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taxbulletin

Dear Sir or Madam,

We are pleased to send you the second edition of our 2012 TaxBulletin in English. This publication is intended to keep you up-to-date about current topics and news regarding Swiss tax laws, as well as information about appropriate tax planning.

Professional Securities Trading

1. Primacy of tax-exempted private capital gains

In Switzerland, capital gains on movable private assets, like securities, are generally tax-exempt. The Swiss tax authorities, however, qualify such gains as taxable income from self-employment if the purchase and the sale of such assets exceed the simple management of private wealth. Furthermore, social security contributions of approximately 10% must be paid on such gains. Due to the different tax consequences and the possible social security contribution burden for the above mentioned items, accurately qualifying the management of the private wealth is very important.

To provide more legal certainty, the Swiss Federal Tax Administration (FTA) has published safe haven rules. If these rules are fulfilled, professional securities trading can be excluded. Otherwise, it must be decided on a case by case basis whether the realized gains are the result of professional securities trading or of simple management of private wealth¹.

2. Management of private wealth

Capital gains on securities are tax-exempt as long as the purchase and sale of the securities does not exceed the simple management of private wealth. According to Swiss tax practice, simple management of private wealth always exists if the following criteria are **cumulatively** fulfilled (safe haven rules):

- The holding period of the sold securities was at least 6 months.
- The total of the purchase prices and the sales profits of one calendar year do not exceed five times the value of the securities and assets as of the beginning of the tax period.
- The capital gains on securities are not necessary to cover the living costs (this is generally the case if the realized capital gains do not exceed half of the net income in the tax period).
- The investments are either not leveraged or the earnings (e.g. dividends) exceed the pro rata interest on debt.
- The derivatives (especially options) are bought and sold for hedge purposes only.

If the above-mentioned rules are cumulatively fulfilled, capital gains on securities can be realized without triggering taxes. Otherwise, it must be decided on a case by case basis whether the realized gains are the result of professional securities trading or of simple management of private wealth.

3. Professional securities trading

In case the realization of profits is systematically intended, the purchase and the sale of securities exceed the simple management of private wealth. However, clearly differentiating between simple management of private wealth on one hand and professional securities trading on the other hand is nearly impossible. The circumstances of each single case are always decisive. The qualification is based on various criteria, whereupon only one of them may be sufficient to qualify capital gains on securities as income from self-employment.

¹ See the circular letter no. 36 dated July 27, 2012 of the FTA „Gewerbmässiger Wertschriftenhandel“ which replaces the circular letter no. 8 dated June 21, 2005 concerning the same topic. The new circular letter includes the recent jurisdiction of the Swiss Supreme Court (especially the different weighting of the criteria considered by the tax authorities for the qualification of gains resulting from the trade with securities [see cypher 3]). Furthermore, the safe haven rules (see cypher 2) have been adapted selectively (especially with regard to the holding period of 6 months [12 months until now]; furthermore, the closely connection between the transactions and the professional activity as well as the utilisation of specific know-how is no longer harmful).

Based on the recent jurisdiction of the Swiss Supreme Court, the following criteria are of **primary importance**:

- *Frequency of the transactions and holding period*
Frequent securities transactions and a short holding period indicate that a long-term investment of assets is not predominantly intended, but a quick realization of gains. Such criterion is a weighty indication for a professional proceeding.
- *Use of substantial borrowings for the financing of the trades*
The use of substantial borrowings is a weighty indicator for professional securities trading, especially if capital gains on securities are needed to cover interest on debt as well as charges.
- *Use of derivatives*
Trade with derivatives (especially options) is considered speculative if derivatives are **not** bought and sold for hedge purposes only and if a substantial number of derivatives in proportion to the total assets are bought and sold. The speculative character indicates professional securities trading.

The following criteria are of **secondary importance**:

- *Proceeding systematically and methodically*
If the taxpayer proceeds systematically and methodically, it indicates the professional nature of the trade with securities. In other words, if he tries to systematically utilize the development of the market, as well as if he re-invests the gains in similar assets.
- *Close connection between the transactions and the professional activity as well as the utilization of specific know-how*
Such criterion could be an indicator for a professional proceeding.

According to the jurisdiction of the Swiss Supreme Court, the use of substantial borrowings, the use of derivatives, and the frequency of the transactions must be primarily considered to qualify as gains resulting from the trade with securities. Proceeding systematically and methodically, the close connection between the transactions and the professional activity as well as the utilization of specific know-how, however, are criteria of minor importance which, taken individually, are not sufficient to indicate professional securities trading.

4. Summary

For tax payers with a substantial portfolio, the qualification as professional securities trader can lead to a significant income tax burden. Furthermore, social security contributions (old-age and survivor's insurance, invalidity insurance, income compensation allowances) are due on the realized capital gains on securities. Thus, it might be worth checking the actual portfolio management. We would be pleased to assist you in this matter.

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If you have any questions, our specialists are standing by to assist you. You may call: +41 44 208 10 10.