

Tax News

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Dear Reader

Transfer pricing remains a current and important topic for companies and tax administrations: local tax authorities have an ongoing interest in transfer pricing structures and their documentation. This also applies increasingly to traditional investment locations in Eastern Europe and Asia. In China, for example, a draft bill by the government is under discussion which suggests stricter tax audits in transfer pricing cases. Chinese manufacturing subsidiaries of foreign companies face the prospect of more stringent tax audits especially if they report losses or minimal profits, or a sudden drop in profits in particular after expiration of tax holidays. Chinese tax authorities tend to take the view that this results from the management of intercompany pricing intended to reduce the tax base in China. Moreover, royalty payments are often disallowed for loss-making companies, assuming that the brand is considered to be of no value if it fails to generate any substantial profits.

This means that more and more foreign companies may be subject of transfer pricing adjustments. Therefore, it is recommended to keep transfer pricing records for Chinese subsidiaries.

Further information on the latest developments in international transfer pricing can be found in this edition of Tax News.

Philip Robinson
Country Managing Partner Tax and
Member of the Management Committee
philip.robinson@ch.ey.com



Germany - current trends

Heiko Kubaile, Tax Advisor, Senior Manager, Head German Tax Desk; heiko.kubaile@ch.ey.com

1. FFC limits German taxation right on special operating assets

According to a judgment issued by the Federal Finance Court, the highest German tax court (hereinafter FFC), on October 17, 2007 (I R 5/06), interest earned by a US-resident partner in a German partnership in return for granting a loan to the partnership in question should, pursuant to the double taxation agreement of 1989 between Germany and the US, be taxed in the US rather than in Germany. In this case interest is deemed to be a special income of the partner and is thus subject to different tax treatment than the partner's portion of the partnership's collectively earned profit, which is subject to German taxation.

This judgment has the potential to have a significant influence on the previous rules regarding German taxation of special income of partners in German partnerships, and could bring about a considerable change in the German tax authorities' current practice. Once again, therefore, it is necessary to wait and see whether the German tax authorities will apply this judgment over and above the specific situation which is relevant to the decision reached. If they were to do this, a notice would need to be published in the German Federal Tax Gazette, and this has not yet happened.

It remains to be seen how far the German tax authorities will also apply this judgment to investments made by Swiss shareholders in German partnership structures. To clarify: contrary to the double taxation agreement between Germany and the US, Germany's permanent establishment clause in Art. 7 para. 7 sentence 2 of the double taxation agreement between Germany and Switzerland also explicitly applies to income received by a partner in a partnership for his activities, for the granting of loans or for the transfer of business assets. This is special income, the taxation rights to which were subject of the above-mentioned FFC proceedings. In the case of Swiss outbound investments, however, Germany has an ex-

PLICIT corresponding taxation right, and so it is to be expected that the German tax authorities will not apply this judgment in relation to the double taxation agreement between Germany and Switzerland.

2. FFC: activity required in relation to international intercorporate privilege under the Trade Tax Act

Pursuant to a German international intercorporate privilege, dividends from foreign intercorporate investments, such as Swiss subsidiary corporations, are exempt from German trade tax (§ 9 no. 7 sentence 1 of the Trade Tax Act) if, in addition to compliance with a minimum holding requirement, the gross income of the subsidiary is also derived exclusively or almost exclusively from active involvement as defined in § 8 para. 1 no. 1-6 of the German Foreign Transaction Tax Act.

Formerly it was unclear in this context whether and for which taxpayers the activity performed via an (intermediate) partnership should be taken into account. The FFC has now issued a judgment on this matter:

If a foreign subsidiary corporation (such as a Swiss company) owns part of another company as a partner in a partnership (co-partnership), any gross income earned under this co-partnership must be attributed proportionally by type and amount, subject to the active involvement of the foreign corporation in terms of the gross income earned. This was decided by the FFC in a recently published judgment dated February 13, 2008 (Az. I R 75/07). The same applies to multilevel holdings in co-partnerships. An intermediate partnership does not act as a shelter for multilevel investment arrangements. This ruling is based on the principle of transparency, and may be advantageous in relation to compliance with the rules on active involvement pursuant to § 9 no. 7 of the Trade Tax Act.

New memorandum of understanding applicable to senior managers

Heiko Kubaile, Tax Advisor, Senior Manager, Head German Tax Desk; heiko.kubaile@ch.ey.com

The competent authorities in Switzerland and Germany reached the following memorandum of understanding in mid-September 2008 (cf. Art. 26 para. 3 Double Tax Agreement Germany-Switzerland, hereinafter: DTA D-CH):

As of 2009 the special rule contained in Art. 15 para. 4 DTA D-CH for executive employees will now only apply to individuals whose status as authorized officer (i.e. power to sign on behalf of the company, referred to as Prokura), director, deputy director, vice director or general manager is entered in the commercial register. The former practice (memorandum of understanding of July 7, 1997) had been wider in scope: it had included the category of executive employees who were not entered in the commercial register but had "either

power to sign on behalf of the company (Prokura) or other power of representation such as Zeichnungsberechtigung" and who could present a corresponding certificate issued by the employer. This former practice led to problems of definition and according to the new memorandum of understanding may no longer be applied for assessment periods commencing after December 31, 2008.

This amendment should be observed with regard to employees holding positions as executive employees in Switzerland if their country of residence (and the country of residence of their family, as the case may be) is in Germany: lacking ability to submit an extract from the commercial register to the German tax authorities may lead to negative tax consequences in Germany.

International transfer pricing - recent developments

Salim Damji, Partner, Head of Transfer Pricing Schweiz; salim.damji@ch.ey.com
Ulrike Wolff, German Attorney at law, LL.M., M.R.F., Manager, Tax; ulrike.wolff@ch.ey.com

Transfer pricing continues to be a key issue for a large number of national tax administrations. Chinese subsidiaries with persistent losses or low profits will be preferred targets for transfer pricing audits.

By Guoshuihan No. 236 the Chinese State Administration of Taxation (SAT) directs local tax offices to review foreign-owned manufacturing subsidiaries more closely which report losses or only marginal profits. SAT officials tend to assume that such persistent losses or low profits are a result of the management of intercompany pricing intended to decrease the Chinese tax share. In fact, SAT statistics show that more than half of the taxpayers in China are not reporting profits despite a booming market situation as presented in the media.

Many companies that are experiencing a sudden drop in profitability, especially after expiration of tax holidays, are now likely to draw the attention of tax officials. Taxpayers might also become an audit target if tax officials consider their profit margins to be lower than the industry average. Moreover, royalty payments are often disallowed for certain loss-making companies based on the fact that the brand is considered to have no value since its use does not result in any kind of substantial profits. As a result, more and more foreign-owned companies will have to deal with some kind of transfer pricing adjustments in the future.

The SAT is also expected to release a further draft of its Regulation of Special Tax Adjustments circular after some key issues are resolved, such as thin capitalization and contemporaneous documentation. During audit processes, SAT officials tend to use primarily profit-based methods, most likely the transactional net margin method, usually disregarding the availability of CUPs justifying current arm's length returns. Accord-

ing to local experts, the situation will further worsen since it is expected that the forthcoming transfer pricing regulations will insist on an adjustment to the median for most cases.

In 2004 and 2005, the SAT selected more than 2000 cases for audit, but because of a highly centralized process, only 200 cases are currently decided for on a yearly basis. However, income adjustments are expected to increase substantially and many barriers

are raised to prevent taxpayers from filing appeals (such as extensive administrative burdens and information requests). In fact, most adjustments are already part of the local tax authority's yearly budget even before an audit process has been started.

Therefore, it is recommended to keep transfer pricing records for Chinese subsidiaries, in particular in persistent loss and low profit as well as royalty situations.

Developments in the OECD

Bernhard Hössli, Manager, International Tax Services; bernhard.hoessli@ch.ey.com

1 2008 update to the commentary on the OECD model convention

Three years on from the last revision of the OECD model convention and the accompanying commentary, the OECD approved a series of changes to the OECD model convention and commentary on July 17, 2008. The following is a brief explanation of the three key changes.

1.1 Art. 5 OECD model convention (taxation of services)

In line with the "residence-based theory," income from services is only taxed in the country where the income originates if it can be assigned to one of the service provider's permanent establishments domiciled there. In negotiating new double taxation agreements, OECD member states frequently found that non-OECD states resisted this regulation. In an attempt to take these circumstances into account, the OECD added a recommendation for an alternative clause in paragraph 42.23 of the new commentary on Art. 5 of the OECD model convention. According to this clause, services provided abroad can constitute an establishment and

thus justify limited tax obligations (source-based theory).

1.2 Art. 7 OECD model convention (international attribution of earnings)

The adoption of the Report on the Attribution of Profits to Permanent Establishments by the OECD Council on July 17, 2008, has far-reaching consequences for Art. 7 of the OECD model convention and the commentary on it. In the first phase, those parts of the report that do not contradict the applicable version of Art. 7 will be taken up in the commentary. This phase was implemented with the 2008 revision. Essentially, this is a question of the international attribution of the earnings of permanent establishments. This will be done according to the "Authorized OECD Approach" (AOA), which is based on the fiction that the permanent establishment is a separate company. The basis for international attribution of earnings according to the AOA is formed by the basic principles for checking transfer pricing between companies that the OECD published in 1995. The second phase will be revising Art. 7 of the OECD model conven-

tion and the commentary in line with the Report on the Attribution of Profits to Permanent Establishments.

1.3 Art. 25 paragraph 5 of the OECD model convention (arbitration clause)

Art. 25 of the OECD model convention has been expanded to include an arbitration clause (paragraph 5). This new clause is structured as an integral part of the negotiation process and not in the form of a new article. It seemed simpler to make the new regulations attractive for the representatives of the OECD member states in this way. Accordingly, a case can be taken before an arbitration tribunal if the contracting states do not come to an agreement within two years from the start of the negotiation process. However, the prerequisite for being heard by the arbitration tribunal is that a double taxation agreement is entered into and the case has not already been decided by a court in the contracting states. If the tax-paying party does not agree with the solution found by the arbitration tribunal, then it has the right to reject the decision and take the case to the domestic courts.

2 Information for the treatment of Collective Investment Vehicles

2.1 Background

At present, Collective Investment Vehicles (CIVs) and their investors are not regulated in a satisfactory manner either by the OECD model convention or its accompanying commentary. Therefore, the Committee on Fiscal Affairs (CFA) founded the Informal Consultative Group (ICG) in 2006. This committee is currently working on a report on the tax treatment of CIVs and the granting of tax relief for cross-border investors. On these issues, the ICG is in contact with the European Commission, which is working on a similar project.

2.2 Status of the work

Technical aspects: The favored approach is essentially to treat CIVs as being domiciled in the contracting state and as the beneficial owners of the income earned. However, the contracting states can decide whether to grant the benefits from the agreement only to the investors entitled according to the agreement or whether they grant the

benefits relative to the CIV's overall income, if investors entitled by the agreement participate in the CIV to a certain extent. As an alternative, it should be possible to "look through" the CIV. This approach should be used if the investor (e.g. a pension fund) can claim extensive or complete repayment of the foreign withholding tax due to direct participation. Moreover, investors should be able to receive foreign tax credits for withholding taxes accrued on the level of the CIV.

Procedural aspects: The goal of the ICG is to develop an efficient system that works with the smallest administrative expense possible, and also facilitates the enforcement of

the domestic laws of the two contractual states. Thus it is especially important to create rules that make it possible to identify the beneficial owners of the income earned by the CIV. To ensure this, the ICG is considering creating a kind of incentive system, so that every CIV that would like to claim benefits from the pooled refund has to submit information to the originating country about the beneficial owners of the income. By exchanging information, the originating country can then pass on this data to the beneficial owner's country of domicile and thus ensure the taxation of the income.

The final report should be published in January 2009.

Taxation of EU savings income back on the agenda

Alberto Lissi, PhD (Law), Lawyer, Swiss Certified Tax Advisor, Partner, Tax Services - FSO; alberto.lissi@ch.ey.com
Janine Ziegler, lic. iur., Assistant, Tax Services - FSO; janine.ziegler@ch.ey.com

Interest earned on savings in the EU has been subject to Council Directive 2003/48/EC (EU Savings Tax Directive) since July 1, 2005. The Directive regulates the taxation of interest payments made to individual persons resident in the EU by countries outside their state of residence and endeavors to tackle the problem of tax evasion. The EU has a separate bilateral agreement with Switzerland on the taxation of savings income which aims to make it impossible for individuals to circumvent the Directive by opting to invest in Switzerland instead of in an EU Member State. In contrast to the vast majority of EU Member States, Switzerland does not take part in this exchange-of-information regime involving the automatic disclosure of interest payments made to EU residents. Instead, it safeguards these tax receipts by imposing a 20% withholding tax (since July 1, 2008, which will be increased to 35% from July 1, 2011) and passes on the revenue to the investor's state of residence - thereby leaving Swiss banking secrecy intact.

Based on Art. 18 of the EU Savings Tax Directive, on September 15, 2008, the European Commission published its first report on how the Directive had fared in its first three years. While the Directive proved effective within the limits set by its scope, the evaluation revealed that it had numerous loopholes. For example, income earned by Liechtenstein foundations and trusts was not reported as the present Directive made it possible for natural persons to get round this by channeling their assets to an interposed legal person or arrangement. In response, the European Commission put forward corrections which mainly related to the term "beneficial owner," the definition of paying agent and treatment of financial instruments.

The EU would like to close these loopholes as fast as possible. But any amendments to the Directive need the unanimous consent of all parties. Austria and Luxembourg follow Switzerland's lead by imposing a withholding tax in the interests of keeping their

banking secrecy intact and would obviously repel any efforts to amend the Directive as long as non-EU countries such as Switzerland were not equally obligated to apply the new regulations.

Under the agreement between Switzerland and the EU, any amendments to the Directive can only be made once sufficient experience has been gained from the full imposition of the withholding tax regime. This will not be the case until 2013 at the earliest, i.e., any demands by the EU for a revision of the agreement on the Savings Tax Directive prior to this date could be rejected. Switzerland is, however, basically willing to engage in talks with the EU as to the possibility of extending the Directive's scope. But, at the same time, it must be pointed out that any broadening of its scope will only go to increase the attractiveness of more distant tax jurisdictions outside the EU. This could be counteracted by concluding similar agreements between the EU and emerging Asian financial centers such as Singapore or Hong Kong.

Dumont Practice: bidding farewell to a Federal Supreme Court judgment

Urs Schüpfer, Partner, Corporate Tax; urs.schuepfer@ch.ey.com

Sereina Purtschert, Master's Degree in Law, Assistant, Tax Services; sereina.purtschert@ch.ey.com

The Federal Supreme Court's passing of the so-called "Dumont Judgment" in 1973 heralded in a change in the practice concerning deduction of expenses related to the maintenance of private property. The Federal Court restricted the deductibility of maintenance expenses incurred immediately upon ownership of newly purchased property. A parliamentary initiative gave the impetus for reconsidering the Dumont Practice which resulted from the Federal Supreme Court's decision of 1973. After the National Council (Nationalrat) had spoken clearly in favor of abolishing the Dumont Practice with a vast majority, the Council of States (Ständerat) also approved the abolishment of this practice in its fall session.

The essence of the Dumont Practice

With its decision in 1973, the Federal Supreme Court heralded in a fundamental change in the practice concerning tax relief for maintenance expenses, which was concretized in 1997. Since then, a property owner can, as a general rule, claim to deduct maintenance and operating costs for their property. However, expenses incurred by the new owner to restore the newly purchased property, which had been poorly maintained by the previous owner are not tax deductible during the period of the first five years. The Federal Court based its decision on the principle of economic performance and considered costs for maintenance work which are incurred during the first five years after purchasing the property as cost of acquisition and therefore not deductible. Likewise, the principle of equality before the law was not guaranteed in the eyes of the Federal Court on account of such deductibility. By restricting the deductibility, a person who purchases a poorly

maintained or neglected property at a correspondingly lower price is put on par with someone who buys a renovated property at a correspondingly higher price.

Abolishment versus continuing with the Dumont Practice

According to those in favor of abolishing the practice, there is no justification for treating the former and new property owners on different terms. A change of ownership ought to have no influence on the taxation of the incurred maintenance costs for the lifetime of the property. Not granting tax deduction in this respect dissuades many taxpayers from purchasing old buildings in a very poor state of repair. For those in favor, abolishing the Dumont Practice would be a means to encourage individuals to purchase residential property. Besides, abolishing this practice would promote building activity which in turn would have a positive influence on the construction industry.

Those against abolishing the Dumont Practice insist that the Dumont Practice is applied in very few cases, as nowadays only a very small number of properties are considered neglected or in need of repair. Furthermore, the opponents dispute the positive effect on the construction industry and fear a price increase of old property, which, owing to the abolishment of the Dumont Practice, would become more attractive. In addition, a more stringent practice - which will consequently affect all property owners - of distinguishing between maintenance costs aimed at preserving the value of the property and those aimed at increasing the value of the property is also expected.

Consequences of abolishing the Dumont Practice

By abolishing the Dumont Practice, all maintenance costs would be fully deductible for the new owner too. This would be laid down in the tax laws.

Indeed, fully abolishing the Dumont Practice would inevitably bring in its wake several changes to the real estate capital gains tax in the cantons. Thus, maintenance costs to restore the newly purchased property, which would be fully deductible as a result of abolishing the Dumont Practice, would no longer be attributable to the purchase price at the time of calculating the real estate capital gains tax at the cantonal level. As a result, the taxable profit after the sale of a property would increase, which in turn would lead to a higher real estate capital gains tax. However, income tax deficits could be covered at the cantonal and municipality level in most cases from the increased real estate capital gains tax (in the case of a sale). This is not possible on a federal scale, as a real estate capital gains tax does not exist at this level.

Approval in Parliament

The impetus for reconsidering the Dumont Practice came from a parliamentary initiative, which demanded a relaxation of the Dumont Practice (reducing the five-year period) at a federal level. Subsequently, the Committee for Economic Affairs and Taxation of the National Council prepared a bill aimed at the complete abolishment of the Dumont Practice at a federal level. The Federal Council even went one step further and emphasized in its statement that abolishing the Dumont Practice solely at the federal level would be a wrong step and that it would represent a wrong approach and spoke for abolishing the practice at a federal and cantonal level. This opinion was endorsed by the Committee for Economic Affairs and Taxation of the National Council, also due to findings from the consultation procedure in which the majority of the cantons and a majority of the organizations were strongly in favor of abolishing the Dumont Practice fully. The motion of the Committee to abolish the Dumont Practice on a federal and cantonal level was accepted by the National Council by a significant majority during its spring session.

During its fall session, the Council of States as well had agreed to the abolishment of the Dumont Practice. Should no referendum take place against the abolishment of the Dumont Practice, then an amendment in

the law is expected at a federal level as early as for the tax year 2010. After the law has come into force, the cantons will have a period of two years to adapt their legislature to the new directives. At the end of this

period, the new provisions of the tax harmonization law shall be applied directly, in case the cantonal tax laws contradict the new law.

Tighter regulations on the valuation of securities without a market value

Wealth tax on shareholders in SMEs to triple as of January 1, 2011?

Walo Stählin, Partner, Tax; walo.staehlin@ch.ey.com
Lucie Detrych, Assistant, Tax; lucie.detrych@ch.ey.com

In its circular of August 28, 2008, the Swiss Tax Conference revised and significantly tightened its guidelines on the wealth tax-related valuation of securities without a market value ("the Guidelines"). The revised version is to apply to valuations with the balance sheet date of January 1, 2008, or later and primarily affects trading, industrial, and service companies whose equities are not traded on any stock exchange. Their stockholders are likely to face a significant wealth tax increase if the capitalized income value is zero.

Changes at a glance

- ▶ Changes to the calculation of capitalized income value from 2008
- ▶ Minor amendments with regard to net asset value from 2008
- ▶ Material changes to the calculation of enterprise value for trading, industrial, and service companies from 2011

Capitalized income value of the company

The company to be valued can now choose between two capitalized income valuation models. The first model is based on the financial statements of the two previous years, with net profit for the last financial

year weighted double. The second model is based on the last three years' financial statements but weights all three financial years equally.

The formerly used risk impact, which used to allow valuing average net profit 30% lower, has been replaced by a slightly higher capitalization rate. As a consequence of this slightly higher rate, the capitalized income value tends to be lower.

As before, the applicable capitalization rate will be published annually in the FTA rates table.

Net asset value of the company

The maximum permissible deduction from untaxed hidden reserves, where these are included in valuations, to account for deferred taxes is now 15% instead of 20%.

Such deductions for deferred taxes were previously permissible for nonoperational properties, developed or undeveloped, only where such properties were recorded at market value or at capitalized income value. This provision now applies to operational properties as well.

Changes to the calculation of enterprise value

Consequently, the changes to the capitalized income value and the net asset value have a knock-on effect on how the enter-

prise value of trading, industrial, and service companies is calculated. In most cases, this will likely result in a higher tax burden on stockholders.

The Guidelines, although published in August 2008, will come into force retroactively with effect from January 1, 2008.¹

Who is affected?

Individuals who own participation rights in limited companies are subject to wealth taxation at the cantonal and municipal levels for those rights. Previously, the taxable value of participation rights in the form of unlisted securities used to be calculated according to the 1995 guidelines (Wegleitung 1995 in German).²

How did it work up to now?

In terms of the 1995 guidelines and those of the Swiss Tax Conference³, the enterprise value of trading, industrial, and service companies used to be calculated according to the mean value method. The mean value method assigns a double weighting to the capitalized income value and a single weighting to the going concern value of assets, and then divides the sum of these values by three.

This made it possible to minimize the wealth tax burden on stockholders of SMEs with no or little profit, in particular.

What is going to change?

In terms of the recently revised Guidelines, the Swiss Tax Conference is planning to introduce a minimum value as the enterprise value applicable to trading, industrial, and service companies. *According to margin number 36, this minimum value corresponds to the going concern value of a company's assets.* This provision is due to take effect on January 1, 2011.⁴

What effects does this have?

Previously, if the net asset value was divided by three under the mean value method with a capitalized income value of zero, the resulting enterprise value was merely a third of the net asset value. Now, by contrast, the total net asset value will be used as the enterprise value.

Given that thousands of SMEs usually pay tax on little more than their net asset value, this change will combine with the other more rigorous provisions to massively increase tax burdens.

Basing the enterprise value only on net asset value is not economically justifiable. In practice, the capitalized income value plays a far more important role.

Interpellation by H. Germann

Hannes Germann, member of the Council of States, submitted an interpellation on October 1, 2008, calling on the Federal Council to review the clause governing the basis of minimum valuation. Germann, along with many companies, takes issue with the idea of these stricter provisions coming into force without a clear legal basis. The Federal Council has yet to respond.

Conclusion

Should the Guidelines (effective 2008) and the controversial provision in margin number 36 (effective 2011) remain in their current form, the stockholders of medium-sized businesses will most likely face higher wealth taxes. This eliminates in part the advantage afforded them by the partial taxation of dividends (in terms of Swiss company taxation reform II). Likewise, it offsets the cantonal "brake on the wealth tax" as practiced by a number of cantons, including Bern.

In terms of the changes to the calculation of capitalized income value, the new Guidelines do provide some leeway for planning. In the future, businesses will need to consider in good time which model for calculating capitalized income value may suit them better, not least because they will have to follow the same model five years in a row.

¹ Guidelines on the wealth tax-related valuation of securities without a market value (Wegleitung zur Bewertung von Wertpapieren ohne Kurswert für die Vermögenssteuer, in German), Circular 28 of August 28, 2008, Section 3.2; <http://www.steuerkonferenz.ch/d/aktuelles.htm>

² Guidelines on the wealth tax-related valuation of securities without a market value (Wegleitung zur Bewertung von Wertpapieren ohne Kurswert für die Vermögenssteuer, in German), 1995 Edition, published by the Swiss Tax Conference and the Swiss Federal Tax Administration's securities valuation department.

³ Guidelines on the wealth tax-related valuation of securities without a market value (Wegleitung zur Bewertung von Wertpapieren ohne Kurswert für die Vermögenssteuer, in German), Circular 28 of August 21, 2006

⁴ Guidelines on the wealth tax-related valuation of securities without a market value (Wegleitung zur Bewertung von Wertpapieren ohne Kurswert für die Vermögenssteuer, in German), Circular 28 of August 28, 2008, margin no. 36; <http://www.steuerkonferenz.ch/d/aktuelles.htm>

Is there any Swiss withholding tax obligation for Swiss employers regarding work activities performed for them in a country without a double taxation agreement?

Andreas Tschannen, Executive Director, Tax; andreas.tschannen@ch.ey.com

Michelle Fahrni, Senior, Tax; michelle.fahrni@ch.ey.com

According to a decision of the Administrative Court of the Canton of Zurich on January 23, 2008 (No. SB.2007.00078), the presence of the employee in Switzerland is an absolute requirement for withholding tax obligations as defined by the Swiss Direct Federal Tax Act (DBG) to arise. The practice according to which the accrual of value generated by a Swiss source was sufficient to create a withholding tax obligation, valid under the Federal Council's decision on levying direct federal taxes (BdBSt), is thus to be discontinued. The decision is, however, the subject of an appeal to the Federal Court.

Background

A German citizen with tax residence in Switzerland was employed by a company domiciled in the Canton of Zurich. The employee was subject to Swiss withholding taxes. On May 1, 2006, the employee relocated to Qatar (a country with which Switzerland does not have a double taxation agreement) and continued to work there for the Swiss company, which continued to pay his salary. The company withheld Swiss taxes from the employee's May and June 2006 salary payments, even though the employee was no longer working in Switzerland. This case then generated a controversy as to whether the employee could be reimbursed for the withholding taxes already paid in May and June 2006, in light of the fact that his withholding tax obligation ended on May 1, 2006, when he moved to Qatar.

The Tax Office of the Canton of Zurich took the position that the work in question does not have to be performed in person in Switzerland in order to establish the eco-

nomic connection as per Art. 5 DBG; instead, the accrual of value from a Swiss source is sufficient to justify the levying of Swiss withholding taxes. After the objection was rejected, the Swiss employer appealed the case to the Tax Appeal Commission, which concluded that the income earned from May 1, 2006, onwards is no longer subject to withholding taxes and ordered that the employee be reimbursed for the taxes already withheld. The Tax Office of the Canton of Zurich subsequently submitted a complaint to the Administrative Court, which however then essentially confirmed the decision of the Tax Appeal Commission.

Taxation principles according to domestic regulations and the OECD model convention

Because there is no double taxation agreement with Qatar that would restrict fiscal jurisdiction, the possible presence of (withholding) tax obligations is to be assessed according to domestic regulations, from June 1, 2006, onwards. Article 5 of DBG, mentioned above, regulates the tax obligations of natural persons who do not have a tax domicile or residence in Switzerland. According to this article, natural persons have tax obligations when they work in Switzerland. The issue here is whether presence in Switzerland is a prerequisite for such work or whether an accrual of value from a Swiss source is, by itself, enough for taxes to be levied. The Administrative Court requires an actual presence, basing its standpoint on the principle of good faith and on a common-sense interpretation of the concept of "work." Furthermore, this line of argumentation is also supported by the OECD model convention, in which the employee must be personally present for the work to be considered as performed for tax purposes. Art. 15 of the OECD model convention, which enables Swiss taxation

according to the work location principle (instead of the domicile principle), is however mitigated by the fact that the German employee had not worked in Qatar on a temporary basis and had exceeded 183 days (183-day clause).

The principle that the presence of the employee is required in order to levy withholding taxes receives additional support from the laws and ordinances on withholding taxes. According to Art. 91 DBG, those who are employed in Switzerland for a short period of time (or as cross-border or weekly commuters) must pay withholding taxes. This is another example in which the work's actual location in Switzerland is clearly indispensable.

The argument made by the Tax Office of the Canton of Zurich that the concept of "work" in Art. 5 DBG is not necessarily to be equated with an activity performed "in person" could not be confirmed. Furthermore, arguments that had been raised in connection with different cases concerning senior managers were not relevant because the German employee was not a senior manager.

Summary

In conclusion, we can state that according to Art. 5 DBG, a natural person who works in Switzerland is only subject to withholding taxes if he or she is physically present in Switzerland, irrespective of whether the employee is paid by a Swiss company and whether he or she is a senior manager (except in the relationship between Germany and Switzerland, in which senior managers' tax is regulated separately under the double taxation agreement). However, it remains to be seen whether the Swiss Federal Court will confirm this interpretation.

Changes in relation to withholding tax, stamp duty and lump-sum tax imputation

Noëmi Schenk, Master's Degree in Law HSG, Assistant, Corporate Tax Services; noemi.schenk@ch.ey.com

The changes to the ordinances in relation to stamp duty, withholding tax and lump-sum tax imputation, as adapted by the Federal Council on September 15, 2008, include a considerable number of conceptual amendments to the ordinances, bringing them into line with the new terminology used in various revised federal laws and implementing the changes at the ordinance level which have already been clearly defined in those laws. In addition, the proposed amendments also include some new regulations which are presented in brief below.

Ordinance on Stamp Duty

Obligation to submit annual accounts

Pursuant to the Federal Council decision of April 13, 2005, regarding the implementation of Aufgabenverzichtplanung (part of the Federal Council's series of cost-cutting measures), Art. 9 para. 4 will be amended to state that limited companies must only submit their annual accounts on their own initiative if their total assets exceed CHF 5 million or if they have to pay share issuance tax on the basis of their self-declaration.

Duty on insurance premiums

A third sentence will be added to Art. 28 para. 1 to clarify that premium invoices may also be used for secondary objectives provided that there is a legal basis for the claim and that it is clearly designated and shown as a separate amount.

Swiss Federal Withholding Tax Act Implementing Ordinance

Obligation to submit annual accounts

Like the Ordinance on Stamp Duty, Art. 21 para. 1^{bis} restricts the obligation to submit annual accounts to limited companies 1.) with total assets exceeding CHF 5 million, 2.) whereof a benefit is taxable, 3.) which have benefitted from a double tax treaty and 4.) which are assessed pursuant to Art. 69 DBG or 28 StHG (participation deduction).

Declaration procedure

Art. 26a paras. 1 and 3 and Art. 38a allow the declaration procedure to be applied to collective capital investments and public-sector entities, and extend it to include all types of dividends (previously restricted to cash dividends).

Ordinance on lump-sum tax imputation

Art. 5 para. 4 governs lump-sum tax imputation within the context of the different regulations to lighten the burden of double

taxation at federal and cantonal level. The entitlement to lump-sum tax imputation is reduced or does not apply to dividends which are not taxed at all or taxed at a reduced rate. The various relief methods have to be taken into account.

Entry into force

Except for the regulations on insurance premiums duty, the proposed changes will enter into force on January 1, 2009.

VAT reform: the story so far...

Barbara Henzen, Master's Degree in Law, Attorney at Law, Swiss Certified Tax Advisor, Partner, Tax Services; barbara.henzen@ch.ey.com

Patrick Lehmann, Master's Degree in Law, Attorney at Law, Indirect Tax Services; patrick.lehmann@ch.ey.com

1 Background

Since its introduction in 1995 VAT has established itself as the federal government's most important source of income. The Federal Council's report "10 years of Value Added Tax" revealed, however, that there is a fundamental need for reform at various levels.

2 Message in two parts

Based on the results of the consultation draft published in 2007 relating to the simplification of the Swiss VAT Act, the Federal Council on June 25, 2008, approved a message in two separate parts (A and B), which can be debated independently of one another.

Part A proposes a complete revision of the VAT Act but leaves the (three) existing tax rates and the fiscal exceptions unchanged.

Part B on the other hand proposes the introduction of a single VAT rate and the elimination of many fiscal exceptions, in addi-

tion to the complete revision foreseen under Part A.

In the consultation process in 2007 the first part generally encountered widespread approval, while the single tax rate and the extensive curtailment of fiscal exceptions proved controversial.

2.1 Part A: complete revision of the VAT Act with over 50 measures

Part A, with the complete revision of the VAT Act, constitutes the mainstay of the reform. The legislative changes are intended to simplify the system and enhance legal certainty and transparency via amendments to over 50 points of law (e.g. definition of key terms; the place-of-receipt rule as a residual concept; own consumption reduced to an input-tax correction mechanism; abolition of own-consumption deductions in the construction sector; significant changes to procedural law; etc.).

2.2 Part B: single tax rate of 6.1 percent and elimination of exceptions

In the second part of the message, the Federal Council recommends (in addition to the measures in Part A) the introduction of a unitary tax rate of 6.1 percent and the elimination of as many exceptions as possible. Exemptions from tax liability would only be granted if the administrative cost were out of all proportion to the income (e.g. primary production) or if it were technically virtually impossible to determine the tax base (e.g. financial and insurance services or sale and lease of real estate etc.).

3 Status of reforms

On August 25, 2008, the National Council's Committee for Economic Affairs and Taxation (WAK-N) commenced discussion on the VAT reform. In the debate scheduled for its next meeting, in October 2008, the committee will decide whether the two parts should be dealt with at the same time or at different speeds.

The completely revised VAT Act is not expected to enter into force before 2010.

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