

Single family offices in Switzerland

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Over the last few years, family offices, particularly single family offices, have become far more widespread in Switzerland. It is estimated that there are 70 single family offices and 400 multi-family offices, and it is expected that the number of family offices will continue to grow.

This article focuses on the reasons surrounding this trend and sets out the legal and tax environment for family offices. It also discusses the possible configurations for single family offices.

SINGLE FAMILY OFFICES

Entrepreneur and banker families (for example, the Medici and Rothschild families) used family office services for a long time before a distinct sector emerged. The origins of family offices can therefore be traced back as far as the Renaissance.

A family office provides a large number of services for high net-worth individuals or families going far beyond traditional private banking services. As well as asset management, for example, a family office is involved in the legal and strategic questions relating to the structuring of an individual's or a family's assets. These questions might relate to the following:

- The strategic management of the family's business.
- The management of and risk assessment concerning significant sections of their business.
- Estate planning and fulfilment of the differing requirements of family members.

In many cases, family offices also assist their clients with administrative matters, or co-ordinate the instruction of other service providers such as tax advisers and lawyers. Families establish single family offices due to the need for:

- Individual investment solutions.
- The complexity of certain asset classes.
- The need for risk assessment, monitoring and other services banks do not normally provide.

The number of single family offices in Switzerland is growing. The ratio between single family offices which have only transferred their seat to Switzerland and newly established single family offices is unknown. Single family offices typically manage family assets in excess of at least US\$250 million in the US and at least CHF500 million in Europe (as at 1 October 2012, US\$1 was about CHF0.9). Since the number of wealthy individuals and families who own assets which allow the establishment of a single family office is growing steadily, it follows that the total number of single family offices worldwide is growing as well.

WHY SWITZERLAND?

Switzerland offers many advantages to wealthy families such as security, stability, good education and health systems, high environmental standards, an excellent infrastructure and a beautiful landscape. These factors all contribute to a country with one of the highest standards of quality of life worldwide.

Furthermore, Switzerland has a strong financial services industry providing a high quality of financial services and a labour market that is comprised of a workforce that is well educated, multi-lingual and service oriented. Furthermore, the location of Switzerland is an advantage, since it is in the centre of Europe and provides excellent flight connections to almost all major cities.

Switzerland possesses a stable economy, an efficient capital market and a strong currency. Moderate taxation as well as the possibility to negotiate favourable tax rulings with the tax authorities further enhance the attractiveness of Switzerland as a location for wealthy families and their family offices.

REGULATORY ENVIRONMENT

Prudential supervision

This article focuses on investment management services rendered to wealthy individuals and families through their family office.

Currently, asset managers and wealth advisers are not subject to direct prudential supervision by the Swiss Financial Market Supervisory Authority (FINMA). Therefore, a family office providing asset management and/or wealth advisory services does not need permission or a registration with FINMA.

However, restrictions apply on investment in collective investment schemes on behalf of clients. Asset managers who wish to invest on behalf of their (retail) clients in collective investment schemes must join a professional self-regulating organisation (SRO) for asset managers and adopt the SRO standards. Although certain exceptions exist (for example, asset managers who render their services exclusively to wealthy clients), it is recommended to join an SRO. There are several advantages attached to SRO membership, including the following:

- It allows banks and other regulated financial intermediaries to treat the asset manager as a qualified investor with regard to collective investment schemes.
- It allows the asset manager within the boundaries of the asset management agreements to invest in collective investment schemes on behalf of all his clients.
- It allows the asset manager to invest in foreign collective investment schemes.
- Banks are quite strict in accepting third party asset managers and usually require certain proof of prudential organisation.

There are several SROs for asset managers. These are privately organised associations with several hundred members. They are subject to supervision by the FINMA. Joining an SRO slightly increases costs and administrative work but these costs are still reasonable.

Pure wealth advisers such as Swiss family offices offering solely investment advice and not asset management services are not obliged to join a professional asset managers' SRO. Therefore, it is important to consider both the:

- Scope of the services to be rendered.
- Duties arising out of the regulation on collective investment schemes before a new family office is established.

Anti-money Laundering Act

The Anti-money Laundering Act (AMLA) imposes a number of duties on financial intermediaries. In terms of the AMLA, financial intermediaries are persons or legal entities who, on a professional basis, accept or hold on deposit, assets belonging to others, or assist in the investment or transfer of these assets. A family office qualifies as a financial intermediary if:

- The family office, through activities falling within AMLA's scope, achieves a gross revenue of more than CHF20,000 in a given calendar year. The net revenue must be taxed as balance sheet profits. Therefore, for a client-owned single family office, there is no incentive to make a profit. Whether a family office achieves a profit or not primarily depends on the way in which the contracts with the client have been structured. Provided that the contractual relationship between the family office and its client(s) has been structured accordingly there will be no business profits.
- Within a particular calendar year, the family office has entered into long-term business relationships with more than 20 contracting parties or maintains long-term relationships with at least 20 contracting parties. Single family offices will not normally meet this requirement, if they limit the provision of their services to one core family.
- In the context of an ongoing business relationship, the family office has power to dispose of assets belonging to others that exceed CHF5 million at a given point in time. As it is only worth setting up one's own family office when the family assets far exceed CHF5 million, this criterion is generally fulfilled by single family offices.
- A family office, through activities within the scope of AMLA, effects transactions the volume of which exceeds CHF2 million annually.

Therefore, most family offices qualify as financial intermediaries and must comply with AMLA provisions. AMLA imposes a number of duties on financial intermediaries. Notably, they must join an SRO or submit to direct supervision by FINMA. Some anti-money laundering SROs are professional SROs for asset managers or offer dual memberships. Combined or dual membership is recommended as it reduces administration costs and the time exposure.

TAX SITUATION

Cantonal differences

Switzerland has a strongly federalist structure, which is reflected in its taxation system. Only the federal government can levy certain, primarily indirect, taxes, such as value added tax (VAT), stamp taxes, withholding tax on dividends and certain interest payments. However, other taxes, primarily the direct taxes on income and net-worth are levied at the levels of the cantons and municipalities. Legislative power relating to cantonal and communal taxes generally lies with the legislative bodies of the 26 cantons. Therefore, there is a variety of different cantonal tax systems and rules and the effective income and capital/net-worth tax burden varies considerably from canton to canton and between the municipalities of a canton.

Corporate income and capital taxes

Swiss resident corporations are generally liable for federal, cantonal and communal taxes on their income. At the cantonal/communal level, corporations also owe an annual capital tax on their net equity (that is, paid-in share capital, surplus and retained earnings). Depending on the canton and the applicable taxation system, the effective capital tax burden may range from 0.001% to 1%.

Income and capital attributable to a foreign permanent establishment or foreign real estate is unilaterally exempt from Swiss taxes. Dividends from substantial participations are partially exempt by applying dividend taxation relief. A corporation is considered resident in Switzerland if it is incorporated in Switzerland or, in the case of a corporation incorporated abroad, if it is effectively managed from Switzerland.

The system of economic double taxation of the corporation and its individual shareholder still partially applies. Accordingly, corporate profits are firstly taxed at the level of the corporation and, subsequent to their distribution, also subject to income tax in the hands of the shareholders holding the participation as part of his private assets. However, individual shareholders which own more than 20% of the shares in a company are partially relieved from this double taxation.

Federal income tax

Corporate federal income tax is levied on worldwide net profit at a flat rate of 8.5% (effectively 7.83% as taxes are tax-deductible costs). Losses can be carried forward over seven years and no loss carry-back is provided for.

Combined with cantonal, communal and federal taxes, an ordinary corporation is taxed in Switzerland between approximately 12% and 25% depending on the respective commune.

Service, auxiliary or administration companies

In several cantons, entities can have the tax status of a service or auxiliary company if they fulfil the following criteria:

- They are incorporated in the relevant canton.
- They have an operating office with employees in Switzerland.
- They do not carry on ordinary commercial transactions within Switzerland.

These entities engage in the management of foreign subsidiaries or affiliated companies, financing transactions, marketing, publicity and technical assistance, and so on. The specific requirements for this tax status vary from canton to canton, and must be negotiated in each individual case. Generally, the service, auxiliary or administration company is exempt from cantonal/communal income taxes on a substantial portion of its foreign-source income whereas it pays ordinary income tax on any income from Swiss sources. Income and gains from substantial equity holdings are exempt from cantonal/communal tax.

In some cantons, these service companies can request to be taxed according to the cost plus method. This means that the taxes are levied on an income basis which is deemed to be a percentage of the incurred costs. Depending on the respective percentage (starting from 5%, usually 10% to 20%) this tax calculation method can be favourable for single family offices which provide only investment advice to foreign clients (for example, trustees). Any such structures require that there is sufficient substance in the involved foreign jurisdictions (personnel, effective decision making, office space, and so on).

VAT

The Swiss federal VAT system is generally in line with the harmonised VAT systems of the EU member states.

Swiss domestic and foreign companies must register for VAT purposes if they carry out taxable activities on Swiss territories with a turnover exceeding CHF100,000. The standard VAT rate is currently 8%.

Double taxation treaties and tax rulings

Switzerland has concluded bilateral tax treaties with more than 60 jurisdictions including the US, Canada, Japan and most of the European jurisdictions. These treaties offer legal certainty in most cases. In addition, most cantons offer the possibility to request a binding ruling from the tax authorities on an individual matter.

The Swiss and foreign tax implications must be reviewed before a new family office is established. This is particularly important with regard to complex structures and structures with an international background. Tax rulings are a powerful tool to optimise the tax situation and to reduce legal uncertainty.

Furthermore, Switzerland has acceded to the HCCH Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trusts Convention). This allows Swiss family offices to act as trustees of a foreign trust without negative tax consequences and ensures that in case of a bankruptcy of a Swiss trustee, the trust assets can be separated from the bankrupt's estate.

POSSIBLE CONFIGURATIONS FOR SINGLE FAMILY OFFICES

Legal form

Theoretically, family offices can use any legal form that permits this kind of business activity. However, in practice, most operate as public or private limited liability companies (*Aktiengesellschaften*

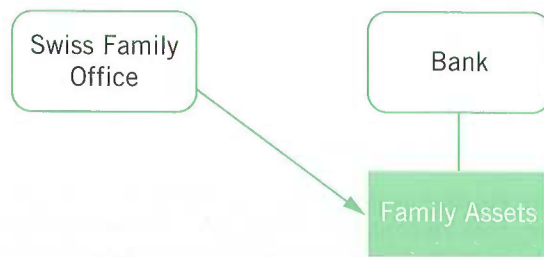
or *GmbH*). A company constituted in one of these forms has its own name, its own legal personality separate from its shareholders/members and a fixed nominal capital divided into shares. The shareholders' personal liabilities are generally limited to the full payment of the nominal value of their shares.

Possible set-ups

The individual circumstances of persons and families needing the services of a single family office are very diverse. A wealthy individual whose wealth is broadly diversified and invested on the financial market has other needs than, for example, a South American client who owns a group of industrial companies. It is necessary to assess the specific needs of the client before a structure is chosen.

There are three main possible set-ups for a single family office which can be combined and adapted to the individual needs.

Classic single family office. The single family office is constituted as a stand-alone limited liability company. The main services provided are usually asset management, reporting and related wealth services. Generally, the family office works closely together with one or several banks. Beside asset management, classic family offices often provide a range of auxiliary services, such as wealth and succession planning and legal and administrative services to their principals (that is, the individual or the family to whom the single family provides services).



Advisory company. An alternative configuration is the use of the Swiss single family office as a pure advisory company. In this case, the assets are usually held by foreign trustees or by foundations. The family office gives investment advice to the trustees or the members of the foundation board.

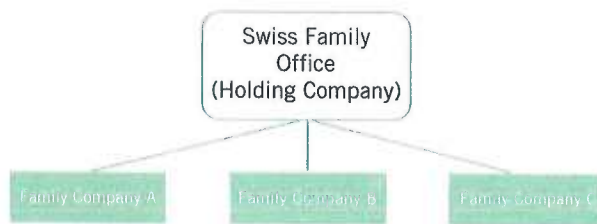
Depending on the tax situation in the jurisdiction where the principal lives and in the jurisdictions where the trustees are located, this set-up can be more advantageous than the classic single family office, where the family office manages the assets directly.



Analysis

Family holding. If the wealth of a family consists to a substantial part of a family business and the family holds the shares in the respective company, it can make sense to organise the family office as a holding or “mother” company and to organise the family business as a subsidiary or subsidiaries of the family office.

Distribution of the shares in the holding company to the principal's family members, allows family members to participate in strategic decision making and decision taking as well as in the income generated by the family business. However, the financial participation in the family business can also be separated from the voting rights by introducing voting and participation certificates. This separation can provide great flexibility and allow bespoke solutions for the client's family.



Ownership

The shares of a single family office can be owned either:

- Directly by the principal.
- By a holding company.
- By a trust or a foundation.
- Fully or partly by the persons working in the family office.

An additional holding company is not usually necessary.

The most suitable model depends on the individual circumstances. However, from the principal's point of view, it is recommended to align the interests of the persons working in the family office with the interests of the principal. This can be achieved by offering them performance-oriented salaries rather than by giving them shares in the family office. This allows the principal to keep control over the family office in general and particularly over employment matters.

In some situations, it is sensible to use a star trust. A star trust is a Cayman Islands purpose trust which has no beneficiaries but serves a specific purpose (for example, holding all the shares in a family office). This structure allows the shares of the family office to be kept out of the principal's estate.

Services

Single family offices can render a wide range of services including:

- Asset management.
- Wealth advisory services over managing the family business.
- Auxiliary services such as, taking out tax advice, succession planning and administrative services.

Tax rulings

In most cases, a tax ruling should be sought regarding income taxes, to ensure that the tax authorities will accept the company's calculation methods. For classic family offices, a tax ruling can be useful to negotiate the pricing of the services rendered to the principal. Family offices which provide only advisory services and would like to calculate their taxes based on the cost plus method must always apply for a tax ruling.

A tax ruling is also recommended if the principal would like to set up his own charity. In this case, the tax ruling can confirm charitable status for tax purposes and set out the rules for segregation of charitable and non-charitable activities.

Conclusion

Financial markets are under pressure worldwide. Although Switzerland and its financial market are not a safe haven, it is expected that its advantages will continue to attract family offices regardless of the financial crisis. Therefore, it is expected that more family offices from abroad will transfer their legal seat to Switzerland as well as a continuing trend of wealthy families establishing a new family office in Switzerland.

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