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Private Wealth

Schellenberg Wittmer

Inheritance Law Reform: More Flexibility, also for Business Succession

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Key Take-aways

1.
In the future, the testator will be able to freely dispose of a larger part of his estate.

2.
Existing wills and succession pacts should be reviewed.

3.
Additional relaxations for business succession are already planned.

1 Introduction

By resolution of 19 May 2021, the Federal Council clarified the **effective date** of the first part of the inheritance law reform: the new provisions will be effective as of **1 January 2023** and will provide more flexibility for planning your estate planning.

This newsletter provides an overview of the **most important changes** and their impact on estate planning. Particular attention is paid to the extent to which existing wills and succession pacts may need to be amended. Further, the planned additional relaxations to facilitate **business succession** are briefly outlined.

2 Key changes as of 1 January 2023

2.1 Reduction of the descendants' and abolition of the parents' compulsory shares

The most significant change of the revised provisions relates to the **forced or compulsory shares**. The compulsory shares are those parts of the estate that certain heirs cannot be deprived of. In practice, compulsory shares are the biggest obstacle to estate planning which are often difficult to overcome, in particular in the area of business succession. Going forward, the compulsory shares will be smaller and the freely-disposable part of an estate will thus increase: the **compulsory share of descendants will only be** 1/2 (so far 3/4) of their intestate share, while the **surviving parents' compulsory share will be abolished entirely** (so far 1/2 of their intestate share). The **compulsory share of the surviving spouse** or registered partner remains unchanged (1/2 of their intestate share).

Due to this reduction or abolition of the compulsory shares, a testator may in future **freely dispose of at least half of the estate**. Hence, there will be more flexibility for favouring life partners, the partner's children or other closely-related persons, or for allocating a larger share (property, companies, etc.) to specific heirs. That said, one should keep in mind the potentially-high **inheritance tax consequences**, depending on the canton, particularly when favouring non-related persons.

The size of the compulsory shares in each individual case depends on the specific circumstances: If the testator is married or lives in a registered partnership and leaves descendants, the spouse or registered partner and all descendants are each entitled by law to receive 1/2 of the estate. Due to the reduced compulsory shares, only 1/2 of the estate will be subject to the compulsory portions (formerly 5/8). Where the testator leaves descendants only, they shall by law receive the entire estate and their compulsory share will now only amount to 1/2 (so far 3/4). If the testator leaves behind a spouse or registered partner and parents or siblings, but no descendants, 3/8 will be subject to compulsory shares, leaving 5/8 that the testator may freely dispose of.

The revised provisions will apply to the **estates of all persons who die after 1 January 2023** and are also relevant for wills and succession pacts that have previously been drawn up. It is therefore **recommended to review existing testamentary dispositions**, in order to **benefit of the new flexibility** and to **eliminate any potential ambiguities**. For example, if an existing will states that descendants should only get their compulsory portion, it should be clarified whether they should continue to receive 3/4 of their intestate share (current law) or only 1/2 of their intestate share. Testators without children should specify whether their parents should still receive certain share after 1 January 2023.

2.2 Clarifications regarding the order of abatement

Heirs who do not receive the full value of their compulsory share may seek the reduction of certain dispositions made by the testator. So far, there was some ambiguity as to the order of reduction, in other words, which dispositions will be hit. The reform clarifies **that in the first place, shares devolving to an heir under intestate rules (so-called intestate succession)**, i.e. the heir's statutory share **shall be reduced** up to their compulsory share. In a second step testamentary dispositions may be reduced and, finally, lifetime gifts. It has further been clarified that benefits arising from marital agreements or property contracts qualify as lifetime gifts, which was controversial so far.

2.3 Loss of entitlements in case of pending divorce proceedings

Under current law, spouses and registered partners lose their statutory inheritance rights and their right to a compulsory share only upon a final and binding divorce order. Under the new law, the surviving spouse or registered partner will **no longer be entitled to a compulsory share** if the other spouse or partner **dies during a pending divorce or dissolution proceeding**, provided the proceedings has been initiated or continued at the spouses' joint request or if they have been living separately for two years. However, the spouses will **keep their statutory inheritance rights until the divorce is final and binding**. Therefore, a **testamentary disposition is required** (i.e. active action is needed) if the testator no longer wants his/her spouse or partner to benefit from the estate.

Further, once divorce or dissolution proceedings have been initiated, spouses or registered partners shall generally **no longer have any claims based on former testamentary dispositions** unless this has been explicitly stated. The same applies, in principle, with regard to benefits under former succession pacts, as well as to benefits arising from marital agreements or property contracts.

2.4 General prohibition of gifts after concluding a succession pact

According to case law of the Federal Supreme Court, a testator remains generally free, after having concluded a succession pact, to dispose of his/her assets by way of lifetime gifts, subject to any contrary provisions in the succession pact and provided there is no apparent intent to cause harm. Under the new rules, this **freedom will be severely restricted** and actually transformed into a **prohibition of gifts**. Testamentary dispositions and lifetime gifts – with the exception of occasional customary gifts – may in the future always be challenged if they are incompatible with the duties arising under the succession pact and provided they have not been reserved in the pact. Therefore, when concluding succession pacts, one should consider **carefully whether and to what extent the testator shall remain free to dispose of his or her assets during his or her lifetime**. Again, **action is needed** and existing succession pacts should be reviewed.

3 Revision of corporate succession law

3.1 Status quo

The reduction of the compulsory shares and the accompanying greater freedom of disposition will make it easier for **entrepreneurs to pass on their business within their family**. Additional measures to facilitate business succession are already in the pipeline and shall further reduce existing obstacles in view of business succession. The new rules should apply to a broad range of "companies", i.e. to all forms of legal entities governed by the Swiss Code of Obligations, except for pure investment companies and listed companies.

The consultation process on the draft legislation was completed in April 2019 and the draft has been received with broad approval. It is expected that the Federal Council will sign off the dispatch on the new law for discussion in Parliament in the second half of 2021.

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3.2 Main changes (consultation draft)

The proposed amendments to corporate succession law relate in particular to lifetime transfers of companies and to the allocation of companies when dividing an estate if the testator has not made any division rules.

The main changes include the following:

- **Decisive business value in case of lifetime transfers**: Often, a business is already transferred to the next generation during the testator's lifetime. Whenever such a transfer occurs without adequate compensation, the question arises as to the business' value that shall be taken into account when dividing the remaining estate. Under current law, generally the value at the time of death is decisive. As a result, changes in value (both gains and losses) which occur between the transfer of the business and the time of death have an impact on all the heirs (and not just on the business successor), which can lead to unfair results. The new draft legislation therefore introduces new rules to determine the decisive value. Those **assets which are necessary for operating the business shall be taken into account at their market value at the time of transfer, insofar as this value can be proven**. Accordingly, the successor will no longer have to share an increase in value of the operating business with his co-heirs. However, non-operating assets, i.e. assets which are not required for operating the business, shall still be taken into account at their market value at the time of death.
- **Deferment of payments by the successor**: To further facilitate business succession within the family, it is planned that the business successor may be granted a **deferral for settling the equalization payments owed to the other heirs**. This should enable the successor to raise or generate sufficient funds to pay the claims of the co-heirs. Such deferral is, however, **limited to a maximum of five years** and may be subject to certain conditions. Under current law, claims of co-heirs must generally be settled immediately and if no amicable solution can be found, the only option might be to sell or liquidate the business.
- **Right to take over the business as a whole**: Absent any testamentary rules on the division of the estate, transferring a business to one of the heirs is currently only possible if all co-heirs agree. Indeed, currently all heirs have the same right to take over the assets belonging to the estate and there is no legal entitlement to take over a business as a whole; moreover, according to case law, the equalization payments owed to co-heirs may not, in principle, exceed 10% of the respective heir's share in the estate. Yet, as this is regularly the case for businesses, taking over a business by one of the heirs in the course of the estate division is often not feasible. The revision of the law addresses this problem. It is envisaged that the business, or shares or membership rights granting control over a company, **may be allocated as a whole to one heir, provided the testator has not made any dispositions** and provided the respective heir makes an **application**. If several heirs file an application, it will be up to the court to decide who is most suitable for taking over the business. That said, it should be noted that there is no requirement for the successor to manage the business himself or herself (unlike in the case of agricultural farms). This and other points have been **criticized in the consultation process** and it is well possible that the draft bill may still be adjusted in parliament.

4 Outlook and conclusion

The revised provisions, which will enter into force on 1 January 2023, will **significantly increase the testamentary freedom** when planning your estate. In order to make the most of this new flexibility, **you should review existing wills and succession pacts**. This also applies in view of the new planning opportunities in the event of divorce or dissolution of a partnership, as well as with respect to the impact a succession pact has on gifts during a person's lifetime. Finally, the expected amendments for facilitating transfers of family businesses should be observed carefully and we will gladly keep you updated.

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