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INFORMATION SHEET

Expenditure-based taxation

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1. Introduction / subject

This information sheet deals with the preconditions and calculation methods for expenditure-based taxation.

The Swiss Federal Council issued the Ordinance on Expenditure-Based Taxation for Direct Federal Tax on March 15, 1993 to regulate the levying of this tax. The Swiss Federal Tax Administration (FTA) clarified the details of this Ordinance in its Circular No. 9 of December 3, 1993.

The Federal Council's Ordinance and the FTA Circular apply mutatis mutandis to the expenditure-based tax levied under cantonal and municipal taxes. In contrast to the direct federal tax, which does not include any net wealth tax, for the cantonal and municipal taxes it is also necessary to specify net wealth (assets) corresponding to expenditure.

2. Legal basis

The legal provisions are based on Art. 6 StHG (Federal Act on Harmonization of the Direct Taxes of the Cantons and Municipalities) and Art. 14 DBG (Federal Act on Direct Federal Taxation).

§ 24 StG (Cantonal Tax Law of the Canton of Aargau)

[1] Natural persons who acquire tax domicile or tax residence in Switzerland for the first time or after an absence from the country of at least ten years, and who do not engage in any gainful employment here, have the right to pay the expenditure-based tax instead of the income tax and net wealth tax, until the end of the current tax period.

[2] If the said persons do not have Swiss citizenship, they have the right to continue to pay the expenditure-based tax after this period.

[3] The tax is assessed according to the expenditure of the taxpayer and his or her family, and calculated according to the regular tax rates. However, it may not be less than the tax calculated according to the regular tax rate on the total gross amount of

a) the immovable assets in Switzerland and the revenue from these;
b) the movable assets in Switzerland and the revenue from these;
c) the movable capital assets in Switzerland, including the receivables secured by real estate, and the revenue from these;
d) the copyrights, patents and other similar rights used in Switzerland, and the revenue from these;
e) the retirement income, old-age pensions and other pensions that originate from sources in Switzerland;

f) the earnings for which the taxpayer claims partial or total exemption from foreign taxes on the basis of a double-taxation treaty concluded with Switzerland.

[4] The Cantonal Executive Council issues the regulations needed for levying the expenditure-based tax. It may provide for a type of tax assessment and tax calculation which differs from that stipulated in clause 3 if this is necessary to enable the taxpayers stated in clauses 2 and 3 to be exempted from the taxes imposed by another country with which Switzerland has concluded a double-taxation treaty.

§ 5 StGV (Ordinance on the Cantonal Tax Law)

When determining the income corresponding to the expenditure, the Ordinance on Expenditure-Based Taxation for Direct Federal Tax of March 15, 1993 applies mutatis mutandis.

3. "Subjective" preconditions for expenditure-based taxation

3.1 Moving to Switzerland

Taxpayers who acquire tax domicile or tax residence in Switzerland for the first time or after an absence from the country of at least ten years have the right to pay the expenditure-based tax.

Taxpayers who move here from another canton also have that right, if they had already been paying the expenditure-based tax in the other canton in accordance with Art. 14 DBG, and if they continue to meet the legal requirements.

Natural persons who previously had limited tax liability in Switzerland due to their economic affiliation, may choose the expenditure-based tax if they take up residence in the Canton of Aargau.

3.2 Exclusion of gainful employment in Switzerland

Only those taxpayers who do not engage in any gainful employment in Switzerland are entitled to choose the expenditure-based tax option.

A person who pursues a main or secondary gainful occupation in Switzerland is said to be engaged in gainful employment, which excludes the person from the option of choosing the expenditure-based tax. This also applies to artists, scientists, inventors, sportspersons and company directors who are personally engaged in gainful employment in Switzerland.

However, it is not relevant whether the taxpayer had previously been engaged in gainful employment in Switzerland if the person takes up residence in Switzerland for the first time or after an absence from the country of at least 10 years and no longer practices any gainful employment in Switzerland after returning here.

If the taxpayer takes up or continues employment outside Switzerland, he or she does not forfeit the right to expenditure-based taxation.

If the taxpayer takes up gainful employment in Switzerland, the right to expenditure-based taxation expires, with effect from the start of the tax period in which the gainful employment commenced.

3.3 Term for the right to expenditure-based taxation

3.3.1 Persons with Swiss citizenship

Persons who hold Swiss citizenship have the right to expenditure-based taxation from the time of moving to Switzerland until the end of the tax period in which they took up their tax domicile or tax residence in Switzerland. Swiss citizens who also have the citizenship of another country (double citizenship) are classed as persons with Swiss citizenship.

3.3.2 Persons without Swiss citizenship

Persons who do not hold Swiss citizenship have the right to expenditure-based taxation for an unlimited period of time. The entitlement to expenditure-based taxation for an unlimited period of time still applies if the taxpayer's children have Swiss citizenship.

3.3.3 Jointly taxable married couples

Jointly taxable spouses have the right to expenditure-based joint taxation for an unlimited period of time if

- both spouses meet the above preconditions;
- neither of them has Swiss citizenship.

3.4 Start and end of expenditure-based taxation

The right to expenditure-based taxation starts from the time when the taxpayer is first obliged to pay tax as a result of personal affiliation (because of taking up domicile or fiscal residence in the canton), provided the other preconditions are met.

The assessment of the taxable income in the year of moving to the canton is made in accordance with § 58 (3) StG, and the assessment of the taxable net wealth is made in accordance with § 60 (3) StG.

The right to expenditure-based taxation expires when the taxpayer ceases to fulfill the "subjective" preconditions, as follows:

- on taking up gainful employment in Switzerland, with effect from the beginning of the tax period in which the gainful employment was taken up;
- on acquiring Swiss citizenship, with effect from the beginning of the year following that in which the citizenship was acquired;
- for persons with Swiss citizenship, with effect from the beginning of the next tax period following the year in which the person moved to Switzerland.

4. Objective preconditions for expenditure-based taxation

4.1 General

Expenditure-based taxation is generally calculated on the basis of the living expenses of the taxpayers and their dependents. The living expenses are defined as at least five times the rent or market rental value of the taxpayer's own house, or twice the cost of board and lodging (see Section 4.3 below).

§ 24 (3) StG stipulates that the tax on income and net wealth calculated on the basis of the living expenses must be not less than a specified minimum value, to allow for a "Control calculation" as a reference, and to ensure that a minimum tax rate is paid.

To assess the effective income and assets for the tax return for each tax period, the income tax and wealth tax derived from the living expenses are therefore to be compared to the income tax and wealth tax that result from the "Control calculation". The greater of these two amounts is then used to determine the tax.

4.2 Determining the cost of living

The taxable expenditure is defined as the total amount of the annual living expenses paid by the taxpayer in Switzerland and abroad for him/herself and his or her dependents living in Switzerland. This includes in particular the expenses for

- food and clothing;
- accommodation, including expenses for heating, cleaning, garden upkeep etc.;
- cash payments and payments in kind to the staff in the taxpayer's household;
- education, entertainment, sports etc.;
- travel, holidays, stays at health resorts etc.;
- keeping of costly animals (horses for riding, etc.);
- maintenance of cars, boats, airplanes etc. .

The taxable expenditure also includes the cost of living that the wife and children in the parents' care pay from their own funds, if they are living in Switzerland.

4.3 Effective minimum expenditure

The following principles apply when determining the effective minimum expenditure.

4.3.1 Taxpayers living in their own home

The effective minimum expenditure is deemed to be the quintuple of the rent or rental value of the person's own house or the flat in the person's own house, but in any case the figure for the taxable income must be at least CHF 250,000.

The rent is that which is actually paid, excluding heating costs. If the rented flat or rented house is owned by a natural person or legal entity who is close to the taxpayer, the amount that a third party would have to pay for the rent (market rental value) is to be used for the calculation.

For the taxpayer's own house or flat, the figure to be used for the rental value is the rent that the taxpayer would have to pay for an equivalent property at the same location (market rental value).

Where the taxpayer has more than one property available for his or her use in Switzerland, the one with the highest rent or rental value is to be used as the basis for the calculation.

4.3.2 Other taxpayers

The effective expenditure is deemed to be twice the cost of accommodation with board and lodging, but in any case the figure for the taxable income must be at least CHF 250,000.

The annual cost of accommodation is deemed to be the total expenses for board and lodging in hotels, guesthouses and the like, including the cost of drinks, heating, service etc. .

4.4 Determining the net wealth corresponding to the expenditure

Basically, the taxpayer will need to have assets in Switzerland or abroad in order to finance the living expenses. Consequently, the net wealth needed to finance the living expenses is determined by capitalizing the total living costs, i.e. either the effective living costs or a flat rate for them derived from the "Control calculation".

The revenue that does not come from assets, for example Swiss pensions or pensions from abroad, is deducted from the amount that is to be capitalized. No deduction is made, however, for income from gainful employment abroad that is not included in the assessment in Switzerland.

The capitalization rate is 5 %. Generally the taxable net wealth will be at least CHF 5,000,000.

5. Control calculation (minimum tax)

5.1 Control calculation for income tax

The "Control calculation" uses the gross revenue from the following income of the taxpayers and the children in their custody.

From sources in Switzerland:

- from immovable assets in Switzerland;
- from movable assets in Switzerland;
- from movable capital assets in Switzerland, including the receivables secured against real estate;
- from intangible rights that are used in Switzerland;
- from the retirement income, old-age and other pensions that originate from sources in Switzerland.

Income from movable capital assets located in Switzerland include revenue from securities and funds that are subject to the Swiss withholding tax, revenue from other receivables and funds from debtors residing in Switzerland, and from receivables that are secured against Swiss properties or by pledging Swiss mortgage deeds.

From sources abroad:

- the earnings for which the taxpayer claims partial or total exemption from foreign taxes on the basis of a double-taxation treaty concluded by Switzerland.

Only the following deductions are allowed from these gross revenues:

- the cost of maintenance and administration of immovable assets located in Switzerland;
- the expenses for the usual administration of securities and credit, the revenue from which is taxed.

All other expenses, in particular those for interest on debts, for pension contributions and continuing charges, cannot be deducted.

5.2 Control calculation for the net wealth tax

The net wealth tax must be set so that it is not lower than the tax on the total gross amount of

- the immovable assets in Switzerland;
- the movable assets in Switzerland;
- the movable capital assets in Switzerland (see Section 5.1);
- the intangible rights that are used in Switzerland.

6. Calculation of the tax

The tax is calculated using the tax rate derived solely from the effective expenditure and the net wealth corresponding to the expenditure.

Deductions for social security contributions are not allowed (see Art. 3 of the Federal Ordinance of March 15, 1993 on Expenditure-Based Taxation for Direct Federal Tax). Therefore the taxable income corresponds to the effective expenditure, and the taxable net wealth corresponds to the net wealth that results from the capitalization of the expenditure.

When determining the expenditure-based taxation, the regular tax rates and tax multipliers apply (see § 24 para. 3 StG).

7. Procedural matters

Taxpayers who lay claim to expenditure-based taxation have to submit an appropriate application to the Cantonal Tax Office (*Kantonalen Steueramt, Leitung Veranlagung, Telli-Hochhaus, 5004 Aarau*), and provisionally fill in and submit the special tax return with the list of securities; they also have to provide evidence that the required preconditions are met.

The Cantonal Tax Office will then examine the application and, if approved, specify the parameters in a written agreement and instruct the competent Tax Commission to prepare a report with the request that it be approved or rejected.

If the preconditions are not fulfilled or the requested documents have not been provided, even after being sent a reminder, the expenditure-based taxation shall be refused. The decision is to be made by the overall Tax Commission of the competent municipality, and delivered to the taxpayer. The usual means of legal recourse can be used to appeal against a negative decision.

If the Cantonal Tax Office and the Tax Commission of the competent municipality differ in their ruling, a formal decree (*Feststellungsverfügung*) must be issued.

If the request is mutually approved, the Municipal Tax Office then prepares a provisional statement for the current tax period, based on the agreement. After the tax period ends, the Cantonal Tax Office issues to the taxpayer the tax return form together with the list of securities for the expenditure-based taxation, and inspects the completed tax return. On the basis of this, the Cantonal Tax Office submits a request to the competent Tax Commission for the tax assessment.

For each tax period, until the time when the tax assessment comes into force, the taxpayer still has the right to pay the ordinary income tax and wealth tax based on a completed tax return for natural persons instead of the expenditure-based taxation.

Before each tax assessment is made, the fiscal authorities must establish that the taxpayer fulfills the preconditions for expenditure-based taxation, and that all the required details and documentary evidence have been provided.

8. Reimbursement of withholding tax and foreign taxes at source

In principle, the taxpayer can claim reimbursement of the withholding tax in accordance with the Executive Ordinance on the Federal Act on Withholding Tax of December 19, 1966, provided this revenue is then taken into account when preparing the "Control calculation" referred to in Section 5.1.

The benefits of the double taxation treaties concluded by Switzerland, in particular the relief from foreign taxes at source that they provide for, may in principle be claimed if these revenues are taken into account in the control calculation referred to in Section 5.1 and the expenditure-based taxation does not violate the provisions of the respective double-taxation agreement.

In relation to France, it should be noted that, according to the double taxation treaty, a person who pays expenditure-based tax is not deemed to be resident in Switzerland if he or she is taxed on a flat-rate basis that is calculated according to the rental value of the residence in Switzerland (Art. 4 para. 5 lit. b DBA CH-F). Special preconditions apply under the treaties with the countries Belgium, Germany, Italy, Norway, Austria and USA (Section 10 below).

9. Flat-rate tax credit

Taxpayers who are taxed according to expenditure have no claim to the flat-rate tax credit of the non-recoverable foreign withholding tax ("residual tax", Art. 4 para. 1 of the Ordinance on Flat-rate Tax Credit of August 22, 1967 and December 7, 1981).

There are exceptions to this under the double taxation treaties with Belgium, Germany, Italy, Norway, Austria and the USA. According to Art. 4 (3) of the Ordinance on Flat-rate Tax Credit, natural persons who enjoy a flat-rate tax, but who pay the full taxes on all revenues from these contracting states at the rate for their total income, may claim the flat-rate tax credit for the revenues received from these states (Section 10 below). The respective gross revenues, including the non-recoverable foreign withholding tax, must be declared.

10. Modified expenditure-based taxation for revenues from Belgium, Germany, Italy, Norway, Austria and the USA

A taxpayer who is resident in Switzerland and taxed according to expenditure may claim the benefits of the double taxation agreements concluded by Switzerland, in particular relief from foreign withholding taxes, in relation to the revenues from the six aforesaid contracting states, if these revenues, as well as all income taxable in Switzerland from the respective countries, are subject to the cantonal and municipal taxes and the direct federal tax. The revenues from foreign sources located in these contracting countries are treated as though they were subject to the regular taxation in Switzerland.

The tax is included in the control calculation referred to in Section 5.1, on all the Swiss revenues and on all the other revenues from these contracting countries, provided they are taxable under Swiss law and are not exempt from Swiss tax as a result of the applicable double taxation agreements.

The tax is calculated at the rate that applies to the total worldwide income. If the person taxed according to expenditure chooses not to provide proper details of the overall parameters, the modified expenditure-based taxation at the maximum rate shall apply.

Appendix I

I Tax return for expenditure-based taxation, direct Federal tax (including guide)

[separate document]

(Appendix I continuation)

(Appendix I continuation)

(Appendix I continuation)

(Appendix I continuation – Guide)

(Appendix I continuation – Guide)

Appendix II

Expenditure-based taxation / Supplementary sheet: Net Wealth Tax

[separate document]

(Appendix II continuation – rear page)

Appendix III – Example showing how the tax is calculated

A. Facts of the case

A is a foreign national and wishes to spend the last part of her life in the Canton of Aargau, where her close relatives are living. She retired several years ago. When moving to Switzerland on January 1, 20XX she applied for expenditure-based taxation. In the tax return she submitted, the following information was provided concerning her income (annual amounts):

- Rent of the flat at her place of residence in Aargau incl. auxiliary charges	CHF	42,000
- Dividends from shares in the company Stulpe AG, Denmark	CHF	24,000
- Interest on bonds held at the Aargauer Kantonalbank	CHF	30,000
- Dividends from shares in the company Schuh AG, Zug	CHF	20,000
- Rental income (net) from a property in Davos, GR	CHF	12,000
- Revenue from licenses in France	CHF	120,000
- Revenue from licenses in Switzerland	CHF	100,000
- Pension from a previous position of employment in Switzerland	CHF	36,000

The corresponding assets are indicated as follows:

- Market value of shares in Stulpe AG, Denmark	CHF	6,000,000
- Tax value of bonds held at the Aargauer Kantonalbank	CHF	1,000,000
- Tax value of shares in the company Schuh AG, Zug	CHF	1,000,000
- Tax value of the property in Davos GR	CHF	800,000

C. Calculating the income tax according to expenditure

It is assumed that the effective living expenses are not higher than the minimum creditable living expenses stated in Section 4.3.1 of the Information Sheet.

5 times the rental expenditure (5 x CHF 42,000) Income based on the rent calculation	CHF	210,000
= taxable income (minimum figure)	**CHF**	**250,000**

C. Calculating the wealth tax according to expenditure

Applicable expenditure according to Section B of this document	CHF	210,000
./. Income from pension	CHF	36,000
= creditable income	CHF	174,000
capitalized at 5 % (CHF 174,000 : 5 x 100)	CHF	3,480,000
= taxable income (minimum figure)	**CHF**	**5,000,000**

D. Control calculation for income tax

For the control calculation, according to Section 5.1 of the Information Sheet the following revenues are to be used:

- Revenue from pension	CHF	36,000
- Interest on bonds held at the Aargauer Kantonalbank	CHF	30,000
- Dividends from shares in the company Schuh AG, Zug	CHF	20,000
- Rental income (net) from the property in Davos, GR	CHF	12,000
- License revenues from Switzerland	CHF	100,000
Total revenues according to the control calculation (after deducting any production costs)	**CHF**	**198,000**

The applicable revenues according to the control calculation are less than the revenues calculated by expenditure. Consequently, it is the revenue determined by expenditure that shall serve as the basis for calculating the income tax.

E. Control calculation for net wealth tax

For the control calculation, according to Section 5.2 of the Information Sheet the following assets are to be used:

- Tax value of bonds held at the Aargauer Kantonalbank	CHF	1,000,000
- Tax value of shares in the company Schuh AG, Zug	CHF	1,000,000
- Tax value of the property in Davos GR	CHF	800,000
Total assets according to the control calculation	**CHF**	**2,800,000**

The applicable assets according to the control calculation are less than the assets calculated by expenditure. Consequently, the net wealth determined according to expenditure shall serve as the basis for calculating the wealth tax.