

Tax News

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Dear Readers,

What makes a good tax manager? In the past, the answer seemed to be quite clear: he had to be able to lower his client's tax ratio while at the same time generating the highest possible cash tax savings. But today these skills are no longer sufficient. The Organization for Economic Cooperation and Development (OECD) has taken a critical look at the changing requirements profile of the tax adviser and has shown that he must be equally familiar with risk and process management issues as well as the constantly changing reporting standards. Read our article "New challenges for tax managers" to find out which five key skills today's tax experts need to possess in order to meet the demands placed upon them by companies, the public and the tax authorities.

The new capital contribution principle comes into effect on January 1, 2011. The full particulars are now to be set out in detail in an appropriate directive and in a new circular. In our article "News on the capital contribution principle," we examine various aspects of the new regulation and fill you in on future changes today, thus following up on our article "Transition to the capital contributions principle" from the April edition of Tax News.



The article "International transfer pricing" addresses a highly topical international tax issue. On September 9, 2009, the OECD published its draft proposals for the amendment of Chapters I to III of its Transfer Pricing Guidelines. Moreover, some months earlier, on July 17, 2009, the German Federal Ministry of Finance ("BMF") announced the publication of the first official draft of its "Administration Principles of Function Relocation." Both documents entail a series of important changes or definitions that are particularly relevant for globally active companies. Thus, for example, the OECD draft proposes replacing the previous transfer pricing methods with the "most reliable method."

The article "Customs News" deals with two topics that are also particularly relevant for companies with international trade connections. Thus, according to a draft dated July 1, 2009, Swiss companies meeting certain requirements can be granted AEO status (Authorized Economic Operator), which will significantly simplify trade relations between the EU and Switzerland. The bilateral free trade and economic partnership agreement between Switzerland and Japan, according to which Swiss companies will be able to import Japanese goods on a duty-free basis, is also likely to be of considerable interest to companies with international operations. In this article, you will find out which requirements a company must fulfill in order to qualify for AEO status and the particulars of the Swiss-Japanese trade agreement.

The authors of the respective articles will be happy to answer any further questions you may have concerning the individual subjects. We hope that the subjects we have selected for this edition meet the requirements profile of modern tax managers: varied, differentiated and interdisciplinary.

With this December edition of our Tax News we would not only like to wish you pleasant reading, but also a Merry Christmas and a Happy New Year!

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Customs News

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The introduction of AEO status and the Switzerland-Japan Free Trade Agreement represent major changes in Swiss customs legislation.

AEO status for companies in Switzerland

Due to the events of 9/11/2001, the EU has followed the United States in introducing regulations to secure trading chains for import, export and transit purposes. The measures implemented by the EU include the introduction of AEO (Authorized Economic Operator) status for companies that are particularly reliable and trustworthy, among others. In order to facilitate trade between the EU and Switzerland, the EU and Switzerland are currently negotiating a new agreement on the easing of customs restrictions and customs security, the draft version of which has provisionally entered into force since July 1, 2009. The timing for the approval of the final version has not yet been decided. The Federal Council has approved the dispatch on adopting and implementing the agreement between Switzerland and the EU on easing customs formalities and customs security for the attention of parliament. Based on the agreement, Switzerland is also introducing an AEO status that can probably be applied from the beginning of the second quarter 2010 after the completion of the pilot phase.

The following requirements must be met for AEO status to be granted:

- ▶ The company must be based in Switzerland and/or the Principality of Liechtenstein
- ▶ The company must be entered in the Swiss Commercial Register and/or the Public Register of the Principality of Liechtenstein
- ▶ The company must have previously complied with customs regulations
- ▶ The company must have a system for managing company accounts and, if

applicable, carriage documentation enabling appropriate security-relevant customs checks to be carried out

- ▶ The company must be verifiably solvent
- ▶ The company must have suitable security standards in place.

In order to be granted AEO status, the company must complete a self-assessment questionnaire. The 20-page draft version (link at www.ezv.admin.ch/zollinfo_firmen/verzollung/02955/index.html?lang=de) includes questions on the following areas:

- ▶ General data concerning the company
- ▶ Business volume
- ▶ Previous compliance with customs regulations
- ▶ Applicant's accounting and logistics systems
- ▶ Solvency
- ▶ Security requirements

Obtaining AEO status is free of charge. However, the company may incur significant internal costs (e.g. implementation of the security system and correct accounting system, if not already set up, etc.).

The aim is for companies with AEO status to reduce the amount of data they must specify when making their preliminary customs declarations. Moreover, waiting times at customs should be cut and fewer checks carried out. However, it should be noted that this will probably apply only if all parties involved in the supply chain (e.g. producers, exporters, shippers, customs agents, warehouse keepers, carriers, importers) have AEO status.

AEO status will not be obligatory. Furthermore, it does not have any influence over the other favored statuses such as authorized recipient or sender. Companies without AEO status should not be disadvantaged. Nevertheless, the advantages for

companies with AEO status can, however, gradually result in disadvantages for others (such as longer waiting times at borders).

Free trade and economic partnership agreement between Switzerland and Japan

In February 2009, Switzerland and Japan signed a bilateral free trade and economic partnership agreement that came into force on September 1, 2009.

Japan is considered as one of the most important foreign markets for Swiss exporters and is one of Switzerland's largest trading partners in the Asian economic region. The free trade and economic partnership agreement is thus of major significance. In Europe this agreement is unique in that Switzerland is the first European country with which Japan has concluded such an agreement.

The agreement is also special in that not only preferential terms of origin are laid down, but that several economically significant sectors are additionally given due consideration. Among other things, it includes regulations governing trade with goods and services, supplementary terms relevant to the OECD concerning the protection of any investments made, provisions on intellectual property and e-commerce, simplifications in international passenger transport, cooperation between the competition authorities and a reduction in non-tariff trade barriers.

The signing of this agreement marks the first time that a free trade agreement concluded by Switzerland establishes the basis for addressing specific economic matters.

This agreement enables Swiss companies – as opposed to their counterparts based in the EU – to import goods originating in Japan on a duty-free basis. According to the free trade agreement with the EU, such goods can then be imported into the EU free of duty insofar as the concerned goods undergo sufficient processing in Switzerland and are thus considered original Swiss products. Particularly in the case of goods subject to high customs tariffs, this could open up opportunities for Swiss companies and Switzerland as a business location.

News on the capital contribution principle

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The capital contribution principle set to come into force on January 1, 2011, is to be implemented via a by-law and set out in detail in a new circular. The outlines of the implementation of the capital contribution principle are already becoming more clear thanks to verbal statements made by representatives of the Swiss Federal Tax Administration. The following, therefore, is based on the details set out in the "Transition to the capital contribution principle" article published in Tax News in April. At the same time, various details that are potentially to be laid down in the bylaw or circular will be analyzed below.

Regulatory framework and formal requirements

The normative implementation of the capital contribution principle is to be initially laid down in the bylaw to the Swiss Withholding Tax Act and thereafter in a new circular on the capital contribution principle. Moreover, the aforementioned circular is supposed to discuss the impact of the capital contribution principle on all restructuring aspects, as Circular No. 5 regarding restructurings will only be amended at a later date. The new regulations will also set out the formal requirements that will apply to capital contribution reserves in the future. Probably the most obvious new formal requirement concerns the future reporting of capital contribution reserves in a separate account in the balance sheet. In addition, it is expected that the contribution reserves will have to be reported to the Swiss Federal Tax Administration on an annual basis. In contrast, the duty of declaration at the cantonal level only applies when distributions are made, as only then are direct taxes affected. With regard to formal requirements, it is important to note at this point that the assignment of reserves must already be accounted for at the annual shareholders' meeting for the 2010 fiscal year.

Scope of application of capital contributions

As already announced in the spring Tax News article mentioned above, any shareholders that have made open capital contributions after January 1, 1997, will not be taxed for them upon repayment provided that the aforementioned formal requirements are fulfilled. As such, neither current/retained profits, nor hidden capital contributions, nor open capital contributions that have not been made directly by shareholders qualify as capital contributions. On the other hand, the difference between the price premium and the par value upon sale of treasury shares, which were already taxed during a partial liquidation process,

can be assigned to the capital contribution reserves. Furthermore, contributions to the reserves from convertible and warrant bonds can be credited to the capital contribution reserves at the time of conversion.

Planning options and limits

In the future, companies will reportedly have the option of, for instance, issuing bonus shares or free par value increases from the contribution reserves without them being subject to taxation. Planning options will particularly be opened in the area of restructuring. While profits can only be assigned to profit reserves in the case of certain restructurings, in the case of other specific types of restructuring there will be a free choice as to which company are assigned profit reserves or capital contribution reserves, a fact that could be of importance with regard to later sales of the company. Furthermore, the so-called share premium solution continues to be an option in case of a transposition ("Transponierung"), but only if the participation is allocated to the profit reserves. The planning options are principally limited by the ban on reassigning the remaining reserves as capital contribution reserves. This also covers the open or hidden distribution of profit reserves and their subsequent renewed contribution as share premium, as one could thus, for instance, avoid adverse residual withholding tax consequences on the later sale of the participation abroad.

Quo vadis?

In summary, it can be said that what the Swiss Federal Tax Administration has stated with regard to the new capital contribution principle leaves a rather fiscal mark. However, it should be noted that the statements made so far are of a merely oral nature, and the planned circular and by-law must still be prepared in consultation with various interest groups. Nonetheless, due consideration should be given to the initial statements made.

New challenges for tax professionals

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Tax professionals increasingly have to face new challenges and deal with issues such as risk management, process management or constantly changing reporting standards in order to meet the requirements expected from a modern tax function.

General remarks

The changing role and constantly expanding duties of tax professionals are attributable to a number of developments. The performance of a tax department can no longer be primarily measured by the reduction in the company's effective tax rate or by the cash tax savings; instead he or she must have additional skills to meet the demands expected from a good tax function.

In 2008, the OECD published a study¹ examining the today's requirement profile of a tax professional. The results of the study have been summarized in the following.

Core competencies of a modern tax professional

The findings of the OECD study can be roughly divided into five main areas of competency required from tax professionals in order to meet the needs of management, co-employees, the public and tax authorities.

Business skills

Tax professionals need sound knowledge of the business activities of their respective company in order to be able to assess tax-related matters in terms of modern accounting standards. Previously purely mathematical data are being increasingly replaced by qualitative estimates that account for the specifics of the company concerned.

Risk management

Tax professionals are increasingly adopting a risk-based approach to the planning and implementation of tax measures. This applies to both prioritization work as well as the content design of individual audits and processes. A good understanding of the company's business activities is once again of fundamental importance for effective risk management, as relevant risk areas cannot be identified otherwise. In this context, it is not simply a matter of detecting risks in a purely technical area, but more a matter of tax professionals having to give due consideration to aspects such as financial and business risks or the company's reputation.

Transparency

The possibility of obtaining rulings, the increasing complexity of companies and their international integration as well as media attention have all helped to create a new relationship between the tax authorities and companies, which is characterized by mutual transparency and cooperation and is intended to guarantee a predictable, correct and efficient taxation. Tax professionals are expected to support this cooperation and cultivate a good and open contact with the tax authorities.

Information management

Significant changes in the work of tax professionals have been entailed by the introduction of modern accounting standards. Not only do they demand new content, in formal terms they have also raised the demands on documentation quality and frequency. This means that tax professionals must be in the position to make information available and manage it. In order to record relevant data in a uniform and prompt manner, sound IT skills and a well-conceived information management system at all corporate levels are required.

Since the regulations mentioned above develop more dynamically than other legislation, a reliable information sourcing process is additionally required so that changes can be identified at an early stage and internal processes adapted accordingly.

Leadership

All of these changes mean that the work of the tax professional can no longer take place within the framework of an isolated department, but instead must be integrated into all areas of the company. This particularly affects information management activities, but also monitoring systems within the context of risk management need an integrated tax function. In order to be able to perform these tasks effectively, particularly against the background of a globalized world, tax professionals must possess strong leadership qualities.

Final remarks

Today's tax professionals are confronted with a variety of stakeholders. The company's management expects minimum tax expenses without the company being exposed to greater risks in terms of finances or image. The company's employees, who are supposed to understand and implement the necessary information and risk management systems at all levels, need a competent executive. The tax authorities ultimately expect a competent and transparent cooperation partner with high integrity.

These considerations should be taken into account both in the selection and in the training of tax professionals.

¹ Study into the Role of Tax Intermediaries, OECD, 2008, ISBN-978-92-64-04179-0

Extended net operating loss carryback period lets U.S. companies access much-needed cash

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U.S. companies, including U.S. subsidiaries of Swiss and other non-U.S. multinationals, in a loss position should consider taking advantage of the extended carryback period for net operating losses ("NOLs"), which was recently enacted as part of the Worker, Homeownership, and Business Assistance Act of 2009. Under the act, nearly all U.S. companies, regardless of size, may carry back certain 2008 or 2009 net operating losses up to five years resulting in a refund opportunity.

US Treasury Department Circular 230 disclosure

The US federal income tax advice contained herein was not intended or written by Ernst & Young to be used, and cannot be used, by the recipients, or anyone to whom they disclose our advice, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or under state or local law.

Overview

On November 6, 2009, President Obama signed the Worker, Homeownership, and Business Assistance Act of 2009, provisions of which extended the NOL carryback period up to five years for certain 2008 or 2009 losses (general rule is 2 back, forward 20). It also suspends the 90% limit on the utilization of Alternative Minimum Tax losses for the extended carryback period.

Defining applicable net losses/loss from operations

The act defines an applicable net loss as a net operating loss that arises in a tax year either beginning or ending in 2008 or 2009. Defining the loss this way gives U.S. companies the flexibility to choose the tax year that most benefits them, taking into account such things as the implications of various tax attributes.

Limitations and deadlines

For U.S. companies carrying an applicable NOL back five years, the act limits the carryback amount to 50% of the company's taxable income for that year. The limit is not permanent, however, so companies could carry the remaining NOL forward. No limit applies to applicable NOLs carried back four years or less.

The deadline for making the election is the extended due date of a company's U.S. federal income tax return for the last year beginning in 2009 (15 September 2010 for calendar-year corporations). Once made, the election is irrevocable.

Recommended analysis

1) Determine the taxable year for which to make the election (2008 or 2009) by modeling the benefit of multiple scenarios, determining the available taxable income in each window period and determine the impact on tax attributes for each year or window period and carryback period.

- ▶ Do you carry back the 2008 NOL two years and elect to carry back the 2009 NOL three, four or five years under the new provision?
- ▶ Do you carry back the 2009 NOL two years and elect to carry back the 2008 NOL three, four or five years under the new provision?

2) Consider filing accounting method changes to **enhance** the benefit such as:

- ▶ Deferral of advance payments;
- ▶ Acceleration of deductions for prepaid assets (e.g., prepaid insurance);
- ▶ Acceleration of self-insured medical expenses, general or workers compensation;
- ▶ Changing to a more favorable depreciation method or recovery period;
- ▶ Acceleration of repair and maintenance expenses improperly capitalized;
- ▶ Acceleration of deductions for real property taxes;
- ▶ Changes to inventory valuation methods.

3) Consider **enhancing** the loss by transactions that could trigger losses.

- ▶ Foreign exchange losses;
 - i. "Significant modification" of a foreign currency borrowing;
- ▶ Worthless stock loss;
 - i. Consider liquidating insolvent subsidiaries including by conversion or entity classification election.
- ▶ Trigger deductions by wholly and partially worthless debts;
- ▶ Trigger deductions for property abandonment;
- ▶ Trigger losses by obsolete inventory.

4) Consider tax accounting considerations.

- ▶ Effect on valuation allowance;
- ▶ US GAAP effects of a change in the tax law;
- ▶ Effect on FIN 48.

5) Consultation is recommended to be sure the complex filing requirements are met (e.g., IRS Form 1139 - Corporation Application for Tentative Refund, trigger of Reportable Transactions, IRS Form 3115, etc.).

State and local impact

While most states allow corporations to make adjustments for NOLs, a majority of states (30) do not allow corporate taxpayers to carry NOLs back. Of the states that allow NOL carrybacks, only five allow carryback to two or three years and, therefore, do not tie their statutes to federal law. Of the remaining states which impose a corporate income tax (Nevada, South Dakota, Washington and Wyoming do not impose corporate income taxes), several have state federal conformity statutes which do not

automatically tie to the federal tax law, thereby, automatically allowing the new five-year carryback. Of the small number of states that have rolling conformity with federal tax law, several have decoupled from new federal provisions due to the current economic climate. Therefore, it is likely that additional states will decouple from this new provision. In sum, because of the disconnects between the federal NOLs and the state NOLs, corporations should be careful to closely track and substantiate state NOLs so as to avoid losing state benefits.

Implications

The economic downturn has made cash flow considerations critical to most businesses. By taking advantage of the extended carryback period, interested companies may be able to obtain cash through tax refunds from NOL carrybacks.

International transfer pricing

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On September 9, 2009, the Organization for Economic Cooperation and Development ("OECD") published its draft proposals for the amendment of Chapters I to III of the OECD Transfer Pricing Guidelines. Moreover, the German Federal Ministry of Finance ("BMF") announced the publication of the first official draft of its "Administration Principles of Function Relocation" on July 17, 2009.

OECD: Announcement of the draft publication of the revised transfer pricing guidelines

According to the OECD's Transfer Pricing Guidelines of 1995, a strict hierarchy of transfer pricing methods is in place, in which the comparable uncontrolled price method ("CUP method") is the preferred transfer pricing method, and traditional transaction-related methods such as the cost-plus method and resale price method are preferred to profit-oriented methods. The most important change in the OECD draft is the proposed elimination of the previous hierarchy of transfer pricing methods, to be replaced by the introduction of the principle of the "method best suited to the circumstances of the individual case." The application of the profit split method and

the transaction-related net margin method ("TNMM") will consequently no longer be restricted to exceptional cases. However, in the event that a traditional transaction-related method and a profit-oriented method are both equally suited for reliable application, the traditional transaction-related method is to be chosen. The same applies with regard to the price comparison method, which will continue to be preferred, provided that it and another method can be applied with equal reliability.

In accordance with the OECD draft, the profit split method is to be applied as a general rule, provided that both parties contribute unique or valuable intangible assets, or if the transaction is unique in terms of the highly integrated nature of its processes. To the extent possible, profit distribution is to occur in the same way as independent third parties would divide the profit in comparable transactions, in accordance with the arm's length principle. As a result, the principle set out in the Transfer Pricing Guidelines of 1995, whereby the proportional value of the functions executed in the companies involved is used to determine profit division, is to be discontinued. In comparison with this, the TNMM is to be applied if only one of the parties involved contributes unique intangible assets. On the other hand, in cases where neither of the two par-

ties contributes unique intangible assets, or both parties do so, but only the intangible assets of one of the two parties are to be considered unique, transfer pricing methods other than the TNMM are assumed to be more reliable.

Furthermore, the OECD draft emphasizes the importance of a comparability analysis for the application of the arm's length principle, taking the reasonability limit for taxpayers into account. Nonetheless, the identification of reliable comparative data is regarded as the basis for determining transfer prices. Ten key, but not mandatory, steps are laid down for conducting a comparability analysis, including the comprehensive analysis of the taxpayer's circumstances, the determination of the years to be covered, a functional analysis, the auditing of existing internal comparative data, the determination of available information sources for external comparative data, the selection of the best-suited transfer pricing method, the identification of potential comparative data, the determination and execution of potential adjustment calculations, the evaluation and application of data and the introduction of supportive procedures. In the draft, the basis of and requirements for potential adjustment calculations for comparative data are described. Notably in terms of the comparability of significantly influential differences, adjustments

should be made as far as possible, but too many adjustments are an indication of merely low comparability. Moreover, it is determined that internal comparative data are not necessarily more reliable than external data.

BMF: Publication of the draft letter "Administrative Principles of Function Relocation" dated July 17, 2009

The 72-page draft includes clarification of the interpretation of § 1 Para. 3 of the Foreign Tax Act ("AStG"), whose new version in 2008 regulated the function relocation in Germany by law for the first time, as well as the explanatory function relocation directive of mid-2008 ("FVerIV"). Whereas § 1 AStG and the FVerIV constitute binding law, the "Administrative Principles of Function Relocation" involves their interpretation by the financial authorities without any legally binding effect for taxpayers.

The draft includes in-depth discussion of the concept of a function and its relocation and technical details for the evaluation of the so-called transfer package that is the starting point for the determination of appropriate transfer pricing in the case of function relocation, which comprises a function and the opportunities, risks, assets and benefits associated with it. According to the draft "Administrative Principles of Function Relocation," the production of a single product is considered to be a function, whereas, the production of another product, regardless of any similar product characteristics, is to be regarded as another function.

In cases where the accepting company exclusively carries out routine activities for the transferring company and receives remuneration in the form of its costs plus a markup in return, it is assumed that the transfer package contains no intangible assets or other benefits of any significance and that no valuation of the transfer package is required. The same is also to apply if the transfer price is calculated via a cost-based TNMM or the accepting company is remunerated via payment of commission due to its low risk profile. However, comparative clarification is lacking for cases in which the distribution function is remunerated in accordance with a revenue-based TNMM (or a modified resale price method).

Overview of amendments to cantonal tax laws for selected cantons

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Canton of Aargau

Retroactive abolition of the Dumont practice as an economic support measure

January 1, 2009, marked the early introduction of the third stage of the tax legislation revision. The canton of Aargau is now turning its attention to other fiscal measures aimed at supporting the economy.

Up until now, refurbish costs incurred for a neglected property were not tax-deductible during the first five years after its acquisition. According to the new regulations, such costs are tax-deductible already from the time of acquisition of a neglected property undergoing refurbishment. However, the prerequisite for this is that the respective work is carried out after December 31, 2008.

This regulation is scheduled to be introduced at the federal level at the beginning of 2010. In contrast, this regulation is being retroactively put into effect in the canton of Aargau as of January 1, 2009.

Easing of additional taxation and introduction of voluntary self-disclosure without penalty in inheritance cases

The new federal act on the simplification of additional taxation in inheritance cases and the introduction of voluntary self-disclosure with immunity from penalty as from March 20, 2008 is to be introduced with effect as of January 1, 2010. The consequence of this is that in cases where undeclared income and assets of the deceased testator are disclosed, the heirs benefit from lower additional taxation and lower late interest. Additional tax and late interest are thus only due for the last three tax years prior to the death of the testator, instead of for the last ten years.

In the event that the Aargau Cantonal Tax Act (ACTA) will not have been amended accordingly by January 1, 2010, the Federal Act on the Harmonisation of Direct Taxes (THA) is to be applied directly.

After January 1, 2010 in the case of the firsttime voluntary self-disclosure of tax evasion the penalty may be waived. For each further case of voluntary self-disclosure the penalty is to be reduced to one-fifth of the tax amount subject to evasion. Penalty-free voluntary self-disclosure has already been introduced in the Canton of Aargau under section 236 ACTA. The provision is now to be amended in order to bring it in line with the THA.

Implementation of Corporate Tax Reform II

The Great Council of the Canton of Aargau has approved those regulations set out in the second stage of the Corporate Tax Reform II (CTR II). The provisions concerned, however, will only come into force in 2011. One of the most important changes concerns the extension of the participation exemption for legal entities: When coming into effect, income from participations of 10% or 1 million Swiss francs (fair market value) qualifies for the participation exemption. The same is true with respect to capital gains from the sale of participations of 10% insofar as the participation has been held for at least one year (Art. 28 para. 1, 1bis and 1ter THA).

Canton of Zurich

Abolition of lump-sum taxation

Up until now, Zurich Cantonal Tax Act (ZCTA) foresaw the option of lump-sum taxation. Foreign nationals without employment could be taxed on a lump-sum basis both in the tax period of their relocation to Switzerland, as well as in subsequent years. On February 8, 2009 the popular initiative "No more tax privileges for foreign millionaires (abolition of lump-sum taxation)" was adopted and lump-sum taxation was abolished in the Canton of Zurich: Section 13 para. 2 ZCTA is to be deleted effective January 1, 2010. Lump-sum taxation can

only be applied for in the case of cantonal and communal taxes for the tax period in which the relocation to Switzerland from abroad occurred. Direct federal tax is unaffected by the abolition.

Abolition of the Dumont practice

The Dumont practice does not foresee the possibility for refurbish costs incurred for neglected properties to be deducted from income during the five years subsequent to their purchase.

On October 3, 2008 the Swiss parliamentary councils approved the federal act on the tax-related treatment of refurbish costs incurred for real estate properties. This states that the cost of refurbishing newly acquired properties is deductible.

The matter is to be discussed in the Cantonal Council by early December 2009 at the latest. In the event that approval by the Council is given, the amended section 30 para. 2 ZCTA will come into force with effect as of January 1, 2010.

Revision of tax legislation on further reduction of taxes for individuals

On March 30, 2009 the Cantonal Council of Zurich approved the tax legislation revision concerning further reduction from taxes for individuals. However, the revision cannot come into force on January 1, 2010, as planned. A Cantonal Council referendum was called for in opposition to the resolution passed by the Cantonal Council and two constructive referendum motions with counterproposals were also submitted. The popular vote is likely to be held in June 2010.

Canton of Solothurn

Abolition of the Dumont method

On June 30, 2009, the Governing Council decided to abolish the Dumont method effective January 1, 2010, by means of a directive amendment. As a result, new owners of property can, from the time of acquisition, deduct the cost of repairing property whose maintenance has been neglected. In accordance with the tax legislation in place in the canton of Solothurn, it would have already been previously possi-

ble to deduct maintenance costs incurred for neglected properties. However, decades of court and administrative practice restricted the use of this deduction option.

Canton of Berne

Abolition of the Dumont method

Dumont method discontinued retroactively as of January 1, 2009.

Penalty-free voluntary self-disclosure

The possibility of penalty-free voluntary self-disclosure of tax evasion is new as of January 1, 2010. No fines will be imposed; only standard subsequent taxation and interest on arrears will be retroactively charged for a maximum period of 10 years. Penalty-free voluntary self-disclosure is only possible once per lifetime, and applies to both natural persons and legal entities.

Simplified subsequent taxation for inheritances

The main change here is the fact that the subsequent taxation of inheritances can only be demanded from the heirs for the three prior tax periods in the case of tax evasion on the part of the testator.

Partial revision of the Bernese tax legislation effective as of 2011

The partial revision of the Bernese tax legislation is to enter into force on January 1, 2011. The partial revision focuses on the implementation of mandatory federal law (enhanced deduction of shareholdings, privileged taxation of liquidation profits), as well as the legally prescribed adjustment of the so-called fiscal drag process.

Canton of Lucerne

On September 27, 2009, the revision of the canton of Lucerne's tax legislation was approved by those eligible to vote and will come into force on January 1, 2011. Apart from harmonizing cantonal tax legislation with the federal tax requirements set out in the Federal Law on the Harmonization of Direct Cantonal and Communal Taxes and Corporate Tax Reform II, the aim of this legislative amendment is to continue the ongoing process of tax relief that is intended

to strengthen the competitiveness of the canton of Lucerne.

The most significant change in this context is the sharp reduction in the tax rate on profits for legal entities. A cut in the profit tax rate from 4% to 3% effective January 1, 2010, had already been approved through partial revision of tax legislation in 2008. A further halving of the profit tax rate is scheduled to apply after 2012. As a result, the profit tax burden at the cantonal and municipal level will reach between 4.3% and 6.5%, depending on the municipality concerned. With this reduction, the canton of Lucerne is striving for the number one position among all cantons in terms of the profit tax burden.

In the case of natural persons, the middle income classes will enjoy further tax relief. Furthermore, as far as tax competition is concerned, tax progressions will increasingly level out for higher incomes.

In the context of property taxation, changes will also occur in this area in the canton of Lucerne. In the case of immovable property transfer tax, in the future this tax will be levied on the agreed purchase price for legal transactions between independent third parties. In addition, profits generated on the sale of property by real estate agents based outside the given canton will no longer be subject to the property gains tax after 2011, but will be subject instead to standard income and profit tax.

Canton of Zug

The canton of Zug has decided to go ahead and implement the reduction in income tax for the middle class starting in 2010, which was originally planned to come into effect in 2011. Those set to benefit from the cut in the income tax rate of up to 28% in particular are families with a taxable income of between CHF 40,000 and CHF 160,000, as well as singles with a taxable income of between CHF 20,000 and CHF 80,000.

The 2009 revision to tax legislation saw the tax rate applicable to profits earned by legal entities cut from 7% to 6.75% for the net profit amount exceeding CHF 100,000

for the tax years 2009 and 2010. A further reduction to 6.5% is set to be introduced in the 2011 fiscal year.

Canton of Schwyz

By way of the 2010 partial revision of tax legislation, the federal legal amendments set out in Corporate Tax Reform II and the Federal Law on the Harmonization of Direct Cantonal and Communal Taxes are being implemented at the cantonal level. Moreover, the income tax rates for natural persons are being reduced slightly and the deductions for children and social security increased. In addition, the withholding tax rates for artists, athletes and speakers are being cut to 7-13%.

The most important measure being introduced in the area of corporate taxation is the reduction in the profit tax rate for legal entities. The two-phase rate (2% on the first CHF 20,000 and 4% on the net profit exceeding CHF 20,000) previously in place is to be replaced by a uniform rate of 2.25%. The aim of this cut is to further strengthen the attractiveness of the canton of Schwyz as a business location.

Canton of Obwalden

The canton of Obwalden is not planning to make any changes for the 2010 tax year.

Canton of Nidwalden

No changes are planned in the canton of Nidwalden for 2010.

For the 2011 tax year, however, a partial revision of tax legislation is planned, which is currently in the consultation stage.

Canton of Uri

No changes are planned for 2010.

However, effective January 1, 2011, a full revision of tax legislation, including the Property Gains Tax Act and Inheritance Tax Act, is planned for the canton of Uri. Corresponding consulting measures are likely to take place at the end of 2009.

Basel-Stadt/Basel-Landschaft

Brief comments on the amendments to cantonal tax legislation in the area of corporate taxation in both Basel-Stadt and Basel-Landschaft for the 2009 tax period

For the purpose of improving their inter-cantonal competitiveness, the cantons of Basel-Stadt and Basel-Landschaft (city and region) had already harmonized their tax legislation, with effect as of the 2008 tax period. As far as legal entities were concerned, the changes mainly involved a reduction in tax rates. In addition, it has been possible in both cantons to offset operating losses, which cannot be offset against operating profits, against the value increase in income earned from property sales subject to property income tax since the 2008 tax period.

As far as legal entities are concerned, very few changes are set to come into force in the cantons of Basel-Stadt and Basel-Landschaft with effect from the 2009 tax period.

As part of Corporate Tax Reform II, the following tax relief measures that must be adopted by the cantons are only set to come into effect after the 2011 tax period, which also applies at the federal level.

Legal entities

- Extension of shareholding deductions
- Extension of replacement procurement

Natural persons

- Introduction of the capital contribution principle
- Tax deferral on the transfer of property from business assets to private assets
- Tax deferral on hidden reserves in the case of estate settlement
- Tax relief for liquidation profits
- More advantageous valuation of securities as business assets

Basel-Stadt

With regard to the easing of the burden of double taxation, a motion to introduce the partial taxation of dividends was also accepted in the canton of Basel-Stadt by the Great Council on November 11, 2009 (subject to the holding of a referendum). As such, those dividends, liquidation profits and cash-equivalent benefits arising from shareholdings held by natural persons, which respectively account for at least 10% of the share capital or capital stock of the given company or cooperative, will only be taxable at a level of 50% after January 1, 2011. The canton of Basel-Stadt is thus following the lead of the canton of Basel-Landschaft, in which the easing of the burden of double taxation had already been introduced from the 2008 tax period.

The tax legislation in place in the canton of Basel-Stadt is to be amended in the area of corporate taxation from the 2009 tax period as follows:

Reduction in the maximum profit tax rate

The maximum profit tax rate of 24.5% was cut to 23% as of January 1, 2008, and is to be reduced further to 22%, with effect from the 2009 tax period. From the 2011 tax period on, the plan is to reduce it even further to 21.5%. Furthermore, additional partial reductions in the tax rate by 0.5% in each case are planned.

Basel-Landschaft

The tax legislation in place in the canton of Basel-Landschaft is to be amended in the area of corporate taxation from the 2009 tax period as follows:

Reduction in the tax on capital at the municipal level

The tax on capital at the cantonal level was cut to 1‰ of taxable capital from the 2008 tax period. However, it should be noted in this regard that an adjustment for inflation is no longer simultaneously granted when capital taxes are calculated. Prior to this, the respective taxable capital was reduced by the change in the value of money occurring since January 1, 1987.

The municipalities in the canton of Basel-Landschaft do not raise taxes in proportion to the standard state rate but by setting their own tax rate. Capital tax rates at the municipal level, which previously varied between 1.75-3.5‰ depending on the municipality concerned, have been subject to a maximum rate of 2.75‰ since the 2009 tax period.

Offsetting tax on profit against tax on capital

As far as corporations are concerned, they are to be given the option of offsetting tax on profit against tax on capital at the cantonal and municipal level as part of Corporate Tax Reform II. The tax on capital can thus be reduced by the amount of tax on profit.

In the canton of Basel-Landschaft, tax on profit can be offset against tax on capital from January 1, 2010 on. There are currently no plans for the introduction of such a regulation in the canton of Basel-Stadt.

Canton of Grisons

On June 18, 2009, the parliament of the Canton of Grisons approved the partial revision of its tax legislation. As the deadline for calling a referendum expired on September 23, 2009, the new regulations will enter into force, as planned, on January 1, 2010. An exception to this are the regulations for harmonization with Corporate Tax Reform II, which are only due to come into force on January 1, 2011. The partial revision involves a change to a proportional tax on profit of 5.5% for legal entities. Moreover, the maximum rate of net wealth tax is to be cut to 1.75‰, while net wealth tax allowances are to be increased. In addition, both the adjustment for fiscal drag based on a change in the national consumer price index of 3%, instead of the 10% change currently applied by law, and the abolishment of the Dumont method are planned.

Canton of Appenzell Ausser-rhoden

The partial revision of tax legislation that is to enter into force on January 1, 2010, is intended to contribute to easing the tax burden on lower and middle incomes as well as that on net wealth. To this end, the net wealth tax rate on assets in excess of CHF 250,000 is to be cut from 0.6‰ to 0.55‰, while net wealth tax allowances are to be increased. Furthermore, income tax rates are to be adjusted. Through the partial revision, the Dumont method is scheduled to be retroactively abolished with effect from the 2009 tax period.

Canton of Thurgau

The flat tax proposal was rejected in the referendum on September 27, 2009. The canton now aims to cut the tax multiplier by 10 percentage points with effect from January 1, 2010, and is also planning an amendment to tax legislation that will not come into force before January 1, 2011, at the earliest.

Canton of St. Gallen

The introduction of Amendment VI to its tax legislation sees various changes coming into force in the canton of St. Gallen on January 1, 2010. The most important ones include the reduction in the income tax rate, the abolishment of the Dumont method, the simplified subsequent taxation of inheritances and the introduction of penalty-free, voluntary self-disclosure as well as the adjustment of fiscal drag in the case of a change in the national consumer price index of 3% instead of the previously applicable 8%.

As of January 1, 2011, the following provisions in Amendment III are also set to come into force:

- ▶ The valuation of business asset securities at their income tax values
- ▶ Grounds for deferral such as tax deferrals on the transfer of property from business to private assets and on hidden reserves in estate settlement cases

- ▶ Capital contribution principle
- ▶ Tax relief for replacement purchases in connection with corporate restructuring
- ▶ Tax relief on liquidation profits
- ▶ Enhancement of the deductibility of shareholdings through the reduction in the qualifying shareholding ratio from 20% to 10%.

Tessin

In its December 2008 session, the Great Council approved a partial revision of tax legislation in order to bring cantonal law in line with federal law. On the basis of the second stage of Corporate Tax Reform (CTR II), the following main amendments were approved:

Regulation to come into force on January 1, 2010:

- ▶ The economic double taxation of dividends from qualified participations is to be relieved via application of so-called partial income taxation. Participations held in private assets will therefore only be subject to taxation to an extent of 60% and participations held in business assets to an extent of 50% in the future. Under certain circumstances, profits earned on the sale of qualified participations held in business assets will only be taxed to an extent of 50% as well.

Regulations to come into force on January 1, 2011:

- ▶ Extension of the participation exemption to include participations of at least 10% in a company's share capital or capital stock or with a fair value of at least 1 million Swiss francs;
- ▶ Deferral of the taxation of hidden reserves in the case of the transfer of a business due to estate settlements, provided that the business will continue to operate;
- ▶ Tax relief on liquidation profits when giving up self-employment due to invalidity or the person having reached the age of 55;

- ▶ Simplified transfer of hidden reserves to replacement purchase.

In addition, the Governing Council has decided to abolish the Dumont practice, as of January 1, 2010. As a result, investments in the maintenance of neglected properties will in the future already be tax-deductible from the time of acquisition.

Furthermore, the directive governing the deduction of expenses incurred in the maintenance of properties is to be adapted. In accordance with this, taxpayers are now being given the option to choose whether to claim effective maintenance expenses or a lump-sum amount (a so-called alternative flat-rate allowance) in each tax period. The previously applicable 10-year waiting period has thus been eliminated. This amendment comes into force on January 1, 2010.

Similar to the Swiss federal law on direct federal taxation, additional taxation in the case of inheritance will be simplified in the cantonal tax legislation and voluntary declaration with immunity from prosecution will be introduced for all persons liable to taxation from January 1, 2010.

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