

# Tax News



Dear Reader,

Tax managers are currently facing a quickly changing environment, in terms of both external factors such as changing tax legislation and regulatory provisions, and internal changes such as restructuring of departments or companies and increased monitoring of tax departments by senior management. This dynamic tax landscape is posing numerous challenges for tax functions, but at the same time it is also creating unexpected opportunities for them to reorganize their procedures. A key component of every tax function is the development and communication of an effective tax strategy.

When filing their tax returns in the US, certain companies with assets equal to or exceeding USD 10 million must list, on a new form, uncertain tax positions (UTPs) that were identified for accounting and reporting purposes. As part of the new provisions on disclosure and accounting, the Internal Revenue Service (IRS) is requiring an "exact description" of the individual uncertain tax positions.

This and other current tax topics from Switzerland and other countries will be the focus of this issue of Tax News. The authors of the various articles will be glad to answer any further questions you may have regarding the individual topics.

We hope you find it an interesting and informative read.

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# The need for a tax strategy

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**Tax directors today face a rapidly changing environment, with external factors such as changing tax laws and regulatory requirements, and internal changes such as finance department restructurings, corporate restructuring and increased management scrutiny on the tax department. While this dynamic environment poses many challenges for the tax function, it also provides for exciting new opportunities to change the way the tax function operates. A key component of the tax function is the development and communication of an effective tax strategy.**

Being a tax director is a constant balancing act; working hard to secure the present in the face of more aggressive tax authority challenges and working out ways to sustain the future, as companies reshape their business model in this new economy. Changing tax laws, increased regulatory requirements, finance department restructurings, corporate restructurings, and increased internal and external scrutiny on the tax department have greatly increased the tasks, risks, and responsibilities of the tax function. It is important that the tax function is structured appropriately to actively manage all aspects of this new environment. Building a more effective tax function begins with the development and communication of an effective tax strategy.

In this new environment, how do tax directors chart an effective strategy for the tax department? The tax strategy should be developed in a manner to provide clarity of the tax function's goals and objectives. The strategy should address all aspects of a tax function, including the scope of taxes for which the tax department is responsible, governance, people, performance, processes, and technology. It is important that the tax strategy is in line with the overall business strategy in order to be successful and sustainable. Examples of different components the tax strategy should include are described in the remainder of the article.

## Governance

- ▶ Document the organization's overall approach to the tax function and describe the purpose of the tax strategy.
- ▶ Outline the communication requirements between the tax director and internal and external stakeholders, including the CFO, the Audit Committee, the Board, and taxing authorities.
- ▶ Establish the tax risk management framework of the group and describe the tax risk tolerance parameters applicable to all transactions and tax planning strategies.

## People

- ▶ Outline the roles, responsibilities, and reporting lines within the tax department.
- ▶ Define career development, succession planning, and training requirements for personnel.
- ▶ Describe the policies on the use of external advisors.
- ▶ Detail the interdependencies and communication requirements between the tax department and all other business units.

## Performance management

- ▶ Define performance indicators that the tax department as a whole and tax personnel individually can be assessed against.
- ▶ Develop key performance indicators, which can include measurements around efficiency, growth, quality, and cash flow.
- ▶ Establish incentives when performance criteria are met and hold personnel accountable when those criteria are not met.

## Process

- ▶ Detail the processes related to the tax function, including tax compliance and tax planning.
- ▶ Describe the process and time required for tax return compliance and financial statement compliance, including workflow, information management, resourcing, and technology.
- ▶ Provide detailed guidelines around the type of tax planning that is acceptable to the organization.

- ▶ Describe the process of evaluation, selection, and implementation of tax planning ideas.
- ▶ Establish criteria for all business units to seek the input of the tax department at an early stage in all business planning opportunities.

## Technology

- ▶ Describe all systems used by the tax function, including the finance and other business-related systems that require tax input and knowledge and the systems required and needed specifically for tax compliance, tax reporting, tax research, and tax planning.
- ▶ Specify document preparation and retention requirements.

These are only brief examples of what can be included in the formal strategy of the tax function. The strategy should be categorically detailed for each organization. Creating a formal and detailed tax strategy should not be viewed as a burden. Rather, it should be viewed as a mandate to take action.

The strategy will provide clarity of the tax function, objectives, and goals. The strategy will provide greater visibility to the tax function within an organization and drive the behaviours and views of members within the tax department, as well as all others outside of tax. The strategy will support the business case for the tax department goals and help make available additional resources and tools. A formal tax strategy will help clearly define and communicate the importance of the tax function in the present and in the future. A well-crafted tax strategy will help position the tax function as a key strategic business unit within the organization.

# The Swiss Federal Tax Administration's new practice with regard to grandparent contributions

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**According to a decision by the Federal Administrative Court, grandparent contributions to Swiss companies are not subject to issuance tax if the contribution is not made by the direct shareholder (parent company). This decision revokes the previous practice according to which grandparent contributions were treated equal to contributions from the parent company and consequently were subject to issuance tax.**

## Previous practice of the Swiss Federal Tax Administration (SFTA)

In case of down-the-chain contributions, the SFTA had taken the position that generally all domestic subsidiaries down-the-chain have to pay the issuance tax. For reasons of equity, however, the SFTA did not levy the tax at intermediate subsidiaries and only levied issuance tax once - at the level of the ultimate domestic subsidiary down-the-chain. Under the previous practice, if a grandparent contribution was made directly to a Swiss subsidiary, this contribution was given the same issuance tax treatment as a direct parent company contribution, making it subject to issuance tax. If a grandparent contribution was made directly to a foreign sub-subsidiary (i.e. without making a booking entry at the level of the Swiss intermediate subsidiary), no issuance tax was levied.

## Federal Administrative Court decision

In its decision of 15 April 2009, the Federal Administrative Court found this practice applied by the SFTA in respect of grandparent contributions to Swiss sub-subsidiaries to be unlawful.

Referring to the principle of legality, the Court held that the levy of issuance tax requires an explicit legal basis. The

wording of art. 5 para. 2 letter a. of the Federal Stamp Tax Law (STL) only allows levying issuance tax when a contribution comes from the shareholder. In contrast to the position of the SFTA, the Court argued that, from a formal legal perspective, grandparent contributions do not come from the direct shareholder and therefore there is no legal basis for levying issuance tax.

Regarding the formal term "shareholder" the Federal Administrative Court referred to a decision by the Federal Tax Appeals Commission (TAC) dated 28 June 2005, in which the TAC (a predecessor of the Federal Administrative Court) took an in-depth look at the notion of a formal shareholder. In this decision, the TAC ruled that the sale of a participation owned by a father to a company run by his son, which was executed below fair market value, shall not be subject to issuance tax. The reason for this decision was that the pecuniary benefit granted by the father did not make this a contribution as defined in the STL (Art. 5 para. 2 letter a STL), because it did not come from the shareholder.

In the present case under discussion, the Federal Administrative Court also commented on the question of the extent to which grandparent contributions may be evaluated from the perspective of tax avoidance. Tax avoidance through contributions from third parties should be assumed in situations where, for the purpose of avoidance of issuance tax, persons closely related or associated with the shareholder were "put forward" or where, in the ordinary, proper course of events, a contribution should have been paid by the grandparent company firstly to the subsidiary and only in a second step to its sub-subsidiary.

A third party had not been "put forward" in the present case, the Court ruled, because the company receiving the contribution did not have authority or

power of disposition vis-à-vis the grandparent company and therefore could not have "put this company forward". Nor was the contribution (grandparent contribution) in the present case adjudged to be unusual, improper or peculiar. It was ruled that it is not a case of tax avoidance. In fact, the Court held that the facts of the case reveal objective economic and tax reasons for making the contribution in this way.

## Note

In its decision, the Court accepted the definition of issuance tax as a tax on legal transactions, according to which the legal nature of a transaction is decisive in qualifying a transaction (formal view). It confirmed that, in cases involving issuance tax, economic considerations are of secondary importance.

On the basis of this decision, the SFTA has changed its practice with regard to grandparent contributions. The new regulations were published in Supplement 62 of "The practice of Federal taxes" (Die Praxis der Bundessteuern), under sections 36 and 37, art. 5, para. 2, lit. a STL. At the same time, sections 23 and 25 were revoked.

The Federal Administrative Court's decision is likely to have far-reaching consequences for the financing of group structures. In combination with the SFTA's publication, it has established clarity with regard to the new administrative practice regarding issuance tax consequences of grandparent contributions to Swiss companies. The Court also commented on other interesting issues that could be of relevance for the qualification of issuance tax consequences in other cases with a different fact pattern.

# Notes on the new VAT rates applicable from January 1, 2011

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**The referendum of September 27, 2009, accepted the proposed increase in VAT rates with effect from January 1, 2011. The statutory standard VAT rate will increase from 7.6% to 8%, the reduced rate from 2.4% to 2.5% and the special rate from 3.6% to 3.8%.**

In advance of the increase, the Swiss Federal Tax Administration (ESTV) has published VAT Information Sheet 19 on the VAT rate increase effective from January 1, 2011, and has amended the VAT return form to be used from July 1, 2010. In doing so, the ESTV deviates from its preliminary information to all taxable persons in June 2009 regarding the potential increase in VAT rates to the benefit of the Federal Disability Insurance (IV). This raises a series of questions, particularly with reference to invoicing, taxation and accurate disclosure. These are addressed briefly below. The VAT rate increase also necessitates adjustments to accounting systems.

## Invoicing

Whether a supply is subject to the old or the new VAT rate does not depend on the date of the invoice, nor is it determined by the date that payment is made or received. Instead it is defined by the time at which the supply is actually made.

The old VAT rate will therefore apply to any supplies made before the end of 2010, even if the corresponding invoice is only issued or payment only received in 2011.

Determining the correct VAT rate then becomes difficult when part of a supply is made before the end of 2010 and part of it on or after January 1, 2011. If the supply can be split up according to when it was made (i.e., into one part that was

made before the end of 2010 and one part that was made in 2011) and the invoice states the date or time frame for each of these parts, then both parts can be included on the same invoice, subject to the different applicable rates. Where such a split is impossible or is not made, the entire supply must be taxed and accounted for at the new VAT rate applicable from January 1, 2011.

## VAT returns

New VAT return forms will be in use from July 1, 2010. These will include new fields (sections 301, 311, 341 and 381) for turnover and output VAT according to the new tax rates. For example, if, in line with a payment agreement, an invoice is issued in the third quarter of 2010 for supplies that will be made either partially or wholly after January 1, 2011 (see above), they should be disclosed at the new tax rates and accounted for accordingly. However, this could also be the case before the third quarter of 2010. Until June 30, 2010, such supplies can only be disclosed with the tax rates applicable until the end of 2010. The correction must then be made in the third quarter of 2010 (i.e., in the earliest return after July 1, 2010) by deducting the turnover from the amount subject to the 2010 tax rate and adding it to the field subject to the new tax rate applicable from 2011.

## Peculiarities

Lump sum tax rates will be increased in line with the VAT rates, meaning that the principles mentioned above should equally be a consideration for those taxable persons applying lump sum tax rates. The limits for the application of the lump sum tax rate method will also be raised. The change in tax rates means that, with effect from January 1, 2011, the options provided for in the law, for example with respect to the accounting method, can again be used.

Other peculiarities, in particular with regard to hotels and restaurants, the gross profit supplement in retail, and electric, gas, water and similar utilities can be found in the ESTV VAT Information Sheet 19.

# Taxation of rental value to be abolished?

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## 1 Current situation

Both the Swiss Federal Direct Taxation Act (DBG) and the Swiss Federal Harmonization of Direct Cantonal and Municipality Taxes Act (StHG) provide for the rental value of a property used by the taxpayer to be accounted as income from immovable assets accruing to that same taxpayer.

In accordance with the ability-to-pay principle, it is reasonable that rental value should relate to the market value of the property. A lower value is regarded as tolerable in the case of first homes in order to promote home ownership. The Federal High Court has determined that this value should be at least 70% of the market value.

A number of deductions may be made against the rental value as income. These are the costs of maintenance incurred, insurance premiums, third-party administration costs and debt interest, which are deductible to a limited extent. As a consequence of the setting aside of the "Dumont ruling", these deductions may now be made in the first five years following acquisition too. It had previously been assumed that they would have been reflected in the purchase price.

The rental value - which may, if possible, already have been reduced - can be reduced still further in the case of "under-use", which may occur, for example, after the children have moved out, as their rooms are then subjectively "surplus" from the parents' point of view. Just under half the cantons have rules of this kind applicable to under-use.

The current law has been subject to increasing criticism in recent years, and its continuation has been called into question by a number of motions in Parliament and decisions in the courts. Also worth mentioning, alongside the popular initiative for "Secure homes in old age" that is under discussion here, are the Kuprecht motion of 16 December 2005 entitled "Debt-free in old age: system change in residential property taxation"; the Riklin parliamentary initiative "Abolition of debt interest deduction and rental value on owner-occupied residential property" of 19 December 2008, and the Sommaruga / Schweiger motion, "Simplification of the tax system as applicable to residential property" of 19 March 2009.

In August 2009, the Council of States' Committee for Economic Affairs and Taxation decided to temporarily suspend deliberations on the last motions until such time as more concrete information had become available. The Homeowners' Association's popular initiative might be one way for the people to pre-empt Parliament.

## 2 "Secure homes in old age" initiative

On 23 January 2009, the Swiss Homeowners' Association (HOA) submitted an initiative aimed at the abolition of rental value, the purpose of this being to enable older people to cut living costs as far as possible.

By submitting the "Secure homes in old age" initiative, the HOA is seeking to fulfill the Federal Constitution's mandate to promote home ownership as part of provision for old age. The initiative is specifically intended to alleviate the highly disadvantageous treatment of home ownership by retired persons, whose pension income is particularly significantly impacted and reduced by rental value. At the same time, the present system encourages indebtedness by making debt interest deductible. Property owners who have paid off their mortgages are at a disadvantage. The initiative is also intended to encourage incentives to get people out of debt.

It envisages for people old enough to draw their AHV pensions a one-off right of option, enabling them to decide whether or not they want the residential property in which they permanently live to continue to be taxed on the basis of its rental value. If a taxpayer were to decide that it should not be, they would also lose the right to benefit from deductions for debt interest, insurance and the costs of third-party administration. Maintenance work would continue to be deductible up to a maximum of CHF 4,000. Costs for work on historic buildings or in connection with measures to save energy or protect the environment would continue to be deductible.

## 3 Counter-proposal by the Federal Council

The Federal Council rejects the initiative and has formulated an indirect counter-proposal in the Federal Private Residential Property Taxation Act.

## 3.1 Indirect counter-proposal by the Federal Council

As it wants all residential property owners to be treated equally, the Federal Council seeks to abolish rental value not only for pensioners but also generally. In order to promote home ownership, however, it is allowing two deductions to remain in place (see below). At the same time, given the value of wealth taxes, it is seeking to introduce a special tax on second homes, thus alleviating the reduction in taxes collected by those cantons in which a large number of second homes are situated.

The counter-proposal envisages a change of system, abandoning the taxation of rental value. Under it, the rental value would be disregarded, as would deductions for debt interest and maintenance. By way of an exception, maintenance costs would be deductible only subject to the conditions applicable to work on historic buildings or where incurred in connection with measures to save energy or protect the environment. Relief would also be offered to first-time buyers who live in residential properties on a permanent and exclusive basis. They would be entitled to claim deductions for debt interest, decreasing over 10 years on a linear basis, up to statutory maximum amounts of CHF 10,000 for married couples or CHF 5,000 for single persons. Deductions for debt interest and maintenance would continue to apply in the case of rented or leased properties. Second properties would become subject to a "second properties tax", which would be a special cantonal tax.

## 3.2 Consultation

A total of 73 responses were received to the Federal Council's counter-proposal to the HOA initiative. They were generally unfavorable; 17 cantons and 21 of the organizations concerned expressed their opposition to the Federal Council's proposal, while 6 cantons and 12 organizations defended it with some reservations and 3 cantons and 2 organizations were in favor of changing the system. A variety of views were expressed by the political parties, most of whom had reservations or made additional demands.

The rejection is being justified on the grounds that the counter-proposal simplifies nothing, offers no adequate

encouragement to home ownership for first-time buyers and young families and that the proposed arrangements for the deduction of debt interest disregards the ability-to-pay principle. It is also stated that the abolition of the deductibility of maintenance costs would result in the general deterioration of property and have an adverse effect on the building industry.

One particular reason for agreeing to the counter-proposal is that the rental value that it does away with was regarded as notional and that it would therefore eradicate many of the deficiencies of the current system. A number of reservations were, however, expressed. Among them was the view that the change in the system must not be allowed to result in an increase in tax and that the deduction for first-time buyers was inadequate. There would also, it was claimed, be a need to compensate for tax shortfalls suffered by the cantons in which second homes were located and the deductibility of maintenance costs would have to be retained.

### 3.3 Amended proposal by the Federal Council

Despite the controversy to which the consultation process gave rise, the Federal Council is still intent on simplifying the tax system. It has, specifically, responded by making two amendments to the indirect counter-proposal:

- ▶ Interest on private debt is to be deductible for a maximum of 80% of yield o assets. This is motivated by the idea of only deducting costs that support building taxable wealth. In the interests of promoting home ownership the first-time buyers of residential property will still have a special deduction at hand.
- ▶ The special tax on second properties has turned out not to be in conformity with the Constitution and will be allowed to lapse. The intention is, however, that cantons and municipalities should be allowed, after accounting for costs (for streets and drainage etc) , to levy a tax (termed a cost relief tax)

that might in part compensate for the loss of income from rental value taxation.

In all other respects, the amended indirect counter-proposal is identical to the pre-consultation version.

### 4 Commentary

On the one hand, the Federal Council's second counter-proposal, like its predecessor, contains positive elements, in particular the abolition of rental value as such across the board, so that a burden is lifted from all homeowners, and not just from pensioners in the way the HOA initiative had envisaged.

The first-time buyers' deduction, as envisaged by the Federal Council - CHF 5,000 or, for married couples, CHF 10,000 - amounts to no more than a drop in the ocean and can hardly be said to lighten the load or create incentives for home ownership, yet it is a step in the right direction.

Current situation	Initiative	Counter-proposal I	Counter-proposal II
<b>Rental value</b> Income "as if renting own premises" Max. market value Min 70% of market value	<b>Option for pensioners</b> A) Rental value B) Without rental value (non-pensioners as before)	<b>No rental value</b>	<b>No rental value</b>
<b>Deductions</b> - Maintenance costs - Debt interest - Insurance premiums - Third-party administration costs	<b>Deductions</b> A) As per current situation B) Deductions only for work on historic buildings or in connection with measures to save energy or protect the environment and a max. CHF 4,000 for maintenance work	<b>Deductions</b> Generally none for debt interest and costs incurred in connection with residential property. Exceptions: Work on historic buildings or measures to save energy or protect the environment Also debt interest up to a max. CHF 5,000 (or CHF 10,000 for married couples) , in the first 10 years following the first-time acquisition of properties lived in permanently by the owners themselves.	<b>Deductions</b> Debt interest to a maximum of 80% of yield on assets and costs incurred in connection with residential property, work on historic buildings or measures to save energy or protect the environment. Additionally, deductions for first-time acquisition of properties lived in permanently by the owners themselves of up to a max. CHF 5,000 (or CHF 10,000 for married couples) .
<b>Under-use</b> Rental value reduced in line with unused rooms.	<b>Under-use</b> A) As per current situation B) Lapses in the absence of any rental value	<b>Under-use</b> Lapses in the absence of any rental value	<b>Under-use</b> Lapses in the absence of any rental value
<b>Peculiarities</b> - Since 1.1.2010 it has been possible to make deductions in the first five years, as the Dumont ruling has been set aside.		<b>Peculiarities</b> - Second properties tax on additional properties. - Deductible debt interest declines on linear basis.	<b>Peculiarities</b> - Cost relief tax for second properties. - First-time buyers' deduction declines on linear basis over 10 years.

# The latest tax and social security developments in the area of employee participation schemes

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**The following article provides a brief overview of the latest tax and social security developments in the area of employee participation schemes. It focuses in particular on the status of the planned Swiss Federal Law, the OECD recommendation/practice and the Information Sheet of 21 October 2009 issued by the Canton of Zurich.**

## 1 Introduction

The granting of deferred employee participations has grown considerably in importance in recent years. Many employers have adopted the practice, granting their employee stock options and restricted stock units (RSUs).

The question arises as to at what point in time deferred salary components are actually to be taxed. The taxable event may occur when they are granted (at grant), when the vesting period (the period during which the vesting has to be "earned") expires or when they are exercised (at exercise).

Due to the increasing numbers of foreign companies setting up bases in Switzerland and the growing frequency of inter-cantonal and international employee deployments, a need has arisen for consistent taxation practice across cantons and nations.

## 2 Tax law considerations

Unfortunately, even the cantons are inconsistent in how they tax stock options. The Canton of Zurich taxes stock options in accordance with Circular No. 5 of April 30, 1997 (according to which options are taxed at grant, providing they can be valued objectively), with the Circular published by the Swiss Federal Tax Administration on 6 May 2003 (which clarifies Circular No. 5 (1997) with respect to options with vesting clauses) and with the Information Sheet of 21 October 2009 ("Information sheet from the Cantonal Tax Office on taxation of employee participations for the purposes of state and municipal taxes and the direct Federal tax"). On the basis of these documents, options are taxed only after they are irrevocably legally acquired. In practice this generally equates to taxation at exercise, because most plans allow for

both a vesting period and a truncation of the exercise period if the employment relationship is terminated (truncation clause).

The French-speaking part of Switzerland still uses only Circular No. 5 from 1997, according to which options are taxed at grant provided they can be valued objectively (using the Black-Scholes model, for example - i.e. maximum term of 10 years, vesting period no more than 5 years and without numerous individual conditions which make valuation impossible). Although the French-speaking cantons have, in the past, approved rulings involving taxation at exercise, they insisted on the inclusion of an exit clause stipulating that the options would definitely be taxed if the taxable person left Switzerland. However, this contradicts the international practice of the German-speaking cantons who, in keeping with the OECD recommendation for international cases, tax options on a pro-rata basis in proportion to the number of working days in Switzerland during the vesting period. As a result, the cantons of Vaud and Geneva have recently begun accepting rulings with taxation at exercise and pro-rata taxation pursuant to the OECD recommendation (without an exit clause).

For RSUs, the time of taxation is generally the same (with a few exceptions) across Switzerland. It is worth mentioning the regulation in the new Information Sheet issued by the Canton of Zurich, which states that imported employee stock options and RSUs are, in principle, to be fully taxed in Switzerland unless proof of residence (for stock options) or proof of taxation (for RSUs) from a contracting state can be supplied to allow pro-rata taxation as per the OECD recommendation. Exported stock options and RSUs will now definitely be taxed on a pro-rata basis (based on the number of days of residence in Switzerland during the vesting period). Something that is rather out of the ordinary is the new regulation stipulating that the charge-back of stock option and RSU costs to the Swiss company constitutes the minimum calculation basis. This regulation is one-sided, in that it applies only to exported employee participations, is not in compliance with the OECD recommendation (according to which a charge-back of the costs is irrelevant), and could therefore lead to double taxation in an international context.

In the other German-speaking cantons, the general practice is to tax both imported and exported stock options and RSUs on a pro-rata basis, although obtaining a ruling from the tax authorities is still advisable.

In order to avoid double taxation risks (with the resultant negative consequences for Switzerland as a business location), consistent regulations in line with the OECD recommendation are needed at a Federal level. The Federal Department of Finance (FDF) was therefore given the task by the Federal Council of drawing up a Federal Law on employee participations. The draft law was adopted by the Federal Council in November 2004 and passed to Parliament for its approval.

In the course of the conciliation procedure, an additional report was prepared on the financial consequences of the draft law. This report was submitted to the Commission before the 2008 summer session. Discussions in Parliament are currently suspended. The Council of States and the National Council disagree, among other things, on the amount of the discount on exercise profit on stock options per restriction year. While the Council of States advocates the Federal Council's proposal of 10%, the National Council decided to reduce this to 6%.

In its press release of 28 April 2010, the Federal Council proposes (as part of its measures against excessive salaries in banks and insurance companies), among other things, that employee stock options be taxed at exercise as a matter of principle. In addition, tax-free amounts or rebates should be completely eliminated. The FDF has been instructed to submit the Federal Council's proposals to the relevant parliamentary committees in May 2010.

## 3 Social security law considerations

The treatment of employee participations under social security law is also important. In determining the time at which the employee becomes subject to the social insurance obligation, the compensation funds generally follow the tax assessment. Because employees are normally subject to only one social insurance system at a time, profit has generally been taken into account at 100% for the social insurance system which the employee came under when the taxation took place

(no international pro-rata distribution based on the number of working days).

However, the social insurance aspects have been subject to more recent developments. In the interests of achieving harmonization between the social insurance organizations and the cantonal tax authorities, the compensation fund for the canton of Zug (Ausgleichskasse Zug) confirmed that an employer's specific tax rulings (which provide for pro-rata taxation for imported/exported employee participations) can also be applied to the compensation fund. In general, this is a welcome development. In the case of exported employee participations, however, it bears the risk of double subjectation to social insurance if the employee is subject at the time of taxation to a foreign social insurance system which does not apply pro-rata distribution.

### Summary

The introduction of legal regulations at a Federal level would be a very welcome development because consistent international taxation cannot be achieved if differences already exist between cantons. In addition, both the OECD and Switzerland should define a consistent standard for international social insurance assessments.

## Changes to Switzerland's treaty network with Asian and Latin American countries

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**On 13 March 2009, the Swiss Federal Council resolved to bring Switzerland's policies on international administrative assistance for tax purposes in line with international policy and the OECD standard set out in Art. 26 of the OECD Model Tax Convention. Since this announcement, Switzerland has revised more than two dozen of its existing double taxation agreements (DTAs), in particular with regard to the expansion of administrative assistance. Other important amendments were also resolved during the DTA negotiations. One development seen across the board during the negotiations of new DTAs was the substantial reduction of withholding tax on dividends from qualified participations; another was the introduction of an arbitration tribunal clause. The following is a brief overview of the status of the amendments to agreements with a selection of Asian and Latin American countries.**

### Hong Kong

(New DTA initialled on 15 April 2010)

Hong Kong had previously concluded only a very small number of DTAs (the most significant being with Belgium, Luxembourg, China and Thailand). In the opinion of both the Chinese and the Hong Kong tax authorities, China's existing DTAs do not cover Hong Kong. The new DTA contains an administrative assistance clause in line with the OECD standard. The text of the agreement is still confidential. It will be interesting to see what other topic have been agreed to and to what extent this may create a competitive advantage for Switzerland.

### Singapore

After negotiations on the expansion of administrative assistance in tax matters in accordance with Art. 26 of the OECD Model Tax Convention and on further issues, Switzerland and Singapore originally initialled a revised DTA in August 2009. However, pressure from various interest groups forced the countries back

to the negotiating table. Renegotiations are currently still in progress.

### Japan

(Revised DTA signed on 21 May 2010)

Switzerland and Japan met for a first round of negotiations on the revision of the 1971 DTA in November 2008, before the Federal Council's resolution to alter Switzerland's administrative assistance practice. Both countries agreed to incorporate an extended administrative assistance clause in accordance with the OECD Model Convention into the DTA. The contracting parties also agreed to exempt dividends and royalty payments from significant participations (>50% voting rights) as well as certain interest in the finance sector from withholding tax. Withholding tax on dividends to a corporation which holds at least 10% (until now 25%) of the voting rights of the dividend paying corporation will be reduced from 10% to 5%. Other dividend payments will be subject to 10% withholding tax (until now 15%).

### Indonesia

(Amendments to the DTA entered into force on 20 March 2009)

The most important change to the DTA, which dates back to 1988, is the reduction of the maximum permissible withholding tax rate on royalty payments from 12.5% to 10%. Furthermore, leasing payments will no longer be treated as royalty payments, meaning that in future they will not be subject to withholding tax. The provisions of the amendment protocol apply to income earned as of 1 January 2010 onwards. The revised agreement does not contain an administrative assistance clause in accordance with the OECD standard because it entered into effect at practically the same time as the Federal Council's resolution to change Switzerland's administrative assistance practice.

### Mexico

(Revised DTA signed on 21 September 2009)

Switzerland and Mexico signed the amendment protocol for the existing DTA of 1993 in September of last year. One of the points in the protocol is a provision on extended exchange of information in line with the OECD standard. It was also agreed during the negotiations that dividends on participations over 10% will

only be taxed in the country of residence. In addition, the rate of withholding tax on interest will be reduced from 10% to 5% under certain circumstances. With regard to interest and royalty payments, a most favored nation clause was agreed that guarantees Switzerland to be treated like other OECD member states with which Mexico concludes more favorable agreements regarding the income concerned.

### Uruguay

(New DTA initialled on 18 March 2010)

During negotiations on a new DTA, Switzerland and Uruguay reached agreement on the expansion of administrative assistance in tax matters in accordance with the OECD Model Tax Convention and on other points. Switzerland was able to negotiate a reduction of withholding tax on dividends, interest and royalty payments as well as the introduction of an arbitration tribunal clause. The text of the contract is still confidential.

### Chile

(New DTA ratified and entered into force on 5 May 2010)

Chile has ratified the DTA with Switzerland which had been signed in Santiago on 2 April 2008. The DTA improves legal protection for enterprises and limits withholding taxes on dividends, interest and royalties. According to the Swiss practice at the time when the DTA was signed, the treaty contains a provision as regards the exchange of information with regard to the application of the treaty and the enforcement of internal law in case of tax fraud. Thus, there is no agreement with Chile on an expanded administrative assistance according to the OECD standard. Both contracting countries aimed at an entry into force as soon as possible and therefore renounced on renegotiations in order to expand administrative assistance. The provisions of the treaty will be applicable in Switzerland on income earned on or after 1 January 2011.

### Conclusions

As the above information shows, Switzerland has for the most part been successful in implementing the revised principles on international administrative assistance in tax matters, introduced by the Federal Council on 13 May 2009, with countries in Asia and Latin America and has used the opportunity provided to negotiate further economic advantages.

## NEW IRS Form Will Require Swiss Multinationals with US Subsidiaries or US Operations to Disclose "Uncertain Tax Positions" to the IRS

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**Certain business taxpayers with assets of \$10 million or more will be required to disclose uncertain tax positions which have been identified for financial statement purposes on a new form that will be included as part of their annual tax return filings. In addition, the IRS describes these new reporting and disclosure requirements as requiring a "concise description" of each uncertain tax position – a few sentences that apprise IRS of the nature of the issue – along with an estimate of the maximum amount of potential federal tax liability if the position were to be disallowed in its entirety during IRS audit. This will apply to both US subsidiaries of Swiss corporations and Swiss corporations with business operations in the US regardless of whether such corporation is subject to FIN 48.**

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Under the IRS's proposal, taxpayers with assets of \$10 million or more must provide:

(1) a concise description of each uncertain tax position ("UTP") for which the taxpayer or a related entity has recorded a reserve and for which a

reserve has not been recorded based on an expectation to litigate or an IRS administrative practice and

(2) the maximum tax adjustment (MTA) for a tax position taken in a tax return, which is an estimate of the maximum amount of potential U.S. federal income tax liability associated with the tax year for which the tax position was taken determined on an annual basis. The MTA is an annual determination that does not take into account interest, penalties, or the effects that the tax position may have on state, local, or foreign taxes.

- ▶ Although FIN 48 applies to all income tax positions, corporations have typically applied a materiality threshold (in agreement with their auditor) for identifying their UTPs. Corporations may have to perform a significant amount of additional work to identify, measure, etc. all of their UTPs as currently there is no materiality threshold for this new schedule.
- ▶ There are very different requirements for identifying and measuring UTPs under US GAAP and IFRS. Because the IRS Announcement states that the disclosure will include those positions for which a reserve has been required under FIN 48, or other accounting standards, taxpayers would have different disclosure requirements for the same UTPs depending upon which accounting standard is used by that particular taxpayer to establish a reserve for that UTP. Many foreign clients with US subsidiaries report under IFRS, even if they have US GAAP books for their US subsidiaries. As a result, they may not have analyzed their exposures under FIN 48.
- ▶ The draft instructions indicate that the description of the UTP should only be a few sentences, but must include

- (1) a statement that the position involves an item of income, gain, loss, deduction, or credit against tax;
  - (2) a statement whether the position involves a determination of the value of any property or right, or a computation of basis; and
  - (3) the rationale for the position and the reason(s) for determining the position is uncertain.
- ▶ The IRS Announcement states that this new schedule will be filed with Form 1120, or other business tax returns. This would include Form 1120-F - US Income Tax Return of Foreign Corporation.
  - ▶ For purposes of Schedule UTP disclosures, the draft instructions provide that corporations or related parties record a reserve for a tax position when any of the following occurs in their audited financial statement:
    - ▶ An increase in a liability for income taxes payable or a reduction of an income tax refund receivable with respect to the tax position; and/or
    - ▶ A reduction in a deferred tax asset or an increase in a deferred tax liability with respect to the tax position.
  - ▶ For tax positions related to valuation or transfer pricing, however, taxpayers can satisfy the MTA reporting requirement by ranking those positions according to the size of
    - (1) the estimated U.S. federal income tax adjustment that would result if the position were not sustained, or
    - (2) the recorded reserve amount.
  - ▶ IRS has publicly stated that the IRS is not seeking information on foreign uncertain positions that are not reflected in reserves for US federal returns.
  - ▶ The draft instructions do not use the term "uncertain tax position" unless referencing Schedule UTP or its sections. Instead, they generally use the terms "tax position" and "tax position taken in a tax return." By using this terminology, the IRS seems to be signaling that there are differences between disclosing a tax position on Schedule UTP and the FIN 48 concepts on which it has based these required disclosures.

- ▶ If penalties are assessed for failure to disclose UTPs, it may be possible that a FIN 48 reserve would be required for these penalties, in effect establishing a FIN 48 reserve for your FIN 48 reserves (or positions that have yet to be identified/measured because those positions were below the scope of the

FIN 48 analysis for financial accounting purposes).

- ▶ Currently unclear whether foreign corporations filing "protective" elections would be required to disclose uncertain tax positions but the IRS is aware of the issue and will address in final guidance.

## Germany: changes in real estate transfer tax for corporate restructuring

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**In the coalition agreement of October 24, 2009, the coalition parties agreed on the introduction of a corporate group clause in the country's real estate transfer tax law. The aim of such a clause is to provide an extensive real estate transfer tax exemption for intergroup transfers. The Growth Acceleration Act of December 30, 2009 (Wachstumsbeschleunigungsgesetz) has now introduced such a group clause with respect to real estate transfer tax. The clause is generally applicable to transfers from January 1, 2010.**

The new regulations ease the burden of real estate transfer tax on certain taxable property transfers (within the meaning of § 1 (1) no. 3, 1 (2a) or 1 (3) of the Real Estate Transfer Tax Act (Grund-erwerbsteuergesetz, GrEStG)) that take place as part of restructuring measures, and aim at ensuring that companies do not refrain from making necessary restructuring measures as a result of real estate transfer tax considerations. The exemption is also valid for the transfer of the rights of exploitation over real estate carried out as part of a reorganization, meaning that no tax will be levied in this respect under § 1 (2) GrEStG.

One of the prerequisites for application of the tax relief is that the reorganization must take the form of a merger,

demerger, split-off, spin-off, hive-down or transfer of assets within the meaning of § 1 (1) nos 1 to 3 of the Reorganization Act (UmwG). Comparable reorganizations as defined by the law of another EU Member State or the EEA also benefit from the relief. However, reorganizations in non-EU countries, such as Switzerland, fall outside of the scope of the relief, as do transfers made by way of singular succession, such as a simple increase in capital-in-kind, and simple sales transactions.

A further prerequisite for the tax exemption is that the reorganization

- ▶ involves a controlling entity and one or more of its controlled entities only, or
- ▶ involves several entities controlled by one controlling entity.

An entity is considered controlled for these purposes if, indirectly, directly or partially indirectly and partially directly, the controlling entity has held at least 95% of its capital for an uninterrupted period within 5 years prior to the legal transaction and 5 years following the legal transaction. § 6a GrEStG therefore applies an independent definition of a controlled entity, so that the tax relief cannot be used in a reorganization involving one or more controlled entities within the meaning of § 1 (4) no. 2b GrEStG.

On this point there are still major matters of doubt. One point of contention is whether a partnership could be considered

a controlled entity in this sense. The fact that the term capital is used, while partnerships have none, speaks against their inclusion within the definition. Moreover, it is still unclear whether the 5-year period of ownership prior to the reorganization will also apply for newly founded companies, which would practically exclude these companies from the corporate group clause on real estate transfer tax. The 5-year holding period following the transaction is problematic in the case of mergers, since the entity transferring the rights ceases to exist, making fulfillment of this requirement impossible.

If the prerequisites for application of the corporate group clause relating to real estate transfer tax are met, no real estate transfer tax will be levied in cases of reorganization involving a change in the legal entity owning the property or a transfer of the rights of exploitation within the meaning of the Real Estate Transfer Tax Act.

The same applies where holdings in a company within the meaning of § 1 (3)

GrESTG are transferred to another entity as part of corporate restructuring. Contrary to the original draft legislation, the new regulations provide for tax relief for restructuring processes in which a liability would normally arise for real estate transfer tax purposes under § 1 (2a) GrESTG by virtue of a change in ownership of more than 95% within a partnership in possession of property.

The new group clause should be welcomed because in some cases it will facilitate restructuring processes within a corporate group. However, there are still major issues of doubt surrounding the scope of its application. It now lies with the financial authorities to clarify these questions quickly and issue formal guidance as to the application of the relief, so that tax payers are provided with legal certainty. It would have been ideal if the corporate group clause were comprehensive and covered all transactions liable to real estate transfer tax within a corporate group instead of restricting the scope to reorganizations. The legislator apparently wasn't yet willing to go so far at this juncture.

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### Imprint

#### Tax News

Electronic publication in German, French and English

#### Produced and designed by

Ernst & Young Ltd  
Marketing and External Communications  
P.O. Box  
8022 Zurich

#### Subscriptions / address changes

[www.ey.com/ch/newsletter](http://www.ey.com/ch/newsletter)

[www.ey.com/ch/newsletter](http://www.ey.com/ch/newsletter)

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