

Real estate capital gains tax Zurich

Location class method

Initial situation

Companies often use two different corporations for the realisation **of real estate projects**. “Land AG” buys the property, holds it during the development and construction phase and sells it to third-party buyers. “Construction AG” develops the project until the building permit is obtained and is responsible for the construction. It concludes a contract for work and labour with the third-party buyers.

This structuring enables tax optimisation if the property is located in a canton such as Zurich, which levies real estate capital gains tax on corporate entities and not ordinary profit tax (so-called monistic cantons). The reason for the tax optimisation lies in the **division of the project profit** between two companies: Land AG pays real estate capital gains tax on the increase in the value of the land in the canton in which the property is located. In the case of Construction AG, the profit from the development and construction is subject to ordinary profit tax in the canton in which the company is domiciled. Due to the short holding period, the real estate capital gains tax rate – depending on the applicable cantonal law – is often a multiple of the ordinary profit tax rate. If the real estate project is realised by a single corporation, the profit from the development and construction is also subject to real estate capital gains tax in cantons with a monistic system.

Tax allocation of the project profit

Against this background, the question arises for each project as to how high the profit to be recognised by Land AG must be. Until a few years ago, companies argued that **the increase in the value of the land** could not exceed ten per cent within two to three years. If they bought the land for 1 million, they took the view that Land AG's profit would be a maximum of 100,000. However, it turned out that the development of land prices, especially in the city of Zurich, was quite different in some cases. Increases in value of 15 to 30 per cent during the project phase were quite common.

The tax office of the City of Zurich was therefore looking for a solution as to how the project profit could be divided between Land AG and Construction AG without having to prepare a valuation report or a transfer price study for each project. It found what it was looking for in the **location class method** of the SIV/SIREA¹.

¹ Swiss Association of Property Valuers / Swiss Institute for Property Valuation

- The location class method is **an auxiliary statistical method** for estimating land value shares using spatial information.
- The land value share of an overbuilt property is determined with the help of **location class tables**. There are different location class tables for residential, commercial and industrial properties.
- Depending on the canton, type of municipality (e.g. large, medium-sized, small centres, agglomeration), use of the building, image of the location, relative tax burden and micro-location, this results in a different percentage that represents the **land value share** of a property.
- **Example:** For an apartment building with rental flats in a very good location in the city of Zurich, a land value share of 50 per cent results on the basis of the residential location class table. For the division of the project proceeds between Land AG and Construction AG, this means that 50 per cent is attributable to the land. If a third-party buyer concludes the purchase agreement with Land AG and the work contract with Construction AG for a total of 20 million, the sales proceeds for the land should therefore amount to 10 million and the price for the construction of the building should also be 10 million. If the land was purchased from Land AG for 8 million, this results in a profit of 2 million, which is subject to real estate capital gains tax.

The tax office of the City of Zurich emphasises that the location class method is an auxiliary method. It makes it possible to determine the profit split between Land AG and Construction AG in a relatively simple way and to check its plausibility. The location class method is used in the **assessment procedure** and can also be used as the basis for a **ruling request**. It is important to note that the tax office does not rule out other methods for determining the allocation of project profits. There should therefore still be room for negotiations and individual solutions.

It should be noted that the location class method is a practice that is applied in the canton of Zurich. In the case of property projects in other cantons or intercantonal situations, it remains to be seen to what extent this method can be transferred or whether other approaches need to be taken into account when allocating profits.

If you have any questions on this topic, we will be happy to assist you.

ADB Altorfer Duss & Beilstein AG

Your contact persons



Fabian Duss
Partner
MA in Business Administration
Certified tax expert
LL.M. UZH International Tax Law

+41 44 267 63 67
fabian.duss@adb.ch



Mathias Häni
Director
lic. iur.
Certified tax expert

+41 44 267 63 85
mathias.haeni@adb.ch