

Tax News

Tug of war over tax revenues and their optimization

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Dear readers

In the wake of the controversy about international administrative assistance, events have followed one another thick and fast over recent weeks and months. Following menacing gestures from abroad - some of them emotive - and the tightening up of such regulations as the German «Anti-Tax Evasion Law», Swiss officialdom sought to engage in dialogue with a variety of states to negotiate revised double taxation agreements with them. By last winter, the agreements with the UK and France had already been revised, although both states continue to take a critical view of Swiss tax practice.

Particular mention deserves to be made of the official visit by Federal Council President Hans-Rudolf Merz to the United Arab Emirates, where, at the end of May, he engaged in successful talks aimed at having a double taxation agreement between the two countries that is consistent with OECD standards in place by the end of this year. You will find out more about this in the article by Fabian Duss and Lukas Küttel.



The simplification of subsequent taxation with regard to inheritances and the introduction of voluntary declaration with immunity from prosecution are discussed by Sibilla Cretti and Astrid von Dungern. They shed light on the amendments to the law intended to make hidden income and assets subject to regular taxation again and hence increase Switzerland's tax revenue. Urs Schüpfer and Sereina Purtschert examine to what degree the tax neutrality of restructuring can be applied to real estate gains tax, while Georg Lutz, Flurin Poltera, Daniel Gentsch and Annette Walk, in their article, take a look at the tax considerations involved when selling a division of a company at a profit.

In his article, René Schreiber explains why tax planning matters so much in the ongoing financial crisis and shows how it can help prevent unnecessary loss of liquidity.

As Tax Leader for Switzerland, I am delighted to be able to present to you the summer edition of our Tax News and I hope you will find it an enjoyable and stimulating read.

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As of 2010: Simplified subsequent taxation on inheritances and impunity for voluntary self-accusation of tax evasion¹

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From January 1, 2010 on, heirs revealing a tax evasion committed by the testator can benefit from a lower subsequent taxation as well as lower moratory interest. Subsequent tax and moratory interest is thus only owed for the last 3 instead of 10 years prior to the death of the testator. In the event of a self-accusation (disclosure of a self-committed tax evasion), the normally applicable fine can be waived from 2010 on, with the effect that the perpetrator (exempted from punishment) needs only to pay the subsequent tax together with the moratory interest.

Both measures aim to restore regular taxation on hidden income and assets and to thereby increase the tax revenues of the State. They relate to the direct Federal taxes as well as the cantonal and communal taxes on income and assets and on profit and capital. However, any other taxes or duties which may not have been paid, such as value added tax, withholding tax, inheritance and gift taxes or AHV/IV contributions (Swiss retirement and survivors' pension/disability insurance) are not recorded in this amendment of the law.

Simplified subsequent taxation for inheritances

According to the previous legal situation, heirs had to pay any taxes evaded by the testator plus moratory interest for up to 10 years prior to the death of the testator (subsequent taxation). The new regulation now allows honest heirs to benefit from a subsequent taxation reduced to 3 years.

Two prerequisites are decisive in this. On the one hand, heirs must fulfill their legal

obligation to cooperate with the authorities, i. e. to undertake all that is required to facilitate a complete tax assessment (in particular to contribute to the establishment of a comprehensive and accurate inventory of the estate), and, on the other hand, the tax authorities must have had no prior knowledge of such income and assets.

The new law is applicable to all cases where the testator dies on or after January 1, 2010.

Impunity in cases of voluntary self-accusation

According to the presently applicable law, a taxpayer who voluntarily discloses his/her tax evasion prior to it becoming known to the authorities is punished with a reduced fine amounting to one fifth of the evaded taxes (in place of the ordinary triple of the evaded taxes). Now, however, taxpayers will have the opportunity of being completely exempted from punishment where the tax evasion is voluntarily self-disclosed. This relief is not available for repeated voluntary self-accusations. In all cases, the ordinary subsequent taxation, together with moratory interest, remains due for the 10 precedent years.

A decisive condition for enjoying this exemption from punishment is, again, that the tax authorities have no prior knowledge of the tax evasion (a new case), that the taxpayer supports the authorities in the determination of the subsequent tax without reservation and that he seriously endeavors to make the payments. If these conditions are fulfilled, not only will a fine for this offense not be levied, but criminal prosecution of any further offenses which may have been perpetrated for the purposes of tax evasion (e. g., falsification of documents) will not be undertaken.

Participants in the tax evasion (instigators, accessories, etc.) can escape punishment as well as joint liability for the evaded taxes under the same prerequisites as the main perpetrator.

Legal entities may equally gain impunity if their corporate representatives voluntarily disclose their tax evasion on the terms already mentioned above (i. e. new case, cooperation and payment). Criminal prosecution of the individual representative making such disclosures will then not be undertaken, and they will not personally be held jointly liable for the subsequent taxes due by the corporate entity.

The new regulations apply to all self-accusations submitted from January 1, 2010 on, or which have not yet been finalized at this point in time. According to the legal principle of criminal law that the milder law is applicable, cases occurring prior to 2010, but which have not yet been finalized at this date, will be able to take advantage of the new relief measures. Consequently, in penal proceedings for tax fraud and other tax offences which have not been yet been finalized in the second half-year of 2009, it is advisable, for tactical reasons, to check, whether they may be delayed (by filing appeals etc.) in order to benefit from the above-described impunity.

Conclusion

It is a welcome development indeed that the new regulations, on the one hand, heighten the incentive to declare previously hidden assets and income thus generating more tax revenues for the State, and, at the same time, give the remorseful tax transgressor the opportunity of returning to a state of legality. For the latter, particularly the timing of his actions is decisive in view of the deadline. To this end: "He who comes too late will be punished by life, but so will he who comes too soon!"

¹ cf: Federal law regarding the simplification of subsequent taxation on inheritances, and the introduction of exemption from punishment in the event of voluntary self-accusation of tax evasion of March 20, 2008 (end of referendum period July 10, 2008)

Human capital - Global Mobility Effectiveness Survey 2009

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Ernst & Young conducted in 2009 for the second time the Global Mobility Efficiency Survey among its multinational clients which shows what companies perceive to be their challenges in managing an internationally mobile workforce and how they are dealing with the associated challenges, on which topics they are focusing their efforts to increase efficiency and where scope for improvement can still be found. The survey also looked at the way Global Mobility functions are structured and which activities are performed in-house versus being outsourced to third-party providers.

The 2009 survey focused in particular during the current economic situation on cost awareness of global mobility functions and could show that there is an increased pressure to save cost and to focus on the efficiency of their policies and processes. Our survey identifies cost drivers, focus areas for cost savings and the increasing awareness for risk in global mobility. The vast majority of the surveyed companies indicated that they are planning measures to save costs, and further investigation showed that they are mainly focusing on the increase of global mobility process efficiencies.

The geographic split into American, European and Asian-Pacific headquartered companies shows some significant differences in their approach to international assignments. It is for example interesting to see that in Europe more attention is paid to the repatriation phase although in the Americas more expatriates resign from their company during the first two years following their assignment.

In order to respond to current trends and changes in global mobility companies should regularly review and benchmark their policies. However, only one third of the

surveyed companies update their policies annually while another third even do not review them every third year. Further initiatives in global mobility are necessary in the fields of tax compliance, compensation and benefits and process management.

If you are interested in learning more about the survey results, we will be pleased to send you a copy of the full survey. Please drop an e-mail to Elke Bohn, EY Human Capital Zurich at elke.bohn@ch.ey.com to obtain your copy.

Amendments to the Agreement on the Carriage of Goods between the European Commission and Switzerland

Introduction of the AEO (Authorized Economic Operator) status in Switzerland

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Switzerland and the European Union (EU) acknowledge their security standards in international goods traffic as equivalent.

Imports and exports of goods between Switzerland and non-EU Member States are subject to a summary prior notification requirement.

Provisionally as of 1 July 2009, Switzerland will introduce the status of the authorized recipient, also known as the Authorized Economic Operator (AEO), which will be equivalent to that of the EU and will be recognized by the latter.

Background

Following the terrorist attacks of 11 September 2001, the USA called for various measures in the fight against international terrorism, which amongst other things relate to international goods traffic.

Subsequently, the EU modified its customs code with a security amendment. The most important changes are the following:

- ▶ the requirement for economic operators to notify customs authorities in advance of planned imports and exports to and from the EU;
- ▶ reliable operators will be allowed to undergo less complex security checks;
- ▶ creating common IT-based risk analysis criteria for customs inspections.

Outcome of the negotiations conducted between the EU and Switzerland

The EU and Switzerland (hereinafter understood to include the Principality of Liechtenstein) will acknowledge their security standards as equivalent in the amended Agreement on the Carriage of Goods, effective as of 1 July 2009.

The Federal Council has already approved and decided to sign the agreement. The Parliament will now decide on the adoption of the agreement. However, the agreement is to be applied provisionally from 1 July

2009, subject to the approval of the competent commission.

In the future, Switzerland and the EU will have to interpret the rules in the same way and accept the related legal developments at the same time.

Recognizing security standards as equivalent means that a summary prior notification in bilateral goods traffic between Switzerland and the EU will not be necessary anymore. Since the EU is Switzerland's largest trading partner, this will affect the majority of imports into Switzerland and exports out of Switzerland.

Conversely, Switzerland is to implement new security measures for the transport of goods to non-EU Member States. In the following cases, a summary prior notification is required:

- ▶ consignments of air-freighted goods from Switzerland to a non-EU Member State
- ▶ consignments of air-freighted goods from a non-EU Member State into Switzerland
- ▶ consignments by land from Switzerland, via an EU Member State, to a non-EU Member State

The summary prior notification requirement is to be optional until 31 December 2010 and will become mandatory as of 1 January 2011. Due to the Agreement, this provision will also apply in Switzerland.

The content of the summary prior notification requirement can be found in the COMMISSION REGULATION (EC) No. 1875/2006 of 18 December 2006¹.

Summary prior notification requirement periods

Imported goods must be declared at least four hours prior to arrival in the case of long-haul flights, and at least by the time of the actual take-off of the aircraft in the case of short-haul flights (with a flight duration of less than four hours).

Air-freighted exports must be declared at least 30 minutes prior to take-off of the flight. In the case of exports via other means of transport, the Swiss Customs Authority

has agreed to carry out a risk analysis (especially public health, environment, consumer protection) and where necessary confiscate goods before the border crossing.

Summary prior notification data

There are plans to amend the e-dec Import, e-dec Export and NCTS systems in such a way that summary prior notification data can be entered electronically. The Federal Customs Administration will then pass on the data to the EU. The prior notification requirement referred to above has not yet been definitely decided upon. It has also yet to be decided whether the summary prior notification requirement for consignments should be implemented as of 1 July 2009 or at a later date.

AEO

Switzerland has agreed to introduce the status of Authorized Economic Operator - Security (AEO-S), provisionally as of 1 July 2009. The regulation issued by the Federal Council necessary for its introduction has not yet been approved.

It has, however, been agreed that the status of Authorized Economic Operator is to be the same as that of the EU and therefore will be recognized by the EU.

The major advantages of the AEO-S are the following:

- ▶ less frequent inspections of goods and of documentation;
- ▶ preferential inspection of selected consignments;
- ▶ reduced data records for submission of summary import and export notifications, so-called prior notifications;
- ▶ prior notice in the case of planned inspections;
- ▶ improved cooperation with the customs authorities;
- ▶ acknowledgement of AEO status as a mark of quality (trustworthy business partner).

The introduction of AEO in Switzerland is of major importance, particularly for companies whose headquarters are in Switzerland, which have a lot of goods traffic between Switzerland and the EU and non-EU Member States, and which, in the absence of a branch office in the EU, were up to now hampered from gaining AEO status recognized in the EU since 1 January 2008.

New VAT law will enter into force as of January 1, 2010

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On 12 June 2009, the Swiss parliament voted on the first part of the reform (Part A) of the Swiss VAT law ("VATL") as it has been proposed by the Federal Council. The main goal of this reform is to simplify the VATL. Provided that petition for a voluntary referendum is not taken, the amended VATL will enter into force as of January 1, 2010.

The discussions about part B of the reform project, which includes a reduction of the number of tax exemptions and introduces one standardised VAT rate, will start during the Parliament's autumn session. At this

point in time it is difficult to say whether and when this highly political part B of the VATL's reform will be adopted.

The increase in the VAT rates - which would be limited in time and aims at covering the financing of the invalid insurance - has to be distinguished from the VATL reform as such. The increase in the VAT rates requires a constitutional amendment and is therefore subject to popular vote. This vote will take place on September 27, 2009. In case of acceptance and based on the Parliament's decision taken on 12 June 2009, the increased VAT rates would be applicable as of January 1, 2011.

¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:360:0064:0125:DE:PDF>

Therefore, only the legal amendments of part A of the new VATL's reform have to be implemented in the short term. In order to reduce the number of administrative directives issued by the Federal Tax Administration, the ordinance to the new VATL - based on the press release from the Federal Finance Department - will have a detailed content. In this respect, the role of administrative directives issued by the Federal Tax Administration is meant to change. In the future, the legal weight of said practice, i. e. the Administration's interpretation of the law, will have the same significance as the interpretation of the law made by taxable persons. The first draft of the ordinance to the new VATL has been announced for September 2009. Given that the ordinance will specify the articles of the new VATL, it will be crucial for the implementation of the new VATL.

Overview of the important changes in law

The reform of the VATL will induce companies - in their capacity as taxable persons, as contracting parties, as well as in their capacity as creditors - to closely examine the amended rules in order to determine related consequences for their companies and initiate action to be undertaken. In order to support this process several of the important changes are described below. However, the list of points covered below is not exhaustive as the reform includes over 50 amendments.

A person is **liable to tax** if he or she engages in commercial activity. Up to an amount of CHF 100,000 taxable turnover, the person is exempted from tax liability.¹ It is now possible to waive this exemption² with the consequence that tax liability starts right with the beginning of the commercial activity of a company.³ Thus, the current possibilities to opt for tax liability⁴ where the turnover does not exceed the legal limits as well as the possibility to opt for tax liability for so-called start-up companies⁵ will no longer be applicable. With this new rule an important step has been achieved for companies having a long phase of investment. In the near future, it will suffice to prove that a commercial activity is being carried out in order to become liable to tax.

VAT will still be due on domestic supplies of services and goods which are rendered by taxable persons against consideration. In addition imports of goods as well as acquisitions of supply of services from companies established abroad will still be subject to VAT. However, self-supply tax will adjust prior input tax deduction only.⁶ **Self-supply with respect to construction work** will not represent a taxable activity anymore.

With respect to the rules governing the place of supply of services, these have been subject to important amendments. As far as no other rule is foreseen by the law,⁷ the new rule provides that the **place of supply of services** is the place where the recipient of the service has its business establishment.⁸ Consequently, for cross-border supplies of services, it has to be reviewed whether supply of services which currently used to be taxable at the place where the service provider has its business establishment⁹ are still subject to Swiss VAT. In addition, it is also advisable to check the supplies of services which used to be taxable at the place where the activity is effectively carried out.¹⁰ In accordance with the current practice, it is likely that foreign companies are not entitled to refund of Swiss VAT which has been invoiced, but which would, based on the law, not have been due since the place of supply was not within Switzerland.

The **possibility to opt** for taxation of transactions being tax exempt without credit will be expanded. The new provisions state that, no option for taxation can be applied for insurance and financial turnover as well as for turnover resulting from bets, lotteries, and other gambling activities.¹¹ In addition, turnover resulting from the sale and rent of real estate can be taxed on a voluntary basis as far as the real estate is not only used for private purposes.¹² With this new rule the possibility to opt for taxation of real estate transactions is expanded compared to the current law since currently the option to tax real estate transactions requires that the counterparty is a taxable person and uses the real estate at least partly for taxable purposes.¹³ For all other VAT exempt without credit turnover an option for taxation is possible. The filing of an option form

is no longer necessary. It is sufficient if VAT is shown on the respective invoices.¹⁴ The decision to opt or not can now be taken separately for every contractual relationship. However, it should be noted that the relation between the taxable turnover and the input VAT deduction has to be supported with suitable evidence. This is particularly important if the option (by means of showing the VAT on the respective invoices) is not applied for each turnover of one particular VAT exempt without credit type of turnover.

The formal requirements for **input VAT deduction will be obsolete**. In the future, it will be decisive whether the input VAT has been paid.¹⁵ In this case the right to deduct input VAT exists, as far as the input VAT is not related to VAT exempt without credit turnover for which no option for taxation has been applied. In addition, the **input VAT deduction** with regard to **holding of participations** has been enlarged. Input VAT will be deductible as far as it has been incurred in connection with the acquisition, retention or the sale of participations (i. e. a participation amounts to at least 10% of the capital of a company) with the intention of a long term investment or for restructuring purposes, in the framework of the commercial activity which entitles to input VAT deduction.¹⁶ In case of holding companies, the commercial activity of the companies they hold is decisive.¹⁷

Instead of the current **margin taxation**¹⁸ a fictive input VAT deduction will be introduced.¹⁹ However it has not been determined yet how this fictitious input VAT deduction will be applied. It is also worth

1 Art. 10 Para. 2 Lit. a VATL of 12 June 2009, new VATL hereafter
2 Art. 11 new VATL
3 Art. 14 new VATL
4 Art. 27 Para. 1 VATL
5 Art. 27 Para. 2 VATL
6 Art. 31 new VATL
7 Art. 8 Para. 2 new VATL
8 Art. 8 Para. 1 new VATL
9 Art. 14 Para. 1 VATL
10 Art. 14 Para. 2 VATL
11 Art. 22 Para. 2 Lit. a new VATL
12 Art. 22 Para. 2 Lit. b new VATL
13 Art. 26 Lit. b VATL
14 Art. 22 Para. 1 new VATL
15 Art. 28 Para. 4 new VATL
16 Art. 29 Para. 2 und 3 new VATL
17 Art. 29 Para. 4 new VATL
18 Art. 35 VATL in connection with Art. 10 ff. VATLO
19 Art. 28 Para. 3 new VATL

noting that the current exclusion of deduction of 50% of the input VAT incurred on food and beverages will not be applicable anymore.²⁰

A reduction of input VAT has to be taken into consideration, if among others, **subventions** or other contributions under public law have been received.²¹ Other categories of so-called no-turnover, such as contributions in enterprises, e.g. credits without interests, recapitalization measures and waivers of receivables, do not lead to input VAT reductions. With these rules the VAT risks in connection with **recapitalizations** should be mitigated.

The **notification procedure** has to be applied by affiliated companies in the framework of foundation, liquidation and restructuring procedures. Other taxable persons have to apply the notification procedure if VAT on the sales price is higher than CHF 10,000.²² In the framework of the ordinance, the Federal Council can foresee other cases where the notification procedure will be mandatory.²³ Therefore, it is advisable to wait for further specifications with regard to the notification procedure. For example, it is not explicitly foreseen by the VATL that the notification procedure is only applicable in case of a transfer to a taxable person. However, in general this should be the case, since entitlement to input VAT deduction is intrinsically tied to tax liability.

Another point to monitor will be the developments regarding the **liability of the person acquiring a debt as regards the VAT ceded together with this debt**.²⁴ It is questionable whether or not the objective of the related provision of the law will be accomplished. Nevertheless, the person acquiring a debt has to deal with the fact that it could be faced by a liability or at least by a claim for liability by the Federal Tax Administration, which could trigger additional efforts and costs.

Another goal of the VATL reform is to achieve greater **legal certainty**. Under VATL, a VAT audit is concluded after 360 days by a decision determining the VAT due for the period under review.²⁵ If the VAT due following the audit is paid on an unconditional basis or if the decision is accepted

in writing, this decision will become legally binding and thus unchangeable.²⁶ This rule not only compels the Federal Tax Administration to handle efficiently a VAT audit and to take a final decision, but also the taxable person to act proactively if it does not want to put itself on the spot and to pursue its right by the more costly way of a law suit.

By means of a justified request a taxable person can even **ask for a VAT audit**.²⁷ This rule can increase legal certainty in particular in the case of a transfer of company. However, said provision may not come into force as of January 1, 2010, since the Federal Council is admitted to determine its legal validity.²⁸

Given the times of economic downturn, the possibility given by the Federal Tax Administration to grant deferred payments is important.²⁹ It is also assumed that the ordinance will define the circumstances of undue hardship.

In addition the reasons for a release of debt are considerably extended in the new VATL.³⁰ This provision is not only of importance for taxable persons with payment difficulties but also for the creditors.

Finally, fiscal evasion and fraud provisions have been fundamentally amended.³¹ In practice this can have consequences especially in an international business setting (i.e. in particular as regards exchange of information).³²

Besides the above-mentioned points, it is worthwhile to have a look at other changes covered by the reform. Furthermore it is recommended to combine the review of the changes within the Swiss VATL keeping in mind the changes coming into force within the EU as of January 1, 2010.

In view of the short laps of time remaining to implement these changes, it is advisable to establish priorities between the new provisions. The correct set of priorities can save unnecessary costs. Certain configuration set-ups linked to the new VATL have to be implemented immediately while others can still be done at a later stage. Configuration possibilities leave room for optimization, however, simplifications can also create risks, which need to be avoided.

Background Information

- ▶ Information for the final vote, Federal law on value added tax (VAT law, VATL) of June 12, 2009
www.parlament.ch/sites/doc/CuriaFolge-seite/2008/20080053/Schlussabstimmungstext%20NS%20D.pdf
- ▶ Notice of the Federal Finance Department of June 15, 2009
www.efd.admin.ch/00468/index.html?msg-id=27427&lang=de
- ▶ Federal Law with regard to Value-Added-Tax dated 2nd September 1999
www.admin.ch/ch/d/sr/641_20/index.html

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20 Art. 38 Para. 5 VATL

21 Art. 33 Para. 2 new VATL

22 Art. 38 Para. 1 new VATL

23 Art. 38 Para. 2 new VATL

24 Art. 15 Para. 4 new VATL

25 Art. 78 Para. 5 new VATL

26 Art. 43 Para. 1 Lit. b new VATL

27 Art. 78 Para. 4 new VATL

28 Art. 116 Para. 2 new VATL

29 Art. 90 new VATL

30 Art. 92 new VATL

31 Art. 96 ff. new VATL

32 Fight against fraud treaty

Tax planning is indispensable, especially in times of crisis

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In Switzerland, like elsewhere, the number of businesses feeling the pressure of the current economic climate is continuing to increase. From the tax point of view, businesses need to avoid unnecessary loss of liquidity and preserve maximum room for maneuver for the future.

Why do taxes matter in times of crisis?

Liquidity is the financial engine that drives a business. It follows that any unnecessary outflow of liquid funds – be it for tax or other purposes – is to be avoided. If a company is still managing to keep from making a loss, appropriate action needs to be taken to protect its liquidity. Measures to defer tax can help to minimize the outflow of cash. There is no guarantee that the tax authorities will unquestioningly accept a loss if things are continuing to slide or the trade balance is in the red. The rapidly shrinking tax base and the considerable increase in expenditure (notably on economic stimulus programs) are putting those who manage public finances under enormous pressure not to allow the wholesale loss of tax revenue. More tax corrections on the part of the Swiss tax authorities and particularly by their foreign counterparts thus have to be reckoned with in the near future.

Options for tax planning

Effective tax planning starts even before a business is set up. Because tax rates differ greatly depending on the legal form and location chosen for a company, these decisions will have a considerable impact on a company's effective tax burden, particularly in Switzerland. Tax rates vary significantly from one canton to another, not least of all for legal entities. In order to protect the liquidity of a company that is still making a profit, recourse can be had to the old and familiar weaponry of strategic tax planning. Recognizing necessary additional reserves, making the fullest possible use of hidden re-

serves on inventories, and, above all, thorough scrutiny of debtors with a view to ascertaining potential defaults and adjusting provision for their doubtful debts are simple but effective ways of reducing current outgoings on tax. This must, however, be done in accordance with the tax authorities' instructions in ordinances, circulars and factsheets.

Groups should now be reviewing their legal structures and simplifying where it makes business sense, by means of mergers, for example. This not only reduces accounting, auditing and organizational costs, but also enables any losses to be carried forward in a tax-efficient way. Such losses can normally be deducted from the net profit of the seven business years preceding the tax year in question. If a company is being restructured, however, deductions for losses that serve to compensate a negative balance may not be subject to time limits.

With the advance of globalization, companies' business activities seldomly stop at the borders of the country in which it is based. By the time a company sets up offices or subsidiaries abroad, if not before, it will find itself liable to taxation by more than one state. The latest Double Taxation Agreements (DTAs) are based on the OECD's model agreement and are largely similar in their wording. States that are of major importance to Switzerland – Germany, France and the USA, for example – have now incorporated special tax regulations into national law designed to help extend the domestic tax base. Due to "treaty overriding", the relevant DTA offers inadequate protection or none at all. If, then, a company operates across national borders, it is worth its while to make careful enquiries into the tax situations in the countries in which it does business.

Most recently, tax authorities have also started looking at transfer pricing arrangements. More and more countries are tight-

ening up their policies on transfer payments and enacting rules for documentation. The risk of tax adjustments, double taxation or even penalties makes it vital for companies operating internationally to carefully analyze their internal relationships and review the prices at which group companies perform services for one another.

The tax planning options and recommended courses of action set out above are not exhaustive. At times like these, when economic storms are raging, precise and comprehensive analysis of tax risks and tax planning with a business' long-term growth in mind can help optimize corporate liquidity and are indispensable.

Optimizing cash-in in a carve-out - tax considerations with regard to the sale of a business unit

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The equity financing of Swiss companies is, in international comparisons, considered being relatively strong. Nevertheless, a considerable number of Swiss companies experience difficulties in refinancing their business. Due to a decrease of turnover and cash flow and/or the violation of credit covenants, negotiations with banks can be a difficult task. Companies may even be forced to sell parts of their business. But even if no pressure is imposed by debt providers, the disposal of business units may be considered in the context of focusing on the core business or for the mere purpose of strengthening solvency.

The business to be sold may or may not be a stand-alone unit. Often, it is integrated and to make it operational, needs establishment of central functions, allocation of employees as well as independent systems and processes. Unbundling the business unit from the core business is denoted as "carve-out".

When considering such a carve-out, questions regarding finance/controlling, IT, personnel, supply chain etc. are typically in the spotlight. Tax aspects should however also be considered early in the process as they can lead to significant optimization in various aspects. In fact, taxes may even be the driving factor in determining the carve-out structure. In particular, the following six points should be clarified early on in the process.

A first rough analysis: Profit or loss?

Once [1] the countries affected by the carve-out are identified, [2] various scenarios can be tested and simulated by using model calculations. Based on various assumptions (in particular regarding sales proceeds and purchase price allocation), such calculations give a first indication in which countries a

capital gain and where a capital loss may result from the carve-out.

How much cash is left after taxation of capital gains?

The benefits of a capital gain are reduced by related tax consequences. This is particularly cumbersome in a situation where the seller is in a distressed financial position. If [3] the analysis shows that the capital gain may not be offset against tax losses carried forward, and if no other tax relief is available (e.g. reduced taxation of capital gains or privileged tax status of seller), [4] the evaluation of alternative structuring should be considered. This includes in particular a comparison of "share deal" versus "asset deal", the analysis of tax-efficient supply chain structures for the carve-out business or the international transfer of intangible assets. In some cases, immediate tax costs result to allow for mid- to long-term tax benefits. The before-mentioned model calculations help to assess overall costs and benefits. Besides potential tax issues, numerous other issues must be considered in this context, in particular the feasibility, the time required and the additional complexity of implementing the appropriate tax structure in the context of the whole project.

Even if the analysis of alternative structures does not, in the end, disclose tax savings, be it because a more beneficial structure is not available, or because possible optimization scenarios cannot be implemented, the respective analysis can nevertheless be beneficial: If the buyer in the negotiations asks for a specific structuring of the carve-out, or makes suggestions with respect to the purchase price allocation, the seller can react on short notice because tax implications resulting from alternative scenarios are known, or assessed quickly. In the best case, it is even possible for the seller to suggest win-win scenarios.

Any tax benefit resulting from a capital loss?

If a loss from the carve-out is expected in one country, then [5] the potential to utilize such losses in the future in a tax-efficient manner is of key importance. The value of such losses depends on the question whether and under which conditions a loss carryback or a loss carryforward is possible, as well as on the estimated future profits. Besides answers to these basic questions, the analysis also gives an indication as to what extent potential amendments in the purchase price allocation would be beneficial, adverse or inefficient for the seller.

Which group company is most in need of liquidity?

In addition to the above considerations, it is recommendable to [6] identify early in the process at the level of which entities sales proceeds result, and which companies need the liquidity most. If profit repatriations are required, a tax leakage may result which might, if noticed early enough, be avoided or mitigated, in the context of a restructuring.

Conclusion

Both in-house tax specialists and tax advisors can, in the true sense of the term, create value, through a carefully planned disposal of business units. This however requires that tax-related questions are addressed and systematically evaluated early in the process: the results of the tax analysis may be the driver for the determination of the carve-out structure, and both the evaluation itself as well as the implementation of its outcome (in particular amendments to the corporate structure) are typically time-consuming.

The benefits for the seller are obvious: Not only may immediate tax savings result (i.e. "optimization of cash-in in a carve-out"). The findings of tax-related carve-out planning also increases the responsiveness and flexibility in the negotiations with the buyer. On the one hand, if the buyer asks for an amended deal structure or suggests a purchase price allocation, the seller may quickly assess the related tax implications. On the other hand, a careful analysis may also help to find win-win scenarios. Such material advantages are typically not available if a seller is surprised by the course of events and forced to a so-called "fire sale".

Germany: Act for combating tax evasion might be implemented

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On April 22, 2009, the German Federal Government introduced the draft of an act for combating tax evasion in the legislative procedure (the so-called "Act for Combating Tax Evasion"). Compared to the hotly debated first draft, the current draft of the bill has been eased in some points. The possible tax disadvantages would however remain significant.

The following provides an overview of the significant content of the government draft:

1. Refusal or restriction of deductions for operational expenditure or deductions for income-connected expenses;
2. Refusal of relief from German withholding tax on capital (e.g. zero rate pursuant to Art. 10 para. 3 DTA D-CH);

3. Refusal to apply the de facto 95% exemption of dividend revenues in a German limited-liability company or to restrict the corresponding DTA bill;

4. Substantially increased cooperation and retention obligations of the taxpayer;

5. Expanding the audit rights and sanctions options of German Revenue Offices.

The measures will come into effect when payments are made to persons or associations of persons with residence, registered offices or management in a country with which there is no information exchange in accordance with OECD standards (Article 26 OECD Model Convention). By means of a statutory declaration that all disclosures in the tax declaration are truthful, and by means of the general approval by the tax-

payer that the German finance administration will be able to receive information pertaining to its tax affairs, in particular from foreign finance institutions, the tax disadvantages outlined above would again become obsolete.

Currently, Switzerland would also be affected by the legislative procedure, as the current DTA D-CH only guarantees an exchange of information in the event of tax fraud but not tax evasion. Nevertheless, Switzerland has announced, as has Luxembourg, Austria, Monaco, etc., that the OECD standard will be implemented. Thus the act would then have no more consequences for investments in or out of Switzerland.

Double taxation agreement with United Arab Emirates

President Merz has ended his official working visit to the United Arab Emirates on May 26. During the two-day visit, President Merz met President Sheikh Khalifa bin Zayed Al Nahyan and conducted other official talks.

Switzerland and the United Arab Emirates welcomed the positive developments in their excellent bilateral relations. Along with those at the financial and economic levels, these increasingly include the areas of science, research, energy, the environment, culture, justice and politics. At their meeting President Merz and President Sheikh Khalifa bin Zayed Al Nahyan reiterated their readiness to intensify and strengthen their

friendly, bilateral relations. In addition the United Arab Emirates announced the opening of an embassy in Switzerland.

The meeting between President Merz and the Emirate Finance Minister and the Governor of the Central Bank served as an exchange on the measures taken by both countries to combat the global financial and economic crisis and to promote mutual investments. In addition, it was decided to revise the final pending issues to conclude a double taxation agreement in accordance with the OECD Model Convention by the end of the year.

President Merz met the Vice-President and Prime Minister for other talks along with the Deputy Prime Minister of the United Arab Emirates and the Crown Prince of Abu Dhabi.

President Merz also met the Swiss community in the United Arab Emirates at a reception in Dubai and found out about the financial center strategy of Abu Dhabi and Dubai from high-ranking economic policy representatives and banking representatives.

New and revised double taxation treaties

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Various double taxation treaties have recently been introduced or revised. The following represents a short overview of the most important changes and news in the Swiss treaty network.

France

(Supplementary treaty signed and Federal Council memorandum adopted)

The supplementary treaty for amending the Double Taxation Treaty with France (DTT-F) was signed on January 12, 2009. Switzerland has agreed to further obligations in matters of administrative assistance. The abuse provision for taking advantage of the zero rate on dividends from significant participations was relaxed and the interrelation of Art. 11 and 14 DTT-F with Art. 15 of the Swiss-EU Savings Tax Agreement (STA) could finally be clarified:

According to the previous wording of Art. 11 para. 2 letter b) ii) of the DTT-F, the zero rate for dividends from qualified participations under the DTT-F could not be evoked if the recipient of the dividend itself was controlled by persons or entities not domiciled in an EU Member State. In the memorandum of understanding dated November 23, 2006, it was, however, agreed that this provision would not apply in the application of Art. 15 para. 1 STA. In accordance with the revised Art. 11 para. 2 letter b) ii) DTT-F, the zero rate is now only then not granted, if the recipient of the dividend is directly or indirectly controlled by a person or entity domiciled in none of the contractual states, and, at the same time, is not able to prove that the participation does not merely exist in order to become entitled to the treaty benefits. Thus, under the relevant requirements, dividends from French subsidiaries to Swiss parent companies can now benefit via the DTT-F from a full exemption from withholding tax even if the Swiss parent company is, for instance, held by an US company.

Furthermore, in Art. 11 para. 2 letter b) iii) of the DTT-F, it is now expressly regulated that Art. 11 para. 2 letter b) ii) only applies in the application of Art. 15 para. 1 STA if the recipient of the dividend is controlled by persons or entities who are not domiciled in an EU Member State. Dividends from parent companies which are controlled by persons or entities domiciled in the EU can enjoy the zero rate under the STA without further ado. Where control is exerted by a person or entity domiciled outside of the EU, evidence must be provided pursuant to revised Art. 11 para. 2 letter b) ii) of the DTT-F.

Emphasis must also be placed on the new type of conduit rules pursuant to revised Art. 14 of the DTT-F which now takes the place of the previous bilateral abuse provision. This includes a restriction on a further transfer of 50% of the treaty-protected income to persons not entitled to the treaty benefits, whereby transfer to independent third parties or persons who would be treated the same, or more favorably, under the respective treaty if receiving this income directly, are generally not harmful. The ratification of the DTT is still outstanding.

United Kingdom

(Revised DTT in force)

The protocol for the revision of the DTT with UK (DTT-UK) came into force on December 22, 2008. A 0% net treaty rate for dividends is now granted from a minimum participation of 10%. Dividend payments to pension funds are now also fully exempted from withholding tax, irrespective of the amount of the participation. For the remaining dividend payments, a residual rate of 15% continues to apply. Furthermore, the revision protocol contains new rules regarding the taxation of retirement benefits and the deductibility of pension fund contributions.

Besides the incorporation of an extended administrative assistance clause in the case of tax fraud (and the like), as for holding companies, the revised treaty now also con-

tains a bilateral anti-abuse regulation in the sense of a conduit rule. This conduit rule regulation is defined in Art. 3 para. 1 DTT-UK by not allowing the complete or almost complete further transfer of treaty-protected income to persons not entitled to treaty benefits, unless the recipient would have the same rights under the respective treaty or would be in a better position if the same income would have been received directly.

Other novations

New DTTs have been negotiated with Algeria and Pakistan (already in force) as well as with Malta (signed) which mainly follow the OECD-MC and the Swiss treaty policy. DTTs already in existence with South Africa and Indonesia have been revised and came into force. Furthermore, the memoranda to the newly negotiated DTTs with Bangladesh, Ghana and Turkey have been adopted by the Federal Council. These treaties must be approved by the competent authorities of both countries prior to their coming into force.

Real estate capital gains tax: Particularities and pitfalls in restructuring real estate companies

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Tax neutrality, applicable to some restructuring situations, can also be applied to real estate capital gains tax. Furthermore, with the introduction of the Swiss Merger Law not only mergers but also divisions can be carried out without blocking periods. The sale of participations following a restructuring that involves a real estate company, however, must be more closely examined.

Pursuant to Art. 12 para. 4(a) of the Tax Harmonization Act (THA), tax-neutral restructuring measures under Art. 8 para. 3 and 4 as well as Art. 24 para. 3 and 3quater THA are treated as deferral events for real estate capital gains tax purposes. Accordingly, tax-neutral restructuring measures are not subject to real estate capital gains tax (the transitional period for tax on transfer of real estate expires on 1 July 2009). Furthermore, the Merger Law abolished blocking periods, i.e. temporary tax "alienation bans", in the case of divisions. With regard to mergers, there were basically no blocking periods even before the Swiss Merger Law was enacted. However, the Merger Law stipulates some blocking periods for tax purposes, e.g., for intra-group asset transfers and spin-offs.

However, restructuring measures involving real estate companies require special caution, because under the current practice of property tax authorities might still require restrictions with regard to a subsequent alienation, as shown in the examples below.

**Example 1 (Fig. 1):
 Merger of a real estate company with an operating company**

A merger between a real estate company and an operating company may qualify for tax neutrality. Before the merger, the sale of a majority shareholding in the real estate company would have been treated as a transfer subject to real estate capital gains tax. Assuming that, due to the specific circumstances, the merged company qualifies as an operating company (with ancillary real estate activities), exiting the field of real estate capital gains tax leads to a deemed realization. A subsequent sale of the participation is no longer treated as a deemed transfer of real estate, since, after the merger, the holding company now just holds 100% in an operating company. Accordingly, a sale of the investment in the new operating company should not be subject to real estate capital gains tax, especially due to the fact that neither the taxation nor a blocking period are stipulated in a law. However, the property tax authorities will be paying close attention to these kinds of alienations (occurring within five years after the merger); in particular they will investigate whether the merger and subse-

quent sale constitute a tax avoidance and whether any restrictions may be applicable. The property tax authorities have stated that the possible consequences may be that a blocking period may continue to be applicable, or even that a five-year "special" blocking period - not prescribed by law - may be imposed.

**Example 2 (Fig. 2):
 Quasi-merger of a real estate company and reduction in the holding ratios**

A quasi-merger of a real estate company and a simultaneous reduction in the holding ratios at B is in principle eligible for tax neutrality. From a real estate tax perspective the problem arises that, in the target structure, B only has a 25% investment in the real estate holding, which, however, in value terms corresponds to its previous 100% in the real estate company. As a result, any subsequent sale of the participation will not constitute a transfer of real estate as it will only be a sale of a 25% stake and not of a majority holding. Hence, provided no tax avoidance is assumed, B should in principle be able to sell its stake in the real estate holding without being subject to real estate capital gains tax. However, in such cases the property tax authorities will also, as in Example 1, carefully examine sales made within five years of a merger and consider the possibility of imposing restrictions, i.e., a "blocking period".

Fig. 1

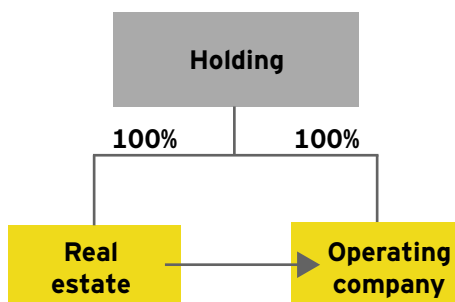
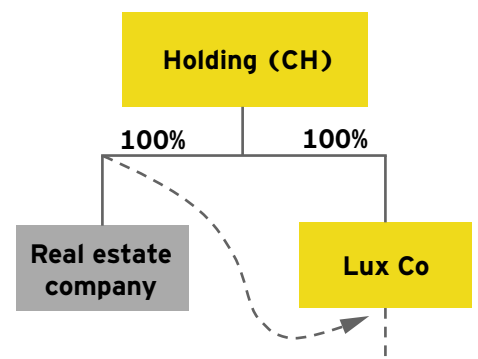


Fig. 2



**Example 3 (Fig. 3):
Transfer of a real estate company to a
foreign group company**

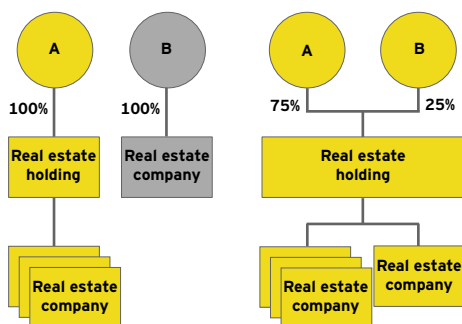
The transfer of a real estate company to a foreign group company can in principle also qualify for tax neutrality. However, with regard to real estate capital gains tax, transfers and subsequent sales of participations have to be carefully examined; the taxation rights stipulated in the double taxation agreement (DTA) are decisive. If the right to tax is assigned to the country of residence (as, e.g., in the DTA with Luxembourg), despite the restructuring being tax-neutral from the perspective of the other taxes, real estate capital gains tax would be levied, due to the exit from the area subject

to Swiss real estate capital gains tax and, thus, in the sense of a deemed realization (as is the current practice of the property tax authorities in Zurich, for example). However, if the DTA follows the situs principle, the transfer would also not be subject to real estate capital gains tax, because Swiss real estate capital gains tax could still be levied on a future sale.

Conclusion

Although the Merger Law allows tax-neutral restructurings from the point of view of the real estate capital gains tax and blocking periods on divisions have been abolished, the possibility of "alienation bans" in the case of real estate transactions must still be borne in mind. With respect to real estate companies it is possible that, even though a restructuring may be tax-neutral for the purposes of real estate capital gains tax and not subject to any blocking periods with regard to the other taxes, property tax authorities may still raise the issue of alienation bans. Furthermore, notwithstanding tax neutrality for the purposes of the other taxes, international restructurings of holding companies may incur real estate capital gains taxes, depending on the rules stipulated in the relevant double taxation agreement.

Fig. 3



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