# Trusts in Swiss international taxation

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**Trusts and DTCs**

Switzerland has concluded double-tax conventions (DTCs) with some *common-law* jurisdictions, some of which expressly mention trusts and/or trustees. Nevertheless, there is a lack of an appropriate set of provisions in Swiss DTCs to deal with the complex issues of trusts and DTCs.

**Circulars No. 30 and No. 20**

The Swiss Tax Conference issued Circular No. 30 on 22 August 2007. It mainly outlines, by way of interpretation, the Swiss fiscal attribution rules in the field of direct taxes (DBG and StHG).

Furthermore, Circular No. 30 outlines the practice of the Federal Tax Administration (FTA) in respect of relief from Swiss federal withholding taxes (WHT) under to the Federal Act on the Federal Withholding Tax (VStG) by Swiss persons, who are subject to Swiss tax liability, and under DTCs by persons, who are resident in a foreign contracting state. It also outlines the practice of the FTA in respect of relief from foreign WHT under DTCs by Swiss resident persons. On 27 March 2008, the FTA has expressly noted by virtue of Circular No. 20 that the rules laid down in Circular No. 30 are also applicable for purposes of federal income and federal WHT.

**International double taxation of trust income**

If the trustee (or the trustees), the settlor and the beneficiary (or the beneficiaries) are not resident in the same state and the trustee *directly* derives income from a third state, trust income may be subject to source taxation in the foreign source state and, at the same time, to residence taxation in the residence state of the trust or the trustee. Furthermore, the foreign residence state may treat the forwarding of trust income as trust distributions that are subject to source taxation. Those forwarding may also be subject to residence taxation in the residence state of the beneficiary. Therefore, there is a significant risk that trust income is subject to international (economic) double or multiple taxation.

**Personal scope of DTCs**

Because a trust is not a "person" under Swiss law, the FTA takes the view that the provisions of Swiss DTCs cannot be applied uniformly to trusts. Furthermore, the FTA outlines that only some DTCs include specific provisions in respect of trusts according to which a trust is a "person" for treaty purposes. However, Switzerland should in general uniformly apply DTCs to trusts. As a rule, Switzerland has concluded its DTCs based on the OECD model. Furthermore, Switzerland recognizes a foreign trust according to the Hague Trust Convention.

**Residence of the trustee**

Circular No. 30 refers to Swiss private international law and derives therefrom that a foreign trust is not to be treated as a legal entity for purposes of *Swiss tax law.* This former approach, according to which the *common-law* trust was compared with a *civil-law* foundation, does no longer comply with the Hague Trust Convention. Swiss tax consequences must rather be based on the *legal relationships* created by the settlor.

In contrast to some *common-law* jurisdictions, Swiss tax law does not provide for specific provisions according to which a foreign trust or trustee is treated as a separate taxpayer. It is correct that the fiscal attribution rules of

Circular No. 30 attribute trust property and trust income in general either to the settlor or the beneficiary, but not to the trust itself or the trustee, also in the case of an irrevocable discretionary trust. For Swiss tax purposes, there is neither a contribution into nor a distribution out of the foreign trust. The trust has no legal capacity and, therefore, cannot own assets. Swiss tax terminology has to take account of this legal situation created by the settlor. The tax law of *common-law* jurisdictions, however, may treat the trust itself or the trustee as separate taxpayers, so that "trust distributions" may be assumed for tax purposes.

According to Circular No. 30, the principle of transparency applies for purposes of *Swiss direct taxes. De lege lata,* neither the trust itself nor the trustee may be subject to limited or unlimited tax liability in Switzerland on trust income. The question of place of effective management of the trust property does not arise in Swiss tax law. However, the question arises as to whether the administration of an offshore underlying company by a Swiss resident trust company, which is member of the board of directors (and which is also the trustee), is considered to be in Switzerland. It seems that according to the FTA's practice the place of effective management is considered to be abroad if the settlor and the beneficiaries are non-Swiss resident persons. The remuneration paid to the trustee is subject to Swiss individual or corporate income taxes if the trustee is a Swiss taxpayer.

**Personal attribution of trust income**

According to Para. 8.2 of Circular No. 30 regarding refund of Swiss WHT by a person resident in a contracting state (i.e. Switzerland is the source state), it seems that the FTA applies a contextual interpretation, if Switzerland is the source state. Thus, the contextual interpretation of treaty attribution rules for purposes of *Swiss WHT* is not based on the principle of fiscal transparency of Circular No. 30, if Switzerland is the source state.

If we assume that the trust was settled by a Swiss resident settlor and Switzerland applies a contextual interpretation, Switzerland may attribute Swiss sourced interest according to foreign tax law to the foreign trust or trustee for purposes of relief from Swiss WHT. Therefore the foreign trust or trustee may be entitled to relief from Swiss WHT under the DTC.

The question arises as to whether a contextual interpretation of treaty attribution rules may limit Switzerland's domestic rights to tax the settlor, who is subject to unlimited tax liability, or whether the Swiss *lex fori* attribution rules of Circular No. 30 are applicable for purposes of residence taxation. If Circular No. 30 was not applicable, the settlor would not be subject to tax on the trust income even though he is subject to unlimited tax liability in Switzerland. However, it seems that a contextual interpretation of treaty law does not limit the unilateral rights to tax its own residents and, therefore, international double taxation of trust income is not avoided in the case of an irrevocable discretionary trust settled by a Swiss resident settlor (double residence taxation).

According to Para. 8.3 of Circular No. 30, a residence certificate is only issued if the trust income is fiscally attributed according to Circular No. 30 to a Swiss resident person. In the case of an irrevocable discretionary trust that was settled by a non-Swiss resident settlor, the trust income is *not yet* fiscally attributed to the Swiss resident beneficiary. Accordingly it seems that the Swiss resident beneficiary will not receive a Swiss resident certificate and, thus, will not have access to the DTC. Conclusively, attribution conflicts between Switzerland as the residence state and the foreign sourced state may also lead to international double taxation of trust income.

Let's assume the irrevocable discretionary trust was settled by a Swiss resident settlor. In this case, trust income is attributed to the settlor and, thus, the settlor will receive a Swiss residence certificate. From a Swiss perspective, the Swiss resident settlor should be entitled to relief from WHT levied in the foreign source state according to DTC. International double taxation may still arise if the foreign source state attributes the interest income to the trust or the trustee (attribution conflict between the foreign sourced state and Switzerland as the residence state) or the residence state of the trust or the trustee attributes interest income to the trust or the trustee (double residence taxation).

**Beneficial ownership of trustee**

A trustee should be considered as beneficial owner of the trust income, if the trustee has the power to control the attribution of the trust income under *common law* and, thus, is neither an agent nor a nominee. Conclusively, a trustee is in general not to be considered as beneficial owner in the case of an irrevocable fixed interest trust or an irrevocable discretionary current trust. However, in the case of an irrevocable discretionary accumulation trust, the trustee should be considered as beneficial owner. It seems that the FTA treats a trustee as beneficial owner in the case of an irrevocable discretionary accumulation trust.

**Conclusions**

Attribution conflicts between Switzerland and foreign contracting states may lead to international double and multiple taxation of trust income. This unfavourable result may be avoided through international tax planning. According to the most basic principle, the foreign trust should not directly invest in foreign assets or only insofar as the foreign sourced income is not subject to foreign WHT. Therefore trusts often invest indirectly through underlying companies. However, an offshore underlying company raises questions in respect of place of residence and access to treaty networks.

A Swiss resident trustee has *de lege lata* – in contrast to trustees who are resident in specific *common-law* jurisdictions such as New Zealand – no access the Swiss treaty law and, thus, is entitled to relief neither from foreign WHT nor Swiss WHT. In the light of the increasing importance of onshore financial services, the lack of treaty access of a Swiss trustee might become a disadvantage in the international context.

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