹ See Art 2 para 1(a) of the Decree of the Federal Council on Expenditure Taxation.

²¹⁰ Decree on the deduction of land costs from private assets in respect of federal direct tax of 24.8.1992, SR 642.116.

²¹¹ See Art 2 para 2 (b) of the Decree of the Federal Council on Expenditure Taxation.

²¹² Locher (fn 3), n 22 (Art 14 DBG); Höhn and Waldburger (fn 5), para 14 n 175; Richner (fn 2), 13. See also Zurich Tax Appeal Commission I, decision of 16.12.1991, StE 1992, fo 29.1 n 3. For the Canton of Geneva, see Art 2 RALIPP I.

²¹³ Höhn and Waldburger (fn 5), para 14 n 175; Locher (fn 3), n 23 (Art 14 DBG); see also Art 2 para 2 of the Decree of the Federal Council on Expenditure Taxation.

The specific problem of modified expenditure taxation

Some of the double taxation agreements concluded by Switzerland raise particular problems in respect of expenditure taxation.²¹⁴ Since the 1970s, certain treaty partners have no longer recognized a taxpayer who is taxed according to expenditure as being 'resident' in Switzerland for tax purposes.²¹⁵ Under agreements with Belgium,²¹⁶ Germany,²¹⁷ France,²¹⁸ Italy,²¹⁹ Norway,²²⁰ Austria,²²¹ Canada²²² and the USA,²²³ relief is available only to persons residing in Switzerland who are subject to the federal, cantonal and communal direct taxes in respect of all income accruing in these countries that is taxable under Swiss law.²²⁴ In all other cases these persons do not qualify as having tax resident status in Switzerland.²²⁵ These treaty provisions rule out all protection under the double taxation treaty and the taxpayer can claim neither full nor partial relief in respect of foreign source tax.²²⁶

²¹⁴ Art 14 para 4 (2nd sentence) DBG and Art 5 of the Decree of the Federal Council on Expenditure Taxation. For details see ESTV-Kreisschreiben (fn 64), 7 f; ESTV-Aufwandbesteuerung (fn 2), 12; Höhn and Waldburger (fn 5), § 14 n 176 ff; Locher (fn 3), n 34 (Art 14 DBG); Oberson (fn 3), § 6 n 60; Richner, Frei and Kaufmann (fn 4), n 49 (Art 14 DBG); Wilhelm (fn 1), 76 f DBG-Zwahlen (fn 119), n 42 ff (Art 14 DBG); StHG-Zwahlen (fn 5), n 43 (Art 6) StHG.

²¹⁵ Wilhelm (fn 1), 76.

²¹⁶ Art 4 § 4 section 2 DBA-B.

²¹⁷ Art 4 section 6 DBA-D.

²¹⁸ Art 4 section 6 (b) DBA-F

²¹⁹ Art 4 section 5 (b) DBA-I.

²²⁰ Art 4 section 4 DBA-N.

²²¹ Art 4 section 4 DBA-A.

²²² Art 4 section 5 DBA-CDN.

²²³ Art 4 section 5 DBA-USA.

²²⁴ The rules according to the double taxation treaty with France are somewhat different: according to this agreement, a taxpayer is not treated as having tax resident status in Switzerland if they are subject to lump sum taxation according to the rental value of accommodation available to them in Switzerland. However, a person taxed according to expenditure is considered as having tax resident status in Switzerland where (1) the relevant income in respect of federal, cantonal and communal taxes exceeds five times the rent or rental value of the dwelling or one-and-a-half times the board and lodging costs and (2) the relevant assessment basis in respect of cantonal and communal taxes does not differ greatly from the income subject to direct federal tax. The relevant amount in respect of cantonal taxation must be at least equal to the aggregate of the Swiss income and of the French income for which the treaty provides relief from French tax. ESTV-Aufwandbesteuerung (fn 2), 11; Richner (fn 2), 15.

²²⁵ ESTV-Kreisschreiben (fn 64), 7; ESTV-Aufwandbesteuerung (fn 2), 12; Richner (fn 2), 15; Richner/Frei/Kaufmann (fn 4), 49 (Art 14 DBG); Locher (fn 3), n 34 (Art 14 DBG).

²²⁶ Richner (fn 2), 15.

A taxpayer who is taxed according to living expenditure and claims relief under one of the treaties mentioned above is therefore treated as being subject to ordinary taxation in respect of income accruing in the relevant treaty country.²²⁷ The consequences in respect of the relevant tax calculation are the following: first, the assessment basis is established according to living expenditure.²²⁸ The control valuation²²⁹ must then be 'extended'²³⁰ to include any other income subject to Swiss taxation according to the relevant double tax treaty and liable for tax under Swiss law.^{231, 232} Here the taxpayer may differentiate between income accruing in different countries, but not between income accruing in the same country.²³³ Finally, the higher of the two assessment bases is applied.²³⁴ This allows for income accruing in a double tax treaty country to be subject to ordinary taxation and thus for taxpayers to make use of relief under the relevant double tax treaty.²³⁵

Tax rate and foreign tax credit

Rate

At federal level, expenditure taxation is based on the ordinary income tax rate.²³⁶ This applies to the majority of cantonal taxes.²³⁷ However, there are also other

²²⁷ Expenditure taxation is to this extent 'modified': on the one hand, there is an expenditure assessment, and on the other a 'target income assessment', governed in part by the ordinary assessment rules; ESTV-Kreisschreiben (fn 64), 7; ESTV-Aufwandbesteuerung (fn 2), 12; Wilhelm (fn 1), 78. DBG-Zwahlen (fn 119), n 42 (Art 14 DBG); StHG-Zwahlen (fn 5), n 43 (Art 6 StHG). See also Locher (fn 3), n 34 (Art 14 DBG).

²²⁸ Art 14 para 3 1st sentence DBG. Art 6 para 3 1st sentence StHG; DBG-Zwahlen (fn 119), n 42 (Art 14 DBG); StHG-Zwahlen (fn 5), n 43 (Art 6 StHG).

²²⁹ Art 14 para 3 2nd sentence DBG. Art 6 para 3 1st sentence StHG.

²³⁰ In other words this income must be counted in the control valuation at gross value.

²³¹ Locher (fn 3), n 34 (Art 14 DBG).

²³² ESTV-Kreisschreiben (fn 64), 7; Richner, Frei and Kaufmann (fn 4), n 50 (Art 14 DBG); DBG-Zwahlen (fn 119), n 42 (Art 14 DBG); StHG-Zwahlen (fn 5), n 43 (Art 6 StHG).

²³³ Richner (fn 2), 16; Richner, Frei and Kaufmann (fn 4), n 50 (Art 14 DBG).

²³⁴ DBG-Zwahlen (fn 119), n 42 (Art 14 DBG); StHG-Zwahlen (fn 5), n 43 (Art 6 StHG).

²³⁵ It should be noted that Höhn and Waldburger (fn 5), § 14 n 178, consider the practical significance (and often the advantages) of modified expenditure taxation to be minor because in most cases the increase in the tax liability due to the addition of foreign source income is higher than the relief under the agreement, and the entire income (and not just the relief-related income) from the source country concerned is counted in the control valuation.

²³⁶ Art 36 DBG (see Art 14 para 3 DBG).

²³⁷ See also examples for the Canton of Zurich § 35 StG-ZH; for the Canton of Obwalden Art 4 of the implementing provisions on expenditure taxation. for the Canton of Thurgau § 1d of the cantonal and communal tax law decree of the Governing Council; see also Wilhelm (fn 1), 79.

models.²³⁸ The tax is calculated, by reference to the ordinary rate, according to the relevant assessment basis.²³⁹ This means that the income counted in the control valuation is left out of the rate determination in cases where the tax is calculated on the basis of rent, rental value or board and lodging expenditure.²⁴⁰ As a general rule, the tax rate does not take account of income that is not included in the assessment basis.²⁴¹

Peculiarities arise again in respect of modified expenditure taxation. Income tax is charged on all income included in the control valuation at the rate for aggregate income (worldwide income),²⁴² where the control valuation result forms the relevant assessment basis.²⁴³ Where the taxpayer fails to properly declare worldwide income, the modified taxation is charged on the declared income at the highest rate.²⁴⁴

Foreign tax credit

The following applies to foreign tax credits: a taxpayer who is taxed according to living expenditure does not have a claim to lump-sum tax credits under a double tax treaty for any tax levied on foreign dividends.²⁴⁵ The above-mentioned agreements in turn constitute an exception to this rule.²⁴⁶

²³⁸ In the Canton of Vaud, for example, the cantonal tax law provides for a band limit at 10% in the case of expenditure taxation. In addition, taxpayers who live in a hotel or boarding house receive a tax reduction of one quarter; different communes in the Canton of Vaud provide for further privileges. In the Canton of Valais there also are similar advantages in the form of 'medium tax rates' (see the resolution of the Governing Council of 30.9.1992 on lump sum taxation). Cantonal tax laws moreover have special rules in respect of foreign source income which must be taxed in view of the existence of a double taxation agreement. In the Canton of Valais the tax on such income is reduced, and various cantons provide for fixed tax rates: Bern 2%, Jura 2%, Vaud 3%. See on the subject Wilhelm (fn 1), 80, with an example of tax valuation in respect of a taxpayer living in Lausanne.

²³⁹ Richner (fn 2), 16; Richner, Frei and Kaufmann (fn 4), n 51 (Art 14 DBG).

²⁴⁰ Richner (fn 2), 16; Richner, Frei and Kaufmann (fn 4), n 53 (Art 14 DBG).

²⁴¹ This deviates from Art 7 para 1 DBG; Richner, Frei and Kaufmann (fn 4), n 53 (Art 14 DBG).

²⁴² Article 5 para 2 of the Decree of the Federal Council on Expenditure Taxation with reference to Art 7 para 1 DBG; ESTV-Kreisschreiben (fn 64), 8; ESTV-Aufwandbesteuerung (fn 2), 12; Locher (fn 3), n 34 (Art 14 DBG); Richner (fn 2), 17; Richner, Frei and Kaufmann (fn 4), n 54 (Art 14 DBG); Wilhelm (fn 1), 78.

²⁴³ This also means that, for eg, interest may be deducted for the determination of the tax rate, even where the interest does not reduce the assessment basis. ESTV-Kreisschreiben (fn 64), 8; Locher (fn 3), n 34 (Art 14 DBG); Richner (fn 2), 17.

²⁴⁴ ESTV-Aufwandbesteuerung (fn 2), 12; Locher (fn 3), n 34 (Art 14 DBG); Richner (fn 2), 17; Richner, Frei and Kaufmann (fn 4), n 54 (Art 14 DBG).

²⁴⁵ Article 4 para 1 of the decree on lump sum taxation 22.8.1967, SR 672.201; ESTV-Kreisschreiben (fn 64), 8; Locher (fn 3), n 35 (Art 14 DBG); Richner (fn 2), 17; Richner, Frei and Kaufmann (fn 4), n 55 (Art 14 DBG).

²⁴⁶ See ESTV-Kreisschreiben (fn 64), 8.

Article 4 para 3 of the Decree on Lump Sum Tax Credits²⁴⁷ states that natural persons who benefit from living expenditure taxation may apply for lump sum credits where they pay full taxes on income accruing in the treaty country at the aggregate income rate.²⁴⁸ The relevant gross amounts, including the non-reclaimable foreign source tax, must be declared.²⁴⁹ Where a taxpayer declines to claim foreign tax credit, the gross amounts accruing in the relevant country less the foreign source tax payable are taken into account in the control valuation.²⁵⁰

INCEPTION AND DURATION OF THE RIGHT TO EXPENDITURE TAXATION

Inception of the Right to Expenditure Taxation

Where the requirements described above are met, the right to expenditure taxation arises at the time the tax liability arises.²⁵¹ This applies equally to persons resident in Switzerland and those domiciled here.²⁵² The length of residence preceding the tax period is counted in when calculating the relevant date. Where a person has resided in different locations, the aggregate residence period is counted. Temporary absence from the country is not considered to interrupt the residence period.²⁵³

Termination of the Right to Expenditure Taxation

The acquisition of Swiss citizenship by a foreign national terminates their right to expenditure taxation.²⁵⁴ Swiss nationals returned from abroad and recently naturalised persons lose the right to expenditure taxation at the latest at the end of the tax period in which they return or naturalisation takes place.²⁵⁵ The right to expenditure taxation also falls away where the taxpayer engages in a gainful

²⁴⁷ See n 245, above.

²⁴⁸ ESTV-Kreisschreiben (fn 64), 8; ESTV-Aufwandbesteuerung (fn 2), 13; Richner (fn 2), 17; Richner, Frei and Kaufmann (fn 4), n 56 (Art 14 DBG).

²⁴⁹ ESTV-Kreisschreiben (fn 64), 8; ESTV-Aufwandbesteuerung (fn 2), 13; Locher (fn 3), n 35 (Art 14 DBG).

²⁵⁰ Article 2 para 3 of the decree on lump sum tax credit (see above fn 245); ESTV-Aufwandbesteuerung (fn 2), 13; Locher (fn 3), n 36 (Art 14 DBG); Richner (fn 2), 17; Richner, Frei and Kaufmann (fn 4), 56 (Art 14 DBG).

²⁵¹ ESTV-Kreisschreiben (fn v), 2; Richner, Frei and Kaufmann (fn 4), n 19 (Art 14 DBG).

²⁵² See Art 8 DBG. ESTV-Kreisschreiben (fn 64), 2.

²⁵³ See Art 3 para 3 DBG; ESTV-Kreisschreiben (fn 64), 2.

²⁵⁴ ESTV-Kreisschreiben (fn 64), 2.

²⁵⁵ Art 14 para 1 and 2 DBG. ESTV-Kreisschreiben (fn 64), 2.

occupation²⁵⁶ or gives up their domicile or residence in Switzerland.²⁵⁷ Diplomats or consular staff and staff of international organisations who remain in Switzerland after retirement may not apply for expenditure taxation if they have been engaged in gainful occupation in Switzerland during the last ten years, even where the corresponding income was exempt from federal tax under international agreements.²⁵⁸

PROCEDURE

The assessment procedure is carried out in accordance with general procedural rules.²⁵⁹ A special tax return form²⁶⁰ should be completed.²⁶¹ Where applicable, the taxpayer must submit a formal table of securities held to make sure they can reclaim tax withheld in the country of source.²⁶² Living costs should be stated on the form, as well as Swiss source income and domestic assets for control valuation purposes.²⁶³ Foreign income should only be declared in the cases described above. Ultimately, it is the taxpayer's responsibility to prove that all requirements for expenditure taxation are met.²⁶⁴

Before the start of every tax period, the tax authority must have the necessary assurance that the taxpayer is entitled to expenditure taxation and, in particular, that the necessary information and evidence has been provided as required.²⁶⁵ Data related to living expenditure and data required for the control verification must be available. In particular, foreign source income must, where applicable, be fully documented, insofar as this information is not apparent from relief claims.²⁶⁶ Before

²⁵⁶ In such cases the right is terminated at the start of the tax period in which the gainful occupation was commenced. Richner, Frei and Kaufmann (fn 4), n 20 (Art 14 DBG).

²⁵⁷ Richner, Frei and Kaufmann (fn 4), n 20 (Art 14 DBG).

²⁵⁸ ESTV-Kreisschreiben (fn 64), 3.

²⁵⁹ See also Art 102 ff DBG in respect of federal direct tax; Richner, Frei and Kaufmann (fn 4), n 23 (Art 14 DBG).

²⁶⁰ See as an example the 2005 tax return form for the Canton of Zug: www.zug.ch/tax/pdf/form_03-2005.pdf

²⁶¹ ESTV-Aufwandbesteuerung (fn 2), 13; Richner, Frei and Kaufmann (fn 4), 22 (Art 14 DBG); DBG-Zwahlen (fn 119), n 43 (Art 14 DBG); StHG-Zwahlen (fn 5), n 44 (Art 6 StHG).

²⁶² ESTV-Kreisschreiben (fn 64), 6; Richner, Frei and Kaufmann (fn 4), 22 (Art 14 DBG); DBG-Zwahlen (fn 119), n 43 (Art 14 DBG); StHG-Zwahlen (fn 5), n 44 (Art 6 StHG).

²⁶³ Wilhelm (fn 1), 75.

²⁶⁴ ESTV-Kreisschreiben (fn 64), 6; ESTV-Aufwandbesteuerung (fn 2), 13.

²⁶⁵ A tax return which is not fully completed or not signed is returned to the taxpayer to be completed; see Art 124 para 3 DBG; ESTV-Kreisschreiben (fn 64), 6; ESTV-Aufwandbesteuerung (fn 2), 13.

²⁶⁶ ESTV-Kreisschreiben (fn 64), 6; ESTV-Aufwandbesteuerung (fn 2), 13.

an enforceable valuation is made, clarification must be sought as to whether or not and to what extent the taxpayer wants to make use of the advantages under a double taxation agreement.²⁶⁷

The following must also be considered regarding the start of a tax period: modified expenditure taxation accords the right to claim a lump sum tax credit. Article 4 para 3 (2nd sentence) of the implementing decree on lump sum tax credits²⁶⁸ provides that this claim is subject to restrictions under certain circumstances. The following course of action should be taken in this respect: taxation is based on the highest value results calculated in accordance with Arts 1, 2 or 5 of the Decree of the Federal Council on Expenditure Taxation. When the assessment basis is calculated according to Art 5 (modified expenditure taxation), the taxpayer should also be notified of the higher result in respect of the valuation made according to Arts 1 or 2 (ordinary expenditure taxation).²⁶⁹

SUMMARY

For decades, expenditure taxation has been firmly anchored in the Swiss tax landscape. It offers taxpayers the possibility, under certain conditions, of being taxed on living expenditure incurred in Switzerland by themselves and their dependents in Switzerland instead of on income and assets as would normally be the case under ordinary taxation. The minimum requirement is that these costs equal at least five times the annual rent or rental value, or, where the taxpayer neither owns nor rents property to live in, double the board and lodging costs. These living costs are then compared against Swiss source income and domestic assets for control valuation purposes, with the higher result constituting the assessment basis. Peculiarities arise where a taxpayer claims relief from tax on foreign source income under a double taxation treaty.

²⁶⁷ ESTV-Kreisschreiben (fn 64), 7.

²⁶⁸ See fn 245.

²⁶⁹ See also the rules of the Canton of Obwalden: Art 6 of the implementing provisions on expenditure taxation; and the rules of the Canton of Uri (see the rules on expenditure taxation of 17.5.2005; also see ESTV-Kreisschreiben (fn 64), 8; Locher (fn 3), n 37 (Art 14 DBG). See also DBG-Zwahlen (fn 119), n 43 (Art 14 DBG); StHG-Zwahlen (fn 5), n 44 (Art 6 StHG).