You can't run forever – Tax Reporting and Disclosure in Switzerland

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A Introduction

This paper shall outline the basic principles of Swiss income and net worth taxation as well as inheritance and gift taxation and summarize the reporting and filing obligations of individuals, banks, trustees, beneficiaries, lawyers and tax advisers. Furthermore, the basic principles regarding fiscal offenses and the effects of self-incrimination will be addressed.

1 Constitutional Basis

The Swiss Confederation is a federal state which is divided into 26 "sovereign" cantons. Each canton is sub-divided into political communes with political autonomy in a range of local matters. The Federal Constitution gives each of the Federal Government, the cantons and the communes the right to impose income and net worth taxes and to enact legislation in that regard. Indeed, income taxes are imposed at the federal as well as at the cantonal/communal level, while net worth taxes are only imposed by the cantons and communes based on cantonal law. A special federal law provides for harmonization between the federal and the cantonal tax codes as far as provisions relating to the determination of taxable income and net worth and certain procedural rules are concerned ("formal" tax harmonization). However, the tax harmonization does not extend to the effective computation of the tax liability (tax rates, amount of tax-free allowances, etc.), which is left to the autonomy of the cantons. As a result, the effective tax burden varies considerably among the cantons, and within the cantons even between the communes. Authority to raise inheritance and gift taxes lies exclusively with the cantons and communes; the Federal Government has no such authority.

2 Scope of Direct Taxes

Individuals resident in Switzerland are in principle subject to unlimited Swiss taxation on their worldwide income as on their worldwide net worth, except for income and net worth pertaining to foreign permanent business establishments and foreign real estate. Further limitations on the Swiss taxing authority may

arise under international double taxation treaties applicable to the taxpayer. Generally, Switzerland applies the "exemption with progression" method in regard to income and net worth pertaining to foreign real estate and foreign permanent establishments, even in the absence of a tax treaty. Since under this method, the overall net income and net worth are determining the applicable Swiss income and net worth tax rates, Swiss taxpayers have to declare all their worldwide assets and income regardless of whether those foreign factors will ultimately be taxed in Switzerland.

3 Procedures

3.1 Scope of Self-Assessment

Individuals are subject to a tax assessment procedure in Switzerland, which may be described as a mix between individual self-assessment and tax assessment ex officio. The process is initiated by the taxpayers who are under an obligation to annually file complete and signed tax returns including all necessary supplementary documentation. As a rule, income and net worth taxes are preliminarily collected by the local tax authorities based on the declarations made by the taxpayer. Later on, a tax inspector will review the declarations and eventually issue a tax assessment order (in some cases after requiring further information from the taxpayer).

3.2 Withholding Taxes

The scope of withholding taxes is rather limited in Switzerland; tax withholding at source mainly applies to dividends paid on Swiss shares and interest paid on Swiss bank accounts and on bonds and debentures. Salaries and wages are not normally subject to any withholding taxes, unless the employee is a foreigner not holding a permanent residence permit.

3.3 Certification Duties of Third Parties

The scope of certification duties of third parties is also rather limited. It mainly pertains to Swiss companies in relation to dividends paid, as well as Swiss banks in regard to interest paid on bank accounts and Swiss resident debtors in regard to interest paid on bonds and notes, as well as Swiss based employers who have to issue salary certificates to their employees working in Switzerland.

B Reporting Requirements under Swiss Tax Law

I Tax Status of Individuals

1 Direct Taxes on Income and Net Worth

1.1 Principle of Residence-Based Taxation

As a rule, individuals are subject to unlimited Swiss taxation of their worldwide net income and net worth if their tax domicile or tax residence is in Switzerland. At the moment, Switzerland is still applying the concept of "family taxation", meaning that income and net worth of married couples and their minor children, if any, are added together and taxed as one unit.

Thus, similar to many other jurisdictions, the concept of "tax domicile" or "residence" is fundamental for the determination of an individual's tax liability and the scope of taxation. Switzerland does not tax individuals based on their nationality. The tax domicile or residence of an individual is generally created when the person takes up domicile in Switzerland with the intent stay permanently, or when the habitual abode is in Switzerland. Moreover, a person moving from abroad to Switzerland becomes resident for Swiss tax purposes is deemed to have a tax residence in Switzerland as soon as, notwithstanding any temporary interruptions, the person stays in Switzerland at least 90 days. A person moving to Switzerland in order to carry out a gainful activity becomes resident for tax purposes already after 30 days staying in the country (regardless of any short-term interruptions). The Swiss tax residence definition may be over-ruled in part whenever a Swiss international double taxation treaty is applicable to the individual in question.

1.2 Scope of Taxation of Residents

Once the Swiss tax residence is established, the individual's Swiss tax liability is "unlimited". The tax liability extends to the worldwide net income (federal and cantonal/communal taxes) as well as the worldwide net worth (cantonal/communal taxes only). Income and net worth pertaining to real estate and permanent business establishments situated abroad is generally exempt from Swiss taxes (however, subject to declaration duties due to the "exemption with progression" system).

Swiss income tax laws usually contain a general clause according to which all (net) income from whatever sources is taxable. That includes any earned income from employment or investment, pension income, the rental value of owner-occupied houses etc. A significant exception pertains to capital gains realised on privately held movable assets such as securities, commodities, objects of art etc., unless the gain may be considered to have arisen in the context of a (quasi) pro-

fessional or commercial activity. Such kind of private capital gains is not taxable and the corresponding capital losses are not deductible for income tax purposes.

Under certain conditions, resident individuals may opt for a special taxation regime, under which their taxable income and net worth is calculated by reference to their family's private living expenses ("lump-sum" or "forfait" regime). Such option is mainly available to foreign nationals who enter Switzerland for the first time or after an absence from the country of at least ten years, provided that they do not perform any gainful activity in Switzerland.

1.3 Net Worth Taxes

In addition to income taxes, Swiss resident taxpayers are subject to annual net worth taxes at the cantonal/communal level (not at the federal level). The basis of the net worth tax corresponds to the taxpayer's net assets (movable and immovable property after deduction of debts) with certain exceptions (personal effects and household goods, foreign real estate and foreign permanent establishment property). Non-monetary assets are generally taken into account at their market value.

1.4 Exclusions

Notwithstanding the above, exposure to Swiss income and wealth taxes do not extend to assets invested in, or to income derived from, business, permanent establishments or real estate located abroad. Such assets and income are only relevant for the purpose of calculation of the applicable tax rates (exemption with progression). Some of the Swiss international double taxation treaties (there are about 70 treaties in total) also cover net worth taxes and may hence impose some limits on the Swiss taxing authority.

1.5 Reporting and Filing Duties

Income and net worth taxes are declared and collected on a yearly basis. The cantonal tax authorities administer both the federal and the cantonal/communal taxes. Taxpayers generally have to submit a tax return every year within a deadline, which is usually by March 31 but may be extended upon request. The tax return has to reflect all worldwide income and assets (including assets that don't generate any income to the taxpayer), even if certain foreign items may be exempt from tax. The tax return will include certain supporting documentation - in particular, for evidencing deductions from income or net worth claimed, but also wage certificates, bank account and deposit statements and the like.

1.6 Certification Duty of Third Persons

Swiss tax laws provide for limited certification duties of third parties. According to art. 127 of the Federal Act on Direct Taxes (“FTA”) and the corresponding provi-

sions of the cantonal tax laws, the following persons are required to issue written certificates to the taxpayer:

a) employers, with respect to their payments of salaries, bonuses etc. to employees;

b) creditors and debtors, with respect to the corresponding debts and interest (if any);

c) insurance companies, with regard to premiums received from the taxpayer, as well as payments of benefits and settlement of taxpayer's claims;

d) third persons who have or had possession of or management control over assets of the taxpayer, with respect to these assets and the profits thereon;

e) persons who are engaged in business transactions with the taxpayer, with respect to the corresponding mutual claims and payments.

These duties can only be imposed on third parties who are themselves resident for Swiss tax purposes. The procedural obligation to submit the required certificates is primarily on the taxpayer. Only when the taxpayer fails to submit such certificates with the tax return, the tax authorities may demand these directly from the relevant third parties. However, legally protected professional secrecies (such as banking secrecy and attorney's secrecy) generally take precedence. The tax authorities do not often use their right to ask certifications regarding the taxpayer from third parties. When they consider the information and supporting documentation furnished by the taxpayer to be incomplete or not conclusive, they would normally rather proceed to a tax assessment based on estimates according to their "best discretion".

2 Inheritance and Gift Taxes

2.1 Taxing Authority

The Federal Government currently has no competence to levy inheritance or gift taxes. These taxes are the domain of cantonal (and in some cases, also communal) laws. Currently all Swiss cantons, with the exception of the canton of Schwyz, levy inheritance and/or gift taxes. Unlimited liability to inheritance or gift taxes generally arises in the canton where the deceased person had his or her last domicile, or where the donor is domicile at the time of the gift. Limited liability to inheritance or gift taxes generally arises in the event of a gratuitous transfer of immovable property situated in the relevant canton, when the decedent or donor is not domiciled in such canton. A few cantons also provide for a limited inheritance or gift tax liability in respect of certain movable assets situated within the canton where the transferor is not resident in such canton. The place of tax residence of the beneficiaries of gratuitous transfers of movable or immovable property is generally irrelevant for the tax liability. Limitations of the cantonal

taxing authority may arise under applicable Swiss international inheritance tax treaties.

2.2 Reporting and Filing Duties, Procedures

The provisions governing the assessment procedure in regard to inheritance and gift taxes vary from canton to canton. Generally, the procedure combines elements of self-assessment with elements of tax assessment *ex officio*. In the case of inheritance taxes, the tax calculation of the tax liability is usually based upon an inventory of the decedent's estate for inheritance tax purposes, which is either drawn up by the executor or administrator of the decedent's will or by the competent tax authority at the decedent's last domicile. In many cantons the heirs or beneficiaries (or the executor/administrator) are required to file an inheritance tax return and/or an inventory of the estate's assets and liabilities.

The liability for gift taxes generally arises with the execution of the gift. Swiss gift tax provisions generally define the donee or beneficiary as the person liable for the gift tax (irrespective of the place of tax residence of the donee). Some cantonal laws provide for a subsidiary joint liability of the donor for the gift tax. Gift taxes are essentially imposed based on self-assessment, whereby the beneficiary of a taxable gift files a gift tax return within the deadline specified by cantonal law.

3 Fiscal Offenses and Sanctions

In the area of combating fiscal offenses in Switzerland, the distinction between the basic offense of tax evasion and the qualified form of tax evasion referred to as "tax fraud" (or "fiscal fraud" in the area of indirect taxes) is fundamental.

3.1 Tax Evasion

Generally, Swiss direct tax laws describe the "simple" evasion of taxes technically as a somewhat minor offense only ("*Übertretung*"). The sanction for "simple" tax evasion is a fine ("penal tax") of maximum three times the amount of evaded tax in serious cases; the "standard" fine being one time the evaded tax. Simple under-declaration of taxable assets or revenues by the taxpayer generally constitutes a tax evasion, but not a tax fraud (see below). Although nowadays the procedure for the imposition of tax fines for tax evasion is considered a criminal proceeding to be conducted by an authority separate from the tax inspector, it is still not a criminal proceeding governed by the federal Penal Code.

3.2 Tax Fraud

Only the qualified form of tax evasion ("tax fraud") is defined as a "real" criminal offense ("*Vergehen*"), which may be punished either with a fine of up to CHF 30,000 or imprisonment for up to three years. Tax fraud is qualified by the element that the taxpayer, for the purpose of evading direct taxes, uses false or

falsified or untrue qualified documents such as business books and records, financial statements, wage certificates and other certifications by third parties in order to deceive the fiscal authorities. In the area of indirect taxes, the essential notion is "fiscal fraud" ("*Abgabebetrug*"). The notion of "fiscal fraud" is somewhat wider in as much as it may be committed not only by the use of false documents in order to evade taxes, but also by any other fraudulent behavior ("*Arglist*") designed to deceive the tax authorities and to hide taxable revenues or assets.

Tax fraud is dealt with in ordinary criminal proceedings, investigated by a criminal prosecutor and sanctioned by a criminal court. The criminal authorities have more far-reaching powers to collect evidence than the tax authorities in a mere tax evasion proceeding. In particular, the criminal authorities may ask banks to lift the banking secrecy and submit bank information needed for a conviction for tax fraud.

II The Position of Tax Authorities

1 In General

The tax laws contain detailed provisions regarding the rights and duties of the tax authorities towards the tax subjects. Such rules concern areas such as personal conflicts of interests of tax authority agents, confidentiality obligations, administrative assistance and information duties among (domestic) tax authorities and with other domestic state agencies, data protection etc.

2 Administrative Assistance in Tax Matters

2.1 National Context

In the purely domestic context, all Swiss federal, cantonal and local tax authorities are required to assist each other and, spontaneously or upon request, to exchange all information considered necessary to warrant a correct and complete assessment of taxes upon the taxpayer. Moreover, other state agencies are obliged, upon request by the tax authorities (or even spontaneously, if they have reason to believe that a tax assessment is incomplete), to render such information to the tax authorities. However, the tax laws provide for a carve-out from the information duty in favor of the executive bodies of the Swiss Post and state-owned banks in relation to any information that is subject to legal confidentiality (secrecy) requirements (in particular, postal and banking secrecy).

2.2 International Context

Generally, the Swiss international double taxation treaties only provide for cross-border exchange of information, if such information is needed for the proper application of the tax treaty itself (excluding mere enforcement of national tax laws). Thus, the scope of information exchange is generally narrower than pro-

vided in article 26 of the OECD Model Tax Convention. However, in recent years Switzerland has come under increasing international pressure to open up its restrictive approach to sharing taxpayer information with foreign tax authorities, which has led to amendments of some of Switzerland's tax treaties.

a) Swiss-US Income Tax Treaty

The revised income tax treaty with the U.S. of 1996 provides that both contracting states may exchange information necessary for the correct implementation of the provisions of the treaty, *or to prevent tax fraud and the like* in relation to taxes which are subject to the convention. The notion "tax fraud and the like" required further clarification. A Memorandum of Understanding between the IRS and the Swiss Federal Tax Administration (dated January 23, 2003) clarifies that Switzerland in certain situations will provide administrative assistance to the IRS even where it could not provide the same level of assistance (i.e. in particular submission of bank records) in a purely domestic case, if the tax offense asserted by the US Administration amounts to the same degree of illegality as the Swiss concept of "tax fraud".

b) Swiss-German Income Tax Treaty

The recent revision of the Swiss-German Tax Treaty provides for the exchange of information not only for the proper application of the treaty, but also for the mere enforcement of national tax laws in the event of fraudulent tax offenses. A "fraudulent offense" generally refers to fraudulent behavior of the taxpayer, which under the tax laws of both contracting states is exposed to a punishment by imprisonment.

c) Switzerland-EU Savings Tax Treaty

In the context of the Savings Tax Convention between Switzerland and the European Union and its member states, Switzerland has agreed to a "memorandum of understanding", whereby it committed itself to agree to amend the Swiss tax treaties with EU member states to include the exchange of information for the enforcement of national tax laws in all cases of "tax fraud and the like". Some of these bilateral tax treaty amendments have already occurred, while others are in the course of being implemented.

III The Position of Banks

1 Swiss Banking Secrecy in General

The legally protected Swiss banking secrecy protects the account information of bank clients against access by, or disclosure to, third parties including state agencies. The breakage of the banking secrecy (which in reality is a legally protected entitlement of the bank customer to confidentiality regarding his/her as-

sets kept or managed by the bank, including the fact of the bank-customer relationship as such) by officers, employees or agents of the bank does not only amount to a breach of the contract between the bank and its (even only prospective) customer, but in addition constitutes a criminal offense.

The existence of "numbered Swiss bank accounts" is partly a myth. While such "numbered accounts" do in fact exist, this only means that the customer identity and further customer data are only accessible by a small circle of senior bank officers. Notwithstanding the banking secrecy, banks in Switzerland are subject to very strict "know-your customer" and anti-money-laundering regulations. Any Swiss or foreign customer of a Swiss bank must provide detailed information to the bank, which does not only include personal data, but also extends to the sources of the funds the customer wishes to deposit with the bank. The banks are subject to detailed verification obligations. A "numbered account" does not provide any additional protection to the bank client behind the account in the event of a legitimate "lifting order" by a criminal prosecutor or court.

2 Lifting the Secrecy

However, the Swiss banking secrecy is in no way absolute. Swiss criminal prosecutors and courts may issue a "lifting order" against the bank in the course of a domestic or international investigation into a criminal offense (punishable with a jail sentence). Lifting orders may also be issued in the context of an international judicial assistance in criminal matters procedure, based on the relevant Federal Act and/or applicable international conventions. The law enforcement agencies of foreign states may be granted judicial assistance in particular in the context of criminal investigations into acts of terrorist financing, money laundering, insider trading, and tax fraud.

As mentioned earlier, the simple under-declaration of taxable assets or revenues by the taxpayer qualifies as tax evasion, but not as tax fraud under Swiss law. Sanctions for "simple" tax evasion normally only include fines (tax penalties). Although nowadays tax evasion proceedings are considered criminal proceedings (with consequences for procedural guarantees in the taxpayer's favor), such proceedings are not within the scope of the federal Penal Code. They are handled by special departments within the tax authorities. These authorities cannot issue any "lifting orders". Such right is reserved to criminal prosecutors and criminal courts in proceedings for offenses threatened with a jail sentence, such as tax fraud or fiscal fraud. The prosecutor or criminal court handling a fraudulent tax offense may demand the bank to submit customer information, account statements etc.

3 Bank Secrecy and Judicial Assistance in Criminal Matters

Generally, Switzerland may render judicial assistance in civil and criminal matters to judicial law enforcement agencies of foreign states. However, the scope of Swiss judicial assistance in criminal matters is restricted in certain areas of criminal law, such as political crimes and fiscal offenses. As a general rule, Switzerland

does not grant any judicial (or even administrative) assistance in fiscal matters, unless the fiscal offense giving rise to the foreign judicial authority's request for assistance is of a nature that would qualify it as a "tax fraud" or "fiscal fraud" under the relevant Swiss tax laws. In such a judicial assistance proceeding, the bank may be asked to render information, to supply bank records etc.

4 The Switzerland-EU Treaty on Savings Taxation

Switzerland and the European Union concluded an agreement on taxation of savings income of EU resident individuals under form of in form of interest. The Savings Tax Treaty complements the corresponding EU Directive and entered into force on 1 July 2005. The treaty applies to payments or credits of interest originating from non-Swiss resident debtors by Swiss banks and other Swiss based intermediaries or paying agents to individual beneficiaries, who may reside in any EU Member State. The Savings Tax Treaty is designed to support and complement the corresponding EU Directive, in order to prevent the circumvention of the effects of the Directive by channeling cross-border interest payments for the benefit of to EU resident individuals through banks or other intermediaries in Switzerland, who are outside the scope of application of the Directive.

Switzerland is not a participant to the system of mutual exchange of banking information as applied by a majority of the EU Member States (however, currently excluding Austria, Belgium and Luxembourg who apply a withholding tax system instead) in regard to cross-border savings interest payments. In the Savings Tax Treaty, Switzerland has agreed to implement a system of tax retention ("*EU Steuerrückbehalt*") in regard to interest originating from non-Swiss sources (interest from Swiss sources being subject to 35% Swiss federal withholding tax, if the interest pertains to a Swiss bank account or a bond or debenture issued by a Swiss resident issuer) and paid or credited by a Swiss bank or other Swiss based intermediary (e.g., an asset manager, lawyer or trustee) for the benefit of an individual resident in any EU Member State.

During the first three years of operation of the Savings Tax Treaty (i.e. until 30 June 2008) the "EU tax retention" amounts to 15% of the gross amount of interest paid or credited. The retention rate will be raised to 20% for the subsequent three years (until 30 June 2011), and to 35% thereafter. The EU resident individual beneficiary may choose to instruct the Swiss bank or intermediary to replace the tax retention by direct reporting of the interest payments to the competent foreign tax authority of the individual's tax home within the EU.

The system agreed in the Savings Tax Treaty with the EU has thus far helped Switzerland to safeguard its banking secrecy laws; in addition, it has gained Switzerland an indirect access to the benefits of the EU tax Directives on dividends between parents and subsidiaries and on interest and royalty payments between associated enterprises (art. 15). Of the total amount of EU savings taxes retained, Switzerland may keep 25% for itself and has to transfer 75% to the relevant EU Member States.

5 QI-System with the US

US citizens and US tax residents should be aware that many Swiss banks and securities dealers have concluded "Qualified Intermediary" (QI) agreements with the United States Internal Revenue Service (IRS). Pursuant to these agreements, the Swiss banks and securities dealers are required to disclose to the IRS the identity of US citizens and US tax residents who have invested through Swiss banks in US securities. Swiss banks and securities dealers therefore now require their US customers to consent to such disclosure or, alternatively, decline to invest in US securities.

IV Trustees/Beneficiaries

1 Legal Background

The concept of a trust is unknown to Swiss civil law.

However, the Swiss Parliament is about to approve the signature and ratification by Switzerland of the Hague Convention on the Law applicable to Trusts and on their Recognition. On March 23, 2006 the Council of the States (Upper House) unanimously approved the corresponding draft of the Swiss Federal Council. The Committee for Legal Affairs of the National Council (Lower House) unanimously approved the draft on July 10, 2006. The National Council will presumably debate the draft in the fall session 2006.

Even after ratification of the Hague Convention, it will not be possible to set up a trust according to Swiss civil law. The main effect of the Hague Convention in Switzerland will be the legal recognition in Switzerland of trusts validly established under applicable foreign law. According to Article 19 of the Hague Convention nothing shall prejudice the powers of the States in fiscal matters. Therefore, the Hague Convention will have no direct impact on the tax treatment of trusts with regard to Swiss tax laws.

2 Basics of Trust Taxation in Switzerland

Since the concept of the trust is alien to Swiss civil law, Swiss tax laws generally do not contain any provisions specifically addressing the tax treatment of trust settlements. Trust taxation has therefore mainly developed as a matter of practices of the tax authorities of the various cantons. Not surprisingly those practices vary considerably among the cantons. In view of the likely ratification of the Hague Convention on the recognition of trusts by the Federal Parliament, the Federal Tax Administration and the "Swiss Tax Conference" (a congregation of the heads of the cantonal tax administrations) have established an ad hoc working group comprising members of the federal and cantonal tax authorities with a view to publishing general tax guidelines relating to the tax treatment of trust settlements, in particular with regard to income and net worth taxes – the can-

tonal inheritance and gift taxes are outside the scope of the formal tax harmonization among the cantons and with federal tax law. Although the final trust tax guidelines are not yet available and despite the uncertainty over the timing of their publication – if at all – there exists a first draft, which outlines two basic concepts of trust taxation:

2.1 Irrevocable Discretionary Trusts

"Irrevocable" discretionary trusts will generally be regarded as separate, foreign resident entities for Swiss tax purposes. Therefore, the current income as well as the assets of the trust are not subject to tax in Switzerland. However, when a Swiss tax resident receives distributions from the trust, such distributions are generally considered taxable income in the hands of the Swiss recipient. If the Swiss resident beneficiary can provide evidence that the distributions are either (i) made out of initial trust capital (i.e. capital contribution made by the settlor), or (ii) constitute a distribution of capital gains, such a distribution could remain tax free[1].

2.2 Revocable Trusts

"Revocable" trusts are generally regarded as a look-through, "transparent" entities for tax purposes. Under such approach, the current income as well as the assets of the trust would be imputed either to the settlor itself or to the beneficiaries (the settler often also being one of the first beneficiaries of the "revocable" trust). Therefore, a Swiss resident settlor or beneficiary would be treated, for tax purposes, as owning the trust assets and the income produced by such assets. The income arising in the "revocable trust" would have to included in the settlor's or beneficiary's taxable income on a current basis, irrespective of the timing of actual distributions of such income from the trust. As a consequence, the distributions themselves would be tax neutral.

2.3 Transparent Versus Non-Transparent Trusts

Trust settlements by or on behalf of a Swiss resident taxpayer and the transfer of property to such foreign trust would often be regarded as a tax-avoidance scheme by Swiss tax authorities (if not even a tax evasion). Typically, the Swiss tax authorities would apply a look-through approach to such trusts, meaning that the assets and income in the trust would continue to be regarded as being owned directly by the Swiss taxpayer. Alternatively, if the trust can be categorized as an "irrevocable" trust, the transfer of property may also be regarded as a gift to the beneficiaries, or to the trust as such, if it is "discretionary". Such a gift would

[1] However, the current practice e.g. of the canton of Zurich would not recognize a tax-free distribution of capital gains, based on the Zurich authorities' theory that the foreign irrevocable discretionary trust is treated as an entity separate from the Swiss beneficiary ("non-transparent") and hence the capital gain has to be regarded as being realized by the trust and not by the Swiss resident beneficiary.

generally trigger cantonal gift taxes. The tax rates on gifts are generally the highest when the beneficiary of the gift is not a close relative of the donor.

3 Reporting Duties of Trustees

Foreign trusts may have trustees who are resident in Switzerland. Provided that the Swiss trustees, who are legally the owners of the assets given in trust, can sufficiently demonstrate based on the trust documents that they are only legal, but not economic/beneficiary owners of the trust assets and the income pertaining thereto, the Swiss tax authorities will not treat the Swiss based trustee as the owner of the trust assets and proceeds for Swiss income and net worth tax purposes. Therefore, the Swiss trustees are not themselves taxable in respect of such trust assets and proceeds and accordingly have no own fiscal reporting obligations in that regard.

Swiss tax laws (such as art. 127 sec. 1 lit. d FTA) provide for certain limited certification duties of third parties relating to income and assets pertaining to a Swiss resident taxpayer. In particular, fiduciaries, asset managers, collateral holders, agents and other persons who have or had possession of or management control over assets of a Swiss taxpayer are required to issue written certificates with respect to the corresponding assets and the revenues produced thereby. In the event that the taxpayer does not submit the required certificates by himself, the competent tax authorities may directly demand these from the third parties. It is not entirely clear whether a Swiss trustee of a common law trust falls under that rule.

Swiss based trustees of foreign trusts with EU resident individual beneficiaries are subject to the EU tax retention obligations on payments of interest from non-Swiss sources.

4 Reporting Duties of Beneficiaries/Settlors

Swiss resident beneficiaries are subject to tax on their worldwide income and net worth. Depending on the classification of the trust, Swiss resident beneficiaries and/or settlors may be obliged to declare either a) the distributions received from the trust or b) the income (and net worth) arising at the trust level (irrespective of distribution). However, as the cantonal practices of trust taxation vary widely, it is not always quite clear how the trust and its income (or distributions) should be reflected on the individual's tax return. In practice, it is not unusual for taxpayers to obtain binding rulings from the tax authorities regarding the classification and tax treatment of a particular trust settlement under which they are settlors or beneficiaries.

V Lawyers, Tax Advisers

Lawyers and tax advisers have no particular reporting obligations in regard to taxable payments to, or assets of, their clients, nor in respect of any inheritance or gift made or received by their clients (except in the situation that a lawyer acts as executor under a will, in which case the executor is under a personal obligation to report the assets of the estate and to prepare, or to support the preparation of, the inventory for inheritance tax purposes).

C Voluntary Disclosure

We have already discussed above the fundamental distinction drawn by Swiss tax laws between "simple" tax evasion and tax or fiscal fraud. When the taxpayer files an incomplete tax return in which certain items of the taxpayer's income or net worth have simply been "omitted" or "forgotten" to be declared and accordingly the taxes effectively paid reflect a deficiency compared to the amount of tax that would have resulted on the basis of a complete and full declaration, this constitutes a tax evasion and may be punished with a "tax penalty" (a fine) of up to three times the evaded tax. Although the tax evasion proceedings are nowadays regarded as criminal proceedings (with consequences for the taxpayer's procedural rights) and the tax penalty (fine) is regarded as a criminal sanction, tax evasion technically still is a minor offense (as it is not threatened with a jail sentence) and the proceedings are handled by special agencies within the tax authorities, not by the ordinary criminal prosecutors and courts (as opposed to criminal proceedings involving tax fraud).

The fine for tax evasion normally reflects one time the evaded tax (which itself of course also has to be paid, including late payment interest). In serious cases the fine may be increased to up to three times the evaded tax, whereas it may be reduced to a minimum of one-third of the evaded tax in rather insignificant cases. A further reduction of the tax penalty to one-fifth of the regular amount is provided by federal tax law in the event of a notice of self-incrimination filed by the taxpayer was filed before the tax authorities have become aware of a tax evasion.

Self-incrimination in the event of tax fraud does not achieve any avoidance of the criminal sanction. However, the fine and possible jail sentence may be reduced.

D Keeping Money Outside Switzerland

1 Income and Net Worth Tax

Keeping money outside the country generally does not achieve any legal reduction of the tax burden on Swiss resident taxpayers, given their unlimited liability to tax in respect of the worldwide net income and net worth. However, as Switzerland unilaterally applies the "exemption with progression" method in regard to

capital invested in permanent business establishments abroad (this does not apply to foreign business incorporated in a foreign legal entity!) or in foreign real estate (again, only if such foreign property is directly held by the Swiss resident taxpayer!), those foreign assets and the revenues produced by such assets will effectively escape Swiss taxation, although they still have to be declared in Switzerland for the purpose of determining the appropriate tax rate to the net factors that are effectively subject to Swiss tax.

Generally speaking, it is possible for a Swiss resident individual to hold assets or carry on business through a legal entity incorporated abroad – even if such foreign entity is incorporated in a tax haven jurisdiction. Contrary to many other European jurisdictions, Switzerland does not normally impose any Swiss taxes on the profit (or "passive income") of foreign "low-taxed" legal entities that are under the control of a domestic resident taxpayer ("CFC" taxation). Swiss income taxes become only due if and when such foreign entity makes a profit distribution to its Swiss resident shareholder.

However, the Swiss tax authorities may still make use of some other weapons to combat the "abuse" by Swiss resident taxpayers of legal entities based in foreign tax havens.

- If a foreign entity lacks any economic substance, it may simply be disregarded by the Swiss tax authorities based on the tax avoidance doctrine and the capital and income of such entity may be directly attributed to the Swiss taxpayer. Such may also be the case, for example, when a Swiss resident taxpayer holds profitable assets through a foreign foundation or trust based in a tax-free environment, over which the Swiss taxpayer can effectively exercise control.

- Moreover, a foreign entity may become subject to Swiss corporate taxes on all or at least a (major) fraction of its net profit and net equity, if it can be regarded to be effectively managed in or from Switzerland, or at least if it can be deemed to conduct some of its operations through a permanent establishment in Switzerland.

- Finally, in a few rather isolated cases, the tax authorities and the Federal Supreme Court have concluded (based on somewhat specific facts patterns) that a foreign incorporated business entity was in fact carrying out certain very profitable business transactions merely as an agent (or fiduciary) on behalf and for the economic benefit of a Swiss resident (corporate) taxpayer, with the consequence that the profits reflected in the accounts of the foreign entity were directly attributed to the Swiss taxpayer.

2 Inheritance and Gift Taxes

Inheritance and gift taxes are imposed in the canton where the decedent or donor had his or her domicile. Therefore, the (prospective) donor or decedent can

avoid Swiss taxation by changing the fiscal her domicile to a tax—free environment prior to the gratuitous transfer.

Limiting the exposure of donees or heirs to inheritance or gift taxes by way of establishing a trust or private foundation is rather difficult for a Swiss resident donor or future decedent. The setting-up of an irrevocable discretionary trust or private foundation abroad by a domestic tax subject could be regarded as a tax avoidance scheme, or even as an attempted tax evasion by the Swiss tax authorities. Swiss tax authorities would often disregard such an arrangement for tax purposes. When the tax authorities conclude that the foreign trust or private foundation has to be treated as an entity separate from the Swiss tax subject, then the transfer of property to the trust or foundation could be classified as a donation, subject to Swiss inheritance or gift tax.

However, in the event that a foreign resident sets up an irrevocable discretionary trust or private foundation before becoming a Swiss resident for tax purposes, such foreign trust or foundation would typically be regarded as a non-resident entity separate from the resident individual taxpayer (special rules apply to fixed interest trusts – basically the Swiss beneficiary has to treat the trust property and income as his/her own, similar as in the case of usufruct). The transfer of property to such entity before the transferor becomes a tax resident obviously cannot trigger any Swiss inheritance of gift taxes. Upon the settlor's death, the assets of the trust or foundation would generally not be added to the decedent's estate for Swiss inheritance tax purposes (unless the trust or foundation was "revocable" during the settlor's lifetime. In practice, there is often a degree of uncertainty as to how a particular trust or foundation arrangement will be treated by the competent cantonal tax authority. Such uncertainty can only be removed by an advance tax ruling.