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SWISS CANTONAL INHERITANCE AND DONATION TAXES: TAX RISKS IN THE CASE OF TRANSVERSALS DONATIONS IN THE DIVISION OF AN ESTATE

In Switzerland, the general rule is that no inheritance tax or donation tax is due in direct ascending and descending lines or between spouses. Since each canton has its own tax law, taxes can sometimes be very high depending on the degree of relationship and the canton.

The division of an estate can in many cases present heirs with major challenges when it comes to the valuation of certain assets or when the heirs wish to divide the estate in a way that is different from what provided for by the deceased person or the law.

In certain cases, there is a risk that tax offices will assess donation taxes in addition to inheritance taxes.

This article does not deal with the new enacted Swiss inheritance law that will come into force on 01.01.2023. Please refer to our article "Reform of Swiss Inheritance Law".

1. INTRODUCTION

According to Article 607, para. 2 of the Civil Code, heirs may freely agree on the division of the estate, unless the testator has laid down rules on the division and formation of the parts by disposition of the deceased (Article 607, para. 2 of the Civil Code).

The heirs may freely agree on the division of the estate and one or more heirs may waive claims under a statutory, property or inheritance law provision such as a marriage contract, will or inheritance contract in favor of co-heirs or third parties.

In principle, the heirs are entitled to decide freely whether, when, how and at what monetary values they divide their inheritance.

Provided that all heirs sign a unanimous resolution (Article 602, paragraph 2, CC), they may even disregard the division provisions of the testators and the law. The renunciation of an heir in favor of a co-heir is recorded in the so-called inheritance division contract.

The transfer value is generally the fair market value, which for certain assets should ideally be estimated by an independent valuator. These are (list not exhaustive) real estate properties, participations in family businesses companies not listed on the stock exchange, works of art or jewelry.

2. DEFINITION OF A TRANSVERSAL DONATION UNDER TAX LAW

In the case of deviations from the statutory, property or inheritance law regulation, the term "transversal donation", which originates from the tax law, may exist. If there is a transversal donation under tax law, the tax office may levy donation taxes in addition to inheritance taxes. Depending on the canton and the degree of relationship, the donation tax can be considerable.

Principle

With the opening of the inheritance, the heirs receive their inheritance portion (object of inheritance tax), while afterwards, in a division of the inheritance, further persons may benefit (object of donation tax).

According to cantonal legislation, the donation tax is levied at the donor's place of residence.

Under certain conditions and circumstances, an inheritance division does **not** qualify as a transversal donation. This is the case if, from the point of view of the parties entering into agreements under the law of partition between themselves, there are reasonable doubts as to the validity or scope of the disposition of the estate upon death and the agreement intended by the heirs to differ from the deceased's legal, property or inheritance regime is neither unusual nor manifestly directed against the tax authority.

The following two conditions must be fulfilled to qualify as a transversal donation for tax purposes:

- One or more parties participating in the succession, waive in favor of co-heirs or third parties their claims to which they are entitled under the statutory, matrimonial property or inheritance regime, in whole or in part.
- The requirements for a **donation** pursuant to Article 239 of the Swiss Code of Obligations must be met: a donation is a voluntary legal transaction inter vivos (in contrast to an inheritance), whereby a person makes a pecuniary donation from his or her assets in favor of another person without corresponding consideration and the recipient of this pecuniary donation is enriched free of charge.

Accordingly, if an heir renounces to all or part of his inheritance in favor of a co-heir or third party, this legal transaction inter vivos may possibly be subject to donation tax, unless the heir has renounced to his inheritance within the statutory period of three months from the opening of the succession.

The assignment or transfer of certain assets (or rights) that deviate considerably from the fair market value (real estate, shares, other) is also risky from a tax point of view. The difference between the fair market value and the transfer value can be qualified as a donation and as such be assessed with a donation tax by the tax office.

Some examples:

- An heir assigns his or her share of the inheritance in part or in full without consideration (gratuitously) to a co-heir (during the testator's lifetime) or renounces to it in favor of a co-heir or third party after the opening of the succession and expiry of the disclaimer period: as a frequent practical example, this may occur between siblings or between a parent and the direct descendants.
- The heirs agree among themselves that a co-heir may take over a property or shares in a family business company not listed on the stock exchange at the fiscal value or another value significantly below the fair market value.
- The surviving spouse waives his or her matrimonial property rights in whole or in part in favor of co-heirs.

Subjective requirement: the evidence of a will to donate (in some cantons)

Since each canton has its own cantonal inheritance and gift tax law, it must be examined individually in each case whether, according to the cantonal tax law, the subjective requirement of the intention to make a donation is necessary or whether it is sufficient that the three objective requirements mentioned above (donation, enrichment, gratuitousness) are fulfilled in order to trigger donation tax.

The intention to make a donation is ascertained if the donation was made consciously without any claim of consideration, or if the person making the donation knew and wanted the donation to be made free of charge.

In principle, the tax office must be able to explain why it assumes an intention to make a donation, since according to federal court jurisprudence, a donation may not be qualified as such if there is no evident intention to make a donation due to the circumstances.

3. CANTON TICINO

The Canton of Ticino makes a donation (and the base to tax a donation) explicitly dependent on the **will to make a donation** (click here to read further – document in Italian).

According to Article 164 of the Cantonal Tax Act, the Canton of Ticino levies a maximum tax rate of 41% on donations and inheritances between non-relatives. Donations and inheritances between siblings are assessed at a maximum tax rate of 15.5%.

Donations and inheritances between spouses and in direct ascending and descending lines, on the other hand, are exempt from inheritance and donation tax.

4. CONCLUSION

For each division of an estate, it must be checked whether there is a risk of transversal donations in the respective canton, which can trigger donation tax in addition to inheritance tax.

When drawing up the inheritance division contract, great attention should be paid to the valuation of the transfer values. Ideally, the division of the estate should only be agreed once the inheritance taxes have been definitively assessed by the tax administration, as properties are valued differently in the various cantons (the fiscal values may be higher or lower than the transfer values).

It may also be advisable to request and obtain a tax ruling before signing the estate division agreement, as a tax ruling gives the taxpayer legal certainty and helps the tax office to correctly assess complex inheritance issues.

Please do not hesitate to contact us for further information on the above

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