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**Introduction of the Swiss Trust** On 12 January 2022, the Federal Council opened a consultation on the introduction of the Trust as a new legal institution in the Swiss Code of Obligations (art. 529a-w PD-CO). The Trust as proposed in the draft bill features the essential characteristics of a trust under common law and is consistent with the definition in the Hague Trust Convention.

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## Introduction of the Swiss Trust



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The trust is a valued and admissible instrument for estate planning and for asset preservation. Due to the current legal restrictions, the family foundation is not suitable to cover the needs in this area. In order to avoid having to resort to foreign trusts (or foundations) for asset structuring and estate planning purposes, the Swiss Parliament has instructed the Federal Council to create a Swiss Trust with the motion 18.3383 "Introduction of the Trust into the Swiss Legal System". It is intended to strengthen Switzerland as a financial center and increase legal certainty. The consultation process on amendments to the law lasts until 30 April 2022.

### The trust as a legal institution *sui generis*

According to the draft bill, the trust will be introduced as a new legal institution *sui generis*, which classifies between fiduciary and foundation. While no *common law* concepts are adopted, the Swiss trust (hereinafter "Trust") is based on legal institutions known under Swiss law. Essentially it is a private legal relationship in which assets ("trust assets") are placed under the supervision of a person ("trustee") to be managed and used in the interest of beneficiaries. The Trust consists of a legally binding long-term relationship. The Swiss Trust shall not act as a so-called *purpose trust*, i.e. a trust where the assets are not allocated for the benefit of specific persons. The draft bill does not provide for any further limitations as to the purpose of the Trust. Therefore, the Trust should be able to fulfill all functions assigned to conventional trusts under common law.

The Trust may be established by any natural person or legal entity ("settlor"), regardless of nationality and residence with capacity to act. The settlor dedicates assets to a separate patrimony administered and managed by one or more trustees in the interest of one or more beneficiaries. The Trust is established either by *unilateral written declaration* or by *testamentary disposition* (so-called

"Testamentary Trust"). Under the current law, the Testamentary Trust is considered inadmissible by doctrine due to the *numerus clausus* of testamentary dispositions. Therefore, art. 493 CO will have to be amended accordingly. The draft bill contains statutory provisions to protect the rights of the settlor's heirs, in particular the right of abatement. However, it is unclear whether an heir who has received distributions from the Trust has a hotchpot duty.

The Trust instrument designates the trustee and the beneficiaries and regulates the administration of the Trust assets. The settlor may reserve rights such as revoking the Trust or amending the provisions of the Trust instrument after its creation.

Upon creation of the Trust, the ownership of the Trust assets is being transferred to the trustee in accordance with the principles of property law. Any natural person or legal entity is eligible to be a trustee. Since the Financial Institutions Act (FinIA) entered into force in January 2020, professional trustees require a license and are subject to supervision. The draft bill provides for extensive identification and documentation obligations for the trustees to ensure the Trust cannot be misused for money laundering, terrorist financing or tax evasion. The trustees manage the Trust assets in the

exclusive interest of the beneficiaries and in accordance with the provisions in the Trust instrument. The Trust instrument may grant certain powers (namely the right to revoke or terminate the Trust, the right to grant or withhold his consent to certain acts of the trustee, the right to replace the trustee and appoint his successor) to one or more so-called protectors.

Depending on the provisions in the Trust instrument, the beneficiaries are either entitled to benefits ("*fixed interest trust*") or have mere expectancies at the trustee's discretion ("*discretionary trust*"). Furthermore, beneficiaries enjoy certain rights of control over the trustees (namely the right to obtain information and demand disclosure). Their rights are further strengthened by a bankruptcy privilege in the event of debt enforcement against the trustee and a so-called tracing right, i.e. a claim for restitution in the event of unauthorized disposition of Trust assets by the trustee to a third party. In the event of serious breaches of the trustee's duties, beneficiaries may demand his removal and claim damages caused to the Trust or the beneficiaries.

The competencies of Swiss courts for trust law matters will be regulated by the Swiss Civil Procedure Code (CPC). It should be emphasized that the draft bill also allows for the Trust instrument to provide for an arbitration clause. In the context of estate planning, this possibility allows families to avoid disputes before state courts.

The Trust shall terminate at the expiration date or when there are no longer any beneficiaries, but no later than 100 years after its creation.

### Taxation of Trust

The current treatment of foreign trusts under tax law is essentially governed by Circular Letter no 30 of the Swiss Tax Conference (SSK). The draft bill provides new taxation rules for Trusts. There are

three basic types of trusts to be distinguished:

*Revocable trust:* In the case of a *revocable trust*, the settlor does not definitively alienate himself of the assets that have been settled into the Trust, as he has reserved the right to return the remaining Trust funds to his own assets. Therefore, for tax purposes, the assets and revenues continue to be attributed to the settlor. Benefits to beneficiaries are subject to inheritance or gift tax, however descendants are basically exempt from said tax. Hence, the proposed statutory regulation would adopt the current tax practice.

*Irrevocable fixed interest trust:* The settlor of an *irrevocable fixed interest trust* irrevocably alienates himself of the assets that have been settled into the Trust. The Trust instrument defines the beneficiaries, the extent and timing of benefits. Therefore, the trustee has no discretionary power to allocate benefits and/or assets of the Trust. For tax purposes, the beneficiary is considered to be an usufructuary, whereby the Trust assets and revenues are attributed to the beneficiary. Upon establishment, inheritance or gift taxes incur depending on cantonal law. Disbursement of benefits does not entail any tax consequences, since the current beneficiary has already been taxed both on the income from these assets and the assets. This provision is in line with current practice.

*Irrevocable discretionary trust:* In the case of an *irrevocable discretionary trust*, the settlor also irrevocably alienates himself of the assets that have been settled into the Trust. However, the Trust instrument contains only abstract classes of beneficiaries, leaving the decision about the ultimate beneficiary in the discretion of the trustee. Since the beneficiaries, the extent and timing of the benefits have not yet been determined at the time of the establishment of the Trust, the beneficiaries are not yet be consid-

ered to be enriched. According to the current tax practice, the settlor domiciled in Switzerland is only depleted of assets if another taxable entity is enriched. Therefore, the assets and revenues of an *irrevocable discretionary trust* continue to be attributed to the settlor. If, on the other hand, the settlor was domiciled abroad at the time of the creation of the Trust and subsequently moved his domicile to Switzerland, the Trust assets are neither attributed to the settlor nor to the beneficiaries. The predominant doctrine classifies such attribution of assets to the settlor as unconstitutional since there is a violation of the principle of taxation according to economic capacity. In addition, the different treatment of the settlor with domestic and foreign domicile is criticized.

The working group considered seven options for the tax regulation of *irrevocable discretionary trusts*. In the draft bill the first option has been implemented: The trust income and assets are to be attributed to the Trust, which is treated as an independent tax subject (similarly to a foundation). Taxation requires, that at least one of the beneficiaries is domiciled in Switzerland. In addition, tax liability does not extend to the shares of beneficiaries resident abroad. If a Trust is resident abroad under the applicable double taxation treaty, Switzerland cannot enforce taxation of the Trust, which is why the Trust's income and assets are attributed to the settlor ("*subsidiary rule*"). Furthermore, the settlor and the beneficiaries are jointly and severally liable in Switzerland for the tax of the Trust.

The option selected renders the Trust for its main application in estate planning, i.e. the Family Trust for the benefit of direct descendants, unattractive in terms of taxes, given the fact that the assets are subject to inheritance tax and gift tax at the non-relative rate and the payment of benefits is subject to income tax.

## Conclusion

The introduction of a Swiss Trust based on Swiss legal institutions is to be welcomed in principle, as it provides a reliable instrument for estate planning and preservation of assets and does not require recourse to foreign legal institutions. However, in order for the Swiss Trust to offer a genuine alternative, improvements would still have to be made, particularly in the tax law treatment of the *irrevocable discretionary trust*. Particularly in the case of Family Trusts, the tax situation is unfortunate, as there is no provision for a privileged tariff on either the establishment or the payment of benefits.

The Walder Wyss Newsletter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this Newsletter should seek specific advice on the matters which concern them.

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