Dear Reader,

Even as we approach the end of the year, tax issues could still scarcely be more varied. Since the controversial ruling by Switzerland’s Supreme Court on 19 January 2011, the Federal Tax Administration has, in a number of cases, refused to use the declaration procedure for dividend distributions, instead maintaining the practice of charging default interest when companies miss the 30-day deadline for declaration. Not even intensive talks between the Swiss Institute of Certified Accountants and Tax Consultants and the FTA have been able to change things. In recent weeks, the FTA has begun issuing countervailable rulings on default interest owed in pending and, for the most part, suspended cases. We urgently recommend companies that receive such notifications to consider submitting an appeal to safeguard their legal position. The appeal should be submitted within 30 days, be thoroughly prepared, and include all pertinent arguments against the levy of default interest.

In this newsletter, you can also read more about indirect partial liquidation and awkward questions on interpretation from everyday practice. We tell you about a new product that allows us to provide small and medium enterprises specifically with pragmatic, targeted support during due diligence. We also present our latest survey on transfer prices, and take a close look at two key rulings of the Administrative Court of the Canton of Zurich concerning offsetting losses. In another current case, the Tax Appeals Court for the Canton of Zurich was asked to rule on the practice of offsetting operating losses against property gains. Against the backdrop of the prevailing laws, we analyze the decision and clarify its position in the context of ongoing discussions and the legislative process.
The VAT package 2015 will bring in several important new rules applicable to telecoms supplies, radio/TV services and other electronically supplied services in the EU, which will mainly affect the place of supply in certain cases and the development of the “one-stop shop” system.

We will also be turning our attention to Asia, where Switzerland’s free trade agreement with China is set to come into force in the second half of 2014. Switzerland is only the second European country after Iceland to sign such an agreement with China, which will afford both signatories better market access while improving their respective export positions. It will also give Switzerland the edge over competitors who have yet to conclude such an agreement with China. On 1 April 2015, Malaysia will be introducing a new VAT regime in the form of a goods and services tax (GST) of 6%, so we advise clients in the Malaysian market to consider the implications of this new tax in good time.

In this issue, we also look at a current Federal Supreme Court ruling on inter-cantonal double taxation of employees taxed at source, and summarize the key developments in cantonal tax legislation.

Finally, we would like to wish you and your families a peaceful Christmas and a good start to 2014.

We hope you find this informative and entertaining reading.

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The Swiss Federal Tax Administration continues charging default interest and issues appealable decisions.

On 19 January 2011, the Federal Supreme Court ruled that the 30-day period in Art. 5 sect. 1 of the Tax Relief Ordinance is an absolute limitation period. If this deadline is missed, then the withholding tax claim can no longer be fulfilled through the application of the notification procedure. According to the ruling, the refund procedure must be chosen, provided all material prerequisites are met.

The aforementioned judgment led to considerably more restrictive practices on the part of the Swiss Federal Tax Administration (FTA). The FTA has insisted since on strict adherence to the 30-day period and has refused application of the notification procedure in a substantial number of cases. Furthermore, the FTA has in some cases billed for significant amounts of default interest if the withholding tax was not declared within 30 days or paid to the FTA in good time.

The Swiss Institute of Certified Accountants and Tax Consultants has held various meetings over the past two years with representatives of the FTA in order to, at the very least, find an acceptable transitional solution for companies. In the past, the FTA did not object regularly and without exception when withholding tax declarations were submitted late. In this respect, the systematic switch to the 30-day deadline represents a change in practice which should have been communicated by the FTA in light of the far-reaching consequences and principle of good faith. Moreover, in practice there have been a number of cases in which the FTA did not object to a breach of the 30-day deadline even after 19 January 2011, meaning that some companies received better treatment than other taxpayers. Prevailing opinion of leading scholars is still that the ruling from 19 January 2011 was materially wrong and should be corrected by means of another Federal Supreme Court ruling. Additionally, in January 2011, the Federal Supreme Court did not comment on the issue of levying default interest and the latest practice reflects solely the opinion of the FTA.

Unfortunately, the meetings held between the Swiss Institute of Certified Accountants and Tax Consultants and the FTA did not yield positive results for tax-paying companies. The FTA informed the Swiss Institute in writing in October that a general waiver of the default interest was not possible. According to the FTA, there has been no actual change in practice and there continues to be no basis for equal treatment of taxpayers in cases of illegality.

Over the past few weeks, the FTA has begun successively issuing appealable decisions on default interest owed in pending and, for the most part, suspended cases. The duty to pay the default interest is decided based on the individual circumstances.

It is imperative for companies that receive an appealable decision regarding default interest owed in regard, we advise our clients to submit all relevant arguments against the levy of default interest.
Indirect partial liquidation: quo vadis?

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The tax law governing the subject of so-called indirect partial liquidation has been in force since 1 January 2007. In practice, the law often presents tricky questions with regard to interpretation. The current practice applied by the tax authorities tends to overreach and is partially not in accordance with the wording of the law.

Background and definition

Capital gains on the sale of participations held as private assets of a Swiss tax-resident individual are generally tax exempt. Dividend income, on the other hand, is treated as taxable income, whereby since 1 January 2011 a partial tax exemption and/or partial tax rate reduction may apply. In the past, this distinction has led to a retention of legally distributable reserves if a sale of the company was envisaged, leading to a sale of a “full wallet”.

The indirect partial liquidation issue as written into law in art. 20a para. 1 lit. a of the Direct Federal Tax Act was the result of extensive case law as created by the Swiss Federal Supreme Court on the subject of tax avoidance in this area. The law states the conditions under which, provided they are cumulatively met, a tax-exempt capital gain may retroactively be requalified as taxable income, namely:

- Transfer of a participation of at least 20% (if shareholders with holdings of less than 20% cooperate with respect to the sale of their investments, the shareholdings are cumulated),
- sale from the private assets of the seller to the business assets of the buyer,
- within 5 years following the sale, distribution of non-operationally required assets from legally distributable reserves to the buyer that were available and could have been distributed already prior to the transaction,
- distribution in cooperation with the seller.

Tricky practice questions with regard to interpretation

In practice, various questions with regard to interpretation of the law arise, in particular as far as the definition of a harmful distribution and, thus, the determination of non-operationally required assets and legally distributable reserves at the time of the transaction is concerned. This is due to the fact that the taxable basis for indirect partial liquidation is determined as the smallest of the following figures:

- non-operationally required assets available at the time of the transaction,
- legally distributable reserves of the target according to the last Swiss-GAAP stand-alone balance sheet prior to the transaction,
- amount of the actual harmful distribution (within five years after the transaction),
- sales price of the target.

The figure that gives rise to most of the discussions in practice is the determination of non-operationally required assets. This is due to the fact that the other three figures generally seem to be unambiguously identifiable. Recent experience, however, has shown that the discussions extend more and more frequently also to the amount of distributable reserves at the time of the transaction. The apparent position of some cantons is that hidden reserves must be taken into consideration not only when determining the non-operationally required assets but even when determining the amount of distributable reserves; a position not covered by wording of the law.

It is undisputed that distributions from profits generated after the transaction are not harmful. It is, however, controversial whether this applies to operating profits only or also to extraordinary profits and whether it is relevant for the latter whether they originate from operating or non-operating assets.

Conclusion and recommendation

Each case is different and there is no general Swiss-wide solution in place. In transactions where the target is sold by a Swiss tax-resident individual it is highly recommended to involve a tax advisor and review potential tax planning ideas as early on in the process as possible. In order to obtain legal certainty, a corresponding upfront tax ruling request should be filed with the competent tax authorities. In addition to a corresponding indemnity clause in the share purchase agreement it should be ensured during the negotiation process that the seller is actually protected for the subsequent 5 years in terms of the buyer’s expected solvency in the mid-term. It should further be borne in mind that the indirect partial liquidation issue applies also on sales of participations in non-Swiss targets as long as they are sold by a Swiss tax-resident individual.

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SME special: The “Mid-Cap” approach leads to success on transactions
Our proven due diligence products are complemented by an SME-specific product

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In the M&A business of the big financial and corporate investors it is nowadays common practice to perform extensive due diligence processes for various topics. These are then often viewed by third parties and are typically quite detailed; furthermore, third parties may rely on it. But if small and mid-cap companies go for acquisitions, they want a pragmatic approach to due diligence, for which EY has now launched a new product.

The customized transaction solution for SME
Under the label “Mid-Cap” EY provides an integrated analysis that concentrates only on really important questions for SME companies. This product is built in order to fulfill clients’ budget expectations and is highly competitive. The due diligence report is quite compressed and very focused. EY offers this approach for financial, tax and legal services. However, if the financing banks and / or minority shareholders request a report from EY on which they can rely on then EY would typically only offer the full fledge due diligence report to ensure that all relevant details are disclosed for both sides to the extent required.

The typical “Mid-Cap” due diligence report and its potential
The contents of the report includes the relevant topics and issues for your decisions and describes the results of our work but not the approach. It summarizes what we have done, provides the necessary information in an appendix and provides directly usable results for your SPA negotiations and purchase price determinations. In summary, this product is similarly set-up to a SWOT analysis, supplemented by clearly defined next steps.

The tailor-made process set can be depicted as follows – personal, efficient, to the point:

Diagram:
- For a specific group of transactions and clients only
- Standard Proposals and scopes
- We tell the client how to do it
- Lean admin processes with less options
- Feeding into a short report + Data Book Style appendices
- Enabling Data Book and Analysis outsourcing within dedicated teams
- A Standard Work Program and Data Book
- If the client then wants more, he is back in the “yellow” world
In 2013, Ernst & Young conducted again a transfer pricing survey of almost 1,000 multinational enterprises. The survey indicated that most companies perceive risk management as a top priority for transfer pricing and are paying particular attention to rapid-growth markets.

Ernst & Young has regularly surveyed multinational enterprises on transfer pricing since 1995. The survey provides a snapshot of how multinational enterprises are navigating and adapting to changes in the transfer pricing environment. 878 multinational enterprises across 26 different markets responded to the latest survey, including 637 parent companies.

The survey shows a clear shift toward prioritizing risk management in transfer pricing for the majority of multinational enterprises. Two thirds of respondents identified risk management as a top priority, compared to only fifty percent of respondents to the last survey in 2010. The main reasons for this shift are as follows:

- Transfer pricing is increasingly viewed by tax authorities as a “high-risk“ tax issue.
- Transfer pricing is receiving greater scrutiny from tax authorities in rapid-growth markets, coupled with a more intense examination of international tax issues generally.

The impact of this shift is also evident in other survey findings:

- 47% of companies reported that they have experienced double taxation as a result of a transfer pricing adjustment following a tax audit.
- 24% of companies have been subject to penalties in the last three years following a transfer pricing audit.
- 28% of companies report unresolved transfer pricing examinations (compared to only 17% in the 2010 survey).
- 15% of companies have referred a transfer pricing case to litigation in the past year.

Rapid-growth markets are a main area of focus for respondents. 30% of respondents operating in the BRIC countries and Africa said that these were their No. 1 or No. 2 priority areas when it comes to managing transfer pricing. One explanation for this increased focus is that these countries increasingly introduced strict transfer pricing documentation requirements. Despite this, 74% of companies indicated that they did not employ any full-time transfer pricing personnel in those jurisdictions.

Unsurprisingly, the survey also reveals that most companies place importance on complying with the relevant transfer pricing rules. 70% of companies claim to be either fully compliant with the rules in every country in which they operate or at least fully compliant wherever they consider transfer pricing to be high-risk. However, this is at odds with the finding that only 20% of companies monitor the impact of transfer pricing on financial results either on a real-time or monthly basis, which would enable them to take prompt corrective action where necessary.

On the basis of the survey findings, multinational enterprises are advised to assess whether their intercompany transactions comply with the arm’s length principle, to review their transfer prices on a regular basis and to maintain appropriate documentation.

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The Administrative Court of the Canton of Zurich has ruled that an assessment of a taxable profit does not necessarily mean that unclaimed tax losses carried forward may never be offset.

In its ruling of 12 June 2013 (SB.2012.00105), the Administrative Court of the Canton of Zurich held that tax losses could be offset even though the company concerned had been assessed in the preceding period with a taxable profit. The Tax Administration of the Canton of Zurich has appealed the ruling to the Federal Supreme Court.

On 30 November 2004, A. AG assumed all assets and liabilities of C. AG in the course of a merger. In its 2004 tax return, the company deducted C. AG’s tax losses carried forward from its reported net income for the 2004 financial year. On 18 November 2009, the Administrative Court rejected the deduction of the loss for the 2004 tax period, both for the cantonal/municipality tax and for the direct federal tax. A. AG appealed the ruling of the Administrative Court to the Federal Supreme Court.

The tax losses were not, are deemed offset. Anything else must result in a reduction of the tax loss carried forward equal to the taxable net income against which the loss could have been offset. On this basis, losses which could have been offset, but were not, are deemed offset.

However, the Administrative Court’s practice to date, by which all losses in previous years are deemed offset in the event of a positive assessment, is no longer accurate in view of the new rulings on the balance between the principle of total income and the principle of periodicity. A violation of the principle of immediate loss offsetting should not yield advantages to the taxpayer. Equally, however, it should not put him at a disadvantage compared with what his position would have been had he acted in accordance with the rules, assuming there has been no wrongful conduct or breach of duty.

Change in practice of the Administrative Court of the Canton of Zurich

The Administrative Court of the Canton of Zurich declined to endorse the Cantonal Tax Administration’s assessment and held that the deduction of the previous years’ losses in the tax returns for 2005, 2006 and 2007 was permissible.

Prevailing opinion and case law indicate that losses carried forward must always be offset in the next period of profit. Anything else must result in a reduction of the tax loss carried forward equal to the taxable net income against which the loss could have been offset. On this basis, losses which could have been offset, but were not, are deemed offset.

Conclusion

In view of the principle of total income and that of taxation by economic performance, this ruling is to be welcomed. The government should not benefit unduly from the errors and omissions of taxpayers by taxing more income than is envisioned by the legislation.

The carrying forward of tax losses from previous years not yet offset is, however, permissible only where there has been no wrongful conduct or breach of duty. Regrettably, the Administrative Court did not provide a definition of the term “breach of duty” in its ruling, stating only that in this case, which is somewhat unique, the taxpayer could not have been expected to appeal the 2009 ruling of the Administrative Court to the Federal Supreme Court. In our opinion this leaves an open question as to whether an erroneous or negligent non-declaration of losses carried forward in the tax return should be interpreted as a breach of duty, raising the possibility that the offsetting could be denied after all.

Offsetting tax losses after the assessment of a taxable profit

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Offsetting tax losses after a temporary period of inactivity

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The Administrative Court of the Canton of Zurich has confirmed the permissibility of offsetting tax losses after temporary inactivity and resumption of business activities.

In its ruling of 22 May 2013 (SB.2012.00150), the Zurich Administrative Court confirmed the permissibility of offsetting losses although the tax-liable company concerned had suspended its business activities for a period of about four years. The ruling has since been appealed to the Swiss Federal Supreme Court, which has not yet ruled on the case.

The ruling concerns A. AG, which was incorporated in January 2001 as a holding company. After the company suffered major losses in 2001 and 2002, the holding activities were discontinued. A. AG was inactive from 2003 to 2006. Leading up to a planned new shareholding acquisition, the company was refinanced in a tax-neutral manner as regards corporate income tax by the shareholder in the fiscal year 2006. However, the shareholding acquisition did not actually take place.

In June 2007, A. AG changed its company purpose and acquired a debt-collecting business from a company within the group. The 2007 fiscal year ended with another loss. In the 2008/2009 fiscal year, A. AG made a profit for the first time. The corporation offset its tax losses carried forward from the years 2002 to 2007 against these profits.

As part of the appraisal and appeal procedure, the Tax Administration of the Canton of Zurich only admitted the tax loss from the year 2007 for offsetting purposes. A. AG then appealed this to the Zurich Tax Appeals Court, which confirmed the Tax Administration’s decision, stating that it considered the procedure chosen by A. AG to be tax evasion.

Administrative Court’s ruling

The Zurich Administrative Court confirmed the principle and ruling of the lower court that the tax-liable company’s inactivity does not stand in the way of its offsetting practices. Article 67 of the Swiss Direct Federal Tax Act (FTA) does not contain any corresponding provision that make such offsetting of tax losses dependent on the presence of business operations or any kind of activity. Given that Article 5 par. 1 of the Mergers Act states that even companies that are formally in the middle of liquidation can participate in mergers as well as the Federal Supreme Court’s ruling of 4 January 2012 that did not rule out – in such cases – offsetting losses for tax purposes within the meaning of Article 67 FTA, offsetting certainly must be permissible for companies that resume business activities after a period of inactivity and would like to offset their own tax losses (arising from earlier business activities) against profits.

In addition, the Administrative Court did not see any tax evasion in the transaction. The procedure adopted by the group in transferring business operations to a refinanced company within the group is not unusual or improper let alone peculiar, the Court specified. It also found the lower court’s reference to A. AG’s formerly different (holding) activity and its temporary inactivity to be a flawed attempt to justify its accusation of tax evasion. As demonstrated, these two circumstances do not justify denying the company’s offsetting of tax losses based on Article 67 FTA and cannot in and of themselves, during an assessment of how the tax-liable party has filed its taxes, be called peculiar in regard to possible tax evasion. However, it is true that the tax-liable company’s tax loss carry-forwards can be rendered applicable again in this manner towards decreasing the tax burden, as long as they have not yet expired. In the given circumstances of this case, this is above all a result of the fact that the refinancing payments in 2006 are to be qualified as non-taxable shareholder contributions and do not influence the offsetting of losses for tax purposes.

Conclusion

The Zurich Administrative Court’s ruling and its unambiguous reasoning are to be welcomed. In practice, other cases are known in which the Zurich Tax Administration has made loss offsetting dependent on a requirement of active operations not stipulated by any legislation or has attempted to deny loss offsetting using other, at times rather flimsy or spurious arguments. This restrictive practice is not intended by lawmakers and this ruling was right in not upholding it.

We hope that the Federal Supreme Court will confirm all aspects of the Zurich Administrative Court’s ruling and not issue another ruling with technically weak reasoning motivated by an aim to increase tax revenues.
The Zurich Tax Appeals Court has recently ruled that companies headquartered in the canton of Zurich may offset operating losses against real estate capital gain realized in the canton of Zurich providing that those losses are generated by permanent establishments outside the canton of Zurich. However, since this ruling has not yet become final, companies are advised to conduct a detailed analysis of real estate capital gain realized within the canton of Zurich until comprehensive loss offsetting is officially introduced.

Clear Federal Supreme Court rulings concerning companies headquartered outside the canton of Zurich and companies solely operating within the canton of Zurich have been confirmed. The Federal Supreme Court has rejected the offsetting of the losses for companies operating solely within the canton of Zurich, whereupon the ruling was based on a case with the following circumstances:

The facts
- Office headquartered in the canton of Zurich
- No permanent establishments outside of the canton
- Real estate capital gain in the canton of Zurich
- Overall loss

There are, however, many setups which differ from those covered by these Federal Supreme Court rulings and on the basis of which the Zurich tax authorities have rejected the offsetting.

Good news for companies headquartered in the canton of Zurich

However, a recent decision from the Zurich Tax Appeals Court shows that before the practice of offsetting operating losses against real estate gain is officially introduced in the canton of Zurich, it must be extended to other setups. In the most recent case, the Zurich Tax Appeals Court was called upon to examine the following circumstances:

The facts
- Head office in the canton of Zurich
- Permanent establishments outside the canton of Zurich
- Real estate capital gain in the canton of Zurich
- Overall loss

The good news first: the Zurich Tax Appeals Court concluded that in a situation where a company headquartered in the canton of Zurich incurs losses in permanent establishments outside the canton of Zurich, it may offset those losses against the Zurich real estate capital gain. According to the Zurich Tax Appeals Court, the concerned Zurich-based company has to qualify as an intercantonal company, which is subject to taxation in another canton on the basis of their permanent establishments. In such cases, the Zurich tax authorities must allow the offsetting of the losses. However, only this part of the losses which is not attributable to the canton of Zurich may be offset against the real estate capital gain realized in the canton of Zurich.

1 As discussed in the article “Offsetting of losses within a canton - the canton of Zurich changes after all” in EY News (June 2013) the canton of Zurich is planning to introduce - at the earliest 1 January 2015 - a system of offsetting operating losses against real estate capital gain also for companies operating solely within the canton.

2 Under Swiss tax law; a permanent establishment is any fixed business premises in which the operations of a company or profession are partially or wholly carried out. Permanent establishments include in particular branches, production facilities and sales points.
Accordingly, companies are required to calculate the proportion of losses realized outside the canton of Zurich, even though standard practice using the total loss offsetting method usually omits the loss allocation across the cantons.

In its reasoning, the Zurich Tax Appeals Court expressly stated that links and connections with other cantons are insufficient to qualify for offsetting operating losses against real estate capital gain realized in the canton of Zurich for a company headquartered in the canton of Zurich. As companies must have a permanent establishment outside the canton of Zurich as defined by the provisions of tax law, the tax authorities are not obliged to allow the offsetting of the losses for Zurich-based property dealers or real estate companies, because such companies are merely subject to taxation outside the canton of Zurich due to property in other cantons.

Further developments remain to be seen - safeguard opportunities
Since the Zurich tax authorities have not accepted the ruling from the Zurich Tax Appeals Court, the last word on that case has not been given. It therefore remains to be seen whether other courts will likewise rule in favor of companies headquartered in the canton of Zurich or not.

Until the law is changed, every property sale within the canton of Zurich should be analyzed from case to case to ensure not to miss the opportunity to offset the losses against the real estate capital gain.
The VAT package 2015 will bring in new rules applicable to telecommunications, broadcasting services and other electronically supplied services in the EU from 2015 onwards. This will change the place of supply in certain cases and will also broaden the application of the "one-stop shop" simplification model under which the corresponding VAT returns can be filed centrally in one EU country.

Current VAT rules on telecommunications, broadcasting and electronically supplied services in the EU
As a rule, telecommunications, broadcasting or electronically supplied services provided by a company established within the European Union ("EU") to a company established outside the EU or to any non-taxable person are not subject to tax in the EU. However, EU Member States may levy VAT on such services if these are effectively used and enjoyed within their own territory.

Any company within the EU which receives telecommunications, broadcasting or electronically supplied services from a non-EU company is in principle liable for tax on those services. Any non-EU company which supplies telecommunications or broadcasting services to non-taxable persons in the EU is generally obliged to account for VAT on those services in the country where they are effectively used and enjoyed. However, electronically supplied services provided by non-EU companies to non-taxable consumers in the EU are in principle subject to tax in the recipient’s country of residence. The place of supply may therefore differ depending on whether telecommunications, broadcasting or electronically supplied services are being provided. Under the current rules, non-EU companies supplying electronic services may opt to register in just one EU Member State and declare via that registration all revenue generated by supplies to non-taxable persons in the EU (i.e., these companies may make use of the “one-stop shop”). In the past this has led to a large number of companies active in this industry registering in Luxembourg in order to apply the lowest VAT rate in the EU (15%).

If supplies of telecommunications, broadcasting or electronically supplied services are made across borders but within the EU to taxable recipients, the recipient is liable for tax on those services in his own country under the reverse charge mechanism. If the services are supplied to non-taxable persons, the supplier must account for VAT on them in his own country.

Changes as of 2015 with respect to VAT on telecommunications, broadcasting and electronically supplied services in the EU
From 1 January 2015, telecommunications, broadcasting and electronically supplied services will always be taxable in the recipient’s country. This will in principle make it necessary to register for VAT and invoice it in the country of the recipient in any case where the reverse charge is not applicable.

However, to ease the supplier’s administrative burden, the single VAT registration system, so far named as “one-stop shop”, for supplies of telecommunications and broadcasting services to non-taxable consumers will be extended and made available to EU companies. These companies will therefore be able to declare revenue from all telecommunications, broadcasting and electronically supplied services provided in the various EU Member States via one VAT registration (i.e., the “mini one-stop shop”). As mentioned above, the single VAT registration has so far only been applicable for electronically supplied services provided by non-EU companies. The new rules are likely to provide for two different models: one for companies established within the EU and another for those established elsewhere.

In the VAT return designed especially for this system, a company must declare all revenue falling under each of the relevant tax rates in the different EU Member States. The administrative burden is eased in that the VAT due is payable centrally to the EU Member State in which the “mini one-stop shop registration” has been established; that Member State will then pass on the relevant VAT amounts to the others. The details – particularly those relating to implementation in the individual EU Member States – are still awaited.

We recommend analysis of the VAT impact of the changes discussed above at an early stage, since VAT obligations may arise as of 2015 in countries where a recipient of supplies is based. Companies are advised to consider using the “mini one-stop shop” to limit the administrative impact of the changes. This is also an important consideration for Swiss companies providing any of the relevant services to non-taxable persons within the EU.

New rules on telecommunications, broadcasting and electronically supplied services in the EU from 2015

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On July 6, 2013 Switzerland has entered into a Free-Trade-Agreement with China and in doing so has achieved a new level of economic exchange with its third largest commercial partner. Switzerland is after Island just the second European country entering in such an agreement with China. The negotiations having officially started in November 2011 proved successful and the agreement is claimed to demonstrate an historic moment for Switzerland. It is supposed to come into effect during the second half of the year 2014 and will bilaterally apply between China and Switzerland.¹

**Scope of application**

Subject to this comprehensive agreement, which is composed of 1152 pages, are in particular the chapters on the trade of goods, supplies of services, intellectual property and questions concerning environmental and working matters. In reference to the GATT, the core elements regarding the transfer of goods are in particular the reduction of tariffs for industrial and agricultural products, unified requirements for the proof of evidence and rules for the facilitation of trade by means of consistent trade procedures. Besides the services of the sovereign sector, all kind of services are affected by the agreement. Another pillar of the agreement is formed by the rules on protection of intellectual property which comply with the requirements formulated in the TRIPS but are claimed to be more precise with the effect of increased protection. The main purpose is to allow an improved enforcement of the intellectual property rights and a transparent procedure. Beside those outlined topics, the agreement copes with environmental-related issues and in doing so acknowledging the importance of environment protection and its impact on commercial ties.

**Purpose and impact**

By signing the agreement, the contracting parties have demonstrated their commitment for an economic and technological cooperation and are obliged to apply the law of competition according to it. The agreement is intended to enable both parties to a better market access and to improve the export situation.

One effect to be emphasised is that the agreement constitutes an effective competitive advantage for Switzerland in contrast to those countries which have yet not signed any agreement with China. For instance, in the absence of such an agreement between China and the European Member States, Switzerland may be an alternative place of production and trading activities for Chinese products. From a Swiss perspective, the agreement is expected to improve Swiss exports of various products to its largest export customer in Asia since it allows for reduced or totally abolished custom tariffs. Advantages for both contracting parties, the agreement forms a base of increased legal certainty for the commercial exchange. Worthy of special mention, Switzerland has achieved to covenant the interests of its national producers with its international economic interests for increased export for which reason it generally enjoys a broad acceptance.

**Appreciation and recommendation**

The agreement is in the light of the above outlined topics to be considered as a great success. It is recommendable for Swiss and foreign companies to analyse impacts and potential optimisations of supply chain and production costs. The benefit from the economic advantages of the agreement may conceivably be of high impact. The long-term effects of implementation in economic exchange remain to be seen but are estimated to be of positive nature.

¹ With respective to the trade of goods, the agreement applies additionally to Liechtenstein by reason of the customs union between Switzerland and Liechtenstein.
² General Agreement on Tariffs and Trade.
³ The General Agreement on Trade in Services.
⁴ Trade related aspects of international property-rights.
Malaysia to introduce GST at 6% from 1 April 2015

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The Malaysian Minister of Finance recently announced that Malaysia will introduce a goods and services tax on 1 April 2015 at the rate of 6%. The government is abolishing the current sales and service tax system.

What is the expected change?
The current sales and service tax (of 5% and 10%) will be abolished and replaced by a goods and services tax ("GST") of 6%. GST is a consumption tax applied at each stage of the supply chain. A GST registered business should be able to offset GST incurred on its purchases (input GST) against GST collected on its sales (output GST). In essence, GST should be cost-neutral to a business with the burden falling on the final consumer.

GST is charged on any taxable supply of goods and services made by a GST registered person in Malaysia and on the importation of goods and services into Malaysia. The threshold to become GST registered is RM 500’000 (appr. CHF 141’000) within a period of 12 months.

Who will be affected – practical implications
Everyone in Malaysia who sells or purchases goods or services will be affected upon implementation of GST. In particular, businesses may need to account for GST on their business activities.

GST will come into force on April 1, 2015. Based on our experience, businesses require a minimum of 12 to 15 months to be fully prepared for such a change. Therefore it is crucial, starting right away with a study on the impact of GST and designing a roadmap for the implementation of changes to accommodate GST, to finally evaluating the readiness of GST reporting.

Business decisions that may need to be considered are:

- Budget allocation
- The impact on product pricing for sales and procurement
- The review of vendor and supplier contracts, transactions, paperwork, online sites, advertising material etc.
- GST impact on employees’ benefits
- Monitor the monthly GST reporting processes
- Capabilities of existing accounting and information technology (IT) systems
- Cash flow implications management of GST
- Training of employees
- Transitional issues

Depending on the size of the organisation, it would normally require two to four months to complete the impact study.

Issues identified during the impact study that cannot be resolved may need to be brought up to the attention of the Customs Department or GST Implementation Office, within the Finance Ministry. The Customs department may consider the possibility of issuing private rulings to resolve these outstanding issues if discussions are held at an early stage.

Once a business organisation understands the impact of GST on its day-to-day operations, the respective departments will need to draw up their own roadmaps or blueprints to determine the changes to their business processes.
Federal Supreme Court ruling in inter-cantonal double taxation of one-off employer remuneration for employees taxed at source

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An employee taxed at source moved his residence from the canton of Basel-Stadt to a municipality in the Basel-Landschaft. As a result, a one-off payment from his employer was taxed in both cantons. In September 2013 the Federal Supreme Court issued a ruling on this intercantal double taxation (2C_116/2013, 2C_117/2013): irregular or one-off payments may only be taxed by the canton where tax liability applied at the time of realization.

Facts and circumstances
An employee taxed at source moved from abroad to Basel and lived initially in Basel-Stadt at the start of the year before moving six weeks later to a municipality in Basel-Landschaft. Upon arrival the employer paid the employee one-off remuneration (an integration and signing on bonus) that was taxed in full in Basel-Stadt, and in Basel-Landschaft on a pro-rata basis upon subsequent regular assessment (as the annual gross threshold of CHF 120,000 was exceeded). The claimant, represented by EY, appealed unsuccessfully against the double taxation in the cantonal courts but won in the Federal Supreme Court. It was only lawful to tax the one-off remuneration in Basel-Stadt - where the employee was resident at the time payment was made.

Considerations
The Federal Supreme Court held that this was a case of actual double taxation. This occurs when a taxpayer is taxed on the same income in the same period by two different cantons. The dispute in this case related to which canton was entitled to tax the one-off remuneration, since both claimed they were fully or partially entitled to do so. The court had to decide whether this payment should be deemed taxable solely by the canton of Basel-Stadt or divided pro-rata between the two cantons in proportion to the length of residence in each ("pro-rata temporis tax assessment").

The administrative guidelines on assessment when residence is moved between cantons (circular no.14 of the Swiss Tax Conference), which is not binding on the Federal Supreme Court, state that when a taxpayer moves to another canton, the canton responsible for issuing the assessment for the entire tax period is the one in which the taxpayer is resident at the end of that year (the destination canton); this canton also determines income and assets for both the old canton and the destination canton. Based on this assessment the two cantons calculate taxes using their own rates, making allowance for any tax already deducted at source. However, the circular is not clear on the disputed matter of how to allocate irregular income. The Federal Supreme Court believes the circular does not clash with statute.

Under current cantonal tax harmonization law, where a person taxed at source changes residence within Switzerland, the respective cantons of residence are entitled to levy tax “in proportion to the duration” of tax liability. The Federal Supreme Court had to decide how this rule should be construed.

There were no problems as far as the standard taxation in arrears just on regular income (monthly salary) was concerned: annual income is divided between the respective cantons of residence pro rata temporis and any taxation already paid at source is deducted. In the event of one-off benefits, balancing payments or repayments of taxation deducted at source between cantons should be avoided as far as possible; such income should be allocated in the same way for both taxation at source and standard taxation in arrears. The Federal Supreme Court therefore concluded that the canton of residence has to the sole right to levy tax in accordance with liability in that canton.

The Tax Harmonization Act Ordinance states that moving tax residence to another canton has the same effect on taxation of a salary taxable at source as the taxpayer leaving Switzerland or taking up residence in Switzerland ("liability to taxation within the year"). So if there is only a liability to tax for part of the year, tax is levied on income generated in that period. The rate used for regular income is based on the income calculated for twelve months; irregular income is subject to full annual tax, but is not converted into an annual income for the purposes of setting the rate.

Conclusion
Unfortunately, the ruling of the Federal Supreme Court did not settle all outstanding issues. EY remains in contact with the tax authorities of Basel-Stadt and Basel-Landschaft to define future processes, notably to analyze the inter-cantonal splitting of other income (e.g. dividends, interest) and various deductions (e.g. pension fund payments in arrears) in the year a move takes place, so as to clear up any possible debates.

The ruling does give clarity on the taxation of one-off remuneration where residence is switched between cantons, but it leaves other questions unanswered, such as whether it is necessary to file one tax return or two for the year a move takes place (i.e. in both the old canton and the destination canton), and which canton may assess income in detail.

To that extent this ruling is a leading case for the taxation of one-off remuneration. All cases suspended during these proceedings must now be reassessed.
Overview of amendments to selected cantons’ tax laws

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Canton of Appenzell Innerrhoden

Amendment to the Tax Act
On 21 October 2013 the Grand Council of the Canton of Appenzell Innerrhoden approved a revision of the Tax Act which will now be voted on by the general assembly in 2014. The revision largely entails adapting the Act in line with changes to federal law. The main points are:

- Simplification of the taxation of lottery winnings;
- Exemption of CHF 5,000 of firefighters’ salaries from tax;
- An increase to the minimum basis of assessment for lump-sum taxation (income of CHF 400,000 and assets of CHF 8 million);
- A change to practice on child deductions where the parents are assessed separately (option to split child deduction equally);
- The introduction of new rules on withholding tax on employee stock options;
- Further legal clarification of deferrals of real estate tax (option of deferral in the event of restructuring in certain instances);
- Discontinuation of court recesses for tax appeals in cantonal tax proceedings;
- Changes to appeals against rulings on tax abatement applications.

Canton of Basel-Stadt

Partial revision of the canton’s tax law
The tax law of canton of Basel-Stadt has been partially revised to align with Federal law. In particular, provisions have been introduced with effect from 1 January 2013 concerning the taxation of employee stock options, tax exemption for firefighters’ salaries and adjustments to the deadlines for appeals to the “Steuerrekurskommission” and the Administrative Court.

Canton of Basel-Landschaft

Partial revision of the canton’s tax law
A partial revision of Basel-Landschaft’s cantonal tax law has adopted a range of provisions as per the Tax Harmonization Act that are binding on the cantons.

The partial revision of the canton’s tax law was passed by its parliament (the Landrat) on 25 April 2013 and implemented by the “Regierungsrat” in two phases. Those provisions which under federal law needed to be adopted as of 1 January 2013 have been implemented with retroactive effect as of 1 January 2013. All provisions falling under cantonal authority will be effective as of 1 January 2014.

The provisions effective as of 1 January 2013 include those relating to the taxation of employee stock options, the tax exemption for firefighters’ salaries and wealth tax on redeemable pension insurance.

Provisions effective as of 1 January 2014 include those relating to the optimization of pensioners’ deductions, reductions in rates for large lump-sum payments from pension schemes and electronic access for public offices and courts to data held by the cantonal tax administration.

Canton of Grisons

New rules on absolute statute-barred assessments
The partial revision of the Tax Act approved by the Canton of Grisons came into effect on 1 December 2013. It raises the absolute statute-bar on tax assessments from 10 to 15 years. The object of this is to ensure that tax assessments will no longer become statute-barred before the main facts of a case have been properly established in pending criminal, criminal tax or court proceedings.

Grand Council rejects church tax initiative
On 21 October 2013 the Grand Council rejected the “fewer taxes on businesses” cantonal popular initiative, which calls for the abolition of church tax on legal entities. The voters of Grisons are expected to decide on the initiative on 9 February 2014.

Canton of Lucerne

Lump-sum taxation
After the voters of the Canton of Lucerne approved the counter proposal to the proposed initiative to abolish lump-sum taxation on 11 March 2012, the law was subsequently amended and came into force on 1 January 2013. Since that date, the tax basis used to determine taxable income under the lump-sum taxation rules equates to at least seven times annual rent or imputed rental value or three times the cost of meals and accommodation in a hotel, but not less than CHF 600,000. Taxable wealth equates to twenty times taxable income and must not be lower than CHF 12 million. There is a five-year transitional period for current lump-sum taxpayers.

Switchover from the fixed flat rate to the flat rate or actual costs model for property maintenance costs
After the Federal Supreme Court held that a fixed flat rate for property maintenance costs was contrary to federal law, the Canton of Lucerne switched from the fixed flat-rate model to the flat rate or actual costs model with effect from 1 January 2013. This means that taxpayers can now, in any tax period, opt either to deduct actual costs or to use the flat-rate deduction. The flat-rate deduction was also reduced to 10% (buildings less than 10 years old) or 20% (buildings older than 10 years) of the gross rental income or taxable rental value.

From the 2013 tax period onwards property maintenance costs are split from value-adding expenses under a revised directive.

Tax News EY December 2013
Popular initiative: abolition of the real estate tax
On 9 February 2014 the voters of the Canton of Lucerne will have a say on whether to abolish real estate tax. At the same time, they will vote on a counter-proposal put forward by the cantonal government, which provides for the abolition of real estate tax with effect from 1 January 2017.

Canton of St. Gallen
No changes.

Canton of Thurgau
Tax Act amendment in 2014
The Thurgau Grand Council approved a change to the Tax Act on 14 August 2013. The four main changes are:
- Switchover from a real estate tax to a dualistic system;
- Simplified taxation of lottery winnings, in line with federal law;
- Abolition of supplementary wealth tax;
- Expansion of tax exemptions on transfers of property to heirs.

The changes to the cantonal Tax Act are expected to come into effect on 1 January 2014. The referendum deadline expired on 23 November 2013.

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