

# Taxation of private equity fund managers in Switzerland

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# Taxation of Private Equity Fund Managers in Switzerland – recent developments

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Income, such as carried interest, derived from a fund and received by a fund manager (individual) is generally subject to income tax in Switzerland at ordinary income tax rates ranging from 15% to 40%.

A circular to be published will confirm that the Swiss tax authorities differentiate between the situation where

- (a) the fund manager participates in the performance (gains/profits of the fund) disproportionate to the invested fund equity and
- (b) the fund manager participates proportionate to the invested fund equity.

#### **Disproportionate participation to investment in fund equity by the fund manager**

If the fund manager participates in the performance of the fund disproportionate (e.g. based on the offering

memorandum or the management agreement) to his formal equity investment, carried interest as well as excess profit (i.e. any amount received exceeding the return directly proportionate to the amount of equity invested) is subject to income tax. The fund manager is deemed to be self-employed if he receives the excess profit personally.

#### **Proportionate participation to investment in fund equity by the fund manager**

If the fund is not fully funded by equity but also by a large amount of debt received from investors, and profit participation is proportionate to equity, this is generally accepted by the tax authorities. By structuring the fund in this way it is possible that no excess profit has to be paid out. The full amount can be paid out as capital gain (to the extent the fund's income is capital gain only) and Swiss resident fund managers can generally receive these payments tax free.

# In Switzerland, carried interest is deemed as such only if according to the tax authorities a disproportionate interest payment is made.

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## Definition of carried interest

It should be noted that the use of the above terminology is different to that in the UK. In Switzerland, carried interest is deemed as such only if according to the tax authorities a disproportionate interest payment is made. If, however, the return on equity to the manager is proportionate to the other investors' equity return, this qualifies as capital gain and is thus not carried interest.

## In a nutshell

Carried interest paid out disproportionately to the investment in the fund equity directly from the fund to the fund manager is taxable and not tax free. If the fund is structured correctly, the fund manager can be rewarded tax free by receiving capital gains paid out proportionately to their equity investment and not by carried interest.

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