

KENDRIS

THE WEALTH OF
INDEPENDENCE



Taxation in Switzerland of Trusts and foundation : similarities and differences

Plan

- › Introduction
- › Direct and indirect taxation of trusts
- › Comparison with Foundations
- › Some practical cases



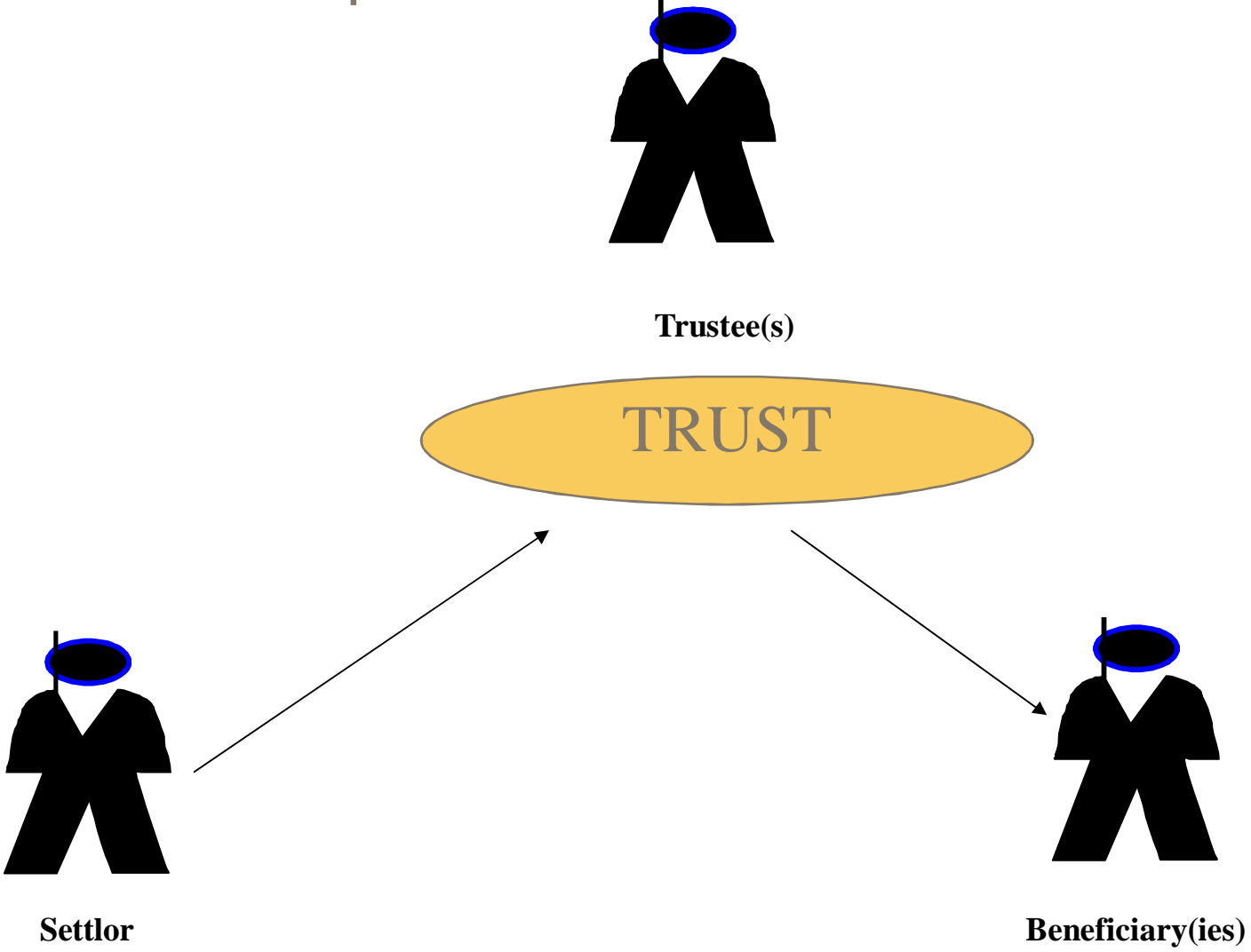
Introduction

Trust concept

- › “The Term “trust refers to the legal relationships created – inter vivos or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose”

(Art. 2 of the Hague convention on the recognition of Trusts)

Trust concept



Classification of trusts

- › From the perspective of the Settlor
 - _ Revocable
 - _ irrevocable

- › From the perspective of the beneficiaries
 - _ Fixed interest
 - _ Discretionary



Direct & indirect taxation of trusts

Principle governing the fiscal characterization of trusts

- › No specific tax provisions related to Trust in the tax law.
- › Circular letter 30 of the Swiss tax conference
- › Federal tax administration has taken over this circular in its circular 20 (of 27 March 2008)

Recognition of trusts for tax purposes

- › General principle
 - _ Not treated as other comparable civil law concept
 - _ Recognition of the effect of the Hague convention
- › Recognition of the segregation of assets
 - _ Restrictive view of what constitutes an irrevocable trust (based on economic reality rather than formal designation in the trust deed)
 - _ Due to certain circumstances an irrevocable trust can be treated taxwise as a revocable trust
 - _ Segregation of assets not recognized in case of an irrevocable discretionary trust created by a Swiss resident settlor

Taxation of Trusts and Trustees ?

- › Tax treatment of the Trust
 - _ No legal personality -> not a tax subject

- › Tax treatment of the trustee
 - _ Trustee have no power of disposition over the trust assets
 - _ Trustee cannot be taxed on the trust assets and income (principle of financial capacity)

Tax treatment of the Swiss resident Settlor

			Irrevocable	Revocable
Defini- tion			<ul style="list-style-type: none"> No power to revoke Definitive divestment of the settlor Not the case if the settlor is trustee or beneficiary, or he retain any kind of influence Economic reality vs formal designation in the trust deed <p style="text-align: center;">RESTRICTIVE VIEW</p>	<ul style="list-style-type: none"> By opposition to irrevocable trust A revocable trust will become irrevocable at the death of the settlor
Income and net wealth tax	Fixed interest		Not taxed in hand of Settlor (assets and income attributed to beneficiaries)	<ul style="list-style-type: none"> Settlor is not considered as having definitively disposed of his assets. -> Trust is no recognized Settlor remains fully taxable on the trust's assets (wealth) and income
	Discre- tionary	Settlor in CH when trust created	<ul style="list-style-type: none"> No corresponding enrichment of the beneficiary (he has only an expectative right) Settlor is not considered as having definitively disposed of his assets. -> Trust is no recognized Settlor remains fully taxable on the trust's assets (wealth) and income Treatment of a lump-sum Settlor slightly different 	
		Settlor abroad when trust created	<ul style="list-style-type: none"> Trusts assets and income cannot be attributed to anyone Foreign resident Settlor has definitively disposed of his assets. Settlor not taxable on Trusts assets and income upon his subsequent arrival in Switzerland. <p>Trusts assets and income will escape Swiss taxes as long as they are not transferred to a beneficiary who is subject to Swiss taxation</p>	

Tax treatment of the Swiss resident Settlor

		Irrevocable	Revocable
Gift and inheritance taxes	Fixed interest	<ul style="list-style-type: none"> • Gift from the Settlor to the beneficiary in the amount of Trust capital • Settlor in Switzerland when trust created : Swiss gift tax; rate determined by the canton of residence • Settlor abroad when trust created : No Swiss gift tax; treatment abroad depending on the residence tax law • Upon death of the Settlor, no inheritance tax due on assets allocated to Trust 	<ul style="list-style-type: none"> • No gift tax at creation • Upon death of Settlor, trust become irrevocable and an inheritance tax is due at rate depending on the level of kinship between settlor and beneficiaries or at rate applicable to the potential beneficiary with the most distant degree of kinship (VD and GE)
	Discretionary	<ul style="list-style-type: none"> • Settlor in Switzerland when trust created : not treated as a gift since the trust assets and income remain attributable to the Settlor. Subsequent distributions from the trust to the beneficiary will be treated as gifts from the settlor to the beneficiary -> subject to gift tax as above. Upon death of Settlor, inheritance tax due at maximum rate (depends on canton) • Settlor abroad when trust created : gift was made when Settlor abroad ; no Swiss gift tax. Subsequent distribution not subject to gift tax. Upon death of settlor no inheritance tax 	<ul style="list-style-type: none"> • No gift tax at creation • Upon death of Settlor, trust become irrevocable and an inheritance tax is due at maximum rate or at rate applicable to the potential beneficiary with the most distant degree of kinship (VD and GE)

Tax treatment of Swiss resident beneficiaries

- › Revocable trust -> distributions treated as gift, subject to gift tax if Settlor in Switzerland at the time of distribution. Will then be part of the wealth of the Swiss beneficiary (subject to wealth tax)
- › Upon Settlor's death a revocable trust is requalified into irrevocable trust. Distributions to beneficiaries are treated as for irrevocable trust (see next slide)
- › Irrevocable trust : fixed interest vs discretionary

Tax treatment of Swiss resident beneficiaries

	Fixed interest	Discretionary
Definition	Irrevocable trusts where the beneficiaries entitlements are pre-determined in the sense that the beneficiaries listed in the trust deed have a fixed claim to the trust assets and benefits	<ul style="list-style-type: none"> Trusts in which the beneficiaries are not determined as such in the trust deed. The trustee has the power to determine the beneficiaries (sometimes with the consent of the protector). Beneficiaries have therefore only an expectative right on Trusts assets and income.
Income and net wealth tax	<ul style="list-style-type: none"> Distributions treated as taxable income, unless capital gain from private patrimony or initial capital is distributed (has to be demonstrated). The income is considered realized as soon as the beneficiary obtains a fixed claim to the trust income or at the time of effective distribution Initial capital can only be distributed after distribution of all trust income Beneficiaries subject to net wealth tax on their respective share of the trust assets. 	<ul style="list-style-type: none"> No wealth tax on assets allocated to the trust (expectative right). Beneficiaries are subject to income tax at the time of the effective distribution of the trust income. Initial capital reimbursement is exempted, but can only be distributed after distribution of all trust income Capital gain distribution ARE TREATED AS TAXABLE INCOME -> different treatment from fixed interest.
Gift and inheritance tax	<ul style="list-style-type: none"> The creation of an irrevocable fixed interest trust is subject to gift tax if the Settlor is Swiss resident Beneficiaries are taxpayer based on the cantonal law of residence of the Settlor 	<ul style="list-style-type: none"> Settlor in Switzerland at time of setup : <ul style="list-style-type: none"> Trust treated as revocable : no gift tax Upon death of Settlor trust becomes irrevocable : inheritance tax due at maximum rate (depending on cantons) Settlor abroad at time of setup : <ul style="list-style-type: none"> Gift made abroad. No gift tax in Switzerland Upon death of Settlor. No inheritance tax.



Differences with Foundations

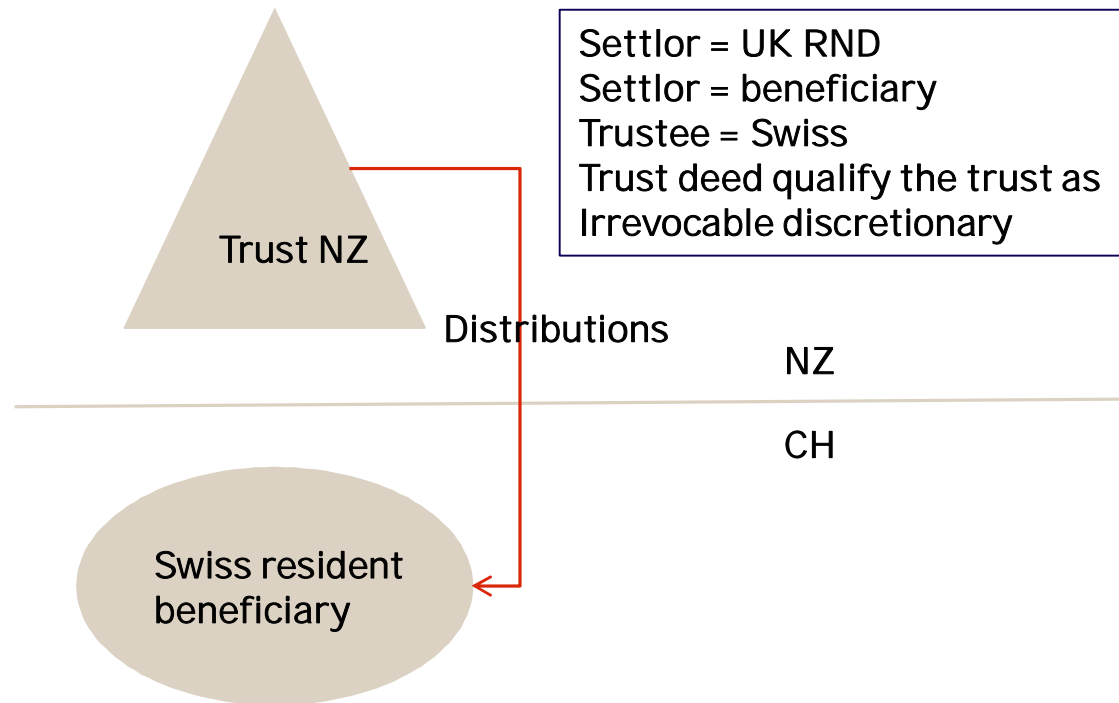
Foundations

- › Foundations are recognized entities in Swiss law (except some type of foundations (maintenance, «fideicommiss»))
- › As such, taxwise, they are treated as independent taxpayer and pay taxes on their profit and on their capital
- › Foreign foundations may be treated as Swiss foundations if they are effectively managed from Switzerland.
- › They may not be recognized from a tax point of view based on the abuse of law concept. In that case they are treated as transparent (same treatment as a revocable trust)
- › It is generally the case when the founder keep power on assets allocated to the foundation (similar definition as for trusts)
- › If foundation is recognized :
 - _ Contribution to the Foundation by a Swiss founder, subject to gift tax at maximum tax rate (difference with an irrevocable fixed interest trust)
 - _ Foundation profits and wealth are taxed as an independent taxpayer
 - _ Distributions to beneficiaries are treated as income and taxable in hand of beneficiaries (double taxation – difference with trusts)



Practical cases

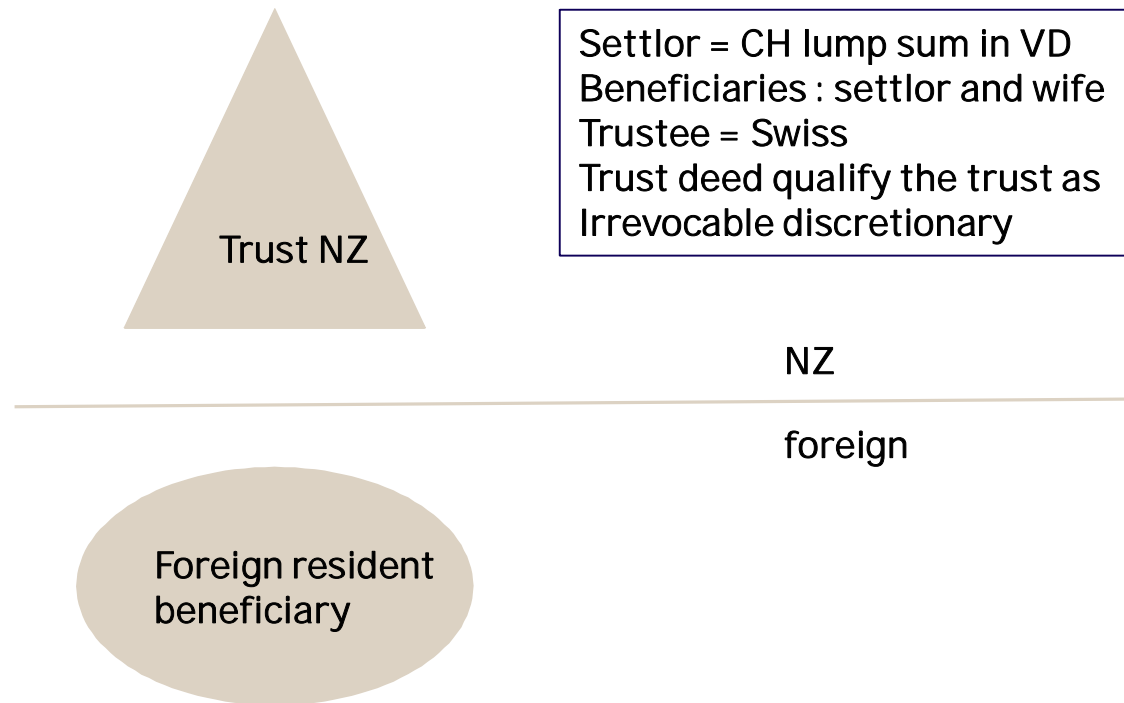
Practical case 1



Practical case 1

- › Tax treatment of distribution in Switzerland
 - _ Qualified for tax purposes as revocable trust
 - _ Distribution qualified as gift from settlor to the Swiss beneficiary. No Swiss gift tax. UK treatment ?
 - _ Distribution not spend on 31.12 is part of the wealth tax of the Swiss beneficiary.
 - _ Quid of regular distribution (monthly, quarterly....) might requalify the trust into fixed interest (irrevocable ???)
- › What if UK settlor resign as beneficiary ?
 - _ Requalified as irrevocable discretionary trust
 - _ Distribution subject to income tax unless initial capital distributed
 - _ Capital gain distributed is taxable
- › What if UK settlor dies ?
 - _ Requalified as irrevocable discretionary trust. Same treatment as above

Practical case 2



Practical case 2

- › Trust is treated as revocable trust.
 - _ No gift tax.
 - _ Because of lump sum, only Swiss assets and income subject to control calculation. Limited or no impact.
 - _ Distribution to foreign beneficiaries treated as gift and subject to gift taxes at cantonal rate.
- › Upon death of 1st beneficiary. No requalification into irrevocable trust as long as 2nd beneficiary survives (better treatment as if no trust in place)
- › Upon death of the 2nd beneficiary : requalification as irrevocable discretionary trust :
 - _ Inheritance tax at rate applicable to the potential beneficiary with the most distant degree of kinship.
 - _ Further distributions treated as income. Not taxable in Switzerland for foreign beneficiaries.

Practical case 3

Foundation
Liechtenstein

Founder = Swiss resident
(founded when resident
abroad)
Founder and wife are first
beneficiaries

Swiss beneficiaries

Practical case 3

- › Foundation probably not recognized based on the abuse of law concept.
Treated as transparent.
 - _ All income and assets are allocated to the Founder
 - _ Distribution to beneficiaries is subject to Swiss gift tax at rate depending on the degree of kinship
 - _ Upon death of the Founder and wife : Foundation should be recognized
 - _ Subject to inheritance tax at maximum tax rate (even if beneficiaries are exclusively direct descendent !!!)
 - _ Yearly income of the Foundation is taxed in Switzerland (if effective place of management) as well as wealth tax.
 - _ Distribution to Swiss beneficiaries is probably subject to income tax in hand of beneficiary

Practical case 3

- › What if Founder and wife where not beneficiaries ?
 - _ Foundation might be recognized as a separate entity.
 - _ Settled when founder abroad -> no Swiss gift tax
 - _ If Foundation is managed effectively abroad it will not be taxed in Switzerland
 - _ If Foundation is effectively managed from Switzerland : yearly profit and wealth of the Foundation is taxable base on the corporate tax law.
 - _ Distribution to Swiss beneficiaries is probably subject to income tax in hand of beneficiary

Practical case 3

Wealth CHF 10'000'000
 Annual income CHF 300'000

Consequences upon death of Settlor / Founder where beneficiaries are exclusively direct descendant resident in Switzerland, in Lausanne

	Revocable and discretionary trust		Foundation (taxable in Switzerland)	
Inheritance tax	= CHF 10'000'000 * 7%	CHF 700'000	= CHF 10'000'000 * 50 %	CHF 5'000'000
Taxes on income and capital due by the structure		0		CHF 118'000
Distribution of the annual income		CHF 124'500		CHF 124'500
Total after one year		CHF 824'500		CHF 5'242'500

Conclusion

- › Foundations are, from a tax point of view, less well treated than trust
- › This may create additional tax charge compared to similar trust structures, especially upon death of the Founders.
- › Because of complexity, it is advisable to get advance ruling.
- › Treatment may differ from one canton to another.



Questions ???

Contact

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