80 Number of partner states with which Switzerland has agreed to theAutomatic Exchange of Information

Almost out of the woods

Switzerland has undergone and is still undergoing rapid and profound changes in order to safeguard and improve the country's competitive tax and business environment. Dimitri M. Rotter and Catherine Morf report

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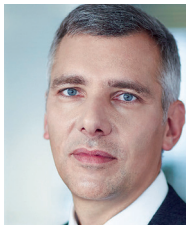
This article surveys the key developments affecting the tax laws relevant for wealth management structures with an exposure to Switzerland.

The highlighted changes relate to the introduction of the automatic exchange of information for 2017 with a first exchange in autumn 2018, the introduction of the spontaneous exchanges of rulings in tax matters with actual exchange as from 1 January 2018 and the initiation of the consultation of the so called tax proposal 17, the tax reform package replacing the corporate tax reform III that was rejected in a public referendum by the Swiss voters in February 2017.

Tax Proposal 17 aims to implement appropriate measures to replace the privileged tax regimes that have to be abolished. The introduction of the spontaneous exchange of tax rulings together with the abolition of harmful tax regimes, Switzerland implements the BEPS minimum standard on Action 5.



Dimitri M. Rotter (top) is a partner with Froriep Legal AG, heading its tax practice and is a certified Swiss tax expert and attorney at law.

Catherine Morf is a Counsel with Froriep Legal AG, a certified Swiss tax expert and attorney at law.

AUTOMATIC EXCHANGE OF INFORMATION

Switzerland implemented the domestic legal base for the Automatic Exchange of Information (AEOI). On 1 January 2017, the Administrative Assistance Convention, the Multilateral Competent Authority Agreement, the Federal Act on the AEOI, the Ordinance on the International Automatic Exchange of Information in Tax Matters as well as the final version of the AEOI Guideline entered into force.

The Interest Savings Agreement between Switzerland and the EU is replaced with the new global AEOI standard. The withholding tax exemption on dividends, interest and royalty payments for group companies located in the EU, which was included in the Interest Savings Agreement, is however still applicable.

The purpose of the AEOI is to reduce the possibility of tax evasion by holding assets abroad – either directly in the name of an individual or indirectly in the name of a company, partnership, trust or foundation.

To achieve that goal, the Organisation for Economic Co-operation and Development (OECD) has developed a single global AEOI standard for financial account information – the so called Common Reporting Standard (CRS). As of June 2017, 101 jurisdictions have committed to implement the CRS in their domestic law (so-called "participating jurisdictions") by signing the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information (MCAA). Aside from Switzerland, almost 100 states, including all major financial centres, have declared their intention to adopt the standard.

Unlike in most jurisdictions, in Switzerland the AEOI is not already activated with the signing of the MCAA but it is activated separately with each individual participating jurisdiction on a bilateral basis.
To date, Switzerland has agreed to the AEOI with 80 partner states (including the 28 EU member states). Thereby, with the EU and nine other partner states (Australia, Canada, Guernsey, Isle of Man, Iceland, Japan, Jersey, Norway and South Korea) Switzerland starts to collect information in 2017 with a first exchange of information in September 2018 (wave 1), with all the other jurisdictions one year later (wave 2) (for a complete list of countries please see the following link: www.sif.admin.ch/sif/

"Until the new corporate tax reform legislation enters into force, the current tax privileges should generally remain available"

en/home/themen/internationale-steuerpolitik/automatischer-informationsaustausch.html).

CRS requires Swiss Financial Institutions (i.e. banks, brokerage firms, specified insurance companies and investment entities) to report information on accounts held by persons (individuals or companies domiciled in an AEOI partner state) or by passive non-financial institution (such as domiciliary companies, partnerships, trusts and foundations to which a look-through approach applies) to the Swiss Federal Tax Administration.

For passive non-financial institutions, the financial institution is required to not only report the information about the company, partnership, trust or foundation but also information about its Controlling Person(s). Pure wealth management structures are most likely to either qualify as passive non-financial entities or as financial institutions (professionally managed investment entity).

Controlling Persons must hence be identified and reported by the Financial Institutions.

Provided that the residence country is a partner state of Switzerland, the Federal Tax Administration then transmits the information to the account holders' and Controlling Persons' countries of residence on an annual basis.

It is important that all persons involved in wealth management structures are aware of who has to be reported and of who has which reporting obligations. It should also be evaluated whether it would be beneficial if a wealth management structure itself were to report as a financial institution (as a professionally managed investment entity) rather than to leave the reporting to the account-keeping banks and/or to other persons qualifying as Financial Institutions (e.g. discretionary asset managers or a trustee service provider company). Further, the persons to be reported should ensure that they are fully tax compliant in their residence jurisdictions. If necessary, appropriate actions should be taken immediately.

EXCHANGE OF TAX RULINGS

Switzerland implemented the domestic legal base for the spontaneous exchange of rulings in tax matters and of other relevant information based on the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC). It entered into force on 1 January 2017. The spontaneous exchange of tax rulings takes place as from 1 January 2018.

THE SCOPE OF RULINGS TO BE EXCHANGED AS DEFINED IN THE APPLICABLE ORDINANCE ON ADMINISTRATIVE ASSISTANCE IN TAX MATTERS IS QUITE GENERIC

The wording in the MAC is very broad and leaves open a wide space for interpretation. The spontaneous exchange of information is also the instrument to exchange tax rulings as required by the OECD's so-called BEPS Action 5, addressing certain harmful tax practices of companies. BEPS Action 5 foresees the following five categories of tax rulings to be in scope of the spontaneous information exchange:

1. Taxpayer-specific rulings regarding privileged tax regimes (for Switzerland these are holding, domicile and mixed and principal company regimes, finance branches);
2. Cross-border unilateral advance pricing agreements ("APAs") covering transfer pricing;
3. Downward adjustment rulings concerning a downward adjustment to the taxpayer's taxable profits that is not directly reflected in the taxpayer's financial accounts;
4. Permanent establishment rulings concerning the existence or absence of and the attribution of profits to a permanent establishment in the country issuing the ruling;
5. Related party conduit rulings.

The scope of rulings to be exchanged as defined in the applicable ordinance on administrative assistance in tax matters is quite generic and thus potentially broader than the above list according to BEPS action 5. Accordingly, it cannot be excluded that further types of rulings are being included during the implementation phase. For example rulings about tax treatment of individuals are outside the scope of action 5, but are not explicitly excluded by the Swiss ordinance..

What is being exchanged is an OECD-designed template with relevant information but not the actual tax ruling. The model form contains, among others the ruling reference number, the identification of the taxpayer, the date of issuance, the accounting period / tax years covered in the ruling, an indication of the type of ruling and additional information and short description of the ruling's content.

Clearly in scope are all tax rulings issued after 1 January 2018 but also all tax rulings issued since 2010 and which are still in force in 2018. Not in scope are therefore tax rulings issued since 2010 but which are terminated before 1 January 2018 either based on the wording of the ruling or based on a specific request by the tax payer.

Clearly in the scope of exchange are all tax rulings for the privileged tax regimes of holding, mixed or domiciliary companies as well as finance branches and principal companies. Since holding, mixed and domiciliary regimes are clearly defined in the law, in standard situations it is possible to withdraw the ruling by the end of 2017 and nevertheless be taxed according to these special regimes (as long as they are in force, see below Tax Proposal 17). Finance branches and principal structures though, are mostly more

59.1% Proportion of Swiss voters who rejected the draft legislation of Corporate Tax Reform III in a February 2017 referendum

complex and it will be difficult to handle them without specific ruling.

TAX PROPOSAL 17

The EU and the OECD have put pressure on Switzerland to give up privileged tax regimes for holding, mixed and domiciliary companies as well as for finance branches and principal companies.

It was the aim of the so called draft legislative proposal of Corporate Tax Reform III (CTRIII) to implement those changes and to replace the current tax privileges with privileges that are in line with OECD practice. On 12 February 2017 in a public referendum Swiss voters clearly rejected the draft legislation of CTRIII by 59.1%.

The Federal Council and cantons have launched a new effort to reform the corporate tax system under the title Tax Proposal 17 (TP17). On 9 June 2017 the Swiss Government presented the outline of the new proposal and on 6 September 2017 it dispatched the draft legislation TP17 and started the consultation procedure.

It was already the aim of CTRIII and it is the aim of TP17 to abolish the privileged tax regimes while maintaining the fiscal attractiveness of Switzerland as an important business location and at the same time to ensure sufficient tax revenues to finance public functions.

The new proposal shows the following major key elements:

1. *Abolition of the privileged tax regimes for holding, mixed and domiciliary companies, for finance branches and principal companies.*

In order to mitigate the transition for affected companies, TP17 foresees a special taxation for hidden reserves and goodwill accumulated under these privileged tax regimes but without creating a deferred tax asset for multinationals subject to a fair view accounting standard such as IFRS or US GAAP, which would have been detrimental for them (TP17 step-up). Additionally, a large number of cantons offer the possibility for a step-up of hidden reserves and goodwill upon the voluntary transition from a privileged tax regime to ordinary taxation already under their current tax laws.

2. *Significant decrease of cantonal corporate income taxes.*

Although not directly part of the TP17 draft legislation, many cantons have announced to reduce their cantonal/communal corporate tax rates in order to maintain their international fiscal attractiveness. In various cantons that effective combined federal/cantonal/communal tax rate might become as low as 12%.

3. *Introduction of a new patent box and of a super-deduction for R&D.*

Profits from patents and similar rights shall be segregated from other profits and shall be subject to a lower cantonal/communal tax rate. The cantons can generally determine the amount of the patent box relief however the ceiling of the relief is at 90%. The implementation of the Swiss patent box will be compliant with the patent box as defined by OECD (nexus approach). Further, the cantons have the option to introduce a deduction increased by 50% on the effective costs for research and development.

4. *Step up for foreign companies relocating to Switzerland.*

Foreign companies relocating to Switzerland shall be allowed to disclose their hidden reserves including goodwill accumulated abroad (step-up) and to depreciate them tax-effectively over the first few years.

This measure may be especially interesting for companies that are domiciled in low tax jurisdictions and consider relocating to Switzerland as an on-shore country.

5. *Further measures.*

A limitation of the overall tax relief of certain of the above mentioned measures to 70% was introduced in June 2017.

Further measures include option to reduce the annual tax on equity in proportion to the equity represented by participations and patents and similar rights qualifying for the patent box, a limitation of the qualifying dividend relief for individuals to 30% and an increase of the minimal family allowances by CHF30m. Furthermore, the share of the cantons of the direct federal income tax deriving from their territory shall be increased from 17% to 20.5%.

Not part anymore of new proposal TP17 is the notational interest deduction.

After the end of the consultation procedure on 6 of December 2017, the Federal Department of Finance submits its proposal to the Swiss parliament in spring 2018. According to the Department, in the best case the new law will enter into force in 2020. It is uncontentious that the tax privileges have to be abolished in order to not face repressions from the OECD or the EU or unilaterally by single countries.

Until the new corporate tax reform legislation enters into force, the current tax privileges should generally remain available. We recommend all companies affected to continue their ongoing adoption process. Inbound restructurings and tax-neutral step-up transactions remain a high priority for 2017 and 2018.

WITH ITS WIDESPREAD AND FLAWLESS INTRODUCTION OF THE AUTOMATIC EXCHANGE OF INFORMATION SWITZERLAND HAS ALMOST BECOME A PIONEER IN THE FIELD OF INTERNATIONAL TRANSPARENCY

FURTHER DEVELOPMENTS

Of less importance for the wealth management sector is the introduction of the domestic legal base for the country by country reporting in connection with the implementation of the BEPS minimum standard, a partial revision of the Swiss VAT Act and changes to the notification procedure applicable on intra-group dividend payments.

With its widespread and flawless introduction of the automatic exchange of information Switzerland has almost become a pioneer in the field of international transparency and with the initiated replacement of the so-called harmful tax regimes with OECD-compliant measures, Switzerland will soon be out of the woods. ■