

## Switzerland

# Swiss Supreme Court Confirms Form-over-Substance Approach in Stamp Duty Matters

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**Issue:** Derivatives & Financial Instruments, 2017 (Volume 19), No. 4

**Published online:** 13 July 2017

## 1. Introduction

In a judgment delivered on 7 March 2017,<sup>[1]</sup> the Swiss Federal Supreme Court rejected an appeal brought by the Federal Tax Administration (FTA) against a ruling given by the lower instance court (the Federal Administrative Court). This ruling had stated that for Swiss federal transfer stamp duty purposes, the secondary market trade of taxable securities carried out by a “grantor trust” set up under US law by a Swiss pension fund could not be attributed directly to the Swiss grantor (settlor) and beneficiary of the US trust. Accordingly, such trades were not subject to Swiss federal stamp duty on the transfer of securities for consideration (Supreme Court Decision 2C\_996/2015). The judgment provides a welcome confirmation and clarification of the legal character of the federal stamp duty payable on such transfers of securities. It makes it clear that this is an indirect tax imposed on legal transactions, which is governed by legal form rather than any consideration of the economic substance behind the transaction.

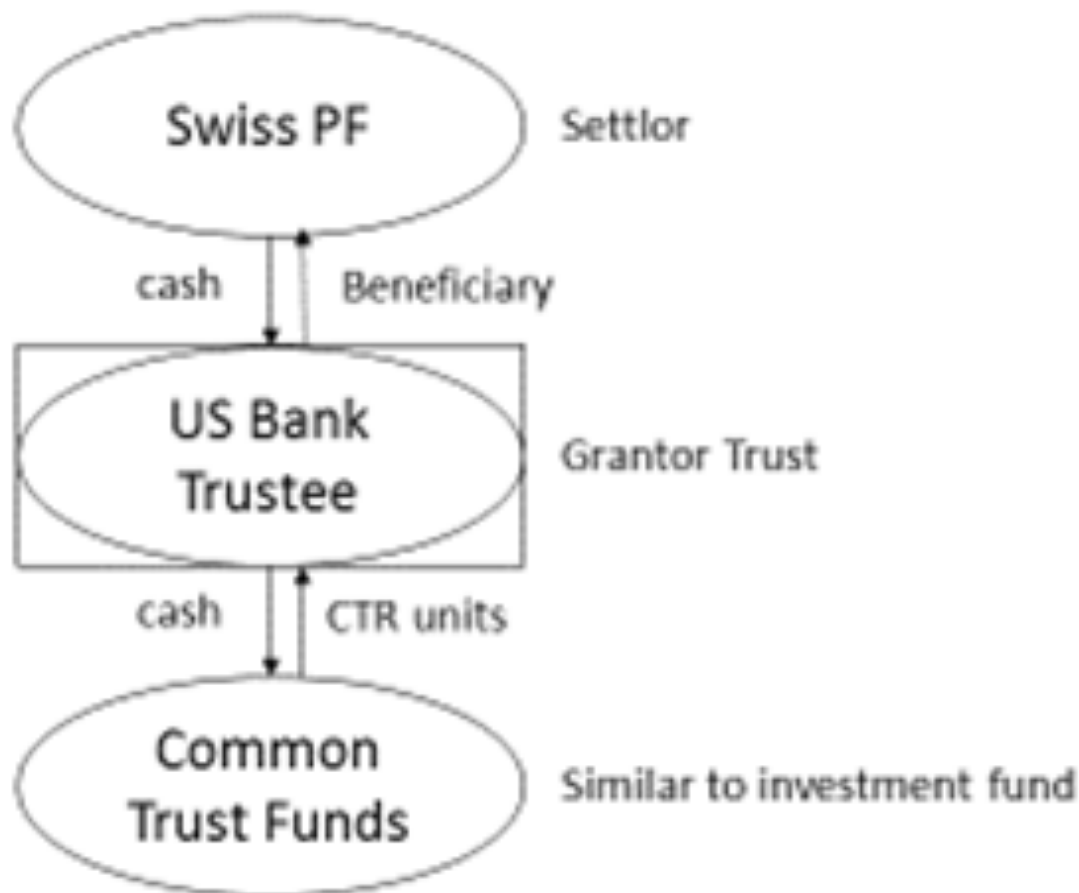
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1. Supreme Court judgment of 7 Mar. 2017, case 2C\_996/2015.

## 2. Summary of the Facts and Legal Positions Taken by Each Party and the Lower Court

### 2.1. Basic facts



The case decided on 7 March 2017 concerned a qualified tax-exempt Swiss pension fund making indirect investments into certain common trust funds (CTFs) under US law, following receipt of investment proposals from a US bank. For that purpose, the pension fund settled a grantor trust (a discretionary and revocable trust) under applicable US law and appointed the US bank as trustee. The pension fund remained the main beneficiary of the trust. The US bank acting as trustee then invested the trust capital into CTFs, which for Swiss tax purposes were likened to foreign collective investments (i.e. units in a foreign investment fund). For Swiss federal stamp duty purposes, both Swiss and foreign investment fund units or shares are taxable instruments. The legal transfer of taxable instruments for a consideration is subject in principle to federal transfer stamp duty, where a Swiss securities dealer, as defined for stamp duty purposes, participates in the trade either as a party or as an intermediary. Swiss pension funds are qualified as “securities dealers”.

### 2.2. The advance tax ruling

The pension fund had obtained an advance tax ruling from the FTA for stamp duty purposes back in 2003. Essentially, the tax ruling confirmed that, even though the CTF units were substantially comparable to investment fund units/shares (i.e. taxable instruments), the actual investment process involved two stages: (i) the initial settlement of the trust and (ii) the actual investments made through the trust (i.e. by the US trustee) in the CTF units. On that basis, the tax ruling confirmed that the pension fund was not in fact acting as a “securities

dealer” in the course of its ordinary operations. This meant that no transfer stamp duty would be due on the purchases and sales of CTF units through the trustee.

## 2.3. The tax audit and the FTA’s change of position

However, in 2010 the FTA began an audit of the pension fund and determined on 28 December 2011 that it had directly recorded the CTF units as assets in its accounts. In the FTA’s opinion this meant that the pension fund itself had to be seen as the owner of the CTF units, requiring the direct attribution of the purchases and sales of such units to the pension fund for stamp duty purposes. Based on that conclusion, the FTA revoked the earlier tax ruling with retrospective effect as of 1 July 2007. On 15 March 2013 the FTA issued its formal decision, requesting the pension fund to pay transfer stamp duties totaling CHF 43,834 on trades of CTF units made between 1 July 2007 and 31 December 2010, plus a further 5% p.a. in late payment interest. The trades in question were obviously carried out by the US bank as trustee for the grantor trust.

## 2.4. The litigation

The FTA dismissed a formal objection against that decision by the pension fund on 28 March 2014. The pension fund then decided to file an appeal to the Federal Administrative Court, which ruled in its favour on 29 September 2015.<sup>[2]</sup> The Administrative Court essentially confirmed the “formal nature” of the federal stamp duties (a legal transaction tax) arguing that the pension fund was not the legal owner of the trust property and accordingly had never acquired legal title to the CTF units.

The FTA appealed against that lower court ruling to the Supreme Court, but went on to suffer a further defeat.

# 3. Considerations Set out by the Supreme Court

In coming to its conclusions, the Supreme Court referred to the notion of (transfer of) “ownership” used in article 13 paragraph 1 of the Stamp Duty Act and raised the question of whether, in the light of the grantor trust arrangement, the pension fund or rather the US bank had become the owner of the CTF units that were purchased and sold from time to time.

## 3.1. Legal versus economic conception of “owner” notion

The Supreme Court highlighted the character of the federal stamp duty as being a legal transaction tax. Stamp duty is due on the consideration paid for certain legal transfers of taxable securities. The Supreme Court pointed out how this differs from cantonal direct taxes imposed on capital gains derived from transfers of real estate. These do not focus on the (legal) transfer as such, but rather on the realization of a financial gain in that context. The Supreme Court pointed to the legislative “message” of the Federal Council when introducing and proposing the Stamp Duty Act to the Federal Parliament as far back as 1917. They also referred to consistent jurisprudence,<sup>[3]</sup> according to which the federal stamp duty has to be understood as a (formal) tax on formal legal transactions necessitating the application of a strict form-over-(economic-)substance approach. This stands in stark contrast with direct taxes on income including withholding taxes, which are governed by the substance-over-form principle. Thus, the “owner” notion – for stamp duty purposes – has to be given a strictly legal (civil law) meaning. With the exception of apparent situations, such as abuse (of law), economic considerations have to stand well apart from the formal legal analysis of the “owner” position (of taxable instruments).

## 3.2. Recognition and qualification of US trust

The Supreme Court went on to analyse the US grantor trust arrangement from a Swiss legal point of view. The Court referred to the fact that Switzerland is a signatory state of the Hague Convention of 1 July 1985 on the applicable law pertaining to trusts and their legal recognition. This has applied in Switzerland since 1 July 2007. While the Trust Convention does not prevent the signatory states from freely legislating on taxation matters around (foreign) trust settlements (the “trust” concept is not known under Swiss domestic law), the Supreme Court found essentially that the grantor trust at hand was settled under validly chosen US laws, compliant with them and was therefore subject to them. Accordingly, the trust arrangement existing under foreign (US) law had to be recognized by the Swiss authorities including the Supreme Court as a matter of Swiss civil law.

## 3.3. Consequences for attribution of ownership rights

The Supreme Court then analysed whether the US bank (as trustee) or rather the Swiss pension fund had to be seen as the owner of the CTF units, as those units were held by the trustee on behalf of the trust. The Supreme Court considered that the concept of “ownership” used in the context of Anglo-Saxon trust settlements is complex, given the distinction between legal and equitable ownership. The Court pointed to legal doctrine that attributes legal title to the trust assets to the trustee, while in general equitable title (or beneficial ownership) is attributed to the ultimate beneficiaries. The Court held that in its external relations with the outside world, the trustee’s legal title to the assets prevails; the beneficiaries’ equitable title only counts in their internal relationship with the trustee. Ultimately, the Supreme Court concluded that the trustee had to be regarded as the relevant, sole owner of the assets given in trust by the settlor, except for

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2. Federal Administrative Court judgment of 29 Sept. 2015, case A-2347/2014.

3. Supreme Court decisions of 10 June 2015, case 2C\_976/2014, cons. 3.4; of 4 Oct. 2010, case 2C\_381/2009, consid. 2.4; and of 5 Mar. 2002, case 2A.84/2001, consid. 2.2.

sham trust situations; such a sham trust (contrary to a valid, legitimate trust) would not be recognized under Swiss civil law (pursuant to Swiss private international law).

### 3.4. Stamp duty to follow civil law analysis

The Supreme Court further noted that this civil law analysis also forms the basis of Swiss tax regulations (in fact, the tax guidelines set out in the Trust Circular pertaining to Anglo-Saxon trusts (Circular 30 of 22 August 2007, which was drafted by the FTA in collaboration with the cantonal tax authorities).

Considering the relevant facts, the Supreme Court noted that it was agreed among the parties that the pension fund had validly settled a (grantor) trust under US law and appointed the US Bank as trustee; it was also clear that the pension fund had legally transferred the capital (cash) needed for the (subsequent) investment into the CTF units to the trustee. The Supreme Court concluded that it was exclusively the US bank, in its capacity as trustee and professional trader of securities, who was in a position actually to carry out the purchases and sales of the CTF securities, whilst the Swiss pension fund was effectively barred from doing so in line with the legal principle *nemo plus juris transferre potest quam ipse habet*.<sup>[4]</sup> As the US bank was obviously not a Swiss securities dealer, and given that the pension fund as a Swiss securities dealer was not a legal party to the securities trades in question, the Supreme Court reached the conclusion that no conditions existed to create any Swiss stamp duty obligation.

### 3.5. Qualification under the Trust Circular not decisive for stamp duty analysis

The Supreme Court considered the fact that the trust in this case qualified as a “revocable”, “transparent” trust for the purposes of the Trust Circular was irrelevant for the stamp duty analysis. The Supreme Court went on to clarify that those regulations of the Trust Circular exclusively related to federal and cantonal income taxes and to the federal withholding tax; the securities transfer stamp duty as a pure legal transaction tax has a different focus. The Supreme Court stressed again that the pension fund was not a party to the legal transfers of the CTF units in question; all unit transfers were made in the name of the US bank as trustee and legal owner. In that context, the Supreme Court also expressly dismissed as irrelevant the FTA’s argument that the CTR units were in fact listed directly as assets on the pension fund’s commercial balance sheet (thereby “ignoring” the existence of the trust). The Supreme Court stressed that the commercial accounts take an economic, rather than merely a formal legal approach; accounting ownership of an asset may also result from mere economic control, even in the absence of any formal legal title. However, this was not considered relevant for transfer stamp duty purposes, as any stamp duty relies strictly and exclusively on the formal civil law ownership position (except for instances involving obvious abuses of law).

## 4. Conclusion

The Supreme Court confirmed its long-standing jurisprudence, according to which federal stamp duties are indirect taxes imposed upon certain legal transactions – such as transfers of taxable securities for consideration made by or with a “Swiss securities dealer” – and therefore, in principle the strictly legal meaning of legal notions such as “ownership” is relevant for the analysis whether a taxable transaction has occurred. An exception to this general principle can apply only if the Stamp Duty Act itself refers to economic rather than merely legal concepts – for example “corporate decisions concerning mergers or business combinations that are economically equivalent to a merger, a transformation or a demerger”. In the case at hand, the Swiss pension fund in question never directly acquired, held or transferred legal ownership of the taxable securities, which were traded through an underlying trust established under US law, and accordingly was not held accountable for federal securities transfer stamp duties.

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4. “No one can transfer more rights than he has himself.”