SWITZERLAND

LAW AND PRACTICE: p.497

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The ‘Law & Practice’ sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

TRENDS AND DEVELOPMENTS: p.508

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The ‘Trends & Developments’ sections give an overview of current trends and developments in local legal markets. Leading lawyers analyse particular trends or provide a broader discussion of key developments in the jurisdiction.

Law and Practice

Contributed by Lenz & Staehelin

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1. Types of Business Entities Commonly Used, Their Residence and Their Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

Most businesses involving multiple individuals choose to adopt a corporate form. The most frequent corporate forms used are the company limited by shares and the limited liability company.

The company limited by shares is best suited for major businesses, requiring a large amount of capital contribution. Its share capital must amount to at least CHF100,000. Meanwhile, the limited liability company requires a minimum share capital of CHF20,000 and is more suited for small- and medium-sized businesses.

Corporations are seen as separate legal entities, and are consequently taxed as such on their profits and their capital.

1.2 Transparent Entities

Transparent entities under Swiss law include the simple partnership, the general partnership, as well as the less popular limited partnership. Such partnerships are created for the sake of simplicity and flexibility.

Specific transparent entities exist under Swiss law for collective investment schemes, namely the open-ended investment company and the limited partnership for collective investment.

Transparent entities are taxed on their profits and their capital in the hands of the partners.

1.3 Determining Residence

Corporations are considered to reside in Switzerland if their statutory seat or effective administration is in Switzerland. The statutory seat is determined by the place in which the company is registered. The effective place of management is determined through the Supreme Court's case law and is considered to be where the company has its effective and economic centre of activity – ie, where its day-to-day management is.

As far as transparent entities are concerned, they are considered Swiss residents insofar as their partners are themselves residents in Switzerland.

1.4 Tax Rates

The Confederation levies an annual income corporate tax on the corporation's net profits, and the canton and the commune in which the corporation has its residence levy corporate income tax as well as capital tax. The effective tax rate on the Confederation level is at 7.83%. The effective tax rate of the cantons and communes varies depending on the location. The combined effective income taxes (federal, cantonal and communal) range from 12% to 24%. The capital tax rate depends on the canton and commune of domicile but varies between 0.001% and 0.5%.

With the introduction of a new tax reform in 2020, the Tax Project 2017, subsequently renamed Tax Reform and AHV Financing (TRAF), the combined effective tax rates will drop. It is expected that the combined effective taxes will vary between 12% and 18%. If no referendum is called, it should come into full force as of 2020.

Profits and capital of partnerships are taxed in the hands of the partners, meaning that the tax rates will depend on the personal tax rate of each partner. Such tax rate varies according to their total income and wealth, as well as their place of residence.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

Taxable profits are based on the accounting profits, specifically the balance of the profit and loss account. This tax base is subject to few adjustments. More specifically, three types of adjustments for tax purposes may take place:

- adjustments to ensure compliance with Swiss mandatory accounting rules;
- adjustments to ensure compliance with the periodicity principle; and
- adjustments aimed at preserving the system when Switzerland loses its taxing rights – for example, in the case of a transfer abroad.

Finally, corporations are taxed on their profits on an accruals basis.

2.2 Special Incentives for Technology Investments

There are no specific R&D tax incentives in Switzerland. There is, however, at the time being, a licence box in the canton of Nidwalden, applicable at the cantonal level only.

With the introduction of the TRAF 2017 as of 2020, a mandatory patent regime will be introduced at cantonal level as well as optional R&D super-deductions. More precisely, in the patent box regime, the net profits from domestic and foreign patents as well as similar rights will be taxed separately with a maximum deduction of 90%. The deduction rate will vary depending the canton. Regarding the optional R&D super-deduction, the cantons may choose to introduce and apply a maximum deduction of 50% to personnel expenses for R&D plus a flat rate surcharge of 35% for other costs and 80% of expenses for domestic R&D carried out by third parties or group companies.

2.3 Other Special Incentives

Other special tax incentives include a privileged regimes of taxation of profits for holding companies, domiciliary companies, mixed companies, principal companies, as well as Swiss finance branches. However, the TRAF will abolish such regimes. As of 2020, all companies will be subject to ordinary corporate income and capital tax. Among the measures taken in order to compensate for the loss of these tax privileges most cantons will lower their tax rates.

Moreover, with the entry into force of the TRAF, hidden reserves (including goodwill) at the moment of migration to Switzerland or the moment of transition from a privileged regimes to ordinary taxation are confirmed by the tax authorities. In the case of migration, a step-up plan will be applied and in case of transition a two-rate system will be applied.

2.4 Basic Rules on Loss Relief

Losses of seven financial and tax years preceding the current tax period can be deducted to the extent they could not be included in the computation of taxable net profit of those years.

Swiss tax law does not allow losses to be carried back.

2.5 Imposed Limits on Deduction of Interest

Interest payments are considered as a business expense deductible from the corporation's taxable income. Interest payments to related parties (shareholders or affiliates) must respect the fair market rate set out annually by the Federal Tax Administration. In addition, thin-capitalisation limitations apply; the relevant debt-to-equity ratio depends on the class of assets (eg, 100% of cash, 85% of receivables, etc). A deviation from these safe-harbour rates may be accepted if the company can prove that the rates used are at arm's length.

It should be noted that Switzerland has not taken any measures to implement the recommendations of BEPS action No 4; see section **9 BEPS** for full details.

2.6 Basic Rules on Consolidated Tax Grouping

Separate entity taxation applies for tax purposes. There are no tax consolidation rules and they are not expected to be introduced in the near future.

While mergers and other transactions of two or more companies lead to the consolidation of the tax base of the companies involved, such reorganisations are disregarded if the only goal is to combine the tax base of the companies involved and to set off taxable profits with losses of other companies.

2.7 Capital Gains Taxation

Gains on the sale of assets (capital gains) are generally subject to income taxes at the federal, cantonal and communal levels. Two exceptions to the general rule exist: (i) participation reduction, and (ii) replacement of certain assets. Moreover, depending on the canton and/or the municipality, gains from the sale of real estate can be exempt from the cantonal and/or communal income taxes, but will be subject to cantonal and/or communal real estate gains taxes.

Participation reduction
Companies holding at least 10% of the share capital of another company or the rights to at least 10% of the profits and reserves of another company, for at least one year, are entitled to a participation relief on the capital gains realised on the sale of such participation.

The corporate income taxes due are first calculated in the usual way, and are then reduced by the ratio of net earnings on participations (gross earnings minus financial and administrative expenses) to the total net income. For example, if the net capital gains amount to 50% of the company's total net income, corporate income taxes will be reduced by 50%.

Replacement relief
The replacement relief further allows a company to differentiate taxation of profits from the sale of fixed assets used in connection with its business, if such profits are reinvested within a reasonable time in the replacement of fixed business assets located in Switzerland. Consequently, the corporate income taxation of unrealised gains can be differentiated. This also applies to real estate if the legal requirements above are fulfilled. Thus, if participations are sold by a company and the proceeds of sale are reinvested in other participations within a reasonable time (that is, within one to three years), no corporate income taxes will be due on the unrealised gains.

Corporate income taxes on capital gains resulting from the sale of shares can be further minimised by using a holding company to acquire the shares. If this acquisition is financed with debt, no push-down on the target company is possible, as each entity is considered separately under Swiss law. In addition, a merger between the holding company and the target company would be viewed as abusive. Therefore, the share price is generally kept as low as possible at acquisition (for example, by distributing dividends before the transaction or by reducing the capital of the target company).

2.8 Other Taxes Payable by an Incorporated Business
Stamp duty is generally levied on shareholders' contributions to a company and on the transfer of securities. However, some transactions such as certain restructurings are exempt.

The Securities Issuance Stamp Tax is a stamp duty tax that is levied on the issue (primary market) of certain Swiss securities (shares, similar participating rights, etc) as well as on equity contributions to such corporate entities. The taxable person is the company or the person issuing the securities or benefiting from the equity contribution. The tax rate is 1% of the capital contribution. It should be noted that capital created or increased by a corporation or an LLC is exempt from the issuance stamp tax, up to the amount of CHF1 million.

The Securities Transfer Stamp Tax is levied on the transfer of certain Swiss and non-Swiss securities, if a Swiss stockbroker is involved as a party or an intermediary to the transaction. Stockbrokers are mainly banks, companies holding taxable securities with a book value over CHF10 million, etc. The tax rate applicable on the purchase price is 0.15% in respect of Swiss securities and 0.3% in respect of foreign securities.

Certain transactions require a notarial deed for which fees are payable (eg, incorporation or a corporation or limited liability company, transfer of real estate). Land register charges are due on selling, acquiring or transferring real estate located in Switzerland.

A withholding tax of 35% on income derived from movable capital assets (eg, interest on bonds and dividend payments) is levied. The tax must be deducted by the debtor from the amount due to the recipient. In certain circumstances, a partial or total refund of the tax withheld can be obtained.

2.9 Incorporated Businesses and Notable Taxes
Corporations are subject annually to capital tax, which is levied at a cantonal and communal level. It is based in the corporation net equity. That is, its paid-in capital, opened reserves and retained profits. The amount subject to tax may also be increased by the debt recharacterised as equity in the application of the Swiss thin-capitalisation rules. The tax rate depends on the canton and the community of domicile varying between 0.001% and 0.525%. As of 2020 with the introduction of TRAF, the cantons will have the option to allow capital tax relief. Specifically, the canton may reduce the capital tax base relating to patents and similar rights, qualifying participations and intra-group loans.

Moreover, excise taxes are levied, such as the VAT on the supply of goods or services and the import of goods or services. The standard rate is 7.7%, the reduced rate (eg, medicine, newspapers, books and food) is 2.5% and the lodging services rate is 3.7%.

Furthermore, other taxes may be payable depending on the canton. For example, certain cantons may levy tax on real estate situated in such cantons or 'professional tax' which is calculated as a percentage of the turnover, rent paid and number of employees.

3. Division of Tax Base Between Corporations and Non-corporate Businesses

3.1 Closely Held Local Businesses
Most closely held local businesses operate in a corporate form. Only very small businesses generally operate in a non-corporate form.

3.2 Individual Rates and Corporate Rates
Individual professionals are generally taxed as a self-employed physical person on their income and wealth. The taxation of self-employed individuals is the same as to that of salaried individuals.

However, they may also operate through an entity subject to corporate taxes, in which case the entity pays a salary and/or dividends to the individual which are then taxed as an income respectively as wealth of the physical person. In such a case, the sum of the taxes paid by the entity and the taxes paid by the physical person on the dividends received amounts to a total rate similar to what a self-employed individual would pay.

3.3 Accumulating Earnings for Investment Purposes
There are no rules to prevent closely held corporations from accumulating earnings for investment purposes, in particular no dividend acceleration rules.

3.4 Sales of Shares by Individuals in Closely Held Corporations
Income Tax
Swiss income tax is levied on any distribution of profits qualifying as a dividend and paid to individuals holding shares in closely held corporations. The tax is levied on the gross amount received. Individuals holding at least 10% in the nominal value of the share capital of a company can obtain a reduced tax base.

In this respect, individuals holding shares as private asset are only taxable, depending on the canton, on the 40% to 70% of the dividend received or at a rate of 35% to 60% of the ordinary rate. Individuals holding shares as a business asset are only taxable on the 50% of the dividend received. With the introduction of the TRAF, adjustments to the rates will be made. To be more precise, at the Confederation level, the tax rate will increase for both dividends received as private assets and business assets to a standard rate of 70%. At the cantonal level, a minimum taxation rate of 50% will be introduced.

If the threshold of 10% of shareholding is not reached, individuals are taxable on the gross dividend payment.

With regard to gains obtained on the sale of shares, the tax treatment depends if the shares are held as a private asset or as a business asset. The sale of shares held as a private asset is exempt from taxation, unless held as a business asset or if the shareholder qualifies as a professional trader.

The definition of a professional trader is not specified under Swiss law. The Swiss tax authorities must examine each case individually to determine whether someone qualifies as a professional trader. The following criteria are generally relevant for the qualification: a shareholding that lasted less than one year, the frequencies of transactions, the necessity to obtain such gains to ensure someone's lifestyle, etc.

Swiss law provides other exceptions to the general principal of gain-exemption. In particular, an income tax may be levied on the sale of shares by an individual where:

- the shareholder sells at least 20% of its shares to a company and the purchaser uses the assets of the purchased company to finance the sales price;
- the shareholder sells at least 5% of its shares to a company controlled by the same shareholder – if so, such a transaction qualifies as a taxable 'transposition' (it should be noted that the TRAF will remove the 5% threshold);
- a company purchases its own shares and the maximum percentages of ownership (10% or 20% under certain conditions) provided by Swiss corporate law are not observed or the purchase is related to a capital reduction.

Withholding Tax
Dividend distribution made by Swiss corporations are subject to withholding tax (WHT). The applicable WHT rate is 35%, whether paid to a Swiss-resident or a non-resident recipient. Swiss resident recipients may obtain full refund of the dividend WHT, provided they have properly reported the gross amount of dividend received as taxable income and claim refund within a period of three years. A non-resident recipient may apply for a full or partial refund of dividend pursuant to the provisions of an applicable tax treaty. Otherwise, the tax is considered as final.

Capital gains resulting from the sale of private shares by individuals are also exempt from Swiss WHT. If the qualification of an exempt capital gain is challenged by the Swiss tax authorities, a Swiss WHT of 35% may apply. As for dividends, a full or partial refund may be applicable.

Transaction Stamp Duty
A transaction stamp duty may be levied in the transfer of certain Swiss and non-Swiss securities – mainly shares or similar participation rights in corporate entities – if a Swiss security dealer is involved in the transaction. This duty is calculated at 0.15% on Swiss securities and 0.30% on non-Swiss securities sold/purchased during the year.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

Individuals that receive dividends from publicly traded corporations are treated identically to those that receive dividends from closely held corporations for Swiss income tax, withholding tax and transaction stamp duty purposes. The reduced tax rate based on a 10% ownership may be more difficult to reach from an income tax perspective.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Withholding Tax (WHT)

Swiss WHT may be levied on interests from bonds issued by a Swiss resident issuer, on dividends paid by a Swiss company to a foreign entity or investor, on interest paid to Swiss or foreign creditors on bonds or similar debt instruments issued by Swiss resident issuers, such as loans. However, Switzerland does not levy any WHT on interests from private and commercial loans (including inter-company loans).

WHT on interests is only levied for companies that qualify as tax resident for withholding tax purposes. The application of the WHT only arises if the payment comes from a Swiss tax-resident company; the residence of the creditor is irrelevant.

Moreover, profit distributions made by a Swiss corporation are subject to WHT (please see above, **3.4 Sales of Shares in Closely Held Corporations**).

Further, Switzerland does not levy WHT on royalties, whether paid to a resident or non-resident person. It should be noted that if the royalties paid do not respect the 'arm's-length principle', they can be requalified as hidden dividends if paid to a shareholder or a related party to the shareholder.

The Swiss WHT rate of 35% applies to such interests, dividends and other costs economically equivalent to hidden dividends. Without the application of an income tax treaty, such tax is considered as final and no reimbursement is allowed by the Swiss tax authorities.

Tax at Source on Mortgage-secured Loans

A tax at source may be levied for the interests paid on a loan which is secured by a Swiss real estate. Individuals who are not domiciled or resident in Switzerland for Swiss tax purposes are also subject to a specific withholding tax levied by the canton where the property is located. The cantonal tax may vary from 13% to 21%.

4.2 Primary Tax Treaty Countries

Foreign investors tend to use double tax treaties concluded with Switzerland where a full tax relief can be granted. This includes France, Germany, the UK and the USA for the withholding tax paid on interests. However, most of the countries provides for a Swiss residual withholding tax from 5% to 15%.

With regard to dividends, double tax treaties are usually used within EU and, in particular, Luxembourg where investors can be granted a full tax relief based on a 10% ownership.

4.3 Use of Treaty Country Entities by Non-treaty Country Residents

The Swiss Federal Council introduced in 1962 a decree imposing measures against the abusive use of double tax treaties concluded by Switzerland (ACF 1962). This decree aims at restricting the right of Swiss residents companies to benefit from double tax treaties. It contains a number of tests that must be fulfilled by every Swiss-resident company in order to be eligible for treaty benefits.

A case of abusive claim is recognised if most of the direct or indirect shareholders of a Swiss company do not benefit from the double tax treaty, provided that the Swiss company does not proceed to appropriate dividend distributions. Another case of abuse is also recognised when an essential part of income benefiting from a double tax treaty is used directly or indirectly to compensate counterparts that do not themselves benefit from the double tax treaty. The compensation can, for example, relate to interests, royalties, or any other type of expenses paid to such counterparts.

According to the Swiss tax authorities, a foreign entity claiming a refund of the Swiss WHT must fulfil all the mandatory requirements. In particular, the tax authorities review if the company requesting a refund is the real beneficiary of the income and is entitled to such refund. The tax administration also has an economic approach to the facts and reviews the structure to determine if it has been arranged with the sole purpose of obtaining a full or partial refund of WHT.

In such cases, the refund of the withholding tax withheld may be denied by the Swiss tax authorities.

4.4 Transfer Pricing Issues

Swiss domestic law does not provide any specific transfer pricing rules or regulations. As such, Switzerland applies the OECD guidelines to transfer pricing issues and is participating in the BEPS project.

4.5 Related Party Limited Risks Distribution Arrangements

There are no specific rules with respect to the use of related-party limited-risk distribution arrangements in Swiss tax law. The Swiss tax authorities may, however, review the structure with regard to safe-harbour rules and the 'arm's-length principle' to challenge an abusive use of that related party.

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

As mentioned previously, Switzerland applies the OECD standards for transfer pricing issues.

5. Key Features of Taxation of Non-local Corporations

5.1 Taxing Differences

Local branches and local subsidiaries of non-local corporations are similarly taxed in Switzerland for corporate income tax purposes. For withholding tax purposes, however, subsidiaries are subject to withholding obligations, whereas branches are not.

5.2 Capital Gains of Non-residents

Capital gains of non-residents on the sale of stock in local corporations are not subject to tax in Switzerland, unless it is a gain derived from the sale of a Swiss real estate company.

Should a double taxation treaty corresponding to the OECD Model Convention on Income and Capital be applicable in the case at hand, that real estate gain would typically only be taxable in Switzerland.

5.3 Change of Control Provisions

Change of control of a non-local corporation may trigger taxes/duty charges exclusively for real estate companies. The specifics will depend on the canton's legislation.

5.4 Formulas Used to Determine Income of Foreign-owned Local Affiliates

There are no specific formulas recommended by law or in the administration's published practice. Nevertheless, all transactions with a Swiss-related entity must be carried out at arm's length.

5.5 Deductions for Payments by Local Affiliates

Deductions are allowed in Switzerland, including expenses paid to related parties, as long as such expenses are commercially justified.

Management and administrative services provided by a non-local affiliate to a Swiss company are often remunerated based on a cost-plus method in practice. As per this method, the costs incurred by the supplier of services to an affiliate enterprise serves as basis to determine the income to be allocated to said service provider. An appropriate mark-up – typically oscillating between 5% and 15% – is then added to these costs, resulting in an appropriate profit in light of the functions performed and the market conditions.

5.6 Constraints on Related Party Borrowing

Borrowings from a non-local affiliate to a Swiss foreign-owned affiliate must be remunerated by interests paid at an arm's length rate, published yearly by the Federal Tax Administration. Such interests are typically not subject to Swiss withholding tax (35%), unless they are characterised as bonds.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

Corporations resident in Switzerland are subject to Swiss tax on an unlimited basis – that is, their worldwide profits (including foreign income) and capital (except for the income that is attributed to a foreign permanent establishment or immovable property).

In certain instances, Swiss companies whose business is predominantly oriented abroad may qualify for the auxiliary tax regime and thus benefit from a preferential tax rate on incomes generated abroad. Once again, this regime will be abolished with the implementation of the TRAF in 2020.

6.2 Non-deductible Local Expenses

The expenses proportionally attributable to foreign incomes that are not subject to Swiss tax are not deductible in Switzerland. Special rules, however, apply with respect to the debt loss 'carry-over' of foreign permanent establishments of local corporations.

6.3 Taxation on Dividends from Foreign Subsidiaries

At a federal and cantonal/communal level, the participation reduction regime applies, so that the effective tax rate applicable to the dividends received is proportionately reduced as per the ratio of the net dividend income over the total net taxable income, provided that the Swiss company holds at least 10% of the participation or participation rights with a market value of at least CHF1 million. As a result, the dividend income is usually virtually tax-exempt.

The participation exemption applies irrespective of whether the dividends are paid by a resident or a non-resident company.

Holding companies may take advantage of a special status at the cantonal/communal level and are, in general, tax-exempt from corporate income tax. However, the TRAF will abolish this preferential regime.

6.4 Use of Intangibles

So far, Switzerland has not introduced specific provisions with regard to the taxation of intangibles. The deriving incomes are therefore subject to profit taxes. However, under the mixed company tax status, profits derived by non-Swiss source income might be taxed at a substantially reduced rate for cantonal/communal tax purposes.

With the introduction of the TRAF, as mentioned above, a patent box with a maximum relief of 90% will be introduced at the cantonal level, and the cantons will have the option to apply R&D super-deductions of a maximum 50% and a capital tax relief on patents and similar rights. Overall tax relief will be limited 70% or less depending on the canton.

6.5 Taxation of Income of Non-local Subsidiaries Under CFC-type Rules

Switzerland does not have a CFC regime. However, according to the case law of the Federal Supreme Court, profits of companies formally domiciled abroad with little or no local substance that are effectively managed in Switzerland or have a permanent establishment in Switzerland may be subject to Swiss income tax.

To consider that a company is effectively managed in Switzerland, the local tax authorities (including tax administrations) follow a case-by-case approach aiming at determining where the economic centre of the company's existence is located. They weigh the different relevant factual elements. The key element used to determine the location of the effective management is the place where the management is exercised– ie, the day-to-day actions required to realise the statutory purpose. By contrast, the place where the fundamental decisions are taken or the place where the simple administrative work (accounting, correspondence) is done can only be taken into account as secondary elements. Other secondary elements used to determine the location of the effective management are the residency of the managing bodies, the place where the operational contracts are executed or the place of storage of the documents and archives.

Particular attention should be given to the following elements, which must be avoided so as to limit at a maximum any requalification of the non-local seat as a pure formal seat (and, as the case may be, recognition of a place of effective management in Switzerland): domicile and location, infrastructure/employees, professional qualification of employees, contracts, banking operations, book-keeping, board of directors, annual shareholders meeting.

Under Swiss tax law, a foreign company is also subject to limited tax liability when it has a permanent establishment in Switzerland. Only the income derived from the permanent establishment is subject to tax in Switzerland. To constitute a permanent establishment, there must be (i) a place of business, (ii) which must be fixed, and (iii) from which business must be carried out. The interpretation of these conditions is wide and it is considered that such place of business can be located in the premises of another company.

Furthermore, the TRAF provides that Swiss permanent establishments of foreign companies should be able to claim withholding taxes on income from third countries with a flat-rate tax credit.

6.6 Rules Related to the Substance of Non-local Affiliates

Please see above, **6.5 Taxation of Income of Non-local Subsidiaries Under CFC-type Rules**.

6.7 Taxation on Gain on the Sale of Shares in Non-local Affiliates

If a corporation realises a capital gain on the sale of a qualifying participation, it is entitled to a participation reduction. To qualify for relief on capital gains, a Swiss company must make a profit on the sale of a participation which represents at least 10% of the share capital of another company which it has held for at least one year. Companies with qualifying capital gains may reduce their corporate income tax by reference to the ratio between net earnings on such participations and total net profit.

Losses incurred as a result of the sale of qualifying participations remain tax-deductible.

A capital gain is defined as the difference between the proceeds from the sale of a qualifying participation and the acquisition cost of the investment. Hence, any amount of previously tax-deductible depreciation or provision on the participation is not taken into consideration to calculate the amount of gain which can benefit from the relief. In addition, revaluation gains from participations do not qualify.

Favourable tax treatment is also available for qualifying participations transferred to group companies abroad; the group holding or sub-holding company must be incorporated in Switzerland.

7. Anti-avoidance

7.1 Overarching Anti-avoidance Provisions

In Switzerland, GAARs are not contained in a specific act. The Federal Supreme Court developed through the years a general principle of abuse of law or tax avoidance, applicable to all Swiss taxes. In accordance with this principle, applied by all Swiss courts and tax authorities, tax authorities have the right to tax the taxpayer's legal structure based on its economic substance, in certain situations.

In addition, Swiss tax authorities generally apply the arm's-length principle and follow the OECD transfer pricing guidelines. Swiss regulation also contains specific anti-avoidance provisions.

Regarding the specific issue of treaty-shopping, on 7 June 2017 Switzerland signed the OECD's Multilateral Instrument, that introduced a "principal purpose test", according to which a benefit under a tax treaty shall not be granted if obtaining that benefit was one of the principal purposes of an arrangement or transaction.

8. Other

8.1 Regular Routine Audit Cycle

Swiss law does not outline specifics of the tax audit process. After filing of the tax return by the taxpayer, the tax authorities may request further information/documentation prior to issuing the tax assessment. The tax authorities are obliged and entitled to gather all necessary information to assess a taxpayer on a true and complete base.

With regard to the resolution of tax disputes, Switzerland has a well-established and efficient practice. When confronted with an unlawful tax assessment, the taxpayer is generally not obliged to challenge that assessment in court immediately. Rather, the taxpayer may turn to the tax authority which issued the tax assessment decision being challenged, to request it to make a new decision. For the purposes of this chapter, this procedure will be called a 'formal complaint'.

A formal complaint is a quick and efficient procedure that allows numerous questions to be resolved with little cost, the majority of these being technical questions. This formal complaint procedure thus eliminates the need for court proceedings and generally takes a few months. However, for complicated issues, this way of appeal offers limited solutions. In such cases, tax authorities usually prefer to wait for a binding judgment made by a higher independent body (ie, a tribunal). It is very common for taxpayers to exercise their right to challenge the tax assessment decision of a tax authority. Tax authorities then issue a decision on formal complaint.

9. BEPS

9.1 Recommended Changes

Switzerland is actively participating in the BEPS project and, as such, has already gone forward implementing some of the project's outcomes or is in the process of doing so. Switzerland intends to implement the minimum standard of the BEPS project. Few changes are needed in order to meet these minimum standards.

Multilateral Convention To Implement Tax Treaty Measures to Prevent BEPS (MLI)

On 7 June 2017, Switzerland signed the MLI that will serve to amend efficiently double taxation agreements in line with the minimum standards agreed upon in the BEPS project. Switzerland will implement these minimum standards either within the framework of the multilateral convention or by means of the bilateral negotiation of double taxation agreements. These include the modification of the preamble of Double Tax Agreements (DTA) and prevention of treaty abuse via the principal purpose test. Switzerland has reserved the right not to apply the standards for transparent and dual resident entities (Articles 3 and 4), anti-abuse rules for PEs situated in third jurisdictions (Article 10) and the artificial avoidance of PE status through commissionaire agreements (Article 12).

Switzerland announced that it would include only 14 tax treaties as covered taxed agreements, including the ones concluded with Argentina, Italy and Luxembourg. These 14 partner states have agreed to negotiate the precise wording for amending the tax treaties through the MLI instrument. A handful of countries, which are currently negotiating a DTA with Switzerland, will revise/adopt bilaterally the BEPS minimum standards. The MLI is currently undergoing the standard parliamentary approval process and will enter into effect in accordance with Article 35 of the MLI.

BEPS Action 5 (Counter Harmful Tax Practices and Patent Boxes)

With the implementation of a new tax reform, namely the TRAF, in 2020 (subject to a potential referendum), the privileged tax regimes for holding companies, domiciliary companies, mixed companies and the existing allocation rules on principal companies, which are no longer acceptable as per international standards, will be abolished. Further, a patent box regime will be introduced in accordance with the OECD standards. It will be mandatory for all cantons. The net profits from domestic and foreign patterns, as well as similar rights, will be taxed separately with a maximum deduction of 90%.

In order to counter further harmful tax practices and to promote transparency, Switzerland introduced the spontaneous exchange of information in tax matters through the adoption of the OECD Convention on Mutual Administrative Assistance in Tax Matters as well as revising the Swiss Federal Act and Ordinance on Tax Administrative Assistance Act. All the above entered into force on 1 January 2017. The first exchange of information took place on 1 January 2018 and included exchange of information on tax rulings.

Finally, as of 2009 Switzerland no longer makes a reservation on Article 26 of the OECD Model Convention on Income and Capital in its double tax treaties on income and capital. Switzerland, therefore, has fully adopted the OECD standards in exchange of information in tax matters.

BEPS Action 6 (Prevention of Treaty Abuse)

With the entry into force of the MLI, Switzerland is expected to adapt the title and preamble of the Swiss tax treaties to the minimum standard. Further, it has opted for the Principal Purpose Test (PPT) rule alone, which provides that a benefit under a tax treaty shall not be granted, if obtaining that benefit was one of the principal purposes of an arrangement or transaction.

BEPS Action 13 (Country-by-country Reporting)
As of 1 December 2017, the Swiss Federal Act on the International Exchange of Country-by-Country Reports (CBCR) came into force.

BEPS Action 14 (Dispute Resolution Mechanism)
Switzerland chose within the framework of MLI for mandatory MAP, with corresponding adjustment as well as mandatory arbitration. It should be added that Switzerland has more than 30 provisions that deal with arbitration in its treaty network, either in the form of arbitration clauses or most-favoured nations.

9.2 Government Attitudes

Switzerland has embraced the BEPS project from the beginning and is actively contributing in its development. The country is supporting the primary aim of the BEPS project – that is, in essence, the taxation of profits in the jurisdiction where the economic activity that gave rise to the profits took place. Switzerland's goal remains to be compliant with the OECD recommendations and that is why it intends to implement the minimum standard of the BEPS project.

Switzerland has focused mainly on the following standards:

- patent/IP boxes;
- spontaneous exchange of information on tax advance rulings;
- preferential regimes;
- dispute resolution mechanisms;
- prevention of treaty abuse; and
- country-by country reports.

9.3 Profile of International Tax

As it has also been the case in other Western countries, over the last few years international tax policy has become more and more of a public debate. The Swiss Parliament passed in June 2016 the Corporate Tax Reform Act III, which aimed at strengthening the tax competitiveness of Switzerland and resolving the tax disputes it had with the EU by abolishing the privileged regimes, as well as aligning with the standards resulting from the new OECD principles. The Reform Act, which was subjected to popular vote, was rejected.

The measures provided in the Reform act III included the patent box, notional interest deduction on excessive equity, abolition of preferential regimes with the possibility of disclosing built-in gains without additional tax consequences and reduction of corporate tax rates. The popular belief at the time was that all the above measures would result in a heavier tax burden for the individuals.

A replacement project, the Tax Project 2017, subsequently renamed Tax Reform and AHV Financing (TRAF), was introduced and is expected to enter into force in 2020 – that is, if no referendum is called. The project has the same purpose as the Corporate Tax Reform Act III. It includes the abolition of privileged regimes, disclosure of hidden reserves and introduction of higher taxation of dividends for qualifying shareholders. Moreover, various measures have been included to maintain the attractiveness of the Swiss tax system, such as the introduction of a mandatory patent box regime and the reduction of corporate tax rates. The TRAF is more balanced, comprehensive and, most importantly, politically widely accepted.

9.4 Competitive Tax Policy Objective

As mentioned above in **9.3 Profile of International Tax**, the TRAF includes various measures in order for Switzerland to maintain its attractive tax system.

9.5 Features of the Competitive Tax System

The competitive tax system of Switzerland includes features such as privileged tax regimes and advanced tax ruling, both of which were highly criticised by the OECD and the EU. That is why Switzerland – wishing to be in line with the new OECD and EU principles – abolished the privileged tax regimes and tax rulings are subject to spontaneous exchange of information.

With the implementation of BEPS recommendations – as analysed above in **9.1 Recommended Changes** – as well as of the TRAF, Switzerland should not have any 'vulnerable' areas in its tax regime.

9.6 Proposals for Dealing with Hybrid Instruments

As far as hybrid mismatch arrangements are concerned, the current Swiss tax law is sufficient to prevent any hybrid structures. Switzerland has adopted the common approach. The country's international tax policy has always been one that supports the elimination of double non-taxation resulting for an unintended lack of tax co-ordination. It should be noted that the recommendations of the BEPS project are much wider, therefore any implementation by Switzerland would require a number of changes in Swiss tax domestic law.

Finally, Switzerland will apply to its residents the switch-over clause of Article 5 of the MLI.

9.7 Territorial Tax Regime

Switzerland applies a worldwide basis jurisdiction to tax, which is limited by the principle of territoriality in certain cases such as foreign subsidiaries. For the time being no interest deductions rules in line with action plan No 4 have been implemented or are foreseen to be implemented. Switzerland has thin capitalisation rules that only apply to related parties. In the future, Switzerland may need to change its thin-capitalisation rules in order to expand to the overall level of interest deductions in an entity, but no such motion has been put in place.

9.8 CFC Proposals

Switzerland does not have CFC legislation, as Swiss residents are not taxed on profits derived by foreign legal entities, such as foreign subsidiaries, up until they are distributed to the shareholder. Moreover, Switzerland provides for unconditional unilateral tax exemption that is not conditional on the payment of taxes abroad. The above is also reflected in its double tax treaties, as Switzerland favours the application of the exemption method. However, recent jurisprudence has allowed the taxation of passive income with insufficient nexus with a foreign country. As such, the corporate veil of a foreign legal entity may be pierced, and a broader interpretation of effective management may be admitted. Therefore, although the courts tend to adopt a position similar to the BEPS project principles, Switzerland for the time being does not intend to introduce any CFC legislation in its tax system.

9.9 Anti-avoidance Rules

Switzerland has accepted LOB articles in its DTAs only at the request of some of its treaty partners, namely the USA and Japan. Otherwise, Swiss treaty practice has never favoured such articles.

With the entry into force of the MLI, a general anti-avoidance rule (GAAR) in the form of the principal purpose test (PPT) will be applied. However, this GAAR is not new to Swiss law and policy. Case law of the Swiss Federal Supreme Court (2005) recognises that unwritten GAAR which is conceptually similar to the PPT and is consequently implicitly included in every Swiss DTA. It should be pointed out that controversial issues might arise as the scope of the PPT is much broader. The current unwritten GAAR is limited to dividends, interest or royalties, whereas PPT will be applied to all provisions of a DTA.

9.10 Transfer Pricing Changes

Switzerland does not have any transfer pricing rules in its domestic law. The authorities are implementing the OECD guidelines. Further, Switzerland does not plan to make transfer-pricing documentation compulsory.

9.11 Transparency and Country-by-country Reporting

Parent entities of multinational enterprises residing in Switzerland with more than CHF900 million consolidation revenue in the financial year preceding the reporting year, or surrogate parent entities, must comply with the country-by-country reporting obligations and provide the Federal Tax Administration with the report. The first financial year that CBCR is mandatory is on or after 1 January 2018 and it will be exchanged with partner countries at the beginning of 2020. The submission of reports for the 2016 and 2017 tax years is still optional.

As far as transparency is concerned, Switzerland is a country that issues tax rulings including advanced tax rulings that clarify the tax consequences of a certain given transaction planned by the taxpayer. Tax rulings are a very important tool that facilitate the co-operation of the taxpayer with the authorities, rendering the Swiss tax system even more attractive. In order to be in line with BEPS action 5, as of 2018, tax rulings are subject to spontaneous exchange of information.

9.12 Taxation of Digital Economy Businesses

Switzerland has not taken any unilateral action with regards to the taxation of digital economy. The State Secretary for International Finance has been working intensively on the taxation of digital economy and performed an analysis on the subject. Switzerland holds the opinion that it is necessary to favour multinational approaches, where tax profits are taxed in the jurisdiction where added value is generated and which do not cause double or over taxation, and also that measures outside the scope of double taxation agreements are to be avoided.

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Trends and Developments

Contributed by Lenz & Staehelin

Lenz & Staehelin Lenz & Staehelin is the largest law firm in Switzerland, with over 200 lawyers forming its legal staff. Internationally oriented, the firm offers a comprehensive range of services and handles all aspects of international and Swiss law. Languages spoken include English, French, German, Italian, Russian and Spanish. Lenz & Staehelin's tax team is one of the largest among Swiss law firms, with more than 25 tax attorneys offering a full range of tax advice in its three offices in Geneva, Zürich and Lausanne. Tax practice areas include M&A, restructurings and buyouts, financing, financial products and derivatives, estate and tax planning for executives, including employee share and stock option plans, investment funds, private equity funds, property (acquisition and development), value-added tax; internal investigations, and tax litigation.

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Trends & Developments in Swiss Corporate Tax

"PF 17" (Tax Proposal 17)

Switzerland is currently undertaking a major transformation of its corporate tax system, initially driven by pressure from the European Commission in disagreement with certain aspects of Swiss taxation. The current legislative project embodying this global reform, which includes the removal of the disputed items as well as the implementation of other tax rules, is known as "Tax Project 2017" and will be the subject of this contribution.

As an introductory background, the main point of disagreement between Switzerland and the European Commission has historically concerned special corporate tax statutes, known in Switzerland as "holding company status" and "administrative or mixed company status", and regarded as being attractive and business-friendly features of the Swiss corporate tax system. They were primarily intended for companies that were considered highly mobile, and aimed to offer Switzerland a competitive tax status at the international level.

Briefly, the holding company status provides a full cantonal tax exemption for holding companies that perform no commercial activity in Switzerland and whose corporate purpose is effectively to hold participations, if (i) at least two-thirds of its asset value consists of participation or (ii) two thirds of its income is derived from participation in the form of dividend.

The administrative or mixed company status is applicable for companies with business activities that are predominantly foreign-oriented. For example, oil-trading businesses are interpreted as such, as the resources of trading activity are located and exchanged abroad. The status provides that only the portion of foreign income that relates to Switzerland (for example 20%) will be taxed, effectively reducing the tax rate of "mixed companies". It also applies to pure "administrative" companies, which are only providing technical assistance, or financial or administrative management to related companies.

Both of these special tax statutes are only relevant at the cantonal level, and it should be highlighted that Switzerland distinguishes from cantonal (and communal) taxation on one level and federal taxation on another.

Two other Swiss tax special statutes (or specific implementation thereof) that will disappear are applicable on both federal and cantonal levels. They are the principal company and the Swiss finance branch statutes. The former applies to companies that centralise different functions of a company group, with a tax treatment that partially allocates income abroad, hence including only a portion of the overall profits in their own tax base. The latter is a Swiss permanent establishment and acts as a central treasury department for the company group and may deduct deemed (notional) interest expenses.

As indicated, the European Union has disputed these corporate tax statutes for several years, under the opinion that they constitute a violation of the free trade agreement between Switzerland and the European Community of 1972, placing Switzerland under threat of potential blacklisting and termination of tax treaties from EU Member States.

In this political context, Switzerland has resolved to reform its corporate tax system. Initially known as "Swiss Corporate Tax Reform III", the first project of this tax reform was rejected by the people and the Cantons in a popular vote known as a referendum on 12 February 2017.

In response to the arguments of the project's opponents that excessive tax benefits would have been granted by the reform, the new version of the still necessary corporate tax reform is henceforth known as "Tax Project 17", and has smoothed out the most contentious aspects of the "Swiss Corporate Tax Reform III", albeit keeping its essential components.

The Federal Council's message (the Federal Council being the Swiss executive government body) regarding Tax Project 17 has invoked an "absolute priority", meaning its approbation is of utmost importance for the Swiss government, again mostly because of external political pressure. Due to the Swiss legislative process, a popular vote could be held on the subject. The referendum deadline to gather the votes calling for such a referendum expires on 17 January 2019, and the potential vote would take place at the end of May.

The main features of the Tax Project 17 are as follows.

At the origin of the project, the repeal of the above-mentioned special tax statutes is one of the flagship measures. These statutes would then be abolished with the entry into force of the tax reform, although given a transitory period until, most likely, at least 2020. Due to the increase in tax burden for companies with special statutes and as a compensation measure, most Cantons are planning to reduce their corporate tax rate to avoid a massive departure of tax-privileged corporations; this is, after all, one of the main features of Tax Project 17. It effectively means that, as of 2020, depending upon the Canton of incorporation, the effective total income tax rate (ie, federal, cantonal and communal) will range from about 10% to 14%, with the Canton of Zurich most probably having the rate of 18.19%.

Given these reduced rates resulting from special tax statutes and the acceptance under Swiss corporate law of hidden reserves (usually resulting from under-valued assets), Tax Project 17 also provides for a solution to avoid the unfair taxation of these hidden reserves. To this extent, existing hidden reserves of companies under special tax statutes would be determined in a tax decision and taxed at a reduced rate at the time of their realisation.

Under current Swiss tax law, dividends and others profits deriving from shares are taxable at the reduced rate to mitigate the effect of double economic taxation (corporate income tax on the corporation's income as well as private income tax on the distribution for the shareholder). This reduced rate amounts to 60% of the distributed benefits from participation (for example, dividends) on the federal level if participation rights constitute at least 10% of the share capital of the company, while Cantons have different reduced rates. Under Tax Project 17, the reduced rate would be increased to a minimum of 70% at the federal level and at least 50% at the cantonal level. The Cantons may provide for higher taxation.

Tax Project 17 also plans the implementation of a "patent box" for Cantons. No reduction would be granted on the federal level, but on the cantonal level, income related to patents and similar rights would be taxed with a reduction of at most 90%. This income would include licence fees or benefits from the sale of patents and comparable rights. The patent box would have to comply with OECD's rules, taking into account R&D expenses, in order to ensure that patent box benefits are linked to economic substance. Also, and contrary to the Swiss Corporate Tax Reform III, non-patented inventions of SMEs and software protected by a right would not be eligible for the patent box. Although of limited practical application, the patent box would also be applicable for independent business owners.

Additional deductions for R&D are provided by Tax Project 17 alongside the patent box. On the cantonal level, these additional deductions will be limited to at most 50% (as R&D and all other expenses justified by commercial use are already deductible from taxable profit under current law, it would then be a 150% deduction on such R&D expenditure). By reference to the Federal Law on the promotion of research and development and innovation, R&D would be determined in a broad sense, including fundamental research, research oriented towards applications, and science-based innovation.

Cantons with a combined cantonal, municipal and other public corporation tax rate of at least 13.5% may also introduce a notional interest deduction on security equity capital (self-financing deduction). Security equity capital is the portion of equity capital that exceeds the equity capital required for long-term business activity. The interest rate will be calculated based on the rate paid on ten-year federal bonds.

To avoid excessive cumulative tax reductions, the Cantons are required to provide for a limitation of the global tax reduction based on the patent box, additional deductions for R&D expenditure, and the self-financing deduction. The reduction in taxable income under these schemes may not exceed 70% or a more restrictive ceiling.

Unlike the Confederation, the Cantons levy a capital tax on legal entities in addition to income tax. This tax is based on the company's own capital. Since most Cantons allow for a reduced capital tax rate for special tax statutes, Tax Project 2017 proposes that the Cantons should also be authorised to provide for reductions in capital tax. These reductions would concern the equity capital of a company's equity linked to participations as well as to patents and comparable rights.

Lastly, Tax Project 17 also includes measures to rebalance fiscal equalisation between the federal and the cantonal level, so that the federal financial compensation to the Cantons would be higher. It also includes an increase in the minimum requirements of family allowances (minimum amounts would be increased by CHF30), mostly for political reasons and the acceptability of the reform.

In summary, the planned Tax Project 17 takes into account the need to adapt Swiss tax law to the profound changes resulting from the position of Switzerland's economic partners and developments in international tax law. It also provides for safeguards following the dismissal of the Swiss Corporate Tax Reform III in the popular vote. This reform, while adapting to modern tax standards, should allow Switzerland to remain at the forefront of the European corporate tax landscape.

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