Switzerland: recent developments

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Collective investment schemes

Two years after the new collective investment schemes act (CISA) entered into force, the Federal Tax Administration has issued two circular letters with its interpretation of the new law for tax purposes, circular letter number 24, dated and in force January 1 2009 for withholding tax and stamp duty, and circular letter number 25, dated and in force March 5 2009, for direct taxes (income respectively profit taxes).

Confirmation of already existing practice

In general, the circular letters not only confirm the practice which has been developed during the past two years but increase the legal certainty and predictability of legal decisions. Although they do not constitute formal law, investors as well as the financial and the advisory industry now have much clearer indications with regard to possible tax consequences of certain fund structures. However, there are still open issues and continuing discussions on certain topics, such as the qualification of fund structures for participation relief or the reclaim of Swiss withholding tax.

In particular, investment companies with variable capital (SICAVs), limited partnerships for collective capital investments (LPCCIs) and common contractual funds (FCPs) are treated equally for direct tax as well as for withholding tax and stamp duty purposes, whereas the closed-ended investment companies with fixed capital (SICAFs) are treated differently, namely as common limited companies.

An exception has to be made for collective investment schemes investing directly in real estate in Switzerland. Their profit arising from the real estate (either capital gain or rent) located in Switzerland is taxed separately from any other income but at reduced rates.

Direct taxes - transparency

According to circular letter number 25, all the SICAVs, LPCCIs and FCPs are treated as transparent for Swiss income tax purposes, as long as they do not invest in Swiss real estate. Therefore, such vehicles are not subject to income tax and the income realised is attributed directly to the investors. This principle generally applies irrespective of whether a Swiss or a foreign collective investment scheme is affected.

It should be noted that these principles apply both for distributing as well as for accumulating funds. With regard to accumulating funds, according to circular letter number 25, special booking requirements apply to non-private investors.

Especially in cases, where the investors are tax exempt (such as pension funds), the transparent treatment of a collective investment scheme is very advantageous.

Fund-of-funds structures

According to circular letter number 25 and the generally transparent treatment of all levels of a Swiss fund-of-funds-structure, the income of any target fund will be taxed only at the level of the master fund, provided the master fund is a qualifying collective investment scheme (SICAV, LPCCI or FCP), the net income of the target funds does not exceed 2% of its net asset value (any other income is derived from capital gains) and the master fund can provide a summary of any assets in the target funds annually. If these conditions are met, the master fund is allowed to book the whole revenue as capital gain (which is tax free for Swiss resident private investors).

As regards foreign fund-of funds structures where investments are usually made in a master fund via a feeder fund structure, the feeder structure as well as the master fund are treated fully transparent. The taxable income is determined based on the audited annual financial statement of the target fund which is in accordance with a recognised GAAP standard even in case the target fund itself consists of a fund-of-share-funds structure. There are some further conditions which have to be met, but broadly, the taxable income on the level of the feeder fund can be determined based on the aggregated income of feeder fund, master fund and target fund minus deductible expenses. Circular letter number 25 provides in its attachment a sample reporting of such structures.

Withholding tax and double tax treaties

Dividends derived from units in a collective investment scheme are subject to Swiss withholding tax if the issuer of these units is a collective investment scheme with registered office or principal centre of management in Switzerland, or if the issuer is a foreign collective investment scheme and the collective investment units are issued together with a Swiss resident, for example a Swiss depositary bank. Thus, any income distributed by such collective investment scheme, unless it has been generated from separately distributed capital gains, is subject to Swiss withholding tax at 35%. According to circular letter number 24, such withholding tax will be imposed and has to be delivered to the Federal Tax Administration both by distributing as well as by accumulating funds at the time of distribution respectively allocation of the income to the investors.

If the only investors of a Swiss collective investment scheme are tax exempt Swiss pension funds, a notification procedure can be applied to the income distributed by the Swiss collective investment scheme instead of levying withholding tax. Accordingly, income distributed by or accumulated within a Swiss collective investment scheme in favour of the Swiss pension funds should not be reduced by the withholding tax, which is a cash flow benefit.

The Federal Tax Administration recently came to the conclusion that in analogy to the above, also a foreign collective investment scheme is intransparent for Swiss withholding tax purposes. This (new) practice, which is unfortunately not mentioned in circular letter number 24, makes it very difficult, not to say impossible, for Swiss investors investing into Swiss securities via a foreign collective investment scheme. Whereas a Swiss collective investment scheme is entitled to reclaim withholding tax on dividends paid by a Swiss company to the collective investment scheme in its own name, there is no such provision for foreign collective investment schemes. Furthermore, since the transparent treatment of the collective investment scheme is denied for Swiss withholding tax purposes, the Swiss investors are not recognised as direct holders of the respective securities. As a consequence, nobody is entitled to reclaim the withholding tax, neither the foreign fund itself (unless a double tax treaty would apply; see below), nor the Swiss investors themselves. In fact, there is a tax burden of 35% even for investors, such as Swiss pension funds, which are tax exempt for direct taxes. As a result, Swiss investors will be forced to pool their investments into Swiss securities via Swiss collective investment schemes instead of foreign structures.

As with regards to the applicability of double tax treaties, the situation can be different compared to what was said before:

Whether a foreign collective investment scheme has to be treated transparent or not is subject to the respective double tax treaty. If, for treaty purposes, such vehicle is transparent, then the investors should be entitled to reclaim withholding tax imposed in the other state, since they are treated as if they would hold the investment directly. The question of transparency is in practice, however, not always easy to decide.

Some treaties, such as for example the double tax treaty between Switzerland and the US, provide the right to reclaim withholding tax even in case of non-transparency. Under the said treaty, a US limited partnership is entitled to reclaim 20% Swiss withholding tax deducted, since it is deemed to be a resident in the US to the extent that the income derived by the partnership is subject to tax in the US in the same manner as the income of a US resident, either in its hands or in the hands of its partners. This would mean that US resident investors, investing through a US limited partnership into Swiss securities, should be entitled to reclaim Swiss withholding tax that has been deducted on income taxed in the US and vice versa.

Furthermore, foreign collective investment schemes, which obtained in the past a tax ruling from the Federal Tax Administration confirming that they are treated transparent for Swiss withholding tax purposes, may, on an exceptional basis, be able to retain that status, at least for withholding tax deducted up to the year 2008. Swiss investors in such foreign collective investment schemes should, therefore, be entitled to reclaim Swiss withholding tax, provided they have declared (private investors) respectively duly booked (non-private investors) the respective income. With regard to accumulating funds, the question has come up, what duly booked means: although the Federal Tax Administration has not given a specific answer to this question, it appears that they would expect more than just the movement in net asset value at year end despite some contrary regulatory requirements. However, discussions with regards to this issue are still pending.

Circular letter number 24 contains in its attachment a list of double tax treaties which allow the applicability of the treaty also for collective investment schemes. Furthermore, among others, the circular letter number 24 contains a decision tree in order to determine whether a foreign structure is to be treated as a collective investment scheme, to which the respective legislation and practice apply.

Issuance stamp duty and securities transfer tax

The issuance of units of a Swiss or foreign collective investment scheme regulated by CISA is not subject to the Swiss issuance stamp duty. However, the issuance of units of a foreign collective investment scheme is subject to Swiss securities transfer tax at a rate of 0.3%, whereas the issuance of units of a Swiss collective investment scheme is exempt.

Furthermore, the contribution in kind of taxable securities (such as shares) in return for units of a Swiss or foreign collective investment scheme regulated by CISA is also tax exempt.

Through smart structuring, a Swiss investor, such as a pension fund, may achieve the full tax exemption of the transfer and sale of its securities. For institutional investors pooling their assets these annual savings can have a significant impact on the return on investment. Such structuring is, however, always set under the condition that it does not constitute tax evasion and requires careful planning and advice.

VAT

VAT is not subject of the circular letters numbers 24 and 25. However, according to the Swiss VAT law and the respective practice of the Federal Tax Administration, the place of performance of custody services rendered to a Swiss collective investment scheme is Switzerland. Therefore, generally, such services are regulated by Swiss VAT law. Under the respective legal provisions, such custody services rendered to a collective investment scheme according to CISA are VAT exempt (unless rendered to a SICAF). Also VAT exempt are most fund management and distribution services rendered by third parties to the fund manager or custodian.

Although the new circular letters contain many other single issues, conditions, and provisions, the following can be stated: From a Swiss investor's tax perspective, the use of a Swiss collective investment scheme appears more advantageous than of a foreign one, in particular, if investments in Swiss securities should be made. In case Swiss investors decide to invest through a foreign vehicle, they should avoid investing into Swiss securities, subject to Swiss withholding tax. It is questionable whether this result was the intention of the legislator, since, in effect, the Swiss investors are limited by choosing their investment vehicle and are worse off than foreign investors which under certain circumstances would be entitled to claim Swiss withholding tax based on a particular double tax treaty.

Information exchange

In the past, Switzerland made a reservation to article 26 of the OECD model tax convention and consequently granted exchange of information to the extent the information was necessary for carrying out the provisions of the given treaty. It has been Switzerland's view that the purpose of the information exchange should not be the enforcement of the domestic tax law of other states. Accordingly, information could exclusively be exchanged in order to avoid double taxation or an abuse of the double tax treaty and only upon specific request. The scope of the information exchange is limited to the taxes regulated in the respective treaty. Some (limited) exceptions apply in the treaties with Germany, Norway, France and the US in which exchange of information in cases of tax fraud is granted. Furthermore, under the agreement regarding taxation of interest savings concluded with the EU, Switzerland agreed to conclude agreements on exchange of information in case of tax fraud and the like. Since then such agreements have been concluded with numerous EU countries.

The restricted information exchange policy results, among others, from the banking secrecy, which is guaranteed by Swiss law and which protects the private sphere of bank customers as long as they are not involved in criminal actions. The Swiss authorities have the right to obtain bank information for the purpose of prosecuting criminal offences, including tax fraud but not simple tax evasion. Such information may also be forwarded to other states in the context of mutual assistance in legal matters or through the process of administrative assistance in the case of the USA.

New developments

In the forefront to the G-20 meeting of April 2009 the international pressure on so-called tax havens grew immensely and, similarly to other countries knowing banking secrecy (Singapore, Luxembourg, Austria, Liechtenstein), the Swiss Federal Council announced on March 13 2009 that Switzerland is about to change its information exchange policy and is willing to adopt the OECD standard on administrative assistance in tax matters in order to fully comply with article 26 of the OECD model tax convention.

By adopting this new policy, Switzerland will also assist enforcement of foreign domestic tax law and will, therefore, waive banking secrecy not only in cases of tax fraud but also in cases of tax evasion. This declaration prevented Switzerland from being included on the so-called black list. Instead, Switzerland forms part of the so-called grey list.

The Swiss Federal Council published the following parameters for broadening the scope of information exchange:

- Respect for established administrative assistance procedures;
- Information exchange upon request only;
- Restriction of administrative assistance to individual cases (no fishing expeditions);
- Fair transitional solutions;
- Limitation to taxes covered by the OECD model tax convention;
- The principle of subsidiarity in accordance with the OECD model tax convention;
- Willingness to eliminate discrimination.

Furthermore, the Swiss Federal Council demands improved market access for international financial services and equal treatment with regard to the supply and quality of information compared to other countries on the OECD list.

With this decision, an extended information exchange will be granted only in individual cases where a justified request has been made. This approach consequently should exclude abstract requests that would for instance concern several cases based on a similar fact pattern. Similarly, no information would be exchanged without any specific request (such as upon discretion of a domestic tax authority in connection with a current domestic proceeding or prosecution). Hence, the information exchange request has to be based on a precise, individual tax case or a group of specific individual tax cases. These parameters comply with the requirements set out by the OECD and G-20. An automatic information exchange is being clearly rejected.

A domestic tax or banking secrecy will no longer be considered a reason to reject a request for information. The Swiss banking secrecy remains nevertheless intact as Switzerland rejects any form of automatic exchange of information. The privacy of customers should still be protected from unauthorised access to information concerning private assets.

This modification will have no effect at the Swiss national tax law level. The situation for taxpayers resident in Switzerland as well as the (limited) right of the Swiss tax authorities to access bank data under Swiss domestic law remains unchanged.

Implications

Given the criterion formulated by G-20, Switzerland intends to renegotiate at least 12 double tax treaties with a view to including an exchange of information clause by the end of 2009 in order to be moved from the grey list to the white list. Since Switzerland made a concession with regard to the exchange of information, it is expected that the counterparties should in turn grant some benefits (for example lower residual withholding tax rates) in the newly negotiated treaties, based on the fact that these benefits were previously denied, because of the limited information exchange granted by Switzerland.

The European Commission presented a solution of a central European agreement regarding information exchange with Switzerland that could replace negotiating double tax treaties with every single EU member state. However, the proposal has been rejected by Switzerland as it would not allow for using the opportunity of negotiating advantageous conditions with each counterparty, and thus re-balancing the interests of both states in the treaty.

As of June 12 2009, four revised double tax treaties have been initialled – with Denmark, Norway, France and another, as yet undisclosed, country. The contents of the revised treaties have not been made public yet. In addition, treaties with the USA, Japan and Poland are being negotiated. Altogether, 23 treaties should be renegotiated in the near future, including treaties with Argentina, Belgium, Brazil, Germany, France and the UK. It is expected that the negotiations of the first several treaties with important partners (such as USA, Germany and the UK) will be more time consuming and that the process of revising subsequent treaties will be faster.

While the details of the new revised treaties are not known, given that one of the parameters formulated by the Swiss Federal Council is a fair transitional solution, it would be desirable if the revisions would allow for a relatively smooth transition from the restricted to a more relaxed exchange of information regime.

Considering the procedure for ratification of international treaties, it is to be expected that the first double tax treaty with revised provisions will be subject to public vote, in other words, the first sample double tax treaty will need to be accepted in a referendum.

At the same time, Switzerland is working on the expansion of its network of over 70 treaties. Talks with Saudi Arabia and the UAE are planned.