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RECENT DEVELOPMENTS
IN INTERNATIONAL TAXATION

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RÉBECCA DORASAMY

Lenz & Staehelin

INTRODUCTION

Switzerland is a federal state. As such, the Swiss Federal Constitution grants both the federal government and the cantons the power to levy direct taxes. In many ways, the cantonal taxing power in direct tax matters is harmonised through federal legislation, leaving only limited leeway to cantons as to implementation.

The past year has been one of change for Swiss tax law at the cantonal, federal and international levels. Some of the major changes are addressed in this report.

DEVELOPEMENTS OVER THE PAST 12 MONTHS

Legislation

The Federal Act on Tax Reform and AHV Financing

The most important change in Swiss tax law for the year 2020 was the entry into force of the Federal Act on Tax Reform and AHV Financing ('TRAF') on 1 January 2020.

Following significant international pressure, Switzerland reformed its corporate tax system to bring it in line with Organisation for Economic Cooperation and Development (OECD) and European Union standards, in particular through the abolition of the special cantonal statuses. With the entry into force of the TRAF, Switzerland underwent a myriad of changes, some mandatory and others optional for the cantons.

- Abolition of special tax statuses (mandatory): With effect on 1 January 2020, the cantonal holding, mixed and domiciliary company regimes were abolished. In addition, a five year transitional period was introduced, including a separate taxation mechanism on hidden reserves and goodwill of such cantonal status companies passing from a special tax system to an ordinary tax system. The federal practices for principal companies and for Swiss Finance Branches were abolished as well.
- Additional research and development (R&D) deductions (optional): In order to promote R&D, the cantons will be able to increase the weighting of R&D expenditure as tax deductible expenses for cantonal and communal tax purposes. Qualifying R&D expenditures are defined and this additional deduction is limited; it can be made with an uplift of up to 50 per cent of the actual R&D expenditure.
- Patent box (mandatory): Switzerland has introduced an OECD-compliant patent box regime (following the residual method with a modified nexus approach). Under this regime, profits from patents and similar rights will be taxed separately from other profits and at a lower rate. Such profits may benefit from a maximum reduction of 90 per cent (ie, at least 10 per cent of those profits will be considered as taxable). This measure is mandatory for cantonal and communal tax purposes, but the level of reduction may be freely determined by each canton.
- Step-up (mandatory): Companies relocating their headquarters, transferring business operations or functions to Switzerland will be able to disclose existing hidden reserves (including goodwill) and amortise them in a tax-effective manner. The immigration step-up is mandatory at the federal, cantonal and communal level. A similar provision has been introduced to tackle cases of emigration from Switzerland.
- Notional interest deduction (NID) (optional): A NID is granted on safety equity, ie, the equity which in the long term exceeds the average equity required for

business operations, for cantonal and communal tax purposes. The deduction is a measure intended only for so-called high-tax cantons; it is has been introduced only in the canton of Zurich.

- Overall limitation mechanism (mandatory): Although the new measures may be applied in combination, the tax relief resulting from the separate taxation mechanism due to the loss of a cantonal tax status, the patent box, the additional deductions for R&D and the NID must not exceed 70 per cent. The cantons may freely set a different base erosion threshold (minimum taxation of 30 per cent of the tax basis that would apply without such measures).
- Reduction of cantonal tax rates (optional): To keep Switzerland attractive to businesses following the abolition of the special cantonal statuses, most cantons lowered their income and capital tax rates. In one year, the average effective income tax rate in Switzerland fell from 17.1 per cent to 15.1 per cent. Geneva made the most substantial reduction by lowering its effective corporate income tax rate from 24 per cent to 13.99 per cent. The lowest corporate income tax rate is Zug with 11.91 per cent.

Multilateral Instrument

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('MLI') entered into force in Switzerland on 1 December 2019 after the lapsing of the applicable referendum period and the deposit of the instrument of ratification on 29 August 2019.

Switzerland opted to implement only the minimum standards relating to the prevention of treaty abuse and to a more effective dispute settlement mechanism and has expressed reservation on the majority of the MLI provisions. Switzerland adopted the following provisions:

- amendment of the preamble by expressly stating that, in addition to double taxation, tax treaties do not offer the possibility of double non-taxation or reduced taxation through practices of tax evasion or avoidance;
- Principle Purpose Test as a minimum standard to prevent treaty abuse;
- Mutual Agreement Procedure; and
- a binding arbitration clause.

It is important to differentiate between the entry into force of the MLI in general and the effects with respect to a specific covered agreement.

According to Switzerland, the MLI directly amends the Double Tax Agreement (DTA) if the counterparty to said DTA (1) shares its view that the MLI has the same effect as an amendment protocol and (2) agrees to confirm the exact wording of the DTA as amended by the MLI.

Currently, out of its approximately 100 DTAs, Switzerland has DTAs covered by the MLI with the following countries: Argentina, Austria, Chile, the Czech Republic, Iceland, Italy, Lithuania, Luxembourg, Mexico, Portugal, South Africa and Turkey. Switzerland thus follows the 'amending view' in the sense that it has reserved the right to apply the instrument once it has notified to the OECD that it has completed its internal procedures to amend the specific Agreement.

Alternatively, the Base Erosion and Profit Shifting (BEPS) minimum standards can be negotiated bilaterally (a bilateral treaty amendment), which requires a parliamentary approval process.

Recent court decisions

Transfer Pricing

Although case law involving transfer pricing issues is quite rare in Switzerland, the Swiss Supreme Court (the ‘Court’) recently addressed the question of transfer pricing in cross-border transactions between companies of the same group. In one case, the situation of a Swiss company performing services to third party clients, partly sub-delegating them to a Seychelles subsidiary, was considered. The Court found that the pricing applied on the services between the Swiss entity and its foreign subsidiary breached the arm's length principle, in particular as the Swiss entity was bearing all major functions, assets and risks with respect to the services, while the subsidiary was only performing low-value adding services.

The tax authority was hence able to demonstrate the existence of a clear asymmetrical relationship between the allocation of tasks between the entities and the constant loss-making position of the Swiss company, which was sufficient evidence that the pricing may be incorrect. In this case, the burden of proof shifted and rests on the company, which had to demonstrate that the cost of the services in question was commercially justified. The company unsuccessfully tried to justify the applied pricing using a Comparable Uncontrolled Price (CUP) method. In this respect, the Court emphasised that in order for the CUP method to be used, the underlying facts must be sufficiently comparable.

In this respect, five areas of comparability must be examined, as per the OECD Transfer Pricing Guidelines. In the case at hand, it was impossible to demonstrate that price lists for services published on websites from third parties can be applied, as no indication on comparability factors were available. Therefore, the Court approved the method used by the tax administration to apply a cost plus method on the foreign low-value added services of the foreign subsidiary, while allocating all other profits to the Swiss company.

Exchange of information

On 26 July 2019, the Court held that France's request for administrative assistance in tax matters concerning approximately 45,000 bank accounts held by UBS clients was not a fishing expedition.

This request was based on two lists (B and C) reporting approximately 45,000 bank accounts held by UBS clients in Switzerland. These lists did not mention the names of the holders of the listed bank accounts. The accounts were, however, linked to a French domicile code.

The Double Tax Agreement between Switzerland and France ('DTA CH-FR') provides that the competent authorities of the contracting states shall exchange information that is foreseeably relevant to the application of the provisions of the Convention (Article 28 para 1 DTA CH-FR). Fishing expeditions are prohibited.

The Court had to consider whether the French application could be qualified as a fishing expedition. According to the Court, in order to be admissible, and not qualified as a fishing expedition, a collective request must meet three conditions:

1. it must provide a detailed description of the group, setting out the specific facts and circumstances that led to the formulation of the request;
2. it must set out the applicable tax law and the grounds for assuming that the taxpayers in the group would not have fulfilled their tax obligations; and
3. it must demonstrate that the information are appropriate to ensure that these obligations are met.

In this case, only the second condition was disputed.

Contrary to lists B and C, list A, with 1,000 accounts, indicated the name of the holders and was hence not subject to a request for information exchange. One third of the persons on this list had already been subject to a tax audit in France and half of the controlled persons on list A were confirmed to be French taxpayers whose assets are either undeclared or in the process of being regularised. Is it possible to deduce from this that the 45,000 people on the other two lists are likely to have defaulted on their tax obligations? The Federal Court says yes.

Consequently, the French collective request cannot be qualified as fishing expedition.

Covid-19

The Covid-19 crisis is leading to loss of income and to liquidity shortages. In order to mitigate its impact on taxpayers, the Confederation and the cantons have adopted a series of measures in the area of taxation.

In light of the situation, the Federal Council decided on 20 March 2020 to adopt measures in the tax area, in particular an ordinance on the temporary waiver of interest on arrears to allow companies to delay their tax payments. The interest rate is reduced to zero per cent for VAT, customs duties and special consumption taxes from 20 March 2020 to 31 December 2020. For the direct federal tax, the waiver will apply from 1 March 2020 to 31 December 2020.

At the cantonal level, in addition to introducing an automatic extension of the deadline for filing tax returns, the majority of cantons also issued a waiver on late interest payments. Some cantons went further: the parliament of the canton of Zug voted in favour of a reduction of the cantonal tax multiplier from the current 82 per cent to 78 per cent for the tax periods 2021-2023 in order to overcome the Covid-19 crisis. The canton of Valais allows for the accounting of a tax effective provision for potential losses triggered by Covid-19 of up to 50 per cent of the net earnings calculated based on the 2019 net profit (to a maximum of CHF 300,000; the provision needs to be reversed in financial year 2020). The cantons of Aargau, Thurgau and Zug also announced that they would accept extraordinary provisions in connection with the Covid-19 crisis for financial year 2019.

Most cantons will also grant instalment payments or the deferral of payment generously.

FUTURE DEVELOPMENTS

Revision of tax at source

The Swiss tax at source system, which has been unified since 1995, will be radically overhauled as of 1 January 2021. The provisions on tax at source had to be amended because they did not fully comply with the principle of equal treatment laid down in the agreements between Switzerland and the EU/the Europe Free Trade Association (EFTA).

These new provisions are intended to extend the possibility for taxpayers subject to tax at source tax who are domiciled in Switzerland to have recourse to subsequent ordinary taxation. This possibility is also available to taxpayers subject to tax at source who are not domiciled in Switzerland, but who earn a large part of their worldwide income in Switzerland.

Abolition of Stamp duties

Federal stamp duties are taxes on legal transactions and the movement of specific capital. They are levied on the creation of participation rights (issuance stamp duty), on securities trading (transfer stamp duty) or on the payment of premiums for certain insurance policies (insurance premium duty). In 2019, stamp duties generated approx. CHF 2.2bn for the Confederation.

A parliamentary initiative for a three-step abolition of these stamp duties has been under examination for over ten years.

Stressing that stamp duties preclude the optimal allocation of resources, the majority of the Committee for Economic Affairs and Taxation (the ‘Committee’) considers it necessary to abolish them in order to guarantee the attractiveness of the Swiss financial centre and to promote economic growth, which will compensate in the long term for a large part of the loss of revenue generated.

A minority of the Committee believes that, in view of the numerous tax reforms that are currently under way or will be introduced, it would currently not be responsible to lose the revenue from stamp duties.

In addition, in view of the current situation with Covid-19, many think it is not appropriate to deprive the Confederation of the issuance of stamp duty revenues before knowing the extent of the losses to be incurred by the federal budget. Others consider that the abolition of this stamp duty would allow companies to strengthen their equity capital, a measure to be welcomed in light of the Covid-19 crisis. They believe it would be a mistake not to take the opportunity of the current crisis to abolish the stamp duty. The idea would be to waive the stamp duty at least temporarily when companies raise capital to compensate for losses due to the Covid-19 pandemic.

Microtax initiative

A popular initiative called ‘Micro-tax on cashless payment traffic’ was published in the Federal Gazette on 25 February 2020.

This initiative envisages a new constitutional norm that would introduce a federal ‘microtax’ at a flat rate on the cashless payment traffic in Switzerland. The maximum rate would be five per thousand. This tax is intended to replace VAT, direct federal tax and stamp duty. The tax would be levied by cashless payment traffic operators (including systematic clearing). Cashless payments made abroad by persons resident in Switzerland for tax purposes would also be subject to this tax via a self-declaration process.