Switzerland keeps options open for attractive tax system

Oliver Jaeggi and Dieter Weber, of Tax Partner – Taxand, explain that tax competition, the abolition of the issuance stamp duty on debt capital and a wide and growing tax treaty network are examples of how Switzerland has maintained the attractiveness of its tax system.

More attractive, more efficient and more credible: these are the characteristics of the latest developments in the Swiss tax system.

Despite the global financial and economic crisis, Switzerland has a robust economy. Figures speak for themselves: in 2011 government debt to GDP was 42% compared to an average of 96% in the EU, and the unemployment rate is 2.9% (in the EU it is more than 10%). The reasons behind this success are international competitiveness, the availability of a skilled labour force and the rational use of the national budget. Nevertheless, or maybe due to this success, Switzerland is under pressure internationally.

Swiss banking secrecy is a focus of neighbouring countries as well as the US. Simultaneously, the Swiss government is fighting off attempts by the EU to abolish attractive tax regimes for international companies. Domestic discussions about fiscal justice inside Switzerland do not make things easier. Switzerland's reaction to these challenges is to continuously improve its tax system to strengthen international acceptance while maintaining its global position as an attractive place for businesses and investors.

Further reduction of corporate income tax rates

While the economic crisis has forced other European countries to increase their corporate tax rates, many cantons are cutting rates for 2013 to their lowest ever level. The lowest corporate income tax rates are in the cantons of Lucerne at 11% and Schwyz at 12%. Besides these, in half of the cantons the corporate income tax rate ranges between 13% and 16% (for example, the cantons of Appenzell, Nidwalden, Obwalden, Schaffhausen, Zug, Uri, Thurgau, Glarus and Fribourg).

These are tax rates for ordinary taxed companies. Even lower tax rates are available for international trading, finance and intellectual property (IP) companies. It is expected that the reduction of corporate income tax rates in Switzerland will be sustained (in contrast to other European countries) and the cantons will not be obliged to increase their corporate income tax rates in the next few years. Switzerland's attractive corporate income tax rates are a result of the continual domestic tax competition between the cantons. The Federal Constitution allows each of the 26 cantons broad tax sovereignty; cantons remain free to determine their own tax rates and are responsible for their budget. This shows that competition is the best way to achieve good results.

Improvements for financing

The Swiss Parliament has decided to abolish the issuance stamp duty on debt capital. The aim of abolition is to improve the fiscal requirements of the Swiss financial centre and to provide a positive impulse to economic growth. The abolition entered into

force on 1 March 2012. Until this date, stamp duty was levied on the issuance of bonds and money market papers. Switzerland still levies an issuance stamp duty of 1% on equity (that is, on the issuance of shares of Swiss corporations and increase in equity). Important exemptions are available, such as the tax-exempt threshold of Sfr1 million ($1.062 million) or the exemption for tax-neutral reorganisations as, for example, the contribution of participations into a Swiss corporation. The Swiss Federal Council communicated in January 2013 that the issuance stamp duty on equity should also be completely abolished, possibly with the envisaged Corporate Tax Reform III.

New rules for lump-sum taxation

Lump-sum taxation works on the principle that the tax is levied on the expenditure of the taxpayer (that is, worldwide living costs). Under the tax rules, minimum annual living expenses corresponds to five times the annual rent or rental value of the Swiss residential property. The tax is not calculated based on effective worldwide income and net wealth, but on worldwide expenditure. In any case, the tax on such lump sum amounts may not be lower than the tax payable on the total gross amount of income from immovable and tangible assets located in Switzerland and income for which the taxpayer claims exemption from foreign taxes in accordance with a double tax treaty.

In recent years, lump-sum taxation has been the subject of intense political debate in Switzerland. In several cantons, referendums took place at a cantonal and communal level either to completely abolish it or to increase the minimal tax base. Thus, in the cantons of Bern, Lucerne, St Gallen and Thurgau, complete abolition was rejected but an increase in the minimum tax base was decided according to the new federal law. In contrast, lump-sum taxation was completely abolished at cantonal and communal level in the cantons of Basel-Land, Basel-Stadt, Schaffhausen and Zurich. However, in these cantons the number of taxpayers it applied to was not significant.

For its part, the Swiss government considers lump-sum taxation as an important instrument of considerable economic significance which has a long tradition. The government intends to keep it and to increase people's acceptance of it. It proposed, in particular, to raise the minimum limits of the tax basis. Under the new tax law, lump-sum taxation will be revised for federal tax as well as for cantonal and municipal tax like this:

- In determining the tax assessment base, the minimum limits for both federal tax and cantonal/municipal taxes should be set at seven times the rent or rental value (previously five times) or three times the cost of board and lodging (previously double).
- Alternatively, a minimum taxable income of Sfr400,000 is envisaged for federal tax. Regarding cantonal and municipal tax, the cantons should also set a minimum sum.
- In addition, the cantons should regulate how wealth tax can be compensated by lump-sum taxation.
- Taxpayers who benefit from lump-sum taxation at the time when the new regulations come into force, will be taxed under the previous regulations for a transition period of five years.

Based on this proposal, the Swiss Parliament adopted the revision of lump-sum taxation in September 2012. The referendum deadline expired in January 2013 without one being called. The Federal Council has determined that the revision will come into force on January 1 2014 for cantonal and communal tax (with a maximal period of two years for implementing into the cantonal law) and on January 1 2016 for federal tax.

These adjustments should increase people's acceptance of lump-sum taxation without compromising the attraction of Switzerland as a location for lump-sum taxpayers.

Biography

Dieter Weber
Tax Partner – Taxand

Tel: +41 44 215 77 07
Email: dieter.weber@taxpartner.ch
Websites: www.taxpartner.ch
www.taxand.com

Dieter Weber is one of the founding partners of Tax Partner, a leading Swiss independent tax boutique. He has broad experience in national and international corporate and private tax.

He is involved in tax planning, restructuring and transactions for national and international corporate groups and privately owned businesses. He also works on estate planning and successions for families and individuals. Dieter has published various articles on national and international tax law and speaks regularly at international tax seminars. He is a member of the Swiss branch of the International Fiscal Association and serves in the board of the VSUD (*Vereinigung Schweizer Unternehmen in Deutschland* – the Association of Swiss Companies in Germany) and on the board of directors of various companies.

Dieter studied law at the University of St Gallen followed by his graduation as an attorney and a certified tax expert. He started his career in 1988 with Ernst & Young in Zurich, becoming a partner in 1995. In 1997 he was one of the founders of Tax Partner serving today as a partner and president of the board. Today Tax Partner comprises of 11 partners and 20 tax professionals. Tax Partner co-founded Taxand in 2005, an independent global network of tax specialists. Taxand provides high quality tax advice across nearly 50 countries with about 450 partners and 2,000 advisers.

Biography

Oliver Jaeggi

Tax Partner – Taxand

Tel: 41 44 215 77 41
Email: oliver.jaeggi@taxpartner.ch
Website: www.taxpartner.ch

Oliver Jaeggi has more than 10 years experience of local and international tax. He is mainly involved in tax planning, restructuring and transactions of national and international corporations and entrepreneurs. He also works on estate planning, tax litigations and for private clients. He has published various articles on tax matters.

Jaeggi studied at the bilingual University of Fribourg in Switzerland before graduating as an as an attorney and a certified tax expert. He speaks fluent German, French, English and Spanish.

Tax Partner is one of the leading tax firms in Switzerland. With 32 professionals, the firm has been advising important multinational and national corporate clients as well as individuals. Tax Partner co-founded Taxand in 2005 – a global network of independent member firms, with more than 2,000 tax advisers and 400 partners in 50 countries.

New law on taxation of employee participation instruments

A new federal law on the taxation of employee participation instruments entered into force on January 1 2013. The new law is intended to clarify and simplify various aspects of the practice on equity-based compensation and define the taxable event of distributions of employee shares and employee options. In addition, the law defines rules on the taxation of employee participation plans in cases where the employee has changed his tax residence during the vesting period, which are in accordance with the rules suggested by the OECD. The new law will give more legal certainty for difficult questions in the field of employee participation instruments.

Extension of double tax treaty network

Switzerland has a wide network of double tax treaties for income and capital taxation and is continuously extending it. Eighty eight treaties are in force. New ones with Hong Kong and Malta entered into force in 2012 (the agreement with Hong Kong is applicable from January 1 2013 with regard to Swiss taxes and from April 1 2013 concerning Hong Kong taxes; the agreement with Malta is applicable from January 1 2013). Both treaties provide, in particular, a full withholding tax exemption for dividend payments between related companies with a quota of at least 10% in the participation. With these new double tax treaties, Switzerland offers a further efficient dividend route.

Exchange of tax information / group requests

The international standard on exchange of information in tax matters is contained in article 26 of the OECD Model Convention. The standard provides for information exchange on request, where the information is "foreseeably relevant" for the administration of the taxes of the requesting party. In March 2009, the Swiss government decided to adopt the standard to facilitate administrative assistance according to article 26 of the OECD convention. Since then, Switzerland included the administrative assistance clause in more than 41 double tax treaties (29 of these double tax treaties have been entered into force, two are approved by the Swiss Parliament, five have been signed and five have been drafted).

It is often forgotten that administrative assistance in tax matters is not limited to private-bank clients, but is also applicable to enterprises. In this regard, exchange of information may play an important role when, for example, foreign tax authorities are challenging the transfer pricing rules established by an enterprise or the allocation between a headquarter and a permanent establishment.

The OECD updated article 26 of the model tax convention on July 18 2012 and published the adopted commentary. The update explicitly allows for group requests. This means that tax authorities are able to ask for information on a group of taxpayers, without naming them individually, as long as the request is not a fishing expedition. The distinction between an admissible request and a forbidden fishing expedition will be more difficult. In this regard, a decision of the Federal Administrative Court in Switzerland in April 2012 for administrative assistance under the double tax treaty with the US is determining. The court stated that group requests must respect the constitutional principle of proportionality and thus must contain a very detailed description of the action taken, for example, by bank clients to avoid taxation and must be clearly distinct from fishing expeditions.

The procedural implementation of administrative assistance in fiscal matters is governed by the new Swiss national law, Tax Administrative Assistance Act (TAAA), which entered into force on February 1 2013. Administrative assistance is provided exclusively upon request. Group requests in accordance with the updated OECD standard are permitted from the time the TAAA entered into force (that is, admissible for information on issues which concern the period of time from February 1 2013). Requests will not be considered, if for example, they are based on information that

was obtained through acts punishable under Swiss law, such as the illegal acquisition of data.

The development in the field of administrative assistance shows that Switzerland accepts international standards well but will respect principles of a constitutional state.

Withholding tax agreements with the UK, Austria and other countries

The tax agreements with Austria and the UK on the introduction of a final withholding tax entered into force on January 1 2013.

The agreements provide for an anonymous withholding tax for banking relationships. Swiss banks deduct a flat-rate tax on existing assets from UK or Austrian clients (past) and on investment income and capital gains (future) and forward the corresponding tax amount anonymously to the Swiss Federal Tax Administration (SFTA) to be transferred to the tax authorities in Austria and the UK.

The anonymous withholding tax is a final withholding tax. When it is paid, the tax liability for the client in Austria and the UK is finally settled (in contrast to the EU savings tax agreement which does not have a definitive settlement effect).

The tax rate ranges from 21% to 41% of the assets for the UK and 15% to 38% for Austria. The withholding tax rate for future income is the same as the highest rate applied in Austria (25%) and the UK for each category of investment income and gains (between 27% and 48%). Any change in the Austrian and UK tax rates will be adopted for the purpose of the agreement.

As an alternative to the anonymous withholding tax deduction, the banking relationship both for the past and the future may – with the consent of the relevant person – be disclosed to the SFTA, which will forward the relevant information to the Austrian and UK authorities. With this, the agreements respect the requirement of protecting the privacy of bank clients under Swiss banking secrecy. The banking relationship will be disclosed only with the explicit consent of the person concerned.

A bank's clients have to announce whether the withholding tax is to be deducted or whether they wish to disclose their account details by the end of May at the latest. Already in January 2013, the UK received an upfront payment of Sfr500 million from the banks under the terms of the agreement. No such upfront payment was agreed upon with Austria.

In the agreements the parties acknowledge that the final withholding tax is equivalent to the automatic exchange of information for the long term. Accordingly, the final withholding tax fulfils both the tax claims by the states and the protection of the privacy of bank clients, unlike the automatic exchange of information.

Recently, the study "Taxing Savings Sensibly" published by the European Policy Forum, a British institute, in December 2012 confirmed that the system of a final withholding tax is more efficient than the automatic exchange of information. The final withholding tax brings effective tax revenue whereas the automatic exchange only produces a lot of paperwork which the tax authorities may not be able to handle. This proves that even though several high-tax countries require automatic exchange of information, the final withholding tax established by Switzerland has proved to be a much better and more efficient mechanism for collecting taxes.

Besides the existing tax agreements, Switzerland entered into negotiations with other countries such as Greece and Italy. Other countries both within and outside Europe have also shown an interest. The signed tax agreement with Germany was finally rejected by the German parliament in December 2012 and did not enter into force on January 1 2013. The rejection was provoked by the opposition parties in view of the upcoming 2013 election. It cannot be excluded that the tax agreement with Germany will still enter into force at a later stage should the parties in the coalition government win the election in 2013.

"Values that last."

The pyramids of Giza were built at the behest of three pharaohs: Cheops, Chephren, and Mykerinos. Dating back over 4500 years, they are by far the oldest of the ancient wonders. The Cheops pyramid consists of about 2.3 million limestone blocks, each weighing between 2 and 4 tons. Rising to a height of 146.5 meters, it was the tallest structure in the world until the Middle Ages. Each of the pyramids took about 20 years to construct. They became a UNESCO World Heritage Site in 1979.

We compete with the best.

Tax Partner AG
Consultants

Talstrasse 80
8001 Zurich
Switzerland

Phone +41 44 215 77 77
www.taxpartner.ch

www.taxand.com