

Swiss tax authorities

Peter Spori (peter.spori@prager-dreifuss.com), **Samuel Dürr** (samuel.duerr@prager-dreifuss.com),
Michael Leiser (michael.leiser@prager-dreifuss.com).

Prager Dreifuss | Mühlebachstrasse 6, CH-8008 Zurich, T +41 44 254 55 55, mail@prager-dreifuss.com, www.prager-dreifuss.com
Prager Dreifuss | Schweizerhofpassage 7, CH-3011 Bern, T +41 31 327 54 54, mail@prager-dreifuss.com, www.prager-dreifuss.com



von Peter Spori,
Füersprecher und Steuerkonsulent

The Anglo-Saxon trust and the Swiss tax authorities.

Since 1 July 2007 when the Hague Trust Treaty also became applicable in Switzerland, if not before, trust solutions may be seen more often in Switzerland (also in the case of Swiss estates) and therefore there is now an urgent need for an answer to the question of how Swiss taxation practice deals with the trust (that is subject to a foreign legal system but which must also be recognised in Switzerland). The possible scenarios are many and varied:

- persons in Switzerland act as a trustee or protector.
- tax payers in Switzerland set up a trust (as settlors) and transfer some of their assets to the trust.
- persons resident in Switzerland are beneficiaries of a trust and in certain circumstances are already receiving distributions from the trust.

Do Swiss tax implications arise from these situations and if yes, what are they? The Swiss Tax Conference, a coordination body made up of cantonal authorities, has recently agreed on certain basic answers in its Circular 30 dated 22 August 2007. Despite this, there are still a large number of questions that remain to be answered, firstly because

a review by the courts of these principles has yet to take place, and secondly because the diversity of trusts does not allow for their easy classification. Nonetheless, the Circular now provides a basis for analysing existing or intended trusts with Swiss connections as to their tax implications and then structuring the trusts in such a way that they do not give rise to fiscal surprises. The following remarks deal with a number of key themes, more as an effort to stimulate further interest in this matter than as a source of exhaustive information.

Does the appointment of a Swiss Trustee lead to tax implications in Switzerland?

The trust as such is not in our view taxable. The trust assets and the trust income are not attributed to the trustee for tax purposes either. The sole fact that a (natural or legal) person in Switzerland has been appointed as a trustee or protector and that the trust is accordingly administered in Switzerland does not lead to any Swiss tax implications. It would be different if we were not dealing in legal terms with a trust, but with a foundation or establishment. Cases where a trust moves the assets to

an offshore company also require special examination. If the place of effective management of a foreign foundation, establishment or corporation is in Switzerland, then it can be taxed without limitation here.

Does a settlor in Switzerland remain taxable in respect of the trust assets?

With a logic that is not immediately comprehensible, the Circular treats the following two cases differently:

- If a trust is set up by a person who is ordinarily liable to tax in Switzerland, the trust assets should normally continue to be attributed to that person. This should even apply if the settlor has set up an irrevocable trust and in terms of his trust deed has assigned all decision-making powers to the trustee (an irrevocable discretionary trust). So the settlor remains taxable in respect of the trust assets and the trust income. Consequently, no inheritance or gift tax is levied (yet) on the setting up of the trust. This rule may not remain undisputed for long. The only exception is the fixed interest trust, in which the the beneficial arrangements have been irrevocably

and comprehensively defined (as regards persons, time and amount) by the settlor – probably not a frequent situation. Here the trust assets are attributed to the beneficiary, even before they have been distributed (see below).

- If the trust has been set up by a person who was not taxable at the time the trust was set up but only moved here subsequently, Swiss taxation practice will refrain from attributing the trust assets to this person, even in case of an irrevocable discretionary trust. So in this case the settlor is not liable any more to Swiss taxes in respect of the trust assets and the trust income. His death does not trigger cantonal inheritance tax liability (subject to certain exceptions). The condition however is, that the trust be organised as a genuinely irrevocable trust. Purely formal irrevocability is not sufficient. Even a “memorandum of wishes” can prevent the trust from being recognised as irrevocable.

When are beneficiaries in Switzerland taxable?

Normally, tax liability for beneficiaries resident in Switzerland only arises when they receive distributions from the trust: the distributed amount or asset value is regarded as taxable income for the recipient. In the case of the most common form of discretionary trust, it should no longer be possible to avoid this by showing that the distribution originates from a capital gain made by the trust (e.g. from stock exchange transactions). On the other hand, income tax is not incurred if a trust transfers the assets brought in by the settlor to beneficiaries after he has already distributed all the accumulated income and profits. Inheritance and gift tax on distributions only comes into question if the trust assets remain being attributed before distribution to a settlor with domicile in Switzerland (see above).

There are exceptions that are treated differently:

- If the beneficial arrangements are irrevocably and comprehensively (as regards persons, time and amount) defined by the settlor (a “fixed interest trust”), then the beneficiaries in Switzerland become already taxable in respect of the trust assets when the trust is set up. Normally they have to pay tax on the trust income as soon as it is realised by the trust and not only when it is distributed. In this case capital gains remain exempted from income tax. Gift tax may be payable by the beneficiaries (including beneficiaries living abroad) at the time that the trust is set up, but only if the settlor is domiciled in Switzerland when the trust is set up or if Swiss real estate property is transferred.
- If the trust is set up by someone who is normally taxable in Switzerland, and if it is a revocable trust, or if the beneficial arrangements are left to an extent to the discretion of the trustee (a “discretionary trust”), then, as already mentioned, the trust assets will continue to be attributed to the settlor. He must continue to pay wealth tax on the trust assets and income tax on the trust earnings. Beneficiaries in Switzerland in receipt of distributions made by the trust may then be subject to gift or inheritance tax (depending on their family relationship with the settlor).

The need for a ruling

For a variety of reasons, it is strongly recommended that a tax ruling be obtained for any trust that has connections with Switzerland: Assessment of a trust deed (whether the trust is revocable or not, or whether discretionary or not) is open to broad interpretation. In the ruling, an authoritative interpretation can be agreed with the tax authority. In addition, inheritance and gift tax is not

covered by the Circular mentioned earlier. There is a particular need for clarification in relation to this. Ultimately, information provided by the authorities in the past can no longer simply be regarded as binding in view of the new Circular; nonetheless such information should still afford a degree of legal protection, the validity of which must then be confirmed. ○