Dear Reader,

Now that the summer break is over, it’s time to take a look at the latest tax developments outlined in our Newsletter.

We begin by reporting on the new draft agreement between Switzerland and France for the avoidance of double taxation with respect to inheritance taxes (5 July 2012). The agreement currently in effect dates back to 1953, and we outline the key amendments involved.

We also have news for you of changes in the taxation of employee stock options, which are due to take effect on 1 January 2013. The new rules impose additional certification and tax retention obligations on employers. We explain the implications of these new requirements for businesses, in particular for those which employ, or have in the past employed, staff who work abroad.

We also report on the major issue of expansion into new growth markets and employee secondments. In our fourth Global Mobility Effectiveness Survey 2011, we polled over 350 businesses operating in a range of sectors within Europe, North and South America, Asia and Africa. We provide a summary of the survey findings.
market, shareholders and the press all want to have their say about managers’ salaries and how to achieve greater wage fairness. Companies are looking for compensation schemes which provide compensation commensurate with performance and at the same time satisfy stakeholder requirements. Find out more in our Newsletter.

Finally, we provide an overview of the current status of DTA negotiations following the adoption, in March 2009, of the OECD model. In addition, to help us provide you with the most relevant information, we invite you to participate in our mini-survey.

We hope you find the Newsletter an interesting and informative read.

Dr. Philip Robinson  
Managing Partner Tax and Legal  
philip.robinson@ch.ey.com

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We have defined the following locations:

- Zurich 15.11. 2012  
- Berne 27.11. 2012  
- St. Gallen 29.11. 2012  
- Geneva 03.12. 2012  

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**Tax Law Event series**

In November and December we host again our Tax Law-event series.

Topics: Capital Contribution Principle, new rules on employee participation, the new VAT legislation and new limitation rules in purchasing and contracts for work / changes to the Swiss general business terms

- Request your invitation now
On 31 December 1953, Switzerland and France entered into a bilateral agreement for the avoidance of double taxation with respect to inheritance taxes. In 2011, France indicated that it wished to negotiate a new agreement with Switzerland, failing which it would terminate the agreement currently in force by giving six months’ notice. Following negotiations in the first six months of 2012, a new draft agreement was adopted on 5 July 2012. The key amendments that have been proposed are discussed briefly below.

1953 Agreement
Under the current Agreement, real estate is subject to inheritance tax only in the country in which it is situated. Inheritance tax is payable on other assets (subject to some exceptions) in the country in which the deceased was last resident.

Where double taxation arises, the exemption method may be applied, which means that income that is taxable in another country will not be factored into the home country tax base.

Draft agreement
Under the draft agreement (which is due to enter into force on 1 January 2014, without retroactive effect), inheritance tax will still be charged on real estate in the country in which it is situated, but also on real estate held by real estate companies or companies forming part of the deceased’s estate. Other assets will generally be taxed in the country in which the deceased was last resident.

Switzerland will continue to use the exemption method for relieving double taxation, while France has elected to apply the credit method, under which all assets will be taxable in France, but the taxpayer may claim a credit or deduction for any taxes actually paid in Switzerland against his tax liability in France.

The draft agreement also includes a provision allowing France to tax all assets (movable and immovable property) due to the estate, if the heir to the estate was resident in France at the date of the testator’s death and for a minimum of six years during the ten years preceding the year in which the assets are distributed.

The draft agreement has given France substantially greater powers of taxation. In France, inheritance tax is payable at rates of up to 45% where the heir is connected to the deceased by lineal descent, and 60% where there is no family connection. This would have a considerable impact on estates, given that the tax rates for Switzerland are between 0 and 7% (depending on the canton).

Switzerland has granted extensive taxing powers to France to prevent it from terminating the 1953 Agreement and to avoid a situation in which there would be no double taxation agreement between the two countries pertaining to inheritance.

This also means that the draft agreement operates broadly in line with the French national inheritance tax regime.

The draft agreement is a matter of concern to the 170,000 Swiss nationals living in France and the 155,000 French nationals living in Switzerland. It is estimated that approximately 2,000 French nationals residing in Switzerland benefit from the lump-sum taxation regime. To enable France to bring a small minority of wealthy tax exiles into the tax net, inheritance taxes will increase significantly for hundreds of thousands of people.

Implications of the draft agreement
Given the extent of the changes, wealthy French tax exiles targeted by the reform are likely to move their place of residence to a neighboring country where they would fall outside the ambit of the double taxation agreement and benefit from a more generous inheritance tax regime. Contrary to all appearances, then, France would reap only limited benefits from the new agreement.

In conclusion, given the reaction of politicians and stakeholder groups, it is hard to believe that Switzerland would not renegotiate certain key aspects of the agreement to lessen the impact of the proposed amendments. It follows that the safest approach is to wait and see where the negotiations are headed. This will allow us to assess more fully the impact of the reforms on Swiss and French residents, and to identify appropriate tax planning solutions on this basis.
On June 27, 2012 the Swiss Federal Council passed the Employee Stock Option Ordinance (MBV) into law. An urgently needed reform, the ordinance is intended to harmonize the differing practices for levying direct federal tax in the cantons. It is scheduled to enter into force together with the Federal Act on the Taxation of Employee Stock Option Plans on January 1, 2013. What legal obligations will now be eliminated from the business owner’s point of view? Will companies be expected to be able to provide proof of the tax residency status of their employees at all times – particularly those who work internationally – even after their employment relationship has been terminated?

The core objective of the ordinance is to define the details of the new federal law with regard to the allocation of equity-based compensation in cross-border situations, known as imported and exported employee stock options. The allocation basis is determined by the period from the date the stock options are granted until they become vested (known as the grant to vest allocation). The application of the allocation for imported employee stock options will thus most likely no longer require a double taxation treaty to be in place and/or proof of taxation in the foreign country (which was the case in some cantons up to now). This change aims to simplify procedures. In Zurich, the minimum taxable income related to imported stock options will no longer be linked to the costs charged back to the Swiss company. The ordinance also cites further special cases illustrating how to calculate taxable income or costs of employee stock options taxed at the date of grant, when stock options are released before the end of the vesting period or are returned prematurely to the employer due to a planned termination of the employment relationship. This serves as the basis for fulfilling the following corporate obligations according to the law.

The ordinance describes in detail the obligation to provide proof and retain taxes (at source) in relation to equity-based compensation. Proof must be supplied in all annual salary statements provided by employers as from 2013. It should be noted here that many cantons have already raised their requirements in this respect; in many cases, however, the new obligations to provide proof go beyond the existing ones. For employees who work internationally, however, the procedures for complying with the duty to provide proof and retaining taxes will have to be adjusted. The tax retention obligation requires more precise information with respect to employees who, after leaving Switzerland, continue to receive income from employee stock options that in some cases is attributable to residency in Switzerland. This will be taxed at the federal level at a uniform rate of 11.5%. The cantonal tax rates still have to be set by the cantonal governments responsible. In Zurich, the applicable tax rate will probably be below 20%. The cantonal tax will go to the canton in which the employer is domiciled, regardless of the employee’s former place of residence. In the case of imported and exported employee stock options, the employer must also provide proof of the number of working days in Switzerland during the vesting period. How this proof is to be provided, whether directly and to which tax authority or via the employee, will depend on the personal circumstance of the employee at the date of exercise or sale of the options.

In order to comply with the legal obligation to provide proof, employers will face the challenge of gathering information required by the new ordinance from various departments (e.g. personnel, payroll administration, finances and plan administration). Some cantons will publish special forms to be used for this, but they do not recommend waiting before introducing appropriate processes for providing proof. Employers are advised to review their employee stock option plans and related advance ruling certificates in light of the new federal law and ordinance in order to make sure they can comply with its requirements from the beginning of 2013. These changes will also be of interest to employees and should therefore be communicated to them appropriately. After many years of debate at national level, these provisions have now been incorporated into federal law, but there may still be differences in cantonal practices.

Changes in the taxation of employee stock options from January 1, 2013 impose additional requirements on employers to provide proof and retain taxes

Markus Kämpf, Executive Director Human Capital, Zug, markus.kaempf@ch.ey.com
Louise Barrelet, Senior Manager Human Capital, Lausanne, louise.barrelet@ch.ey.com
Debora Müller, Senior Consultant Human Capital, Zürich, Debora.mueller@ch.ey.com
Global mobility ahead of new challenges – focus on growth markets

Chris Debner, Executive Director Human Capital, Zurich, chris.debner@ch.ey.com

Whether the financial and economic crisis has been fully overcome or whether another one is in store is not certain. Political crises and revolutions, economic turbulence and constant changes in the legal environment continue to pose challenges to companies.

Expansion into new growth markets has developed into a key strategic theme, and alongside this, employee assignments in these regions are also increasing.

Against this backdrop, for the fourth year in a row, Ernst & Young has published its annual Global Mobility Effectiveness Survey 2011. More than 350 companies, based in Europe, North and South America, Asia and Africa, and from a variety of industries, responded to the survey.

In past years, many international employee assignment strategies and policies were adapted to the changing circumstances. Many companies are still working on making, or planning to make, their assignment programs more flexible and robust. A renewed rise in cost pressure should find those companies that did their homework following the crisis less unprepared than in the past.

At the same time, cost-effective and attractive assignment strategies have to be defined that can address the new challenges posed by increasing employee assignments in and from growth markets such as Brazil, India, Russia, China and Africa. The Global Mobility Effectiveness Survey 2011 focuses on the question of how companies are adapting themselves to be competitive in growth regions.

Expatriates on the rise again

During the recent economic crisis, the number of short-term assignments fell, while the number of long-term assignments remained more or less constant. In 2011 there was a significant increase in short-term assignments as well as a rise in the number of long-term assignments.

The increase in assignments in growth markets certainly contributed to the rising numbers. Most growth markets were relatively unaffected by the past financial crisis, and in some cases were even able to increase or maintain growth. This is presumably one of the main reasons why companies are increasingly investing or even expanding in these markets, and to this end sending employees to these regions on assignment.

Mobility and talent management

For many companies, talent management has become a rising priority. In particular, the competition over qualified employees and the expectations of Generation Y make it necessary for companies to increasingly deploy their global mobility function, and in many cases an international assignment also represents a development opportunity for employees. This requires that new types of assignments be considered, such as developmental policies for example, which though smaller in scale offer possibilities for ongoing development and open up career opportunities. Thus, even for long-term assignment policies, the financial incentives for transfers are increasingly being replaced by the intrinsic motivation of employees, who hope for improved career prospects through their experiences abroad.

While 21% of the surveyed companies already have a developmental policy, 17% of the companies are currently working to implement such a policy. The trend toward developmental policies forecast in past years thus continues to be confirmed. Only in the case of around 12% of the companies is the global mobility function involved in the selection process. The survey also shows that a greater level of persuasion is required at the management levels in order to achieve a greater level of involvement. The inclusion of mobility in talent management is a strategic
coordinated processes and efficient interface management are indispensable for a successful integration.

**Shorter cycles for reviewing employee assignment guidelines**

Of the firms surveyed, 60% had reviewed their assignment policies during the last twelve months and 52% are going to carry out a review of their policies in the next six months.

These figures represent a clear increase in review cycles over the last three years. For many companies, the process of developing new guidelines and receiving approval for them is still a lengthy one. Internal approval processes, including those for issues requiring co-determination, are partially to blame. However, it is also difficult for global mobility functions, which are already working at full capacity, to focus on additional strategic themes such as a reworking of policies in addition to the demands of operational business. The majority of companies (60%) still tackle policy projects in house, whereas 29% already enlist a third-party consultant.

It is still the desire to be competitive (51%) that motivates many companies to benchmark and rework their policies. Benchmarking is no simple exercise in a market in which practically 100% of companies are changing or planning to change their policy within the span of a year. The choice of benchmarking partners plays a key role. Otherwise, making regular comparisons within defined groups over extended periods of time can very quickly result in a blind spot as regards developments in other relevant industries, especially in terms of the labor market.

We are finding that achieving long-term flexibility requires a modular policy structure. Modular policy elements can be combined together in any combination to define different employee assignment conditions. Although in the past "cafeteria" systems for policies could not be implemented because they did not provide for equal treatment and planability in terms of the costs they entailed, modular policies or even multiple policies that build on specific business cases are taking shape as a practicable solution both for adjusting to the continually changing operating conditions and to support the different business cases for employee assignments.

**Risk management**

The global deployment of employees is subject to complex rules, the risks of which should not be underestimated, since they require the balancing of provisions from different legal areas and between different countries. To add a further layer of difficulty, the relevant legal areas are subject to constant change. Most companies are aware of this: 54% of the surveyed firms placed a greater focus on risk management in the area of global mobility over the last twelve months. The greatest challenge continues to be seen in the area of tax compliance (53%), followed by immigration (40%) and compensation and benefits (34%).

The causes for this assessment are clearly visible. Tax authorities subject employee assignments to tax audits to a greater extent in order to monitor the correct taxation of income earned internationally and to tap what is possibly a previously unused potential source of tax revenue. Not only does this affect the taxation of expatriates, it also requires that attention be given to risks related to corporation tax. Increasingly, business establishments

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**Part 2 of the graph:**

**Which of the following IHR topics are the most challenging for your company?**

- **Tax Compliance**
- **Immigration**
- **Compensation and benefits**
- **Payroll**
- **Labor law issues**
- **Housing and schooling**
- **Share plans and stock options**
- **Policy management**
- **Social security**
- **Pension**
- **Global Health Care**
- **Insurance**
- **Relocation and shipping**

**Graph 1**

**Legend:**

- Very challenging
- Challenging
- Not challenging
are being identified that lead to a taxation of corporate profits in the host country.

The globalization of the economy means that the experience of tax authorities in the previously peripheral area of global mobility is growing continuously. Information exchange between governments is increasing - and between tax and immigration authorities in particular.

Companies sense these increasing compliance requirements, and have therefore identified compliance on tax issues as the most pressing risk area.

Special challenges and risks also arise in the case of short-term assignments and business travel, the so-called "accidental expatriates." In such cases, the international HR department often does not receive sufficient information about the scope and duration of the foreign assignments performed. Potential risks, for example those arising from exceeding defined time periods, are not identified and cannot be managed. Therefore, companies are devoting increasing attention to this area and implementing processes to reduce risk. (see graph 2)

The challenge of growth markets

Growth markets were selected as the focus theme for the Global Mobility Effectiveness Survey 2011. The growth markets covered here were not only the traditional BRIC nations (Brazil, Russia, India, the People's Republic of China), but also Africa. As a result of commodity wealth and large investments from China and India on the African continent, the African market is even forecast to have the highest growth rates among the growth markets in terms of inbound expatriates until 2014. Many growth markets very frequently still have underdeveloped infrastructures and, as a result (aside from other factors such as climate, security, etc.), a lower quality of life.

A large number of the employees that companies send on assignment to these markets are managers (45%), constituting a higher proportion than for assignments to developed markets. Not unexpectedly, the greatest challenges for companies in Brazil, Russia and India are compliance with the local legislation and the granting of work permits. Whereas those surveyed stated that in China the challenge is the complex laws and the higher remuneration demanded by the assignees, in Africa it is the security risks to employees. The Ernst & Young Africa Attractiveness Survey 2011 reports that an unstable political situation, corruption and low safety standards constitute three of the four largest hurdles for investments in Africa. Firms provide compensation for these risks to their employees largely through additional allowances and flights home; 60% of all companies surveyed are of the opinion that the additional investments in assignments in growth markets do pay off. We expect that the number of intra-regional assignments (third-country nationals) will continue to rise, and that this will enable cost reductions to be achieved.

Furthermore, the number of assignments of employees from growth markets to developed markets continues to increase. This presents an entirely different set of challenges for companies, as one of the chief problems is the large salary differential between the markets. While differentiation of assignment packages according to country of origin should not occur for reasons of equal treatment, high remuneration levels often then result in a lack of incentive to repatriate, because repatriation would result in what is seen as a serious cut in salary - but often also because the integration in the host country was successful. A German Dax 30 company reported the example of a Chinese native who, on account of his two German-born children, the one-child policy in place in China and the resulting cultural challenges to be expected should he return, decided not to return when his assignment ended, but stayed in Germany. Thus the original goal of bringing employees from these growth markets for a stay and training at the head office to prepare them for new responsibilities following their return to their home country is missed. (see graph 3 on next page)

Summary

Effective global mobility functions within companies must support strategy, have clear and flexible policies and structure their processes efficiently. Constantly evolving challenges call for a response not only from the companies themselves, but also their global mobility functions. Compliance, immigration, talent management and succeeding in the growth markets represent the largest challenges. Of course, a high degree of flexibility is called for, along with the consistent treatment of all employees. This is a balancing act that requires mental gymnastics, which will take a different shape at each firm to take into consideration company-specific circumstances.

Interested parties may order the study sending an e-mail to hc-newsletter@de.ey.com.

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<tr>
<th>Process</th>
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<td>Income tax reporting and withholding</td>
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</tr>
<tr>
<td>Accidental expatriates</td>
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</tr>
<tr>
<td>Social security reporting and withholding</td>
<td>47</td>
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<tr>
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<tr>
<td>Immigration</td>
<td>41</td>
</tr>
<tr>
<td>Employment law</td>
<td>27</td>
</tr>
<tr>
<td>Global equity</td>
<td>25</td>
</tr>
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*Multiple responses possible*
Energy, chemicals and utilities
Communication, leisure and entertainment
Industrial products, manufacturing and engineering
Retail and consumer products
Financial and professional services
Automotive
Pharmaceuticals and health sciences
Technology
Conglomerate and general industry

2014 projected inbound assignees by industry sector

Graph 3

Africa

China

Brazil

India

Russia
Paying executives fairly? The market and shareholders have their say

Jane Djaté, Executive Director, Geneva, Switzerland e: jane.djate@ch.ey.com
Britta Schmitt, Executive Director, Zurich, Switzerland e: britta.schmitt@ch.ey.com
Justin Szwaja, Senior Manager, Geneva, Switzerland e: justin.szwaja@ch.ey.com

Executive pay remains high on the agenda of Swiss companies. Companies are grappling with maintaining sensible remuneration arrangements that match pay and performance and balancing this with the demands of stakeholders.

Most companies are focused on the primary question – getting executive pay right for their company. The starting point for this process usually requires current data on what comparative companies are doing so the issue of fairness and reasonableness can be addressed. The Ernst & Young 2012 review of the largest Swiss companies provides such market data and we summarize some of our findings for the SMI companies below.

Stakeholder demands, in particular the say-on-pay agenda or what has been dubbed as the ‘shareholder spring’, must also be factored into remuneration design. Most of the largest listed companies in Switzerland already give shareholders the opportunity to vote on remuneration, and most of these shareholders do in (or withdraw), the indirect counter proposals; the Initiative or, if not voted on the company.

What does the market say?

Benmarks should be carried out in a way that will be relevant to each company. However, the SMI companies give us some insight into what leading companies are doing:

- Even though stock option plans remain common in SMI companies, the trend is towards instruments like performance shares or restricted stock units following a global pattern
- The most common LTI key performance indicators (KPI) is total shareholder return or TSR, and increasingly TSR is measured relative to comparative companies
- Otherwise, both STIs and LTIs tend to be based on earnings and individual (financial and/or non-financial) KPIs

These kinds of insights help companies, regardless of their size, start internal discussions about whether remuneration arrangements remain appropriate.

Say-on-pay is on the horizon

Following over four years of heated public and political debate, reforms on board and executive pay and corporate governance in general are set to be introduced in Switzerland. These reforms largely result from Thomas Minder’s “Abzocker” initiative, otherwise known as the initiative “against rip-off salaries”.

No later than March 2013, the Swiss electorate will effectively be given the opportunity to choose between two major proposals; the Initiative or, if not voted on (or withdrawn), the indirect counter proposal (ICP).

Under the Minder Initiative, shareholders of listed companies will be given the entitlement to vote on the total compensation of the board members and executives. Under the ICP, shareholders would also be given some additional say on the ability to determine whether the annual vote on total executive (but not board) compensation is binding or non-binding. Otherwise, both under the Minder Initiative and the ICP, remuneration voting will be binding on the company.

With the outcome still unknown (though indications seem to favor the Initiative) many companies already seek to bring their corporate governance practices and remuneration packages into compliance with current market practice and are taking steps to prepare for any future changes in law.

This is proving challenging as, for instance, companies are grappling with the practicalities of dealing with a potential “no” vote and the possible impact of the Initiative depending on whether the binding vote will relate to prior or future compensation. Along with this, companies are dealing with proposed stringent limitations on remuneration in advance, “sign-on payments”, “golden parachutes” or “golden handshakes”, as well as corporate transaction-related bonuses.

The strain on companies is compounded by the fact that most of the SMI and SMIM companies that disclose voting results experienced decreasing support in the 2012 annual general meeting season. Further, the SMI and SMIM companies that received the lowest voting results in 2011 found themselves with further decreasing support on their remuneration votes in 2012.

The market is reacting

Change is coming. What are companies doing? Despite the challenges ahead, rather than engaging in any value assessment of the proposed legislative reform, many companies are proactively seeking to deal with the changes and reviewing their compensation and corporate governance practices.

Companies frequently review their compensation strategy, or at least elements of compensation, such as by benchmarking pay or realigning incentives to ensure clarity of the relationship between pay and performance. The review process can take the good part of a year, which makes sense given the impact people and remuneration arrangements have on a business. Conducting a full remuneration review will involve understanding the business strategy, consultation with stakeholders, assessment of market practice and implementation of pay that remains fair and incentivizes key performers in a way that is aligned with company success.
Companies are bringing their review process forward, realizing that with greater transparency and shareholder say on the horizon, this is an opportune time to take stock and implement change. By managing this process strategically, these companies are seeking to remain ahead of the curve, rather than simply reacting to change.

While the outcome of the legislative change remains uncertain, there are consistent messages that may be drawn from these corporate governance developments, and companies are accordingly seeing to implement appropriate actions. Setting a timeline which plans for the review of compensation, annual reporting and proposed changes is just one action item. Engaging with key stakeholders is considered a recipe for achieving higher levels of agreement with the selected compensation practices going forward. Review and decision-making on appropriate levels of transparency which retain competitive secrets, yet provide sufficient disclosure for shareholders to make investment decisions and exercise voting rights in an informed manner, is ever more part of boardroom discussion.

Leading companies are bringing the changing landscape onto the agenda; dealing with challenging global conditions, focus on delivering strong company performance and working to implement remuneration practices that will see them well into the future.
Double taxation agreement (DTA)

Nirmal Dias, Manager, Corporate Tax Geneva; nirmal.dias@ch.ey.com
Vjola Postoli, Senior, Corporate Tax Geneva; vjola.postoli@ch.ey.com

On March 13, 2009, the Federal Council took the decision to adopt the standard set out in Art. 26 of the OECD Model Convention with respect to international administrative assistance in tax matters. Switzerland has since negotiated numerous new DTAs or correspondingly revised DTAs. The passages below provide an overview of the current state of DTA negotiations.

Extension of the Swiss treaty network

Taiwan
On December 9, 2011, the Federal Council recognized the DTA of October 8, 2007 effective for Chinese Taipei (Taiwan). The Federal Act on the Recognition of Private Agreements for the Avoidance of Double Taxation of June 17, 2011 forms the basis for recognizing the agreement between both trade offices. In this case, the two contracting parties to the private double taxation agreement are the Trade office of Swiss Industries in Taipei and the Taipei Cultural and Economic Delegation in Switzerland. Said private agreement is based on the OECD Model Convention and entered into force as of December 13, 2011.

Uruguay
Following the diplomatic exchange of notes on 28 December 2011, the DTA between Switzerland and Uruguay entered into force. Aside from the exchange of information consistent to the OECD standard, Switzerland and Uruguay have agreed that dividends will be taxed at an ordinary 15% in the source state unless the companies have a capital stake of at least 10% in the company making the payment.

Malta
The DTA between Switzerland and the Republic of Malta entered into force on the same day as the diplomatic exchange of notes on 6 July 2012. It contains provisions on the exchange of information in accordance with the current international standard applicable. In addition, Switzerland and Malta have in particular agreed withholding tax exemption for dividend and interest payments between related companies with a capital stake of at least 10% in the company making the payment.

Tajikistan
The DTA with Tajikistan in the area of taxes on income and capital entered into force on 26 October 2011. In line with the Swiss agreements policy at the time of the initial negotiations, the DTA with Tajikistan does not contain any provisions on the exchange of information in accordance with the international standard applicable at present.

Georgia
This recent DTA entered into force in August 2011. Similar to the above-mentioned DTA with Tajikistan, the treaty with Georgia does not contain any provisions on the exchange of information in accordance with the international standard applicable at present. However, new negotiations are planned to adapt the administrative assistance to the international standard.

Quatar
The DTA with Qatar has entered into force in December 2010. It includes a provision on the exchange of information in accordance with the OECD standard as well as a low withholding tax rate for dividends on substantial holdings. Interest and royalty payments are exempt from withholding tax.

Turkey
The DTA between Switzerland and Turkey entered into force in May 2011. It contains provisions on the exchange of information in accordance with the current international standard applicable. Originally, Switzerland and Turkey had signed a DTA on 22 May 2008. However, this did not enter into force, as the Federal Council had in the meantime decided on the new administrative assistance policy in accordance with the internationally applicable standard.

Revision of DTAs
Starting with the amendment of the DTA with France which entered into force in November 2010, Switzerland has finalized the revision of a significant number of treaties (including Sweden, Slovakia, Singapore, Canada, Germany, Japan, the Netherlands, Poland, Denmark, Romania, South Korea and Greece) and is going forward with this process (revision of DTAs with Ireland, Czech Republic, Bulgaria, Colombia, Spain and Oman still to be ratified), which is primarily resulting from the decision of the Federal Council to ensure that the DTAs forming its treaty network are fully compliant with international standards in terms of administrative assistance and exchange of information, consistently with Switzerland’s approach in negotiating new DTAs.

In addition to promoting the development of bilateral economic ties, these developments have allowed to achieve important economic benefits such as reductions in withholding tax or in some cases tax exemptions for dividends, interest and royalty payments in the source state and arbitration clauses within the scope of mutual agreement procedures.
Recent/Upcoming VAT changes in the European Union

Tania Segovia Tornero, Senior Consultant, Indirect Tax Services, Geneva, tania.segovia-tornero@ch.ey.com
Virginie Favre, Consultant, Indirect Tax Services, Geneva, virginie.favre@ch.ey.com

Indirect taxes are booming. As governments around the world continue to struggle with the fallout from the financial crisis, they are increasingly turning to increase in VAT, excises and other indirect taxes as the most straightforward ways of raising additional revenues.

The purpose of this article is to update you of the upcoming raises in VAT and excise duties as well as enforcement of new regulations to intervene within the next few months in the European Union. Finally, we will conclude this article by an overview of VAT rates applicable as of 1 August 2012 in the European Union.

France
Cancellation of Répondant Fiscal Scheme
Our French colleagues have informed us that according to the new regulations and guidelines published by French Tax Authorities on 20 June 2012, a non-established company can no longer apply local French VAT on its domestic supplies in France. Instead, any non-established company will have to shift the VAT liability to its customers (i.e. by applying the reverse charge mechanism). In the event the non-established company only performs French domestic supplies, it will be required that such company cancels its French VAT registration no later than 1 October 2012. Consequently, any French input VAT incurred by the non-established company can only be reclaimed via a foreign VAT reclaim procedure (Eight Directive for EU established companies and Thirteen Directive for non-EU established companies). Non-established companies which perform supplies for which it is mandatory to have a French VAT registration, e.g. intra-EU and export supplies (but not intra-EU acquisitions) can still recover the French input VAT via its French VAT returns.

In particular for companies established outside the EU, it occurs that the Répondant fiscal is also acting as tax representative. In such case, the cancellation of the Rédondant fiscal will not modify the status of the appointed company to remain the French tax representative if a French VAT registration is still mandatory.

Spain
New VAT rates applying as of 1 September 2012
Spain increased both its standard and reduced VAT rates from currently 18% to 21% respectively from 8% to 10% as of 1 September 2012. The super-reduced VAT rate is remaining at 4%. Further, certain specific goods and services are taxed at the standard rate while they were taxed at the reduced rate.

Our Spanish colleagues have informed us about the following main issues to be considered regarding the change of VAT rates:

- Issuance of an invoice with a different date than the date on which the supply was made
- Advanced payments for supplies after 1 September 2012
- Continuous supplies

Discounts granted after the transaction takes place, refunds or amendments for other causes
The tax rate applicable in the corresponding amendment invoice will be the one in force at the time that the transaction was carried out, even if the correction is made after 1 September 2012.

Imports
The new VAT rates will apply to those imports for which the import declaration has been formally admitted for Customs clearance after 1 September 2012.

Netherlands
Standard VAT rate applying as of 1 October 2012
As part of new budgetary measures, the Dutch government decided to increase the standard VAT rate from 19% to 21% as of 1 October 2012. The reduced VAT rate is remaining at 6 %.

Our Dutch colleagues have informed us about the following main issues to be considered regarding the change of VAT rates:

- Advanced payments for supplies after 1 October 2012

The transitional measures provide that an adjustment needs to be made in situations where the VAT becomes chargeable before 1 October 2012 in respect of supplies of goods and services carried out on or after 1 October 2012. In such cases, the prepayments have been invoiced with the standard VAT rate of 19%. Based on the transitional measures proposed, the 2% difference between the current standard rate of 19% and the new standard rate of 21% becomes chargeable on 1 October 2012.

The Dutch Act provides that suppliers can issue an additional invoice for the 2% VAT difference to their customers (even if according to the sales agreement 19% Dutch VAT is to be charged). As a simplifying rule, the Dutch State Secretary of Finance has approved that even prior to 1 October 2012 for supplies of goods and services which will be supplied on or after
1 October 2012, the supplier can issue an invoice showing the VAT rate of 21%.

 continuous supplies
Although the proposed transitional measures do not provide for a specific scheme relating to continuous supplies, the Dutch State Secretary of Finance has agreed that when the payments with respect to these supplies relate to a period ending on 30 September 2012, the payment period should be split. For the period before 1 October 2012, the current standard Dutch VAT rate of 19% can be applied.

... This highly dynamic indirect tax environment poses many challenges for businesses, particularly those that operate across borders. Rates of VAT, excises and duties vary from country to country leading to errors easily arising on the classification of sales and purchases and uncertainty over how some transactions should be treated. Therefore companies must deal with the risk of non-compliance and ineffective processes by spending an increasing amount of time managing their indirect taxes and focusing on the changing regulatory trends to manage such complexities. In that respect, we invite our clients to consider our following recommendations in the implementation of the increase of VAT rates.

financial impact
On the one hand, businesses (in particular in the retail sector) will have to think through whether as a result of the rate increase, prices will need to rise and what the associated impact on sales volume may be. On the other hand, businesses that cannot fully recover VAT on purchases will have to factor in the changes of their budgets.

systems, contracts, invoices, advertising material, websites
As a result of the increase of VAT rates, businesses will need to inform their customers, change prices where VAT is included or stated separately and review on-line sites, advertising material, contracts, paperwork etc.

In respect of invoicing, ERP systems need to be prepared well in advance to ensure, as far as possible, a smooth transition to the mandatory increase of VAT rates (thereby ensuring compliance with the tax point rules including transitional measures). We recommend businesses using VAT codification to create new VAT codes applying new VAT rates in parallel to existing VAT codes applying old VAT rates. We would like to point out the necessity to keep old VAT codes open in case of discounts, refunds or any kind of amendments to intervene in relation to supplies performed before the increase of VAT rates. The invoicing requirements will have to be adapted in this respect.

Finally, we would like to conclude our article by an overview of VAT rates applicable as of 1 August 2012 and expected increase of VAT rates in the European Union on a short-term period.

List of VAT rates applied in the Member States as of 1 August 2012

<table>
<thead>
<tr>
<th>Member States</th>
<th>Super Reduced Rate</th>
<th>Reduced Rate</th>
<th>Standard Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td></td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Belgium</td>
<td></td>
<td>6 / 12</td>
<td>21</td>
</tr>
<tr>
<td>Bulgaria</td>
<td></td>
<td>9</td>
<td>20</td>
</tr>
<tr>
<td>Czech Republic</td>
<td></td>
<td>14</td>
<td>20</td>
</tr>
<tr>
<td>Cyprus</td>
<td></td>
<td>5 / 8</td>
<td>17</td>
</tr>
<tr>
<td>Denmark</td>
<td></td>
<td></td>
<td>25</td>
</tr>
<tr>
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<td>9</td>
<td>20</td>
</tr>
<tr>
<td>Finland</td>
<td></td>
<td>9 / 13</td>
<td>23</td>
</tr>
<tr>
<td>France</td>
<td>2.1</td>
<td>5.5 / 7</td>
<td>19.6</td>
</tr>
<tr>
<td>Germany</td>
<td></td>
<td>7</td>
<td>19</td>
</tr>
<tr>
<td>Greece</td>
<td></td>
<td>6.5 / 13</td>
<td>23</td>
</tr>
<tr>
<td>Hungary</td>
<td></td>
<td>5 / 18</td>
<td>27</td>
</tr>
<tr>
<td>Iceland</td>
<td></td>
<td>9 / 13.5</td>
<td>23</td>
</tr>
<tr>
<td>Italy</td>
<td>4</td>
<td>10^</td>
<td>21^</td>
</tr>
<tr>
<td>Latvia</td>
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<td>12</td>
<td>21</td>
</tr>
<tr>
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<td></td>
<td>5 / 9</td>
<td>21</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>3</td>
<td>6 / 12</td>
<td>15</td>
</tr>
<tr>
<td>Malta</td>
<td></td>
<td>5 / 7</td>
<td>18</td>
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<tr>
<td>Netherlands</td>
<td></td>
<td>6</td>
<td>19^</td>
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<tr>
<td>Poland</td>
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<td>5 / 8</td>
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</tr>
<tr>
<td>Portugal</td>
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<td>23</td>
</tr>
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<td>Romania</td>
<td></td>
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</tr>
<tr>
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</tr>
<tr>
<td>Spain</td>
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<td></td>
<td>6 / 12</td>
<td>25</td>
</tr>
<tr>
<td>United Kingdom</td>
<td></td>
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<td>20</td>
</tr>
</tbody>
</table>

1 Please note that the Spanish reduced VAT rate will increase to 10%, as of 1 September 2012.
2 Please note that the Spanish standard VAT rate will increase to 21%, as of 1 September 2012.
3 Reduced rate expected to increase from 10 to 12% (1/10/2012) and finally increase up to 12,5% (1/1/2014).
4 Standard rate expected to increase from 21 to 23% (1/10/2012) and finally to increase up to 23,5% (1/1/2014).
5 Please note that the Dutch standard VAT rate will increase to 21%, as of 1 October 2012.
EFRAG revitalizes the discussions around IAS 12

Marco Mühlemann,
Senior Manager, BTS, Zurich, marco.muehlemann@.ch.ey.com
Antonio Pérez, Manager, BTS, Zurich, antonio.perez@ch.ey.com

Revitalization of discussions around a potential revision or modification of IAS 12

In March 2009 the International Accounting Standard Board (IASB) issued an exposure draft to revise IAS 12 income taxes (ED/2009/2). The major aim for the issuance of the exposure draft was to resolve problems in practice under IAS 12, without changing the fundamental approach and preferably without increasing the divergence with US-GAAP. However, apart from the amendment in connection with the recovery of underlying assets concerning the determination of deferred taxes on investment property measured at fair value - that was issued during December 2010 - no further amendments to IAS
12 have become effective so far and the potential revision to IAS 12 overcame to a “Sleeping Beauty”. Especially, since on October 2009, the IASB had decided to not further pursue a revision of IAS 12 but to introduce certain amendments to improve IAS 12.

As a result of such “smaller” amendments to IAS 12, on May 3, 2012 the IASB published for public comment an exposure draft (ED/2012/1) of proposed amendments to International Financial Reporting Standards (IFRS) under its annual improvement project. These proposed amendments include also potential amendments to IAS 12 in connection with the recognition of deferred tax assets for unrealized losses. Comments to this exposure draft may be submitted to the IASB by September 5, 2012. This new exposure draft may also help to re-launch the discussions to further amend/revise IAS 12. Especially, since beginning of the year the EFRAG (European Financial Reporting Advisory Group) started the discussions by launching a discussion paper (“DP”). The EFRAG is an organization that was established to assist the European Commission in the endorsement of IFRS by providing advice on the technical quality of IFRS. The aim of the DP was to awake the “Sleeping Beauty” by stimulating the discussion and debate pro-actively how IAS 12 could be improved in order to make the standard less difficult to understand and apply.

The EFRAG’s DP examines whether significant improvements to IAS 12 should be considered by not replicating the work already performed by the IASB. Consequently, the DP has put the focus for the improvements on the users’ needs that would like to obtain on the one hand more transparent information regarding the composition of the income tax charge/benefit and on the other hand would like to see the impact on future cash flows.

In particular and according to the EFRAG, the improvements would require a more transparent and standardized tax rate reconciliation in the disclosure requirements that should reduce the diversity currently seen in practice.

As further area of improvement, the DP also highlights that the current standard does not provide a clear guidance how uncertain tax positions should be recognized and measured. However, this was also addressed in the exposure draft issued in March 2009, where it was proposed that current and deferred tax assets and liabilities should be measured at the probability-weighted average of all possible outcomes, assuming that the tax authority examines the amounts reported to it by the entity and has full knowledge of all relevant information.

The DP addresses the current lack of discounting deferred taxes under IAS 12. This has been especially raised, since under IFRS discounting is required for other balance sheet positions in case the effect is material. However, since deferred tax positions are material to many companies issuing financial statements in accordance with IFRS, one may come to the conclusion that deferred taxes should also be valued by considering the time value of money. Nevertheless, it goes without saying that such an introduction would significantly increase the level of complexity.

Finally and in the second section of the DP, the EFRAG reviews potential alternative approaches for income taxes. In particular the following approaches are reviewed: temporary difference approach (which is the one currently applied under IAS 12); differences between the carrying amount of an asset or liability in the statement of the financial position and its tax base, flow through approach (under this approach, the only tax expense that is recognized in the financial statements is current tax), partial tax allocation approach (under this approach deferred tax liabilities are only taken into consideration to the extent that they are likely to become taxable), valuation adjustment approach (this approach is referred as the ne-of-tax approach), and accruals or timing difference approach (under the accruals approach the tax effects of all income and expenses are recognized, whether or not the tax effect is taken into account for the current or the future period). The DP generally explains the different mechanism of the approaches and highlights the advantages by also referring to potential weaknesses.

The discussion has now been launched but it remains still difficult to predict whether this may also lead to fundamental changes to further improve IAS 12.