Dear Reader,

In this spring issue of our quarterly newsletter, we kick off our 2015 news activities by telling you about current tax developments.

As part of the fight against base erosion and profit shifting (BEPS), the OECD has agreed on the “Modified Nexus Approach”. In the first article of this issue, we explain what this means and what impact it may have on the planned license box in Switzerland.

The recent decision of the Swiss National Bank to lift the cap on the Swiss franc to euro exchange rate presents the Swiss economy with major challenges and also raises important fiscal questions with regard to the 2014 financial statements. We analyze for you whether provisions for foreign currency related losses or impairments of euro-denominated balance sheet positions can already be recognized for tax purposes in the 2014 financial statements.

In its report of 10 November 2014, the Committee for Economic Affairs and Taxation of the National Council published a preliminary draft on adjusting the deadline regulation with regard to the notification procedure for withholding tax purposes. The preliminary draft containing a number of different proposals for implementing the parliamentary initiative “Clarification of the longstanding practice regarding the notification procedure for withholding tax”. We tell you about the key points and comment on the various options that have been proposed.

In a decision of 16 October 2014, the Swiss Federal Supreme Court looked at questions in connection with intra-group financing. The Swiss Federal Supreme Court ruled for the first time that the paid-in surplus is to be treated as part of the statutory general reserve and may therefore in principal be distributed. In addition, the Swiss Federal Supreme Court ruled that intra-group upstream and cross-stream loans not made at arm’s length will require that freely disposable equity capital being blocked in an amount equal to such loans. This decision is not only important from a legal perspective, but also raises tax-related questions as well.

In order to ensure fulfillment of the international obligations under the EU-Swiss free movement agreement, differential treatment of persons taxed at source on a pay-as-you earn basis and those who are taxed on the standard assessment basis is to be resolved. The Swiss Federal Council sent a corresponding draft bill regarding the amendment of the source tax regime to the Swiss parliament. We present the proposed new regulations and provide you with a look at the next steps towards the implementation of the draft bill.

The intensive negotiations on a double taxation agreement with the Principality of Liechtenstein were concluded on 2 February 2015. The entry into force of the new agreement is expected for 1 January 2017, replacing the current bilateral agreement signed in 1995. Details can be found in the last article of this issue.

We hope you have a pleasant and sunny spring!
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The license box proposal, which aims to introduce a model that is internationally accepted and at the same time offers as many companies as possible an alternative to the current cantonal tax regimes, is closely based on the UK’s patent box. The critical issue is how much substantial activity the license box has to demonstrate in order to enjoy preferential tax treatment. Discussions on this issue are currently ongoing at an international level. At the beginning of February, the OECD reached an agreement in the Base Erosion and Profit Shifting (BEPS) project on the restrictive approach known as the "modified nexus approach". Below we will explain what is meant by this term and what its impact on the proposed license box will be.

1. Consultation proposal
   In order to ensure that Switzerland continues to offer an attractive tax environment for companies in spite of the abolition of the varying cantonal tax regimes, the draft bill contains a broad interpretation of the substantial activity condition for the license box, in order to offer as many companies as possible a real alternative to the current tax regimes. Admittedly the draft does not go so far as to allow purely passive companies without any substantial activity to profit from this license box but companies which “make a substantial contribution to the development of the underlying invention” can expect to enjoy tax benefits. According to the draft bill a “significant contribution” is defined as follows:

(i) creating or developing the invention or a product based on the invention,  
(ii) exercising control over development in affiliated companies within a group or  
(iii) belonging to a group in case of an exclusive license or usufruct.

As we set out below, these criteria may have to be amended due to developments at the OECD level.

2. The modified nexus approach
   Under action point 5 of the BEPS initiative, the OECD is seeking to define criteria according to which certain tax regimes can be classified as harmful. The focus was on the substantial activity criterion and three different models for verifying substantial activity were considered: the transfer pricing approach, the value creation approach and the nexus approach.

Initial discussions did not produce any consensus as to which method would be used to verify substantial activity. Eventually, the compromise proposal by the UK and Germany based on the nexus approach gained broad support from the OECD and the G20 countries. At the beginning of February 2015, the OECD therefore announced that the agreement has definitively been reached on what is known as the modified nexus approach.

The conventional nexus approach only allows income from intellectual property rights to benefit from the license box where it is the result of R&D activities carried out by the company at the tax domicile of the license box. The nexus approach therefore requires a direct link between the taxpayer’s expenditure for R&D and the income allowable for the preferential tax treatment. As the nexus approach only recognizes actual R&D activities as relevant, this approach disregards the fact that other activities, such as strategic planning, financing and patent protection, are important in allowing intellectual property rights to be developed or marketed profitably in the first place. The so-called Modified nexus approach puts this restrictive approach so far into perspective as that expenditure on R&D abroad and the acquisition cost in connection with intellectual property rights may be considered to a certain extent in the qualifying expenditure. However, the qualifying expenditure may thereby be increased by max. 30%. The modified nexus approach therefore only differs from the conventional nexus approach in that a slightly higher level of qualifying expenditure can be used to calculate the tax relief. There is therefore no change in the critical issue that profits from intellectual property rights may only benefit from the license box to the extent that they are attributable to R&D activities which the company has carried out at the tax domicile of the license box.

3. Criticisms of the (modified) nexus approach
   The main criticism of the nexus approach is that only income generated as a result of the company’s own R&D activities benefits from the license box, whereas income from all other activities connected with intellectual property rights is largely excluded. It is therefore not surprising that smaller countries, including Switzerland, are particularly critical of the nexus approach as it evidently favors larger countries which have access to a bigger pool of researchers. As a result, subsidiaries based in countries where there are only limited R&D resources are inevitably forced to shift such activities to other countries. On the other hand, companies take advantage of other benefits in small countries; in Switzerland’s case, a stable financial centre, the large pool of specialists in the fields of economics and law and its favorable geographical position within Europe. As the nexus approach only recognizes actual R&D activities as relevant, as explained above, it ignores the fact that other activities are equally important in developing intellectual property rights in the first place and allowing them to be marketed profitably. The modified nexus approach does not change this position significantly, although it takes certain additional costs into consideration.
A further problem with the nexus approach is that its implementation will entail considerable compliance costs e.g. to differentiate all payment flows into qualifying and non-qualifying expenditure (known as “tracking and tracing”). The proposal on the modified nexus approach put forward by the UK and Germany calls on the OECD to reach agreement on a practical and proportionate expenditure tracking approach that can be implemented by affected companies (“Tracking and Tracing”). However, it is difficult not to conclude that the benefits of the license box, which are already fairly limited as a result of the restrictiveness of the modified nexus approach, will only justify the additional costs in certain cases.

4. Impact of the modified nexus approach on Switzerland

Switzerland can no longer stand aside from international developments. It supports fair international tax competition with appropriate rules for all countries. However, Switzerland is also concerned to ensure that the rules of the Forum on Harmful Tax Practices are not biased towards particular states or groups of states, or distorted in other ways, and is therefore actively involved in the BEPS project.

In its consultation proposal Switzerland largely follows the transfer pricing approach. However, the explanatory report on the draft law already concedes that there may be a need for modifications to the proposed structure of the license box should the nexus approach prevail at international level. With the adoption of the modified Nexus approach by the OECD, the draft law in this regard must be adapted to the new requirements. This means that very few of the companies that have previously enjoyed preferential taxation will be able to benefit from the license box, as most companies carry out their R&D abroad rather than in Switzerland. Since, as mentioned above, Switzerland is only willing and able to introduce tax models which are internationally accepted, there is very little scope for the license box to be structured more generously. On the other hand the license box will benefit many companies which are already engaged in R&D and manufacturing in Switzerland and which sell their products in Switzerland and abroad, as they were previously subject to full taxation. In other words, a large proportion of the Swiss export sector will benefit from reductions in their tax liability for the first time, while companies that previously enjoyed preferential tax rates will now have to pay tax at the full rate. Thus, if the cantons which are most affected by the Corporate Tax Reform III want to remain attractive in terms of tax, they will have very little choice but to consider significant cuts in tax rates.

More information about the developments of the Corporate Tax Reform III: www.ey.com/ch/CTR-III
Tax impact of the lifting of the Swiss franc cap on 2014 financial statements

The decision of the Swiss National Bank to lift the cap on the Swiss franc to euro exchange rate raises some interesting fiscal questions in relation to 2014 financial statements.

**Background**
On 15 January 2015 the Swiss National Bank (SNB) lifted the cap on the Swiss franc to euro exchange rate, which was in place since 2011, without warning and with immediate effect. This led to a sharp appreciation of the Swiss franc and in some cases to significant foreign currency related losses on the valuation of foreign currency denominated assets.

The SNB's decision not only creates major business and financial challenges for companies but also raises interesting accounting and taxation issues relating to the 2014 financial statements. For example, the question arises as to whether provisions for foreign currency related losses or impairments of euro-denominated balance sheet positions can already be recognized for tax purposes as of 31 December 2014.

**Accounting treatment**
From an accounting perspective it should be differentiated between the different accounting standards. While the accounting standards founded on a true and fair view (Swiss GAAP FER and IFRS) are focused on the reporting-date, the accounting regulations of the Swiss Code of Obligations give considerable prominence to the imparity principle as an essential element of the principle of prudence.

The separate financial statements under the Swiss Code of Obligations are definitive for tax purposes. Under the imparity principle, losses or expenses must be recognized in the financial statements if the event giving rise to the loss or expense was known at the year-end or there was a reasonable probability of its occurrence. Income and gains, on the other hand, should only be recognized when these are realized. Income is considered to be realized when the underlying claim is both de jure and de facto enforceable.

Provisions for currency translation losses occurring after balance sheet date should therefore be recognized on the balance sheet if the triggering event was already known or foreseeable on 31 December 2014. In relation to the SNB's decision this leads to the following conclusion:
- If the SNB's decision was already known or foreseeable with a reasonable degree of probability at the year-end, provisions for currency translation losses should have been recognized in the 2014 financial statements.
- However, if the SNB's decision was not yet known nor foreseeable with a reasonable degree of probability at the balance sheet date, the currency translation losses may not be recognized in the 2014 financial statements. Material events that occur between the balance sheet date and the publication of the accounts must, however, be disclosed in the notes.

If events occurring after the year-end jeopardize a company's ability to continue as a going concern, they must be recognized in the 2014 accounts, irrespective of the reporting-date or imparity principle. The lower of cost or market approach is a further exception. Under this principle, impairments must be recognized on the book value of assets (e.g. inventories) in the 2014 financial statements if the selling price of the assets, less selling costs, is reduced by the appreciation of the Swiss franc to such an extent that the cost of the goods exceed its selling price in Swiss francs at the reporting date. A similar situation could occur if the selling price of the goods had been agreed in a foreign currency (e.g. a sale of goods in euro to customers in Germany).

**Tax impact**
Provisions for expected foreign currency related losses and impairments recognized under Swiss accounting law are only permissible for tax purposes if they have a sound business justification at the reporting date. Provisions are considered to have a sound business justification if they are recognized to cover an imminent
risk of loss. If provisions are deemed not have a sound business justification, they will be added back for tax purposes.

**Conclusion**

The SNB’s decision was announced on 15 January 2015, i.e. after the year-end. There was no imminent risk of loss apparent on the reporting date, as the euro exchange rate did not move steadily during the financial year and nor were there any clear indications of a further reduction in the exchange rate as at the reporting date. Moreover, the SNB had confirmed in public in December 2014 that it would maintain the minimum euro exchange rate. Therefore, as at 31 December 2014, there were no grounds to actually expect that the cap would be lifted shortly afterwards. An imminent risk of loss did not exist on the reporting date. Foreign currency related losses recognized in the 2014 financial statements are therefore likely to miss an appropriate business justification and are therefore not justified for tax purposes.

In practice certain cantons expressed a more generous approach in their assessment when considering provisions for foreign currency losses. This could be driven by the fact that this would merely represent a shift in the timing of the expenses recognition for tax purposes and would not result in a loss of actual tax base. A uniform policy is not apparent at present, and it may therefore be worthwhile for companies to clarify with the relevant tax authorities whether any foreign currency losses could be considered also for the 2014 financial statements.

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**Developments regarding the notification procedure - consultation by the CEAT**

On 10 November 2014 the Committees for Economic Affairs and Taxation (CEAT) of the National Council published a preliminary draft containing a number of different proposals for implementing the parliamentary initiative entitled "Clarification of the longstanding practice regarding the notification procedure for withholding tax." The preliminary draft is now out for consultation which will continue up to and including 6 March 2015. A summary of the contents is set out below.

### I. Legal position and practice today

Under the current legal position and practice a taxpayer who meets the substantive requirements for applying the notification procedure must declare and report the taxable amount to the Swiss Federal Tax Administration (SFTA) within 30 days of the due date of the dividend. According to the practice and case law of the Federal Supreme Court, this 30-day period represents a forfeiture period. If the taxable amount is not declared and reported within this time period, the right to apply the notification procedure is forfeited. The withholding tax is then collected via the ordinary procedure and must be declared, paid and passed on to the recipient of the dividend (incl. late payment interest as of the 31st day after the dividend’s due date).

### II. Report of the CEAT

#### 1. New regulation for the notification procedure

**Majority view**

The majority of the CEAT proposes to retain the declaration and notification time limit of 30 days, but to redefine it as an administrative deadline, provided the substantive conditions for applying the notification procedure are met (article 24 ff. Withholding Tax Ordinance/VStV). Non-compliance of a taxpayer qualifying for the notification procedure with the 30-day deadline would no longer lead to a forfeiture of the right to report the withholding tax and subsequent application of the ordinary tax assessment procedure. Furthermore, those qualifying for the notification procedure would no longer be charged late payment interest. Instead,
failure to meet the declaration and/or reporting deadline could be sanctioned by means of an administrative fine.

The majority of the CEAT argues that the SFTA’s current practice and interpretation has disproportionate consequences for taxpayers qualifying for the notification procedure (liquidity outflow due to ordinary payment of the withholding tax and additional financial burden due to late payment interest) and consequently damages the business location Switzerland. Moreover, the majority of the CEAT argues that the adoption of a stricter practice by the SFTA following the Federal Supreme Court decision dated 19 January 2011 contradicts the will of the legislature of ensuring a non-bureaucratic and business-friendly environment.

**Minority view**
The minority of the CEAT favors an overall extension of the declaration period to 90 days (also for taxpayers who do not qualify for the notification procedure) and an extension of the notification period to one year. In correspondence with the current legal position and practice, these would continue to be forfeiture periods. It should be noted that the one-year notification period would only apply if the declaration had been duly filed within 90 days of the dividend’s due date. In case of non-compliance with the declaration period, the right to apply the notification procedure would also be forfeited upon expiry of the 90 days (even if the substantive conditions for the application of the notification procedure were fulfilled). Additionally a late declaration would continue to lead to late payment interest (also for those who qualify for the notification procedure as per the 91st day).

**2. Retroactive effect**

**Majority view**
The majority of the CEAT advocates applying the new regulations retroactively on dividends which became due in calendar year 2011 and onwards. In addition, taxpayers qualifying for the notification procedure should be able to reclaim any default interest levied since 2011.

This proposal is based on the opinion of the majority of the CEAT that the SFTA’s current legal practice and interpretation changed after the Federal Supreme Court’s decision dated 19 January 2011, when the court ruled the 30-day declaration and notification period to be a forfeiture period.

**First minority view**
The first minority of the CEAT favors extending the retroactive effect to include not just the tax liabilities which became due in calendar year 2011 and onwards but also those tax liabilities which became due before 2011 but are not yet time-barred or have entered into legal force after 1 January 2013. This way all pending cases involving taxpayers with a substantive entitlement to apply the notification procedure would also be included.

**Second minority view**
The second minority of the CEAT opposes a retroactive effect of the new regulations. In their view, a retroactive effect is problematic from a legal certainty and rule of law perspective and would lead to tax deficits as well as additional administrative costs at level of the SFTA. Moreover, the second minority argues that there is no need for a retroactive regulation, as the SFTA’s practice has not changed since the Federal Supreme Court decision of 19 January 2011.

**III. Conclusion**

In view of a business-friendly solution regarding the notification procedure for withholding tax, the new regulation according to the majority view is to be supported. Consequently the declaration and notification deadlines for withholding tax should return to being administrative deadlines for those who qualify for the notification procedure (in line with the SFTA’s original practice). However, with regard to a potential retroactive effect we consider that the new regulation should be applied retrospectively to all tax claims which became due in calendar year 2011 and onwards or which became due before 2011 but are not yet time-barred or have entered into legal force after 1 January 2011. This is the only way to avoid unequal legal treatment since the stricter practice of the SFTA has been implemented.
Detailed clarification from the Swiss Federal Supreme Court on intra-group financing

In connection with loans made to shareholders under a cash pool arrangement, a recent Swiss Federal Supreme Court decision (4A_138/2014, 16 October 2014) held for the first time that a paid-in surplus (Agio) is to be treated as part of the statutory general reserve and may therefore be distributed, provided the general reserve remains higher than one half of the share capital. The Federal Supreme Court also held that intra-group upstream and cross-stream loans not made at arm’s length will result in the freely disposable equity capital used for (dividend) distributions being blocked in an amount equal to such loans.

Underlying facts
In its decision of 16 October 2014, the Federal Supreme Court ruled on the company law treatment of physical cash pool deposits. The case involved the Swiss group company B AG, part of the Swissair Group, which held cash pooling claims of CHF 16.5 million against its Dutch affiliate (pool leader) as well as short-term loans receivable of CHF 7.2 million from the parent company as of 31 December 2000. Its capital comprised equity capital of CHF 2.5 million and disclosed reserves of CHF 32.85 million. For fiscal year 2000, the Annual General Meeting of B AG voted to issue a dividend of CHF 28.5 million, which was paid out in June 2001.

Blocking disposable equity by granting intra-company loans that qualify as distributions
In respect of upstream or cross-stream intra-group loans (to be assessed in light of the ban on the refund of capital contributions), the Federal Supreme Court and prevailing opinion doctrine apply the arm’s length principle (see also the November 2012 issue of Legal News). Shareholder loans not paid out of freely disposable equity capital must be granted at the same conditions that apply in the case of independent third parties. If this is not the case – at any rate in the (somewhat contentious) interpretation of the Federal Supreme Court – the loan is deemed to be fictitious, i.e. a concealed distribution, which results in the freely disposable equity available for (dividend) distributions being blocked in an amount equal to said loan. Therefore, in the case at hand, the amount of 24 million was no longer available for distribution.

Paid-in surplus (Agio) may be used for dividend distributions
In its decision of 16 October 2014, the Federal Supreme Court follows the prevailing doctrine that a paid-in surplus must be treated like a normal general reserve, which does not require any special protection and can therefore be used for dividend distributions. The paid-in surplus is allocated ex lege directly to the general reserve without the need for an additional resolution by the general meeting. This is in line with the practice adopted by the tax authorities, who have been treating paid-in surpluses as a generally disposable reserve ever since the capital contribution principle was introduced.
Conclusion from a company law perspective
On the basis of the above description of the financial situation, the dividend of B AG should only have been CHF 7.95 million (CHF 32.85 million in disclosed reserves minus CHF 1.25 million in restricted reserves minus CHF 23.65 million in blocked reserves as a result of the group loan).

Indeed, the Swiss Federal Supreme Court noted that it was "dubious from the outset" as to whether participation in cash pooling in which the participant may freely dispose of the liquidity would hold up as an arm's length transaction. However, the Federal Supreme Court avoided addressing this question in more detail. Several factors are relevant in connection with determining whether a transaction is at arm's length, including a sufficiently high interest rate. It is important to note in this regard that the interest rates published each year by the Swiss Federal Tax Administration (SFTA) for closely-related parties are not necessarily decisive for arm's length transactions in view of the blocked reserves.

Recommendations for intra-group financing
Cash pools and upstream/cross-stream loans should be carefully evaluated. In particular if these loans exceed the lender’s freely disposable equity capital, additional collateral should be provided and it is advisable to adequately monitor the financial situation of the parties involved. Depending on the circumstances, it is worth considering reducing any loan amounts which are in excess of the freely available equity.

Consequences for tax practice?
Thomas Nabholz, Oliver Everts

Follow-up questions concerning taxes
In view of appropriate risk distribution (cluster risk), it appears to the Federal Supreme Court to be unlikely that a zero balancing cash pool could ever be characterized as customary on the market, even without a resolution concerning the dividend. The ruling thus calls into question the participation of a Swiss group company in upstream and cross-stream cash pooling, particularly in a zero balancing cash pool. This gives rise to the tax question as to whether any loan granted on the basis of physical cash pooling is now to be considered as a hidden profit distribution. This would have a number of tax implications when granting such loans (withholding tax on the loan amount, taxable income for the cash pool leader, negative reserve in the taxable capital of the creditor), when repaying them (hidden capital contributions) and when making interest payments (likewise, hidden capital contributions). In our view, a generic disallowance of such cash pool deposits would be unjustified for the following reasons.

Cash pooling variants
The goal of group cash pooling is to utilize interest rate advantages within the group by concentrating as much liquidity as possible from group companies with the cash pool leader. This minimizes external interest on debit balances and allows for more favorable lending terms through economies of scale. In practice, a distinction is made between physical cash pooling (i.e., the physical transfer either of all liquidity, known as zero balancing, or of liquidity up to a fixed amount, known as conditional balancing) and virtual cash pooling (notional cash pooling, which is the daily virtual offsetting of credits and outstanding balances by the financial intermediary). Physical cash pooling is used much more frequently in practice, in part because of regulatory restrictions.

Transfer pricing guidelines of the OECD
In general, Switzerland follows the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. This explicitly states that "associated enterprises may engage in transactions that independent enterprises would not undertake. Such transactions [...] may occur because in transacting business with each other, members of an MNE group face different commercial circumstances than would independent enterprises. [...] The mere fact that a transaction may not be found between independent parties does not of itself mean that it is not arm's length." Provided the terms of the cash pool deposits, particularly with regard to term and interest rate, are in line with the market and the cash pool participant does not have reasons to doubt that the cash pool leader is able and willing to repay the deposit, the deposit may be considered to be at arm's length.

Fiscal practice regarding hidden profit distributions in connection with loans
According to current Swiss tax practice, a hidden profit distribution (constructive dividend) is given if the following criteria are met cumulatively:

- Service without equivalent consideration, which leads to a financial loss for the company;
- Legal reason in the shareholder relationship: the service would not be provided to an independent third party on the same terms;
- The disparity must have been recognizable to the corporate bodies.

In connection with loans to affiliates, this practice has been specified under the heading of "simulated loans". A loan is said to be simulated if, based on evidence such as the lack of creditworthiness of the borrower, cluster risks that are entered into, a lack of written agreements, etc., it would not be granted to an independent third party and repayment is impossible or is not planned from the outset.

With cash pool deposits, under normal circumstances the participant can expect full repayment, meaning that the respective receivable can be capitalized and its recoverability is confirmed by the auditor. Hence, in this normal case, there is no financial loss that would give rise to taxation of a hidden profit distribution. The interest rates in cash pools are generally structured so that they are more attractive for participants than those offered by an independent bank. Thus, even from the perspective of the individual group company there are good reasons to participate in the cash pool.

Conclusion
The recent Federal Supreme Court ruling on the treatment under capital protection law of cash pool deposits does not justify, in our view, to generically treat such deposits as hidden profit distributions for tax purposes. Accounting principles and long-standing practice with respect to loans to affiliates should continue to be followed without change. However, it is advisable to solidly document the arm’s length conditions of the respective loans. The way fiscal practice develops in this regard remains to be seen, though.
Amendments to the taxation of employment income at source - implementation of the EU-Swiss free movement agreement

On 28 November 2014, the Federal Council sent a draft bill to parliament containing proposed amendments to the Law on Direct Federal Taxes (DBG) and the Federal Law on Tax Harmonization (StHG). The primary aim of these amendments is to abolish the differential treatment of persons taxed at source on a pay-as-you earn (PAYE) basis and persons taxed on the standard assessment basis (i.e. after completing a tax return) in order to comply with international obligations.

Taxation at source in the DBG and StHG currently

Taxation at source on employment income applies to foreign workers without a permanent residence permit "C" who are resident in Switzerland for tax purposes (residents) and all persons who are not resident in Switzerland but earn employment income in Switzerland (non-residents). If the annual gross employment income of a resident individual subject to PAYE taxation exceeds a certain limit (usually CHF 120,000), they are required to undergo a subsequent standard assessment by submitting a tax return. In the course of this subsequent assessment, the PAYE tax is credited against the final tax liability and any shortfall or excess is requested from the taxpayer or reimbursed directly to them.

If the taxpayer has other income or assets above a certain threshold, only this income or these assets are taxed via a supplementary standard tax assessment (in addition to the tax at source on the employment income).

Due to technical differences between PAYE and standard taxation (e.g. the use of a canton-wide average municipal tax rate for PAYE, PAYE tax is levied monthly rather than annually etc.), there can be small discrepancies in the effective tax rate.

Rulings of the Federal Supreme Court on the agreement on the free movement of persons

Under the Agreement on the Free Movement of Persons between Switzerland and the EU and its member states (in force since 1 June 2002), citizens of an EU country resident in Switzerland cannot be discriminated against based on their nationality.

The Federal Supreme Court concluded in a number of rulings that the anti-discrimination clauses in the agreement were directly applicable and superseded provisions to the contrary in domestic tax law (including in the DBG and StHG).

In the case of a cross-border commuter resident in France who was subject to PAYE taxation in the canton of Geneva, the Federal Supreme Court ruled that this commuter had a right to the same tax deductions as someone resident in Switzerland. Because the cross-border commuter earned more than 90% of his income in Switzerland, in the Federal Supreme Court’s view he was in similar situation to a Swiss resident (referred to as "quasi-residency").

Another case related to a person subject to PAYE taxation in Switzerland who was obliged to submit a tax return (for a subsequent standard tax assessment) and who moved from the canton of St. Gallen to the canton of Schwyz. In this case...
the court regarded a special provision in domestic tax law which allowed the right of taxation of the employment income to be divided up between the two cantons as discriminatory under the free movement agreement.

**Proposed new regulations**

**a) for Swiss residents**

According to the draft bill, the PAYE system for employment income is to be retained for residents without Swiss nationality or a C residence permit. At the same time the subsequent standard tax assessment will also be retained where the employee exceeds a certain income threshold, which is yet to be determined.

The supplementary standard tax assessment for income and assets which are not subject to PAYE but are taxable in Switzerland is to be replaced by the subsequent standard tax assessment. This will harmonize the procedure for residents subject to taxation at source.

Residents subject to taxation at source who are not obliged to submit a tax return will in future have an option, which may be exercised once only, to submit a tax return (for a subsequent standard tax assessment with crediting of PAYE tax). This new regulation is intended to bring to an end the discrimination between residents based on their nationality. For reasons of administrative efficiency, the proposal is that this regulation will also apply to nationals from non-EU states.

**b) for non-residents in Switzerland**

Persons not resident in Switzerland subject to PAYE who earn a large proportion of their income in Switzerland or whose situation is comparable to that of a resident (quasi-residents) will in future have the option to submit a tax return. Moreover, in future tax deducted at source (PAYE) from non-residents will have tax finality in all but a few exceptions. In other words, non-residents will in future no longer be able to deduct additional expenses from their income.

For non-residents in Switzerland this may result in expenses being disregarded both in Switzerland and in the country of residence. In particular, this would affect expenses relating directly to an employment exercised in Switzerland (such as the costs of travel home and additional accommodation costs for weekly commuters working in Switzerland) if the country of residence decided that these expenses were only eligible in Switzerland as the country in which the taxpayer was employed and to which he or she commuted weekly.

Taking account of a person's entire worldwide income, including the income of a spouse working outside Switzerland, to determine whether the conditions for quasi-residence are met is likely to lead to additional conflict situations. This will be the case in particular for partial tax liability in the event of non-residence in Switzerland.

**Procedure for implementing the draft bill from here**

If the bill becomes law in 2015 with a transitional period of two years to allow the cantons to amend their cantonal tax legislation, the new law is unlikely to enter into force before 1 January 2018.

In the meantime, in the event of breaches of the principle of non-discrimination enshrined in the free movement agreement, taxpayers remain to invoke its direct applicability in any disputes with the tax authorities.
Switzerland and Liechtenstein conclude a double taxation agreement

The intensive negotiations on a double taxation agreement (DTA) between Switzerland and the Principality of Liechtenstein were successfully concluded on 2 February 2015. In spite of the close links between the two neighbours and Switzerland’s extensive DTA network, the previous bilateral agreement signed in 1995 only covered the taxation of cross-border commuters. In reaching this agreement Switzerland is following in the footsteps of Germany and Austria, which already have a DTA with Liechtenstein.

The proposal in detail
According to the two parties, the text of the agreement, which will only be published in detail after it has been signed, will be in line with the OECD model agreement. Withholding taxes are particularly key in this context. Liechtenstein has been using the Swiss franc as its national currency for almost 100 years. Nonetheless, in the past it has been relatively unattractive for Liechtenstein citizens to access the large equity and bond markets in Switzerland. Investments in Switzerland were discriminated against for many decades due to the 35% withholding tax levied on interest income from bonds and bank deposits as well as on dividends. As there was no DTA, the withholding tax could not be reclaimed by private individuals resident in Liechtenstein. Liechtenstein in turn had already abolished its coupon tax of 4% on dividends, bonds and certain commercial loans in its 2011 tax reform, and the transitional period for legacy reserves will expire at the end of the year.

According to the press release from the Liechtenstein Ministry of General Government Affairs and Finance of 5 February 2015, dividend payments to companies from significant investments will be completely exempt from withholding tax in future. Swiss withholding tax will be reduced from 35% to 15% for portfolio dividends and dividends received by private individuals. These tax rates are in line with the standard rates of the OECD model agreement. For interest payments the zero rate will apply both to companies and private individuals for withholding tax purposes.

Taxation of cross-border commuters will remain unchanged, as Liechtenstein was unsuccessful in its attempt to impose a withholding tax on the incomes of cross-border commuters. As a result, income will continue to be taxed solely in the country of residence. Moreover, the taxation of Liechtenstein pensions paid to private individuals in Switzerland, in place since 2012, will be abolished. Switzerland will pay annual compensation of CHF 450,000 to Liechtenstein to take account of pensioners who did not previously work as cross-border commuters.

The agreement is due to be signed in the summer of 2015 and is expected to enter into force from 1 January 2017. However, this schedule depends on the domestic ratification procedures, which could delay the process.

The expectation is that this important step towards avoiding double taxation will further strengthen business relationships between Switzerland and Liechtenstein. Investors with existing cross-border relationships should therefore analyse their activities under the proposed new regulations.