

Switzerland

Taxation

HEDGE FUNDS 2009

Hedge fund managers/advisors

Taxation

Tax rates applying to hedge fund managers/advisors

Most Swiss hedge funds are legally set-up as contractual funds with a fund of funds structure. Swiss contractual funds are managed by a fund management company that takes the form of a Swiss corporation. As such, the management company is considered as a separate taxpayer in Switzerland and subject to corporate income tax at federal, cantonal, and communal level.

Foreign hedge funds can have a Swiss advisory company that usually also takes the form of a Swiss corporation.

Dividend distributions from Swiss companies to their shareholders are subject to Swiss withholding tax at the rate of 35 percent (shareholders resident in Switzerland can claim a refund of the Swiss withholding tax).

The effective tax rate usually suffered by hedge fund managers/advisors

Depending on the place of registration of the management company, the effective tax rate on the profit can vary from 16 percent to 27 percent.

Tax concessions, allowances, or exemptions specifically available to hedge fund managers/advisors

There are no specific tax concessions, allowances, or exemptions that are specifically available to management companies of Swiss hedge funds.

As a principle, the same applies to advisory companies of foreign hedge funds. In exceptional cases and as a pure matter of practice, advisory companies are successful in obtaining a tax status of an administration company (also called mixed company status), which applies to companies whose activities are mainly carried out abroad and whose Swiss activities are of insignificant character. Under such status, only a small part of the company's foreign-source income is subject to ordinary taxation at cantonal and communal level (this status is not available at federal tax level). Swiss-source income (if any) is fully subject to ordinary taxation.

Details of anti-avoidance tax rules that could bring the profits of an offshore hedge fund into tax

According to domestic legislation, a foreign company is subject to Swiss corporate income tax if:

- it is managed and controlled in Switzerland; or
- the foreign company has a permanent establishment (PE) in Switzerland.

A foreign company has a PE in Switzerland if it has infrastructure and carries out activities in Switzerland.

In the context of foreign hedge funds set up by Swiss residents, there are always certain tax risks when:

- (a) the foreign fund management company only has limited substance abroad (usually in an offshore location);
- (b) the directors of the company are domiciled in Switzerland;
- (c) the board meetings are held in Switzerland; and/or
- (d) management decisions are taken in Switzerland.

The risk is that the Swiss tax authorities, fully aware of all facts and circumstances, could either (a) consider that the foreign fund management company has a PE in Switzerland or (b) even consider that the tax residence of the fund management company is in Switzerland. As a result, the foreign fund management company would become subject to both Swiss corporate income and capital taxes. In a worst case scenario, there could be a full attraction, that is, the foreign hedge fund itself could be considered as a Swiss fund and, as a result, its income distribution or reinvestment would be subject to Swiss withholding tax at 35 percent.

Requirements to charge VAT (or equivalent sales tax) and the rate

The services rendered by a Swiss resident fund management company are generally exempt from VAT. As a result, the input VAT supported by the fund management company cannot be claimed back.

The services rendered by an advisory company are subject to VAT but zero-rated if the recipient of the services, that is, the fund management company, is located outside of Swiss territory. As a result, the full input VAT can be claimed back.

Hedge fund structures

Taxation

Tax rates applying to the fund

The taxation of Swiss investment funds depends on the way they are legally structured under the new Federal Act on Collective Investment Schemes which entered into force on 1 January 2007. The basic principles of taxation can be briefly outlined as follows:

Contractual funds and investment companies with variable capital (SICAV)

Swiss contractual funds, as well as SICAV, are generally treated as transparent for Swiss tax purposes and therefore do not constitute entities subject to Swiss corporate income and capital taxes in their own right. As a result, taxation is applied exclusively and directly to the investors (principle of tax transparency) and is determined by the tax laws in force in the country of their tax residence.

Limited partnerships for collective investment (LP)

The above-mentioned principle of tax transparency also applies to the LP. Since the general partner (the member who bears unlimited liability) must be a limited company with registered office in Switzerland, it is considered as a separate taxpayer in Switzerland and is subject to corporate income and capital taxes in its own right.

Investment companies with fixed capital (SICAF)

The above-mentioned principle of tax transparency does not apply in the case of the SICAF. The SICAF is treated the same as any other limited company with registered office in Switzerland. As such, it is considered as a separate taxpayer in Switzerland and is subject to corporate income and capital taxes in its own

right. The taxation at the level of the investors, who are shareholders, takes place only when the profit realized by the SICAF is distributed.

Access to double tax treaties

In principle, Swiss hedge funds are not considered to be eligible to claim treaty benefits according to the double tax treaties entered into by Switzerland.

However, as an exception, Swiss funds may obtain relief for withholding taxes on dividends and/or interest from the following jurisdictions:

A relief at source can be obtained under the double taxation treaties with Australia, Japan, and Canada.

A refund of foreign withholding tax is possible under the double taxation treaties with Germany, France, United Kingdom, the Netherlands, Austria, Norway, Denmark, Spain, and Sweden.

The benefits of such treaty relieves can be applied only in respect of the portion of Swiss resident investors in the fund.

Value-added tax registration and charging requirements

The Swiss fund itself is transparent and, as such, not considered as a VAT taxpayer. Neither is the fund management company, since the services it renders are generally exempt from VAT.

Withholding tax on dividends or interest payments

As a principle, all income distributions made by Swiss contractual funds, SICAV and LP are subject to Swiss withholding tax at a rate of 35 percent (distributing fund). The yearly income received by the fund is also subject to 35 percent withholding tax when the income is reinvested (accumulating fund).

As an exception, no withholding tax is due on the distribution or the reinvestment of net capital gains realized by the fund if such capital gain is clearly separated from the income received by the investment fund.

As a further exception, there is no Swiss withholding tax on the distribution or the reinvestment of income if:

- eighty percent or more of the income is derived from foreign sources; and
- the custodian bank can confirm that the unit-holder is resident outside Switzerland (that is, so called affidavit procedure).

Dividend distributions from the SICAF to its shareholders are subject to Swiss withholding tax at the rate of 35 percent (there is no exemption applicable for SICAF).

Tax returns requirements

Contractual funds, SICAV, and LPs do not file corporate income tax returns. The SICAF is treated the same as any other limited company with registered office in Switzerland and, as such, must file the usual returns for corporate income tax purposes.

Investors

Taxation

Swiss resident companies and life insurance companies would prefer to use corporate feeder vehicles because they are usually entitled to claim the participation exemption on dividend distributions and capital gains made on qualified investments.

Specific anti-avoidance tax legislation applying to an investor in an onshore fund

There is no specific anti-avoidance tax legislation applying to an investor resident in Switzerland where the hedge fund is resident in Switzerland.

Specific anti-avoidance tax legislation applying to an investor in an offshore fund

There is no specific anti-avoidance tax legislation applying to an investor resident in Switzerland where the hedge fund is resident offshore.

Tax information needs of investors

In principle, as far as income tax is concerned, the Swiss tax legislation does not distinguish between investments in Swiss or foreign investment funds. In both cases, distributed and reinvested fund income received from a contractual fund or a SICAV is subject to income tax while capital gains are tax-free for investors holding their assets for private investment purposes (if distributed with separate coupon or if the fund provides specific information on the portion of capital gain and income included in the distribution). This means that Swiss resident individuals are subject to income tax in respect of undistributed income of a foreign accumulating fund in the same way as for Swiss accumulating funds. The Swiss Federal Tax Administration recently published model calculation excel spreadsheets for the determination of the taxable income of foreign funds and fund of funds vehicles for Swiss tax purposes

Based on this, a Swiss resident investor will require details on the fund income and the tax value of his/her investments in order to complete his/her tax return. The taxable income and the tax value for net wealth tax purposes of numerous Swiss and foreign funds is published each year by the Swiss Federal Tax Authorities in an official list.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.