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Real Estate

Switzerland – Law and Practice
Niederer Kraft Frey

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SWITZERLAND

LAW AND PRACTICE:

p.3

Contributed by Niederer Kraft Frey

The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

Contributed by Niederer Kraft Frey

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SWITZERLAND LAW AND PRACTICE

Contributed by *Niederer Kraft Frey* **Authors:** Andreas F. Vögeli, Marco Häusermann, Thomas A. Frick, Sandro Abegglen

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Niederer Kraft Frey's Real Estate Team is recognized as one of the leading practices in Switzerland. We cover the full lifecycle of real estate, providing a holistic approach for our clients. Our Real Estate Team advises on property acquisition and investment, development, management and leasing, financing, restructuring, and disposition of all asset classes of real estate. We also advise in all aspects of commercial, hospitality and residential real estate, including

regulatory framework and structures. NKF offers domestic and foreign investors (including listed and privately held property companies) comprehensive legal advice regarding the acquisition, management and sale of real property and real property portfolios. Our Real Estate Group is closely linked to the expertise from our Tax, Banking- and Finance and Corporate and M&A teams needed in large-scale real estate projects.

Authors



Andreas F. Vögeli heads the real estate practice group which deals with a variety of real estate transactions and projects. He specialises in large and complex real estate transactions including sale and lease back transactions, hotel and leisure projects as

well as the development of former industrial sites. He has authored a number of articles in industry publications. He is a Fellow of the Royal Institution of Chartered Surveyors, member of the board of several real estate companies and foundations, among others member of the board of Procimmo SA an asset manager of collective real-estate investments approved by the financial markets supervisory authority (FINMA) and the chairman of the AFIAA Foundation for International Real Estate Investments a real estate investment foundation based on the Federal Law on Employee Pension Funds (BVG) and supervised by the Federal Occupational Pensions Regulatory Commission. Andreas F. Vögeli is also engaged as an expert on the Master of Advanced Studies in Real Estate at the University of Zurich (CUREM) and is a Council member of the Real Estate Management programme of the Institute of Financial Services Zug IFZ, Lucerne University of Applied Sciences and Arts.



Thomas A. Frick specialises in counselling Swiss and foreign banks and other financial institutions in all kinds of legal and regulatory issues, with a particular focus on customer contracts, interbank contracts and syndicated finance. He

advises on a regular basis a number of foreign banks financing Swiss commercial real estates. He furthermore advises in competition law issues. Thomas Frick is partner in our Banking & Finance practice.



Sandro Abegglen advises on all regulatory aspects within the real estate sector. He advises banks, asset managers and real estate funds on all regulatory aspects of real estate investments/vehicles. He has written for industry publications and is Adjunct Professor (Privatdozent) for contracts, corporate law and banking and financial services regulation at the University of Berne Faculty of Law.



Marco Häusermann is specialised in banking and finance (regulatory and transactional) matters, debt capital markets transactions and restructuring and insolvency law matters. He frequently advises domestic and international

financial institutions and corporates on syndicated debt financings, leveraged finance, asset and project finance and structured finance transactions as well as in work-out and restructuring situations.

1. General

1.1 Main Sources of Law

Switzerland has a civil law system. The main source of real estate law is codified law, namely:

- the Swiss Federal Code of Obligations (in particular Art. 58 regarding the liability of owners for defects of a building; Arts. 216-221 regarding real estate sales and purchases, options and pre-emption rights; and Arts. 253-301 regarding leases and usufructuary leases);
- the Swiss Federal Civil Code (in particular Arts. 641-712t regarding real estate; Arts. 730-792 regarding easements and real burdens; Arts. 793-875 regarding mortgages; and Arts. 942-977 regarding the land register);
- the Swiss Federal Act on the Acquisition of Real Estate by Persons Abroad (so-called *Lex Koller*), the Swiss Federal Debt Enforcement and Bankruptcy Act; and
- the Ordinance on the Land Register.

Public law, including rules regarding zoning, planning, procurement and environmental issues, is also relevant, as well as various acts in relation to tax issues.

1.2 Main Market Trends and Deals

After a price growth in the residential property sector over 14 years, stagnation in 2015 and even a drop in 2016 there is now again a noticeable upward trend of prices for condominiums and single-family homes. Different from the residential property sector, there is no upturn in sight regarding the rental accommodation market, with the downturn that set in during 2016 continuing throughout 2017. The negative interest environment prevailing for over three years and the investment crisis resulting from this are driving the construction of rental apartments to very high levels – despite the fall in demand due to lower immigration. At the end of 2017, vacancies in the rented accommodation sector have reached a record level in Switzerland. Tenants are increasingly benefiting from lower rents.

As far as the commercial property sector is concerned, although the situation eased for some investors in 2017, office market conditions remain difficult and asking prices are falling. However, construction of offices is still rising. As for retail premises, retail turnover is suffering greatly from online retailing. A ray of hope comes from consumer spending which is expected to rise. Furthermore, cross-border shopping should start to decline following the appreciation of the euro. The number of construction permits for retail premises has increased in the past six months.

All in all, real estate investments have remained very high in investors' favour in 2017. Although the yield spreads to alternative investments have passed their peaks, demand for "concrete gold" has remained robust due to negative interest

rates, particularly among institutional investors. There was simply a lack of alternatives to solve investors' yield problem without excessive risk. However, it is likely to become increasingly difficult to maintain the good performance of the previous years as further capital will be fed into a comparatively high-yielding real estate market where yields are consistently under pressure. As a consequence, investors look for alternative investment possibilities such as real estate development projects, with the aim still to achieve attractive yields.

Some of the most significant real estate deals in the last 12 months – all of them with a volume exceeding CHF200 million – have been:

- the purchase of a residential property portfolio consisting of ten properties located in Zurich by AXA Insurance from Zürcher Freilager;
- the sale of a commercial property portfolio with properties in Geneva by Bank Lombard Odier & Co and Compagnie Immobilière Lombard Odier to AXA Insurance;
- the purchase of the famous high-rise building "Hochhaus zur Palme" in Zurich by Swiss Life from the Merbag Group; and
- the sale of a commercial property portfolio with properties in Adliswil and Nyon by Generali Switzerland to Allreal.

1.3 Proposals for Reform

Parliament has mandated the Federal Council to change the Ordinance on the Land Register, so that the owner of a ground can see who has been making requests about his land through the electronic land register. Therefore, the Ordinance on the Land Register will be changed in the near future.

In March 2017, the Federal Council of Switzerland opened a hearing procedure for the amendment of the *Lex Koller*, the law restricting the acquisition of real estate by persons abroad (see **2.4 Real Estate Due Diligence**). The Federal Council proposed that an authorisation be required for the acquisition of main residences in Switzerland by nationals of non-EU/EFTA states with a C permit. The proposed authorisation would always be linked to the obligation to resell a dwelling within two years of giving up residence in Switzerland. Shares in housing co-operatives, however, would be acquirable by these persons without an authorisation if the acquisition of shares is necessary for the rent of such a dwelling. Controversial questions in practice would be clarified and the procedure for establishing authorisation requirements would be shortened, according to the proposals of the Federal Council.

The Federal Council also put up for discussion very severe restrictions, in particular over whether commercial properties (eg offices, factories, logistics, shopping centres, hotels etc) should, as a rule, be subject to the Lex Koller again, repealing the corresponding liberalisation of the Lex Koller that was enacted in 1997. Foreign investors would thus be excluded from acquiring commercial properties in Switzerland in the future. The only exception would be where owners use the properties for their own business activities and do not lease the property to third parties. The Federal Council also put up for discussion whether the acquisition of shares in a legal entity, the real purpose of which is the acquisition of real estate, should be subject to an authorisation even if these shares are listed on a stock exchange in Switzerland. Only the acquisition of shares in a SICAV would be exempt.

The hearing procedure closed at the end of June 2017. The proposals and the restrictions put up for discussion faced heavy opposition from many political parties, organisations and from the real estate industry. Therefore, it is at this time not clear whether or what changes the Federal Council might propose to Parliament.

Currently, the Swiss Federal Law on Public Procurement being revised. The main objectives are to reflect the multilateral agreement on public procurement between the member states of the World Trade Organization (WTO) as well as to harmonise the procurement regulations of the Swiss Confederation and the Cantons. Furthermore, Parliament aims to introduce regulations with regard to further reductions of carbon dioxide emissions; the launch of subsidies for energy efficient building restorations; and the abolishment of the taxation of the imputed rental value for self-occupied premises. Further legislative work concerns the revision of the Swiss Federal Land Use Planning Law affecting, for example, hotels outside the building zone. It is not yet possible to forecast when these amended laws will enter into effect.

2. Sale and Purchase

2.1 Categories of Property Rights

The most important categories of property rights are sole ownership; joint ownership; co-ownership (including the condominium-principled co-ownership); building rights; usufructuary rights; and rights of residence. There are also other benefits to and burdens on real estate, such as rights of way, easements, access rights and mortgages. Pre-emption, purchase and repurchase rights on the one hand and lease and usufructuary lease agreements on the other are similar to rights in rem if they are annotated in the land register.

2.2 Laws Applicable to Transfer of Title

At a federal level, the Swiss Civil Code contains the principles of Swiss property law (types of ownership and in rem

rights) and the limitations applying to them, as well as provisions with regard to the land register filing. The contractual provisions with regard to the sale and purchase of real estate are governed in the Swiss Code of Obligations. Said provisions also include that real estate sale deeds must be signed before a notary public to be valid, and filed with the land registry for registration purposes. Real property transactions involving rights of pre-emption, purchase or repurchase are subject to the same notarisation requirements. At the cantonal level, each canton has its own notary regulations, and some of them have their own Lex Koller implementation statutes. The tax treatment of sales is also mostly regulated by cantonal laws.

The Lex Koller and the respective ordinances restrict the acquisition of Swiss residential real estate and land reserves by foreign investors. Primary residences in communes which have more than 20% of second homes can in principle only be transferred to a person who is domiciled in the commune, due to the restricted use detailed within the Federal Act on Second Homes.

In connection with the transfer of property to the acquirer, Swiss real estate transfer tax and notarial and registration duties may apply. The seller is subject to real estate capital gains tax (if a gain is realised on such a transfer). The payment of the Swiss real estate transfer tax and the real estate capital gains tax is usually secured by a statutory lien in favour of the relevant tax authorities over the relevant property. In certain circumstances, Swiss VAT aspects may need to be analysed as well, in case of a transfer of Swiss property.

2.3 Effecting Lawful and Proper Transfer of Title

Every (privately owned) piece of land has its own file in the land register, where the following information is recorded: title information (owner, size and description of the real estate); easements; mortgages; mentions (typically restrictions of ownership); and annotations (contractual pre-emption rights and selling restrictions).

Title to real estate is transferred to the new owner by way of registration in the land register. The prerequisite for registration is a notarised contract between the seller and the purchaser constituting the legal grounds for acquisition of ownership or any other rights in rem on real property. Only such a contract constitutes an obligatory right of entry into the land register.

Title insurance is neither needed nor common as purchasers acting in good faith are legally protected and can rely on the registration of title in the land register.

2.4 Real Estate Due Diligence

Due diligence in any real estate transaction always includes an examination of a certified land register excerpt regarding

the plot, including all supporting documents connected to the entries in the land register. In addition, existing leases must be examined, as these are transferred to the purchaser who is becoming the new landlord by acquiring the property. Maintenance agreements, management agreements, recent construction agreements and insurance policies are customarily reviewed as well. Other important elements of due diligence involve building permits, zoning plans and environmental law (the latter because the legal owner of the property is partly liable for contamination of the property, even if the property was contaminated before the transfer of title). Moreover, buyers regularly carry out tax, technical and financial due diligence.

In principle, the acquisition of Swiss real property by foreigners (in particular EU/EFTA nationals who do not have their permanent residence in Switzerland and nationals of other countries who do not hold a C permit) is subject to authorisation under the Lex Koller (see **1.1 Main Sources of Law**, above). The conditions for granting such authorisation are very restrictive – namely, the foreign investor must fall under one of the exceptions to proceed with a real estate acquisition. Purchase restrictions apply to residential and other non-commercial real estate as opposed to commercial real estate, a market that has been considerably opened to foreign investors with the 1997 and 2002 Lex Koller revisions. In the context of due diligence, the Lex Koller is therefore often an important aspect, including pertaining (cantonal) practice. The Federal Council is currently discussing tightening the Lex Koller (see **1.3 Proposals for Reform**).

2.5 Typical Representations and Warranties

In the absence of a waiver, a seller is liable to a purchaser for express representations made; in addition, the seller is liable that the object of purchase has no physical or legal defects which eliminate or substantially reduce its value or fitness for use.

In both asset and share deals, however, contracts often contain a disclaimer to all warranties with regard to physical defects of a property. The property is purchased “as seen.” Exclusion and limitation of liability clauses with regard to physical defects of the property are valid only if the seller did not deceive the purchaser as to the defects.

Important warranties relate to the correctness of rent records; the due diligence information being accurate, complete and up to date; and the absence of pending or threatened litigation with tenants, neighbours or authorities, as well as specific environmental and tax representations. Subject to the agreed statute of limitations, the purchaser may usually claim damages from the seller in case of a breach.

In share deals, warranties typically also relate to the correct organisation and valid existence of a company, the cor-

rect presentation of the financial statements and the title to shares.

2.6 Important Areas of Law for Investors

The most important areas of law are described above, under **1.1 Main Sources of Law**.

2.7 Soil Pollution or Environmental Contamination

Based on Swiss environmental law, a buyer of real estate may also be responsible for soil pollution. The law differentiates between the owner and the polluter who actually caused the pollution of the site through his actions. In remediation cases where the polluter cannot be called upon to bear the costs, the remediation costs remain with the cantons and may partly remain with the owner of the land.

Therefore, in asset deals, real estate that is registered in the cadaster of the contaminated sites can only be transferred with the approval of the respective cantonal authority. The authority may ask to secure the potential future costs of remediation.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Swiss law provides detailed (federal, cantonal and municipal) zoning and building regulations on the procedures and circumstances under which land can be developed. As a rule, the owner must file a request for a building permit for any construction. The potential buyer should therefore request a copy of all relevant permits from the seller.

Most zoning and building regulations provide special building regulations – eg design plans – which can help to facilitate major projects such as shopping centres, the transformation of industrial wastelands and larger residential developments etc.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation of land is only possible if it is necessary for predominant public interest, such as the development of infrastructure, widening of roads, or construction of highways. The state needs to establish the following prerequisites for a permitted expropriation:

- the legal grounds for the expropriation;
- the expropriation is in the public interest;
- the expropriation suffices the principles of proportionality;
- there is no other reasonable measure to achieve the result; and
- full compensation is granted to the property owner.

The property owner can challenge the expropriation through legal proceedings and has the right for an independent court

to decide on the suitability of the expropriation and the compensation offered.

2.10 Taxes Applicable to a Transaction

The transfer of real estate is subject to land registry and notary fees.

In most cantons of Switzerland, real estate transfer taxes apply (cantonal and/or municipal), and range from 1% to 3.3%. Most cantonal regulations provide that the buyer has to pay the real estate transfer tax, but it is not unusual for the parties to agree that the real estate transfer tax as well as the land registry and notary fees will be shared. In certain cantons, tax laws stipulate a first ranking legal lien on the real estate to secure real estate transfer taxes.

Share deals or corporate restructuring of real estate companies (eg transfer of assets and liabilities according to the Swiss Federal Act on Merger, Demerger, Conversion and Transfer of Assets and Liabilities) are not subject to real estate transfer taxes or land registry fees. However, fees are levied by the register of commerce.

2.11 Legal Restrictions on Foreign Investors

The Lex Koller (see **1.1 Main Sources of Law**) provides that foreign real estate investors can only buy real estate which is used for commercial purposes (eg offices, shopping centres, retail, hotels etc). Residential real estate as well as land reserves cannot be acquired by foreign investors (see also **2.4 Real Estate Due Diligence**).

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Swiss real estate transactions are usually financed by a mix of own funds and external financings. In particular, Swiss and foreign institutional investors (eg, pension funds and insurance companies) invest and hold significant real estate portfolios that are financed without external financing. On the other hand, other real estate investors often use a mix of own funds and external debt, the latter often in the form of a secured term loan and a revolving credit facility.

3.2 Typical Security Created by Commercial Investors

The security package for real estate financings consists primarily of a security interest (most often in the form of an ownership transfer for security purposes (Sicherungsübereignung)) with respect to mortgage notes (Schuldbriefe). Mortgage notes can be created as register mortgage notes (Registerschuldbriefe) or as mortgage notes in paper form (Papiersschuldbriefe). Register mortgage notes are exclusively recorded in the name of the creditor. As for mortgage notes

in paper form, however, the bearer (Inhaberschuldbrief) or a specific person (Namenschuldbrief) may be named as the creditor. Mortgage notes in paper form must be physically handed over to the lender, together with an endorsement on the mortgage note in favour of the lender. By virtue of the creation of a mortgage note, an independent claim in the amount of the mortgage note is created, which is separate from the claim created under the credit documentation (eg the loan(s)). Such mortgage loan claim is then secured by the underlying property.

Further security is usually taken with respect to rent and other receivables as well as insurance claims (in each case to the extent assignable) by means of a security assignment agreement (Sicherungscession). Furthermore, share pledges may be granted over the shares of the borrower and its subsidiaries (if any), and receivables assignments may be made, eg with respect to expected rental payments.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

There are no restrictions in relation to Swiss commercial real estate.

Lex Koller restrictions on the acquisition of residential real estate in Switzerland (see **2.4 Real Estate Due Diligence** and **2.11 Legal Restrictions on Foreign Investors**) must also be taken into account when granting or enforcing security with respect to Swiss residential real estate. The mere granting of security over mortgage notes should not create a problem under the Lex Koller if the terms and conditions of the financing/security are at arm's length and the transaction is not structured to circumvent the Lex Koller restrictions. If the ratio between the external financing and the value of the residential property is very significant (eg a loan-to-ratio [LTV] exceeding 80%) or in case other elements of the financing cause uncertainty, it may be advisable to obtain a ruling from the competent cantonal Lex Koller authority in this respect.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The establishing of a mortgage note is subject to a registration fee, set by cantonal law.

The holder of a mortgage note can register itself in the creditor register (Gläubigerregister) maintained by the competent land register at the place where the property is registered. A small registration fee may become due in connection with this.

The granting of security over Swiss real estate in the form of mortgage notes to secure loans granted by non-Swiss lenders generally triggers Swiss cantonal and federal source tax on the interest payments connected to such loans. A refund

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of the Swiss source tax or a reduction at source will only be available based on and in accordance with the applicable double taxation treaty, if any.

See below (3.5 Legal Requirements Before an Entity Can Give Valid Security) re Swiss withholding tax in case of upstream and cross-stream security.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The granting of security by a Swiss company for obligations of affiliates other than subsidiaries – so-called upstream and cross-stream security – raises a number of issues under Swiss corporate law and may trigger Swiss withholding and other tax consequences in case of the enforcement of the security, or if the conditions for granting such security are not in line with the principle of dealing at arm's length. The risks associated therewith are generally mitigated by a special purpose clause in the articles, corporate actions and contractual limitations in the loan and security documentation (essentially limiting the value of such security to the freely distributable capital of the Swiss company at the time of enforcement, minus any Swiss withholding tax [currently 35%], if applicable).

3.6 Formalities When a Borrower Is in Default

While a self-sale of mortgage notes is theoretically feasible, it is not usually the preferred route as the acquirer will thereby only acquire the mortgage note itself and therefore the secured claim against the property, but not the actual property. The official debt enforcement process (Betreibung auf Pfandverwertung) will instead be initiated, with the aim of achieving the sale of the property itself by the competent debt enforcement authority. However, the property owner has several legal remedies that can substantially delay any such enforcement process (even more so in an international context). Therefore, instead of going through an official debt enforcement process, in larger real estate investments it is common for lenders and investors to agree on the private sale of a property in order to avoid the risks associated with a public auction, a lengthy proceeding and higher costs.

There are no special steps necessary to give priority of a lender's security interest over the interests of other creditors, provided it is secured by a mortgage on the property. However, certain claims (eg certain tax claims) may be preferred by operation of law.

3.7 Subordinating Existing Debt to Newly Created Debt

It is generally possible for existing secured debt to become subordinate to newly created debt if there is an agreement among the relevant creditors. However, the recognition and handling of such subordination agreements in an insolvency scenario is somewhat controversial, as the Swiss Debt

Enforcement and Bankruptcy Act details only the secured creditors and three pre-defined classes of unsecured creditors. Thus, it is unclear whether and how an insolvency administrator must respect such subordination arrangements among certain creditors of the Swiss company.

3.8 Lenders' Liability Under Environmental Laws

As a general rule with respect to polluted sites, the Swiss Federal Environmental Protection Act states that the person responsible for the pollution bears the costs of the measures required to investigate, monitor and remediate polluted sites. If two or more persons are responsible for the pollution they bear the costs pro rata in accordance with their contribution to the pollution, with the person who caused the need for the remedial measures being primarily responsible. A person simply involved as owner of a property shall not be held liable for costs if, by exercising the required care, such owner could not have had any knowledge of the pollution. The competent public authority bears the share of the costs of any person responsible who cannot be identified or is unable to pay.

Lenders who financed the property may not become liable because of the mere holding of security, but they may indirectly finance the borrower to pay for such costs. In the case of an enforcement of security and a transfer of the property to a third party, the above rules must be taken into account.

3.9 Effects of Borrower Becoming Insolvent

Security granted by a Swiss borrower will not become void per se if the borrower becomes insolvent. However, Swiss law includes the concept of avoidance actions (with hardening periods between one and five years) which, if the criteria are fulfilled, may have the effect that the security is set aside. Furthermore, upstream and cross-stream security granted by a Swiss borrower may be of no value if the Swiss borrower is in financial distress (see above).

The opening of Swiss insolvency proceedings against a Swiss borrower generally has the consequence that the right to enforce security interests is restricted and subject to the rules and obligations of the formalities of the official insolvency proceeding whereby, as a general rule, the insolvency administrator organises the enforcement process and the distribution of assets resulting from such an enforcement process.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Swiss authorities at the federal, cantonal and municipal levels have various regulatory responsibilities with respect to planning, zoning and public construction law. As a matter of principle, zoning and building regulations are enacted by the

cantons and implemented by the municipal building authorities. Accordingly, there are 26 different cantonal zoning and building regimes. Any new building or construction and any change to an existing building or construction is required to obtain a building permit from the competent local authority.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Buildings, structures and their surroundings must be designed in a way that creates a favourable or pleasing picture when combined with each other as a whole as well as individually. Buildings and land under cultural heritage protection or nature conservation areas are subject to particularly strict regulations. Also, buildings must be constructed in accordance with the rules governing the area of a property that may be used for construction in relation to the area that must remain unused, as well as dimensions and distances that have to be observed.

4.3 Regulatory Authorities

Building permits must usually be obtained from the local authority where the construction work is performed. The local authority co-ordinates with the cantonal authorities and further bodies involved in the granting of the building permit.

The following legislations apply: the Swiss Federal Land Use Planning Law (Raumplanungsgesetz, RPG); building laws of the cantons (Baugesetz) and zoning laws of the local communities (Bau- und Zonenordnung); as well as various other federal and cantonal laws, such as the Environmental Protection Act (Umweltschutzgesetz), the Noise Control Act (Lärmschutzverordnung), the Clean Air Act (Luftreinhalteverordnung), the Water Protection Law (Gewässerschutzgesetz), the Energy Law (Energiegesetz) etc.

4.4 Obtaining Entitlements to Develop a New Project

As mentioned, planning applications must be submitted to the competent municipal authority. Thereafter, the project is published in the local official gazette and all affected parties are given the opportunity to raise objections against the project. A building permit is issued if the competent building commission finds that the project complies with all applicable regulations.

4.5 Right of Appeal Against an Authority's Decision

Both an applicant and the third party whose rights have been affected have the right to lodge an appeal with the superior administrative authority against the decision of a municipal authority. Moreover, Swiss federal law stipulates that the possibility of an appeal against the decision of an administrative authority to a court of law must be provided. The Swiss Supreme Court has final jurisdiction.

4.6 Agreements with Local or Governmental Authorities

Besides the possibility of design plans, which can help to facilitate major projects, it is not common to enter into agreements with local authorities. However, it is possible to enter into a contracting agreement with utility suppliers.

4.7 Enforcement of Restrictions on Development and Designated Use

In order to ensure that the project is executed in accordance with the plans submitted in the planning proceedings, the competent local authority must be notified of all relevant steps of the execution, and supervises their conformity with the permit. Violations of the permit may lead to criminal as well as financial liability of an owner, and result in an order to remove illegal structures. If the owner refuses to obey such an order, the authority has the power to have the structures removed at the owner's cost.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Specific objects can be acquired either directly by the individual investor or indirectly through a legal entity established for that purpose. The traditional way of investing in real estate in Switzerland is direct investment. With a growing market for real estate investment products, there has been a general trend towards indirect real estate investments, since these typically involve relatively lower transaction costs, higher liquidity, broader diversification and, most importantly, a lower entry level compared to direct investments into specific objects.

The main types of indirect real estate investments/investment vehicles are:

- Real estate funds (see the SXI Real Estate Funds Index for the real estate funds listed on the SIX Swiss Exchange), which can appear in the form of a:
 - (a) contractual investment fund (Art. 25 CISA);
 - (b) SICAV (investment company with variable capital; Art. 36 et seq. CISA);
 - (c) KGK (limited partnership for collective capital investments; Art. 98 et seq. CISA);
 - (d) SICAF (investment company with fixed capital; Art. 110 et seq. CISA);
- Non-regulated investment companies limited by shares (Art. 620 et seq. CO), which must either be listed or only accessible for qualified investors (cp. Art. 2 para. 3 CISA);
- Swiss real estate investment foundations which are governed by Art. 53g et seq. of the Occupational Retirement, Survivors' and Disability Pension Plans Act (OPA), the Ordinance on the Supervision of the Occupational Retirement

Contributed by *Niederer Kraft Frey* **Authors:** Andreas F. Vögeli, Marco Häusermann, Thomas A. Frick, Sandro Abegglen

ment, Survivors' and Disability Pension Plans (OPO 1), the Ordinance on Investment Foundations (IFO) and Art. 80 et seq. CC; and

- Special purpose vehicles (SPVs).

The most common investment vehicles for traditional real estate investment vehicles are contractual investment funds and SICAVs. In addition, in this space real estate investment companies and real estate investment foundations have become very popular in recent years. Depending on the type of investor, non-regulated SPVs may also be an option. Real estate investment trusts (REITs) and real estate derivatives are typically not set up in Switzerland and may be subject to regulatory requirements or restrictions with respect to their distribution into Switzerland.

In the non-traditional space, in particular for private equity real estate and real estate projects (finance), the KGK, which is the Swiss version of the Anglo-Saxon limited liability partnership, is the structure of choice (and often the only one permitted for regulatory reasons).

The government is currently working on an amendment of law to introduce a Swiss "copy" of the new Luxembourg Reserved Alternative Investment Fund (RAIF).

5.2 Main Features of the Constitution of Each Type of Entity

The contractual investment fund is not a legal entity but a contract. It is based on a collective investment agreement (fund contract) under which the fund management company (a legal entity) commits itself to involve investors in accordance with the number and type of units which they have acquired in the investment fund, and to manage the fund's assets in accordance with the provisions of the fund contract at its own discretion and for its own account. The fund management company draws up the fund contract and, with the consent of the custodian bank, submits it to FINMA for approval.

SICAVs are established under the relevant provisions of the Swiss Code of Obligations but are exempt from the provisions governing non-cash contributions, non-cash acquisitions and special privileges (Art. 37 para. 1 CISA). A SICAV must be authorised by FINMA before it can begin operations, and must obtain approval for its constituting documents (eg its articles of association and investment regulations). The following are specific authorisation and approval requirements for SICAVs:

- the company's name must contain a description of its legal form or the abbreviation SICAV;
- company and investor shares which do not have a nominal value and are freely transferable must be fully paid up in cash;

- investment regulations must be defined;
- a custodian bank must be designated; and
- the SICAV must choose to be either self-managed (eg it handles its own administration and may delegate portfolio management activities as set out in Art. 51 para. 1 CISO) or externally managed (eg it delegates both administration and portfolio management activities as set out in Art. 51 para. 2 CISO).

A KGK is a company whose sole object is collective investment. At least one member (the general partner) bears unlimited liability, while the other members (limited partners) are liable only up to a specified amount (the total limited partner's contribution) (Art. 98 para. 1 CISA). Unless CISA provides otherwise, the provisions of the Swiss Code of Obligations apply in relation to KGKs. A KGK must be authorised as an institution by FINMA before it can begin operations. The constituting document (partnership agreement) also requires approval. The general licensing and approval requirements set out in CISA apply, but there are other specific requirements which must be met, the most important of which are that:

- a general partner must be constituted as a limited company with its registered office in Switzerland and must act solely for one KGK;
- limited partners must be qualified investors as defined in Art. 10 para. 3 CISA;
- the partnership exists as soon as it appears in the Commercial Register; and
- the partnership's name must contain a description of its legal form or the abbreviation KGK.

A SICAF is a company limited by shares as defined in Art. 620 et seq. CO. Its sole object is collective investment. It is usually not listed on a Swiss stock exchange and its shareholders are not necessarily qualified as required in Art. 10 para. 3 CISA. A SICAF must be authorised by FINMA as an institution before it can begin operations. FINMA must also approve the SICAF's constituting documents, namely its articles of association and investment regulations. The following specific authorisation and approval requirements for SICAFs are set out in Art. 110 et seq. CISA and Art. 122 et seq. CISO:

- the company's name must contain a description of its legal form or the abbreviation SICAF;
- the issuing of voting shares, participation certificates, dividend right certificates and preference shares is prohibited;
- the key provisions concerning investments, investment policy, investment restrictions and risk diversification, etc. must be set out in the articles of association and investment regulations;
- a custodian bank must be designated; and
- an audit firm must be appointed.

As an exception to the general rule of a FINMA approval and supervision, an investment company in the form of a company limited by shares is not subject to the CISA where: a) the shares of the investment company are listed on a Swiss exchange; or b) its shareholders are exclusively qualified investors under the CISA; or c) the investment company qualifies as an investment club.

A company limited by shares may be established by natural persons or legal entities. It is established when the founding members declare by public deed that they are forming a company limited by shares, lay down the articles of association therein and appoint the governing bodies (Art. 629 para. 1 CO). The company is entered in the commercial register of the place at which it has its seat and acquires legal personality only through entry in the Commercial Register (Art. 640 and 643 para. 1 CO).

The launch of a Swiss investment foundation requires a broad range of documents, such as foundation regulations, articles and a prospectus (Art. 53g para. 1 OPA in connection with Art. 12 et seq. OPO 1 and Art. 80 et seq. CC). It is subject to (pre-)approval and direct supervision by the Occupational Pension Supervisory Commission.

5.3 Minimum Capital Requirement

Minimum capital requirements are as follows:

- Contractual investment fund: Share capital of the fund management company of at least CHF1 million, to be paid up in cash (Art. 43 CISO). Additionally, the investment fund must have net assets of at least CHF5 million, at the latest one year following its launch (Art. 35 para. 2 CISO).
- SICAV: In respect of a self-managed SICAV, company shareholders must provide a minimum investment of CHF500,000 at the time of formation; where a SICAV is externally managed, a minimum investment of CHF250,000 is required (Art. 54 CISO). Additionally, the SICAV must have net assets of at least CHF5 million, at the latest one year following its launch (Art. 53 in connection with Art. 35 para. 2 CISO).
- KGK: General partners must have paid-in capital of at least CHF100,000 (Art. 118 para. 2 CISO). There are no further capital requirements.
- SICAF: Shares amounting to at least CHF500,000 must be fully paid up in cash at the time of formation (Art. 122a para. 1 CISO). Additionally, pursuant to Art. 122b CISO, the governing bodies must at all times hold treasury shares as a percentage of the total assets of the SICAF as follows, subject to a maximum of CHF20 million:
 - (a) 1% for that portion not exceeding CHF50 million;
 - (b) 0.75% for that portion exceeding CHF50 million but not exceeding CHF100 million;
 - (c) 0.5% for that portion exceeding CHF100 million but not exceeding CHF150 million;

- (d) 0.25% for that portion exceeding CHF150 million but not exceeding CHF250 million; and
- (e) 0.125% for that portion exceeding CHF250 million.

- Company limited by shares: A company limited by shares must have a share capital of at least CHF100,000 (Art. 621 CO). When the company is established, capital equivalent to at least 20% of the nominal value of each share must be paid up. In all cases, the (initial) capital contribution must be at least CHF50,000 (Art. 632 CO). Under the circumstances specified in Arts. 628 and 634 CO, contributions in kind may satisfy the contribution requirement. Special listing rules and capital requirements apply in the case of listed investment companies.
- Swiss investment foundation: A minimum capital of CHF100,000 must be dedicated at the establishment of the investment foundation (Art. 22 OPO 1).

5.4 Applicable Governance Requirements

In general, and particularly according to Art. 14 para. 1 CISA, authorisation for entities that require FINMA approval is granted if:

- the persons responsible for management and the business operations have a good reputation, guarantee proper management, and possess the requisite specialist qualifications;
- the significant equity holders have a good reputation and do not exert their influence to the detriment of prudent and sound business practice;
- compliance with the duties is assured by internal regulations and an appropriate organisational structure;
- sufficient financial guarantees are available; and
- the additional authorisation conditions listed in the relevant provisions of the CISA are met.

Furthermore, FINMA may make its granting of authorisation dependent on compliance with the codes of conduct of a specific industry body (Art. 14 para. 2 CISA).

Similar rules apply with respect to the investment foundation. General corporate governance rules apply to the company limited by shares.

5.5 Annual Entity Maintenance and Accounting Compliance

The costs for annual entity maintenance and accounting compliance vary greatly depending on the volume and structure of the vehicle.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

There are basically two types of purely contractual arrangements (as opposed to the rights in rem mentioned under

2.1 Categories of Property Rights above): the lease and the usufructuary lease.

6.2 Types of Commercial Leases

See **6.1 Types of Arrangement Allowing the Use of Real Estate for a Limited Period of Time** ; this classification is, however, not limited to commercial leases.

6.3 Regulation of Rents or Lease Terms

Rent and/or lease terms are only negotiable within the mandatory limits of Swiss tenancy law, which favours the interests of tenants.

Excessive rents are prohibited and tenants have the right to challenge them in court as being abusive. Generally, rent is not considered abusive if, for example, it is within the range of rents that are usual in the neighbourhood or if it is based on increased costs or additional benefits provided by the landlord.

6.4 Typical Terms of a Lease

Typically, parties to a lease agree to a term of five years, with the possibility to extend the lease for one or several similar terms. Various types of such extension options may be agreed by the parties. Under so-called real options the conditions of a lease are maintained, whereas under so-called unreal options parties are not bound by the previous conditions.

Lease terms may also be concluded for an indefinite period.

The costs for regular maintenance and small repairs (usually not exceeding 1% of the annual rent) must be borne by a tenant, regardless of whether or not he is responsible for the damage. By contrast, a landlord is responsible for the costs of any other (larger) maintenance and repairs.

Monthly advance payments of rent are common in Switzerland, but the frequency of rent payments is negotiable. Depending on the credit standing of a tenant and the guarantees provided, it might be advisable to agree on a quarterly or six-monthly advanced payment.

6.5 Rent Variation

A rent increase is possible under narrowly defined formal and quantitative requirements as per the next possible termination date and if the landlord can demonstrate that the increase does not result in an excessive rent. A landlord must notify a tenant about the rent increase at least ten days before the beginning of the next notice period.

Moreover, if the lease term is at least five years, parties may agree a partial or full rent adjustment in accordance with the Swiss Consumer Price Index (so-called “indexed rent”). It is also not unusual to agree on a staggered rent. If the parties do so, the term may not be less than three years.

Within the term of the staggered rents, a combination with indexed rents is not possible. Another adjustment possibility is to include an explicit reservation of a rent increase in the lease contract, stating the amount of the possible increase; however, this is only possible if the original rent lies below market value.

Furthermore turnover rents may be agreed. These depend on the turnover of the business run in a leased property, but are usually combined with a minimum rent. This mechanism can also result in different lease amounts during a lease term.

6.6 Determination of New Rent

See **6.5 Rent Variation**.

6.7 Payment of VAT

Generally, pursuant to Art. 21 para. 2 no. 21 of the Swiss VAT Law, the rent of real estate is exempt from VAT (with certain exceptions). A landlord who is registered as a VAT payor, however, has the possibility to opt for the taxation of the rent, provided that the tenant does not use the leased premises exclusively for private purposes.

6.8 Costs Payable by Tenant at Start of Lease

It is common practice to request a security deposit from a tenant at the start of a lease (see also **6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations**). If the parties agree on a tenant fit-out, costs in that respect are payable by the tenant as well.

6.9 Payment of Maintenance and Repair

Maintenance and repair costs for a building and its surroundings (landscaping) are generally paid by a landlord but reimbursed by the tenants via the service charges.

6.10 Payment of Utilities and Telecommunications

Costs for utilities are generally paid by a landlord but reimbursed by tenants via the service charges. Costs for telecommunications services are paid by tenants.

6.11 Insuring the Real Estate That is Subject to the Lease

An owner must insure a building against damages caused to the property, such as fire or water damage. Insurance for environmental problems is, in general, not available.

6.12 Restrictions on Use of Real Estate

Parties may agree on a certain use of a premises. Often the usages which could adversely affect the real estate or other tenants are prohibited. Furthermore, the use of the buildings has to comply with the zoning regulations.

In addition, a sublease by the tenant is subject to the landlord's approval, but such approval may only be withheld if the tenant refuses to disclose the terms of the sublease, if the

terms of the sublease are abusive, or if the sublease has major disadvantages for the landlord.

6.13 Tenant's Ability to Alter and Improve Real Estate

If a tenant wants to alter or improve the rented property, s/he has to obtain written permission from the landlord. Otherwise, the tenant has to reinstate the original situation upon move-out of the property. If the landlord agrees to the alterations and they result in substantial improvement of the property, the tenant is entitled to adequate compensation.

6.14 Specific Regulations

Swiss law only distinguishes between commercial and residential leases. In the context of commercial leases, specific agreements in consideration of the type of business may of course be concluded within the scope of statutory law.

6.15 Effect of Tenant's Insolvency

If a tenant becomes insolvent, the landlord can request security for future rents. If security is not provided within a grace period, the landlord is entitled to give extraordinary notice and immediately terminate the lease contract.

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations

A landlord usually requires a rent security deposit. If the tenant provides security in the form of cash or negotiable securities, the landlord must deposit it in a bank savings or deposit account in the tenant's name. The bank may release such security only with the consent of both parties or in compliance with a final payment order or a final court decision.

Alternatively, bank guarantees may also serve as rent security.

6.17 Right to Occupy After Termination or Expiration of a Lease

Once a lease is terminated, a tenant has no right to continue to occupy the property. However, tenants are entitled to submit a request for extension of the lease term to a judge if the termination would cause undue hardship which cannot be justified by the landlord's interests.

Due to the right of extension, a landlord cannot generally undertake precautionary legal measures to ensure that a tenant moves out on time, unless it becomes obvious that the tenant will not leave on the agreed date. Under these circumstances, it might be possible to evict the tenant on the date of termination.

6.18 Right to Terminate Lease

Lease contracts with a fixed term expire without any further action at the end of their term, unless both parties continue

to maintain the contract, in which case the contract is converted into a lease with an indefinite period.

Unless otherwise agreed, the notice period with regard to indefinite business leases is six months. As mentioned, tenants are entitled to submit a request for extension of the lease term to a judge if the termination would cause undue hardship which cannot be justified by the landlord's interests. The maximum extension for commercial leases is six years.

Default in the payment of rent entitles a landlord to terminate a lease. However, the landlord must first grant a deadline of a minimum of 30 days for payment, combined with the announcement of termination in case of further default, and may then terminate the lease with a notice period of another 30 days. The landlord may also terminate the lease if the tenant becomes insolvent (see above **6.15 Effect of Tenant's Insolvency**).

A tenant may terminate a lease if the landlord does not hand over the leased premises at the time agreed upon, or if, at the handover, the premises have defects that significantly impair the suitability for the intended use. During the lease, the tenant may give notice with immediate effect if the landlord is notified about such a defect and fails to remedy the defect within an adequate period of time.

In addition, both a landlord and a tenant may terminate a lease for valid reasons that make it impossible to continue the lease.

6.19 Forced Eviction

Tenants can be forced to leave – see **6.18 Right to Terminate Lease**. The duration of the process depends on court instances and can take several months or years.

6.20 Termination by Third Party

A lease can be terminated as per the next possible termination date by the new owner of a property if he can prove urgent need for him or his family. Government or other authorities cannot terminate private leases.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Most construction contracts qualify as work contracts according to which a contractor promises to produce a work project for which the principal promises to pay a certain price. The essential feature is that the amount to be paid by the principal is due only if the work is completed as agreed. The compensation may either be a fixed price (which may generally not be exceeded unless extraordinary circumstances are given) or may be determined in accordance with the

value of the work performed. The contractor usually bears the risk of success of his endeavours, especially where a fixed price is agreed.

Conditions of payment in larger projects usually provide for stage payments, which entitle the contractor to draw a percentage of the total compensation whenever certain predefined steps of the construction process are completed.

7.2 Assigning Responsibility for the Design and Construction of a Project

A common organisational structure of a project is for the owner of a property to hire a general contractor. In its relationship with the owner, the contractor is liable for the performance of the contract and thus for the work of the subcontractors.

7.3 Management of Construction Risk

In construction contracts a contractor usually provides a performance guarantee. Upon completion, the contractor gives a warranty with regard to defects of the construction. Typically, the performance guarantee as well as the defects warranty are secured by either a bank guarantee or other surety. Based on the bank guarantee, the guarantor bank commits to pay any sum up to a predefined maximum amount to the guaranteed party, upon the latter's first demand; the guarantee is irrevocable and unconditional, and may be exercised even if certain underlying obligations have not been met. In a surety contract the grantor undertakes to fulfil the obligations of the principal obligor towards the secured party in case the principal obligor is not able to do so. In this constellation, and in contrast to the guarantee, the grantor has all the legal defences of the principal obligor since the surety does not create an independent contractual claim like the guarantee does.

Generally, the contractor also takes out insurance coverage for civil liability in connection with damages resulting from the construction. Furthermore, the property owner must ensure sufficient insurance coverage for civil liability relating to damage resulting from the property itself.

7.4 Management of Schedule-Related Risk

As mentioned above (see 7.1 **Common Structures Used to Price Construction Projects**), stage payments are usually agreed to manage schedule-related risk. The terms of construction contracts often also include provisions relating to penalties to be paid by a contractor in case of default, consequences of early termination, etc.

If instructions by the owner risk causing delay, defects or an increase in work costs, it is incumbent upon the contractor to notify the owner about such risk as, otherwise, the contractor may be liable for any consequences.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is common for the contractor to provide a completion guarantee, commonly issued by a bank (see also above, 6.3 **Management of Construction Risk**).

7.6 Liens or Encumbrances in the Event of Non-Payment

A contractor may request that the court establishes a statutory charge on a property for the performed work within four months of its completion. The charge is registered only if the claim has been acknowledged by the property owner or confirmed in a court judgment, and may not be requested if the owner provides the claimant with adequate security.

7.7 Requirements Before Use or Inhabitation

Before a project can be inhabited, the authorities will order a final inspection and acceptance of construction works; they will particularly check if all fire and safety rules have been fulfilled.

8. Tax

8.1 VAT

Pursuant to Art. 21 para. 2 no. 20 of the Swiss VAT Law, the sale of real estate is exempt from VAT. However, pursuant to Art. 22 para. 2 lit. b of the Swiss VAT Law, a seller who has registered as a VAT payer may opt for taxation at the standard VAT rate (currently 7.7%) provided that the purchaser does not use the real estate exclusively for private purposes.

8.2 Mitigation of Tax Liability

Since transfer, recordation, stamp or other similar taxes (if any) are levied on a cantonal or communal level, there is no commonly used method to mitigate such taxes. Optimisation possibilities (eg exemptions in case of group reorganisations, reduction of calculation base etc) have to be analysed on a case-by-case basis.

8.3 Municipal Taxes

There are no municipal taxes paid on the occupation of business premises.

8.4 Income Tax Withholding for Foreign Investors

Net rental income (gross rental income less attributable deductions) and capital gains of foreign investors derived from Swiss real estate are taxable in Switzerland. Foreign owners of Swiss real estate are obliged to file a tax return in Switzerland in the canton where the real estate is located, and to pay the resulting taxes.

Tax rates on net rental income vary from canton to canton and from commune to commune. For corporate owners, the applicable maximum corporate income tax rates in the dif-

ferent cantons and communes range from 12% to 25%. For individual owners, the maximum income tax rates in the different cantons and communes range from 22% to 41%. Exemptions may be available for tax-exempt entities such as charitable institutions and pension schemes.

Taxation of capital gains derived from Swiss real estate also varies from canton to canton and even from commune to commune. Capital gains tax rates may be progressive and may also depend upon the duration of ownership. Different capital gains tax rates may apply to corporate and individual owners. The range of applicable capital gains tax rates is therefore large, and may be between 0% (in the canton of Geneva after a duration of ownership exceeding 25 years) and 60% (for short-term capital gains in the cantons of Zurich, Zug and Basel City). Exemptions may be available in case of

reorganisations or for tax-exempt entities such as charitable institutions and pension schemes.

8.5 Tax Benefits

A tax payor using Swiss real estate for commercial purposes may benefit from standardised depreciation rates as fixed by the respective guidelines issued by the Swiss Federal Tax Administration (Guideline of 1995 regarding Depreciation of Assets of Commercial Entities). Furthermore, any other commercially justified costs relating to Swiss real estate are tax-deductible.

An individual tax payor using Swiss real estate for its own private purposes is taxed on a deemed rental income but is allowed to deduct any maintenance and financing costs relating to the real estate.

Niederer Kraft & Frey

Bahnhofstrasse 53
8001 Zurich

Tel: +41 58 800 8000
Fax: +41 58 800 8080
Email: andreas.f.voegeli@nkf.ch
Web: www.nkf.ch

NIEDERER KRAFT & FREY