Illusion No. 16

GINESTA REAL ESTATE'S KNOW-HOW BRIEFING LETTER

Real estate brokers have no interest in tax matters!

... Of course, that is just not the truth. For this reason, in this informational bulletin we provide you with important information on the issue of taxes and real estate.

Property owners and sellers are continuously confronted with various tax issues that arise both during the period of ownership and upon the sale of the real estate. For this reason, it is well worth taking a closer look at the various types of taxes and their features and implications. Due to the complexity of the tax system, the following discussion only covers the situation faced by natural persons.

a) Tax implications of property ownership

Income taxes: Imputed rental value
Throughout Switzerland, this form of income tax on homeowners applies to those who reside at their own home, apartment or vacation property. By living in your own four walls, you as the owner waive the potential to procure rental income. However, such rental revenues would increase the taxable income, and thus income taxes. The state does not waive these potential revenues voluntarily. It therefore applies a fictitious income to the homeowner. Based on the current practices of the Swiss Federal Supreme Court, this figure equals no less than 60 % of rents customary for the market. The various cantons take a variety of approaches to computing the imputed rental value.

Most often, the cantons rely on the putative land value and the appraised value of the building insurance to set the tax asset value and the imputed rental value. Based on the calculated imputed rental value, the homeowner can claim two different deductions: First, mortgage interest charges; second, the costs of maintenance and repair (value-preserving but not value-enhancing expenditure). Whereas mortgage interest charges can be deducted in general, the deductibility of building maintenance is regulated in very different ways among the individual cantons. Either a flat-rate amount (10% - 25% of the imputed rental value) can be deducted from the imputed rental value as a building maintenance fee, or if the effective, documented expenditures were higher, then in most cantons the effective total costs can be deducted. This optional choice exists in numerous cantons on an annual basis, while in others, the deduction method must be determined for a specified period of time (5 years, for instance). The imputed rental value increases the taxable income of the homeowner. Despite the option to deduct maintenance costs, this calculation may not be substantially reduced without deduction of the mortgage interest charges.

For older citizens in particular, who have repaid their mortgages and live off of a fixed pension, this tax practice is more than an irritation, because it may result in a considerable increase to their taxable income. Based on today‘s very steep mortgage interest charges, a private residence is typically mortgaged at 60 % - 70 % of the present value with a mortgage loan, thereby preventing any negative tax effect. This set of problems is acknowledged on a political level, and the National Council as well as the Council of States already resolved to abolish the imputed rental value (and thereby rescind the associated deductibility of maintenance and debt interest). However, no proposed legislation has been able to achieve a majority to date.

Wealth taxes
In terms of Switzerland‘s tax on wealth, real estate is assessed only at approximately 70 % of the market value.

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By purchasing a property for CHF 1 million, you can therefore anticipate a tax-related decrease of roughly 30 % or CHF 300,000 in wealth. The taxable asset is reduced by this amount, which results in a (slight) tax reduction. Nevertheless, the homeowner can exert neither positive nor negative influence on wealth taxes.

Property taxes
In 12 cantons (Bern, Lucerne, Fribourg, Appenzell Innerrhoden, St. Gall, Grisons, Thurgau, Ticino, Vaud, Valais, Geneva, Jura), an annual property tax must be paid on the ownership of private property. This may be levied either at the cantonal or at the municipal level, and depending on the canton, ranges between 0.3 - 3.0 thousandths of the official market or tax value.

b) Title transfer taxes (property sales)

Capital gains taxes

One tax that is frequently a source of immense concern to a homeowner is the capital gains tax. The tax is levied by cantons and municipalities, but not by the federal government, and represents a highly important revenue source. The computed difference between the sale and purchase price represents the profits from a real estate sale. Normally, the possibility exists to add value-enhancing capital improvements invested since the purchase to the actual costs. Additionally, the state guarantees a reduction (rebate) on the tax rate, depending on the holding period. This partially takes into account the inflation for the period between purchase and sale date. A complete netting of inflation to the purchase price is permitted in only a few cantons. We illustrate the capital gains tax using the cantons of Zurich and Vaud as an example:

Determination of capital gains tax		**Zurich (in CHF)**		**Vaud (in CHF)**
KPurchase price of the property 17 years ago		1‘000’000		1‘000’000
Value-enhancing investments in the last 17 years*		250’000		250’000
Total investment costs, including investments		1‘250’000		1‘250’000
Sale price today**		–1‘750’000		–1‘750’000
Nominal capital gains tax		500’000		500’000
Calculation of capital gains tax:				
Base rate per 500,000 francs of capital gain		189‘400		150’000
Reduction resulting from holding period (17 years)	-41 %	–77’700	-63 %	–95’000
Capital gains tax owed:		**111’700**		**55’000**

* including acquisition costs
** after deduction of sales costs

The capital gains tax must be paid by seller. A few cantons establish a legal right of lien on the sale, meaning that the buyer of a property may be jointly liable for any tax debts.

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Title transfer taxes

A title transfer tax is required on property sales that may equal 0.35 % - 3.3 % of the recorded sale price, depending on the canton. Individual cantons apply lower rates on long holding periods. The tax is paid by buyer or by seller, depending on the canton, although in several cantons, the tax is split between buyer and seller, unless individual agreements on its application are reached. Under such conditions, both parties are jointly liable for tax claims. For title transfers between married partners resulting from inheritance, gift or bankruptcy court sales, in most cantons reduced tax rates apply, or the tax is dropped entirely. In a few cantons - like Zurich, for instance - the title transfer tax has been abolished.

Other fees that may be incurred in the sale of a property (not taxes)

- Land registry charges and notarial fees
- Costs for origination and increase of mortgage notes
- Bank fees for the origination of a mortgage (appraisal, consulting, closing a mortgage agreement)
- Mortgage interest rate hedging fees (for premature hedging)
- Insurance for new homeowners (e.g., building, water, glass breakage, household insurance)

The range of ways to optimize your capital gains tax situation:

- When purchasing a replacement property in Switzerland within a defined deadline (3 years, based on current jurisprudence), the homeowner seller is entitled to a tax deferral.
- In some cantons, e.g. the canton of Zurich, tax authorities assess an appraised value for a property after a holding period of 20 years: The state tends to set low values, in order to trigger higher tax revenues. The seller does not have to accept the determined value without debate. Real estate advisors who have worked in the market for more than 20 years and who know comparable properties are better equipped to critically analyze state appraisals than the layperson, and file objections in each case. This specialized expertise is tremendously valuable to the seller, and could even result in a tax reduction that equals many times the sales commission.
- Investment costs of a value-enhancing or value-preserving nature (e.g., kitchen renovation with higher standard finishes) are permitted to be applied on a percentage basis (up to 50 %, for example) and in the manner of a value-enhancing investment. Here as well, perspectives diverge between seller and tax authority, and there is a lot of room for legitimate debate.
- Broker commissions, advertising costs (newspaper, Internet, etc.), notary fees and title transfer taxes can be deducted from the capital gain. In doing so, the broker commission could be indirectly reduced by 20 % - 40 % for the seller, depending on the tax rate.

Comparison of cantons regarding selected taxes and deduction options

	Bern	Geneva	Grisons	Vaud	Valais	Zurich	Federal
Title transfer taxes (in % of purchase price)	1.8 %	3 %	1.5 % - 2 %	2.2 %	0.4 % –1.2 % depending on value	abolished since 1.1.2005	None
Who normally pays the title title transfer tax?	Buyer	Buyer	Acquiring purchase [2]	Buyer	Buyer	–	–
Are real estate taxes assessed?	yes	yes	yes	yes [3]	yes	no	no
Imputed rental value; Flat-rate deductions for maintenance	10 % – 20 % [1]	Not possible	15 % – 25 % [1]	20 %	1,5 %[4]	20 %	10 % – 20 % [1]

1) Depends on age of building.
2) Deviating contractual agreements are taken into account if the seller is not a tax-exempt subject.
3) Levied only on certain properties of legal persons.
4) Shown as % of the cantonal tax value.

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Claude A. Ginesta is a federally licensed real estate fiduciary (registered with the SVIT, the Swiss Federation of Real Estate Fiduciaries) and owner and CEO of Ginesta Real Estate AG. The company was founded in 1944 and specializes in the sale of properties in the Zurich and Grisons markets. With offices in Küsnacht, Horgen and Chur, the company operates as real estate broker throughout Switzerland for properties located across the country.

Publisher of the "Illusions" series
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