

# Potential tax controversies in the area of wealth management

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# **A WELL-EQUIPPED TOOLBOX**

## The tax authorities have a well-equipped tool box at their disposal

Hidden profit  
distributions

Economic  
approach

Abuse of law  
theory

Old reserves

Place of  
effective  
management

Beneficial  
ownership

Simulation

Reclassification  
of income

Arm's length  
tax  
adjustments

Etc. etc.

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# **PLACE OF EFFECTIVE MANAGEMENT: DEFINITION**

## **Place of effective management (POEM)**

- Companies are subject to Swiss unlimited taxation if they have their seat or their POEM in Switzerland.
- The same rule also applies in intercantonal situations.
- A non-Swiss company is subject to unlimited taxation in Switzerland if it is effectively managed in Switzerland.
- Swiss case law and practice: POEM effectively “overrides” a mere formal seat.

## **POEM: Definition**

- The POEM of a company depends on the nature of the company's ongoing activities.
- Substance over form approach
- The POEM is typically located:
  - where the threads of management come together,
  - where the essential business decisions are taken,
  - where the company has its economic and real center of existence, or where the relevant actions necessary for the achievement of the corporate purpose are usually taken.
- Management activity in that sense must however be distinguished from mere administrative activities (such as accounting) and from supervision or strategic activities, i.e. functions typically carried out by a board of directors or by the general meeting of the shareholders.
- Mere letter boxes, empty meeting rooms, nominee directors at the location of choice are usually not worth very much.

## **POEM: Definition**

- In certain cases it might even be presumed that the POEM of a mere passive investment company is located at the (Swiss...) domicile of the controlling shareholder (e.g. Court decision of the Zurich administrative court, dated 2 April 2014, SB.2013.00037).
- The POEM concept can have a retroactive effect: taxes, interest, potentially penalties up to ten years back.
- In a globalized world, with instant communication and digital connectivity, with clients who are highly mobile, the concept of POEM may seem anachronistic. Yet it remains applicable.



# **PRACTICAL IMPLICATIONS**

## Practical implications

- Typical problematic scenarios:
  - Investment companies with offshore seat,
  - Offshore underlying companies of trusts with Swiss settlor/beneficiaries
  - Foreign finance companies
  - Companies without economic substance
  - Service company located very far away from its sole shareholder / manager's domicile "(who would travel that far every day?")
- Currently very hot topic in both international and intercantonal scenarios
- Anecdotal evidence suggests that some high tax cantons are systematically reviewing potential "opportunities": The typical angle of attack is the ordinary tax assessment procedure of resident shareholders who own non-resident companies.

## Practical implications

6. November 2018

**[REDACTED] AG**  
**Vorentscheid über die Beanspruchung der Steuerhoheit**

Sehr geehrte Damen und Herren

Das kantonale Steueramt hat über die Beanspruchung der Steuerhoheit mit nachfolgender Begründung entschieden:

**Die Steuerhoheit des Kantons Zürich und der Gemeinde Zürich wird ab 01.10.2014 beansprucht.**

### **Rechtsmittelbelehrung**

Gegen diesen Entscheid können die Steuerpflichtige und die Gemeinde innert 30 Tagen nach Zustellung schriftlich Einsprache erheben.  
Die Einsprache ist unter Beilage einer Kopie dieses Entscheids beim Kantonalen Steueramt Zürich, Zentrale Dienste, 8090 Zürich, einzureichen.

Mitteilung an das Steueramt Zürich und die kantonale Steuerverwaltung Zug.

Freundliche Grüsse

## Practical implications

- Tax audit for the last five, maximum 10 years
- Corporate profits retroactively subject to Swiss corporate income taxes
- Equity capital retroactively subject to Swiss corporate capital taxes
- Risk of international or intercantonal double taxation (see Judgement of the Swiss Supreme Court of 17 July 2017, 2C\_655/2016).
- Potentially penalties for tax evasion (depends on the facts).
- What about Swiss withholding tax (35%) on past dividends, hidden profit distributions and transactions that were not at arm's length? Swiss WHT law requires not only POEM but also a commercial activity in Switzerland ...

## Key takeaways

- If it's too good to be true, then it is probably too good to be true: Outsourcing personal wealth to a foreign controlled company in order to save or defer income taxes is probably not going to work.
- Pre-immigration planning: review and restructure the client's wealth organization (also applicable to lump sum taxed clients!)
- Review existing structures: If appropriate, raise the issue with the tax authorities before they raise it with you.
- The legal structure should follow the economic reality. Letter box companies are "out".
- Generally speaking, what about Swiss-based trustees of irrevocable discretionary trusts with underlying offshore companies? *"In the exercise of their functions and in addition to all powers of management and administration conferred upon them by law the Trustees shall have all the powers of an absolute beneficial owner including the following powers: (...)"*

**Thank you very much.**

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