Tax treatment of trusts in Switzerland

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On 1 July 2007, the HCCH Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trusts Convention) came into force in Switzerland.

The ratification of the Hague Trusts Convention and the related amendments in Swiss domestic legislation do not create a substantive Swiss trust law. As was the case before ratification of the Hague Trusts Convention, it is not possible to establish a trust under Swiss law. However, the enactment of the Hague Trusts Convention:

- Enables the full recognition of foreign trusts and foreign trust decisions in Switzerland.
- Standardises the law applicable to trusts.

This article considers:

- General rules relating to taxation in Switzerland.
- Guidelines for taxation of trusts in Switzerland (Circular Letter No. 30 and VAT-Branch-Info No. 14).
- Income and net wealth tax and trusts.
- Gift and inheritance tax and trusts.
- Withholding tax and trusts.
- VAT and trusts.

**GENERAL RULES RELATING TO TAXATION IN SWITZERLAND**

This section provides an overview of relevant taxes in Switzerland.

**Income tax and net wealth tax**

Swiss residents are subject to Swiss income tax on their worldwide income at the federal, cantonal and communal level. Further, they are subject to net wealth tax on their worldwide assets at the cantonal and communal level (Articles 3 (1) and 6 (1), Federal Direct Tax Act, of 14 December 1990, as amended (FDTA) and Article 2, Federal Tax Harmonisation Act of 14 December 1990, as amended (FTHA)). This does not apply to businesses, permanent establishments and real estate located abroad and the income derived from these. Income tax rates at the federal level range from 0% up to 11.5%, depending on the amount of taxable income and the family status of the taxpayer. Cantonal and communal tax rates vary, depending on the canton and municipality involved. On average, they are generally twice as high as the federal tax rates.

Income tax is levied on all income upon receipt of the income (net income theory) (Einkommenszugangs-theorie). Receipt of income is defined as the point in time at which the recipient has the right to claim the income.

The holder of an usufruct (the right to use and benefit from the assets of something belonging to somebody else) is taxed on the assets and income that he has the right to use, as if those assets and income were his own (Article 20 (1), lit. d FDTA; Article 7, FTHA; Article 13 (2), FTHA).

**Withholding tax**

Swiss withholding tax is levied on income from movable capital assets, such as interest, rents, dividends and other income, derived from, for example, bonds and shares issued by a Swiss resident (Article 4 (1), Federal Withholding Tax Act of October 13, 1965, as amended (FWTA)). The withholding tax rate amounts to 35%, however, a partial or full refund may be available, depending on the country of residence of the recipient and the applicable double tax treaty.

**Gift tax and inheritance tax**

Gifts are not subject to income tax, but may be subject to cantonal and communal gift taxes under the relevant cantonal law (Article 24 (1), FDTA; Article 7 (4), FTHA). Inheritance tax is also governed by cantonal law. The rates of gift and inheritance tax depend on the canton and municipality involved.

**GUIDELINES FOR TAXATION OF TRUSTS IN SWITZERLAND**

Each signatory state to the Hague Trusts Convention has sovereignty over tax matters within its jurisdiction (Article 19, Hague Trusts Convention).

Under Swiss tax law there are no provisions governing the taxation of trusts. On 22 August 2007, however, the Swiss Tax Conference (Schweizerische Steuerkonferenz) (SSK), which comprises representatives from all 26 cantonal tax administrations as well as representatives from the Federal Tax Administration (FTA), released Circular Letter No. 30 on the taxation of trusts (Circular Letter). The Circular Letter was also adopted by the FTA in an identical Circular Letter No. 20, published on 27 March 2008.

The Circular Letter provides general guidelines on the taxation of trusts and therefore, to a degree, predictability for Swiss residents concerning personal tax consequences related to trusts.

The Circular Letter is confined to considering trusts from a tax perspective. Note that the Circular Letter draws a distinction, when considering the tax treatment of trusts, between revocable and irrevocable trusts, which is vital. For a summary of the Circular Letter’s consideration of this issue, see box, Revocable and irrevocable trusts.

**Issues dealt with by the Circular Letter**

The Circular Letter harmonises the different cantonal practices on the taxation of trusts in relation to:

- Income and net wealth tax (see above, General rules relating to taxation in Switzerland: Income tax and net wealth tax),
- Withholding tax (see above, General rules relating to taxation in Switzerland: Withholding tax),

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Issues not dealt with by the Circular Letter
The following are not dealt with by the Circular Letter, or only to a limited extent, and are governed by the cantonal laws:

- Cantonal gift taxes and inheritance taxes, which can be levied at the time of the death of the settlor (see below, Inheritance tax treatment of trusts).
- VAT. However, the FTA has provided information concerning its practice in VAT-Branch-Info No. 14 regarding the financial sector (VAT Info) (MWST-Branchen-Info 14, ESTV, Ziff. 7.3) (see below, VAT consequences of entering into a trust).

Duty to co-operate and duty of information
Settlers, trustees or beneficiaries who are resident in Switzerland must provide the tax authorities with all relevant information, documents, and so on, regarding the establishment of trusts, as well as any distributions by and any expenses of the trust (section 6, Circular Letter; Article 126, FDTA; Article 42, FTHA).

INCOME AND NET WEALTH TAXATION FOR TRUSTS

Trust transparency for tax purposes
A trust itself is not subject to tax as it lacks legal personality (section 4.1, Circular Letter). A trustee must manage the trust assets and use them according to the purpose of the trust as defined by the settlor in the trust deed. The trustee must isolate the trust assets from his own assets and has no equitable interest in them. This means, therefore, that the trust assets do not belong to the trustee, and a trustee that is tax resident in Switzerland is neither subject to tax on the trust assets or the income generated from those assets. This also applies to a Swiss tax resident protector.

A trust, therefore, is regarded as tax transparent. Capital gains and income derived from the trust assets are attributed directly to either the settlor or to the beneficiaries (section 5.1, Circular Letter). All income derived from a trust is subject to income tax at the level of the person receiving the income, unless the distributions from the trust are considered as a gift, which is exempt from income tax (Article 16 (1), FDTA; Article 7 (1), FTHA).

Trustee and protector
Although the trustee and protector do not pay tax on the trust assets or income of the trust (see above, Trust transparency for tax purposes), they are liable to Swiss income tax on any fees that they receive for services that they provide to the trust (section 4.2, Circular Letter).

Settlor
If the settlor of a trust is not resident in Switzerland he is not subject to income tax in Switzerland.

If the settlor is tax resident in Switzerland when he establishes the trust, the tax treatment of the settlor depends on whether he establishes a revocable, an irrevocable fixed interest trust, or an irrevocable discretionary trust (see box, Revocable and irrevocable trusts). If an irrevocable fixed interest trust is established, a final determination as to whether the trust is revocable or an irrevocable trust (section 5.1.1.2, Circular Letter).

On the other hand, when a settlor is tax resident abroad when he establishes an irrevocable discretionary trust, he is not subject to tax on the trust assets and income after moving to Switzerland (Michael Fischer/Benjamin Dori, in: Der Schweizer Treuhänder 8/13, Trusts und Steuern, S. 549-553, S. 549, m.w.H). Why the FTA makes a distinction between a settlor establishing a trust that is resident in Switzerland and a settlor that is resident abroad in the case of an irrevocable discretionary trust is not explained in the Circular Letter.

Tax treatment of beneficiaries
Irrevocable fixed interest trust. In this case, the beneficiaries, the amount and the time of the distribution of the benefits to the beneficiaries are defined. This means that the assets of the trust and the income from those assets can be attributed to the beneficiaries. At that stage, it must be determined whether the distributions are to be considered as income or gifts (section 5.1.2, Circular Letter; Article 24 lit. a, FDTA; Article 7 (4) lit. c, FTHA).

Irrevocable discretionary trust. In this case, the beneficiaries merely have a potential future entitlement (Anwartschaft). The exact amount and the time of the distribution are not defined, but are at the discretion of the trustee. Often the beneficiaries do not know that they are beneficiaries. Therefore, the distribution can only be subject to tax once it is effectively paid out. At that time it is necessary to determine whether the distributions are to be considered as income or gifts (section 5.1.2, Circular Letter; Article 24 lit. a, FDTA; Article 7 (4) lit. c, FTHA).

Examples
The Circular Letter provides three examples which illustrate these taxation principles (see box, Examples of income and net wealth tax treatment of trusts under the Circular Letter).

INHERITANCE TAX TREATMENT OF TRUSTS

The Circular Letter does not cover cantonal inheritance taxes which may be levied at the time of the settlor's death (see above, Guidelines for taxation of trusts in Switzerland: Issues not dealt with by the Circular Letter). Just as for income and net wealth tax purposes, the trust cannot be subject to inheritance tax as it lacks legal personality. Neither the trustees nor the protector are subject to inheritance tax as they do not have an equitable interest in the trust assets and income from those assets. This leaves the settlor and the beneficiaries as persons that are possibly liable to inheritance tax (Fischer/Dori, loc. cit., S. 550, m.w.A).

The settlor cannot be subject to inheritance tax as it is his death that leads to the levy of the inheritance tax. Therefore only the beneficiaries can be subject to inheritance tax (Fischer/Dori, loc. cit., S. 550, m.w.A).

In the practice of the cantons the following situations are possible (Fischer/Dori, loc. cit., S. 550 ff.):

- A revocable trust becomes an irrevocable fixed interest trust at the time of death of the settlor: at the time of death the inheritance tax is generally levied on the trust assets at the tax rate applying to the relationship between the settlor and the beneficiary.
- A revocable trust becomes an irrevocable discretionary trust at the time of death of the settlor: at the time of death the inheritance tax is levied at the maximum rate.
- An irrevocable discretionary trust with a Swiss-resident settlor becomes an irrevocable fixed interest trust at the time of death of the settlor: at the time of death the inheritance tax is generally levied on the trust assets at the tax rate applying to the relationship between the settlor and the beneficiary.
- An irrevocable discretionary trust with a Swiss-resident settlor continues to be an irrevocable discretionary trust at the time of death of the settlor: at the time of death the inheritance tax is levied at the maximum rate.
- An irrevocable discretionary trust with a settlor resident abroad becomes an irrevocable fixed interest trust at the time of death of the settlor: at the time of death the inheritance tax is generally levied on the trust assets at the tax rate applying to the relationship between the settlor and the beneficiary, if the settlor was a Swiss resident at the time of death.
- An irrevocable discretionary trust with a settlor resident abroad continues to be an irrevocable discretionary trust at
the time of death of the settlor: no inheritance tax is levied, regardless of where the settlor dies.

- An irrevocable fixed interest trust: the death of the settlor does not trigger any inheritance taxes.

SWISS WITHHOLDING TAX ISSUES FOR TRUSTS

The Circular Letter considers the position regarding the imposition of withholding tax in domestic and international situations, particularly in relation to whether a refund can be claimed.

Domestic situations

Distributions from a trust to the beneficiaries are not subject to Swiss withholding tax, as they do not fall within the scope of the Swiss Withholding Tax Act (section 7.1, Circular Letter).

Due to the lack of a legal personality, a trust itself cannot claim a refund of Swiss withholding tax levied on contributions such as dividends and interest payments to the trust. In the case of a revocable trust the settlor can claim a refund. In the case of an irrevocable fixed interest trust the beneficiaries can claim a refund, if they are Swiss tax residents at the time the contribution to the trust is due. In the case of an irrevocable discretionary trust no refund is possible, until the trust assets can be attributed to a specific person. Only at the time of a distribution to a beneficiary can the beneficiary claim a refund (section 7.2, Circular Letter).

International situations

If a trust incorporated under foreign laws requests a refund of the Swiss withholding tax, the tax authorities will firstly check whether the trust is a resident of the other contracting state according to the applicable double tax treaty. Not all double tax treaties contain provisions regarding trusts. However, for example, the double tax treaties between Switzerland and the United States, Canada and the UK contain provisions according to which a trust is considered a person according to the double tax treaty. Even in these cases, though, a trust can only claim a refund of the Swiss withholding tax based on the double tax treaty where:

- It is tax resident in the other contracting state.
- It is the beneficial owner of the relevant income.

If the tax authorities conclude that the trust or the trustee are tax resident in the other contracting state, the tax authorities agree that the double tax treaty is applicable and generally grant a refund of the Swiss withholding tax (section 8, Circular Letter).

VAT CONSEQUENCES OF ENTERING A TRUST

The Circular Letter does not provide for any provisions regarding VAT consequences for a trust, however, the separate VAT-Info has provided information related to the VAT treatment of a trust (see above, Guidelines for taxation of trusts in Switzerland: Issues not dealt with by the Circular Letter). The following is a brief summary.

The services of a Swiss-resident trustee provided to a trust can be subject to VAT if the trustee is registered for Swiss VAT and if the place of service is located in Switzerland (that is, the recipient of the service). If the settlor is resident in the other contracting state, the services provided by the trustee are considered to be located at the place of residence of the majority of the trustees. If the majority of the trustees are resident in Switzerland, the services provided by the trustee are subject to Swiss VAT. If more than 50% of the trustees are resident abroad, the services are generally not subject to Swiss VAT (Putschert Hess, loc. cit., S. 527 f., Diagram. MWST-Branchen-Info 14, ESTV, Ziff. 7.3.2.7 and 7.3.3).

- Irrevocable fixed interest trust. The trust assets and income from the assets are not attributed to the settlor, but to the beneficiaries. The place of service of the service provided from the Swiss-resident trustee to the trust is considered to be located at the place of residence of the majority of the beneficiaries (more than 50%). If at least half of the beneficiaries are resident in Switzerland, the services provided by the trustee are subject to Swiss VAT. If more than 50% of the beneficiaries are resident abroad, the services are generally not subject to Swiss VAT (Putschert Hess, loc. cit., S. 527 f., Diagram. MWST-Branchen-Info 14, ESTV, Ziff. 7.3.2.7 and 7.3.3).

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- Irrevocable fixed interest trust. The trust assets and income from the assets are not attributed to the settlor, but to the beneficiaries. The place of service of the service provided from the Swiss-resident trustee to the trust is considered to be located at the place of residence of the majority of the beneficiaries (more than 50%). If at least half of the beneficiaries are resident in Switzerland, the services provided by the trustee are subject to Swiss VAT. If more than 50% of the beneficiaries are resident abroad, the services are generally not subject to Swiss VAT (Putschert Hess, loc. cit., S. 527 f., Diagram. MWST-Branchen-Info 14, ESTV, Ziff. 7.3.2.7 and 7.3.3).

- Irrevocable discretion ary trust. If the settlor is resident in Switzerland at the time of establishment of the trust, from a VAT perspective the discretionary trust is treated in the same way as a revocable trust (see above). If the settlor is resident abroad at the time of establishment of the trust, the trust is not treated transparently. In the case of an irrevocable discretionary trust, the beneficiaries are usually not known. Therefore, to determine the place of service, that is, where the recipient is located, the place of residence of the beneficiaries is usually not used. Instead the FTA takes into account the place of residence of the trustee. If the majority of the trustees are resident in Switzerland, the place of service is considered to be in Switzerland and therefore the service is subject to VAT. If the majority of the trustees are resident abroad, no VAT is levied (Putschert Hess, loc. cit., S. 529 f., Diagram. MWST-Branchen-Info 14, ESTV, Ziff. 7.3.2.8 and 7.3.3).

Potentially, service import tax (Bezugsteuer) may be charged if the trustee is resident abroad, and either his services provided to recipients resident in Switzerland exceed CHF10,000 per annum or the recipients are subject to Swiss VAT. This situation, however, lies outside the scope of this article.

CONCLUSION: INCREASED CERTAINTY AND REMAINING INSECURITY

Since the ratification of the Hague Convention foreign trusts have been fully recognised in Switzerland. The law applicable to trusts is standardised. As a result of the Circular Letter and the VAT-Info, taxpayers have gained more certainty in how trust assets and income from those assets are taxed in Switzerland, and whether trustee services provided to trusts are subject to VAT.

In particular, a Swiss resident should be mindful that, unless he establishes an irrevocable fixed interest trust that he establishes will be treated as a revocable trust and that any assets and income will be attributed to him for taxation purposes.

However, for a settlor resident abroad an irrevocable discretionary trust may be very favourable from a tax perspective. He or she will not be subject to Swiss income and net wealth tax on the trust assets or income after moving to Switzerland. The beneficiaries will only be taxed on distribution from the trust (Philippe Butty, in: Der Schweizer Treuhänder 1-2/09, The Trust as regulated under Swiss law – Some key answers to crucial questions, p. 92-94).

Although the provisions in the Circular Letter and the VAT-Info have improved and harmonised the Swiss tax treatment of trusts, there are still areas of insecurity. In particular, in regard to inheritance taxes or in international situations, the practice of the Swiss tax authorities has not been fully harmonised.

For the settlor, the beneficiaries and/or the trustee it is, therefore, still highly recommended to obtain a ruling confirmation by the competent tax authorities in situations involving a trust in order to gain certainty on:

- How these persons will be taxed in relation to the trust assets and the income from those assets.
- Whether inheritance tax is levied at the time of death of the settlor.
- Whether the services provided by a trustee to a trust are subject to VAT.
REVOCAIBLE AND IRREVOCABLE TRUSTS

Of importance to the taxation of trusts is the question of whether the relevant trust is a revocable or an irrevocable trust.

This section considers the distinction drawn by the Circular Letter between revocable and irrevocable trusts, and the criteria set out by the Circular Letter to distinguish the two.

What constitutes a revocable or an irrevocable trust?

The Circular Letter distinguishes between the following:

- **Irrevocable trust.** This is where the settlor has definitively disposed of his assets in favour of the trust. In that case, he has established an irrevocable trust. Irrevocable trusts are further divided between the following:
  - **Irrevocable fixed interest trust.** This is where the details of the entitlements of the beneficiaries are described in the trust deed. The trustee has no discretion over who should receive the trust assets, or the income from those assets. The beneficiary of the irrevocable fixed interest trust has an enforceable claim to the trust assets for the income from those assets, and is treated, for tax purposes, as the holder of a usufruct (section 3.7.2, Circular Letter) (see above, General rules relating to taxation in Switzerland: Income tax and net wealth tax);
  - **Irrevocable discretionary trust.** The trust deed of an irrevocable discretionary trust generally provides for only abstract classes of beneficiaries. The final decision on who will benefit from the trust assets and distributions is in the trustee’s discretion. At the time of the establishment of the trust the beneficiary is not yet enriched, as it is not clear at that time who will benefit in what amount and at what time from a distribution by the trust. This means that the beneficiary only has a potential future entitlement (Anwartschaft) (section 3.7.3, Circular Letter).

- **Revocable trust.** This is where the settlor keeps in some form, legally or economically, a certain influence on the trust assets. In that case, he establishes a revocable trust, which will apply if the settlor acts as a trustee or beneficiary of the trust. A settlor who establishes a revocable trust reserves his right to revoke the trust at a later point in time and to take back the remaining assets. The settlor does not definitively alienate his assets to the trust. Generally, revocable trusts become irrevocable trusts at the time the settlor dies (section 3.7.1, Circular Letter).

Criteria to distinguish between a revocable and an irrevocable trust

The Circular Letter provides for a number of criteria which are considered helpful in distinguishing between a revocable and an irrevocable trust (which have been taken from Federal Supreme Court practice concerning family foundations):

- Is the settlor a beneficiary of the distributions of trust assets and/or income from those assets?
- Does the settlor have the right to:
  - revoke the trustee and name another trustee(s) in his place?
  - nominate new beneficiaries or have them nominated?
  - revoke the protector who in turn has powers that are similar to the ones conveyed to a trustee?
  - change the trust deed or have it changed?
  - revoke the trust?
  - ask for the liquidation of the trust?
  - veto decisions by the trustee concerning the trust assets?

If one of the above questions is answered in the affirmative, it is likely that the trust qualifies as a revocable trust from a tax perspective (section 3.7, Circular Letter).
The establishment of a trust does not trigger any tax consequences, as the assets and the income from the assets continue to be attributed to the settlor, unless an irrevocable fixed interest trust is established.

**Revocable trust**

A revocable trust is considered transparent and the trust assets and the income from the assets are attributed to the settlor. The following tax consequences must be considered at the time of the establishment, during the trust and at the liquidation of the trust:

- **Establishment.** The establishment of a trust does not trigger any tax consequences, as the assets and the income from the assets continue to be taxed at the level of the settlor.
- **During the trust’s lifetime.** Distributions to the beneficiaries may trigger cantonal gift taxes as they are considered as gifts from the settlor to the beneficiaries. Depending on the cantonal law, the gift tax rates can vary highly. In most cantons gifts to one’s spouse and one’s children are exempt from gift tax (in the cantons of Appenzell Innerrhoden, Vaud and Neuchâtel gifts to children are not tax exempt). The trust assets and the income from the assets are attributed to the settlor and subject to income and net wealth tax.
- **Liquidation.** The liquidation of the trust does not trigger any tax consequences, if the assets are transferred back to the settlor, as the assets are deemed to have remained with the settlor. If the assets, however, are distributed to the beneficiaries the same tax consequences arise as for distributions (section 5.2.2, Circular Letter. See also Stephanie Putschert Hess, in: Steuerrevue 68/2013, Trusts und ihre mehrwertsteuerliche Behandlung, S. 518-530, S. 521, Diagram).

**Irrevocable fixed interest trust**

From a tax perspective, the beneficiaries of an irrevocable fixed interest trust are treated the same as holders of an usufruct. Therefore, the trust assets and the income from the assets are attributed to the beneficiaries. The following tax consequences must be considered at the time of the establishment, during the trust and at the liquidation of the trust:

- **Establishment.** The establishment of a trust may trigger cantonal gift taxes as the transfer of the assets to the trust may be considered as gifts by the settlor to the beneficiaries. Depending on the cantonal law the gift tax rates may vary highly. In most cantons, gifts to one’s spouse and one’s children are exempt from gift tax (in the cantons of Appenzell Innerrhoden, Vaud and Neuchâtel gifts to children are not tax exempt).
- **During the trust’s lifetime.** The income derived from the trust assets will be attributed to the beneficiaries. Depending on whether the assets are regarded as being held as private or as business assets, the capital gains derived from the assets are tax exempt (private assets) or taxable (business assets) at the level of the beneficiaries (Article 16 (3), FDTA). Other income derived from the trust assets is taxed as income at the level of the beneficiaries. The trust assets are attributed to the beneficiaries and subject to net wealth tax.
- **Liquidation.** The liquidation of the trust does not trigger any tax consequences as the initial trust assets are distributed to the beneficiaries, who are considered to already own the trust assets; only the portion of the distribution corresponding to realised income will be subject to income taxes (section 5.2.2, Circular Letter. See also Putschert Hess, loc. cit., S. 522, Diagram).

**Irrevocable discretionary trust**

Where the settlor has its place of residence in Switzerland at the time of the establishment of an irrevocable discretionary trust, the trust assets and the income from the assets are still attributed to the settlor. Therefore the same tax consequences arise as for a revocable trust (see above, Revocable trust).

Where the settlor is resident abroad at the time of the establishment of the trust, neither the trust assets nor the income from the assets can be attributed to the settlor or to the beneficiaries. The following tax consequences must be considered at the time of the establishment, during the trust and the liquidation of the trust:

- **Establishment.** The establishment of a trust is considered as a gift from the settlor to the beneficiaries in the amount of the trust assets. However, as the settlor (the donor of the gift) is resident abroad, generally no gift tax is levied.
- **During the trust’s lifetime.** Until the effective distribution of the trust assets and the income from the assets, the beneficiaries have not acquired an entitlement, that is, they do not have the right to claim the trust assets or the income, therefore, they are not subject to net wealth tax and income tax on the trust assets and the income from those assets. Distributions are generally subject to income tax at the level of the beneficiaries. Unlike the irrevocable fixed interest trust, no distinction is made between distributions from privately held assets or business assets, because the assets cannot be attributed to the settlor or the beneficiaries.
- **Liquidation.** The liquidation of the trust resulting in distributions of income to the beneficiaries and are generally subject to income tax at the level of the beneficiaries; the distribution of initial trust assets is however not subject to income tax (see above) (section 5.2.3, Circular Letter. See also Putschert Hess, loc. cit., S. 523, Diagram).
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