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# RECENT DEVELOPMENTS IN INTERNATIONAL TAXATION

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SWITZERLAND

Marcel Meier
Founding Partner at OBERSON ABELS Ltd
mmeier@obersonabels.com

OBERSON ABELS Ltd
Rue De-Candolle 20
1205 Geneva
Tel: +41 58 258 88 88

## 1. SUMMARY

There is a continued focus on keeping Switzerland attractive for businesses and individuals. The Tax Proposal 17 ("**TP17**"), in particular, will make a significant contribution to keeping various appealing business locations in Switzerland. The TP17 will also meet international corporate tax law requirements which will result in a stable tax framework for long-term investments in Switzerland.

## 2. MAJOR STATUTORY DEVELOPMENTS

### 2.1 Corporate tax reform

The federal law on the Corporate Tax Reform III was rejected by popular vote on 12 February 2017. A steering body comprised of federal and cantonal representatives has adopted recommendations on a balanced TP17 for the attention of the Federal Council on 1 June 2017. During its meeting on 6 September 2017, the Federal Council initiated the consultation on TP17.

Following the consultation process, the Federal Council adopted the dispatch on the TP17 on 21 March 2018. The Swiss Federal Parliament will decide on the TP17 in autumn 2018. Should there be no referendum called, the first TP17 measures will come into force on 1 January 2019. However, most of the measures will come into force on 1 January 2020.

The TP17 provides for the following key measures for the *Cantons* and the *Municipalities*:

- Abolition of preferential cantonal corporate tax regimes (holding, domiciliary and mixed or auxiliary company tax status): *Mandatory* abolition of the current cantonal statutory rules in order to re-establish compliance with international tax law standards. In addition, a separate tax rate model for hidden reserves of previous tax status companies (formal assessment) has to be introduced (5-year transitional period). Furthermore, the current regulatory practices regarding Swiss finance branches and principal companies will be abolished.
- Patent box: *Mandatory* introduction of a patent box in accordance with OECD standards (in particular, residual method and modified nexus approach). The net profit from patents and similar rights are separated from other profits and taxed at a lower rate. The tax relief on the qualifying net profit is maximum 90 %. Patents for software granted abroad should qualify for the patent box.
- Research and development ("R&D") super deduction: *Voluntary* implementation of additional R&D deduction which reduces, identical to other commercially justified deductions, the taxable profit. The Swiss definition of R&D takes into account the relevant OECD guidelines. The additional R&D deduction is maximum 50 % and computed on the basis of R&D staff costs, increased by (i) a 35 % uplift to cover other R&D expenses and (ii) in the event of R&D mandates in Switzerland, 80 % of the fees invoiced by Swiss third party service providers.
- Base erosion limitation: *Mandatory* provision whereby (i) the tax relief in the patent box, the additional R&D deduction and the depreciation / amortization in relation to the termination of a previous preferential cantonal corporate tax regime, must not exceed 70 % of the taxable profit of a company (in other words, at least 30 % of the taxable profit, calculated without application of the aforementioned special rules, has to be taxed) and (ii) the application of the special rules must not generate losses for a company.

The 26 Swiss Cantons benefit from significant political, financial and fiscal autonomy. Therefore, each Canton has to define its tax strategy in the scope of the TP17. For instance, the entry into force of the Vaud cantonal corporate tax reform has been confirmed for 1 January 2019. On this date, the Vaud effective ordinary corporate tax rate will be reduced from approximately 21 % to 13.79 % (including federal, cantonal and communal levels), regardless of the outcome of the TP17. Other Cantons may

also decide to significantly reduce the current effective ordinary corporate income tax rates which may then range between 12 % and 18 % (including federal, cantonal and communal levels). The Cantons may also introduce some equity tax reductions in the scope of the TP17.

In addition, the TP17 includes the following key measures which are *mandatory* at federal, cantonal and communal levels:

- Step-up of asset values: Possible disclosure of existing hidden reserves, upon immigration of head office or transfer of business operations / functions to Switzerland, which allows additional depreciations and/or amortizations following commencement of the Swiss tax duty (symmetric Swiss tax treatment upon emigration from Switzerland).
- Dividend taxation for individuals: The preferential taxation of dividends paid to Swiss tax resident individuals who own qualifying equity participations (i.e. at least 10 %) should be designed as relief of the taxable basis (as opposed to the reduction of the ordinary tax rate). Furthermore, this taxable basis should be 70 % at federal level and at least 70 % at cantonal and communal levels.
- Other measures: The TP17 provides for some additional mandatory measures, such as (i) abolition of the currently tax exempt 5 % threshold in the scope of the so-called transposition (i.e. the shareholder transfers privately held equity participations to a self-controlled holding company for a remuneration, e.g. cash, equity or receivable) and (ii) introduction of statutory rule that Swiss permanent establishments of foreign tax resident entities are entitled to lump-sum foreign withholding tax credits if the relevant conditions are met.

## 2.2 Implementation of global minimum standards of the Base Erosion and Profit Shifting Project of the OECD and G20 Countries

a) Swiss implementation approach

Switzerland has committed to adopt the global minimum standards based on Actions 5 (*counter harmful tax practices more effectively, taking into account transparency and substance*), 6 (*prevent treaty abuse),* 13 *(re-examine transfer pricing documentation*) and 14 (*make dispute resolution mechanisms more effective*) of the Base Erosion and Profit Shifting ("**BEPS**") project. Accordingly, on 7 June 2017, Switzerland signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**BEPS Convention**"). On 20 December 2017, the Federal Council initiated the consultation on the BEPS Convention which terminated on 9 April 2018. From a Swiss point of view, the BEPS Convention serves to efficiently amend existing Agreements to eliminate Double Taxation ("**DTAs**") in line with the minimum standards agreed upon in the BEPS project. This approach should avoid the issue that the text of the BEPS Convention and the Agreement to eliminate Double Taxation ("**DTA**") need to be read in parallel and thus improve legal certainty and readability of the relevant DTA. Switzerland implements these minimum standards (i) either within the framework of the BEPS Convention or (ii) by means of the bilateral negotiation of DTA amendments.

At the time of signing the BEPS Convention, Switzerland notified the amendment of the DTAs with 14 countries, including Argentina, Austria, Chile, Czech Republic, India, Iceland, Italy, Liechtenstein, Lithuania, Luxembourg, Poland, Portugal, South Africa and Turkey. These States are prepared to agree with Switzerland on the precise wording of the DTAs to be adapted via the BEPS Convention. Other countries may follow based on this approach or negotiate on specific DTA amendments (e.g. bilateral protocol of amendment signed by Switzerland and the United Kingdom on 30 November 2017). Both the BEPS Convention and the Swiss / UK bilateral protocol of amendment will be debated by the Swiss Federal Parliament most likely this autumn and are subject to the optional referendum in Switzerland.

b) Main treaty amendments

With respect to the main treaty amendments which Switzerland is willing to implement (subject to ratification), BEPS Action 6 (Articles 6 et seq. BEPS Convention) makes provision for (i) supplementing the preamble of DTAs in terms of purpose and (ii) the Principle Purpose Test (abuse clause in DTAs which, from a Swiss point of view, is already applied by means of a general anti-avoidance rule). To avoid double non-taxation in the event of hybrid mismatches (BEPS Action 2 and Article 5 BEPS Convention), Switzerland has decided to implement Option A which corresponds to a switch-over clause for Swiss tax residents. Moreover, BEPS Action 14 (Articles 16 et seq. BEPS Convention) will result in some adjustments to the dispute settlement provisions within the framework of memoranda of understanding (all Swiss DTAs already include some mutual agreement procedure provisions). In accordance with its DTA policy, Switzerland additionally advocates including the mandatory binding arbitration clause provided for in the Part VI of the BEPS Convention which is going beyond the minimum standard and, concerning this matter, generally opts for the final offer procedure (so-called baseball arbitration). Contrary to the foregoing, based on the current position Switzerland will, for instance, not introduce the BEPS Action 7 regarding the definition of permanent establishments.

c) Exchange of tax information

The spontaneous exchange of information on tax rulings approved by Swiss tax authorities is part of the minimum standard of BEPS Action 5. The international and domestic legal framework for this information exchange entered into force on 1 January 2017 and became applicable on 1 January 2018. The Swiss Federal Tax Administration ("**SFTA**") informed on 8 May 2018 that they transmitted information on Swiss advance tax rulings to 41 partner States (including France, Germany, the United Kingdom, the Netherlands and Russia) for the first time. This information included international content of tax rulings approved by Swiss tax authorities as of 1 January 2010 and still applicable on 1 January 2018.

In addition, Switzerland has implemented BEPS Action 13 in relation to the exchange of country-by-country reports ("**CbC reports**") of multinational enterprises ("**MNEs**"). Indeed, at the international level, the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("**Administrative Assistance Convention**") came into effect on 1 January 2017 and the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports of 27 January 2016 entered into force on 1 December 2017. At the Swiss domestic level, both the Federal Act and the Ordinance on the International Automatic Exchange of Country-by-Country Reports of Multinationals came into effect on 1 December 2017. MNEs headquartered in Switzerland with an annual group turnover which equals or exceeds CHF 900 million (EUR 750 million) have to submit annual CbC reports (i.e. mainly information on most important activities and on how turnover and taxes paid are attributed globally) to the SFTA. In addition, the Swiss Federal Council has determined the countries with which CbC reports will be exchanged. Accordingly, Swiss MNEs will be obliged for the first time to draw up CbC reports for the 2018 tax year. The exchange of country-by-country reports between Switzerland and its partner States will therefore take place as of the calendar year 2020.

## 2.3 Automatic exchange of financial account information

Switzerland generally implements the automatic exchange of financial account information ("**AEOI**") on the basis of (i) the Administrative Assistance Convention, (ii) the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information, and (iii) the Federal Act and the Federal Ordinance on the International Automatic Exchange of Information in Tax Matters which entered into force on 1 January 2017.

In addition, Switzerland and the European Union ("**EU**") signed a bilateral agreement on the AEOI in tax matters in May 2015 which adopts the global AEOI standard set by the OECD and G20. This agreement entered into force on 1 January 2017 and replaced the taxation of savings agreement concluded between Switzerland and the EU in 2005. Accordingly, financial institutions in Switzerland and the EU member States collect financial account data on non-tax residents as from 2017. This account information will be exchanged for the first time in autumn 2018. Furthermore, the Swiss Federal Council decided in October 2017, to apply the agreements on the AEOI with Singapore and Hong Kong provisionally as of 1 January 2018 and to exchange account information with these countries for the first time in autumn 2019. The introduction of the AEOI with other financial centers is proposed.

Based on the legal framework outlined above, Switzerland does not only provide financial information to foreign competent authorities, but as of 1 January 2018 Switzerland also receives information from abroad. Therefore, Swiss tax resident individuals (i.e. obligation to declare total worldwide assets and income in their Swiss tax filings), who have undeclared foreign assets are, as of 1 January 2018, subject to the risk of automatic disclosure. Swiss tax resident individuals are entitled to rectify their tax evasion through voluntary disclosure, with full exemption from penalties and criminal liabilities once in a life time. However, the SFTA published their point of view on 15 September 2017 that, in the scope of the 2018 AEOI, an unpunished voluntary disclosure will no longer be admitted from 30 September 2018. The same point of view applies mutatis mutandis to additional partner States where the AEOI takes place only in autumn 2019.

### 2.4 Tax treaty network

Switzerland has concluded more than 90 DTAs (including, for instance, with China). Therefore, Switzerland is considered to be a prime location for doing business, including for high profile multinationals. Based on the information of the Swiss State Secretariat for International Finance, 59 DTAs contain a provision on the exchange of information according to international standards whereby 51 of these 59 agreements are in force. Furthermore, Switzerland has signed 10 tax information exchange agreements, 9 of which (Andorra, Belize, Greenland, Grenada, Guernsey, Isle of Man, Jersey, San Marino, the Seychelles) are in force (status on 16 May 2018).

The most important recent development is that Switzerland extends its network of DTAs to Brazil, its key trading partner in Latin America. Indeed, Switzerland and Brazil signed a DTA in the area of income taxes on 3 May 2018. This DTA should facilitate international cross border investments and transactions such as dividend, royalty and interest payments and other capital flows as well. Moreover, it is in conformity with the BEPS actions, such as treaty abuse provisions, mutual agreement procedure as well as exchange of tax information upon request. The agreement still has to be approved by the parliament in both countries before it can come into force.

### 2.5 Value Added Tax

The partial revision of the Swiss Value Added Tax Act came into effect on 1 January 2018. This revision should make a significant contribution to the removal of VAT-related competitive disadvantages for Swiss domestic companies. Indeed, a company's global turnover is now decisive for the assessment of the mandatory Swiss tax liability, and no longer just its taxable turnover in Switzerland. Companies whose global turnover is at least CHF 100'000 (or CHF 150'000 in the event of non-profit voluntary sports or cultural associations or charitable organizations) are generally liable to Swiss VAT from the first franc of taxable turnover in Switzerland. Previously, foreign companies could provide their supplies in Switzerland without VAT up to a turnover level of CHF 100'000 from supplies located on

Swiss territory, which resulted in competitive disadvantages for Swiss businesses, especially in the border regions, like Geneva or Ticino. Furthermore, as of 1 January 2018, the ordinary Swiss VAT rate is reduced by 0,3 % and now amounts to 7,7 % instead of 8 %.

## 3. MAJOR REGULATORY DEVELOPMENTS

### 3.1 Securities lending and repo transactions

On 1 January 2018, the SFTA published a revised version of the circular letter no. 13 on securities lending and borrowing ("**SLB**") and repo transactions. This circular letter introduced important changes to the previous SFTA practice, notably with regard to the Swiss federal withholding tax ("**WHT**") refund position of (i) foreign tax resident borrowers in the scope of SLB arrangements over Swiss securities and (ii) foreign tax resident cash providers under repo transactions on Swiss securities. From the perspective of the SFTA, these changes should avoid wrongful or even multiple refunds of WHT which is a risk in the event of so-called "Cum-Cum" and "Cum-Ex" transactions. They apply to all dividends and interest due as of 1 January 2018 and thus there is no grandfathering for SLB and repo transactions concluded before 1 January 2018.

According to the revised practice of the SFTA regarding long borrowing over Swiss securities, only the original Swiss or foreign tax resident lender is entitled to claim a WHT refund, subject to the conditions that (i) the foreign tax resident borrower (or the ultimate borrower in a chain of SLB or repo transactions) holds a long position on the dividend record date or interest due date and (ii) the original lender proves that they receive the original dividend or interest payment under the relevant arrangement from the borrower which was subject to WHT at a rate of 35 %. Should the securities be sold or delivered to a third party by the borrower, the third party acquirer is the only one entitled to a WHT refund (either based on Swiss domestic law or an applicable DTA), whereas the original lender or the borrower have no right to do so. Contrary to the foregoing, the SFTA practice has not changed in cases where borrowers are tax residents in Switzerland, as such borrowers have still to levy a second WHT of 35 % on any manufactured payments they make to a Swiss or foreign lender in order to be in the position to claim a refund of the WHT levied on the original dividend payment received. The borrower is however entitled to use the WHT refund claim to offset WHT on the manufactured payment.

### 3.2 Taxation of Swiss and foreign collective investment schemes

The SFTA issued updated versions of the circular letters on the Swiss taxation of collective investment schemes and their investors. The updated circular letter no. 24, which applies in the scope of the WHT and the stamp duties, came into effect on 20 November 2017 and repealed the previous circular letter issued on 1 January 2009. The updated circular letter no. 25, which deals with the taxation of collective investment schemes and their investors in the scope of the federal direct tax, came into effect on 23 February 2018 and replaced the previous circular letter published on 5 March 2009. Most of the relevant changes aim at updating and completing these circular letters based on the existing SFTA practice (e.g. minimum number of investors required for a scheme has been reduced from five to two).

### 3.3 Taxation of bonds and financial instruments

On 3 October 2017, the SFTA has updated circular letter no. 15 regarding the taxation of bonds and derivative financial instruments in the scope of the federal direct tax, the Swiss federal withholding tax and the stamp duties. This circular letter entered into force on the 2017 publication date, replaced the previous circular letter issued on 7 February 2007 and applies to income due from 1 January 2018. The

main modifications and updates have been undertaken in relation to predominantly one-time interest bearing bonds, capital-guaranteed derivatives, bonds issued by foreign group companies with the guarantee of a related Swiss group parent company and structured products. Furthermore, the tax impact of negative interest rates has been clarified.

### 3.4 Tax treatment of equity based compensation instruments at the level of the employer

The SFTA published for the first time guidelines on the Swiss tax treatment of equity based compensation instruments at the level of the employer on 4 May 2018. The circular letter no. 37A covers both (i) the participation in the equity of the Swiss based employer and (ii) the participation in the equity of a (foreign) affiliate. The circular letter mainly clarifies the computation of commercially justified expenses or taxable profit in relation to equity participation schemes in various scenarios and also includes some illustrative accounting examples for the Swiss based employer.

## 4. MAJOR JUDICIAL DEVELOPMENTS

### 4.1 Qualification of German limited partnership (GmbH & Co. KG)

The controversial issue decided by the Swiss Federal Supreme Court (Case 2C_707/2016 on 23 March 2018) was whether two German limited partnerships (GmbH & Co. KG) qualify as foreign businesses or permanent establishments for Swiss tax resident partners which would result in a Swiss tax exemption with progression under domestic law. The Swiss Federal Supreme Court ruled that the minimum requirement to qualify as foreign permanent establishment is the presence of an entrepreneurial or profit making activity abroad. The private asset management activity carried out in Germany is not from the outset of the quality of a business. As such, the Swiss Federal Supreme Court has qualified the relevant German partnerships as transparent non-commercial partnerships. Accordingly, a fiscally relevant permanent establishment in Germany and the related Swiss tax exemption were denied.

### 4.2 Short selling of shares cum dividends

In the event of short selling of shares cum dividends (i.e. selling shares that are not owned by the seller yet), the seller is merely in a contractual relationship with the buyer and thus has no financial rights towards the relevant companies. Indeed, the short seller was unable to procure a right to dividends due to the subsequent purchase and delivery of shares on or after the ex-dividend date, but dealt only with a replacement payment for shares or related dividends owed to the buyer. Accordingly, for lack of a taxable object based on Swiss domestic tax law, the Swiss Federal Supreme Court (Case 2C_123/2016 on 21 November 2017) held that this replacement payment of the short seller is not subject to the WHT. Furthermore, a refund of the relevant amount paid to the SFTA and charged to the account of the short seller was refused, since the latter was not impoverished under the relevant contracts.

### 4.3 Mutual administrative assistance in tax matters

The Swiss Federal Supreme Court (Case 2C_201/2016 on 3 November 2017) ruled that the SFTA can provide the requesting State with information on the status of the proceedings in the context of international administrative assistance in tax matters ("status updates" practice). Indeed, the information provided to Spain in the present case, whereby "*an appeal was filed and the proceedings were pending before the Swiss Federal Courts*" is in compliance with the currently applicable Swiss law.

A large number of judgments involving various countries (e.g. United States, India, France, the Netherlands, Sweden) were delivered in Switzerland in the scope of mutual administrative assistance in tax matters from June 2017 to May 2018. Even though additional judgements in this area will follow, it is to be expected that this development will slow down due to the beginning of the AEOI.