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PRACTITIONERS' CORNER

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On September 6, 2011, the Swiss Tax Conference published guidelines on the Swiss tax characterization of an investment in a U.S. limited liability company.¹ The Swiss Tax Conference — an association of the Swiss federal and cantonal tax administrations — issues recommendations to the Swiss tax authorities to harmonize specific tax issues nationally; they are not binding on the courts.

In the past, it was uncertain whether for Swiss tax purposes a share in an LLC qualifies as a share in a partnership or a share in a corporation. The qualification matters because the participation relief is only available if the LLC is deemed a corporation from a Swiss tax perspective. Furthermore, different issues were unsettled under the Switzerland-U.S. income tax treaty of October 2, 1996.

Assimilation With a Swiss Corporation

After a thorough analysis and discussion of the diverging opinions expressed in the literature, the guidelines state that an LLC may be assimilated with a Swiss corporation in general and, more specifically, with the GmbH/Sàrl (*Gesellschaft mit beschränkter Haftung/société à responsabilité limitée*). Both the LLC and the GmbH/Sàrl are legal entities in which their mem-

bers' liability is generally limited to the assets of the entity; neither will automatically be liquidated if a member resigns. However, if the taxpayer proves that the specific structure of the LLC is more akin to a partnership, the investment in an LLC can qualify as an investment in a foreign partnership. Also, the provisions regarding piercing the corporate veil are expressly reserved.

Independent from the qualification according to the treaty, distributions of the LLC to Swiss corporate members qualify as participation income for the purpose of the Swiss participation relief. Individual members derive income from movable assets and not from independent services, and if they hold more than 10 percent of the LLC's capital, distributions received qualify for the partial taxation.

As a foreign corporation for Swiss tax purposes, the LLC is taxable in Switzerland only if its place of effective management is in Switzerland or if the LLC owns real estate or has a permanent establishment in Switzerland.

Different Treatment of Swiss Members

Distributions from the LLC to its Swiss members are deemed to be dividends according to article 10(4) of the treaty only if they are subject to the same tax treatment as income from shares in the United States. This is the case only if the LLC has opted to be subject to tax in the United States.

If the LLC is transparent for U.S. tax purposes, its profit is attributed to the members. If its members are

¹The guidelines are available in German at http://www.steuerkonferenz.ch/pdf/2011_steuertliche_behandlung_US_LLC.pdf and in French at http://www.steuerkonferenz.ch/pdf/2011_traitement_fiscal_US_LLC.pdf.

residents of the United States and Switzerland, the business of the transparent LLC is partly attributed to the members resident in the United States and partly to the ones in Switzerland. The Swiss part of the profit is taxable in Switzerland not as profit from independent personal services by the Swiss members but, to the extent that profits are actually distributed to the Swiss members, as return of movable assets.

As the transparent LLC is not taxable in the United States, it is not a resident of the United States (article 4(1a) of the treaty). Without the partial attribution of the business, notwithstanding the LLC's seat and business activity in the United States and its members' residence in the United States and in Switzerland, the business of the LLC would not qualify as an enterprise of a contracting state, according to article 3(1c) of the treaty.

The derived income of a Swiss resident from a transparent LLC qualifies in general as a business profit according to article 7(1) of the treaty. That in-

come is therefore only taxable in Switzerland. If the business activity of the transparent LLC is carried out through a PE in the United States, the profit is taxable there and exempt in Switzerland (article 7(1) and article 23(1a) of the treaty).

If the transparent LLC does not carry on a business under article 7 of the treaty (which may be the case if the LLC engages in passive investment only), its profits are deemed "other income" under article 21(1) of the treaty and are only taxable in the state of residence of the member.

Conclusion

The guidelines are in line with the practice of the Swiss Federal Tax Administration, which denies refunds of the withholding tax levied in Switzerland on distributions to a transparent LLC if the request is filed by the LLC. So far, there has been no court decision on the matter. It remains to be seen whether the guidelines will stand up in court if challenged. ◆