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# Risks and Pitfalls of the Management of SPVs in Switzerland

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# Introduction

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- Ratification of the Hague Convention, July 2007
- No new specific legislative tax provisions
- Swiss Tax Conference Circular, August 22, 2007
- Federal Tax Administration Circular, March 27, 2008
- No reference to ‘underlying companies’

# Taxation of Trusts

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- The Trust is not a tax subject
- The Trustee shall not be taxed on the trust assets
- The same applies to the Protector
- Only the Settlor/Beneficiaries may be taxed on the trust assets depending on the trust's characteristics (as defined by Swiss fiscal standards):
  - Revocable vs. Irrevocable
  - Fixed vs. Discretionary

# Taxation of Offshore Companies

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Various possible approaches of Swiss tax authorities:

- Transparency ('look-through')
- Consolidation theory (Federal Tribunal Case of 2006)
- Effective management (Federal Tribunal Case of 2003)
- Permanent establishment
- Transfer pricing approach
- Mandate theory (Federal Tribunal Case of 1995)

# Effective Management

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## – Key elements

- **Day to day business**
- **Effective and economic center**
- **Acts that serve as a whole the statutory purpose**
- ≠ Administrative activities (e.g. accounting, following up contracts, execution)
- ≠ Activities of the company's supreme bodies limited to strategic decisions
- *Board meetings / general assembly?*
- Case-by-case basis

## – Major Swiss tax consequences

- Corporate income tax
- Capital tax
- Withholding tax

# Case law

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- Zurich Administrative Court, Decision of 2 April 2014
- Geneva Court of Justice, Decision of 11 October 2016
- Federal Tribunal, Decision of 7 March 2017

# Zurich Administrative Court | 2 April 2014

## The facts

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- Zurich resident settlor (professional asset manager)
- Jersey trust
- Jersey corporate trustee
- Zurich based protector (attorney)
- Jersey underlying company
- Trust assets: (undeclared) Swiss bank accounts
- Beneficiaries: settlor, his wife and children
- *The Zurich tax administration argued that the underlying company was effectively managed from Switzerland and was thus liable to taxes as a Swiss resident company*

# Zurich Administrative Court | 2 April 2014

## The holding (1)

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- Trustee:
  - Pure administrative functions (bookkeeping, accounting, etc.)
- Underlying company
  - Very limited activities (e.g. delegation of the asset management to third-parties and no modification of initial appointments)
  - Minimum equity + Unsecured interest free loan of CHF 30M from the Trust invested in highly speculative investments (requalified as Settlor's equity)
- Settlor
  - Contacts with the bankers (meeting twice a year, direct reporting)
  - Was actually the one making decisions in relation to the company



# Zurich Administrative Court | 2 April 2014

## The holding (2)

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- The trust was to be considered as **fiscally revocable** due to the Settlor's retained control, which made him (rather than the trustee or the trust) the shareholder of the underlying company
- The company directors in Jersey were only carrying out basic administration activities and took no decision in relation to its management
- The **effective management** was carried out by the Settlor in Zurich; the Jersey company's place of effective management was therefore in Switzerland

# Zurich Administrative Court | 2 April 2014

## Comments

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- Settlor's motives for setting up the Trust?
- Numerous ties to Switzerland
- Economic approach

# Geneva Court of Justice | 11 October 2016

## The facts

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- Geneva resident individual
- Company based in Guernsey
- Boat kept in Turkey
- Finances
  - Acquisition financed by a shareholder's interest-free loan
  - Boat's accounting value lower than the shareholder loan
  - Company's loss each year: no income / costs included administration costs and secretarial services
  - Maintenance and running costs directly borne by the shareholder

# Geneva Court of Justice | 11 October 2016

## The facts (2)

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- Geneva tax administration's position
  - Guernsey company was effectively managed from Geneva
- Taxpayer's position
  - Effective management had been delegated to two individuals in Turkey, where (i) the boat was kept, (ii) its maintenance was carried out, and (iii) the employees were based
  - Boat constituted a permanent establishment in Turkey

# Geneva Court of Justice | 11 October 2016

## The holding (1)

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- Company has **no commercial activity**
- Company's limited goals:
  - to own the boat;
  - to maintain it; and
  - to place it at the shareholder's disposal
- Shareholder's extensive involvement:
  - entirely financed the purchase;
  - *directly* borne most of the company's costs; and
  - *directly* appointed an agent and a captain to take care of the boat

# Geneva Court of Justice | 11 October 2016

## The holding (2)

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- Burden of proof
  - Company failed to demonstrate having contractually delegated the management
  - Payments were made to an agent and a captain in Turkey: not sufficient to demonstrate the effective management abroad
  - The captain and agent did not provide reports regarding the use of the funds – the Court found that this implied that the shareholder actually controlled the use of the funds
  - The Court found the company's position (i.e. that the shareholder was not at all implicated in the day-to-day management) not credible
- All decisions were actually taken by the shareholder in Geneva; thus, the effective management was in Geneva
- No permanent establishment in Bodrum (no fixed installation)

# Geneva Court of Justice | 11 October 2016

## Comments

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- Choice of jurisdiction
- ‘Play the Corporate Game’
- Transparency?

# Federal Tribunal | 7 March 2017

## The facts

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- A Swiss Pension Fund settled a US grantor trust
- The Trustee was a US Bank
- The Trustee purchased units in US funds ('Common Trust Funds')
- The Swiss pension fund booked the investment in the US funds in its accounts
- FTA claimed that the Transfer Stamp Duty (**TST**) was owed supporting that the **purchasing party** was the Swiss Pension Fund
- Taxpayer challenged the position arguing that the **legal owner** was the Trustee, a foreign bank
- Notion of ownership: who held ownership over the units?



# Federal Tribunal | 7 March 2017

## The holding

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- Legal form of the operation vs. economic reality
- Civil definition of ownership (unless there is a tax evasion – not claimed)
- Trust validly settled and duly recognized under Swiss law (Hague Convention)
- Pension Fund had transferred legal ownership to the Trustee: the Trustee was to be recognized as the **legal owner** (since the Trustee was a foreign bank, the TST was not owed)
- Pension Fund's accounting was not relevant for ownership purposes
- FTA Circular was not applicable for TST purposes; hence the analysis of the trust's characteristics was not helpful (even if it may qualify as revocable)

# Federal Tribunal | 7 March 2017

## Comments

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- Formal approach
- Impact on Trustee based in Switzerland? Qualification as professional securities dealers?
- Consequences of holding units through an offshore underlying company? Risk of effective management?

# Conclusions

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- Level of courts decisions
- Formal approach vs. Economic approach
- Applicable doctrine (effective management, transparency)
- Type of companies (underlying company, stand-alone company)
- Geographical location of relevant parties (Trustee, Settlor, Beneficiaries)
- Tax regime applicable to Swiss resident individuals (ordinary, lump-sum)

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# Q&A

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