19.06.2025

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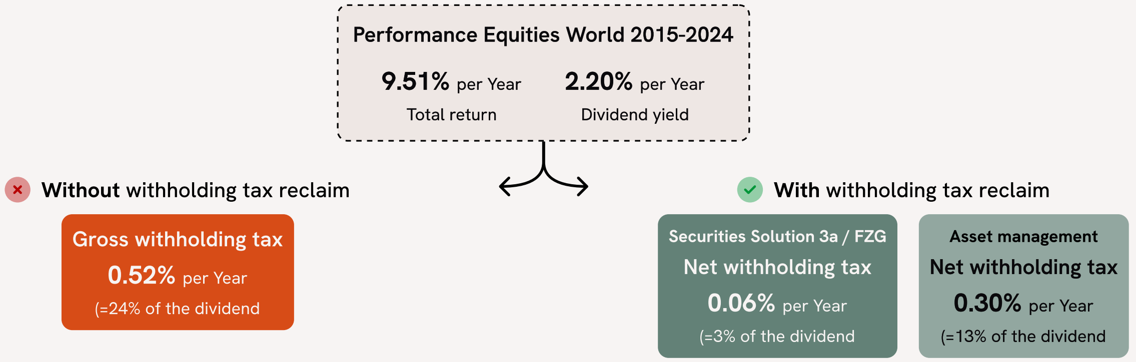
Economico Flash #35

Withholding tax on dividends from foreign shares

Chart of the week: Gross and net withholding tax on world equities



Source: Index fund data of Swisscanto Asset Management AG, as at 31.12.2024, index reference: MSCI World, dev. countries

In this Flash, we address the last important cost and tax topic in securities management: **withholding tax**. If you would like to study the topic of costs in more detail, please refer to our whitepaper.

Anyone investing in foreign shares loses part of the return achieved, as the company's country of domicile levies withholding tax on dividend distributions. In the USA - by far the largest chunk in an equity portfolio invested according to equity market capitalization at over 70% - withholding tax amounts to 30% of the dividend. The capital-weighted average taxation of dividend income (reference MSCI World) amounts to 24% of dividends.

Over the 10-year period from Jan 1, 2015 to Dec 31, 2024, the gross dividend yield was 2.20% per year, 24% **withholding tax deduction** results in a steep yield deduction of **0.52% per year**, which is almost as high as the recurring asset management costs of a competitive provider (see Economico marketplace).

Thankfully, so-called **double taxation agreements** are therefore being negotiated in the offices across borders, on the basis of which certain investor groups can (partially) reclaim these withholding taxes or even be completely exempted from them. This way, **Swiss pension institutions (BVG; FZG; 3a)** benefit from the possibility of being completely exempt from withholding tax on American, Canadian and Japanese shares.

However, this withholding tax exemption does not apply to Swiss private investors, which is why, according to Chart of the Week, a considerable withholding tax burden remains in free asset management even after reclaim and exemption. The best alternative for Swiss private investors who wish to invest in global equities is to purchase an Irish-domiciled fund or ETF, as these can reclaim half of the US withholding tax.

Important: All these reclaim and exemption options only apply if the most suitable, i.e. **withholding tax-efficient investment instruments** are used in the portfolio construction. Unfortunately, it still happens far too often that instruments that are not withholding tax-efficient are also used in asset management. And oops, suddenly you have a withholding tax burden of 0.52% per year instead of 0.30% or 0.06% respectively (for 3a/FZG). It is therefore worth choosing an asset manager who understands his trade or - if you opt for self-administration - to find out more about withholding tax.

Takeaways

- The amount of withholding tax on dividends from foreign shares is also relevant for the net return.
- Avoid withholding tax-inefficient investment instruments for foreign shares.