

Introduction of Swiss trust – Tax changes

Private Clients



To satisfy the need in practice for a new flexible instrument for wealth structuring and estate planning, the Federal Council was instructed by the Parliament in 2018 to provide a legal basis for a Swiss trust. Draft legal provisions were released for public consultation on 12 January 2022. This will now run until 30 April 2022, after which the draft provisions will be discussed in Parliament.

It was anticipated that the Federal Council would take the opportunity in that context to address the tax treatment of trusts.

Current tax practice

The most critical tax issues to address from a tax point of view relate to the personal attribution of trust income and

assets as well as the fiscal qualification of distributions by the trustee. In essence, the current tax authorities' practice can be summarized as follows:

Revocable trusts: trust income and assets are attributable to the settlor for income and wealth tax purposes. This applies also to formally irrevocable trusts where the settlor can directly or indirectly exercise control over the trust. And it applies as well to irrevocable and discretionary trusts that are created by a Swiss resident settlor who is subject to ordinary tax.

Irrevocable fixed interest trust: in these circumstances, assets on trust are attributable to the beneficiaries from a wealth tax point of view.

Irrevocable and discretionary trust: subject to the above-mentioned exceptions, assets on trust are attributable to no one for tax purposes as long as the trustee does not decide a distribution in favor of one or several beneficiary/ies. This "loophole" is coherent with the fact that until such time, beneficiaries avail of no more than a mere expectancy over a possible distribution while the settlor effectively divested itself of the trust assets.

Distributions from irrevocable and discretionary trusts to Swiss resident beneficiaries: in principle subject to personal income tax, whereby the initial capital of the trust will be tax exempt and deemed to be distributed last (usually upon liquidation).

Tax treatment of trusts according to the draft provisions

One purpose of the draft provisions is precisely to close the above – mentioned loophole by ensuring that trust income and assets are in all circumstances attributable to a tax subject. The Federal Council was also keen on safeguarding the trust industry in Switzerland (the new provisions will not favor foreign trustees) and putting trusts on an equal footing with foundations.

Having this in mind, under the draft provisions, trust income and assets will be attributed to the following tax subjects:

- The settlor where he or she did not definitively renounce such assets and income** (revocable trust)
- The beneficiaries, to the extent that they are entitled to claim benefits out of the trust assets** (irrevocable fixed interest trust)
- The trust itself in all other** (irrevocable and discretionary trust)

Where a trust is regarded as irrevocable and discretionary, it may be subject to tax as a foundation on trust assets and income, provided a jurisdictional link to Switzerland exists. Such link may be established in the first place by reference to the tax residence of beneficiaries or, alternatively, of the settlor. More specifically, the trust would be subject to a worldwide tax liability, provided that at least one beneficiary is a tax resident of Switzerland. In these circumstances, the trust’s liability to tax would however be restricted to the portion of the trust assets of Swiss resident beneficiaries. And in case beneficiaries cannot be determined, the trust would be subject to tax on

all trust income and assets if the settlor is a Swiss tax resident during his lifetime or upon his demise.

One consequence of the characterization of an irrevocable and discretionary trust as a foundation is that all distributions to a Swiss resident beneficiary would be subject to income tax, including the initial capital of the trust. That is a significant difference compared to the current practice.

Beneficiaries and settlors of a trust who are Swiss tax residents would also be severally liable for the payment of income and wealth taxes due by the trust. Furthermore, trusts that were set up prior to the entry into force of the new provisions would, however, remain subject to the current tax practice, provided that the settlor does not place assets on trust after that date (grandfathering rule).

Take away

Taking advantage of the introduction of a “Swiss” trust to address the tax treatment of Swiss and foreign trusts in a comprehensive fashion is certainly welcome. And so is the objective of ensuring that Swiss based trustees are not put at a competitive disadvantage.



Overview

| | Revocable Trust (as before) | Irrevocable Fixed Interest Trust (as before) | Irrevocable Discretionary Trust (new) |
|----------------------------------|--|---|---|
| Establishment | No tax consequences, as the assets are still attributed to the settlor | Inheritance and gift taxes (depending on canton) | Inheritance and gift taxes (depending on canton) |
| Current income and assets | Income and wealth tax at the level of the settlor; capital gains are tax free | Income and wealth tax at the level of the beneficiary; capital gains are tax free | Corporate income and capital tax at the level of the trust (taxation like a Swiss foundation) |
| Trust distributions | To the settlor: no tax consequences. To beneficiaries: inheritance- or gift taxes (depending on canton) | No tax consequences, as already current income and assets are taxed at the level of the beneficiary | Income tax |

Yet, as they stand, the proposed rules raise a number of issues, such as:

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| <p>How will the portion of the trust assets and income be determined with a view to compute the extent of the liability to Swiss income and wealth taxes of an irrevocable and discretionary trust?</p> | <p>Can we assume that if a Swiss resident settlor who is subject to ordinary taxation sets up an irrevocable and discretionary trust, the Swiss tax authorities will recognize that he or she effectively divested from the trust assets if he or she effectively relinquished control?</p> | <p>May an irrevocable and discretionary trust the beneficiaries of which cannot be determined remain subject to tax in Switzerland if it was settled by a Swiss resident settlor once the latter moved to another jurisdiction? And in which circumstances would we consider that the beneficiaries cannot be determined?</p> | <p>Imposing income tax on the initial capital of the trust may be seen as inappropriate, particularly if the initial transfer by the settlor to the trustee triggered gift tax implications or inheritance.</p> | <p>To the extent that it is subject to tax as a foundation in Switzerland, would a trust be entitled to claim the application of double taxation treaties to avoid double taxation on the yield from foreign investments?</p> |

These and other issues will for sure be addressed in the context of the consultation phase. KPMG will participate to this debate and closely monitor forthcoming developments.

The content of the proposed provisions may of course change over time. It is also still unknown at this stage

when or even if they will at all enter into force. That said, they nonetheless give a hint of what the tax treatment of trusts could be in the near future. Families and their advisors are therefore well advised to assess the potential impact on existing or contemplated trust structures.

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