

TRUST BUSINESS IN SWITZERLAND - DO'S AND DON'TS

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An overview of what has changed since 1 July 2007

Switzerland already enjoyed certain popularity for trusts prior to 1 July 2007. Typically, one encountered co-trustee or Swiss administration arrangements, meaning, for a Jersey proper law trust, one trustee in Jersey and a co-trustee in Switzerland. Another common approach was to have a Cayman licensed trustee and a Swiss administrator. Protectors were frequently to be found in Switzerland. Then, it seems – in anticipation of ratification of the Hague Trusts Convention or perhaps for other reasons, trust management was increasingly delivered partly or wholly from a Swiss administration platform. Since ratification there has been a marked development of trustees offering sole trusteeships, that is, managing trusts wholly in or from Switzerland. The empirical evidence is that, already prior to ratification, there was a strong business case for trusts over assets custodied with Swiss banks. Since ratification, the empirical evidence suggests that the business case has received a strong shot in the arm.

The ratification has introduced legal certainty as to the proper law governing a trust managed in or from Switzerland. In addition, the Convention and the accompanying measures adopted by Switzerland have introduced other easy to use and liberal provisions; firstly, facilitating choosing an exclusive jurisdiction to hear trust matters arising in connection with a trust managed in or from Switzerland; secondly, setting the framework for registration of property such as land, boats, airplanes and intellectual property rights; and thirdly, permitting the enforcement of foreign judgements in trust matters. Crucially, Swiss law now recognises a separation between the trustees own property and the trust assets. This ring fencing was cruelly lacking prior to 1 July 2007.

Apart from the ratification of the Convention and the statutory accompanying measures a number of other changes have flowed naturally from the recognition of trusts in Switzerland. Article 19 of the Convention provides that it does not prejudice the powers of states in fiscal matters. In Switzerland, where you have federal, cantonal and municipal taxes, there is no specific tax legislation addressing the taxation of trusts. In view of the ratification, something needed to be done. Ultimately a circular dealing with the taxation of trusts was published. We shall take a closer look at this circular shortly. There is no doubt however that it has further assisted the business case for locating trustee activities in Switzerland. In effect, it makes clear that only the trustee fee is taxable, thus providing a potential platform for international estates looking for a tax-free home for the assets and a convenient and accessible location for trustees, settlors, protectors and beneficiaries alike.

Very quickly after ratification, on 5 July 2007, a group of institutional trustees formed the Swiss Association of Trust Companies. Standing alongside STEP, the SATC includes most, if not all, the big name trustees in Switzerland and intends, in the absence of any government regulation in Switzerland, to further professionalise the market place for trustees in Switzerland and to give a guarantee of high quality standards in the offering of trustee services in or from Switzerland. Membership is optional and membership requirements are designed to replicate possible regulatory requirements when those come to Switzerland in the trustee field. In addition, the Federal land registry has published guidance for registering land in Switzerland in the name of a trustee as trustee, and more recently guidance has been supplied on the difficult practical problem of how to apply Switzerland's authorisation regime for ownership of Swiss real estate by foreigners where a trust is involved. In 2008 the Swiss Banker's Association finally introduced a specific form, known as form T, required to complete Swiss anti-money laundering requirements when opening a Swiss bank account for a trust.

The Swiss courts have already had cause to refer to the Convention, the first case apparently concerning none other than the estate of Robert Palmer of *'Addicted to Love'* fame. In the face of some opposition to the deceased's appointment of his manager as executor and trustee, the court noted that the trust assets would be separate from the manager's own property.

Taxation issues

When considering Swiss taxation, you should be aware that there are federal, cantonal and municipal taxes. The federal taxes are an income tax and a withholding tax. At the cantonal and municipal level there is income tax, capital gains tax on real estate transactions, gift and inheritance tax and wealth tax. You must appreciate that each of the 26 cantons has its own tax system, and the cantonal administrations administer the taxes, federal, cantonal and municipal. As you would imagine, in the absence of any specific legislation governing the taxation of trusts, each canton had its own practice. There were also regional differences.

In 2004, the Swiss Tax Conference (an association of cantonal tax officers which seeks to harmonise inconsistent tax practices amongst the cantons in order to enhance legal certainty) met to prepare a circular. For some time it was not clear whether any circular would be issued. Particular difficulties were the tax treatment on creation of a trust by a Swiss resident settlor and the taxation of benefits received by Swiss resident beneficiaries. Circular 30 of the Swiss Tax Conference was finally issued on 22 August 2007. I have included an unofficial English translation as the Appendix below. It is important to note that the circular is not a legislative instrument but a guideline for each of the Cantonal Tax Authorities.

Subsequently, the Federal Tax Administration adopted the circular in its own circular, in this case, circular 20 of 27 March 2008. The effect of the adoption of this circular by the Federal Tax Administration is that, for Swiss withholding tax, it is acknowledged that the content of the circular represents the practice of the federal tax administration (exclusively competent to assess Swiss withholding tax). For income taxes (for which the federal authorities exercise a supervision of the cantons), an assessment by the cantonal authorities which is compliant with the circular would not be challenged by the federal supervisory authorities.

I have mentioned that regional differences existed in the cantonal practices applied to trusts. Most important of these were the Swiss Romande practice of considering the trust as transparent and the Zurich practice of considering the trust as not transparent. The latter led the Federal Tax Administration to consider that a trust might be fiscally assimilated to a domestic foundation, liable to federal corporate income tax. Probably the most significant aspect of the circular is that it concludes that a trust is a trust. Trusts established for estate planning (including asset protection purposes) are not a company or a foundation or some other civil law substitute. They are fiscally transparent and not a taxpayer in their own right. As a trustee only has a formal property right (but no right to the trust assets), the trustee cannot be taxed on the trust assets and income. Logically, a similar conclusion is reached in the case of Protectors. Needless to say, however, that the trustee or protector remains taxable on the fees derived beneficially for the services provided. As mentioned at the outset, this has further assisted the business case for locating trustee activities in Switzerland. It should be noted however that the circular does not address any Swiss taxation issues arising in connection with underlying companies forming part of the trust assets. Such issues are typically dealt with on a case by case basis.

Having heard the good news for trustees, at this stage it is important to emphasize two aspects of the circular which have drawn much criticism and which can be viewed as quasi anti-avoidance rules with respect to trusts. In effect, they limit the circumstances in which the tax administration will accept that a settlor has truly parted with the trust assets. Firstly, the circular takes a restrictive view of what constitutes an irrevocable trust (based on the economic reality rather than the formal designation in the trust deed). In particular, a trust will be treated as revocable if the settlor can do any one of the following:

- benefit from capital distributions from the trust assets;
- benefit from distributions of income from the trust assets;
- remove the trustee and appoint another one;
- appoint or cause the appointment of new beneficiaries;

- replace the protector who in turn has powers comparable to those of a trustee;
- amend the trust deed or cause it to be amended;
- revoke the trust;
- require liquidation of the trust;
- exercise a veto over the trustee's decisions with respect to the trust assets.

This restrictive approach results in a settlor being considered by the tax authority to still be the owner of the trust assets. It has been criticised for a number of reasons but principally because it ignores the position at law.

Secondly, the circular provides that a trust created by a Swiss settlor is ignored for tax purposes unless a beneficiary acquires an immediate present entitlement to the trust assets. In effect this means that only irrevocable fixed-interest trusts created by a Swiss settlor are recognized for Swiss tax purposes. A special case is made for Swiss residents subject to tax on the lump sum basis. In those cases, only assets in Switzerland and income from Swiss sources are to be taken into account in their tax assessment. Hence, such persons may still set up discretionary irrevocable trusts recognized for tax purposes. Such a trust would also be recognized provided it was created prior to the taking up of residence of the settlor in Switzerland.

It follows that essential preliminaries to analysing the potential Swiss tax effects of any given trust are to ascertain, firstly, if the trust is revocable, in the extended sense of the Swiss tax administration and, secondly, to identify the Swiss resident participants, whether as settlor or as beneficiary and whether they are taxed on the ordinary basis or the lump sum basis. For what follows, I have proceeded on the assumption that we are dealing with someone subject to ordinary taxation. It remains then to look at what might be the Swiss tax consequences of creating a trust and making a distribution. In each case, this will vary depending on the type of trust under consideration, revocable, irrevocable fixed interest or irrevocable discretionary trust.

Dealing with creation first. Whether the settlor is Swiss resident or not, revocable trusts are effectively ignored because the settlor is considered not to have parted fully with the trust assets. The trust assets remain taxed to the settlor and there is no gift or inheritance tax. Upon death of the settlor, if then residing in Switzerland, there may be an inheritance tax depending on the canton of residence and the potential beneficiaries. In the case of an irrevocable fixed-interest trust, the settlor is considered to have parted with the trust assets as the beneficiary has acquired a fixed present entitlement to the trust income. Accordingly, the trust assets and income are no longer included in the tax base of the settlor. Consistent with this approach, the transfer of assets to the trust is treated as a gift (in the amount of the trust capital). The modalities of taxation of such gift is left to the canton of domicile of the settlor.

The tax treatment at creation of an irrevocable discretionary trust depends on whether the settlor was a Swiss or foreign resident at the time of the trust creation. For a Swiss resident settlor the circular does not recognize the trust for Swiss tax purposes and the settlor remains fully taxable on the trust assets and income. In the case of a foreign resident settlor, the circular provides that the transferred assets cannot be attributed to the settlor even if he later takes up residence in Switzerland, nor to the beneficiary who has a mere expectation and not an entitlement to the trust assets. Accordingly, the trust assets and income are not subject to Swiss taxation for so long as they are not transferred to a beneficiary who is subject to Swiss taxation.

Turning now to distributions. Several principles need to be established in this context before looking at each type of trust. Firstly, all distributions from a trust will be considered a distribution of taxable income unless the distribution is deemed to be a gift. The determination of whether a distribution constitutes taxable income or a gift depends on the type of trust under consideration. Secondly, one would expect a distinction to be made between distributions of (i) initial trust capital, which are tax exempt; (ii) private capital gains, which subject to the terms of the circular would not ordinarily be taxable; and other income, which is taxable if arising to a Swiss resident beneficiary.

Logically, based on the fiscal transparency of the trust set out in the circular, one would expect a full 'flow through' to the beneficiary. Unfortunately there seems to have been an unhappy compromise. The 'flow-through' is subjected to two restrictions: The trust capital contributed can only be distributed after distribution of all trust income; If the taxpayer cannot show that there are tax free capital gains in the distribution or that it is a distribution of the trust capital, the entire distribution will be treated as taxable income. In addition, private capital gains are effectively transformed into income in the irrevocable discretionary trust case as we shall see shortly.

Turning to the different types of trust: In the case of a revocable trust any distribution is treated as a gift by the settlor to the beneficiary. Whether there is a Swiss gift tax will depend on the residence of the settlor at the time of the gift. In the case of an irrevocable fixed-interest trust any income is attributed to the beneficiary. Finally, in the case of an irrevocable discretionary trust any distribution is treated as taxable income of the beneficiary. Given the principle of fiscal transparency of the trust, the distribution of the initial trust capital is however exonerated. Again, the 'flow-through' approach is somewhat restricted in case of a distribution of capital gain. The circular states that, since the capital of the trust is not attributed to the beneficiary, the distribution of the capital gain cannot be fully or partly exempted from tax as if it were the private capital gain of the beneficiary. As a result, the capital gain is, de facto, transformed into a taxable income, which is contrary to the principle of transparency of trusts.

To conclude on taxation matters, I would like to stress the non-binding status of the circular in connection with cantonal and municipal taxes. It should be understood that the principles laid down in the circular do not necessarily reflect the practice of each cantonal tax authority. The practical consequence is that, particularly as concerns settlor and beneficiary taxation, it may still be necessary or appropriate to apply for an advance tax ruling from the competent cantonal tax authority.

What does it mean for managing trusts in Switzerland?

Leaving taxes now, what implications are there for managing trusts in Switzerland? The good news is that a trust is now a trust. It is not a company or a foundation or some civil law substitute. A fine example of the consequences of this is the Form T introduced into the Swiss Bankers Agreement. For decades the form developed for domiciliary companies was deemed sufficient despite being hopelessly ill-adapted to trust accounts. The moans of the entire trust industry fell on deaf ears. There is now a specific form which speaks of a certain coming of age of the trust, even if the actual form is not to everyone's liking.

We have seen earlier that there should now be more legal certainty in managing trusts in or from Switzerland. To have this certainty settlors and trustees must be mindful to include a choice of law and jurisdiction clause in the trust deed. In addition it must be borne in mind that the Convention provisions are helpful if the trust under consideration falls within the definition of a trust in the Convention or is an oral trust. I will speak more of this later.

The really good news however, is the point made earlier, that the trustees own property and the trust assets are segregated. As Switzerland is a civil law jurisdiction, a prudent trustee will pay careful attention to ensuring that trust assets are clearly identifiable as such and distinct from the trustee's own property to avoid practical problems, for example in the administration of a bankrupt trustee's estate. It is also interesting that a Swiss based trustee might be trustee of trusts from any trust jurisdiction, Cayman, Jersey, BVI, Singapore, New Zealand. This *à la carte* possibility speaks powerfully in bespoke high end estate planning. Administering such a trust company may however be complex and many trustees do settle on a preferred jurisdiction or jurisdictions, usually selecting a jurisdiction which recognises trusts as defined in the Convention.

Finally, it should be stressed that Article 4 of the Convention excludes *preliminary issues relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee* from the scope of the Convention. This makes it very important as a practical matter for trustees to be

satisfied, not only that the trust is valid under the designated proper law, but also that the acts by which property was transferred are valid under the law applicable to those transfers.

Possible limitations

I hope I have succeeded in demonstrating that there has been considerable change in Switzerland in connection with trusts. Around the time of the ratification there was much discussion and many calls for more on the tax and other fronts. For example, there was also the suggestion that Switzerland should update its law on *fiducie* and proposals were before the Government to do just that. Bearing in mind the difficulties that might be encountered in seeking to amend the Civil Code and the Tax Laws, the government did the manageable. No doubt what has been done is not perfect.

In this context, I feel we should spend a little time on some possible limitations or points to watch. The first would be the absence of regulation as more traditional offshore jurisdictions would know it. It is perhaps striking that most onshore jurisdictions do not seem to have any specific regime for regulating trusts or trustees, except in the charitable field. The offshore jurisdictions, with the particular concern of seeking to protect their reputation, do have such regulation. As a civil law jurisdiction and given the importance of the wealth management industry to the Swiss economy, one might have thought that Switzerland has a marked interest in introducing some regulation. Certainly trustees are already regulated in the anti-money laundering field, being obliged to submit to the rules and oversight of the Swiss financial regulator or an approved self-regulatory organisation. However, there were calls and the government did consider at the time of ratifying the Convention whether some form of regulation of trusts, similar to that in place for Swiss foundations, or an authorisation regime for trustees should be put in place. The conclusion was that the regulation of trustees would be revisited when and if the government revisits the regulation of independent asset managers. At this stage, it is not clear when this might be. In the meantime, the work of STEP, in providing training and continuing education for trust officers, and SATC, in providing an industry body for trustees are important contributors to professionalizing the Swiss trust marketplace.

A second issue to keep in mind when locating trust business in Switzerland is the interface between the Convention and Swiss domestic laws, in important fields such as succession law, matrimonial law, debt collection and court appointed legal representatives. The Convention assists in providing certainty as to the Proper Law of a trust and in setting out at its Article 11 what recognition of the trust implies. In particular, the key segregation of the trust assets from the trustees own assets. However, the Convention has limits. Article 2 defines 'trusts' To have the benefit of the Convention, you must be satisfied that the trust under consideration does fall within that definition. Perhaps two comments: the definition does refer to assets placed under the control of a trustee '*for the benefit of a beneficiary or for a specified purpose*' which would seem to open the door to non-charitable purpose trusts; it is further provided that the '*reservation by the settlor of certain rights and powers*' is not necessarily inconsistent with the existence of a trust. This would seem to admit settlor-directed or reserved powers trusts.

As you will know, Article 3 provides that the Convention applies '*only to trusts created voluntarily and evidenced in writing*'. What you may not know is that Switzerland has provided that the Convention applies in Switzerland, **whether or not the trust is evidenced in writing**, which introduces the possibility of oral trusts. Perhaps some interesting litigation is in prospect. I commented on Article 4 which excludes '*preliminary issues*' and the practical consequences earlier and will not repeat it here.

Finally, we can make a laundry list of other limitations where the designated proper law will give way. In effect, in some cases the Convention provisions operate to displace the law chosen to govern the trust relationship in favour of the law designated by the conflicts rules of the court hearing the matter. The key provisions in this respect seem to be:-

- (a) Article 11d) which provides that trust assets may be recovered when they have been disposed of in breach of trust. However, it further provides that *'the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum'*.
- (b) Article 15, which introduces a similar reservation in the fields of protection of minors and incapable parties; personal and proprietary effects of a marriage; succession rights, including indefeasible shares of spouses and relatives; transfer of title to property and security interests in property; protection of creditors in matters of insolvency; protection of third parties acting in good faith. If recognition is prevented the court is required to *'try to give effect to the objects of the trust by other means'*.
- (c) Articles 16 and 18, which deal with several aspects of public policy or *'ordre public'*.

Many advisers would like the limits of all these provisions spelt out in accompanying legislation or guidance. For the moment however, that is not to be. The government took the position at the time of ratification that it will be for the courts to trace the limits of these provisions. In that respect, there has already been one helpful decision of the Swiss federal tribunal.

A third issue to consider when locating a trust in Switzerland is the issue of litigation. The Swiss ratification of the Convention was associated with the introduction of provisions allowing the settlor or trustee to specify the jurisdiction for trying trust disputes. Absent contrary indication such a jurisdiction selection clause is considered by the Swiss to be a choice of exclusive jurisdiction. In effect therefore, a settlor or the trustee may insist on selecting the courts of the chosen proper law to hear trust disputes. At the time of ratification the government stated that these provisions on jurisdiction should apply not only in hostile disputes but extend also to jurisdiction in matters of *construction or direction summonses'*. In practice, I have started to see some trust deeds which select the Swiss courts, although I am not aware of any application to the Swiss courts for directions for the time being. Clearly, which courts to select is an important decision and warrants careful analysis. The Swiss courts have had experience of applying foreign laws in trust matters, in fact they did so in deciding that the trust involved in the Werner K Rey matter, heard prior to ratification, was a sham. One cannot help thinking however that if litigation risk is usually assessed at 30 percent when courts are hearing matters governed by their own laws, this figure must be higher where courts are applying a law which is not their own.

Finally, under the chapter of possible limitations, I think you must keep in mind the possibility of plain misunderstandings. I am very impressed with the speed with which Swiss practitioners and government officials are deepening the know how of trusts in Switzerland. This is evidenced in the wealth of publications since ratification of the Convention and the guidance that has been issued so far. However, the legal concepts and the language are different. A good example is in the testamentary trust field. A foreigner domiciled in Switzerland may choose his or her national law to govern their estate, provided they have not acquired Swiss nationality at the date of death. Frequently, such a will includes a testamentary trust. However, when the will is produced to the competent authority for the estate in question, it must be translated. Involvement in such an exercise quickly brings you to the realisation that is very hard to translate a testamentary trust faithfully. For example, a life interest will be invariably translated as a *'usufruit'*. I am happy to say I am yet to be involved in a situation where such matters have made a difference. Nevertheless, it remains important to have this to mind in the planning stages and to allow for it in whatever solution is proposed.

What might the future hold?

The possibility of growth of the trust industry within Switzerland is difficult to analyse as there are currently no statistics available for numbers of trusts, assets under management or even number of

trustees operating in Switzerland. SATC has looked at the number of STEP members as providing perhaps the best indication: 1992-50; 2002-270; 2007-594; 2008-740. Another comparable might be the number of staff in a large trust company. In Switzerland this might be 20/30 staff. It seems that in the Channel Islands this would be more like 50-100 staff. When asked for the reasons for the increased popularity of Switzerland as a trust jurisdiction, SATC mentions the following:-

- (a) The predominance of private client banking and asset management in Switzerland makes the offering of trustee services compelling as part of the coordinated wealth management proposition.
- (b) The existence of client confidentiality and sensible regulation in the financial services industry provides an attractive and flexible environment to deliver wealth management services from Switzerland.
- (c) The central location within Europe, reputation for high service standards, employment law flexibility and educated, multi-lingual workforce all give Switzerland competitive service advantages as compared to other locations.
- (d) Since the ratification of the Hague Convention, we now have certainty as to the treatment of trusts under Swiss law in respect of governing law of the trust and the separation of trust assets from the trustee's own assets.

I would agree with these observations. I would add that the really good news is that Switzerland has accepted the trust and that there are steady moves towards improving the welcome that trusts receive in this country. If these observations are linked with the findings of STEP's report examining international trends in the trust and estate planning industry then I think there is even more reason for optimism. The key trends identified in that report were:

Firstly, what the report calls the Transparency Dividend. The end of secrecy will mean families will seek out advisers and trustees who can master global tax advice. Economic conditions will mean tax competition between countries will increase and the distinction between offshore and onshore will disappear.

Secondly, that trust and estate planning will be transformed into a wider wealth management business.

Lastly, what the report calls 'Trust Plus' strategies, will see new products being added to the traditional trust based model, including trusts being used in novel, more flexible ways.

Even the apparently accelerating cycle of bad news about tax information exchange does not seem to shake the basic business case for the use of trusts. I think the reason for this is that the Swiss have gone beyond the trust as a mere tax device. They now see it as a real succession planning tool, which still has its place even if it is tax neutral. One issue that has arisen in the last twelve to eighteen months has been associated with the UBS case and the sudden upsurge in tax information exchange agreements. Certain members of Parliament and one journalist in particular have acquired the conviction that the irrevocable discretionary trust is the anglo-saxon version of bank secrecy. I am not sure how this view has come to hold sway. As mentioned earlier, a trustee must comply with Swiss anti-money laundering laws and runs the risk of criminal responsibility in case of failing to comply. The trustee is subject to audit. There have also been calls for Switzerland to adopt its own trust law or to revive the proposal to update the fiducie. We shall have to see if this comes to pass. In any event, it indicates moving further in the acceptance of the trust into Switzerland.

To conclude I would like to mention one other, perhaps surprising, aspect of the Swiss ratification, which may hold some promise for the future, much in the way that trusts seemed to

develop in Italy post ratification. The Convention contains provisions, Articles 5 and 13, which exclude the operation of the Convention if the selected proper law does not include trusts or the type of trust in cause or if the key connecting factors are with a country that does not have a trust law or the type of trust in cause. Switzerland has chosen to exclude these provisions, with the effect that trusts may be established by Swiss nationals or domiciliaries and should be recognised under the Convention, subject to the limitations already mentioned. In view of the tax circular's provisions, this would only seem to be of interest if there is a tax neutral solution which the trust can provide and no equivalent Swiss law solution. For the time being my experience has been that this is only really of interest for Swiss nationals or domiciliaries who have assets outside of Switzerland and the trust is the optimal way of holding that asset in the relevant jurisdiction. However, there are signs that there may be other situations where the trust could be of interest and it may be that this is an area where trusts may further develop.

APPENDIX

Lenz & Staehelin - Unofficial translation

Taxation of trusts

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1. Introduction

With the growth of internationalisation, the demand for uniform tax treatment of trusts has been expressed more strongly, both on the part of tax payers and by the authorities. The current different tax practices from one canton to another generates problems which are detrimental to transparency and legal confidence.

The aim of the Circular is to enable a change from the current divergent tax practices to a uniform set of rules. Due to the diversity of the forms of trusts, the following discussion is limited to a discussion of the essential characteristics necessary to determine the tax treatment. In the first section, the basic legal nature of the trust and the terms used in connection with a trust are explained. Based on this, conclusions as to the tax treatment are then drawn.

2. Trust

2.1 Main features of a trust

The concept of a trust describes a legal relationship which arises on the basis of a constitutive document (trust deed), when the founder (settlor) transfers certain assets to one or more persons (trustees) who have a duty to manage and use them for the goals established by the settlor in advance for the benefit of one or more third parties (the beneficiaries).

The trust is a legal institution which has developed historically in England and has principally spread to the Common-law states (Great-Britain, USA, Australia, Canada, South Africa, New-Zealand). In addition, institutions comparable to trusts can be found in other states such as for example Japan, Panama, Liechtenstein, Mexico, Colombia, Israel and Argentina.

In practice, trusts show that they are an instrument of enormous flexibility. Trusts are frequently used for succession planning purposes or for what is known as “asset protection” (preservation of assets) for individuals. Furthermore, under Anglo-Saxon law, trusts are among the tools most often used in the field of charitable institutions as well as pension plan funds. They are also frequently found in effecting company stock option plans for listed companies. In view of the multiple different forms trusts may take, listing all different types of trusts would be an impossible exercise and of little use in determining a tax assessment. It is much more worthwhile to establish the principles which are applicable to the tax treatment of trusts which are independent of the type of trust concerned.

A trust can be created either by a legal act between living persons or by testamentary disposition.

Even if by its composition, the trust seems to be similar to a Swiss foundation, it is not a legal entity. From a strict point of view, the trustee has legal title, even if only in a fiduciary capacity, to the trust assets. On the other hand, the trust is also not a mere contract. Although a trust is created originally by a settlor, it constitutes, after its creation, essentially a legal relationship between the trustee and the beneficiaries which is governed by the trust deed in the first place, and in the second place by the norms of the proper law governing the trust. The settlor has relatively a lot of freedom with respect to the organisation of a trust. However, after the trust has been established, and as with the case of a Swiss foundation, the settlor has only limited means of influencing the trust. After the trust is established, the first duty of the

trustee is to protect the interests of the beneficiaries and not those of the settlor. Another typical characteristic of the trust can be found in the complex legal situation which exists with respect to the trust assets; the trustee is in effect the holder of a civil right (in common-law: legal interest), on the trust assets, but he must administer them separately and, in the event of the death or bankruptcy of the trustee, the trust fund will not be considered to be his own but will continue to be subject to the law applicable to the trust and to this separation, in favour of the beneficiaries, or to the new trustee to be appointed.

2.2 Distinguishing from a foundation

The foundation under Swiss law has the purpose, comparable to that of a trust, of dedicating certain assets for a particular goal (art. 80 CC). The foundation becomes a legal entity on its creation. By comparison, the trust is not a legal entity in itself. The trust does not have legal capacity and therefore cannot be the legal owner of the assets. In contrast to a trust, the foundation becomes the owner of the assets that are subject to its purpose.

2.3 Distinguishing from a fiduciary [“fiducie”]

The fiduciary relationship under Swiss law is based on a contractual relationship (a mandate agreement within the meaning of art. 394ss CO). The fiduciary must accept the mandate for the contractual relationship to exist. The agreement of a trustee is, in contrast, not necessary for a trust to be created. As a result, the settlor can designate any person as trustee by a unilateral legal act made while he is living or by testamentary disposition. Such a designation is comparable to the institution of executor of a will under Swiss inheritance law, which confers on him the position of an independent fiduciary in his own right.

The trust is not a mere contract. Although the trust is originally created by the settlor, it is essentially, after its establishment, a legal relationship between the trustee and the beneficiaries. After the establishment of a trust, the primary obligation of the trustee is to protect the interests of the beneficiaries and not those of the settlor.

2.4 Establishments, Foundations and Fiduciary under Liechtenstein law

Due to the way they are structured, Establishments, Foundations and Fiduciary contracts under Liechtenstein law are greatly different compared to the legal institution of a trust. Due to this, they will not be discussed further in this circular.

2.5 Hague Convention on the law applicable to trusts and their recognition

The Hague Convention on the law applicable to trusts and their recognition came into force in Switzerland on the 1st of July 2007. It enables foreign law trusts to be recognised within the civil law based on recognised international norms, and improves legal confidence in this area.

The tax treatment of trusts is still determined exclusively under Swiss tax law. Indeed, Article 90 of the Hague Convention expressly states that the Convention does not affect the competence of states in fiscal matters. As a result, the ratification of the Hague Convention has no effect on the tax treatment of trusts.

3. Terms

3.1 Settlor

The settlor is the person who sets up the trust, by a legal act between living persons or effective upon death. Inasmuch as the settlor establishes an irrevocable trust, he definitively gives and in principle, he has no further rights or obligations in relation to the trust assets. Alternatively, the settlor can establish a revocable trust. In this case, he keeps control over the trust assets.

3.2 Beneficiary

The beneficiary is the person who benefits from the trust funds. The settlor can designate himself or another individual or legal person of his country or abroad as a beneficiary. The assets of the trust can be distributed to the beneficiary during the lifetime of the settlor or after his death.

The beneficiary can bring legal proceedings in respect of future claims to distribution from the trust assets as well as the performance of the trustee's duties in relation to the administration of the trust. He has the economic ownership of the trust assets (in common-law: equitable interest). Furthermore, he has a right to these assets separately in the event of bankruptcy of the trustee. The beneficiary therefore does not only have a claim which can be made relating to payment, but he equally has certain rights of control and supervision, which makes him a kind of "organ of the trust". If the trustee misappropriates the trust assets, the beneficiary can make a claim for the restitution of the assets by the trust or by the trustee.

3.3 Trustee

By setting up a trust, defined assets are transferred to one or more individuals or legal persons (trustees), who have the obligation to manage them and use them for the purposes established by the settlor in advance. The trustee has full right to dispose (ownership under civil law) of the trust assets but he has the duty to manage for the benefit of the beneficiaries, in accordance with the terms of the trust. Within the framework of the trust provisions, he administers and uses the trust assets in his own name as independent holder of legal right with respect to third parties, but separately from his own assets.

The trustee has an obligation towards the beneficiary (and not towards the settlor) as well as towards any protector to allow access to the written documents concerning the administration and the management of the trust.

3.4 Protector

The protector is an individual or legal entity which can be put in place by the settlor if he so desires, in order to supervise the carrying out of the trustees' obligations in conformity with the settlor's wishes. The powers and functions of the protector can be wider or narrower, according to the settlor's choice set out in detail in the trust provisions.

3.5 Trust deed

From a strict point of view, the trust must be created by a written legal act which must be signed by the settlor and the trustee (the agreement of the trustee is nevertheless not a necessary condition for the creation of the trust). This legal document constituting the trusts

(trust deed), which binds the trustee contains the terms concerning the administration and the preservation of the value of the trust assets in favour of the beneficiaries designated in it.

3.6 Letter of wishes

The settlor can communicate his wishes and decisions to the trustee under the form of a letter of wishes. In contrast to the trust deed, this declaration of intention is not legally binding and only therefore represents a description of the manner in which the settlor wishes the trust to be administered. Essentially, a letter of wishes is only of practical important for irrevocable discretionary trusts.

3.7 Revocable/irrevocable trust

It is appropriate to make a distinction between revocable and irrevocable trusts. Furthermore, for irrevocable trusts, one must distinguish between discretionary and fixed interests trusts.

In order to determine their tax treatment, the decisive question is whether the settlor has definitively renounced [“dessaisi”] his assets by creating the trust or whether he retains control over the trust assets through economic or legal means.

Inasmuch as the settlor establishes an irrevocable trust, he gives away his assets definitively and no longer has, in principle, either rights or duties in relation to the trust assets. Alternatively, the settlor can establish a revocable trust. Thereby, he generally has not definitively given away his assets if the settlor designates himself as a trustee or as a beneficiary. If there is a possibility that the settlor can exert an influence on the trust, whatever that may be, the assets will not be deemed to be definitively given away. The following factors (examples listed by comparison with the jurisprudence of the Federal Tribunal on family foundations) can distinguish between revocable and irrevocable trust:

Does the settlor benefit from

- capital distributions from the trust assets?
- income distributions from the trust assets?

Does the settlor have the right

- to remove the trustee and appoint another?
- to add or cause to be added new beneficiaries?
- to replace the protector, who has powers comparable to those of the trustee?
- to modify the trust deed or to cause it to be modified?
- to revoke the trust?
- to demand the termination of the trust?
- to veto decisions of the trustee regarding the trust assets?

A positive response to one of the question listed above will tend to qualify the trust for tax purposes as a revocable trust.

3.7.1 Revocable trust

In the case of a revocable trust, the settlor retains the right to revoke the trust at a later date and to receive the remaining trust assets, or to have them transferred to someone else. Therefore the settlor has not definitely given away his assets.

It is not the label of the trust in the trust deed that determines its tax treatment but its economic effect. A trust labelled irrevocable can therefore also fall into the category of revocable trust if the giving away of assets is not definitive.

Revocable trusts can transform into irrevocable trusts upon the death of the settlor, unless another person has the right to revoke or if this right is transferred to another person upon the death of the settlor.

3.7.2 Irrevocable fixed interest trust

Concerning fixed interest trusts, the matters affecting the beneficiaries and the rights conferred on them arise directly from the trust deed. With this type of trust, the trustee does not have any discretion concerning the distribution of the income or capital of the trust. The trustee has neither an economic right nor an independent power to dispose of the trust assets. By establishing an irrevocable fixed interest trust, the settlor definitively disposes of his assets.

In contrast to a discretionary trust where the beneficiaries' right are only in the nature of an expectation, the beneficiaries of fixed interest trusts have a claim on the assets of the trust which is legally enforceable. In consequence, the beneficiaries of fixed interest trust can be assimilated to an "usufruitier".

3.7.3 Irrevocable discretionary trust

As a rule, the trust deed of a discretionary trust only describes theoretical classes of beneficiaries. The decisive decision which ultimately must be in conformity with the terms of the trust is left to the trustee.

The settlor may eventually reveal to the trustee what motivations have led him to establish the trust in letter of wishes and make known, in a way which is not legally binding, the way in which he should exercises his powers.

If the settlor gives a particular importance to certain issues, it can be provided in the trust deed that certain decisions of the trustee require the prior consent of a protector.

At the time of the establishment of a discretionary trust, there is no gain by the beneficiary because one cannot yet say which persons will effectively receive a distribution from the trust anymore than the amount or the timing of such distribution. The right of the beneficiaries are therefore only of the nature of a mere expectation.

4. Tax treatment of the trust, trustee and protector

4.1 Tax treatment of the trust

Foreign legislation does not give legal personality to the trust. By reference to international private law (International Private Law Act (IPLA); incorporation theory), Swiss tax law cannot grant legal personality to the trust either.

Further, a trust is not a “foreign legal entity” within the meaning of Article 49 par. 3 Direct Tax Act (DTA) and Article 20 part 2 Tax Harmonization Act (THA), since these provisions only apply to bodies of persons to which Swiss private law gives legal personality. However, Swiss private law does not give legal personality to trusts.

According to most legal doctrines, a trust is also outside the scope of articles 11 DTA and 20 par. 2 THA. The tax qualification provided by these provisions only applies to entities whose members are bound by a “personal relationship”. This is the case for example for communities of heirs or partnerships subject to common law. The type of relationship typical for these types of entities does not exist in case of trust.

Under current Swiss tax law, there is no legal provision that could allow assimilating a foreign trust to a legal entity for tax purposes. Therefore, we must conclude that the question of limited or unlimited tax liability of the trust (for example on the grounds that one or several trustees are residing in Switzerland) does not arise at all.

4.2 Tax treatment of the trustee and the protector

As a matter of principle, the net assets attributed to the trust and the income arising therefrom must not be taxed in the hands of the trustee. This opinion is in compliance with the principle of taxation according to economic control. This principle guarantees that a taxpayer will not have any item of income or capital attributed to him if he has no power of disposition over them. From an economic point of view, the trustee has no right over the assets in spite of the formal ownership granted to him.¹ In addition, the trustee bears only the risk which is the responsible management of the assets in accordance with the rules set out in the mandate contract.

The above has as a consequence that the question of the effective place of management sometimes used to justify the non-imposition of tax on the trustee does not arise either.

The above considerations apply equally to an individual or to a legal entity acting as protector of the trust and whose place of residence, or its statutory seat or place of effective management respectively, is in Switzerland. A person that assumes only the function of protector does not have more rights over the assets of the trust than the trustee, either from a legal or economic viewpoint. Thus, these assets cannot be attributed to it.

However, it is clear that the fees that the trustee or the protector receive in exchange for their services must be accounted for and are taxable. They must in addition be listed in detail and be verifiable.

5. Tax treatment of the settlor and of the beneficiary

Trusts can be used in a lot of different situations. It is therefore not possible to list in detail the tax treatment of each specific case. Below, we shall thus just describe the principles

governing the individual taxation of the settlor and of the beneficiary. We shall start from the assumption that the specific trusts are aiming at estate planning or asset protection for an individual (most frequent cases of application).

5.1 Principles applicable to the tax treatments become part of the assets of the taxpayer

For taxation purposes, the assets and the income of the trust (capital, capital gains or ordinary income) are attributed either to the beneficiaries or to the settlor (transparency principle). This arises from the fact that under Swiss tax law currently in force the assets concerned cannot be attributed either to the trust or to the trustee.²

Under Swiss tax law, income is defined by the so-called “increase of wealth theory” that qualifies income as any increase of the net wealth (including the rights to use) that has occurred during a given period. In addition, the income is considered as having been received at the moment it accrues but only on realisation. According to long-standing practice and legal doctrine, the income is generally considered as having been received and as being acquired only at the time when the taxpayer receives it or acquires a fixed right to it unless the effective realization of such income is very uncertain. In the last case, the moment of the effective realization is the relevant time. The completed acquisition of a right, which might be as a result of the the acquisition of a receivable or of the property ownership is the fulfilment of the “entry” into ownership which is relevant from a tax point of view. Mere expectations or claims subject to a condition precedent do not lead to the realization of income.

As a matter of principle, by applying the general provision stating that income is taxable (Article 60 par. 1 DTA and Article 7 par. 1 THA), all distributions made by a trust constitute taxable income for the beneficiary unless it is characterised as a gift (Article 24 let a DTA and Article 7 par. 4 let. c THA).

In addition, the concept of gift does not correspond to the definitions of non-harmonised cantonal laws relating to taxation of gifts and bequests. Rather it is defined by reference to the taxable income concept as defined by the DTA and the THA. This definition is based on civil law according to which gifts suppose the realization of four elements, i.e. a transfer between living persons, an enrichment arising from the wealth of a third party, the absence of remuneration and the desire to give, or to grant an advantage.

According to legal doctrine and case law, we apply, in the taxation process, the generally recognised principle which provides that the tax authorities have the burden of demonstrating the facts that give rise to a tax claim, whereas the taxpayer has the burden of demonstrating the facts that reduce or eliminate the tax claim.

Notwithstanding the above, tax avoidance and abuses are expressly reserved.

5.1.1 Treatment of the settlor

5.1.1.1 In general

The taxation of the settlor depends on whether he creates a revocable trust or an irrevocable trust. In contrast to an irrevocable trust, the settlor who creates a revocable trust does not dispose definitely of the assets attributed to the trust. See for example point 5.2

5.1.1.2 *Settlor residing in Switzerland*

In most cases, the settlor is resident outside Switzerland at the moment of the creation of the trust, but he could also be resident in Switzerland. Should the settlor be resident in Switzerland, the Settlor will only be deemed to have disposed of his assets according to Swiss tax law, if another taxable person has been enriched. This will only occur in case of the creation of an irrevocable fixed interest trust (see 5.1.2). In all other cases, the wealth and its income remain attributed to the settlor (see also Article 335 of the Swiss Civil Code and the general reserve of the tax avoidance). The above is not applicable in case of lump sum taxation (Article 14 DTA and Article 6 THA) because in such a case, only the assets in Switzerland and income from Swiss sources are taken into account in the tax assessment.

5.1.2 Treatment of the beneficiary

In the case of an irrevocable fixed interest trust, the beneficiaries, as well as the amount and the timing of the distributions to the beneficiaries are fixed. Due to the fact that a right exists and is known, a corresponding part of the wealth of the trust can be attributed to the beneficiary. At the time of the distribution, it is necessary to consider whether it corresponds to taxable income or to a gift exempt from income tax (Article 24 let e DTA; Article 7 par. 4 let. c THA).

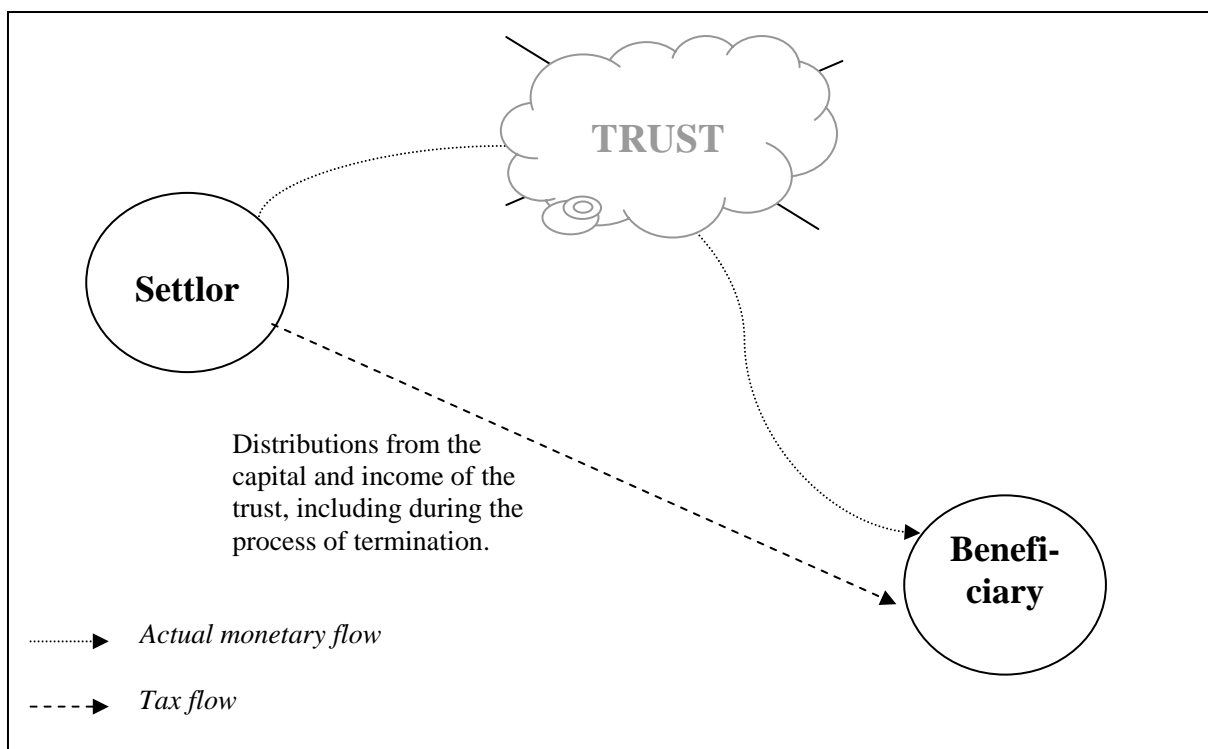
The right of the beneficiaries of an irrevocable discretionary trust are in the nature of a mere expectation. The timing and the amount of possible distributions are not determined because these points are left to the discretion of the trustee. The beneficiaries sometimes even do not know that they are beneficiaries of a trust. For that reason, a distribution can only be subject to tax at the time of the effective payment. It is at this time that the characterization as taxable income or as exempted gift will be made. In the rare cases where the amount and the timing of the distribution has been determined in a legally compelling manner or in the case that these distributions arise in a regular manner, the same treatment as for fixed interest trusts can be applied. See for example point 5.2.

5.2 Examples

Because of the wide diversity of cases, the examples cannot deal with all the variations. The examples are limited to the three basic situations (revocable trust, irrevocable fixed interest trust, irrevocable discretionary trust). The treatment is determined by applying the tax principles described above. We start from the hypothesis that the settlor creates a trust when he is alive (inter vivos trust) and that the trust is aimed at estate planning or asset protection for an individual. In any case, point 5.1.1.2 should be taken into account.

5.2.1 Irrevocable fixed interest trust

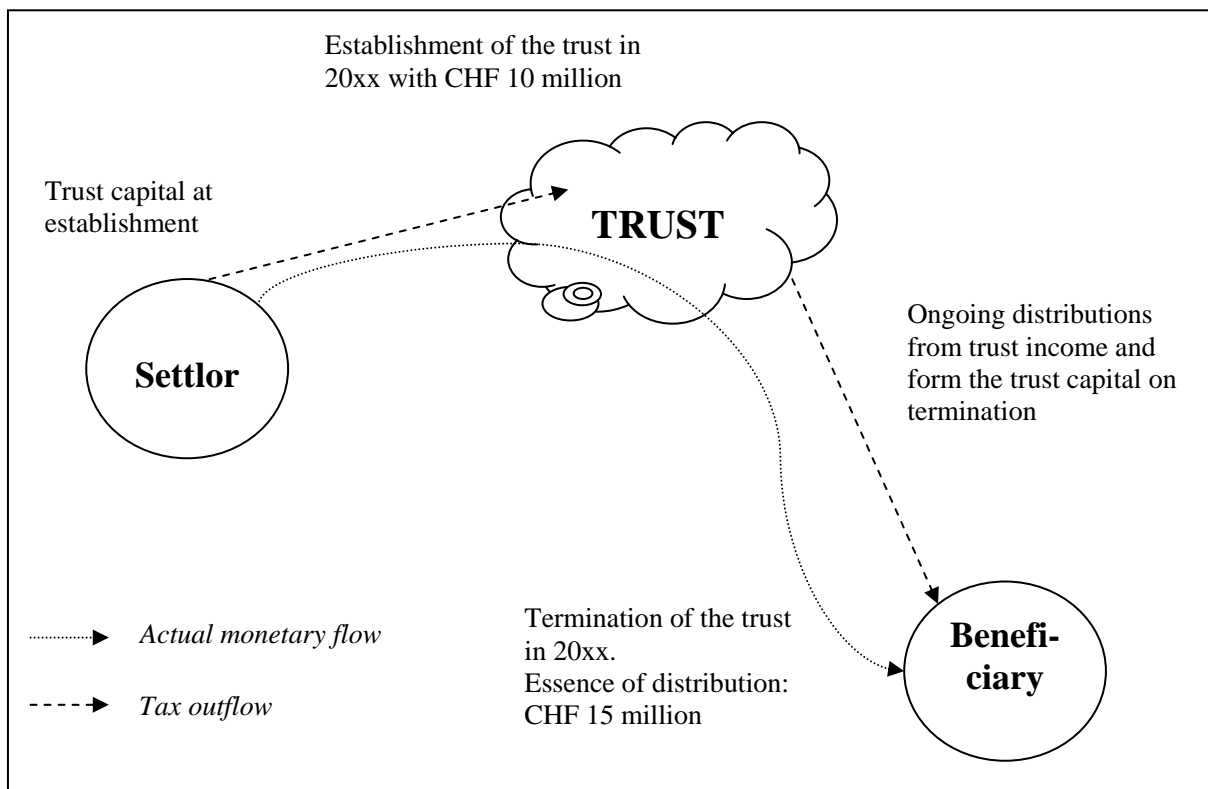
The beneficiary of the trust can be treated as an usufructory (see Archives of Swiss Tax Law 55, page 657ss). This is the reason why the assets and the income of the trust are attributed to the beneficiaries from tax purposes. The tax treatment will thus be the following:



Duration of the trust	Tax treatment
Creation	No tax consequences. The assets and their income remain taxable in the hands of the settlor at the place of his residence.
Distribution to the beneficiary	Characterized as a gift. The determination of the tax rate is left to the competence of the Cantons.
Liquidation	In the case that the assets are attributed back to the settlor: no taxation. In the case of distribution to the beneficiary, see above: distributions to the beneficiary.

5.2.2 Irrevocable fixed interest trust

The beneficiary of the trust can be treated as an usufructuror (see Archives of Swiss Tax Law 55, page 657ss). This is the reason why the assets and the income of the trust are attributed to the beneficiaries from tax purposes. The tax treatment will thus be the following:



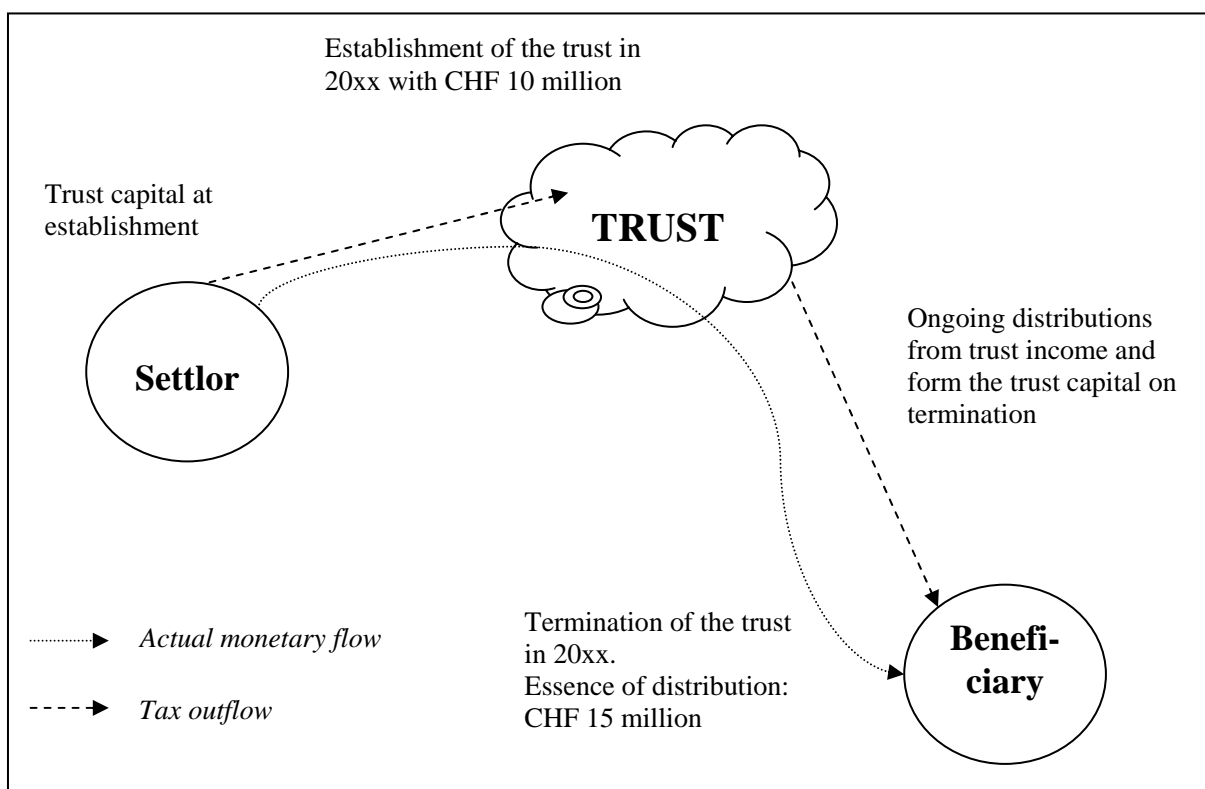
Duration of the trust	Tax treatment
Creation	<p>There is a gift from the settlor to the beneficiary for an amount corresponding to the capital of the trust.³</p> <p>The determination of the rate of tax is left to the competence of the Cantons.</p>
Distributions to the beneficiary	<p>The distributions to the beneficiary constitute in principle taxable income. In addition, the income is considered as realized at the time the beneficiary acquires a fixed right to the income of the trust or at the time he receives the distribution.</p> <p>The beneficiary is subject to wealth tax on his share on the assets of the trust. If such share cannot be determined, the income he receives therefrom can be capitalised.⁴</p> <p>It follows that because of the attribution of the assets of the trust to the beneficiary for tax purposes, the distribution of capital gains (as long as it is capital gains realized on private wealth) and of initial capital of the trust is not taxable (Article 16 par. 3 DTA and Article 7 par. 4 let. b THA, respectively Article 24 let. e DTA and Article 7 par. 4 let. c THA). In the case that it is not possible, in a specific case, to demonstrate that this distribution comes from capital gains or from the capital of the trust, the general principle, according to</p>

	<p>which the whole distribution is taxable income, will be applied.</p> <p>The trust is, because of its legal nature, a long lasting entity, so that the capital cannot be distributed before the distribution of all the accumulated income of the trust.</p>
Liquidation	Please refer to the above: distribution to the beneficiary.

5.2.3 Irrevocable discretionary trust

If the settlor is a Swiss resident at the time of the creation of the trust, the assets of the trust and their income remain attributed to the settlor (see 5.1.1.2). The tax consequences are thus the same as for the revocable trust (see 5.2.1).

If the settlor is residing abroad at the time of the creation of the trust, the assets of the trust can be attributed neither to the settlor nor to the beneficiary (see above 3.7 on the question of whether it is in effect an irrevocable discretionary trust). Hence, the following principle will be applicable for the tax treatment:



Duration of the trust	Tax treatment
Creation	The transfer of assets from the settlor to the trust or to the trustees is treated as a gift from the settlor for the amount of the capital of the trust.
Distributions to the beneficiary	<p>The beneficiary is not subject to wealth tax on the assets of the trust.</p> <p>Distributions to the beneficiary from the assets of the trust cannot be taxed before their effective payment, or before the granting of a fixed right to their payment.</p> <p>The distribution must generally be considered as income of the beneficiary (art.16 al.1 LIFD and art. 7 al.1 LHID). This income will be taxed unless it can be demonstrated that it does not constitute income or that only a part of the distribution constitutes income (proof that it is a distribution of the initial capital of the trust which has already been treated as a gift upon contribution to the trust; (art. 24 let. a LIFD and art. 7 al. 4 let. C LHID) this recognition can only apply to the initial capital of the trust or to the capital contributed thereafter and it is the taxpayer who has the burden of proving this.</p> <p>In addition, one should take into account that the trust is, because of its legal nature, a long-lasting entity, so that the capital cannot be distributed before all accumulated income has been distributed.</p> <p>Due to the fact that the assets of the trust are not attributable to the beneficiary from a tax perspective, it is not possible to exempt from tax whole or part of the distribution on the ground that it can be characterised on a capital gain of the beneficiary.</p>
Liquidation	For the tax treatment of the liquidation proceeds, please see above: distribution to the beneficiary.

6. Duty to inform and collaborate

Settlors, trustees and beneficiaries liable to tax in Switzerland have the duty, on the basis of Article 126 DTA and Article 42 THA respectively, to provide all information necessary as well as to provide all documents, or attestations from third parties, to prove the existence of the trust and corresponding payments in kind or expenditure.

It should be added that, in the event of a tax audit, the trustee cannot invoke professional secrecy. He has a duty to disclose all the documents relating to the trust. This is also valid in the case that the trustee is an attorney because the management of a trust is not, strictly speaking, one of the activities of an attorney.

7. Information relating to withholding tax

The practice of the Federal Tax Administration (FTA) is expressed below.

7.1 Income from wealth arising from assets of the trust

The distributions of the trust to the beneficiaries cannot be subject to Swiss withholding tax because trusts are not listed in Article 4 par. 1 Withholding Tax Act (“WTA”).

7.2 Reimbursement from Swiss withholding tax

As the trust does not have a legal personality, it cannot claim reimbursement of Swiss withholding tax. Furthermore, absent such legal personality, the trust cannot qualify as a foreign company entitled to reimbursement. Article 55 let. c of the Ordinance on Withholding Tax (“OWT”) cannot be applied to the trust either because the latter does not constitute an estate (“masse de biens”).⁵ The explanations developed below under point 8 (“Double tax treaties”) are limited to international relationships.

7.2.1 Revocable trusts

From a tax law perspective, a revocable trust must be attributed to the settlor who, with the reservation of tax avoidance, will be treated as the holder of the right to use. In such a case, the settlor must comply with the requirements that allow him to obtain reimbursement of Swiss withholding tax levied on the income arising from the trust assets.

7.2.2 Irrevocable fixed interest trust

To the extent that the trustee can prove the existence of the trust relationship by providing the trust deed, the trust assets cannot be attributed to him from a tax perspective. In such a case, the beneficiary is considered to be the holder of the right to use. Should the beneficiary be resident in Switzerland at the time of maturity of the payments that are subject to Swiss withholding tax (Article 22 par. 1 WTA), he can claim the reimbursement of withholding tax by applying by analogy the rules relating to fiduciary relationships (Article 61 par. 2 OWT).

7.2.3 Irrevocable discretionary trust

In the case of discretionary trusts, the trust deed does not grant to the beneficiary a right to receive trust distributions. On the contrary, the trustee has a discretionary power to determine when he chooses to make payments in favour of the beneficiaries listed in the trust deed. Between the time of the establishment of the trust and the time of an effective distribution, neither the assets of the trust nor the income arising from such assets can be attributed to the beneficiaries; they only have a mere expectation. Furthermore, the assets of the trust cannot be attributed from a tax perspective to the settlor because the latter has definitely disposed of the assets transferred to the trust. As long as the assets of the trust cannot be attributed from a tax perspective to one person, and hence until the time of an effective distribution, there are no means of obtaining a reimbursement of Swiss withholding tax. This practice is in line with the treatment applied at the level of direct taxes according to which no tax treatment over a discretionary trust is possible prior to an effective distribution.

Should the settlor be domiciled in Switzerland at the time of the creation of the trust, given the absence of enrichment of another taxpayer, the settlor is not considered as having reduced his assets, which as a consequence means that the assets of the trust and its income remain

attributable to the settlor. Hence, for reimbursement of Swiss withholding tax, the same rules as for a revocable trust apply, and the settlor must fulfil the requirements for reimbursement of Swiss withholding tax levied on income arising from the trust assets.

8. Information relating to Double Tax Treaties (DTT)

8.1 In general

Double tax treaties concluded by Switzerland deal with the reimbursement of Swiss withholding tax on dividends and interest paid to foreign residents as well as the right to the reimbursement of foreign withholding taxes in favour of Swiss residents.

Since the trust is not a “person” under Swiss law, the application of treaty provisions may not apply in a uniform manner. Specific cases are examined on a case-by-case basis as they occur depending on the applicable treaties.

Certain treaties such as the Swiss/US DTT, the Swiss/Canada DTT and the Swiss/UK DTT (by interpretation) contain provisions relating to trusts (notably, they provide that a trust is a “person” within the meaning of that DTT), but that sole provision still does not mean that a reimbursement can be granted. The benefit of treaties is granted to persons that a) are residents within the tax meaning of the term according to the treaty and b) are the effective beneficial owners of the income.

8.2 Reimbursement of Swiss withholding tax

When faced with a request for reimbursement presented by a foreign trust, the practice of the FTA consists in examining in the first place whether by applying the legislation of such State, the trust is a “person” that is residing in such State (subject to tax), due to the fact that the trust itself or because of one or several trustees are residing in such State and generating a liability to taxes in such State. In such a case, the FTA considers that the application of the provisions (dividends, interest) of the DTT is correct and reduces the double taxation by partially reimbursing Swiss withholding tax; the fact that the “trust” is not a person within the meaning of Swiss law (and not necessarily within the meaning of the treaty) is less relevant than the fact that there is one person entirely subject to ordinary taxes in the other State.

The question is more complex when a trust is subject to ordinary taxes in one contracting State, but a mechanism of deduction of the income transferred to the beneficiary or a tax credit could result in effective transparency, general or partial, in relation to certain income (and to non-taxation). In such a case, it could be that persons who would not be entitled to the benefit of the treaty (non-residents of the State of the trust that is claiming the reimbursement) are the effective beneficiaries of the Swiss income. This is only one illustration among others that shows the difficulty of applying the treaty provisions and the necessity to examine each specific case in light of the applicable DTT. In any case, it is the foreign beneficiary or any other person that claims the benefit of the DTT who has to provide the FTA with the information necessary to process the request.

8.3 Reimbursement of foreign withholding taxes

Switzerland does not recognise the institution of trust, so the question of a request for reimbursement of foreign tax by applying a DTT by a Swiss resident trust does not arise. However, since the Swiss tax authorities tax the recipients of trust income residing in

Switzerland, it could be that a beneficiary claims a right (possibly pro rata) to the partial reimbursement of a foreign source tax on income that has been paid by a trust.

In such a case, from the strict viewpoint of the Federal Tax Administration, if the person who files the request is subject to ordinary taxes in Switzerland, and if such income is attributed to him by virtue of the law and the tax principles detailed in the present circular, the FTA stamps the request and according to the procedure applicable in these circumstances, returns it to the beneficiary or transfers it to the foreign tax authority of the State where the income subject to source taxes has arisen. The result of such claim for reimbursement in the foreign state will depend on how the income distributed to the trust, or to the trust in question or to its beneficiaries, is regarded by that State.

8.4 Agreement on Savings Tax

Explanations relating to trusts that are found in the Directives issue by the FDA relating to the EU Savings Tax dated June 24, 2005, are only applicable to the EU Savings tax and to the voluntary disclosure provided for by the agreement passed between Switzerland and the European Community.

¹ See on this respect the distinction between “legal interest” and “equitable interest”, under 2.1 or 3.2.

² See above, par. 4.

³ To the extent that the fiscal sovereignty is conceded under the cantonal legislation.

⁴ For example by applying the rates of capitalisation provided in the current list of the Cantonal Tax Administration.

⁵ See above, par. 4.1.