

# Tax News

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Dear Reader

Internal cash management and cash repatriation has always been a topic of high importance for multinationals. Today with the tightening of the credit crisis and the reduction of credit lines, corporations are more than ever looking for new strategies to optimize their internal cash position.

Even financially stable companies can be the victim of a disruption in their supply chain if some entities become unable to finance raw materials or inventory. Therefore implementing effective cash management strategies has become a priority for many international companies.

Multinationals facing the prospect of cash shortages can apply different strategies to facilitate the flow of internal cash: payment of dividends, intercompany loans, renegotiation of terms from one entity to another, temporary reorganization of the supply chain, etc. However, each such method needs to be applied carefully as it often results in changes of tax rates or function and risk reallocations. Whenever doing cash-planning it is important to do it in a tax-efficient manner, be it by minimizing withholding taxes on distributions, by avoiding the consumption of tax loss carry forwards with basically tax-exempt dividend income or by avoiding transaction taxes, by reducing custom duty costs or by accelerating VAT recovery.



Further information on the different methods which can be used to maximize the utilization of internal cash resources can be found in this edition of Tax News.

Finally I would like to inform you that this was my last issue of the Tax News. As of January 1, 2009, I will join the global Tax leadership team of Ernst & Young as Global Director of Indirect Tax.

My successor as Head of Tax and Legal Services in Switzerland will be Dominik Bürgy. He has been a Partner at Ernst & Young since 2002. Aged 42, Bürgy is a lawyer and certified tax expert and a member of the Management Board of the Swiss Institute of Certified Accountants and Tax Consultants. Within the international Ernst & Young organization, he is a member of the management body for Tax Services in the GSA region, which comprises Germany, Switzerland, and Austria.

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# Developments in international tax legislation

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## 1. EU tax dispute

On September 23, 2008, Ambassador Alexander Karrer, leader of the Swiss delegation, informed representatives of the European Commission in Brussels about the current status of the work towards a new corporate tax reform. He reports that there was no in-depth discussion at this meeting about the contents of a possible reform. At the annual meeting on the bilateral free-trade agreement between Switzerland and the EU, held on November 20, 2008, the EU expressed concerns about the new Swiss regional policy, which they feel creates increased incentives for businesses to relocate to Switzerland.

After achieving the objective of the dialogue, i.e. to clarify the two standpoints, during the first three roundtable discussions, the Federal Council were then extremely tight-lipped following a closed session regarding the tax dispute with the EU on November 27, 2008, and went no further than announcing further reform steps to provide tax relief for companies.

On December 10, 2008, Minister of Finance Hans Rudolf Merz presented the strategies developed by the "International Tax Competition" working group for a planned Corporate Tax Reform III. He explained that the abolition of one-time capital duty on equity and debt capital, together with the exemption of intra-group transactions from withholding tax and stamp duty, should make Switzerland more attractive as a business location. The cantons would also be authorized to choose whether or not to levy corporate capital tax. As a concession to the EU in the tax dispute, under the planned reform, both foreign and domestic income generated by holding and auxiliary companies will be handled in the same way for tax purposes. It is also envisaged that the current ban on business activities carried out by holding companies in Switzerland will be extended to include foreign activities as well. The status of "domicile company" is to be abolished meaning that all affected companies would have to be converted into

mixed companies. The proposal for a uniform corporate income tax, however, has come up against a large amount of opposition from the cantons and is not to be pursued any further due to fiscal concerns.

It is in the interests of Switzerland as an investment location that a solution to the tax dispute should be worked out as quickly as possible. Given the prevailing global tax competition and the criticisms that are still being voiced by EU member states, continued legal uncertainty could prove disadvantageous for Switzerland, and so Minister of Finance Hans-Rudolf Merz's presentation of Corporate Tax Reform III is a welcome development in that this reform should not only solve the tax dispute with the EU but also enhance Switzerland's attractiveness as an investment location.

## 2. New and ratified double taxation agreements

A number of double taxation agreements have recently been concluded or ratified, and a number of existing double taxation agreements are currently undergoing revision. The following is an overview of the most important changes introduced to Switzerland's network of agreements.

### 2.1 Ghana

(New agreement signed)

On July 23, 2008 in Accra, Switzerland and Ghana signed a double taxation agreement initialed in March of this year. The agreement covers taxation of income, assets and capital gains. The agreement mostly follows the OECD model convention and is in line with Switzerland's agreement practice. Residual withholding tax on profit distributions is 15% but this reduces to 5% for companies with a participation quota of 10% or greater. Residual withholding tax was negotiated at 10% for interest and 8% for license fees.

### 2.2 Great Britain

(Proposal by the Federal Council approved)

On August 27, 2008, the Federal Council approved the protocol to amend the double

taxation agreement between Switzerland and Great Britain to avoid the double taxation of income. The protocol will be dealt with by the Federal Parliament in the December 2008 session. The Council of States already approved the agreement on December 2 and it is expected that the National Council will do likewise. The agreement could then come into force as early as January 1, 2009. Residual withholding tax on profit distributions is generally 15% but reduces to 0% for pension funds and companies with a participation quota of at least 10%. With regard to interest and license fees, the source country continues to have no rights to residual withholding tax.

### 2.3 Columbia

(Proposal by the Federal Council approved)

On May 21, 2008, the Federal Council approved the proposal for a double taxation agreement with Columbia to avoid the double taxation of income and assets. The agreement mostly follows the OECD model convention and is in line with Switzerland's agreement practice. For dividend payments, residual withholding tax is generally 15%; with a participation quota of 20% or more, the source country can no longer tax a company for profit distributions. It was also agreed that residual withholding tax on interest and license payments would be 10%. It should be noted that, along with payments which ordinarily fall under the term "license fees", payments for technical support, technical services and advisory services are also included. Also of interest is the anti-abuse clause included in the double taxation agreement in the form of a conduit regulation.

### 2.4 Pakistan

(Ratification documentation exchanged)

In Islamabad on November 24, 2008, Switzerland and Pakistan exchanged the ratification documentation relating to the double taxation agreement signed in July 2005 covering the taxation of income. The provisions of the agreement apply from January 1, 2009 in Switzerland and July 1, 2009 in Pakistan. In terms of content, the agreement mostly follows the OECD model convention and is in line with Switzerland's agreement practice. Residual withholding tax on profit distributions is 20% but this re-

duces to 10% for companies with a participation quota of 20% or greater. A 10% residual withholding tax on interest and license fees was agreed to. The source country is entitled to levy a withholding tax of 10% on

payments for technical services. This rule is, however, subject to a protocol provision according to which the Pakistani withholding tax remains limited to 7.5% as long as Switzerland does not levy a withholding tax on

these types of services. Upon proof of the relevant expenses, just 80% of gross pay is used as the basis for the calculation. As a result, the withholding tax in Pakistan effectively stands at 6%.

## Amendment to the Savings Tax Directive

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**Following its report on the application of the Savings Tax Directive (hereinafter "Directive") of September 15, 2008 (see October's edition of EY Tax News), the European Commission submitted an amendment to the Directive on November 13, 2008.**

**The Commission now proposes amending the Directive to reflect the findings of its report and by doing so eliminate existing loopholes.**

The Commission suggests the following main amendments to the Directive:

### **Expansion of scope of application to include income equivalent to interest**

The scope of application of the Directive should be expanded to include income from innovative financial vehicles which are in actual fact equivalent to interest-bearing forms of investment. These are securities with protected capital and returns on investment that are predefined at the time of issue. Life insurance contracts should also fall under the Directive if their performance is strictly linked to income from debt claims or equivalent income and if they have less than 5% risk coverage.

### **Income from investment funds**

As far as investment funds domiciled in the EU are concerned, only income from undertakings for collective investments (UCITS; see UCITS Directive 85/611/EEC) is taxed. Income from investment funds is now to be subject to taxation irrespective of the legal form of the fund in question.

### **Treatment of intermediate structures**

To solve the problem of intermediate structures, the Commission proposes introducing two models, their employment of which depends on the circumstances in question: (a) Paying agents established in the EU which make interest payments to intermediate structures established outside the EU are recommended to apply the Directive as if the payment were made directly to the individual in question. (b) In the case of intermediate structures established in the EU, the Commission suggests treating them as "paying agents upon receipt", which means that upon receipt of any interest payment from an upstream economic operator (e.g. a bank) the

provisions of the Directive (exchange of information or withholding tax) must apply, irrespective of the actual distribution of any sums to the individual beneficial owners.

A "paying agent upon receipt" should include all entities and legal arrangements (trusts, foundations, etc.) which are not taxed on their income under the general rules of taxation in their member state of establishment.

### **Outlook**

The Commission's proposals must now be approved unanimously by the finance ministers of all the EU member states. The EU's Commissioner for Taxation and Customs, László Kovács, has indicated that the amendments could be approved this year and become effective as early as 2012. An amendment to the Bilateral Agreements such as the one between Switzerland and the EU is also to be reviewed.

## Germany: current trends

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### **Continuous use of a business facility does not, on its own, constitute a permanent establishment**

According to successive rulings of the German Federal Finance Court (BFH), the highest German tax court, the existence of a permanent establishment is conditional on the possession by the entrepreneur of a power of disposal which is more than temporary in nature over the business facility or installation used by him. The rulings state that an adequate power of disposal exists only if the taxpayer has a legal position of which he cannot readily be deprived. The mere performance of activities on the

premises of a contractual partner is not, of itself, according to the Court, sufficient to justify the required power of disposal and hence a permanent establishment. This was stated by the BFH in a judgment dated 4 June 2008 (I R 30/07). In addition to a time-related component, there must also be other factors indicating that the activity is established in a certain location. The plaintiff's ability to obtain access to individual premises of the contractual partner, and/or to use a telephone and fax machine installed there, was found not to be sufficient for the required establishment in a specific location if, as in the disputed case, the plain-

tiff merely made personnel available to perform services in his capacity as subcontractor. Justification for a permanent establishment is, according to the BFH, ultimately decided by whether an entrepreneurial activity is carried out in a business facility or installation with a fixed local attachment and whether such attachment indicates that the enterprise is to some extent rooted in the location where the entrepreneurial activity is carried out.

It remains to be seen whether the German tax authorities will apply the BFH's judgment in situations other than that to which the ruling relates. At the very least, the court ruling would need to be published to this effect in the German Federal Tax Gazette, and this has not yet happened.

### **Federal Ministry of Finance (BMF) versus BFH: deduction of certain losses by foreign establishments**

Until the 1998 assessment period, taxpayers could, as a general rule, apply to claim a tax reduction in Germany for fiscally negligible losses by foreign permanent establishments, even though revenues from such permanent establishments were exempted according to double taxation agreements (DTAs) (§ 2a, para. 3, German Income Tax Act (EStG), 1990). However, this tax deductibility did not extend to certain commercial losses by such establishments, among them those related to tourism services. According to its judgment of 29 January 2008 (I R 85/06), the BFH found this exclusion to be in contravention of European law; this suggests that similar decisions may be expected for the other activities listed in § 2a, para. 2 of EStG 1990 for which the deduction of losses is denied.

However, the German tax authorities do not intend to apply the BFH's ruling beyond the individual case which has been decided. As grounds for their non-application decree of 4 August 2008 (IV B 5 - S 2118-a/07/10012), they cite the ECJ's decision (handed down after the aforementioned BFH judgment) in the case of Lidl Belgium (C-414/06) dated 15 May 2008. The BMF states that it is therefore unnecessary, at least, to take account of losses by the EU establishment in the cases listed in § 2a, para. 2, EStG, if there is a general legal or actual possibility of utilizing the losses in the state where the establishment is located. The BFH's forthcoming decisions on § 2a, EStG, taking account of Lidl Belgium's case before the ECJ, are awaited with some excitement.

## **Transfer pricing ideas for efficient cash reallocation**

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In multinational companies, optimizing internal cash needs has always been challenging as cash is often retained in entities where it is not immediately needed. With the tightening of the credit environment, the situation has worsened and many multinationals are addressing the issue of internal cash management and cash repatriation. Reduced credit lines can paralyze operating functions in the supply chain if the company is unable to finance operating needs such as raw materials or inventory.

Transfer pricing can be used as a tool to meet short- or long-term cash needs. The following strategies provide an overview of cash repatriation possibilities.

The first strategy could involve the origination of a new transaction between two entities, such as the transfer of an intangible asset or the sale and leaseback of a fixed asset by a cash-poor entity to a cash-rich entity

which can result in the immediate release of trapped cash. However, it can also affect the function and risk allocation within the company, and it may result in high one-time time tax payments due to the large intercompany payments. Therefore, this strategy is more effective when the cash-poor entity has net operating losses.

The second possibility involves a modification of the terms and conditions of an existing intercompany transaction. For royalties and service fees, back-end fees could be replaced by up-front fees for example, allowing the cash-poor entity earlier access to the cash it needs. Likewise, extending receivables terms by cash-rich entities can bring immediate relief to cash-poor entities. This is an arm's length solution to the credit squeeze and is in line with most transfer pricing legislations as they often provide mechanisms to account for the extension of implicit financing through working capital

balances. However, intercompany agreements should be conducted to provide arm's length interest rates always taking into consideration local requirements (e.g. in the US, the rules require an arm's length interest rate to be used to accrue interest on intercompany balances exceeding 90 days).

The third strategy relies on intercompany loans granted to cash-poor entities. Following the arm's length principle, the intercompany loan should reflect terms and conditions of external debt available. The lending entity and the terms and conditions of the loan have to be selected carefully, since tax rates on interest income differ widely and withholding taxes might become due on the interest payments.

Another strategy requires a supply chain reorganization where cash-rich entities finance raw materials or inventory on behalf of entities performing routine functions, such as contract manufacturing or distribution. Distributors for example traditionally require high amounts of working capital to purchase finished goods. As a solution, entrepreneurial entities controlling the supply chain could retain the finished goods until the sale has been made by the distributors,

reducing the cash needs of the distributors. However, a modification of the supply chain usually implies a revision of the comparables analysis and may be very long to implement.

Finally, the repatriation of cash could be done through the payment of dividends. However, this method often is the least efficient, as dividends can only be paid up through the organizational structure.

These solutions can be used as a tool to optimize internal cash resources. However, they should be selected carefully and adjusted to each company's internal functions, risks and requirements. Our specialists will be happy to assist you and provide detailed guidance in the implementation of such strategies.

## Overview of amendments to cantonal tax laws for selected cantons

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### Canton of Zurich

#### **Rate reduction procedure for dividends - new directive from the Zurich Cantonal Tax Administration**

The revised version of Article 35 of the Zurich Cantonal Tax Act (ZCTA) came into force on 1 January 2008. Para. 4 of this provision regulates the reduction of double taxation of dividends from qualifying shareholdings. On 27 February 2008, the Zurich Cantonal Tax Administration has issued a new directive on this matter explaining how the new statutory provision is to be implemented in practice.

In the course of the Corporate Tax Reform II Article 7 Para. 1 of the Swiss Tax Harmonization Act (STHA) will be revised (effective as of 1 January 2009) to explicitly grant the cantons the right to introduce provisions for the reduction of the double taxation on dividends from qualifying shareholdings in the cantonal tax laws. By introducing a respective statutory provision, the Canton of Zurich is following the majority of the other cantons and the regulation on the Federal level (Art. 20, Para. 1bis, Direct Federal Tax Act (DFTA) - in force as of 1 January 2009). As the wording leaves the cantons largely free to choose their own method for achieving the reduction of double taxation, the different solutions adopted differ substantially. The details of the Zurich solution are briefly outlined below.

Following the explicit provision of the STHA, the minimum participation quota for claiming a reduction has been set at 10%. This quota is governed by the share in capital, not in votes, and the amount of the participation is determined on the dividend due date. The company paying out the dividends must be a limited company or cooperative with its registered office in Switzerland. In applying this restriction, the Zurich legislature is again following the majority of cantons, but is diverging from the solution at federal level which also applies to distributions by foreign companies. According to the wording of the law, the privilege applies to "distributed profits" which, according to the directive, include dividends and liquidation proceeds in the form of open and hidden distributions of profits, capital repayments for bonus shares and income from transposition and indirect partial liquidation. Distributions based on participation certificates and dividend right certificates also qualify for the relief, provided there is a participation of at least 10% in the capital. It should be noted that the reduction of the double taxation in the Canton of Zurich - as in all other cantons except Uri, which follows the Federal solution in this regard - is achieved by reducing the tax rate, not the assessment basis. Consequently, this is not a partial taxation procedure but a partial rate procedure. Regardless of whether the investment is held as part of private or business assets, the tax rate reduction is 50%.

### Canton of Aargau

#### **New tax rates for limited companies and cooperatives - crediting of income tax to capital tax**

The Canton of Aargau is amending Article 75 of its Cantonal Tax Act (ACTA), introducing new tax rates, which will apply to limited companies and cooperatives as from 1 January 2009 onwards. Until now, the basic corporate income tax for limited companies and cooperatives has been 7% on that portion of net income not exceeding 5% of the equity capital, but at least on the first CHF 100,000, and thereafter 11% of taxable net income. Basic corporate income tax will now be 6% on the first CHF 150,000 of taxable net income and 9% on the remaining net income. This amendment, together with the reduction in the cantonal tax multiplier which already came into force on 1 January 2008, causes a reduction in the maximum effective tax rate (based on profit before tax) from approx. 22.32% in the tax year 2007 to approx. 19.75% in the tax year 2009, moving the Canton of Aargau into the upper mid-field as compared to the other cantons.

Article 30, Para. 2 of the STHA will come into force as of 1 January 2009, empowering the cantons to make provision in their cantonal tax laws for crediting income tax to capital tax. At the same time, the new Article 86 of ACTA - Para. 4 of which provides

for income tax to be credited to capital tax – will come into force. Aargau, then, is following Appenzell Innerrhoden (1 January 2007) and Thurgau (1 January 2008) in becoming the third canton to grant this relief to legal entities.

There is a dovetailing effect between the two new amendments in the Canton of Aargau that are described above. The introduction of a two-stage, progressive corporate income tax rate that is independent of return may constitute a drawback for highly capitalized companies, but this may be compensated by crediting income tax to capital tax.

#### **New leaflet on tax exemption for legal entities**

On 1 October 2008, the Aargau Cantonal Tax Administration issued a new leaflet on tax exemption for legal entities with public or charitable purposes, essentially based on Federal Tax Administration (FTA) Circular no. 12 dated 8 July 1994. The Cantonal leaflet follows the same structure but is less detailed. It is advisable to submit the specific circumstances of a case to the tax authorities for preliminary review. Attention should also be paid to the detailed practical notes of the Swiss Tax Conference dated 18 January 2008.

## **Cantons of Basel-Stadt and Basel-Landschaft**

In order to improve intercantonal competitiveness, the cantons of Basel-Stadt and Basel-Landschaft have adjusted their tax laws as of January 1, 2008. For legal entities, the changes mean, first and foremost, a reduction of tax rates.

A reduction of the double taxation burden for shareholders through the partial taxation of dividends has only been introduced in the canton of Basel-Landschaft. Alongside Corporate Tax Reform II, which comes into force at federal level for the 2009 tax period, the canton of Basel-Landschaft's new tax law already provides for the partial taxation of dividends for shareholders and came into force on January 1, 2008. However, there is still no sign of any agreement on this matter in the high-tax canton of Ba-

sel-Stadt. When adopting the tax package for 2008, the Great Council of the canton of Basel-Stadt rejected for the time being a motion to introduce the partial taxation of dividends.

#### **Basel-Stadt**

The canton of Basel-Stadt has amended its Tax Act in relation to corporate taxation for the 2008 tax period as follows:

##### **Reduction of the maximum corporate income tax rate**

The previous maximum corporate income tax rate of 24.5% has been gradually reduced since January 1, 2008. The maximum corporate income tax rate for the 2008 tax period is only 23% and will be reduced further to 22% for 2009.

##### **Reduction of the real estate tax/ minimum tax**

Legal entities pay a real estate tax to the canton of Basel-Stadt on properties located within the canton. This is levied based on the value of the real estate at the end of the tax period. Real estate tax is, however, credited against corporate income tax and capital tax for the same tax period and therefore only has to be paid if it exceeds the corporate income tax and the capital tax. From the 2008 tax period, real estate tax is down from 4‰ to just 2‰ for all legal entities subject to taxation.

##### **Offsetting of operating losses against real estate gains**

The canton of Basel-Stadt Tax Act has also been adjusted to bring it into line with Federal Supreme Court decision BGE132 I 220 regarding the offsetting of intercantonal allocation losses.

As of January 1, 2008, business losses that cannot be offset against taxable profit can be offset against real estate gains from sales of property subject to real estate capital gains tax (similarly, business losses from the seven tax periods preceding the current business year should also benefit from this regulation).

Real estate capital gains tax will be assessed at the date of a property. An offsetting of operating losses can subsequently be requested once the definitive financial results

are available (e.g. by applying for a revision procedure).

#### **Basel-Landschaft**

##### **Reduction of the double taxation burden on shareholders (natural persons)**

Unlike the canton of Basel-Stadt, the canton of Basel-Landschaft has adjusted the cantonal law to bring it into line with Corporate Tax Reform II in order to reduce the double taxation burden with effect from the 2008 tax period. The adjustments are as follows:

At the level of individuals, dividends, liquidation surpluses and pecuniary benefits arising from equity interests of at least 10% of a company's or cooperative's share capital, will only be taxed at half (50%) of the normal income tax rate, as of January 1, 2008.

In addition, the canton of Basel-Landschaft Tax Act relating to corporate taxation for the 2008 tax period has changed as follows:

##### **Corporate income tax/capital tax**

As of the 2008 tax period, new tax rates will apply in the canton of Basel-Landschaft for both corporate income tax and capital tax.

Until the end of the 2007 tax year, the corporate income tax rate was dependent on rates of return and was based on the relation between net income and average taxable capital. Under this system, the tax rate stood at a minimum of 6.5% and a maximum of 20%.

As of the 2008 tax period, the corporate income tax rate is generally 12% with the first CHF 100,000 being subject to a 6% tax rate. This change will not necessarily reduce the tax burden for all companies, but the new regulation does benefit companies that were subject to a tax rate of between 12% and the maximum 20% due to high levels of returns. Companies with low returns that up to now have been subject to a tax rate of between 6.5% and 11% could now, due to the change in legislation, be faced with a higher tax burden from the 2008 tax period onwards.

Municipality corporate tax rates remain unchanged at between 2% and 5% and are set

somewhere between this range each year by the municipalities.

As of the 2008 tax period, capital tax has been reduced to 1% of taxable capital (previously 2%). However, it should be noted that, at the same time, an adjustment for inflation is no longer granted when calculating capital tax. Previously, taxable capital was reduced in accordance with inflation dating back to January 1, 1987.

The reduction of the capital tax rate also affects municipal taxes. Municipalities in the canton of Basel-Landschaft do not draw their taxes proportionately to the statutory tax rate but apply their own tax rates. Municipal capital tax rates, which currently vary between municipalities from 1.75‰ to 3.5‰, will not exceed a maximum of 2.75‰ as of the 2011 tax period.

#### **Offsetting of operating losses against real estate gains**

As of the 2008 tax period, it will be possible in the canton of Basel-Landschaft, as in the canton of Basel-Stadt, to offset business losses against real estate capital gains from the sale of property subject to real estate capital gains tax (similarly, business losses from the seven tax periods preceding the current business year should also benefit from this regulation).

## **Canton of Berne**

#### **Partial rate procedure in the canton of Berne**

The canton of Berne has already revised its cantonal tax law in regard to partial taxation of dividends. The partial income procedure for cantonal and municipal tax in the canton of Berne came into effect on January 1, 2008. According to this procedure, profits from qualifying equity interests in limited companies and cooperatives whose head offices are in Switzerland are now subject to 50% of the normal income tax rate. An equity interest is deemed to be qualifying if it makes up at least 10% of the company's share capital or its market value amounts to at least CHF 2 million. In this case - unlike at federal level - the tax burden is calculated based on this lower rate (so-called partial rate procedure); the rate reduction for in-

come from private and business assets is 50% across the board. It should also be noted that this reduced tax burden only applies to limited companies and cooperatives whose registered offices are in Switzerland. This restriction does not exist at federal level.

In addition to the reduced tax burden for income from equity interests, wealth tax will also be reduced with effect from January 1, 2009. This means that the wealth tax value of qualifying equity interests will be taxed at a 20% lower rate.

#### **Further repercussions of the 2008 tax law revision by the canton of Berne**

In addition to the introduction of the new partial taxation procedure, the 2008 tax law revision by the canton of Berne also contains the following key points:

- ▶ Lowering of wealth tax rate:  
The wealth tax rate will be lowered by 12% on average (maximum rate of 1.3‰ compared to the current level of 1.55‰). The wealth tax ceiling will be retained subject to the following changes: wealth tax will now be max. 30% (previously 25%) of asset income, but at least 2.4‰ (previously 2.5‰) of taxable assets.
- ▶ Implementation of federal legislation  
The donation deduction will be increased from 10% to max. 20% of net income.
- ▶ Inheritance and gift tax  
In order to facilitate business succession to non-related persons, inheritance and gift tax will be reduced by 100% (previously 50%) under certain conditions.

#### **Entry into force of reforms**

Within the scope of the revision to the Bernese tax law, the partial taxation provision will enter into force retroactively from January 1, 2008. Provisions that lead to a loss of revenue in cantonal and municipal taxes will become effective beginning 2009. Thus, for cantonal taxes for the 2008 fiscal year, a one-off income tax refund of between 2.5% and 12% will be awarded on the basis of the level of taxable income.

## **Outlook regarding further possible changes to Bernese tax law**

Within the scope of the Corporate Tax Reform II, the cantons have the option of giving limited companies and cooperatives an additional tax break by allowing them to credit income tax towards capital tax. The Bernese cantonal authorities are thinking hard about implementing such a form of additional tax relief for limited companies and cooperatives. Any amendment to tax legislation to this effect is not expected until January 1, 2011 at the earliest.

## **Canton of Solothurn**

The Canton of Solothurn has not planned any changes for 2009.

## **Canton of St. Gallen**

With Addendum III to the Tax Act, a number of changes will come into force in the canton of St. Gallen on January 1, 2009. While the most important is, without doubt, the latest reduction in corporate income tax for legal entities from 4.5% to 3.75%, the canton is also abolishing the minimum tax on real estate for legal entities, and, in addition, cantonal law is being adjusted to bring it into line with federal law, largely focusing on Corporate Tax Reform II.

The revision will also affect natural persons. As of January 1, 2011, the maximum progression for income tax will drop from 9% to 8.5%. Wealth tax will also reduce from 1.9‰ to 1.7‰ across the board, taking effect as early as January 1, 2009.

From 2009, the cantonal tax base will reduce markedly, for the second time in a row, by 10 percentage points to 95%. The cantonal parliament approved the proposal by the Finance Commission and the government on November 25, 2008.

## **Canton of Appenzell Innerrhoden**

There will be no amendments to the Tax Act coming into force on January 1, 2009 in the canton of Appenzell Innerrhoden. However, it should be noted that preparations

for a revision of legislation are currently underway. The exact contents of this revision are not yet known.

## Canton of Appenzell Ausser-rhoden

At the end of October 2008, the cantonal government began the partial revision of the 2010 Tax Act. The key changes relate to the reduction of the tax burden on small and medium incomes and the lower taxation of assets. The maximum tax rate for assets is to be reduced from 0.6% to 0.55%. In addition, cantonal law is being adjusted to bring it into line with Federal law. It should also be remembered that at 12.7%, Appenzell Ausser-rhoden has, together with Obwalden, the lowest corporate income tax rate in Switzerland. The government has indicated that it is willing to reduce this rate further if one or more other cantons undercut this rate.

## Canton of Thurgau

The 2010 revision of the Tax Act currently being discussed by the Great Council aims to further increase the attractiveness of Thurgau as a business location. A central aspect of the revision is the abandonment of a progressive tax tariff and the introduction of a flat rate tax of 5.85%. Also on the agenda is the implementation of Corporate Tax Reform II, which makes a rolling adjustment of cantonal law necessary.

## Canton of Grisons

A partial revision of the Tax Act has also been submitted for consultation in Grisons. The most interesting change is, without doubt, the planned reduction of corporate income tax, together with the introduction of a flat rate tax of 5.5% (with a multiplier of 211.5%). A significant part of the proposal is the adjustment of cantonal law to bring it into line with federal law, with the key focus on Corporate Tax Reform II. With the increase in tax-free allowances and the reduction of the maximum rate, wealth tax for natural persons will drop from 2.25‰ to 1.75‰.

## Canton of Uri

The Canton of Uri will, as of 1 January 2009, be introducing the linear tax rate for income and assets, with the linear tax rates applicable to them being combined with high tax-free allowances. This partial revision will provide relief for people in all income categories; in particular, those with low incomes and families will benefit enormously.

The tax regime in Uri is particularly favorable for families. The child deduction is between CHF 8,000 and 20,800 per child and as a new feature, the effective costs of child care can be deducted with no upper limit.

## Canton of Zug

On 30 November 2008, the Canton of Zug voted to amend its tax law, a course of action from which the canton's population – specifically families with children, tenants in the middle-income bracket, individuals with average and high asset levels, and owners of SMEs – benefits directly. As well as various adjustments to deductions for natural persons, the rate of tax on profits for companies is being lowered, and the reduction in the burden of double taxation on distributed profits from limited companies and co-operatives is being increased from 30% to 50%; this also applies to wealth tax.

Furthermore, the amendment ensures that the Canton of Zug can continue to offer an attractive tax environment so that it remains nationally and internationally competitive as a location.

## Canton of Lucerne

In 2009, the Canton of Lucerne will be continuing its policy of continuous tax relief in order to strengthen its competitive edge, and is introducing a linear wealth tax rate of 0.75‰, thus cutting the current wealth tax by about one half.

## Canton of Obwalden

The partial revision of the tax law in the Canton of Obwalden in 2009 entails only very minor changes for 2009. Among other measures, the rate for the tax on profits for associations, foundations, societies and collective investments is being reduced to 6.0%, and real estate gains of less than CHF 5,000 will no longer be taxed.

## Canton of Nidwalden

In the Canton of Nidwalden, a rate adjustment will provide relief for the middle-income bracket and the rule on qualifying equity interests will now also apply to foreign companies.

## Canton of Schwyz

The Canton of Schwyz has not planned any changes for 2009.

## Canton of Ticino

The canton of Ticino is adapting the necessary amendments to the current cantonal tax law of June 21, 1994 in line with the form taken by the federal government:

Adjustment of the Ticino tax law to bring it into line with the federal law of March 23, 2007 on Corporate Tax Reform II.

The most important changes include:

- ▶ the alleviation of the double taxation burden on dividends from qualifying equity interests (of at least 10%) which, for the purposes of cantonal taxation, is set to be a partial taxation and to the same extent as for the federal direct tax, i.e. 60% of dividends from qualifying participations will be taxed if the shares form part of private assets, and 50% of dividends will be taxed if they form part of the commercial (business) assets of the shareholder. A similar partial taxation (50%) is, under certain conditions, also planned for corporate profits that derive from the sale of qualifying equity interests. Capital gains from privately held assets will continue to be tax-exempt;

- ▶ the extension of the reduction for equity interests to those of at least 10% of nominal share capital (reduced from 20%) in order to further reduce multiple taxation for legal entities;
- ▶ the deferment of taxation of hidden reserves with respect to the transfer of real estate from commercial to private assets. This introduces the possibility of postponing the tax on profits to the point in time when they are actually realized;
- ▶ the deferment of taxation of hidden reserves in case of succession in order to encourage heirs to continue the business;
- ▶ the reduction of taxation on liquidation gains in case of termination of an enterprise by reason of retirement at age 55 or by reason of a physical incapacity.

The measures regarding the reduction in taxation on equity interests (dividends and corporate profits) are planned to come into effect on January 1, 2010 (for the Swiss federal direct tax they will come into effect on January 1, 2009). The remaining changes will come into effect on January 1, 2011. The same holds true for the direct federal tax. The Ticino legislature is currently considering moving the reduction in taxation on equity interests forward to January 1, 2009. The Grand Council will decide on this issue before the end of December 2008.

Adjustment of the Ticino tax law to bring it into line with the federal law of March 20, 2008 regarding the simplification of subsequent taxation in the case of inheritances and voluntary disclosure with immunity from prosecution.

It is planned that, for heirs who, at the time of succession, report any tax evasion committed by the deceased person, the period for payment of back taxes (along with interest charges for late payment) will be reduced from the current ten years to three. In addition, for taxpayers who voluntarily disclose any tax evasion for the first time, the fine, currently equal to one-fifth of the amount of the unpaid tax, will be waived. The change to the federal direct tax will take effect on January 1, 2010. The Ticino tax law will be accordingly adjusted.

Extension of an additional four years for the application of the legislative decree of November 13, 1996 regarding accelerated amortization of new investments. The modification to this law makes it possible to accelerate the amortization of new investments at double the rate usually allowed for an additional period of four years (until the end of 2012). The purpose of this extension is to encourage new corporate investments at a time of uncertainty for the canton's economy.

In addition, starting on January 1, 2009, the Ticino tax law is scheduled to be adjusted to the federal law of June 23, 2006 on collective investment schemes and to the federal Host State Act of June 22, 2007 as well as the federal law of December 20, 2006 regarding changes to the procedure for subsequent taxation and changes in procedure for the prosecution of evasion of federal direct taxation. All these changes are required by the federal law of December 14, 1990 on the harmonization of direct taxation of cantons and municipalities and

are mostly of a technical nature. A new aspect in this is the tax regime for collective investment companies with fixed capital (SICAF), which calls for these companies to be taxed as joint stock companies.

On January 1, 2009 will also come into effect a legislative adjustment on letters a) and c) of Art. 34 Para. 1 of the Ticino tax law. This calls for an extension of the age limit from 25 to 28 for tax deductions for children who are studying or serving an apprenticeship and who are still dependents of the taxpayer.

There are also other discussions underway regarding changes to the Ticino tax law that the cantonal government intend to introduce in the framework of the financial package for the 2009 budget and for the target balance 2011. These changes affect, in particular, the measures for adjusting cold progression in the tax rate (Art. 39 of Ticino tax law), the tax rate on real estate gains (Art. 139 of Ticino tax law) and other minor changes.

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