R.I.P SWISS TRUST?

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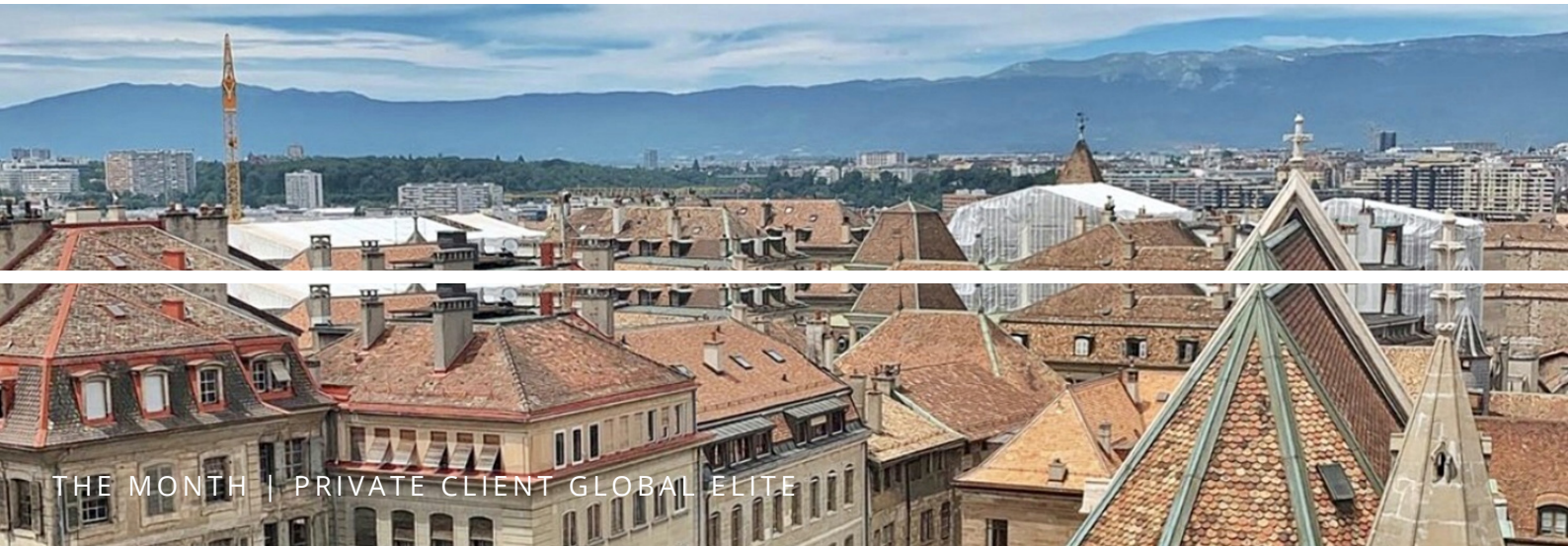
A couple of years ago the idea emerged that Switzerland was in need of its own trust law. This seemed at first fanciful: it is hard to imagine such a common law legal construction fitting in a civil law jurisdiction unfamiliar with the dismemberment of legal and beneficial ownership (Liechtenstein being a notable exception). Yet a group of experts set about working on a proposal which finally found its way in the legislative process. A draft bill has been prepared on which the consultation procedure is open until 30 April 2022.

Initially the support to a Swiss law trust was not, by far, unanimous. In a typical division of the country known as Röstigraben, the Geneva private client industry was generally in favour of the idea whereas its Zurich counterpart was at best doubtful and at worst strongly against. (Apologies to Basel, Bern or Lugano for the lack of nuance of this statement designed to convey a broad understanding of the situation to a non-Swiss readership.) A number of legal experts would have been more inclined to get rid of an outdated and moralistic provision in the Swiss civil code which prohibits the creation of Swiss law family foundations unless their goals are limited to education, health and support in favour of family members. Their views were swiftly brushed off as being politically unacceptable and fiscally inadequate, which is not without irony given the current status of the matter.

Questions were asked about the advantages a Swiss law trust would bring to a country where private client advisers have been familiar with common law trusts for decades and have used them as a very helpful estate planning tool for their foreign clients who still represent the core business of the trust industry. In search for a political justification, some of the supporters have referred (including in recent press articles) to a domestic need and presented the Swiss law trust as a cheaper alternative for Swiss families. The prevailing view is, however, that a Swiss trust is unlikely to be used in a purely Swiss environment and that the costs associated with its creation and administration will not be necessarily cheaper – and why would they, unless the related services are offered by second-class advisers which would hardly be to anybody's benefit.

Admittedly the creation of a Swiss trust would save the costs associated with foreign law advice and might provide a boost to the local trust industry. Switzerland-based trust companies would obviously not stop administering common law trusts but would have an additional option in their offering. European or LATAM families, as an example, may favour a trust instrument created in a civil law jurisdiction closer to their own legal system.

Also, the jurisdiction of Swiss courts in the event of disputes would avoid the costs associated



litigating trust disputes in sometimes paradisiac yet distant locations, requiring an armada of local counsel, London masterminds and prestigious QCs. This view may prove to be dangerously simplistic: for years Swiss lawyers have contributed to the education of Swiss courts in their approach to trusts, with the help of foreign law opinions which have been immensely helpful in the conduct of the proceedings. To a large extent, with some (well publicised) exceptions confirming the rule, court decisions in relation to trusts have been satisfactory from a legal point of view. If the world of trusts is no longer a terra incognita for the Swiss judiciary, it is essentially thanks to the common law doctrine and case law. Without the assistance of this baggage, the sole reliance on civil law concepts could lead to unpredictable results.

All trust practitioners know that a reputable judiciary and a well-functioning court system are important factors in the selection of a trust jurisdiction. In that respect the courts of Switzerland certainly meet the requirements. The draft bill anticipates that a jurisdiction clause may be inserted in the trust deed, failing which the courts of the place of residence or incorporation of the defending party or one of the trustees, or the place of administration of the trust, will have jurisdiction. Interestingly, the draft bill appears to encourage the settlement of trust disputes through arbitration: an arbitration clause included in the trust deed will be binding on the settlor, the trustee, the protector and the beneficiaries. The recourse to arbitration, with a careful selection of arbitrators familiar with trusts, including common law experts, may alleviate the concerns expressed above.

A big question mark remains regarding the approach to trustee directions applications. The draft bill also opens the way to similar applications by the settlor or the protector. With a few exceptions, such as decisions made by a guardian under the supervision of the courts of protection, Swiss courts are typically not of the blessing kind. Overburdened judges may find irritating to be asked to endorse decisions which should be made, on the basis of their own judgement, by those who have been specifically entrusted to make them (and are remunerated for doing so). Whereas an arbitration clause may also cover these applications, the process of appointing arbitrators and other procedural issues associated with arbitration may be incompatible with the requirements of urgent applications which would otherwise be subject to summary proceedings in the ordinary courts.

However, the elephant in the room is neither the judge nor the arbitrator, but the taxman. This remark might not be entirely metaphorical: according to some reports, representatives of the tax administration remained quiet during meetings of the expert group and came up at the last minute with proposals regarding irrevocable discretionary trusts which may seal the fate of the whole project. With an estimated additional annual turnover of CHF139m for service providers, the new Swiss law trust is expected to generate CHF57m tax revenues per year. This was not enough to gather the tax administration's support compared with the risk of losing taxable assets into the black hole of irrevocable discretionary trusts. According to the currently prevailing tax practice, irrevocable discretionary trusts may trigger Swiss gift or inheritance taxes upon settlement and they only generate income taxable in Switzerland if and when distributions are made to Swiss-resident beneficiaries. The proposed new rules would, in addition, subject the trust fund itself to a capital tax and an income tax, by assimilating it to a foundation (hence the irony mentioned earlier in this article), should one of the beneficiaries be resident in Switzerland. There would be a joint liability of the settlor and the beneficiaries for these taxes.

These tax proposals are widely regarded as

unacceptable. The prevailing view among practitioners is that the tax rules should remain uncodified and subject to the Swiss Tax Circular Nr 30, published in 2007, which has since then provided mostly adequate guidelines to the various cantonal tax administrations. Unlike statutory provisions, these guidelines allow for a desirable flexibility. Many cantons are understandably annoyed by the prospect of losing yet another chunk of their much-coveted fiscal independence. The participants to the consultation procedure (including, among others, STEP, the Swiss Association of Trust Companies and various lobby groups of the Swiss banking industry as well as law firms or any professionals with an interest in the project) are likely to be vocal in their opposition to the new tax rules.

Will this opposition kill the project altogether? At the time of writing all positions are not yet known. Some powerful lobby groups are reportedly prepared to withdraw their support to the draft bill if the proposed tax provisions are not substantially amended or removed entirely. From a political point of view, it is unlikely that parties of the left would accept a new "estate planning tool for the rich" without an appropriate taxation. The future will tell whether this will result in an irreconcilable position causing the abortion of the nasciturus Swiss trust. ■