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RECENT DEVELOPMENTS IN INTERNATIONAL TAXATION

SWITZERLAND

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1. INTRODUCTION

There is a continued focus on keeping Switzerland attractive for businesses and individuals. The most important recent development is the Swiss Corporate Tax and Old Age Insurance ("**AVS**") Reform, which will enter into force on 1 January 2020. This reform was previously called Tax Proposal 17 ("**TP 17**"), but was renamed as the Tax Reform and AVS Financing bill ("**TRAF**"), following inclusion of, in particular, a new annual subsidy of CHF 2 billion for the AVS. Since the TRAF fully meets international corporate tax law standards, this reform is expected to make a significant contribution to an attractive and stable tax framework for long-term investments in Switzerland. In addition to the TRAF, Switzerland aims also at strengthening the Swiss debt capital market and thus currently works on (i) the abolishment of withholding tax on interest paid to Swiss corporate and foreign investors and (ii) the introduction of a paying agent model.

2. MAJOR STATUTORY DEVELOPMENTS

2.1 Corporate Tax and Old Age Insurance Reform

On 28 September 2018, the Swiss Federal Parliament approved the TRAF. However, a coalition of young left-wing parties succeeded in collecting the 50'000 signatures from Swiss citizens, which are necessary to request a referendum. Accordingly, a popular vote took place on 19 May 2019. The TRAF was approved by the Swiss population and will enter into force on 1 January 2020.

In this context, 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 implementation of the TRAF. Most Cantons have decided to significantly reduce the current effective ordinary corporate income tax rates, which will very likely range between approximately 12 % and 19 % (including federal, cantonal and communal levels) as of 1 January 2020. Most Cantons will also implement some equity tax reductions.

The TRAF 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 full compliance with international tax law standards. In addition, a separate tax rate model for hidden reserves and goodwill (formal assessment of the relevant amount) of previous tax status companies will be introduced (5-year transitional period). Furthermore, the regulatory practices regarding Swiss finance branches and principal companies are no longer available as of 2019 and will also be abolished on 1 January 2020.

- Patent box: *Mandatory* introduction of an OECD compliant patent box regime (in particular, residual method and modified nexus approach). The net profit from patents (including patented software) and similar rights is allowed to be reduced by maximum 90 % for the assessment of the taxable net profits.

- Research and development ("R&D") deduction: *Optional* implementation of additional R&D deduction, which reduces, identical to other commercially justified deductions, the taxable net profit. The Swiss definition of R&D takes into account the relevant OECD guidelines. The additional R&D deduction is maximum 50 % and computed based on R&D staff costs, increased by (i) a 35 % uplift to cover other R&D expenses and (ii) in the event of R&D outsourcing in Switzerland, 80 % of the fees invoiced by third party service providers.

- Notional interest deduction: High tax Cantons (e.g. Zurich), whose capital city applies a cumulative corporate income tax rate of at least 13,5 % (which results in a total effective tax rate of 18,03%, taking into account the federal direct tax of 8,5 %), are allowed to introduce a notional interest deduction on excess equity financing. Accordingly, a deduction of arm's length interest on intragroup loans financed with qualifying equity would be available.

- Base erosion limitation: *Mandatory* provision, whereby the total relief generated by the foregoing three new tax measures must not exceed 70 % of the taxable profit of a company, which results in a minimum tax basis of 30 %. Furthermore, the application of the three new tax measures outlined above must not generate losses for a company.

In addition, the TRAF 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 on the relevant asset values 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 investments (i.e. at least 10 %) has to be designed as relief of the taxable basis (as opposed to the reduction of the ordinary tax rate). Furthermore, this taxable basis increases to 70 % at federal level and is at least 50 % at cantonal and communal levels. This rule applies to both private and business investments.
- Other measures: The TRAF stipulates some additional mandatory changes, such as (i) the abolition of the current 5 % tax exempt threshold in the scope of the so-called transposition (i.e. an individual transfers privately held equity investments to a self-controlled holding company for a remuneration) and (ii) the extension of the lump-sum foreign withholding tax credit to Swiss permanent establishments of foreign tax resident entities.

The main difference between the TP 17 and the TRAF is the inclusion of a new annual subsidy of CHF 2 billion for the AVS. This subsidy aims at improving the financial situation of the AVS, which has deteriorated in recent years due to a delay in implementing structural reforms. It will be financed by both the Confederation and a 0,3% increase of the total combined contribution rate applied to the relevant salaries paid by Swiss based companies to their insured employees.

2.2 Reform of Swiss Federal Withholding Tax

On 8 March 2019, a group of experts led by the Federal Department of Finance (including the Swiss Federal Tax Administration ["**SFTA**"]) and consisting also of representatives of (i) various Swiss trade associations, (ii) the conference of cantonal finance directors, (iii) the State Secretariat for Economic Affairs and (iv) the State Secretariat for International Finance ("**SIF**") presented a report to the Swiss Federal Council ("**SFC**"). This report recommends that, amongst others, no Swiss federal withholding tax should be levied on interest generated by Swiss investments of Swiss resident legal entities and foreign resident investors.

The objectives of this recommendation are mainly (i) to strengthen Switzerland's capital market position, since it should incentivize Swiss resident multinational enterprises ("**MNEs**") to issue bonds on the Swiss domestic market and to locate its intra-group financing activities (e.g. cash pooling) in Switzerland, and (ii) to create a level playing field for Swiss collective investment schemes.

In addition, the aforementioned report aims at decreasing the Swiss federal withholding tax on dividends paid to foreign resident investors and certain institutional investors from currently 35 % to 15 % to strengthen Switzerland's equity market position, since the current tax rate is very high, compared to international standards.

2.3 Exchange of Information on Request

In Switzerland, the legal authority to exchange tax information derives from Agreements to eliminate Double Taxation ("**DTAs**"), tax information exchange agreements and/or the Multilateral Convention on Mutual Administrative Assistance in Tax Matters as well as the related Swiss domestic legal basis, which came into effect on 1 January 2017.

On 22 November 2018, the SFC adopted the dispatch regarding the federal bill on the implementation of recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes (peer review, phase 2). As to the exchange of information on request, this draft bill contains provisions on (i) the confidentiality of administrative assistance requests, (ii) the capacity to be a party and to take legal action in the relevant proceedings and (iii) the treatment of requests based on stolen data.

2.4 Implementation of Global Minimum Standards of the Base Erosion and Profit Shifting Project of the OECD and G20 Countries

a) Swiss implementation approach of BEPS Convention

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**"). The Swiss Federal Parliament authorized the SFC on 22 March 2019 to ratify the BEPS Convention. Should there be no referendum called by 11 July 2019, Switzerland will deposit its ratification bill for the BEPS Convention with the OECD.

From a Swiss point of view, the BEPS Convention serves as efficient basis to amend existing DTAs in line with the minimum standards agreed upon in the BEPS project. Accordingly, Switzerland implements these minimum standards (i) either within the framework of the BEPS Convention (Argentina, Austria, Chile, Czech Republic, Iceland, Italy, Lithuania, Luxembourg, Mexico, Portugal, South Africa and Turkey) or (ii) by means of the bilateral negotiation of amendments to DTAs (e.g. Brazil, Latvia and the United Kingdom). 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.

b) Spontaneous exchange of information on tax rulings

The spontaneous exchange of information on tax rulings (in particular transfer pricing 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 SFTA announced on 8 May 2018 that they transmitted information on Swiss advance tax rulings to 41 partner states (including, for instance, France, Germany, the United Kingdom, the Netherlands and Russia) for the first time. Until end of May 2019, there has been no additional update available.

c) Automatic exchange of country-by-country reports

Switzerland has implemented BEPS Action 13 in relation to the exchange of country-by-country reports ("**CbC Reports**") of MNEs. Following entry into force of the relevant international agreements, the Swiss domestic legal basis became effective on 1 December 2017. On the same day, Switzerland notified the OECD of the 108 countries with which it will exchange CbC Reports (mainly information on the group's principal business activities, the global allocation of income and taxes paid).

Swiss MNEs are obliged for the first time to draw up CbC Reports for the 2018 tax year. As a rule, the exchange of CbC Reports between Switzerland and its partner states will therefore take place as of the calendar year 2020. However, the SFTA has already sent 109 CbC Reports to 35 partner states in June 2018. The content of the CbC Reports is confidential and subject to the principle of speciality. This first exchange covered the 2016 tax period and was executed on a voluntary basis at the respective MNE's request.

Since additional states have met the relevant criteria for the exchange of CbC Reports since 1 December 2017, the SFC decided on 17 October 2018 to extend this exchange to these states and submitted an updated list of countries to the OECD in December 2018. Furthermore, the Swiss domestic legal framework has been amended (i) with effect from 1 December 2018 by taking into account the updates of the OECD guidelines regarding the preparation and exchange of CbC Reports and (ii) with effect from 1 January 2019 by removing the transitional provision regarding the term "*participating state*" which corresponds to the implementation of the international standard.

2.5 Automatic Exchange of Financial Account Information

Switzerland generally implements the automatic exchange of financial account information ("**AEOI**") based on the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information and the related Swiss domestic legal basis, which entered into force on 1 January 2017. Moreover, Switzerland concluded bilateral agreements on the global AEOI standard with the European Union ("**EU**"), Singapore and Hong Kong.

The SFTA informed in October 2018 that they exchanged 2017 financial account data on non-tax residents for the first time within the framework of the AEOI at the end of September 2018 (36 states and territories). Approximately 7'000 reporting Swiss financial institutions (banks, trusts, insurers, etc.) are registered with the SFTA and transfer data to the SFTA. Data on approximately two million financial accounts were sent by Switzerland to EU states as well as to further nine states and territories (Australia, Canada, Guernsey, Iceland, Isle of Man, Japan, Jersey, Norway and South Korea). Cyprus and Romania are currently excluded from the AEOI, as they do not yet meet the international requirements on confidentiality and data security. Furthermore, as some countries could not yet deliver data due to technical reasons, the SFTA has delayed the data exchange with these countries.

During its meeting on 27 February 2019, the SFC initiated the consultation on the update of the Swiss domestic legal basis, which takes into account the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes. This consultation takes place until 12 June 2019. The final proposal is expected to be discussed by the Swiss Federal Parliament in spring 2020.

In addition, out of the 108 states and territories that are currently committed to the global AEOI standard, 19 are not yet part of Switzerland's network. On 29 May 2019, the SFC adopted the dispatch on the introduction of the global AEOI standard with these 19 additional partner states (e.g. Azerbaijan, Kazakhstan, Lebanon, Nigeria and Turkey). It is planned that the AEOI with these states will be activated as of 2020. Accordingly, the first exchange of financial account information with these states is expected to take place in 2021.

On 29 May 2019, the SFC also approved the report on the review mechanism for the standard-compliant implementation of the AEOI by the partner states with which Switzerland intends to exchange 2018 financial account data for the first time this autumn.

2.6 Tax Treaty Network

Switzerland has concluded DTAs regarding income and asset taxes with over 100 countries and thus is considered to be a prime location for doing business, including for high profile MNEs. Based on the information of the SIF, 60 DTAs contain a provision on the exchange of information according to OECD standards, whereby 51 of these 60 agreements are in force and applicable. Furthermore, Switzerland applies eight agreements for the avoidance of double taxation in regard to inheritance and estate taxes (e.g. with the United Kingdom).

The most important recent development is that Switzerland extends its network of DTAs to Brazil. Switzerland and Brazil signed a DTA in the area of income taxes on 3 May 2018, which was approved by the Swiss Federal Parliament on 22 March 2019. On the same day, the Swiss Federal Parliament approved the updated DTA concluded with the United Kingdom. Switzerland also reached mutual agreements with Colombia and Chile respectively, which aim at clarifying the procedure applicable to the refund or partial exemption at source of Swiss federal withholding tax on dividends and interest for taxpayers who are resident in Colombia and Chile respectively.

In addition, Switzerland has signed 10 tax information exchange agreements (Andorra, Belize, Brazil, Greenland, Grenada, Guernsey, Isle of Man, Jersey, San Marino and the Seychelles) which all came into force. For instance, the provisions of the most recent agreement between Switzerland and Brazil came into force on 4 January 2019 and will apply to requests for tax information exchange for tax years starting on 1 January 2020.

2.7 Value Added Tax

The partial revision of the Swiss Value Added Tax Act came into effect on 1 January 2018. Based on this revision, 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. Various updates of the related administrative guidance have been published by the SFTA since 1 January 2018. In particular, new regulations apply to mail order companies as of 1 January 2019. Furthermore, the SFTA issued the updated guidance in relation to foreign companies in a new booklet called VAT Info 22 on 5 May 2019 (final draft version) which clarifies various issues, such as the declaration of turnover. In short, foreign companies that are VAT registered in Switzerland are only required to report their turnover in connection with their supplies in Switzerland. The declaration of their worldwide turnover is no longer required by the SFTA. The final version of the VAT Info 22 will be applied retroactively as of 1 January 2018.

3. MAJOR REGULATORY DEVELOPMENTS

3.1 Taxation of Bonds

On 5 February 2019, the SFTA published an important guideline to clarify its practice for bonds issued by a foreign debtor with a guarantee of a direct or indirect Swiss based parent company (i.e. down-stream guarantee). This clarification takes immediate effect. In short, it alleviates the previous restrictions on the use of proceeds in Switzerland obtained through bonds issued by foreign debtors. According to the new SFTA practice, proceeds are allowed to be lent to Swiss resident subsidiaries without a requalification of the foreign bond as a Swiss bond and thus without adverse Swiss federal withholding tax consequences if these proceeds do not exceed the relevant threshold. This threshold corresponds to (i) the total amount of the equity of all foreign resident subsidiaries of the group (so-called "equity alternative") and/or (ii) the total amount of loans made by the Swiss resident group companies to foreign resident group companies (so-called "compensation alternative" applied to intragroup financing). The new SFTA practice should provide MNEs with a lot more efficient financing choices.

3.2 Expenditure-based Taxation for Individuals

On 24 July 2018, the SFTA issued an updated version of the circular letter regarding the worldwide expenditure-based taxation of Swiss resident individuals, which resulted from the change of the federal legal basis as of 1 January 2016. This circular letter replaced the previous one issued on 3 December 1993 and applies to all tax assessments in relation to federal direct tax as of the 2016 tax period, however with the reservation of a transitional period of five years. During this period, Swiss resident taxpayers who already benefit from a tax ruling regarding their worldwide expenditure-based taxation in Switzerland, which was approved by the competent tax authority prior to 1 January 2016, will not be subject to the updated tax practice until and including the tax period ending on 31 December 2020.

Foreign nationals, who have never been subject to a Swiss unlimited tax liability before moving to Switzerland (or at least not within the last 10 years), who are tax resident in Switzerland (subject to certain exceptions, since some Swiss German Cantons abolished this tax regime) and who do not perform any business activity in Switzerland, are eligible to be taxed on a worldwide expenditure basis. The updated SFTA practice provides mainly further guidance on various issues, which were not necessarily analysed in a uniform manner by the competent cantonal tax authorities. The main updates deal with (i) married couples whereby both spouses have to meet the relevant requirements, (ii) the generally abolished option to switch between the expenditure-based tax regime and the ordinary taxation, and (iii) the floor of the taxable basis. This basis generally corresponds to the worldwide expenditures of the taxpayer, but it must not go below (i) CHF 400'000 or (ii) seven times the annual rental value or the annual rent paid or (iii) the result of the so-called control computation based on Swiss sourced income and foreign sourced income if the application of a DTA is requested by the taxpayer.

4. MAJOR JUDICIAL DEVELOPMENTS

4.1 UK Partnership

On 28 February 2019, the Swiss Federal Supreme Court ("**SFSC**") denied the existence of a permanent establishment abroad in connection with an interest in a UK limited partnership, since the Swiss resident taxpayer did not succeed in providing evidence on a substantial business activity in a fixed place of business abroad. This decision confirms the previous practice of the SFSC.

4.2 Tax-neutral Demerger

On 11 March 2019, the SFSC has held that the transfer of a single qualifying participation (at least 20 %; active subsidiary) by a Swiss holding company to a newly incorporated and fully owned Swiss holding company qualifies as a corporate income tax-neutral demerger. It has rejected the practice of the Geneva Tax Administration, which has required the transfer of at least two qualifying participations. The SFSC ruled that the relevant conditions for an income tax neutral demerger have been satisfied, since cumulatively (i) a 100 % participation in an active subsidiary was transferred and (ii) both companies, which resulted from the demerger, have continued to perform their holding company functions.

4.3 Mutual Administrative Assistance in Tax Matters

From June 2018 to May 2019, the SFSC has delivered an important number of decisions involving various countries (e.g. Finland, France, Germany, India, Japan, the Netherlands, Russia, Spain and Sweden). In general, there is a trend that the SFSC allows (in cases of doubt) the SFTA the transmission of the relevant tax information requested by foreign states. Even though additional decisions of the SFSC will follow, this development is expected to slow down due to the AEOI applicable as from 2018.

On 17 July 2018, the SFSC rendered a landmark decision on the topic of stolen bank data and the principle of good faith. The SFSC clarified that a tax information request of the Indian tax authorities based on stolen bank data does not by itself breach the principle of good faith. In short, the SFSC ruled that the foreign state is only in breach with the principle of good faith if this state previously explicitly confirmed that it would not use stolen data for information requests or if other facts constitute a breach of this principle. India had not made any explicit declaration to Switzerland that it would not use stolen bank data. Moreover, the stolen data were not actively acquired by India outside the administrative assistance proceedings. Thus, the SFTA was allowed to transmit the requested tax information to the Indian tax authorities.

In addition, the SFSC had to clarify for the first time whether Switzerland has to deal with a bunch of single requests in which the foreign state only indicates the account numbers for the taxpayers concerned by the requests. The German tax authorities requested tax information mainly for German criminal tax proceedings and were only aware of the account numbers and the related assets. On 29 October 2018, the SFSC ruled that the tax information request of the German tax authorities was neither a fishing expedition nor a group request, but corresponds to individual requests where the identification of the relevant taxpayers is made by indicating the account numbers (and not the names). Therefore, the SFSC did not prevent the transmission of the requested tax information to the German tax authorities.

Moreover, the SFSC decided on 1 February 2019 that the information on the Swiss tax regime (expenditure-based taxation) applied to a Swiss tax resident individual qualifies as foreseeably relevant information, which can be transmitted to the French tax authorities if they intend to assess the French domestic tax domicile of the relevant individual. This decision is strongly criticized, since the requested information is foreseeably neither relevant to assess the French domestic tax domicile of the relevant individual based on French domestic tax law nor to solve a possible international conflict of dual tax residence. The latter would have to be analysed solely based on the criteria provided in the tie-breaker rules of the Swiss/French DTA.

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