THE CORPORATE TAX PLANNING LAW REVIEW

Editors
Jodi J Schwartz and Swift S O Edgar

THE LAWREVIEWS

THE

Corporate Tax Planning Law Review

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PREFACE

We are pleased to present the inaugural edition of *The Corporate Tax Planning Law Review*. This volume contains 20 chapters, each devoted to a different country and providing expert analysis by leading practitioners of the most important aspects of tax planning for multinational corporate groups in that country, with a particular focus on recent developments.

The jurisdictions represented in this volume are diverse and include established major economies (such as the United States, Germany and Korea); EU countries that have become popular destinations for new business organisations and those where multinationals tend to form entities to facilitate local operations or investments; the city-states of Singapore and Monaco; and several nations in the Global South (including Colombia, Venezuela and Malaysia). Echoing this geographical variety, *The Corporate Tax Planning Law Review* describes tax developments worldwide that respond to different challenges in different places. At the same time, many countries share goals of preventing jurisdiction-shopping, protecting against erosion of the tax base, promoting local investment and raising revenues. These complex and at times conflicting goals present opportunities for the well advised and traps for the unwary.

While each chapter discusses issues at the cutting edge of tax law, the authors have contextualised their analyses with sufficient background information to make this volume accessible and useful to both generalists and tax practitioners outside each particular jurisdiction. Although *The Corporate Tax Planning Law Review* is, by its nature, an abbreviated overview, we hope it will at least serve as a workable compass to in-house counsel and outside advisers as they attempt to navigate their clients through the unsteady, and at times uncharted, waters of contemporary corporate tax planning.

We are extremely grateful to the contributors who have assiduously distilled a wealth of expertise to create this volume, and to Gina Mete, Nick Barette, Gavin Jordan and Adam Myers at Law Business Research for their editorial acumen and dedication to this project.

Jodi J Schwartz and Swift S O Edgar
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Chapter 17

SWITZERLAND

Floran Ponce and Jean-Blaise Eckert[1]

I INTRODUCTION

Switzerland is a federal democracy. As such, corporate taxes are levied on the federal, cantonal and communal levels.

Switzerland is a stable, liberal country with a business-friendly environment, relatively low corporate income tax and an extensive double tax treaty (DTT) network. Switzerland has no controlled foreign corporation (CFC) rules in place and limited anti-avoidance rules for businesses. Participation relief results in reduced taxes on income and capital gains from participations. This creates tax-planning opportunities for businesses.

Additionally, tax rulings allow businesses to secure a specific tax treatment before relocating to Switzerland. Tax rulings may also inform businesses of the tax consequences related to specific transactions.

A corporate tax reform, which will bring Swiss tax law into line with international requirements, is under way. This reform is expected to enter into force in 2020.

II LOCAL DEVELOPMENTS

i Entity selection and business operations

Entities

Non-corporate entities include general and limited partnerships. They are rarely used by large businesses, since general partners must be individuals and bear unlimited personal liability.

Partnerships are transparent for income tax purposes, so the assets and income derived therefrom are attributed to the partners based on their share of the partnership.

The most common corporate structures in Switzerland are companies limited by shares and limited liability companies (LLC). However, large companies, with the exception of US multinational enterprises (check-the-box elections for US tax purposes), generally do not use LLCs.

Companies are legal persons, so are subject to direct taxes without any possibility to be treated as transparent or considered 'pass-through' entities for Swiss tax purposes. Direct corporate taxes include federal and cantonal corporate income tax and cantonal capital tax. Companies are also responsible for collecting withholding tax on dividend distributions.

Certain legal entities may be exempt from taxes. For example, public benefit companies, charities and pension funds are tax-exempt.

1 Floran Ponce and Jean-Blaise Eckert are partners at Lenz & Staehelin. The authors wish to thank Kathryn Kruglak and Nathan Bouvier for their contribution to this chapter.

Corporate income tax principles

Corporate tax liability and tax rates

Companies with either their statutory seat or their place of effective management in Switzerland are considered Swiss residents for tax purposes.

A company is considered to have its place of effective management in Switzerland if its economic centre is located in Switzerland.

In determining the economic centre, the tax authorities consider a variety of factors and the presence of multiple connecting factors with Switzerland is sufficient to consider that the place of effective management is in Switzerland. The predominant factor is the place where management is carried out (i.e., the day-to-day actions required to carry out the company's statutory purpose). Secondary factors include the place where fundamental decisions are made and the place where administrative work (e.g., accounting, correspondence) is carried out. A passive company's (e.g., a group financing company) place of effective management is where its strategic decisions (e.g., decisions about refinancing, loans and loan conditions) are made.

Swiss-resident corporate taxpayers are subject to corporate income tax on worldwide income, with the exception of income from foreign real estate, permanent establishments and business enterprises. Corporate income tax is levied on the net profit.

Swiss permanent establishments of non-resident companies are subject to income tax on the income attributable to the permanent establishment. Non-resident companies with real estate in Switzerland are subject to income tax derived from that real estate.

The federal corporate income tax rate is 8.5 per cent on profit after tax; cantonal and communal corporate income tax rates vary from 5.55 per cent to 23.36 per cent (statutory rates on profits after tax). Since corporate income tax is a deductible expense, the effective rates on pre-tax profit are between 11.19 per cent and 24.41 per cent (federal, cantonal and communal taxes included); for instance, the effective, aggregate tax rate is 22.18 per cent in Basel; 24.16 per cent in Geneva; 22.09 per cent in Lausanne (canton of Vaud); 14.6 per cent in Zug; and 21.15 per cent in Zurich.

Corporate tax base

In principle, the taxable income is the same as the profit listed in statutory financial statements, which is determined using the accrual-basis accounting method. Generally, all expenses are deductible, provided they are commercially justified. Corrections are allowed when 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 excessive, they will be reduced or denied.

Companies may record depreciations using either the declining-balance method or the straight-line method, but for tax purposes certain minimum rates must be respected (e.g., for commercial buildings, 3–4 per cent using the declining-balance method and 1.5–2 per cent using the straight-line method; and for intangibles, 40 per cent using the declining-balance method and 20 per cent using the straight-line method).

A provision for one-third of the inventory value is permitted for federal and cantonal tax purposes. Further provisions for accounts receivables are allowed. The standard amount is 5 per cent for Swiss receivables and 10 per cent for foreign receivables.

Under Swiss tax law, losses may be carried forward for seven years – there are no provisions for carry-back. Losses must be carried forward using the first in, first out method.

Older losses (more than seven years) may be carried forward during a financial restructuring resulting from insolvency, if carrying forward said losses will allow the company to balance its books of account.

Interest is deductible. The Federal Tax Administration (FTA) publishes annual safe harbour interest rates for loans granted to related parties. Interest payments exceeding the safe harbour rates are reclassified as constructive dividends if paid to a shareholder or related party. Consequently, such interest is not a deductible expense for federal and cantonal income tax purposes and is subject to withholding tax at a rate of 35 per cent (which may be reduced under an applicable double tax treaty).

Similar rules apply to interest paid on debt exceeding the maximum allowed debt. Swiss federal and cantonal tax rules contain thin capitalisation safe harbour provisions (maximum debt rule per asset class based on their book or fair market value); for example, 100 per cent for cash, 85 per cent for accounts receivable and inventory, 70 per cent for investments in subsidiaries, 50 per cent for furniture and equipment, 70 per cent for property and plant (commercially used) and 70 per cent for intangibles.

However, the rules set out above are merely safe harbour rules and different ratios or rates may be used if the taxpayer can justify them.

Participation relief and foreign-source income

As a rule, both income and capital profit are subject to federal, cantonal and communal corporate income taxes.

Participation income is eligible for participation relief if the receiving company owns at least 10 per cent of the equity in the distributing company, if the participation is worth at least 1 million Swiss francs (for dividends) or if the receiving company is entitled to at least 10 per cent of the distributing company's profit and reserves. Participation relief is granted for capital gains if one of the above conditions is fulfilled and the participation has been held for at least one year.

There is no rule limiting the use of the participation relief based on the amount of tax paid by the subsidiary.

Depreciations on participations are possible and tax deductible. However, a recapture rule stipulates that depreciations must be reintegrated as profit if the participation fulfils the criteria for participation exemption and its fair market value exceeds its book value.

Foreign-source income is subject to corporate taxes if it is included in the legal entity's statutory financial statements, with the above-mentioned exception for income from real estate, permanent establishments and business enterprises.

As a rule, Swiss double tax treaties use the exemption method to eliminate international double taxation; however, the credit method is used for foreign-source dividends, interest and royalties.

A Swiss company may offset losses incurred abroad by a foreign permanent establishment against domestic profits even though the foreign-source income is tax-exempt. If the permanent establishment makes a profit within seven years, the Swiss company's initial taxation is revised to recapture the offset foreign losses.

Special statutes

Currently, only the canton of Nidwalden has introduced a patent box regime. However, the Tax Reform and Social Security Funding Act (the Tax Reform Act) includes a mandatory cantonal patent box regime as a replacement measure for the special tax statuses that it will abolish. The cantonal patent boxes may exempt up to 90 per cent of patent-related income; however, total exemption from Tax Reform Act deductions (e.g., patent box, R&D deductions, step up) is limited to 70 per cent of a company's taxable profit.

Holding companies are exempt from cantonal and communal corporate income taxes, with the exception of income and capital gains from Swiss real estate, which are taxed at the ordinary rate.

Holding company status is granted to companies whose statutory purpose is the long-term management of participations in other companies, provided the participations equal at least two-thirds of the company's assets, or the income derived from the participations rights equals at least two-thirds of the company's income. Holding companies may not have commercial activity in Switzerland.

Administrative or mixed company status is given to companies with predominantly foreign-oriented business activities. Companies with this status are taxed on a percentage of their foreign income that corresponds with the percentage of their business activities that is carried out in Switzerland, effectively reducing the tax rate for 'mixed companies'. It also applies to pure 'administrative' companies, which provide only technical assistance or financial and administrative management to related companies.

The Tax Reform Act

Switzerland is in the midst of a major corporate tax reform. This reform was initially driven by pressure from the European Commission, which disagreed with certain aspects of Swiss taxation, in particular tax incentives in the form of 'special cantonal statuses' allowing for lower cantonal and communal tax rates for holding companies and international businesses.

These special cantonal statuses will be abolished in 2020 if the Tax Reform Act enters into force.

To keep Switzerland attractive to businesses, the Tax Reform Act provides other incentives, such as IP boxes, and most cantons will lower their ordinary corporate income tax rates. For instance, the proposed, new effective rates are: 13.04 per cent in Basel; 13.99 per cent in Geneva; 13.79 per cent in Lausanne (Vaud); 12.09 per cent in Zug; and 18.19 per cent in Zurich (federal, cantonal and communal taxes included).

Withholding tax

Swiss companies must levy a 35 per cent withholding tax on profit distributions (including constructive dividends and liquidation proceeds) to shareholders or related parties, irrespective of whether the beneficiary is a Swiss tax resident.

Although interest on bonds and other debt certificates issued by Swiss companies is subject to withholding tax, withholding tax is not levied on interest paid on private loans, including intercompany loans. Withholding tax is not levied on royalties.

Swiss taxpayers (companies and individuals) may request a withholding tax refund. The refund will be granted if certain conditions are fulfilled (e.g., the taxpayers have fulfilled all of their reporting obligations).

Non-resident taxpayers may claim a partial or total refund of Swiss withholding tax if there is a DTT between Switzerland and their country of residence.

Capital tax

Capital tax is a direct tax that is levied on companies' net equity (paid-up capital, as well as open reserves and taxed hidden reserves). Capital tax is levied annually and rates vary (0.001–0.525 per cent) between cantons.

Some cantons permit corporate income tax to be credited against capital tax, meaning capital tax is levied only if it exceeds the cantonal corporate income tax due. There is no federal capital tax; it is only levied by the cantons. In the event of thin capitalisation, the part of the loan reclassified as equity is subject to capital tax.

ii Common ownership: group structures and intercompany transactions

Absence of tax grouping and transfer pricing rules

Switzerland tax law does not permit consolidated taxation for corporate income tax purposes. This means that each legal entity is treated as an independent entity and must comply with the 'dealing at arm's length' principle.

Based on this rule, Swiss tax authorities can correct intra-group transactions that are not at arm's length. When a transaction does not respect the arm's-length price, the difference between the price paid and the arm's length price is treated as a constructive dividend and the taxable income is adjusted. The arm's-length principle is also applicable when choosing the method to determine the mark-up.

In assessing whether an intra-group transaction is at arm's length, the Swiss tax authorities follow the OECD Transfer Pricing Guidelines. It is possible to request an advance pricing agreement from the Swiss tax authorities; the competent authority is the State Secretariat for International Financial Matters.

With respect to intercompany loans, the FTA publishes an annual circular letter with rules regarding safe-harbour interest rates on loans and advances between related parties. This circular letter sets out maximum rates for loans from shareholders to the company and minimum rates for loans from the company to shareholders and related parties.

Regarding interest, thin capitalisation rules may affect the deductibility of interest. However, in most cases, and in view of the generous thin capitalisation rules, it may be worthwhile to finance Swiss subsidiaries through interest-bearing debt.

Participation relief on intercompany dividends and capital gains

Dividends paid to other group companies may benefit from participation relief. In the case of dividends received from, or capital gains on, the sale of a foreign affiliate, participation relief applies irrespective of the withholding tax (see Section II.i, 'Participation relief and foreign-source income').

Reorganisation

In principle, reorganisations (mergers, demergers, conversions and asset transfers) are tax-neutral. The following conditions must be respected for a reorganisation to be tax-neutral: (1) the company remains subject to tax in Switzerland; and (2) there is no re-evaluation of commercial assets.

In the event of a demerger, a business unit or part of a business unit must be transferred. Likewise, intra-group asset transfers are tax-free, but only for operational assets. There is also a blocking period of five years, which means that participations and assets that were part of the reorganisation cannot be sold during this time.

Losses from both companies may be carried forward during a merger, except in the case of tax avoidance or abuse of a right (e.g., merger with a company that has liquidated most or all of its assets). In the event of a demerger or transfer of a business unit, the losses survive and must be allocated between the companies based on economic criteria.

Anti-avoidance rules and CFC

In Switzerland, general anti-avoidance rules are not contained in a specific act. The Swiss Federal Supreme Court has developed a general principle of tax avoidance and abuse of rights, applicable to all Swiss taxes. In accordance with this principle, in certain situations, tax authorities have the right to tax a taxpayer's structure based on its economic substance, rather than its legal structure. Instances in which this doctrine is applied are, however, limited in the context of corporate taxation. Furthermore, Swiss tax law has no CFC regulations.

Withholding tax on intercompany transactions and treaty exemption

As explained above, Swiss companies must levy a 35 per cent withholding tax on profit distributions (including constructive dividends and liquidation proceeds). To qualify for treaty benefits, the foreign parent company must be the beneficial owner of the dividend income. Further, the withholding tax refund will not be granted if the FTA determines that there is treaty abuse. In assessing beneficial ownership and whether a structure is abusive, the FTA examines whether there is sufficient capitalisation (30 per cent) and whether the parent company has substance (personnel and premises) in its country of residence. Generally, holding companies must demonstrate that they hold multiple companies, not just the Swiss company requesting treaty exemption.

Rather than paying withholding tax, companies can request permission to use the simplified notification procedure (withholding tax relief) for intra-group distributions to Swiss parent companies or to parent companies resident in a DTT country.

iii Third-party transactions

Asset deals

An acquisition may be structured as either a share deal or an asset deal.

Asset deals tend to be more favourable for buyers, since a step-up in basis is allowed. They permit the company to record part of the purchase price as goodwill. Payment in excess of the assets' market value is recorded as goodwill, can be depreciated over a period of five years and is tax deductible.

Asset deals are not particularly favourable for the seller, since the sales profit is subject to tax; asset deals involving the sale of qualifying participations benefit from participation relief.

Transferred assets may be subject to VAT and transfer stamp duty (for transfers of securities).

Share deals

In the event of a share deal, capital gains realised by Swiss-resident companies may benefit from participation relief if the participation fulfils the aforementioned conditions (i.e., participation of 10 per cent or more and a holding period of at least one year).

Share deals are also particularly beneficial for individual sellers, since Swiss-resident individuals are not subject to capital gains tax on gains arising from private assets, but are subject to income tax on dividends.

However, for individuals resident in Switzerland, special attention must be paid to rules concerning indirect partial liquidation, since tax-free capital gains arising from share deals can be reclassified retroactively as a taxable dividend.

The criteria for indirect partial liquidation are:

a the sale of at least 20 per cent of the share capital in a Swiss or foreign company to a third party;

b the shares are transferred from the seller's private assets to a company or to the acquirer's business assets (in the case of acquisition by an individual);

c the target company has commercially distributable reserves at the moment of the transfer and assets beyond those required to run the business; and

d these assets are distributed to the acquirer during the five years following the acquisition.

Generally, indirect partial liquidation can be avoided by adding a clause to the share purchase agreement that prevents distributions during the five years following the transfer.

From the purchaser's perspective, acquisitions can be carried out using a local or foreign entity. An acquisition in and of itself does not trigger withholding tax.

When the purchaser is a Swiss company, the purchase price is recorded in the books of account at the share value. This value cannot be decreased (unless the market value decreases).

In the case of a leveraged acquisition, the absence of consolidated taxation for company groups means that interest on the acquiring company's debt cannot be deducted by the target company if the latter does not have operational income. Further, the Swiss tax authorities may treat debt push-down strategies in a leveraged acquisition as tax avoidance.

Further, when using a foreign parent company to hold a Swiss company, investors should ensure that the foreign parent company is located in a jurisdiction that has a DTT with Switzerland to reduce or eliminate withholding tax on dividend distributions. Otherwise, it is advisable to use an intermediary holding company located in a jurisdiction that has a DTT with Switzerland, provided it complies with the criteria for treaty exemption.

In international situations, investors should also be aware of the 'Old Reserves Theory'. Under this theory, if a foreign shareholder transfers shares in a Swiss company to a shareholder located in a jurisdiction with a more favourable DTT, withholding tax may continue to be levied on distributable reserves at the same rate applicable to a tax resident of the first jurisdiction if at the time of the transfer the company had commercially distributable reserves and assets not economically required.

Attention must also be paid to 'liquidation by proxy' in the event of an acquisition in which a Swiss entity acquires a Swiss target entity that was previously held by non-Swiss resident shareholders who were ineligible for a withholding tax refund with respect to dividends paid by the Swiss target entity. In accordance with the Swiss anti-avoidance doctrine, were that entity to be partially or totally liquidated shortly after the sale, it is possible that the Swiss acquiring company would likewise be ineligible for a withholding tax refund.

Share-for-share exchange

In practice, share-for-share exchanges are common and qualify as tax-neutral quasi-mergers. They take place through an in-kind contribution of shares in exchange for shares in the acquiring company. This requires increasing the acquiring company's share capital, as well exchanging shares with the acquired company's shareholders.

Capital gains resulting from quasi-mergers are tax-free for individual sellers, unless there is a case of transposition.

Transposition occurs if (1) transfer is of at least 5 per cent of the share capital of a company, (2) from the private assets of an individual to a partnership or company in which said individual holds at least 50 per cent of the capital after the transfer, and (3) the consideration is worth more than the nominal value of the transferred shares.

Income resulting from transposition is taxed as dividend, rather than as a capital gain. The Tax Reform Act will abolish the 5 per cent threshold.

Share-for-share exchanges may lead to the creation of reserves resulting from capital contributions, which may be redistributed in a tax-neutral manner to shareholders and are not subject to withholding tax. Therefore it may be used in the context of public company transactions.

iv Indirect taxes

Issuance stamp duty

Issuance stamp duty is levied on capital contributions from shareholders to Swiss companies, meaning it is levied on both the initial creation of share capital as well as subsequent increases of share capital and contributions without the issuance of new shares. Stamp duty is levied at 1 per cent.

The first 1 million Swiss francs in share capital is exempt from stamp duty. Exemptions are also granted following a merger or similar restructuring.

The formal nature of stamp duty means that it is only levied when there is a contribution from a shareholder, so it is possible to avoid issuance stamp duty if the contribution is made by an affiliated company, such as a grandparent or sister company, that is not a shareholder.

Transfer stamp duty

Transfer stamp duty is levied when there is a transfer against consideration of a security subject to stamp duty and the transfer involves a Swiss securities dealer. Securities subject to stamp duty include Swiss and foreign bonds, shares, participation certificates, dividend rights certificates and units in collective investment schemes; Swiss securities dealers are defined as banks, securities traders and professional intermediaries (individuals and legal persons) and companies holding over 10 million Swiss francs in taxable securities. Transfer stamp duty is levied at 0.15 per cent for securities issued by Swiss residents and 0.3 per cent for foreign securities.

VAT

The ordinary VAT rate is 7.7 per cent. VAT on accommodation is 3.7 per cent and VAT on essential goods is 2.5 per cent.

Legal entities with a common management can benefit from group taxation for VAT purposes.

Although income from investments does not qualify as turnover from a VAT standpoint, it is possible, and recommended, that holding companies voluntarily register to be subject to VAT, so that they can recover VAT that they have paid and avoid an irrecoverable VAT charge on the acquisition of services from abroad under the reverse charge mechanism. The same advice applies to international companies with an annual turnover under the 100,000 Swiss francs required for mandatory VAT liability.

III INTERNATIONAL DEVELOPMENTS AND LOCAL RESPONSES

i OECD-G20 BEPS initiative

Switzerland has taken numerous actions to comply with the minimum standards set by BEPS.

In response to Action 5 of the BEPS plan, the Swiss parliament adopted the Tax Reform Act (subject to popular referendum) to abolish the cantonal special tax statuses, which had been deemed a harmful tax practice. Other actions include amending Swiss legislation concerning the spontaneous exchange of information on advance tax rulings and changes to Nidwalden's patent box to bring it into line with the nexus approach.

With regard to Action 13 of the BEPS plan, Switzerland also implemented country-by-country reporting regarding exchange of information.

In connection with Action 14 of the BEPS plan, Switzerland is improving its dispute resolution mechanisms.

ii EU proposals on taxation of the digital economy

The State Secretariat for International Financial Matters has taken a position on the issue of taxation of the digital economy. Switzerland is in favour of digitalisation and aims to provide a favourable framework for the development of the digital business model. With regard to taxation and OECD developments, Switzerland's position is that it is important to avoid hindering technological development and innovation through taxation. Thus, it is necessary to tax value where it is created and eliminate double taxation. Switzerland also favours a multilateral instrument and consensual solutions.

Beyond these favourable statements of intent regarding the digital economy and the need to preserve innovation, the digital economy has not resulted in any substantial changes to Swiss tax law.

iii Tax treaties

Switzerland has an extensive network of DTTs, most of which closely follow the OECD MC. Switzerland has concluded treaties with over 80 jurisdictions, including most European countries, the United States, Russia, Japan and China.

Additionally, an agreement between Switzerland and the European Union eliminates withholding tax if the parent company has directly held 25 per cent or more of the subsidiary's share capital for at least two years.

As mentioned, most of Switzerland's DTTs are close to the OECD MC. As a rule, treaties tend to reduce the withholding tax rates from 15 per cent to zero per cent.

State	Dividends				Interest	Royalties
	Ordinary	Subsidiary	Ownership (%)	Holding period (years)		
China	10	5	25	n/a	10	9
France	15	0	10	n/a	0	5
Germany	15	0	10	1	0	0
Italy	15	15	n/a	n/a	12.5	5
Japan	10	5/0	10/50	n/a	10	0
Luxembourg	15	0	10	2 (5% if less)	10	0
Netherlands	15	0	10	n/a	0	0
Russia	15	5	20	n/a	0	0

State	Dividends				Interest	Royalties
	Ordinary	Subsidiary	Ownership (%)	Holding period (years)		
United Kingdom	15	0	10	n/a	0	0
United States	15	5	10	n/a	0	0

On 7 June 2017, Switzerland signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. The Convention will lead to the amendment of double taxation treaties to bring them into line with the minimum standards agreed upon in the BEPS project.

Switzerland regularly updates its network of double tax treaties. On 3 May 2018, Switzerland concluded a double taxation treaty with Brazil.

IV RECENT CASES

i Perceived abuses

Withholding tax

The FTA has taken to rigorously applying anti-avoidance rules with regard to withholding tax. This has had consequences in three areas:

a Holding companies: the FTA used to be relatively lenient with holding companies resident in a DTT country, provided the holding company was not thinly capitalised. The FTA's practice has evolved in recent years, and the FTA now seeks to ensure that the parent company has sufficient substance. For a holding company, this does not necessarily require personnel and premises, but the company must demonstrate that it holds multiple participations and has a real holding function. This can be a challenge for certain investors, such as those in the private equity sphere where funds often use foreign SPVs to carry out acquisitions. Tax rulings can be obtained from the FTA before the transaction or restructuring.

b Third-party acquisition: as previously mentioned, the FTA, with the approval of the Swiss Federal Supreme Court, has developed two restrictions that can be applied in the event of an acquisition from investors who did not benefit from a withholding tax refund. Swiss and foreign investors need to be aware of these restrictions when acquiring a Swiss company and assess the risk before carrying out the transaction. Tax rulings permit investors to know in advance whether they will benefit from a withholding tax refund post-transaction; it is generally advisable to request such a ruling, since there is often a considerable amount of post-transaction scrutiny.

c Dividend stripping: for several years, the FTA has been scrutinising withholding tax relief claims lodged by Swiss and foreign banks, as well as large claims by treaty-resident investors (e.g., pension funds, sovereign funds). The two leading cases[2] concern Danish banks that had purchased Swiss stocks as hedges on total return swaps or futures. The FTA had alleged that the banks were not the beneficial owners and the Federal Supreme Court sided with the tax authorities. The approach followed by the court is not in line

2 Federal Court, 2C_364/2012 and 2C_377/2012 dated 5 May 2015. See Federal Administration Court, A-1951/2017 dated 22 August 2018 and its translation in International Tax Law Reports, p. 285 vol. 21 part. 3 2019 for a recent case and confirmation on the Federal Court Rulings.

with the OECD commentary and it might have been more appropriate to analyse these cases under the principle of treaty abuse. In addition, the criteria developed by the case law are vague and difficult to apply in practice. The criteria are currently the subject of extensive interpretation by the FTA. The FTA has also been challenging certain refunds with the argument that they have been provided with insufficient information about the transactions. This is likely to result in other court cases.

Transfer pricing

In recent years, there has been an increase in transfer pricing disputes, both with the FTA in withholding tax matters and with the cantonal tax authorities in income tax matters.

In connection with withholding tax, the FTA regularly audits companies participating in cash pool arrangements with foreign affiliates and tends to challenge the short-term nature of the deposits to argue that higher interest rates should have applied. Withholding tax audits often result in additional tax charges, since the FTA levies the 35 per cent withholding tax and only grants a partial refund of 20 per cent when the beneficiary of the constructive dividend is a treaty resident but not the direct parent company.

Additionally, the cantonal tax authorities have been conducting more transfer pricing audits than in the past, even though it is still not as frequent as in many other countries.

In a case relating to transfer pricing in 2018,[3] a parent company located in the Netherlands had provided a Swiss-resident subsidiary a licence to use IP rights in return for royalty payments. Since the Swiss company, which was responsible for strategic decision-making, employed the group's general management and gave instructions to the French company, had more than 60 employees carrying out research and development activities, while the parent company only had three part-time employees, the Federal Supreme Court confirmed the tax administration's tax decision. The deductions for the royalties were disallowed and penalties were applied. Although the case did not involve a large business and may not be relevant for multinational enterprises with proper structures in place, it shows that the tax authorities and courts are increasingly using BEPS considerations, such as the economic ownership of the IP, the ability to control risks and the presence of key functions, rather than simply referring to general anti-avoidance principles.

ii Recent successful tax-efficient transactions

Spin and sale transactions can be structured in a tax-efficient manner in Switzerland without excessive difficulties, unlike in many other European countries. This can be carried out by reorganising a business into a subsidiary or a group of subsidiaries in a tax-neutral manner. The Swiss parent company can then sell the subsidiary to a third party and will benefit from the participation relief on the gain.

It is also possible to carry out the spin transaction at the holding company level. This can be done by way of a two-step spin-off (incorporation of a subsidiary with in-kind contribution of assets followed by a distribution of the newly incorporated company to the shareholders). Such a transaction can generally be structured in a tax-neutral manner. The recent spin-off of Alcon from Novartis is an example.

3 Federal Court, 2C_11/2018, 10 December 2018.

V OUTLOOK AND CONCLUSIONS

Switzerland is in the process of reforming its corporate tax system to bring it in line with OECD and EU requirements. On 12 February 2017, Swiss voters rejected the Corporate Tax Reform III. In response to that vote, the Federal Council formed a steering committee to develop a new proposal – Tax Proposal 17. During parliamentary debate, members of parliament agreed to include funding for social security – the Tax Reform Act. This was adopted by Parliament and a public referendum will take place on 19 May 2019.

The Tax Reform Act will abolish the special cantonal statuses, as well as the principal company reduction. The Tax Reform Act will introduce mandatory IP boxes in all cantons and cantons may offer additional R&D deductions. It is expected that most cantons will lower their corporate income tax rates to compensate for the loss of the special cantonal statuses; some cantons will lower their capital tax rates.

This reform will enable Switzerland to have a BEPS-compliant tax regime while maintaining a business-friendly tax environment with a relatively low corporate income tax rate.

Appendix 1

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Floran Ponce is a lawyer and certified tax expert. He advises Swiss and foreign banks, investment funds and corporations on a broad range of domestic and international tax as well as commercial law matters. He advises them on matters relating to mergers, acquisitions, divestitures, financing transactions and restructurings, as well as on the management of tax affairs and controversies before Swiss tax authorities. He also assists private clients on complex tax matters.

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