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Real Estate and Taxation

Schellenberg Wittmer

Building Renovations Improving Energy Efficiency

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Key Take-aways

1.
Buildings are responsible for around 30% of all CO2 emissions and 40% of Switzerland's energy consumption. At the current pace, it would take 100 years to renew the existing buildings.

2.
The Swiss Federation and the Cantons support building renovations which improve energy efficiency with subsidies, but also with various legal measures, in particular in lease and tax law.

3.
As of 1 January 2020, investments costs to improve energy efficiency may be transferred to the following two tax periods, if it is not possible to fully deduct such costs in the current tax period.

1 Introduction

Pursuant to the Federal Office of Energy, buildings are responsible for approximately one third of CO2 emissions and 40 percent of the energy consumption in Switzerland. **A substantial reduction of the energy consumption of buildings is, therefore, key in the current climate discussion**. Pursuant to the Swiss Association of Engineers and Architects (**SIA**), new buildings are substantially more energy efficient than the average existing building. According to the Federal Office of Statistics, new residential buildings account for less than one percent of the existing residential buildings. Pursuant to the SIA, each year only one percent of the existing buildings are renewed. This means that, at the current pace, it would take 100 years to renew all existing buildings. For that reason, the Swiss Federation and the Cantons support energy efficient façade renovations and improvements of building installations. In particular, **on 1 January 2020, the revised Ordinance on Building Costs will enter into force**. In the follwowing, we will discuss various legal aspects of renovations of buildings aimed at improving energy efficiency.

2 Lease Law

Heating costs and, hence, ancillary costs for tenants of buildings with improved energy efficiency are lower than in non-refurbished buildings. This facilitates the leasing of such buildings and can have a positive impact on the initial rent. However, the question is whether a landlord of an already leased building will also directly benefit from such refurbishments.

2.1 Ancillary Costs

Pursuant to article 257a of the Swiss Code of Obligations (**CO**), the tenant shall only pay the ancillary costs if he or she specifically agreed to pay such ancillary costs. Pursuant to literature and case law, the tenant shall only pay the ancillary costs that were clearly and specifically set out in the lease agreement. A general clause such as "all ancillary costs in connection with the leased premises" does not oblige the tenant to bear these costs. Article 5 of the Ordinance on the Rent and Lease of Residential and Business Premises (**VMWG**) indicates **which heating and hot water costs are chargeable**. Pursuant to article 6 VMWG, investment costs are not chargeable. **This means that refurbishment costs cannot be passed on to the tenant as ancillary costs**.

The ancillary costs can be charged either on account or as a lump sum. In the case of payments on account, the tenant makes advance payments, which are settled annually according to the actual costs. If the heating costs decrease due to a renovation, **these cost savings are therefore passed on to the tenant in the context of the settlement of the effective costs**. It is unclear whether the tenant can request a reduction of the payments on account. **In the case of lump sum payments, tenants may demand a reduction in accordance with article 270a CO in the event of significant changes**.

2.2 Rent Reviews

In principle, the landlord is entitled to adjust the rent at any time during the rental period **with effect as of the next termination date** provided he or she uses the officially approved form and observes the statutory or contractual notice periods (article 269d CO). If lease agreements have been concluded for a certain period of time (e.g. five or ten years, as is usual for business leases), no adjustment can be made before the expiry of these fixed periods, unless otherwise agreed in the lease agreement. As a rule, however, landlords reserve the right in the lease agreement to adjust the rent **in the event of additional services even during the fixed period** (which is permissible).

Within 30 days of being notified of a rent increase, the tenant may challenge the increase before the conciliation authority **as improper within the meaning of articles 269 and 269a CO**. In the case of refurbishments, the rent can be adjusted and **an increase is not considered improper if the refurbishment leads to an increase in services** and does not constitute deferred maintenance of a building. However, to some extent it is unclear in which cases a refurbishment qualifies as an additional service (see for example BGE 4A_531/2016 of 11.4.2017).

However, pursuant to article 14 para. 2 VMWG, (i) measures to reduce energy losses via the façade, (ii) measures for a more efficient use of energy, (iii) reductions in emissions from technical installations in buildings, (iv) the use of renewable energies or (v) the replacement of household appliances with high energy consumption by appliances with lower consumption are **energy improvements and thus expressly additional services provided by the landlord**. Whether there is an energy improvement does not depend on the quality or usability of the building after renovation, but only on the reduced energy consumption or the reduction of emissions.

Pursuant to article 14 para. 4 VMWG, rent increases due to energy improvements are not improper and can be passed on in full if they do not exceed the appropriate rate for interest, amortisation and maintenance of the investment. This legal definition avoids uncertainties and thus promotes refurbishments for improved energy efficiency (unlike other refurbishments).

Costs for refurbishments, maintenance as well as repair costs of existing energy-saving installations cannot be passed on to the tenant. If the façade is insulated for the first time, the entire costs can be passed on to the tenant. If the building was already insulated, only the additional costs, which resulted from the new isolation in relation to the replacement of the existing isolation, can be passed on. However, if the first energetic renovation was carried out some time ago and additional work is being carried out, the documentation related the first renovation is often no longer available, which renders proving the added value difficult. Finally, subsidies must be deducted from the investment costs.

3 Construction Law

Improvements of energy efficiency are regularly carried out on the basis of work contracts. In the case of total refurbishments, it may not be possible to clearly identify which costs arise for which refurbishment. However, since only 50 to 70% of the total costs for total refurbishments are considered value-adding investments that entitle the landlord to a rent increase (see section 2.2), it is advisable to **separately set out the costs associated with the the energy efficiency improvements in the work contract**.

Furthermore, refurbishments aimed at improving energy efficiency might entitle the customer to subsidies (see section 5). Accordingly, it is important that the technical parameters that entitle to the subsidies are observed. **These parameters should, therefore, be included as specifications in the work contract**.

With regard to listed buildings, any thermal insulation carried out during the construction project must comply with the regulations for the protection of historical monuments. The planners› fees will generally be higher for (energy) refurbishments than for new construction projects, as work on existing buildings is usually more complex. Finally, it should be noted that energetic refurbishments involve various construction and planning services (façade, heating, building services engineering, etc.), which must be carefully coordinated. For such projects, it is therefore advisable to conclude total or general contractor contracts instead of several individual contracts. This considerably facilitates the assertion of warranty claims, as it may otherwise be difficult to allocate defects liabilities in such projects.

4 Purchase Law

The cantonal building energy certificate (**GEAK**) classifies buildings according to energy consumption (A for "very energy-efficient" to G for "little energy-efficient"). The classification takes into account the building façade, the building technology and the electrical installations. **In a few Cantons (e.g. Fribourg or Vaud), the availability of the GEAK is mandatory for the registration of changes of ownership**.

5 Tax Law

Pursuant to the Real Estate Costs Ordinance, **already today maintenance costs (relate to the preservation of a property value) can be fully deducted from the income of persons holding the properties as private assets**. In order to promote energy efficient renovations, **investments related to energy efficiency improvements** are treated in the same way as maintenance costs. Hence, also investments **can be deducted**. Expenses for measures which contribute to the efficient use of energy or the use of renewable energies qualify as investments related to the improvement of energy efficiency. These measures relate to the replacement of obsolete as well as to the first-time installation of new components or installations in existing buildings. If the measures are subsidised by public authorities, the taxpayer can only deduct its own costs.

Until the end of 2019, however, these investments could **only be deducted in the year in which they were incurred**. If the investments exceeded the income, the surplus was "lost" for tax purposes. As a result, investments were unnecessarily staggered. However, **as from 1 January 2020**, if the expenses for refurbishments aimed at improving energy efficiency incurred in one year cannot be fully taken into account for tax purposes (the net income would be negative), the remaining investment costs **can be carried over to the following tax period**. If the transferred costs cannot be fully taxed in the following tax period, the remaining costs can be transferred to a further tax period.

Instead of the actual costs incurred, **lump sum deductions** can be made for property costs. However, if costs are transferred to a subsequent tax period, no lump sum deduction can be made in this (subsequent) tax period. Finally, the transferable costs can also be deducted after a transfer of ownership. In the context of the current discussion on the abolition of the imputed rental value, however, it is unclear whether the deductibility of maintenance costs (including energy-related renovations) will remain at all.

In a new decision (BGE 2C_511/2017 of 16.09.2019), the Federal Supreme Court indicated that the value of installed solar systems does not have to be included in the building value and thus does not lead to an increase in the imputed rental value (for owner-occupied properties).

Buildings are responsible for around one third of CO2 emissions and 40 percent of Switzerland's energy consumption.

6 Subsidies

Pursuant to article 34 of the Federal Act on the Reduction of CO2 Emissions, one third of the revenue from the CO2 tax, up to a maximum of CHF 450 million per year, shall be used for long-term measures to reduce CO2 emissions from buildings, including the reduction of electricity consumption in the winter period. The Cantons decide individually which measures they want to promote and under which conditions. The basis for the cantonal subsidies is the Harmonised Promotion Model of the Cantons (*Harmonisiertes Fördermodell der Kantone*, HFM 2015). In certain Cantons, the GEAK (see section 4) is a requirement for receiving subsidies.

7 Solar Energy

Within the framework of the **Energy Act, which was revised as of 1 January 2018**, and the associated ordinance, a new set of instruments was created based on which the landlord and his or her tenants can form an association for their own consumption (*Zusammenschluss zum Eigenverbrauch*, ZEV). Based on the ZEV, the landlord can sell self-produced electricity to the tenants. Pursuant to article 6b VMWG, which came into force on 1 January 2018, the costs of electricity (electricity produced by the landlord and electricity from the grid) can now be charged as ancillary costs within the framework of a ZEV, provided that these ancillary costs are listed as a separate cost item in the lease agreement.

When new buildings are leased for the first time, tenants are obliged to participate in the ZEV by means of a supplement to the rental agreement. If the landlord wishes to introduce

the ZEV for **existing leases**, this would qualify as a unilateral change to the lease agreement by the landlord, which must be notified to the tenant via the officially approved form for lease increases. Any federal or cantonal subsidies must be recorded on the form. Tenants may refuse to participate in the ZEV. To do so, tenants are not required to contest the rent increase, but rather only have to notify the landlord of their rejection to participate in the ZEV within the challenge period of 30 days for rent increases.

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