

# Tax News

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Dear Reader,

Before 2011 gradually draws to a close and you can enjoy your well-earned Christmas vacation, please take a look at the fourth e-newsletter we have produced for you this year on key tax developments.

On the following pages, you can read all about the major aspects of the financial institutions that are «too big to fail» (TBTF) or, indeed, «system-relevant». Back in November 2009, the Federal Council instructed a committee of experts to draw up proposals for amendments to legislation. These changes also contain supporting measures that impact on Swiss tax legislation, particularly issue tax and withholding tax.

We also look at Circular no. 34, published by the Federal Tax Administration on July 26, 2011, which deals with the definition of customer credit balances for withholding tax purposes. This circular replaces the April 1999 information sheet with the same title and improves the tax framework for intra-group funding and treasury services.

We explain what the company ID number, introduced on January 1, 2011, reveals about your company and how you can make good use of it.

We also examine a few selected cantonal developments and take another look at the Inheritance and Gift Tax Initiative.

You can read all about these topics and more in this, our last tax e-newsletter of 2011. We would like to wish you every success for the rest of the year and hope you have a good start to 2012.

Sincerely,

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## Inheritance and gift tax initiative

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**Based on a popular initiative launched in August, responsibility for the taxation of inheritances and gifts of individuals having their (last) residence in Switzerland shall be transferred from the cantonal to the federal level.**

At the same time, gifts of over CHF 20,000 per year and per beneficiary, together with inheritances, are to be taxed at 20% flat, irrespective of the (family) relationship between the persons involved. The initiative features a one-off tax-free amount of CHF 2 million applicable to the total of the inheritance and all taxable gifts by any deceased/down. According to the transitional provisions in the initiative wording, all taxable gifts (exceeding CHF 20,000 per year and per beneficiary) made as of January 1, 2012 will be added to a subsequent taxable

inheritance and taxed accordingly.

Considerable tax relief will be granted with regard to companies and farms carried on by heirs or beneficiaries, respectively, in order not to jeopardize their existence and the jobs they generate. Gifts or (parts of) inheritances received by spouses or registered partners shall remain tax-free. When the spouse deceases, however, his/her inheritance exceeding the above tax-free amount will be taxed at 20%.

The initiative committee has until February 16, 2013, to collect the 100,000 signatures necessary to call for a referendum. According to the transitional provisions, the new regulations shall become directly applicable on January 1 of the second year following adoption. Based on this timeline and provided the referendum adopts the initiative, it should not become effective before 2015 at the earliest.

Please note

### Start of retroactive effect of the inheritance and gift tax initiative

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In our last issue, we reported on a popular initiative launched in August concerning the introduction of a federal inheritance tax in Switzerland. The retroactive clause of this bill stipulates that gifts in excess of the annual tax-free amount of CHF 20,000 made even as from January 1, 2012 may be added to the taxable estate, provided that the initiative comes into force in the future and the total value of the estate is least 2 million francs. Given that, at the moment, gift tax is not levied on free gifts to direct descendants in any Swiss canton apart from in AI, NE and VD, the question arises as to whether provisions for successor solutions involving a family's own children need to be made before the end of the year.

## Proposed changes to the Swiss transfer tax and withholding tax regime in the wake of the "Too Big to Fail" (TBTF) discussion

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**Back in November 2009, the Swiss Federal Council had commissioned an expert party to propose changes in the Swiss law. These changes should prevent default situation of banks, which are considered relevant for the Swiss economy (so-called "too big to fail" or "systemically relevant" institutions). Within the proposed legal changes, there are also accompanying measures pertaining**

**to the Swiss tax law—notably in the field of the Swiss issuance stamp tax and the Swiss withholding tax on interest payments—which the current information covers.**

Whilst the proposals are only in a preliminary stadium requiring parliamentary approval, and it is unlikely that they could take effect before 2012, we believe that they warrant your attention as there is a fair amount of pressure on the legislator

to implement these measures (i) lest problems could occur again with defaulting banks and (ii) in order to remediate situations in the tax ambit which are perceived as impairing the competitiveness of Switzerland.

Banks are currently considering to issue contingent convertible bonds ("CoCo bonds") which can be converted into equity once a bank falls short of certain equity thresholds (so-called high triggering contingent convertible bonds and low triggering bonds). From a political angle,

and to prevent that Swiss banks need to issue their CoCo bonds in a foreign jurisdiction, it seems desirable that Swiss banks can issue their convertible bonds in Switzerland and under the regulations of the Swiss domestic law. In particular, the issuance tax on the issuance of the bond itself, on the issuance of new shares subsequent to a possible conversion as well as the burden of the withholding tax are perceived to be a strong impediment to the decision of issuing these bonds in Switzerland. In particular, the current withholding tax burden of 35 percent renders those bonds extremely unattractive for potential investors in non-treaty countries, where not even a partial refund is possible.

The following sections set out the planned measures.

**We would like to point out that due to the preliminary nature of the proposed regulations, these information should not be seen as providing tax advice on certain circumstances but should only be considered as a general information.**

## 1 Issuance stamp tax

For bonds issued in Switzerland and under Swiss law, stamp issuance tax of 0.12 percent for every full or partial year of the tenor is levied. Thus, a bond with a tenor of ten years would attract a 1.2 percent upfront payment of issuance tax. For money market papers, the applicable rate is 0.06 percent calculated exactly to the day.

Large Swiss corporate debtors issue their bonds through offshore group companies under jurisdictions other than Switzerland and usually attach a guarantee or a keep-well agreement of the parent company. Under certain scenarios (notably where the foreign issuing entity is a single purpose vehicle or where proceeds resulting from the bond issue are repatriated into Switzerland), these bonds could be deemed issued in Switzerland and would attract the same stamp issuance tax and withholding tax consequences (cf. below) as a Swiss-issued bond.

For shares/stock the applicable rate of share issuance tax is 1 percent on the market value of the newly issued shares/stock, however, at least calculated on their nominal value. This also applies to shares/stock issued pursuant to a conversion of a convertible bond.

The proposal lodged are: to (i) **generally abolish the issuance stamp tax on bonds and money market papers entirely** and (ii) to **abolish the issuance stamp tax on shares / stock in particular, that had been issued subsequent to the conversion of a CoCo bond.** (i) Is supposed to render the Swiss financial market more attractive for those domestic debtors wishing to issue bonds in Switzerland and to alleviate the inter-company financing through treasury centers in Switzerland. In addition, (ii) is supposed to enable Swiss banks to issue CoCo bonds under Swiss jurisdiction.

## 2 Swiss withholding tax

Currently, the Swiss withholding tax system works based on the "debtor principle", i.e. the Swiss debtor of an interest payment needs to withhold 35 percent of the gross interest amount, irrespective of the payee's status or residence. Swiss resident payees can lodge a request for refund by declaring such income in their personal tax returns and foreign payees can employ a tax treaty, if any. Hence, the withholding mechanism acts as a means to ensure proper and complete declaration of the interest income. For foreign investors, the withholding of 35 percent on the interest payments renders such investment unattractive, not least because of the administrative burden associated with lodging a request for refund and the interest loss.

Generally, the newly proposed measures aim at maintaining and enhancing the "safeguarding mechanism" for Swiss resident natural persons—also for those Swiss resident investors who invest through offshore companies / shell companies—who receive interest payments whilst, at the same time, enabling foreign investors to invest in Swiss-issued bonds without incurring a withholding tax.

Therefore, the proposed changes cover the following fields—

### (i) Transition from the debtor's principle to a paying agent mechanism

Instead of the Swiss debtor, every Swiss paying agent ("Zahlstelle") will be required to identify its payees and—in certain cases—withhold the 35 percent withholding tax on interest payments. The definition of "paying agent" would be akin to the definition provided by the EU

interest taxation, i.e. essentially every economic operator (natural person or legal entity) who or which collects or pays interest to the beneficial owner in the normal course of its business. Besides banks, brokers or investment funds, this would also embrace an interest debtor paying to the beneficial owner directly. Thus, the definition of paying agent is much broader than the definition of interest debtor under the current regime.

### (ii) Definition of payment subject to withholding by paying agent («covered payment»)

The definition which payment is subject to withholding tax by the Swiss paying agent is broadened in that also interest payments resulting from overseas bonds can be subject to Swiss withholding taxes, which is definitely a shift of paradigm. Whether or not the Swiss paying agent needs to withhold hinges on the residence of the payee as well as on the payee's status as a natural person or legal entity as shown in the table below:

#### A) Interest recipient or beneficial owner is a natural person resident in Switzerland

Essentially, the Swiss paying agent needs to apply Swiss withholding tax on **interest resulting from Swiss and foreign bonds** in case of payees who are natural persons resident in Switzerland. This also applies where such interest payment is made to a foreign company whose beneficial owner is a natural person resident in Switzerland (mainly «offshore» companies, generally with little or no substance). This is likely to be the case where the recipient has a custody account with the Swiss paying agent (e.g. a Swiss bank), which, in turn, needs to know the beneficial owners of an offshore company with little or no substance.

#### B) Interest recipient resides in a foreign country

Furthermore, and as a general principle, the Swiss paying agent needs to withhold Swiss withholding tax on interest resulting from Swiss bonds (and only Swiss bonds!) where the payee (irrespective of

whether a natural or a legal person) is resident in a foreign country.

However, there are two important exceptions to this—

(a) if the payee is a natural person resident in one of the EU member countries, the Swiss paying agent needs to withhold the EU savings tax. Albeit at the same rate of 35 percent, the EU savings tax applies a different calculation of the tax base than the Swiss withholding tax. Thus, the EU savings tax overrides the Swiss withholding tax;

(b) if the payee is resident in a foreign country other than a member state of the EU, Swiss withholding tax will not need to be levied where the Swiss paying agent has been provided with a «declaration of domicile» («Domizilerklärung»). Such a declaration of domicile can only be issued by regulated Swiss banks and custodians as well as by foreign institutions that are subject to a comparable regulation. The declaration needs to encompass the details of the issuing institution, details about the nature of the payment as well as the certification that the beneficial owner is not a natural person resident in Switzerland. In addition, the declaration needs to state that the assets yielding the interest payment had resided in a custody account maintained in the payee's name by the issuing institution as of the payment date. Finally, the declaration needs to substantiate that the interest had been paid to or transferred to an account held by the specified payee.

For the purpose of the above, bonds issued by a foreign group company of a Swiss parent company with a parental guarantee attached to them («deemed Swiss bonds»—cf. (iii) below) are to be treated as Swiss bonds.

The table aside shows a synopsis of the above:

**(iii) Foreign bonds issued by companies pertaining to a Swiss group of companies**

WAs mentioned above, bonds issued by a foreign group company of a

Swiss group of companies will be considered deemed domestic bonds if the bond has been guaranteed by the Swiss parent company. An actual repatriation of the proceeds generated by the foreign bond (e.g. by way of loan to a Swiss group company) is not necessary for this qualification. These foreign issued bonds with a guarantee attached by the Swiss parent company will need to be treated as Swiss issued bonds by the Swiss paying agent (cf. table above). However, such foreign issued bonds may be grandfathered provided they had been issued, prolonged or re-opened before the measures described in this memorandum have taken effect (and provided there has been no repatriation of proceeds into Switzerland). In this scenario, no withholding would need to be made on the grandfathered bonds.

**(iv) Tax credit for upstream withholdings**

If a Swiss resident natural person receives interest payments from a foreign bond, the Swiss paying agent would be obliged to withhold 35 percent on these payments

under the new rules (cf. table, above). Where these payments had already been subject to a foreign non-refundable withholding tax, the Swiss paying agent can deduct such foreign tax from the withholding tax and only remit the difference between 35 percent and such foreign tax. As a consequence, the payee will equally suffer a deduction of 35 percent.

**3 Effective date**

The effective date for the accompanying tax measures described in this memorandum is not expected before calendar year 2012. The measures need to pass the parliamentary process and are potentially subject to a referendum before they can take effect.

**4 Effects on banks and other paying agents**

The number of economic operators that would be considered paying agents would certainly be higher than the number of banks. In other words: economic operators which did not (and did not have to) maintain withholding systems would face this challenge in the future if the proposed changes were to be implemented as they stand.

Issuer of bond	Beneficial owner of interest payment (investor)	Tax to be levied by Swiss paying agent
Domestic (Swiss) issuer	Natural person resident in Switzerland	Swiss WHT
	Legal entity resident in Switzerland	none
	Natural person resident in a EU member state	EU savings tax
	Any person resident in a foreign state <b>without</b> declaration of domicile	Swiss WHT
	Any person resident in a foreign state <b>with</b> declaration of domicile	none
Foreign issuer	Natural person resident in Switzerland	Swiss WHT
	Natural person resident in a EU member state	EU savings tax
	All others	none
Foreign issuer affiliated with Swiss parent company with guarantee attached to bond issuance – issuance after effective date («deemed Swiss bond»)	Natural person resident in Switzerland	Swiss WHT
	Legal entity resident in Switzerland	none
	Natural person resident in a EU member state	EU savings tax
	Any person resident in a foreign state <b>without</b> declaration of domicile	Swiss WHT
	Any person resident in a foreign state <b>with</b> declaration of domicile	none

The explanatory paper states that the transition to a paying agent system would cause the industry to change existing systems or introduce new systems; however, the consequences—as the explanatory paper sets out—should not be too drastic as many, if not all, banks already act as paying agents in the ambit of the EU savings tax. Whilst this arguably holds true for banks, this statement fails to recognize that new economic operators (e.g. brokers) will need to set up systems which they did not have before. This also applies to non-bank debtors that pay interest on bonds directly to their investors. We believe though that the implications on all paying agents, including banks, may be vast for the following reason:

The tasks to be performed by all economic operators—and banks will also need to revamp their systems—fit neatly into a pattern that other tax systems (EUSD, FATCA, flat tax rate regimes with various countries like Germany and the UK) require: (i) identification of client; (ii) identification of payment streams and “withholdable” payments; and (iii) effecting a withholding or, as the case may be, furnish a report.

(i) The identification process will require the paying agent to gather client data which had partially not been kept on file or which calls for a mapping of existing client data with new records, i.e. the required payee’s static data file may either not be available, or the existing data may not be congruent with the required data. The paying agent would likely need to differentiate between beneficial owners and recipients who are natural persons as opposed to legal persons/entities and other paying agents (if the system follows the EU savings tax system, no withholding would need to be levied for the latter recipients). Furthermore, the domicile would need to be categorized into Switzerland, EU countries, and others. In addition to this, an entirely new system of collecting and administering declarations of domicile needs to be set up and kept updated. It almost goes without saying that there will be considerable attrition and increased compliance costs due to the fact that foreign banks will need to be solicited and get accustomed to the new system.

(ii) In addition, payment streams would need to be identified. All interest payments resulting from bonds, debentures and deemed bonds would potentially constitute withholdable payments, irrespective whether the debtor of the interest payment is a domestic or overseas resident. This would also apply to OIDs and to deemed interest payments resulting from so-called predominantly non-coupon bearing bonds («überwiegend einmalverzinsliche Obligationen»). This means that depending on whether the Swiss paying agent needs to apply Swiss withholding tax or EU savings tax, different tax bases need to be calculated. On the one hand, this would require the paying agents to have withholding machines in place or to upgrade their present withholding mechanisms to also cope with withholding obligations on foreign bonds and handle the credit mechanism in case of upstream source taxes. On the other, paying agents are likely to call for data providers to furnish the information whether e.g. a foreign bond could be pigeonholed as a predominantly non-coupon bearing bond or as a “plain vanilla” bond. This would mean for data provider that they need have the pertinent information on the latter class of investments on their databases, as regards Swiss issued bonds as well as foreign-issued bonds. The fact that bonds issued by a foreign affiliate of a Swiss company with a parental guarantee attached are considered Swiss-issued bonds (and hence potentially subject to withholding tax), would certainly add to the complexity. In particular, since there will be grandfathered «deemed Swiss bonds» as well as non-grandfathered securities.

(iii) A more severe distortion may result for structured products. In many instances, the bond component of structured product has been issued by designated foreign issuing entities of Swiss banks in order to avoid Swiss withholding tax. These bonds have then been joined together with an option strategy to form the structured product. As the proposed regulations now require to also levy Swiss withholding tax on

foreign bonds (where the beneficial owner is a Swiss resident natural person), such interest resulting from the (foreign) bond component is likely to become subject to Swiss withholding tax, too. This might prompt the banks to re-consider their strategy to deconstruct the structured products and have the components issued by different vehicles.

(iv) Finally, it is interesting to remark that the proposed Swiss regulations go beyond the reach of the EU savings tax. Where the investor is a company, no EU savings tax needs to be withheld. The proposed Swiss regulations try to look through the corporate veil and establish the beneficial owners. This creates more burdensome compliance tasks for the paying agent. However, this is in line with the understanding of recent initiatives like Fatca or the flat rate tax regimes, which aim at looking through to the ultimate beneficial owner, too.

We will inform you about forthcoming changes and the state of discussion as they evolve in the political process. Should you wish to discuss these issues in the meantime, kindly contact one of our financial services specialists who will be glad to assist you.

# Circular no. 34 concerning customer credit balances

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**On July 26, 2011, the Swiss Federal Tax Administration published Circular no. 34 concerning the definition of customer credit balances for withholding tax purposes. The circular replaces the explanatory note of April 1999 with the same name and aims to improve the fiscal terms for intra-group financing and treasury services.**

## **Fiscal barriers hamper financing and treasury services**

Although Switzerland essentially has a competitive corporate tax regime, fiscal obstacles have for many years hampered the supply of financing and treasury services in Switzerland. The so-called «10/20 non-bank lender rule» applied by the Swiss Federal Tax Administration (SFTA) for the purpose of withholding tax and stamp duty made it difficult in international terms for organizations to employ Swiss bond issuing companies. At the same time, a broad-based interpretation of the term «bank» in withholding tax legislation effectively made it impossible for intra-group treasury companies to operate successfully in Switzerland.

In the wake of the implementation on August 1, 2010 of Art. 14a of the Withholding Tax Ordinance (VSTV) and Art. 16a of the Stamp Duty Ordinance, both of which brought some initial relief, the latest Circular no. 34 is seen as a further welcome step towards the creation of a more attractive fiscal regime for financing and treasury services in Switzerland.

## **Explanatory note of April 1999**

According to Art. 4 para. 1 lit. d in conjunction with Art. 13 para. 1 lit. a of the Withholding Tax Act (VSTG), interest paid on customer credit balances of domestic banks is subject to 35% withholding tax. The last time the SFTA established a binding definition for the term «bank» for withholding tax purposes was in April 1999 with the publication of

its «Customer credit balances» explanatory note. According to the explanatory note, a «bank» in the context of the VSTG was any institution qualifying as a bank or savings bank within the meaning of the Swiss Banking Act. Also qualifying as a «bank», however, was any entity with total interest-bearing client payables of a minimum CHF 500,000 owed to more than a total of 20 creditors. Already in the past, foreign and domestic institutions that had been treated as banks in their home jurisdictions did not count towards the total number of creditors.

Up to the end of July 2010, all group companies had to be included in the calculation of the total number of creditors. This meant that Swiss intra-group financing and treasury companies perpetually ran the risk of being classified as a bank for withholding tax purposes because they had exceeded the 20-creditor threshold, with the consequence that any interest payable to group creditors would be subject to 35% withholding tax. The provision of intra-group treasury services such as cash pooling – an operation which typically involves many creditors – was virtually impossible in Switzerland without incurring withholding tax.

## **Relief provided on August 1, 2010**

Art. 14a VSTV lowered the fiscal hurdle by stating that intra-group lenders would no longer count towards the total number of creditors provided that the domestic group of companies does not guarantee a bond issued abroad by one of its subsidiaries (Art. 14a para. 3 VSTV). The latter clause meant that a significant number of Swiss groups with international operations were unable to benefit from the fiscal relief introduced on August 1, 2010.

## **Circular no. 34 of July 26, 2011**

The content of the new Circular 34 is largely in line with the explanatory note of April 1999, apart from the fact that the threshold for the number of non-bank creditors has been increased significantly from 20 to 100. Less relevant in practical terms will be the increase in the threshold

for interest-bearing client payables to a maximum of CHF 5 million.

Raising the number of non-bank creditors to 100 should now make it possible for Swiss groups with foreign bond issuing companies to offer typical treasury services such as cash pooling and invoicing, as well as to finance group companies from Switzerland. With its competitive corporate tax rates, extensive network of double taxation agreements and other existing tax incentives, Switzerland should now be in a position to attract more in the way of international financing and treasury solutions.

## **Explanatory notes “Money market instruments” and “Bonds”**

Please note that the two explanatory notes, «Money market instruments and registered claims of domestic borrowers» and «Bonds», dated April 1999 still apply. The corresponding 10/20 thresholds for the number of creditors should, therefore, still be taken into account along with the tax relief introduced on August 1, 2010.

Additionally, we shall have to wait and see whether the planned switch from the debtor principle to the paying-agent principle in the case of interest payments for withholding tax purposes (cf. draft bill of August 24, 2011) will ever see the light of day.

# Company Identification Number (UID)

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## The new Company Identification Number (UID) has been introduced as of 1 January 2011. The UID intends a definite identification of each company in connection with administration contacts.

The Swiss Federal Tax Administration (SFTA) / VAT Department has in close collaboration with the technical departments of the Federal Statistical Office (FSO) integrated the new UID within its online information system, the so called UID-register. This UID-register is retrievable under the following link: <https://www.uid.admin.ch/Search.aspx>.

The UID-register contains information about the company's name, the respective UID and the subsequent core properties:

- ▶ status
- ▶ legal seat of company address
- ▶ register of commerce data (RC)
- ▶ VAT data (VAT)

The UID is completed with UID complements. The complement "RC" (resp. "HR" in German) will be amended if the company is inscribed in the register of commerce and the complement "VAT" (resp. "MWST" in German) in the case of a registration for VAT purposes in Switzerland. A company can be located on the website by using the integrated search function.

The UID-register is disposable multilingual (German, French, Italian and English). The used abbreviations for the UID complements are thus depending on the chosen language.

### Status Properties

The status properties contain the information whether a company is active / inactive and inscribed in the UID register as well as the complements "RC" and/or "VAT" provided the company is registered for the respective purpose in fact.

The UID number remains unchanged, only the complement may change. The former

RC and VAT number are mentioned on the web page of the FSO as long as the former numbers are not replaced by the effective UID number and its complements (see our comments as stated below under VAT Data row).

### Register of Commerce Data

This core property provides the information in connection with a former registration in the RC, the respective RC number as well as the status of its activity.

The former RC number stays in force until the replacement by an UID complement with respect to the registration in the RC.

### VAT Data

The UID register contains the information in connection with a registration for Swiss VAT purposes as well as its activity, the former (six digit) VAT number, the new UID with the VAT complement ("MWST") and the start date of the VAT obligation.

This unique and permanent UID with the

"VAT" complement will replace the former six digits VAT number. Until 31 December 2013 the companies can use either the former six-digit VAT number or already the new UID. As of 1 January 2014 only the VAT number in the UID format will be allowed to use.

Furthermore, it has to be considered that the sole UID number does not provide any information in connection with the registration for Swiss VAT purposes or a registration in the commercial register. In contrast to the EU the abbreviation "UID" does not mean "value added tax identification number" (Umsatzsteueridentifikationsnummer) but "company identification number" (Unternehmensidentifikationsnummer).

In the case an UID company is registered in the commercial register as well as in the VAT register both complements will be mentioned, separated by a slash behind the real UID number (always the complement of the RC at first).

## Liechtenstein signs double tax treaty with Germany

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On November 17, 2011 the Liechtenstein Prime Minister Klaus Tschütscher and German Finance Minister Wolfgang Schäuble have signed a comprehensive double tax treaty (DTA) between the two countries. With this step, the Principality of Liechtenstein has achieved a milestone in its strategy to conclude a network of treaties with its major business partners and to walk away from its history of not granting any exchange of information in tax matters.

The DTA is following the structure of the OECD model convention with adjustments made to meet the requirements of the specific tax systems of Liechtenstein and Germany. Liechtenstein has achieved a major success in confirming 0% withholding tax rates for dividends of qualifying substantial participations, interest payments and royalty payments. On the other hand, it should be noted that the DTA will not be applicable for Liechtenstein private wealth structures (PWS). Consequently, any dividend, interest or royalty payments from Germany to such structure may not benefit from the preferred treaty rates. The same applies basically to structures which may be seen as passive from a German tax perspective, e.g. pure financing and IP companies. Summarizing the above, the tax situation for active companies and private individuals will be clarified and in many respects improved compared to the current situation. On the other hand, Germany has insisted on far-going misuse provisions which disallow treaty benefits to Liechtenstein structures, companies and persons which enjoy tax exemption or are of a passive nature.

# Overview of amendments to cantonal tax laws for selected cantons - part 1

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## Canton of Basel-Stadt

### **Planned reduction of the maximum corporate income tax rate to 18%**

The canton of Basel-Stadt has decided to reduce the maximum corporate income tax rate to 21% for the 2011 tax period. As early as 2010, the Grand Council of the canton of Basel-Stadt agreed to reduce the maximum corporate income tax rate by 0.5% in two stages (down to 20.5% in 2012, and to 20% in 2013). These are, however, subject to specific criteria in terms of economic growth and the level of cantonal debt.

In a move aimed at promoting the competitiveness of Basel-Stadt and further enhancing the canton's appeal as a business location, the cantonal government presented another draft law at the end of September to reduce the maximum corporate income tax rate. According to government proposals, the gradual reduction in tax rates is set to continue. The maximum corporate income tax rate is to be cut to 18% by 2017, which corresponds to an annual reduction of half a percentage point. The government intends to pursue its policy of coupling the cuts to the robustness of economic growth and the level of cantonal debt (as is the case with the tax cuts to 20% already decided).

## Canton of Basel-Landschaft

### **No crediting of income tax toward capital tax in the case of municipal tax**

As mentioned previously, companies in the canton of Basel-Landschaft have been able to offset corporate income tax against their capital tax since January 1, 2010. It should be remembered, however, that such an offset is currently granted at cantonal level only. As for the municipalities, crediting of income tax toward capital tax is optional. So far, however, no municipalities in the canton of Basel-Landschaft have introduced the option of offsetting income tax against capital tax.

## Canton of St. Gallen

On November 27, 2011, the canton of St. Gallen did vote on the legislative initiative to abolish lump-sum taxation and the counter-proposal submitted by the canton's parliament. Unlike the initiative, the counter-proposal aims to toughen the criteria for applying lump-sum taxation rather than abolishing it altogether. In particular, taxable income will now amount to at least seven times the (annual) rent or rental value, or three times the hotel price of meals and accommodation, but at least 600,000 Swiss Franc. Taxable assets are to be fixed at twenty times taxable income, i.e. they must amount to at least 12,000,000 Swiss Franc. This aims to satisfy initiators' demand for more fairness in fiscal matters, while taking adequate account of developments at federal level. The electorate voted for the counter proposal.

## Canton of Appenzell Innerrhoden

Apart from the amendments to the tax parameters, the canton of Appenzell Innerrhoden is not expecting any further changes in 2012. On December 6, 2010, a Grand Council resolution set the corporate income tax rate, which can range between 6% and 11.5%, to 8%.

## Canton of Appenzell Ausserrhoden

The canton of Appenzell Ausserrhoden is scheduled to decide on March 11, 2012, whether to accept the tax initiative introduced by the Social Democratic Party (SP) to abolish lump-sum taxation. The counter-proposal prepared by the cantonal council aims to fix taxable income at a minimum of seven times the (annual) rent or rental value, or three times the hotel price of meals and accommodation, but at least 600,000 Swiss Franc. Taxable assets are to be fixed at twenty times

taxable income, i.e. must amount to at least 12,000,000 Swiss Franc.

## Canton of Thurgau

On May 15, 2011, the canton of Thurgau held a vote on abolishing lump-sum taxation, with voters accepting the counter-proposal submitted by the Grand Council. The counter-proposal, which is likely to enter into force on January 1, 2012, stipulates that the income tax and wealth tax transferrable by lump-sum taxpayers annually to the canton and the municipalities must amount to at least 150,000 Swiss Franc. In addition, the material expenditure governing determination of the tax must amount to at least ten times the rent or rental value. A transitional period of 3 years will apply to individuals who were already taxed on a lump-sum basis prior to the new regulations coming into effect.

## Canton of Grisons

On September 7, 2011, the Department of Finance and Municipalities of the canton of Grisons initiated the consultation process on the partial amendment to the Tax Act. The crux of the partial amendment is the switch from cantonal estate tax (where the entire estate is taxed as a single entity) to a form of individual inheritance tax (where that part of the estate assets inherited by each single heir is taxed). The amendment also aims to establish a legal framework for the electronic filing of tax returns, as well as electronic invoicing. In addition, various adjustments to federal law are to be made. According to the consultation draft, the new inheritance tax provisions will come into force on January 1, 2015.

## Canton of Zurich

### **Uniform objection periods for tax notices**

In the future, taxpayers in the canton of Zurich will receive their final assessment for both direct federal tax and cantonal and communal taxes at the same time. In order to harmonize deadlines, the policy of suspending deadlines for court recesses has been cancelled with respect to cantonal and municipal taxes. The amendment to the Ordinance on the Tax Act came into force on June 1, 2011.

### **Referendum of May 15, 2011: amendment to the Tax Act**

On May 15, 2011, Zurich's voting public rejected all three Tax Act bills which proposed tax relief for individuals. Tax relief in this form is thus will not be applicable (exception: compensation for the effects of "cold progression"; see below).

### **Offsetting of real estate gains against operating losses within the canton**

The Federal Court, in its judgment of October 7, 2011, endorsed the canton of Zurich's fiscal practice of not allowing operating losses to be offset against real estate gains within the canton, at the same time concurring with the verdict of Zurich's Administrative Court of August 25, 2010, the latter albeit in terms of the outcome, not of the reasoning behind it. As a consequence, Zurich's tax authorities may continue to assess real estate gains without companies offsetting their losses.

Both the Federal Court and Zurich's Administrative Court argued that the Tax Harmonization Act does not regulate the issue of loss offsetting. On the contrary, the Act grants the cantons a certain flexibility of interpretation. But whereas the Administrative Court held that *Zurich companies operating solely within the canton were being subjected to systematic discrimination*, which constituted a breach of the principle of legal equality, the Federal Court found that real estate gains tax - since it attaches to a specific property - was not fundamentally obliged to take the taxpayer's economic and financial situation into account. The question of whether Zurich's practices are unconstitutional did not, therefore, arise.

### **Outlook: compensation for "cold progression" as regards income and wealth tax as of January 1, 2012**

With effect from January 1, 2012, the council of the canton of Zurich has decided to provide relief on income and wealth tax to compensate for the 8.5% inflation accrued since the start of 2002. This corresponds to a saving for taxpayers of more than 4% on the statutory tax rate. Compensation for "cold progression"

was part of the draft bill for the Tax Act and the two counter-proposals, all of which were rejected by Zurich's voting public on May 15, 2011.

### **Outlook: determination of the cantonal tax base for 2012 and 2013**

At its 2012 budget debate set to take place mid-December, the cantonal parliament will need to come to a decision on the tax multiplier for 2012 and 2013. The council has asked the parliament to approve a 7% rise from currently 100 to 107% on the grounds of the expected economic downturn, already finalized tax relief (see above: compensation for "cold progression" with regard to income- and wealth tax), and several major pending investment programs, namely amendment of the Hospital Planning and Financing Act (+5% on the tax multiplier) and restructuring of the BVK (+2% on the tax multiplier).

### **Outlook: tax deductibility of fines**

A single initiative pending in the cantonal parliament's Financial Commission is requesting that fines and penalties of whatever kind incurred at home or abroad by legal entities no longer be declarable as operating expenses. Up to now, only fiscal fines and penalties were explicitly excluded. The council has asked the parliament to reject the initiative, citing that *operating expenses* was a term enshrined in Federal legislation and, as such, did not provide the canton with any legal scope for interpretation. That said, the option of deducting fines from tax would fully conform to the principle of *taxation based on financial strength*. The parliament will come to a decision on the bill at its 2012 budget debate set to take place mid-December.

### **Outlook: implementation of corporate tax reform II**

Even following the City of Zurich's decision to call a communal referendum in autumn 2010, federal requirements in respect of "corporate tax reform II" have yet to be formally implemented. In the canton of Zurich, therefore, the option of offsetting corporate income tax against capital tax is still not available. A date for the vote is not yet known.

## **Canton of Aargau**

### **Outlook: draft amendment to the Tax Act**

Partial amendment of the Tax Act is currently being debated in parliament. Due for implementation in 2013, the planned amendments include income tax relief, a reduction in wealth tax, an increase in child and childcare deductions, and a switch to annual compensation for the effects of "cold progression." A majority of both parliament and council members is in favor of these relief initiatives. That said, the advisory body, the VWA (Volkswirtschaft und Abgaben) Commission, is calling for more substantial tax relief than that currently petitioned with the Grand Council. For example, the Commission is calling for income and capital tax rates to be reduced too. Income tax is to be reduced to 5.5% for the first 800,000 francs, thereafter to 8.5% for the remaining taxable net income. The capital tax rate is to be reduced by 0.5‰, from 1.25‰ to 0.75‰.

## **Canton of Ticino**

Amendments at federal level have necessitated several changes to cantonal tax legislation. These are in particular as follows:

### **► Tax exemption for licensed transport companies**

The cantonal tax law already contained a provision on the tax exemption for transport companies. Accordingly, the main prerequisite for tax exemption was the importance of the transport company for transport policy purposes.

Tax exemption at cantonal level for licensed transport companies will now be harmonized with the Federal Law on the Railway Reform Phase 2 of 20 March 2009. Under the new law, transport companies will be exempted from tax in respect of their transport operations if a federal license has been granted to them or if they receive public sector compensation.

According to Article 56 Lit. d of the Federal Direct Tax Law (FDTL) tax exemption extends to disposable profit

arising from the licensed activity. This is, however, not applicable to auxiliary operations and real estate if the necessary relationship with the licensed activity is not given.

► **Deductions for children**

Similar to Article 212 Para. 2bis FDTL childcare expenses can - under certain circumstances - be deducted from income. At cantonal level, however, a maximum of CHF 5,500 can be deducted.

In addition, social security deductions of CHF 10,900 per minor or child still in education are split between the parents if they are taxed separately and they have joint custody of the child. These social security deductions are only allowed if no maintenance payments for the child have already been deducted.

Furthermore, the Article concerning the supporting documents that must be filed with the tax returns of natural persons with income from self-employment and of legal entities is extended. By publishing a specific list of the required documents, the cantonal tax authorities aim to avoid incomplete tax returns and to make the job of processing tax returns more efficient.

It should be noted that Ticino's Cantonal Parliament has yet to clarify its position with regard to the changes to the cantonal tax law mentioned here and a decision in this regard is expected to be made at the forthcoming session in November 2011. Should the draft proposals concerning the tax exemption for licensed transport companies and the supporting documents to be filed with the tax returns be approved, the new regulations are expected to come into force on 1 January 2012 with retroactive effect from 1 January 2011. By contrast, if the draft proposals on tax deductions for children are approved, the amendments will not be applicable before 1 January 2012.

## French-speaking cantons

### Canton of Fribourg

No changes.

### Canton of Geneva

The Grand Council of the Republic and Canton of Geneva adopted a law (*Loi sur les Jeunes Entreprises Développant des Innovations - LJEDI*) on July 2, 2010 that grants «JEDI» status to new businesses developing innovations; the law came into force on February 8, 2011.

This law is designed to simplify the procedures for tax holiday for young innovative businesses and promote innovation and the development of new companies. Thanks to this new law, the latter now only have to complete a questionnaire to enable them to demonstrate the innovative nature of the business.

The law defines «JEDI» status and sets out the cumulative conditions that have to be met to obtain it as follows:

- the company must develop innovative projects in the field of goods and services;
- the company must have its headquarters or stable base in the canton of Geneva;
- the company must conduct most of its operations in Geneva;
- the company must not have been created following the merger, demerger, transformation, transfer of assets, assignment of assets or of a company with assets and liabilities or of an extension of pre-existing operations or resumption of such operations;
- the company must not have a stock exchange listing, subject to a listing on specialist exchanges for small and medium-sized enterprises;
- the company has been allocating at least 35% of its expenditure to research activities every year since it was established, of which half must be conducted in Switzerland.

Companies with «JEDI» status will find it easier to obtain tax holiday (for cantonal and municipal tax) for up to 10 years maximum.

### Canton of Jura

The Jura government has established favorable taxation on investment made in new innovative enterprises to stimulate the internal economy by making investment in start-ups or spin-offs more attractive. The government's message on the new legislative texts has been passed onto parliament for adoption, enabling the new rules to come into force by the beginning of 2012 at the earliest.

This law defines «new innovative enterprise» status (hereinafter NIE) which will give favorable tax and economic treatment not only to the enterprise itself but also to the investor through separate taxation. The aim is to create an «innovative company» label. In fact, every legal entity that develops an unknown or unexploited element up to product, technology, production process or marketing technique level may apply for this status under certain conditions (i.e. NIE and actual headquarters must be based in Jura).

An NIE will benefit from the following advantages:

- label acknowledging the innovative nature of the products;
- tax exemption on profits and capital of at least 50% (maximum 100%) for 5 years minimum and up to 10 years maximum. Exemption may be at cantonal and municipal level as well as Federal, but only non-commercial investments may benefit from this favorable treatment;
- tax exemption of donations to the NIE;
- reduction in its investor's tax expense if he/she invests a minimum of CHF 20,000 p.a. in his/her own company or that of a third party. The tax rate on income - for the proportion of income equal to the amount of investment is 6.7 times lower than the maximum taxation rate.

## Canton of Neuchâtel

On June 19, 2011, the people of Neuchâtel accepted two main tax reforms:

- ▶ tax on profits may be offset against tax on capital since January 1st, 2011.
- ▶ major tax reforms for businesses to make the canton of Neuchâtel more attractive and transparent, such as:
  - ▶ from tax year 2011 to 2016, corporate income tax at cantonal and municipal level will be gradually reduced (by 2% p.a.) from 20% to 10%. In order to that the with the Federal tax combined effective rate of tax on profits will thereby be reduced based on the following sliding scale:

- ▶ tax on capital for companies with auxiliary/domicile or holding status will be reduced from 0.1% to 0.001% (applicable retrospectively from January 1st, 2010)

## Canton of Vaud

No changes.

## Canton of Valais

No changes.

	Legal tax rate cantonal/municipal	Combined legal tax (federal and municipal/cantonal corporate income tax)	Combined effective legal tax rate (federal and municipal/cantonal corporate income tax)
01.01.2011	20.00 %	28.50 %	22.18 %
01.01.2012	18.00 %	26.50 %	20.95 %
01.01.2013	16.00 %	24.50 %	19.68 %
01.01.2014	14.00 %	22.50 %	18.37 %
01.01.2015	12.00 %	20.50 %	17.01 %
01.01.2016	10.00 %	18.50 %	15.61 %

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Preannouncement

## Draft VAT-Infos: Financial Sector & Real Estate

On 26 October 2011 resp. on 1 November 2011 the second draft of the VAT-Info for real estate management / lease and sale of real estate resp. the VAT-Info for the financial sector have been released by the Swiss Federal Tax Administration (after consultation by the consultative committee, after decision by the Swiss Federal Tax Administration, main department VAT). The final versions should be published soon. We do not expect substantial changes compared to the content of the second drafts.

A short summary of the two VAT-Infos will be published in the next Tax News.

Further, the final version of the VAT-Info for insurance has been published on 7 November 2011.

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