SWISS UPDATE ON TRUST REGULATION AND TAXATION

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Tags
Administrative Assistance
Switzerland
Tax
Trust

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INTRODUCTION

Trusts have been and still are of great importance to advisors all over the world. Even though trusts are mostly found in common law systems (*e.g.*, U.S.A.), several civil law jurisdictions have implemented the concept of trusts (*e.g.*, Liechtenstein). In practice, trusts are often used for international tax and/or estate planning as well as for asset protection.

Put simply, a trust is created by a settlor who transfers some or all of his or her assets to a trustee. The trustee holds title to the property in trust for the benefit of the beneficiaries. The trust is governed by a trust deed and other accompanying documents which stipulate the terms and conditions and the applicable law. Trust law may differ from jurisdiction to jurisdiction, with each jurisdiction assigning varying rights and duties to the trustee.

To date, there is no Swiss trust or Swiss trust law. However, Switzerland recognizes the concept of a trust since adopting the Hague Trust Convention, which entered into force in 2007. Following that, Switzerland has enacted rules on how to treat foreign trusts for tax purposes and for registration purposes in the land register. There have been several attempts to enact a Swiss trust law.

In addition, since January 1, 2020, trustees may fall under the new law regulating the business of Financial Institutions including trusts. The question of which trustees fall under the new law as well as what the regulation includes is dealt with below.

This article discusses the current status of an introduction of a Swiss trust law, provides an overview of taxation of trusts in Switzerland, and addresses administrative assistance in tax matters in connection with trusts and their beneficiaries.

INTRODUCTION OF A SWISS TRUST

In Swiss politics, there have been several attempts to introduce a Swiss trust law. However, these have been rejected to date or have not yet been successfully finalized.

Supporters of a Swiss trust law argue that adoption of a domestic provision will strengthen Switzerland's status as a financial center. It will ensure a level playing field with foreign jurisdictions and eliminate competitive drawbacks. Opponents argue that it would be difficult to introduce a Swiss trust law because the differences between common law and civil law cannot be reconciled without major adjustments. It is also suggested that the admission of the family maintenance foundation would be a possible alternative. The need for legal adjustments would be smaller than in the case of the introduction of a Swiss trust.

As of today, several procedures are running in parallel, which could lead to a Swiss trust law:

- In 2016, a member of the Swiss Parliament proposed an elaborate procedure with the title "Incorporation of the Legal Institute of Trusts into Swiss Legislation." The responsible committee in parliament would like to follow this proposal, but enactment was postponed. It is expected that the National Council (First Council) will consider this proposal in the spring of 2022.
- In 2018, the Swiss Federal Council was instructed by a committee of the parliament to create the legal basis for a Swiss trust. A group of experts appointed by the Federal Office of Justice has been working on regulation proposals since June 2018. The tax treatment or adjustments of the existing taxation rules are being clarified by a working group of the Federal Tax Administration and other stakeholders. In addition, the Federal Council was authorized to prepare a report on the advantages and disadvantages of a possible introduction of the legal concept of trusts into Swiss private law.

There is still a long way to go before a Swiss trust could become a reality. We believe that a Swiss trust certainly has potential. Of course, implementing a concept that is not familiar to civil law is procedurally difficult. Nonetheless, with adoption of appropriate adjustments, implementation should be possible. We see the major advantage in the fact that succession planning can be reflected in one jurisdiction. In a globalized world, simplifying the number of jurisdictions involved in creating and managing a trust makes sense.

REGULATION OF TRUSTEES

Prior to 2020, trustees were generally not regulated in Switzerland. However, trustees are generally obligated to comply with the Swiss Anti-Money Laundering Act.

As of January 1, 2020, Switzerland enacted the Financial Institution Act ("FinIA") which regulates the supervision of financial institution, as defined by the law. The main goal of this regulation is the protection of customers.

Financial institutions include, in particular, asset managers, fund management companies as well as trustees. All must be approved by the Swiss Financial Market Supervisory Authority ("S.F.M.S.A."). Trustees domiciled or resident in Switzerland who operate in Switzerland or from Switzerland fall under the new law. Foreign trustees are subject to the FinIA if they have a branch in Switzerland, establish a permanent establishment here, or are factually managed in Switzerland. In summary, all trustees with a nexus to Switzerland need must determine whether if they fall under the FinIA.

In practice, existing trustees were required to notify S.F.M.S.A. of their presence in Switzerland within six months after entry into force of the, *i.e.*, end of June 2020. Further to that, they must comply with all requirements by end of 2023 and submit a license request to S.F.M.S.A.

The definition of a trust for purposes of Swiss law refers directly to the Hague Trust Convention. Accordingly, a trust means a legal arrangement created by a person, the settlor, applicable during life or as a result of death, in which assets have been placed under the supervision of a trustee for the benefit of a beneficiary or for a

particular purpose. A trustee is a person who, on the basis of a trust deed within the meaning of the Hague Trust Convention, professionally manages or disposes specified assets for the benefit of the beneficiaries or for a specific purpose.

Trustees are deemed to act professionally in any of the following circumstances:

- They generate gross proceeds of more than CHF 50,000 per calendar year.
- They enter into business relations with more than 20 contracting parties per calendar year.
- They have unlimited control over third-party assets exceeding CHF 5 million at any time.

It is not entirely clear if the last alternative (assets exceeding CHF 5 million) is applicable to trustees at all, since one could argue that trusts hold their own assets rather than third-party assets. The law also stipulates some exceptions that apply. For example, for trustees who only manage assets of family members that are related to the trustee or, relatives, spouses or persons who live with the trustee in a long-term relationship are treated as family members.

Protectors may also be subject to FinIA depending on the powers granted to the protector. Generally speaking, where the powers of a protector are similar to a trustee, it is likely that the protector will fall under the new law. Since FinIA is directly linked to the definition of trust, there should be no room to also include board members of foundations under the new regulation.

In order to be licensed by S.F.M.S.A., a trustee must fulfill an extensive list of requirements including

- the adoption of written corporate governance rules,
- the implementation of risk management and internal control systems,
- the maintenance of a minimum capital of CHF 100,000,
- the maintenance of professional indemnity insurance,
- proof of professional qualification, and
- arranging for a yearly external audit.

A trustee that fulfills all requirements is entitled to a license.

By regulating trustees with nexus to Switzerland, the interests of settlors and beneficiaries are protected. At the same time, trustee activity in Switzerland becomes more complex and costly to provide. It is expected that certain trustees with domicile in Switzerland will no longer act as trustee based on the compliance costs involved.

TAXATION OF TRUSTS IN SWITZERLAND

In Swiss tax law, there is no legal basis to consider a foreign trust as being subject to Swiss tax on global income. Trusts are covered in Switzerland by the Hague Trust Convention and for tax purposes by Circular 30 of the Swiss Tax Conference of August 22, 2007. The trust assets are attributed to the settlor or the beneficiaries. It

should be noted that, despite the existence of a circular, cantonal practice may vary considerably. The following information serves as an overview.

Trust With No Nexus to Switzerland

If the settlor as well as the beneficiaries are not resident in Switzerland and the trust assets do not include any Swiss real estates, there are generally no Swiss tax consequences.

Swiss Withholding Tax

Due to the lack of legal personality, a trust cannot reclaim Swiss withholding tax. At most, the Swiss resident settlor or the beneficiaries can reclaim the withholding tax, provided they are considered to be beneficial owners. In some Swiss double taxation treaties, the trust is mentioned, which is why a refund of the withholding tax based on the double taxation agreements may be possible under certain circumstances.

Where a trust structure holds Swiss assets – such as shares – a question arises as to how and to what extent Swiss withholding taxes may be refunded. The refund depends on the applicable double taxation agreement as well as on the type of the trust.

Transfer of Swiss Real Estate to a Trust

Where real estate is transferred to the trust structure, it should be checked if an entry in the land register will be accepted by the cantonal authority, and if it is, the possibility that real estate gain tax consequences will result from the transfer.

"If the settlor as well as the beneficiaries are not resident in Switzerland and the trust assets do not include any Swiss real estates, there are generally no Swiss tax consequences."

Income, Wealth, Gift and Inheritance Taxes

If the settlor or the beneficiaries are resident in Switzerland, a distinction must be made according to the type of trust. The decisive factor for the classification is not the designation in the trust deed, but the actual structuring of the settlor's control rights. The rights of the settlor should be analyzed not only on the basis of the documents, but also how they are actually practiced.

Swiss tax law simplifies the possibilities of structuring trusts and has defined three different types of trusts:

- Revocable trust
- Irrevocable fixed interest trust
- Irrevocable discretionary trust

For a revocable trust, there are no tax consequences on establishment, because the assets continue to be attributed to the settlor with domicile in Switzerland. Consequently, the settlor must continue to pay taxes on the income and assets of the trust. In addition, distributions to the beneficiaries may be subject to cantonal gift tax. Finally, the tax effect of the demise of the settlor should be analyzed prior to the creation of the revocable trust. Depending on the cantonal law and practice, a trust may become an irrevocable discretionary trust at the time of the settlor's death which may trigger the imposition of substantial inheritance taxes.

Upon the establishment of the irrevocable fixed interest trust, a gift is assumed and may be subject to gift tax as the assets are no longer attributable to the settlor. Beneficiaries must pay wealth tax on their share of the trust assets. Distributions to the beneficiaries constitute taxable income. Capital gains in private assets and the distribution of the contributed trust capital do not constitute taxable income. In practice this type of trust is rather seldom encountered. Detailed proof is required for a tax-free distribution of capital gains.

Where an irrevocable discretionary trust is established with the settlor domiciled in Switzerland, the assets and the capital gains are attributed to the settlor. Thus, like a revocable trust, there are in general no tax consequences. Where an irrevocable trust is discretionary and the trust is established by a settlor with foreign domicile, the beneficiaries have no enforceable property right and therefore no wealth tax to pay. However, all distributions are subject to income tax.

ASSISTANCE IN TAX MATTERS

The exchange of information in the area of administrative assistance in tax matters is divided into the spontaneous exchange of information, the automatic exchange of information and administrative assistance upon request.

With regard to trusts, there are two possible scenarios of administrative assistance on request. Thus, either a foreign tax authority may request Switzerland to provide information held by a Swiss bank where trust assets are deposited, or the foreign authority may request the Swiss tax authorities to provide information directly held by a trustee domiciled in Switzerland.

Switzerland participates in the exchange of information in tax matters and began adapting its double taxation agreements by accepting the standard O.E.C.D. Model provision. Thus, Switzerland's revised double taxation agreements provide that the competent authorities may exchange information that is foreseeably relevant not only for the application of the provisions of the treaty itself, but also for the enforcement of the domestic tax law of the requesting state. In addition, a Contracting State may not refuse to provide information solely because it is held by a bank, other financial institution, nominee, or person acting in an agency or a fiduciary capacity, or because it relates to ownership interests in a person.

In practice, many individual factors in the request for administrative assistance relating to trusts will affect whether information will be provided, including the type of trust and the wording of the request.

In a decision of the Federal Administrative Court concerning a request for administrative assistance from a foreign state and relating to bank deposits in Switzerland held by an underlying company and the latter held by a trustee, it was decided that the information would not be disclosed if the taxpayer concerned was only a discretionary beneficiary of a clearly irrevocable trust. The decision has been appealed and the matter is pending before the Federal Supreme Court.

CONCLUSION

In Switzerland, adjustments to the family foundation and the introduction of a Swiss trust are being discussed at various political and stake holder levels. Swiss law

does not provide for trusts and concepts of splitting legal ownership from beneficial ownership. Hence, modifying Swiss law to address a family foundation, which is an alternative to a trust, may require fewer legislative adjustments.

As of January 1, 2020, Switzerland enacted the FinIA. As a consequence, all trustees with a nexus to Switzerland need to check if they may fall under the FinIA.

Swiss tax law simplifies the possibilities of structuring trusts. It has defined three different types of trusts: revocable trust, irrevocable fixed interest trust, irrevocable discretionary trust. In determining the classification of any particular trust, the decisive factor for the classification is not the designation in the trust deed, but the actual retention by the settlor of control rights.

The exchange of information in the area of administrative assistance in tax matters is divided into the spontaneous exchange of information, the automatic exchange of information, and administrative assistance upon request.

A foreign tax authority may request Switzerland to provide information held by a Swiss bank where trust assets are deposited, or the foreign authority may request the Swiss tax authorities to provide information directly held by a trustee domiciled in Switzerland. Whether the requested information will be exchanged depends on the facts of the arrangement. Hence, facts and circumstances will influence the administrative decision.

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