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PARTNERS ' VIEW
November 2019

Who is ... ?
Christian Dietsche

Authenticity is his trademark – he is completely dedicated to his customers.

Christian Dietsche has been working in asset management at swisspartners since 2016. Prior to this, he was employed by various Swiss financial institutions in national and international roles, including his last appointment of 13 years at Julius Bär. Impartiality and entrepreneurial thinking are always at the forefront of Christian's approach to asset management: «The customer always comes first and the related business is of the utmost importance.» However, humour and enjoyment are also vital to his work, not only for Christian personally, but also his colleagues. This is the approach he intends to build on in his new role. Christian superseded Markus Wintsch as head of asset management at swisspartners in early November, when he also became a member of the Group Managing Board.

How does he unwind from a day at work? Christian enjoys relaxing in his home municipality of Zumikon, where he lives and has strong roots. In his spare time, he regularly goes to the cinema and particularly likes reading biographies. He is also involved in the Zumikon municipal council in the department for community, social issues, asylum affairs, young people and the elderly. «It always brings me back down to earth and makes me realise how important it is to stand up for people less fortunate than yourself.»

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Wealth Management
Don't overlook the obvious

It has been said that the only two certainties in life are death and taxes. Perhaps it is time to add a third, which is that the majority of politicians will do whatever is politically expedient to get re-elected.

While there is a lot of noise going on at the moment surrounding the possible impeachment of President Trump, it should be remembered that impeachment is a political process and we are only in the investigation phase.

Given that we prefer to deal in facts rather than fiction, there is no denying that the US president is in a difficult predicament. Moreover, it is more likely than not that the news will get worse for him as the investigation continues.

Looking at his (former) favourite news source, the polling data does not look good.

No other president in history has had such bad ratings so early on in the impeachment process.

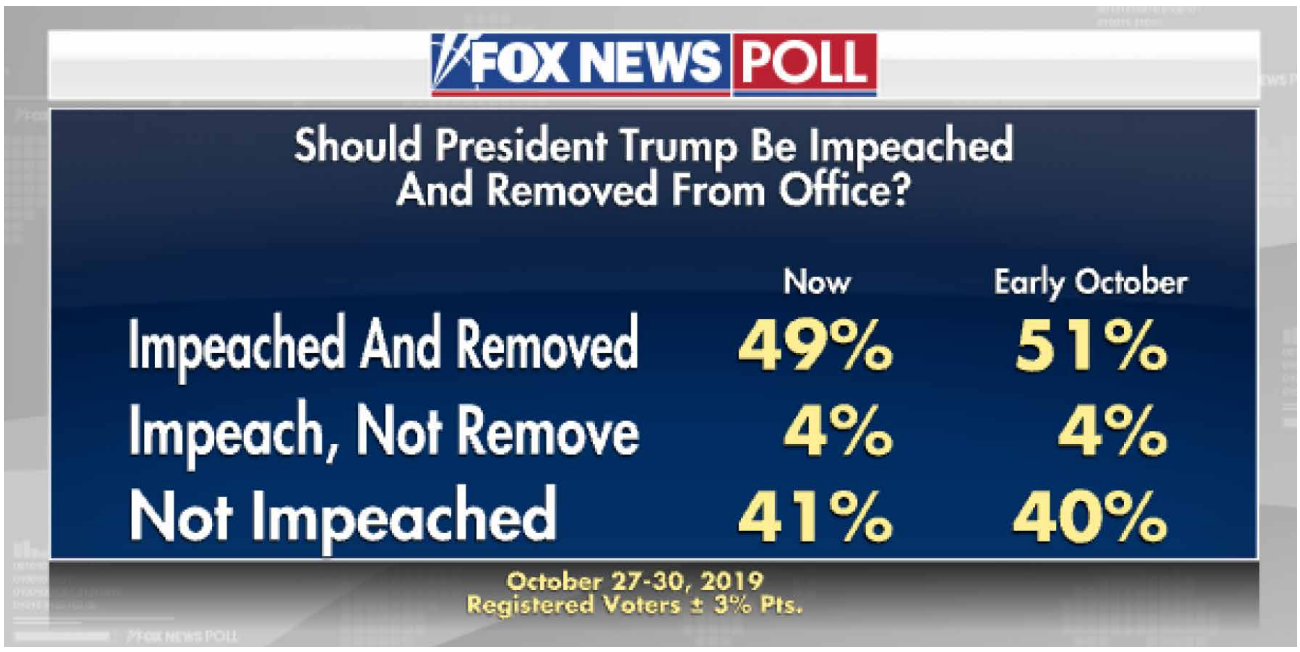
While at this point in time the Republican party seems to behind the president, a further deterioration in these numbers could cause things to change rapidly as Republican candidates reassess their chances of staying in power. In fact, a large majority of Republicans have stayed ominously silent, perhaps hedging their bets.

As we alluded to last time, the drop in US consumer confidence has led to an inflection in real economic data, with US manufacturing now technically in recession and services declining.

As demonstrated below, US retail sales are also exhibiting a worrying trend and it is possible that worse is to come.

All of this combined with a slowing global economy has placed many investors on edge, especially given the powerful psychological effect of last year when markets deteriorated significantly in the last quarter.

However, we should not forget that we have known the global economy is slowing for quite some time. As a result, markets should have priced in the vast majority of this news. Another vital factor this year compared to the same period last year is that central banks are in a highly accommodative mode. While they cannot deliver real economic growth, they can ease the pain somewhat.



Source: Bloomberg Finance L.P.

All paths lead to the same outcome – an easing of trade tensions

It is of course a bizarre coincidence that the recent (unsigned) mini trade deal with China along with the withdrawal of US troops from Syria coincided with some especially noisy impeachment headlines!

Option A
Things carry on as they are with the US economy floundering and no conclusion to trade deals. Trump is not re-elected – after all, who wants to deal with all this nonsense when there is no economic benefit? No incumbent US president has ever been re-elected amidst declining consumer confidence and economic data.

Option B
Trade deals are struck in order to boost the economy ahead of the US elections. While commentators may care about the financial details, markets could not care less as they just want this whole tawdry episode to go away so that growth can return. In fact, since the implementation of tariffs no real progress has been made, with the recent deal being just what China offered the US two years ago, though of course it will be spun a different way.

Option C
Tariffs are increased and a new front in the trade war with Europe opens up. The US economy starts declining sharply, forcing the United States to change course rapidly.

Option D
Trump resigns, not wanting to go through the impeachment process or to see his party turn on him and convict him in the Senate (part of the deal would be a non-prosecution agreement). This impediment to growth is removed and markets rally.

With the yield on US equities (S&P500) higher than that of 10-year US Treasuries (a consistent and reliable bullish market indicator), investors cautiously positioned and glued to political developments in Washington and many commentators talking about decade-long tensions with China, we find it very hard to be negative.

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FIDUCIARY SERVICES SWITZERLAND
Implementation of the corporate tax reform

In a referendum on 19 May 2019, the Swiss public voted in favour of the Federal Act on Tax Reform and OASI (Old Age and Survivors' Insurance) Funding. The tax reform was necessary as the global tax environment has become tougher in recent years, with Switzerland under pressure from other countries to abolish tax privileges for companies or face sanctions. The canton of Zurich has implemented the federal statutory requirements into cantonal tax law, which was approved by the electorate in a vote on 1 September 2019. The tax reform will take effect on 1 January 2020.

Below we will outline the key changes as a result of the tax reform, with a special focus on the canton of Zurich.

Abolition of cantonal tax privileges

At the cantonal level, tax privileges for companies with special tax status (such as holdings, mixed companies and domiciliary companies) will be abolished. The cantons have reacted by reducing the rate of profit tax as of early 2020 or 2021 to maintain their attractiveness as a business location. The level of reduction varies significantly from canton to canton, with the canton of Geneva cutting its rate from 24.2% to 14.0%, for example, compared to a reduction from 21.1% to 19.7% in the canton of Zurich. The reason for these differences is that cantons such as Geneva have a high number of companies with special tax status and are keen to keep these firms in the canton by offering a low rate of profit tax.

Temporary transitional provisions will be introduced simultaneously to cushion the adverse effects stemming from the abolition of tax privileges. Hidden reserves (including goodwill) booked by companies as a result of their special tax status will be subject to a separate lower tax rate during the first five years after the tax status has been changed (1.13% in the canton of Zurich). As an alternative – which has also been possible in the past – hidden reserves disclosed in the tax accounts can benefit from a tax-neutral step-up and be amortised tax effectively within 10 years. The canton of Zurich will implement a combination of these two methods, which should lead to an average tax rate of some 11% over the next ten years for companies benefiting from privileged taxation.

Deductions for research & development and patent box

The cantons can assign a higher weighting to research and development expenditure in order to promote R&D. Companies headquartered in the canton of Zurich can apply a special deduction of 150% for such expenses if they are incurred in Switzerland. The situation for the pharmaceutical industry in the Basel area is not very favourable as the canton of Basel Stadt will not introduce any special deductions, while the deduction in the canton of Basel Land will only be 120%.

The instrument of the patent box is an attractive, albeit complex option for research-intensive companies based in Switzerland. Profits from patents under the Swiss Patents Act, the European Patent Convention or comparable rights will be taxed at a reduced rate at the cantonal level in consideration of the qualified research and development costs per patent. The tax-reducing effect of the patent box will be set at up to 90% of the taxable net profit in the canton of Zurich.

Deduction for self-financing

Companies can apply a notional interest deduction to the portion of equity capital that is not required for long-term business operations (surplus equity capital).

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The interest rate to be used for calculating the deduction is based on the yields of 10-year Swiss government bonds. This deduction is only permissible in cantons with an effective profit tax rate of at least 18.03%. As a result, it is only likely to be introduced in the canton of Zurich.

Increased taxation of dividends

As of 2020, shareholders will have to pay federal income tax on 70% (currently 60%) of income from qualified shareholdings, while the tax rate at the cantonal level will be at least 50%, as previously. The canton of Zurich plans to postpone the increase in dividend taxation until 1 January 2023 at the earliest as part of a new bill. At the same time, the rate of profit tax in the canton will be reduced again from 19.7% to 18.2%.

Transference adjustments

Until now, sales by an individual of shares in excess of 5% to a company controlled by the same individual were subject to "transference", involving the reclassification of what would otherwise be considered a tax-exempt capital gain into taxable income. As of 2020, the 5% rule will be abolished and any sale of shares by an individual to a company controlled by the same individual will be subject to transference. Income from an individual's sale of shares to companies he/she does not control will generally remain tax-exempt.

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TRUST & CORPORATE SERVICES
Family and business dynamics: the relationship between family governance and business governance

In most countries across the world, family businesses employ more than 60% of the workforce and contribute in excess of 70% to the respective nation's gross domestic product. They constitute the economic backbone in both old and new economic regions.

However, only a small number of family businesses survive the third generation after being established. Two-thirds of all family-owned companies are liquidated by their founders or sold, while fewer than 15% are still run by a family member in the third generation (see the IFC/World Bank publication IFC Family Business Governance Handbook (2018) for more information on this).

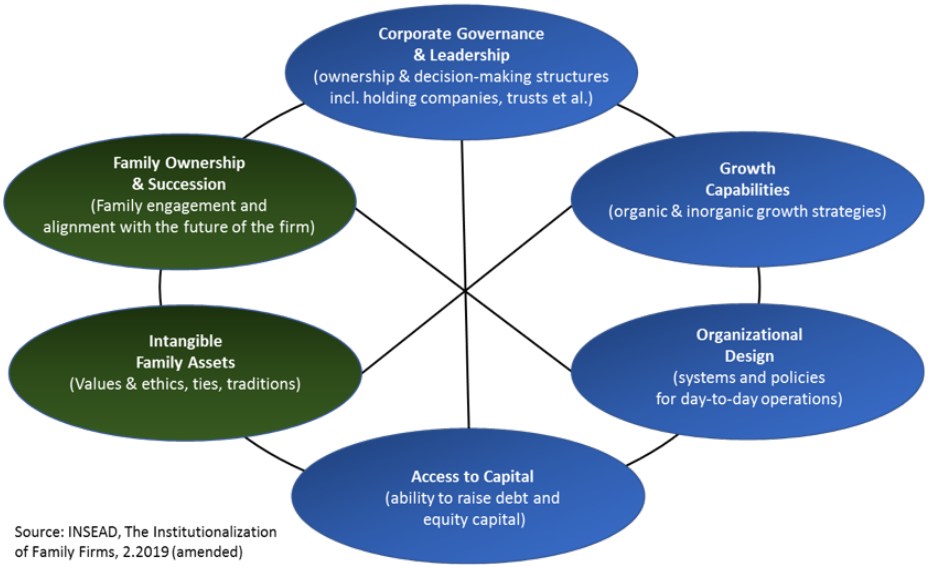
Following the publication of studies conducted by INSEAD on the Institutionalization of Family Firms in Asia-Pacific and the Middle East (2017) as well as Latin America (2019), we are taking this opportunity to discuss some of the underlying reasons for family companies' failure and to demonstrate how closely family and business governance are actually intertwined.

The studies by INSEAD make a distinction between what they refer to as ascendants and champions. Ascendants comprise family businesses that are no more than three generations old, while the champions are already in their fourth generation or later. The INSEAD authors set out the following reasons for the failure of family-run firms in the first three generations:

- **Lack of succession planning and arrangements –** this aspect is the most frequent reason for family businesses going under. Many business founders refuse – either implicitly or explicitly – to put succession arrangements in place or to allow any discussion whatsoever within the family of this emotionally charged issue. Differences in priorities, values and experience between the founding and subsequent generations are not discussed. Successors from within the family are installed by the business founder without these individuals having the necessary qualifications or backing from within the family and the firm.
- **Inadequate promotion of talent –** it is frequently the case that the second generation does not bring forth any personalities who could take over the running of the family business. Alternatively, there may be no programmes in place to identify and foster talent within the family from an early age. At the same time, family businesses may not be able to attract highly qualified external talent as these individuals consider the career opportunities, options for participation and compensation to be too limited.
- **Lack of leadership and governance –** companies run by their founders often lack institutionalised management layers and functions. Seats on the board of directors or management positions are filled by individuals who simply nod through decisions made by the business founder. A seat on the board is often seen as a family birthright regardless of the person's qualifications.
- **Weak decision-making mechanisms –** at companies run by their founders, decisions are often taken by the founders themselves or are subject to their approval. In addition, the family's financial interests may come before the company's commercial interests, negatively impacting the firm's attempts to build up capital over the long term. This aspect is exacerbated over the course of the generations as the number of family members wishing to share in the success of the business grows.

The INSEAD studies recommend addressing the four shortcomings outlined above via a better long-term, sustainable organisation both within the family and between the family and the business. They encapsulate this in the term «institutionalisation», differentiating between six areas of action:

The Attributes of Institutionalization



Source: INSEAD, The Institutionalization of Family Firms, 2.2019 (amended)

The action areas with a green background relate to **family governance** issues; the fields in blue refer to corporate governance considerations. Both family and **corporate governance** have to be developed and put into practice together. In particular, in the absence of long-term family governance it is almost impossible for family businesses to establish and implement stable corporate governance.

Conclusion: the INSEAD authors examined a total of 254 family businesses across the respective global regions in producing these studies. The results demonstrate that for a family firm to survive beyond the third generation, the family has to take a long-term approach to planning its internal structures via family governance and, at the same time, professionalise the leadership and organisation of the company by means of corporate governance. The figures show that champions, i.e. successful family businesses that are in the hands of the fourth or subsequent generations, have done their homework when it comes to these considerations.

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