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Recent Developments in International Taxation

Switzerland

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Introduction

Switzerland is a federal state, where both the federal government and the cantons hold the power to levy various taxes. In many ways however, direct income and wealth taxes are harmonized under the federal legislation, thus restricting the cantons' taxing powers accordingly.

The last 12 months have brought some changes and developments to Swiss tax law, at both domestic and international levels. This report aims to provide an overview of the main changes, and a glimpse at the future developments to expect.

Developments over the past 12 months

Legislation

OECD TWO-PILLAR SOLUTION STATEMENTS

Conscious of the need to adapt tax rules to the digitalization of the economy, Switzerland has adopted the OECD Two-Pillar Solution Statements and is committed to developing and implementing this multilateral consensus-based response.

On 18 June 2023, the Swiss people adopted by a large majority (78.5% of Swiss elective citizens as well as 26 cantons) a federal constitutional amendment serving as legal basis for the Swiss Federal Council and the Swiss Parliament to proceed with the implementation of the OECD/G20 Pillar One (market jurisdiction taxation) and Pillar Two (global minimum taxation) proposals.

While there are currently no concrete plans to implement Pillar One, the implementation of Pillar Two is scheduled for 1 January 2024.

Pillar One

The first pillar aims at adapting the current international provisions regarding the allocation of large corporate groups' taxable profits (market state taxation). Companies with an annual turnover of more than €20bn and profit margin of more than 10% would be affected. In Switzerland, very few companies would be concerned.

As the implementation of Pillar One is reliant on further international developments within the OECD, Switzerland will determine how to implement Pillar One in due course.

Pillar Two (GloBE)

The second pillar introduces a global minimum tax rate of 15% for multinational companies with an annual worldwide turnover of at least €750m.

In order to implement the OECD/G20 project on taxing the digital economy, the Federal Council is proposing a supplementary federal tax, limited to large corporate groups within the scope defined above. This supplementary federal tax will nonetheless be assessed and levied by the cantons, and any revenues deriving therefrom will be shared among the cantons (75%) and the Confederation (25%). It is intended to protect companies from unnecessary tax procedures abroad, providing legal certainty and allowing Switzerland to collect additional tax revenue that would otherwise be collected abroad.

Following the acceptance of the constitutional amendment on 28 June 2023, implementation of Pillar Two in Switzerland will be achieved first by a transitional provision allowing the Swiss

Federal Council to enact a global minimum tax of 15% for large MNEs as of the 1st of January 2024, by means of a temporary ordinance. That temporary ordinance shall later be replaced by a federal tax bill issued by the Swiss Parliament under the ordinary legislative procedure with less time pressure, and once international developments in this matter are better defined.

Under the current draft of the temporary ordinance, the Federal Council will introduce the so-called income inclusion rule ("IIR"), and qualified domestic minimum top-up tax ("QDMTT"). An implementation as of the 1st of January 2025 of the undertaxed profits rule ("UTPR") is currently under discussion.

The Federal Council will however likely align and coordinate the implementation dates with other jurisdictions, in particular the European Union (EU).

The Swiss temporary ordinance does not reproduce the OECD GloBE Model Rules of December 14, 2021 ("the GloBE Rules"), but rather generally refers to said rules, exclusive of a few exceptions and the automatic integration of the subsequent adjustments.

The GloBE tax base relies on international financial accounting standards, and hence substantially differs from the corporate income tax base determined in accordance with the Swiss Code of Obligations ("CO"). Therefore, a Swiss constituent entity of an in-scope MNE will likely have to prepare two sets of financial statements for Swiss and GloBE tax purposes.

An additional complexity stems from the fact that the Swiss corporate income tax is generally determined and levied on a single entity basis (no tax grouping rule), whereas the GloBE rules usually operate on a jurisdictional level. The Swiss federal ordinance implementing the GloBE Rules thus includes coordination rules for cases involving multiple Swiss constituent entities of the same MNE.

The scope of covered taxes for purposes of the GloBE Rules includes corporate income taxes, capital taxes, real estate gains taxes as well as the residual Swiss withholding taxes (on intragroup dividends).

The draft temporary ordinance also includes criminal provisions, with fines of up to three times the evaded amount, as well as prison terms of up to three years. No penalties shall be issued for negligent violation of procedural duties or GloBE tax evasion for all financial years that begin by 31 December 2026 and end before 30 June 2028.

Pillar Two will impact exclusively in-scope companies and is currently expected to affect a low three-digit number of Swiss groups, plus a low four-digit number of Swiss subsidiaries of foreign groups.

This is nonetheless the second extensive tax reform Switzerland is undergoing within a few years following international pressure. While it is expected that most of the measures that Switzerland introduced recently with the Federal Act on Tax Reform and AHV Financing ('TRAF' reform) - notably the reduction of cantonal profit tax rates - will soon be at least partially obsolete for the companies targeted by Pillar Two, these will remain relevant for all other companies, especially small and medium-sized enterprises.

Furthermore, it is to be expected that the Swiss cantons will introduce local compensatory measures to better fit the GloBE general framework and ensure their attractiveness as a business location. As a matter of example, the *taxe professionnelle communale* - a local tax specific to Geneva that would not have qualified as a covered tax under the GloBE Rules - has recently been abolished and replaced by a slight increase of the cantonal corporate income tax rate.

SWISS WHT REFORM

From the 1st of January 2023, the domestic and international Swiss WHT declaration procedure regimes have both been improved:

- In a domestic context, the intra-group declaration procedure (declaration replacing a payment of the Swiss WHT followed by a refund) can now be claimed by all legal entities holding a participation of 10% [instead of 20% previously] in the distributing company.
- In an international context, the authorization granted by the Swiss Federal Tax authority to benefit from the declaration procedure (declaration replacing a payment of the 35% Swiss WHT on distributions followed by a refund of the WHT in excess of the applicable DTA residual source WHT) will be valid for five years [instead of three years previously].

Main tax related popular votes

By popular vote, the Swiss people have rejected the following referendum objects:

- Abolishment of the emission stamp duty (1% on contributions consented by the direct shareholders) on 13 February 2022;
- Reform of the Swiss WHT and negotiation stamp duty system aiming at strengthening the Swiss capital market on 25 September 2022.

The constitutional amendment required for the implementation of the OECD/G20 Pillar One and Pillar Two proposals has however been accepted by the Swiss people on 18 June 2023 (see above for more details). The Swiss people also accepted the increase of the VAT rates aiming at funding old age insurance on 25 September 2022 (see below, "Future developments", for more details).

Recent Court Decisions

DEEMED LIQUIDATION[1] (2C_359/2022)

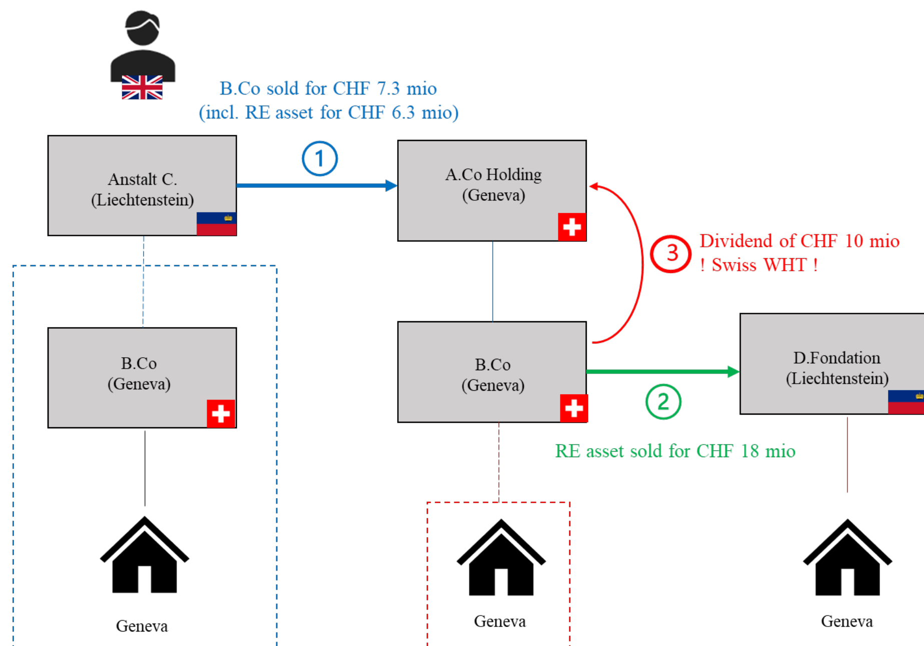
In recent years, the SFTA's practice on granting reimbursement of the Swiss WHT has considerably toughened, resulting in a relative uncertainty for the taxpayers and their advisors, as well as a wider use of the advanced tax rulings options.

Swiss WHT serves different purposes depending on the residence of the beneficiary of the taxable distribution. If the beneficiary is a foreign resident, Swiss WHT is levied with an ultimately "taxing" purpose, given that the foreign beneficiaries are deprived of the right to (full) reimbursement of the WHT, subject to the application of a double taxation treaty. If the beneficiary is a resident of Switzerland, Swiss WHT is levied as a guarantee, and it is refunded to taxpayers if certain conditions are met.

In the case 2C_359/2022, issued on 13 September 2022, a Liechtenstein Anstalt had sold the shares of a Swiss real estate company (B.Co) for the price of CHF 7.3 mio (of which 1 mio related to a debt assumption). On the same day, B.Co sold the real estate asset to a third party (a Liechtenstein Foundation) for a price of CHF 18 mio. About two years later, B.Co distributed a dividend to its shareholder. The SFTA refused to apply the declaration procedure and to grant reimbursement of the Swiss WHT owed on that dividend, as it considered the scheme to be abusive.

1 «Liquidation partielle remplaçante»

The facts can be schematized as follows:



Pursuant to art. 21 (1) let. a of the Swiss Withholding Tax Act (SWHTA), the Swiss resident beneficiary may request reimbursement of Swiss WHT if, on the due date of the taxable distribution, they were the beneficial owner of the asset which produced the taxable income. However, the refund is inadmissible in cases of tax evasion (art. 21 para. 2 SWHTA).

Under the deemed liquidation theory, the SFTA considers that a transaction may be requalified as abusive for WHT purposes, if the Swiss target company (target) is sold by a non-Swiss resident, the transfer of the shares in the target from the seller to the purchaser results in a reduction of the applicable WHT rate, and the target is liquidated shortly after the acquisition. The SFTA considers that the same economic result should indeed have been reached by way of an asset deal instead of a share deal. An asset deal would have generated a distribution of the target and, consequently, the levy of (at least partly irrecoverable) Swiss WHT.

Based on the case law, whether this fact pattern is abusive should indeed be examined. Nonetheless, requalification under the abuse theory requires a series of conditions to be met, which the Federal Court decided were fulfilled in the case at hand. Furthermore, the Federal Court confirmed previous case law under which, in the event of tax evasion, the taxpayer cannot claim a partial refund of the WHT paid. The fact that the tax authorities would have retained only 15% (based on art. 10 ch. 2 let. B of the DTT CH-UK), and not 35%, if the transaction had been carried out properly, is irrelevant in the Supreme Court's view. This position is stricter than the practice of the SFTA, which would typically levy WHT at the rate that would have been applicable to the initial non-Swiss seller of the target on the deemed liquidation proceeds.

The position of the Supreme Court in this case confirms that the conditions of an abusive behavior under the evasion theory must be analyzed, irrespective of the objective fact pattern. Insofar as it confirms that the full WHT should be levied (rather than the eluded WHT) in such cases, it however increases the often unexpected costs related to the potentially abusive situation, which can

be difficult to foresee in practice. Despite the position of the Court in this case, it appears that the previous approach of the SFTA will remain in the future. Nonetheless, this court decision unfortunately increases the legal uncertainty in the international transaction field.

Covid-19 developments

FRANCO-SWISS CROSS-BORDER WORKERS

A specific system applies to "cross-border commuters" who fall under the specific definition of the April 11, 1983 agreement between France and the cantons of Berne, Solothurn, Basel-Stadt, Basel-Landschaft, Vaud, Valais, Neuchâtel or Jura.

Due to the COVID-19 pandemic and related restrictions, most cross-border workers have been required to perform their employment from their state of residence rather than the other state. Switzerland had entered into several mutual agreements with border states, to ensure that the previous tax regime would continue to apply to cross-border workers, even if they had to temporarily work from home.

After several renewals and considering that working from home has become an integral part of modern working life, Switzerland and France have signed on 27 June 2023 an agreement containing new and permanent taxation rules for income derived from work performed in the state of residence. This agreement however still has to be approved following the ordinary legislative process in both countries before it can come into force. Until that and since the 1st of January 2023, a temporary memorandum of understanding, dated of 22 December 2022 and of substantially similar content, is applicable. Under the new agreement, French residents working for Swiss employers may work from home (including 10 days of temporary assignment abroad) each calendar year up to 40% [instead of 25% prior to 2020 and the COVID crisis] of the time without affecting their current tax status. The tax status of the employee, and whether source tax is levied on the salary, still differs depending on the canton.

SOCIAL SECURITY AFFILIATION

Switzerland has also signed an agreement regarding social security affiliation with certain countries in the EU and the European Free Trade Association (EFTA), including Austria, France, Germany, Luxembourg, Liechtenstein and Malta. This new agreement aims to increase the maximum threshold of teleworking activity below which the employee can remain affiliated with the local social security of the state where their employer is located. This threshold has been raised to 50% [instead of the previous 25%].

OTHER TAX DEVELOPMENTS

Cantonal popular initiatives aiming at introducing a temporary 5-year COVID-19 solidarity tax on wealth have been rejected by the people in Geneva (June 2023) and Schaffhausen (May 2022).

Future developments

Value added tax

As per the 1st of January 2024, VAT rates will be increased in Switzerland. The new rates will be as follows:

- Standard rate: 8.1% [currently 7.7%];

- Special rate: 3.8% [currently 3.7%];
- Reduced rate: 2.6% [currently 2.5%].

The date/period on which the goods or services are supplied [rather than invoiced] is decisive in determining which rate to apply.

Proposals in the pipeline to look out for

DRAFT LEGISLATION ON THE TAXATION OF THE RENTAL VALUE

A parliamentary initiative aiming at reforming the current personal income tax system [under which real estate owners pay personal income tax on the deemed rental value of the real estate assets that they own] has been introduced in 2017 with the aim to encourage home ownership.

While the National Council has yet to provide its position on the proposal, both the Federal Council and the State Council have endorsed it, with a few modifications. The outcome of this legislative process is uncertain for now. If this initiative is accepted, and depending on the specificities of the final draft, the personal income tax position of real estate owners could be substantially improved.

DRAFT LEGISLATION INTRODUCING A SWISS TRUST

Under the current legal framework, it is not possible to establish a trust under Swiss law. Foreign trusts are, however, recognized, and the tax treatment applicable to them is explained in a published Circular[2].

On 12 January 2022, the Swiss Federal Council published a draft bill intending to introduce trusts into Swiss law. That bill contained, among others, provisions relating to the taxation of trusts (Swiss and foreign trusts alike). Said provisions largely differ from the current tax treatment as provided for under the Circular, and notably considerably worsen the tax treatment related to the deemed "irrevocable discretionary trusts".

The bill is currently on hold, and it remains to be seen whether the Swiss trust will be examined further, and if so, to which extent the tax provision of the draft bill will be part of the proposal going forward.

EXTENSION OF THE LOSS OFFSET PERIOD

Swiss tax law currently contains a (commercial) loss carry-forward mechanism (no loss carry-back available). Under the current tax system, losses can only be carried forward for a maximum period of seven years ("ordinary tax loss carryforward"), unless the company is undergoing a financial restructuring - in which case previous losses can be offset against the financial restructuring income without time limitation ("extraordinary loss carry-forward").

On 28 June 2023, the Federal Council opened a consultation to extend the loss carry-forward period from seven to ten years in Switzerland. This proposal aims to align the Swiss system with international standards, and would facilitate the recovery of businesses that suffered important losses during the COVID-19 pandemic.

If accepted, this measure is set to come into force on January 1st, 2028. It will cover losses for the fiscal year 2020, but not the losses incurred in earlier fiscal years.

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2 CSI Circular no. 30, of 22 August 2007, "Taxation of trusts".