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## A: Group approach and separate entity approach in domestic and international tax law

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**Switzerland**

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## Summary and conclusions

Switzerland takes a strong separate entity approach, although it does not ignore entirely relationships between related entities. The separate entity principle applies domestically, between cantons and communes, and internationally. In particular, Switzerland has no group provisions for corporate income tax purposes, although it does have provisions for participation relief.

The lack of attention placed on group relationships does mean that it can be difficult to define the notions of 'group' or 'related entity', as neither term is defined under Swiss tax law. However, the Swiss Federal Supreme Court has defined 'related entities' as independent entities under a single economic management; under provisions related to tax-neutral group reorganisations, companies are considered to be part of the same group if one company holds the majority of voting rights in, or exercises control over, the other, which is the same as the definition set out in Swiss commercial law.

One area in which the question of whether entities are related is relevant is participation relief. The Swiss tax system provides for participation relief on intra-group dividends and capital gains realised on the sale of qualifying participations; whether a participation qualifies depends on the size of the receiving entities investment in the distributing entity.

There are no statutory provisions permitting groups to consolidate losses. Still, in some cases, groups may be able to achieve the same effect through a group reorganisation, such as a merger with a company with losses. However, these types of transactions are subject to scrutiny from the tax authorities under the general anti-avoidance principle and there is a risk that the tax authorities could consider the transaction to be a form of tax avoidance.

The notion of related entities also comes into play for loans. Companies may not pay interest on loans from shareholders or related parties in excess of what would be paid to an unrelated third party (based on published safe harbour rates). Swiss tax rules also contain thin capitalisation rules and amounts in excess of the maximum allowed debt are requalified as equity. Both interest paid in excess of the safe harbour rates and interest paid on debt requalified as equity under thin capitalisation rules are treated as constructive dividends when paid to a shareholder or related party, resulting in an increased corporate income tax burden for the paying entity and Swiss withholding tax (35%). However, since dividends paid to a parent company benefit from participation relief, no income tax or withholding tax would be due by the parent company in the event of a constructive dividend paid by a subsidiary.

Since Switzerland does not have special transfer pricing rules, the OECD Transfer Pricing Guidelines, which use the separate entity approach, are followed. It should be noted that Switzerland heavily relies on the OECD Transfer Pricing Guidelines, and on numerous occasions the Swiss Federal Supreme Court has affirmed that the transactions must be

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commercially justified and that commercially justified must be interpreted using the OECD Transfer Pricing Guidelines. The OECD Transfer Pricing Guidelines are used not only to determine whether international transactions were carried out at arm's length, but also for domestic transactions, which also must be carried out at arm's length.

Switzerland also has implemented, and closely follows, the authorised OECD approach with regard to attribution of business profits between foreign and domestic branches and head offices under article 7 of the OECD MC and Switzerland complies with the BEPS minimum standards.

Additionally, even though Switzerland does not have special anti-avoidance rules, the Swiss Federal Supreme Court's case law, based on a general anti-abuse rule, permits the tax authorities to tax a taxpayer's structure based on its economic substance, rather than its legal structure when there is tax avoidance or abuse of a right. For instance, a foreign entity can be disregarded when a structure is considered abusive in that there is a lack of clear separation between the Swiss company and a foreign subsidiary. In such cases, the foreign entity's income and expenses will be attributed directly to the Swiss taxpayer. In practice, this is rare as there is no real tendency in Switzerland to pierce the corporate veil.

Further, it should be noted that participation relief also applies on the international level. This means that participation income from foreign entities qualifies for participation relief, regardless of the foreign entity's tax rate or of the existence of a double tax treaty between Switzerland and the jurisdiction in which the subsidiary is liable to tax, which is rather generous in comparison to other jurisdictions.

Lastly, Switzerland does not have CFC rules.

In summary, Switzerland's approach to groups can be summed up as an OECD-compliant, separate entity approach that takes into consideration relationships between group entities when necessary, such as for transfer pricing purposes or to prevent tax avoidance or tax evasion, but that places limited importance on groups. Generally, this approach is beneficial for groups, since participation relief provides a formidable exception for participation income, including foreign profits; the major downside is the difficulty of consolidating losses.

## Part One: Separate entity approach and group approach in domestic law

### 1.1. General overview

Any analysis of group taxation in Switzerland must start by stating that save for several exceptions, which are explained later in this article, group entities are taxed separately, without taking into consideration whether they are part of a group of companies.

Switzerland's tax system is based on the principle of separate entity taxation[2] – there is no group taxation and Swiss law does not even define what constitutes a group of companies (see section 1.3 below).

The rationale behind separate entity taxation in Switzerland is linked to companies being viewed as distinct from their shareholders. Consequently, companies are seen as

2 ATF 140 II 88, considering 4.1; Arrêt du Tribunal fédéral 2C_1073/2018 of 20 December 2019, considering 11.1.

having their own capacity to pay taxes (*capacité contributive, Leistungsfähigkeit*), meaning taxes must be levied based on their individual capacity to pay,[3] not based on that of their shareholders or other group members.

Historically, the reason for separate entity taxation may also lie in Switzerland's federalist structure. Prior to World War II, taxes were levied uniquely by the cantons, and not by the federal government, which would have made group taxation impossible when group entities were located in multiple cantons. Even today, the majority of corporate income tax is levied by the cantons and the cantonal tax administrations are responsible for determining the taxable income, which would make it difficult to apply a group approach at the national level.

Switzerland's strong tradition of separate entity taxation meant that there was no participation relief at the shareholder level, which resulted in economic double taxation. This had multiple implications, including that individuals who owned companies would often choose to receive a salary or interest payments, rather than a dividend, since expenses could be deducted from the company's taxable income, reducing the economic double taxation.

The Swiss Federal Supreme Court accepted the legality of economic double taxation.[4] However, the Swiss Parliament has since introduced measures to reduce economic double taxation.

In 1996, participation relief (*reduction pour participation*, *Beteiligungsabzug*) for companies was introduced (20% threshold and 100% relief) and, in 2007, participation relief (*imposition partielle*, *Teilbesteuerung*) was introduced for individuals (10% threshold and 60% of the dividend is taxed). Under the 2020 Tax Reform Act,[5] at the federal level, there is a 10% threshold for individuals and 70% of the dividend is taxed (see section 1.2 below).[6]

Bookkeeping requirements also merit a brief mention[7] in any article discussing Swiss corporate taxes.

Unlike in some countries in which companies are required to keep two sets of books of account, one for commercial purposes and one for tax purposes, Swiss corporate taxes are levied based on the commercial books of account,[8] which are governed by the Swiss Code of Obligations.[9] The strong connection between tax law and the commercial accounts prepared based on corporate law is another explanation for why there is no group taxation in Switzerland.

In principle, the taxable income is the same as the profit listed in each company's statutory financial statements, which is determined on an accrual basis. Since Swiss accounting law is based on the principle of prudence[10] and not true and fair view, ordinarily, there is no revaluation and most assets are maintained at their investment cost or subject to regular amortisation schedules.

3 Art. 127 para. 2 of the Swiss Federal Constitution of 18 April 1999, RS 101; ATF 122 I 101, considering 2.aa.
4 See ATF 136 I 49, considering 5.4.
5 The Tax Reform and Social Security Funding Act (Tax Reform Act).
6 Art. 18b and art. 20 para. $1^{bis}$ of the Swiss Federal Income Tax Act (FITA) of 14 December 1990, RS 642 11.
7 Swiss accounting law is addressed in detail in section 1.3.1.
8 Art. 57 FITA.
9 Swiss Code of Obligations (CO) of 30 March 1911, RS 220.
10 Art. 958c para. 1 no. 5 CO.

Generally, all expenses are deductible, provided they are commercially justified.[11]

However, Swiss tax law does impose additional limits (limitations on depreciations, provisions, etc.) and permits corrections to the income listed in the books of account by the tax authorities when the tax law stipulates that a value different from that in the books of account should be used. For instance, if the tax authorities consider depreciations or provisions to be excessive or unjustified, they will be reduced or denied.

The above results in a generous tax system, which generally permits more amortisations than regimes that contain separate tax accounting rules (e.g., all types of acquired intangible assets can be amortised over five years, including intangible assets purchased from affiliated entities). Additionally, investments may be depreciated if their value has decreased.

### 1.2. General system of inter-company transactions outside special group taxation regimes

Although the Swiss tax system is based on the separate entity principle, intra-group relationships are not always completely disregarded when determining an entity's tax treatment.

The Swiss tax system provides for participation relief on intra-group dividends and capital gains realised on the sale of qualifying participations.

In accordance with article 69 FITA, participation income is eligible for participation relief if the receiving company owns at least 10% of the equity in the distributing company, if the participation is worth at least CHF one million (for dividends) or if the receiving company is entitled to at least 10% of the distributing company's profit and reserves. Dividend income includes dividends, capital repayments, proceeds from share redemptions, constructive dividends and liquidation dividends.

Participation relief is granted for capital gains if the receiving company owns at least 10% of the equity in the company, or if it has an investment that entitles it to more than 10% of the company's capital and reserves, and the participation has been held for at least one year.[12]

Under the Swiss participation relief system, corporate income tax is reduced based on the ratio of net participation income to the total taxable net profit (including participation income) generated by the company.[13] Net participation income equals the gross participation income less depreciation resulting from dividend distributions, administrative costs, related financing costs and non-recoverable non-Swiss withholding taxes on gross participation income.[14]

In general, administrative costs are calculated using a lump-sum cost of five percent, but that percentage can be increased or decreased if there is proof that the effective costs differ.[15]

Ordinarily, financing costs are calculated using the ratio of the book value of the

[11] Art. 58 FITA and 24 para. 1 let. a of the Swiss Federal Tax Harmonisation Act (FTHA) of 14 December 1990, RS 642 14.

[12] Art. 70 para. 4 FITA.

[13] Art. 69 FITA.

[14] Art. 70 para. 1 FITA.

[15] Swiss Federal Tax Administration (SFTA), Circular n° 27 *Réduction d'impôt sur les rendements de participations à des sociétés de capitaux et sociétés coopératives* (Bern 17 December 2009), no. 2.6.3.

participation to the total value of assets attributed to participation income.

Since participation relief reduces the corporate income tax that is levied rather than the corporate income tax base, there are key differences between the Swiss participation relief regime and the participation exemption regimes used in many jurisdictions.

First, since qualifying dividends or qualifying capital gains increase the tax base, there are situations where they will be offset by losses from the current year or losses that have been carried forward. This can lead to tax inefficiencies. For instance, if a company has carried forward losses from its operational activities and then receives a qualifying dividend, the dividend would have to be offset with those losses, meaning the company could not subsequently use the losses to offset future operational income.

Another difference is that the participation relief regime allows corporations to deduct losses on investments (participations). In accordance with Swiss accounting law,[16] impairment losses (participation impairments), are deductible for corporate income tax purposes, although the burden of proof is on the taxpayer to prove that there was a depreciation, and some authors believe deductions and depreciations should be allowed only if there are actual losses.[17]

It should be noted that participation impairments are subject to a recapture rule, which allows the tax authorities to reintegrate them into the taxable income in any subsequent fiscal year if the impairment is no longer justified.[18]

Additionally, the participation relief rules contain a recapture mechanism if the participation is sold, since only the difference between the sale price and the investment cost is eligible for participation relief.[19] This means that income arising from the difference between the book value and the investment cost, which generally corresponds to past impairments on participations that were taken as deductions, is not eligible for participation relief.

In summary, participation relief has some advantages, especially if the participations need to be impaired, but it also has a number of inefficiencies. The possibility of switching to a participation exemption regime was discussed during debates surrounding the Corporate Tax Reform III bill,[20] but ultimately the change lacked widespread support and was neither part of the Corporate Tax Reform III bill nor the Tax Reform Act.[21] However, it is possible that such a change could be introduced in the future.

Another area in which the question of whether a company belongs to a group is relevant is transfer pricing, in particular when determining deductible expenses.

Domestic inter-company transactions are subject to transfer pricing rules and, as mentioned above, corporate income tax is levied based on the net profit listed in the commercial books of account, provided expenses are commercially justified,[22] meaning transactions must be at arm's length.

16 Art. 960 par. 3 and 960a para. 3 CO; see Chambre Fiduciaire, *Manuel suisse d'audit* (2014 edn Zurich 2014).

17 RDAF 2014 II 346, 350 *et seq*; Handschin Lukas, *Rechnungslegung im Gesellschaftsrech*, (2nd edn Helbing Lichtenhahn Basle 2016) 332 *et seq*.

18 Art. 62 para. 4 FITA.

19 Art. 70 para. 4 FITA.

20 FF 2005 4613, 4638 and 4677.

21 The Corporate Tax Reform III bill was ultimately rejected by Swiss voters in a 2017 referendum, but in 2019, Swiss voters accepted the Tax Reform Act, which introduced many of the reforms that had been proposed in the Corporate Tax Reform III bill.

22 Art. 58 FITA.

When determining if a domestic transaction is at arm's length, and thus commercially justified, the Swiss tax authorities directly apply the OECD Transfer Pricing Guidelines[23] (see section 2.5 below).

In practice, domestic transfer pricing audits are rare, but they can occur to curb inter-cantonal profit shifting.

## 1.3. Group taxation regimes

### *1.3.1. Groups of companies in commercial law and for accounting purposes*

Swiss commercial law does not define what constitutes a group of companies. However, the CO, which is the main accounting standard in Switzerland, and is widely used by companies to prepare stand-alone accounts, sets forth some principles governing consolidated accounts and contains rules covering when consolidated group accounts are required and which entities are covered by this requirement.[24]

According to article 963 paragraph 1 CO, an entity with an obligation to keep consolidated accounts must include all undertakings that it controls; controlled undertakings are defined as undertakings in which the entity:[25]

– directly or indirectly holds a majority of votes in the highest management body;
– directly or indirectly has the right to appoint or remove a majority of the members of the supreme management or administrative body; or
– is able to exercise a controlling influence based on the articles of association, the foundation deed, a contract or comparable instruments.[26]

In addition to the accounting standards contained in the CO, the following accounting standards also are recognised in Switzerland: IFRS, US GAAP and Swiss FER GAAP (sometimes used by smaller groups). For consolidated accounts, companies often forgo the CO and opt for an internationally recognised accounting standard.

Based on article 963 paragraph 1 CO and rules in other accounting standards recognised in Switzerland, it can be inferred that there is a group when a parent company holds at least 51% of a subsidiary or exercises control in another manner (e.g., articles of association, trust or shareholder agreement).

Although Swiss tax law does not contain any definition of what constitutes a group of companies, it does contain provisions governing tax-neutral group reorganisations. Under these provisions, companies are considered to be part of the same group if one company holds the majority of voting rights in, or exercises control over, the other.[27] Thus, the criterion is the same as the one set out in commercial law.

[23] OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, (Paris 2017).
[24] Art. 963 and art. 963a CO.
[25] Art. 963 para. 2 CO.
[26] This was added during a major reform to Swiss accounting law, which entered into force on 1 January 2013.
[27] Art. 61 para. 3 FITA.

### 1.3.2. *Existence, scope and effects of group taxation regimes*

With the exception of VAT,[28] there is no group taxation in Switzerland. Further, due to the strong principle of separate entity taxation, there is no mechanism to achieve a similar result through procedural rules.

The lack of group taxation is problematic for groups with some companies that turn a profit and others that have losses. However, group reorganisations sometimes may be used to offset, consolidate or shift profits between entities. Still, this is far from perfect and is always subject to scrutiny from the tax authorities under the general anti-avoidance principle (see section 1.5.1).

One possibility is to use a merger to offset losses in some group companies against profits in others; in principle, mergers are tax-neutral, provided there is no re-evaluation of commercial assets. A reorganisation involving a merger with a company with losses is allowed unless there is tax avoidance, and these losses are deductible for the resulting entity.[29]

According to case law and rules issued by the SFTA,[30] there is tax avoidance if one of the merging companies has been economically liquidated, or if shortly after the merger, the company with losses ceases its activities, a transferred business unit ceases its activities,[31] or if the absorbed company stops carrying out a commercial activity prior to the merger.[32]

However, the Swiss Federal Supreme Court has permitted losses to be deducted in cases concerning mergers with companies in liquidation when the deduction of losses was not the sole reason behind the merger. In a 2012 case, the Swiss Federal Supreme Court permitted losses to be deducted during a merger with a company in liquidation after determining that the driving factor behind the merger was the acquisition of intellectual property owned by the company in liquidation.[33] Legal scholars considered that this was in line with the Swiss Merger Act,[34] which permits mergers with companies in liquidation, as well as with the FITA,[35] which stipulates that, in principle, mergers are permitted and tax neutral.[36]

In its more recent case law, the Swiss Federal Supreme Court has nuanced its position and has stopped losses from being deducted when only cash or other liquidities were

[28] Art. 13 para. 1 of the Value Added Tax Act of 12 June 2009 (VAT Act), RS 641.20 stipulates that "[l]egal entities with their registered office or a permanent establishment in Switzerland which are closely associated with one another under the common management of a single legal entity may on application combine as a single taxable person (a VAT group)".

[29] Art. 67 FITA; Danon Robert, 'Article 67' in Aubry Girardin Florence and Noël Yves (eds), *Commentaire romand LIFD* (2nd edn) (Lausanne 2017) no. 13; SFTA, Circular n° 32 *Assainissement de sociétés de capitaux et de sociétés coopératives* (Bern 23 December 2010) no. 4.3.

[30] SFTA, Circular n° 32 *Assainissement de sociétés de capitaux et de sociétés coopératives* (Bern 23 December 2010) no. 4.3.

[31] Arrêt du Tribunal fédéral 2A.583/2003 of 31 January 2005.

[32] *Steuerentscheid* (StE) (2004) B 72.15.2 no. 5.

[33] Arrêt du Tribunal fédéral 2C_351/2011 of 4 January 2012; Danon Robert, 'Article 67' in Aubry Girardin Florence and Noël Yves (eds), *Commentaire romand LIFD* (2nd edn) (Lausanne 2017) no. 13b.

[34] Art. 5 para. 1 of the Swiss Federal Law on Merger, Demerger, Conversion and Transfer of Assets and Liabilities of 3 October 2003, RS 221.301.

[35] Art. 61 FITA.

[36] Danon Robert, 'Article 67' in Aubry Girardin Florence and Noël Yves (eds), *Commentaire romand LIFD* (2nd edn) (Lausanne 2017) no. 13c.

transferred from the company in liquidation[37] or when the company in liquidation had ceased carrying out business activities and the principal reason for carrying out the merger was to reduce the group's costs.[38]

A second possibility is to undergo a reorganisation that shifts profit through an intercompany transfer of assets. Ordinarily, assets used for the business operations can be transferred between group entities at book value without generating any tax liability under the provisions governing tax-free reorganisations.[39] They also can be transferred at their fair market value and the profit then can be deducted from losses that have been carried forward. Thus, it may be strategic to transfer certain income generating assets between group entities, although generally this only will be possible if there are other business reasons for the transfer.

Leveraged acquisitions that use debt to finance the acquisition of a target company through an acquisition company created as a special purpose vehicle (SPV) present a challenge, since the absence of group taxation means that interest on the acquiring company's debt cannot be deducted by the target company if the latter does not have operational income. The practice of the Swiss tax authorities is to systematically treat certain debt push-down strategies in a leveraged acquisition, in particular the merger between an acquisition company and the target, as tax avoidance. However, the prohibition on debt push-down using an SPV to acquire a Swiss target company is not universally accepted. Certain authors[40] argue that this practice is erroneous and that the tax authorities cannot automatically qualify all cases of debt push-down as tax avoidance.

Additionally, this practice has never been challenged before the Swiss Federal Supreme Court, and in a 2016 case concerning debt push-down[41] the Administrative Court of the Canton of Zurich ruled that there had not been tax avoidance.[42]

In practice, if the Swiss tax authorities consider that there was tax avoidance through debt push-down, they will prohibit the acquisition company from deducting interest on loans taken out by the target company for five years following the acquisition.

However, if the acquisition is made by an operating company, which then absorbs the target, it is possible to deduct interest on loans taken out by the company.

The merger also will be accepted if the acquisition was structured as a staggered acquisition. In a staggered acquisition, an acquisition company first acquires a target company, which in turn acquires another target company. Since the first target company has operational income and assets that can be leveraged, it can take out loans to fund the acquisition of the second target company and deduct the interest on the loans. The target companies also can be merged without risk that the interest deduction will be prohibited under the tax avoidance principle, since there will always be business reasons to merge two operating entities.

[37] Arrêt du Tribunal fédéral 2C_701/2012 of 24 November 2012, considering 3.1.

[38] Arrêt du Tribunal fédéral 2C_1088/2014, 2C_1089/2014 of 26 October 2015, considering 5 and 6.2.3; Danon Robert, 'Article 67' in Aubry Girardin Florence and Noël Yves (eds), *Commentaire romand LIFD* (2nd edn) (Lausanne 2017) no. 13e.

[39] Art. 61 para. 3 FITA.

[40] Mirkovic Bojana and Zitter Gernot, ‹Der Debt push-down in der Schweizer Rechtsprechung› (2019) 87 *Archives de droit fiscal suisse* 541.

[41] Entscheid des Verwaltungsgerichts Zürich SB.2015.00073 of 20 April 2016.

[42] Mirkovic Bojana and Zitter Gernot, ‹Der Debt push-down in der Schweizer Rechtsprechung› (2019) 87 *Archives de droit fiscal suisse* 541, 552.

Further, the transformation of the acquisition company into an operating company also is permitted, unless it is done by transferring assets from the target company without a valid business reason.

Lastly, the Swiss tax authorities generally accept pushing the debt down to the target company through the payment of dividends or capital reductions without a cash transfer, although this may be subject to other limitations such as thin capitalisation of the target.

### 1.4. Change of control rules

In general, there are no change of control rules. However, an exception exists when there is tax avoidance or abuse of a right (see section 1.5.1).

The tax authorities consider this to be the case when there is a sale of a company that has liquidated all or most of its assets so all that remains is a shell company (*théorie du manteau d'actions*, *Mantelhandeltheorie*) and the main purpose of the sale is to transfer carried forward losses and avoid the costs entailed in creating a new company. However, in practice, this rule is rarely applied.

### 1.5. Relevance of belonging to a group/control in other contexts

#### *1.5.1. Special anti-avoidance rules*

Switzerland does not have special anti-avoidance rules and there is no codified general anti-avoidance rule (GAAR).

However, the Swiss Federal Supreme Court's case law, applicable to all Swiss taxes, permits the tax authorities to tax a taxpayer's structure based on its economic substance, rather than its legal structure when there is tax avoidance or abuse of a right (*évasion fiscale*, *Steuerumgehung*).
According to the Swiss Federal Supreme Court's case law,[43] there is tax avoidance when:
– the structure chosen by the taxpayer is unusual (*insolite*), strange or inappropriate and does not reflect the economic circumstances;
– the taxpayer intends to reduce its tax liability; and
– the taxpayer's tax liability is reduced.

The tax authorities use this general tax avoidance principle to pierce the corporate veil (*Durchgriff*) and disregard an underlying entity; the Swiss Federal Supreme Court has confirmed that piercing the corporate veil is allowable as an exception to the separate entity principle when a situation is considered abusive and the company and the shareholder are one and the same.[44] In general, it is applied when an individual, who is the sole shareholder,

[43] ATF 131 II 627, considering 5.2; this has been affirmed by subsequent rulings (see ATF 138 II 239, considering 4.1).
[44] Arrêt du Tribunal fédéral 4A_417/2011 of 20 November 2011, considering 2.3; Arrêt du Tribunal fédéral 5A_739/2012 of 17 May 2013, considering 7.2.1; Arrêt du Tribunal fédéral 4A_155/2017 of 12 October 2012, considering 5.1; Muller Valentine, '*Structures de détention d'actifs de valeur, théorie de l'évasion fiscale et TVA*' RDAF 2018 II 349, 361.

operates a company only to benefit from lower tax rates or the deduction of VAT input, and it is rarely used for corporate income tax purposes.[45]

Additionally, the tax avoidance principle can be used to curb attempts to split up entities in order to obtain tax benefits. However, there is very little case law, since few benefits apply uniquely to small companies and corporate income tax rates usually are not progressive, meaning the administrative costs often outweigh the tax benefits of having multiple small companies.

That said, according to the case law of the Board of appeal for federal indirect taxes,[46] creating multiple companies to remain below the threshold for being liable to VAT (CHF 100,000 per year) constitutes tax avoidance and is not allowed.[47]

### 1.5.2. *Special rules for the attribution of intra-group interest*

Companies may not pay interest on loans from shareholders or related parties in excess of what would be paid to an unrelated third party. The SFTA publishes annual maximum and minimum safe harbour interest rates[48] for loans entered into with related parties. The safe harbour rates depend on several factors, such as the loan currency and the type of financing.

Swiss tax rules also contain thin capitalisation rules.[49] Thin capitalisation safe harbour provisions fix the maximum allowed debt financing from a shareholder or related party, which depends on the type of asset and is calculated based on the asset's book or fair market value. The maximum debt is fixed at 100% for cash, 85% for accounts receivable and inventory, 70% for investments in subsidiaries, 50% for furniture and equipment, 70% for property and plants (commercially used) and 70% for intangibles. Amounts in excess of the maximum allowed debt are requalified as equity.

Both interest paid in excess of the safe harbour rates and interest paid on debt requalified as equity under thin capitalisation rules are treated as constructive dividends when paid to a shareholder or related party. Consequently, they are not considered business expenses and cannot be deducted, resulting in an increased corporate income tax burden for the paying entity. Additionally, constructive dividends are subject to Swiss withholding tax.

However, since dividends paid to a parent company benefit from participation relief, no income tax or withholding tax would be due by the parent company in the event of a constructive dividend paid by a subsidiary.

It should be noted that Switzerland has not adopted BEPS Action 4 limiting interest deductions, as it is not part of the BEPS minimum standards.

45 Arrêt du Tribunal fédéral 2C_129/2012 of 15 June 2012; Arrêt du Tribunal administratif fédéral A-5578/2017 of 3 May 2018.

46 *Commission fédérale de recours en matière de contributions* (CRC), replaced on 1 January 2007, by the Swiss Federal Administrative Court.

47 Decision of the CRC of 10.8.2005 (CRC 2004-033) (2006) 70(9) *JAAC*; decision of the CRC of 23.4.2003 (2003) 67(123) *JAAC*; see Glauser Pierre-Marie, 'Evasion fiscale et interprétation économique en matière de TVA' (2007) 75 *Archives de droit fiscal suisse* 750.

48 Art. 65 FITA; SFTA, Circular letter (Swiss francs) (Bern 3 February 2020); SFTA, Circular letter (foreign currency) (Bern 4 February 2020).

49 SFTA, Circular no. 6 *Capital propre dissimulé de sociétés de capitaux et de sociétés coopératives* (Bern 6 June 1997).

As mentioned above, Switzerland's thin capitalisation rules only apply to debt financing from shareholders or related parties, so the recommendations in BEPS Action 4 go beyond restrictions that exist under Swiss tax law.

### 1.6. Special rules at the local or regional level for the profit allocation in groups of companies

In addition to federal corporate income tax, the cantons and communes also levy corporate income tax and net equity tax.

Corporate income tax and net equity tax are harmonised taxes, meaning the rules are set forth in the FTHA. However, the cantons and communes retain the power to set tax rates and, generally, the cantons are responsible for levying taxes, including federal corporate income tax.

The separate entity principle also applies between cantons and communes when related entities are located in different cantons or communes. Further, entities that have activities in other cantons or communes are considered to have permanent establishments in these cantons or communes, and income and net equity must be allocated between the different entities.

However, unlike the international apportionment of profit, which is done using the objective method (see section 2.2 below), inter-cantonal and inter-communal allocation of profit between branches and the head office often uses the formulary apportionment method (indirect method), which is derived from the constitutional principle prohibiting inter-cantonal double taxation.[50] This has been the subject of extensive case law from the Swiss Federal Supreme Court and regulations from the Swiss Tax Conference, a body with representatives from all of the cantonal tax administrations.

Specific allocation rules vary based on the type of company. For instance, for commercial and service companies, it is based on each entity's annual turnover. For production companies it is based on each entity's available capital and labour; in principle, the rental value of an entity's premises is capitalised at 6% and wages are capitalised at 10%. There are also special rules for banks,[51] as well as insurance[52] and telecom companies.[53]

Under the indirect method, net equity is allocated based either on the underlying assets' geographic location or on their economic connection.

### 1.7. Special tax procedure rules for associated corporations and controlled groups

Since the Swiss tax system is based on the principle of separate entity taxation, audits are conducted on an entity per entity basis. However, in practice, when group entities share physical premises, for practical reasons, they often are audited at the same time.

50 Art. 127 para. 3 Swiss Federal Constitution.

51 Swiss Tax Conference, Circular n° 5 (14 November 2018).

52 Swiss Tax Conference, Circular n° 23 (21 November 2006).

53 Swiss Tax Conference, Circular n° 20 (17 September 2009); Oberson Xavier, *Droit fiscal suisse*, (4th edn Helbing Lichtenhahn Basle 2012), 503 *et seq*.

Additionally, in theory, secrecy laws prevent the tax administration from discussing matters related to one group entity with representatives of another group entity, but usually this is waived by the entities.

## Part Two: Separate entity approach and group approach in cross-border situations

### 2.1. Taxation of foreign corporate entities

In general, an entity is considered foreign if its statutory seat is outside of Switzerland and its place of effective management is not in Switzerland.

Non-resident companies are liable to Swiss corporate income tax and net equity tax on a limited basis; they are liable to tax on income arising from, and wealth attributed to foreign real estate, enterprises and permanent establishments.[54] Conversely, Swiss resident entities subject to Swiss taxes on an unlimited, worldwide basis are not taxed on income arising from, and wealth attributed to foreign real estate, enterprises and permanent establishments.[55]

For Swiss direct tax purposes, a permanent establishment is defined as a 'fixed place of business through which the business of an enterprise is wholly or partly carried on'.[56] This is similar to the definition in article 5 of the OECD Model Tax Convention on Income and on Capital (OECD MC),[57] with the exception of dependent agents without a fixed place of business.

Consequently, Swiss branches and other permanent establishments must pay Swiss corporate income taxes and must maintain their own set of accounts, separate from those of the head office. In practice, these accounts can be established either under the accounting rules governing the head office or by following the accounting principles set forth in Swiss commercial law.

### 2.2. Treatment of branches (inbound and outbound)

Switzerland does not levy branch profit tax. Consequently, the remittance of branch profits to a foreign company with its place of effective management outside of Switzerland is not subject to Swiss withholding tax.

Foreign branches of Swiss companies are not liable to Swiss corporate income or net equity taxes.

Further, Switzerland has implemented, and closely follows, the authorised OECD approach (AOA) with regard to attribution of business profits between foreign and domestic branches and head offices under article 7 of the OECD MC.

Under the AOA, branches and head offices are regarded as separate entities and

54 Art. 51 para. 1 FITA.

55 Art. 52 para. 1 FITA.

56 Art. 52 para. 1 FITA.

57 OECD, OECD Model Tax Convention on Income and on Capital 2017 (Full Version), (Paris 2019).

transactions must be carried out at arm's length,[58] based on i) an analysis of the permanent enterprise's economically significant activities and responsibilities and ii) remuneration in accordance with article 9 OECD MC and the OECD Transfer Pricing Guidelines[59] (see section 2.5 below).

Thus, in accordance with the AOA, Swiss tax rules stipulate that the direct (objective) method should be used when determining the profit of a Swiss branch of a foreign entity. The SFTA's regulations on reorganisations also state that Swiss branches of foreign entities should be taxed using the direct method, since this permits Switzerland to tax hidden reserves.[60] Accordingly, the Swiss branch's profit is based on its books of account and is independent of the entity's total profit.

### 2.3. Treatment of income from foreign subsidiaries

Swiss domestic law[61] grants participation relief for participation income if the receiving company owns at least 10% of the equity in the distributing company, the participation is worth at least CHF one million, or if the receiving company is entitled to at least 10% of the distributing company's profit and reserves. Participation relief is granted for capital gains if the receiving company owns at least 10% of the equity in the company, or if it has an investment that entitles it to more than 10% of the company's capital and reserves, and the participation has been held for at least one year.[62]

Swiss companies with foreign branches may deduct losses from those branches,[63] even though income from foreign branches is exempt from Swiss taxes. However, tax shall be recovered for the relevant tax period if there is a subsequent offsetting by the state in which the branch is located.[64] The policy purpose of this rule is to encourage Swiss companies to invest abroad by letting them deduct foreign losses from their operational income. Additionally, it is possible for Swiss companies to deduct impairment losses on foreign participations, as discussed in section 1.2 above. Together, these provisions make Switzerland an attractive jurisdiction for companies investing abroad through branches or subsidiaries.

### 2.4. Application of group taxation regimes to cross-border groups and DTT entitlements of groups

As the Swiss tax system does not provide for group taxation, there are no provisions for group taxation of cross-border groups or double tax treaty entitlements for groups.

58 OECD, OECD MC Commentaries, art. 5 no. 3; OECD, Report on the attribution of profits to permanent establishments, (Paris 2008) 12.

59 OECD, Report on the attribution of profits to permanent establishments, (Paris 2010) 13.

60 SFTA, Circular no. 5 *Restructurations* (Bern 1 June 2004) n° 3.2.2.2.

61 Art. 69 FITA.

62 Art. 70 para. 4 FITA.

63 Art. 67 FITA.

64 Danon Robert, 'Article 67' in Aubry Girardin Florence and Noël Yves (eds), *Commentaire romand LIFD* (2nd edn) (Lausanne 2017) no. 7.

### 2.5. Transfer pricing rules

Switzerland does not have special transfer pricing rules and follows the OECD Transfer Pricing Guidelines, which use the separate entity approach.[65]

As mentioned in section 1.2 above, only commercially justified expenses may be deducted; expenses related to transactions between related entities that are not at arm's length are not considered commercially justified expenses. The notion of arm's length is interpreted in accordance with article 9 paragraph 1 OECD MC and the OECD Transfer Pricing Guidelines.

Swiss tax law does not define related entities, but the Swiss Federal Supreme Court has defined related entities as independent entities under a single economic management.[66]

In numerous rulings concerning transactions between related entities, the Swiss Federal Supreme Court has affirmed that the transactions must be commercially justified and that commercially justified must be interpreted using the OECD Transfer Pricing Guidelines.[67] This is also reflected in the SFTA's regulations.[68]

For instance, in a decision handed down on 14 January 2015, the Swiss Federal Supreme Court summarised the OECD Transfer Pricing Guidelines, stating that it first must be determined whether such a transaction would have occurred between unrelated entities in comparable circumstances (comparable uncontrolled transaction).[69] The decision also stated that, in absence of a comparable uncontrolled transaction, other methods may be used, such as the cost plus method.[70] Other acceptable methods include the transactional net margin method (TNMM) and the resale price and profit split; the most appropriate method should be used – there is no hierarchy of methods.[71]

Further, in practice, the simplified approach (i.e., cost plus five per cent) often is used[72] for low value-adding intra-group services.[73]

It should be noted that when determining whether a transaction would have occurred between unrelated entities in comparable circumstances, the Swiss Federal Supreme Court does not consider only whether the remuneration provided was appropriate, but also whether the transaction would have occurred at all between unrelated entities. For

65 OECD Transfer Pricing Guidelines no. 1.6.

66 Arrêt du Tribunal fédéral 2A.542/2002 of 6 January 2004, considering 3.1.

67 ATF 140 II 88, considering 4.2; Arrêt du Tribunal fédéral 2C_1083/2013 of 14 January 2015 considering 5.2; Arrêt du Tribunal fédéral 2C_11/2018 of 10 December 2018, considering 7.4; Arrêt du Tribunal fédéral 2C_343/2019 of 27 September 2019, considering 4.4.

68 SFTA, Circular no. 4 *Imposition des sociétés de services* (Bern 2 October 2015); SFTA, Circular no. 49 *Preuve de la justification commerciale des charges dans le cadre d'affaires étranger-étranger* (Bern 13 July 2020).

69 Arrêt du Tribunal fédéral 2C_1083/2013 of 14 January 2015, considering 5.2; see OECD Transfer Pricing Guidelines, no, 1.6; comparable circumstances are defined by the OECD Transfer Pricing Guidelines as: i) the contractual terms of the transaction; ii) the functions performed by each of the parties to the transaction, iii) the characteristics of property transferred or services performed; iv) the economic situation of the parties and the market; and v) the business strategies pursued by the parties (OECD Transfer Pricing Guidelines, §1.36).

70 Arrêt du Tribunal fédéral 2C_1083/2013 of 14 January 2015, considering 5.1 *et seq*.

71 OECD, 'Transfer pricing profile (Switzerland)', "https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-switzerland.pdf" accessed 6 December 2021.

72 OECD, 'Transfer pricing profile (Switzerland)', "https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-switzerland.pdf" accessed 6 December 2021.

73 See Section D, Chapter VII Transfer Pricing Guidelines and Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 Final Reports, 141 *et seq*.

instance, in a recent case concerning royalties for use of intellectual property paid by a Swiss subsidiary to its Dutch parent company, which had delegated the entirety of its research and development to a French subsidiary, the Swiss Federal Supreme Court held that the Dutch company did not have sufficient resources to control the risks associated with the IP. The Swiss Federal Supreme Court concluded that, were the parties unrelated, the Swiss company would have entered into a contract directly with the French company, rather than with the Dutch company. As the French company had already applied a 15% mark up on the services invoiced by the Dutch company, the Swiss Federal Supreme Court disallowed the royalty of 2.5% of the turnover charged by the Dutch company to the Swiss one and considered that the difference between the royalty payment and the Dutch company's costs represented a distribution from the Swiss company to the Dutch company and not remuneration for services rendered.[74] While the decision did not refer to BEPS Action 8-10, it is interesting in that it interpreted the criteria of the control over the risks contained in the pre-BEPS OECD guidelines in a BEPS inspired way.

### 2.6. CFC regimes and separate entity approach

Switzerland does not have CFC rules. However, a foreign entity's income and net equity may be liable to tax in Switzerland in certain exceptional circumstances.

First, the case law of the Swiss Federal Supreme Court stipulates that a company whose statutory seat is located abroad, but who has little or no substance abroad and is effectively managed from Switzerland, may be deemed a Swiss taxpayer.

Further, a foreign entity can be disregarded when a structure is considered abusive in that there is a lack of clear separation between the Swiss company and a foreign subsidiary. In such cases, the foreign entity's income and expenses will be attributed directly to the Swiss taxpayer. This approach is rarely applied to corporate groups for whom corrections generally will be made through transfer pricing. In addition, in practice, it is restricted to entities established in jurisdictions that do not levy any income tax and with whom Switzerland does not have tax treaties.

### 2.7. Intra-group withholding taxes or non-deductibility of outbound payments

In general, withholding tax is not levied on interest and royalty payments.

Withholding tax is not levied on interest paid on private and commercial loans, including inter-company loans. However, under the Withholding Tax Act[75] (WTA), interest paid to a Swiss or foreign shareholder on bonds and other debt certificates issued by Swiss companies is subject to a withholding tax of 35% (unless a lower rate is provided for under a relevant double tax treaty).

For withholding tax purposes, loans from ten non-bank lenders with identical terms (loan debentures) and loans from 20 non-bank lenders with variable terms (cash debentures) are treated as bonds if the financing exceeds CHF 500,000. Likewise, withholding tax is levied on interest paid by Swiss banks and a company shall be deemed a

74 Arrêt du Tribunal fédéral 2C_11/2018 of 10 December 2018, considering 8.

75 Swiss Federal Withholding Tax Act of 13 October 1965, RS 642.21.

bank for withholding tax purposes if it has over 100 non-bank lenders or private placements, or both, and its financing or placements, or both, exceed CHF five million. However, the 100 non-bank lenders rule does not apply to inter-company loans, which is important for certain operations like cash pooling.[76] Inter-company loans are defined as loans between entities that are fully consolidated in the group financial statements. Thus, these tax provisions follow the commercial approach to the definition of a group of companies.

As mentioned in section 1.5.2 above, it should be noted that Switzerland has not adopted BEPS Action 4 limiting interest deductions, as it is not part of the BEPS minimum standards.

However, interest paid in excess of the arm's length rate and interest paid on debt that has been requalified as equity under thin capitalisation rules (see section 1.5.2 above) is considered a constructive dividend, and thus subject to a withholding tax of 35% (unless a lower rate is provided for under a relevant double tax treaty). Special rules apply to groups and rather than retaining the withholding tax due, the distributing company can use the notification procedure for intra-group distributions.

### 2.8. Scope of the application of hybrid mismatch rules

In general, Switzerland does not have hybrid mismatch rules.

An exception concerns participation relief (see sections 1.2 and 2.3 above). Since the reason for participation relief is to reduce economic double taxation, participation relief may not be applied to dividends distributed by a foreign company if the distribution is comprised of income that is considered to be part of the subsidiary's commercially justified expenses.

Participation relief also is not applied to distributions from transparent entities, such as limited partnerships. While there is no specific hybrid mismatch rule in Swiss tax law or in the federal regulations, in a position paper on the tax treatment of US LLCs, the Swiss Tax Conference stated that participation relief does not apply to US LLCs treated as partnerships under US tax law.[77] This approach is based on the argument that a transparent LLC is not resident in the United States of America under the US-Swiss double tax treaty and thus should not be viewed as a company. While this approach may lead to a result that could be considered desirable from a tax policy perspective in that it introduces anti-hybrid rules, it contradicts the principle that tax treaties generally only have a negative effect and shall not affect the interpretation of domestic provisions.

### 2.9. Scope of country-by-country reporting

In January 2016, Switzerland signed the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC-MCAA) so as to comply with the minimum standards of the International Exchange of CbC Reports enumerated in BEPS Action 13.

76 Art. 14a of the Withholding Tax Ordinance of 19 December 1966, RS 642.211.

77 Swiss Tax Conference, *Informations pratiques relatives au traitement fiscal des Limited Liability Companies américaines (USA) en matière d'impôts directs* (6 September 2011).

Additionally, the Swiss Parliament adopted the Federal Act on the International Automatic Exchange of Country-by-Country Reports (CbC-Act)[78] and its Ordinance on the International Automatic Exchange of Country-by-Country Reports (CbC-Ordinance).[79] The CbC-Act and the CbC-Ordinance regulate country-by-country reporting. The CbC-MCAA, CbC-Act, and CbC-Ordinance entered into force on 1 December 2017.

For the purposes of the CbC-Act, a group of companies is defined as the group of entities under the control of a company required to keep consolidated accounts pursuant to article 963 CO.[80]

Under the CbC-Act and the CbC-Ordinance, Swiss parent and surrogate parent entities of MNEs with over CHF 900 million in consolidated revenue in the preceding fiscal year are subject to CbC reporting obligations. These companies must provide the SFTA with a CbC report, which consists of three tables.

Table one lays out aggregated information on revenue, profit before income tax, paid income taxes, accrued income taxes, listed capital, accumulated earnings, number of employees, and tangible assets other than cash and cash equivalents; table two contains a list of all constituent entities and their activities; and table three third table lists any additional information that assists with the understanding of the information enumerated in the first two tables.

### 2.10. Scope of application of other instruments

Switzerland does not have any special instruments, such as diverted profit taxes or digital service taxes.

Switzerland complies with the BEPS minimum standards. As such, Switzerland's double tax treaties reflect the minimum standard provided for in article 6 of the multilateral instrument.[81] Consequently, it is rare to find provisions on group taxation in double tax treaties concluded by Switzerland and when they do exist, they have had limited impact. Going forward, we expect this to hold true.

78 Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports, RS 654.1.

79 Ordinance on the International Automatic Exchange of Country-by-Country Reports, RS 654.11.

80 Art. 2 let. c CbC-Act.

81 Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI).


International Fiscal Association