Dear reader

In January 2016 the European Commission released a draft directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market. The rationale behind the directive is to implement the OECD's measures to prevent Base Erosion and Profit Shifting in a coherent and coordinated way. However, the draft directive goes in some respects further than the OECD's recommendations and is likely to have a substantial impact on third states, such as Switzerland.

In this issue of our quarterly newsletter we will inform you on the draft directive of the European Commission and further current tax developments.

In this issue

3 EU Anti-BEPS Directive

5 "Naming and shaming" - divulging confidential tax information

7 Treasury shares under the new accounting law

9 Hidden equity for companies keeping their accounts in foreign currencies

10 Classification of a US LLC for the purposes of taxation in Switzerland

11 Introduction of the Union Customs Code - consequences for Swiss companies

13 Recent VAT practice publications - Overview

14 New regulation on cross-border coordination of social security systems between Switzerland and the EFTA Member States

15 EY's Mobility Performance Improvement Tools
EU Anti-BEPS Directive

On 28 January 2016, the European Commission released the long anticipated and much speculated about proposal of the so called “Anti-BEPS Directive”. Formally titled Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market, the draft Anti-BEPS Directive constitutes one pillar of the EU anti-tax avoidance package, which further includes a proposed Directive implementing the automatic exchange of country-by-country (CbC) reports; a recommendation advising Member States how to implement measure against tax treaty abuse as well as a communication on a new EU external strategy for effective taxation. The stipulated rationale behind the Anti-BEPS Directive is to create legally binding rules, which inter alia secure the implementation of the OECD BEPS measures in a coherent and coordinated way. This should create a minimum level of protection against corporate tax avoidance throughout the European single market, with a remaining option of the EU Member States to adopt stricter rules. Interestingly, the EU Anti-BEPS Directive goes in various ways further than the recommendations resulting from the OECD BEPS Project. It elevates certain non-binding common approaches and best practises of the BEPS Project to a set of legally binding rules with teeth at the level of the European internal market. This could potentially result - contrary to the aim of the BEPS Project - to a fragmentation of the international tax system, with Europe constituting the pinnacle of the degree of regulation. However, what is even more striking at first glance are the two common themes crystalizing from the EU anti-tax avoidance package as a whole. It firstly constitutes (albeit from the backdoor) an attempt for an increased EU harmonization of corporate taxation which is strictly speaking outside the competency of the EU and secondly a protectionist measure against third countries (including Switzerland) not being part of the EU or European Economic Area (EEA).

Currently, the draft Anti-BEPS Directive covers six specific rules, namely (1) an interest limitation rule, (2) a rule on exit taxation,(3) a switch-over clause, (4) a general anti-abuse rule (GAAR), (5) controlled foreign company (CFC) legislation and (6) a rule on how to address hybrid mismatches, which will be briefly described below.

1. Interest limitation rule
The proposed rule under article 4 stipulates an entity-by-entity limit on deductible borrowing costs of 30% of taxable EBITDA (or EUR 1 million if higher). However, in order to add some flexibility countries are permitted to accept full deduction of borrowing costs if a taxpayer can demonstrate that its equity to total assets ratio is no more than 2 percentage points lower than the equivalent group ratio. Member States are equally free to implement a stricter limit on deductible borrowing costs. The scope of the proposed interest limitation rule is limited to “exceeding borrowing costs”, i.e. borrowing costs of a taxpayer exceeding interest revenues and equivalent taxable revenues from financial assets that the taxpayer receives. Financial undertakings (including credit institutions and insurance undertakings) are excluded from the scope of the rule, but it is expected that customized rules will be developed in due course.

The EU’s choice on the binding nature of the rule is striking given that under the BEPS recommendations, the introduction of an interest limitation rule only constituted a common approach subject to mere voluntary implementation.

2. Exit taxation
The Anti-BEPS Directive proposes under article 5 an exit taxation of unrealised capital gains where a taxpayer moves assets or its tax residence from one tax jurisdiction to another one. In cases where the assets or residence are transferred to a EU or EEA State (but not to e.g. Switzerland), the taxpayer may pay in instalments over at least 5 years.

3. Switch-over clause
The proposed switch-over clause in article 6 stipulates that distributions, capital gains on shares and branch profits derived from a country, whose statutory tax rate is lower than 40% of the rate that would have been charged in the recipient Member State, would be required to be taxed in the recipient Member State rather than being tax exempt. A tax credit would be granted, but should not exceed the amount of tax attributable to the income according to the laws of the recipient Member State. Albeit, this rule could also have a limited impact on inter-state investments within the EEA, it will most definitely affect a broad range of structures with European exposure, e.g. the Swiss finance branch of a Luxembourg finance company.
Just as a estimation, when taking the average statutory corporate income tax rate of the EU Member States as a benchmark, which was approx. 22.8% in 2015, a statutory tax rate below 9.1% on the relevant income would trigger the switch-over clause.

4. GAAR

The proposal suggests the introduction of a GAAR into domestic law of EU Member States which should target non-genuine arrangements or a series thereof carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provisions.

5. CFC Rule

The proposed CFC rule in article 8 would impose a charge on undistributed profits of a controlled non-listed entity that is subject to taxation at an effective rate lower than 40% of the equivalent effective rate in the controlling member state, where the entity principally receives financial income (e.g. interest, royalties, dividends, leasing income, certain real estate income, income from insurance, banking and other financial activities, and intra-group service income). This rule will only apply to controlled entities established in an EU / EEA member state if the establishment of the entity in question was 'wholly artificial' or the entity engages in non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage. Arrangements would be regarded as non-genuine to the extent that the entity would not own the assets or would not have undertaken the risks if it were not controlled by a company where the relevant significant people functions are carried out. This limitation does not seem to be applicable to countries outside the EU / EEA, thus generating unequal treatment depending on the residency of the controlled entity. The application of the proposed CFC rule is further restricted when it comes to financial undertakings.

6. Hybrid mismatch rule

The proposed hybrid mismatch rule in article 10 would require the legal nature of a hybrid instrument or entity in a Member State to follow the characterisation of the Member State where the payment, expense or loss has its source. Interestingly this differs from the recommendations under the BEPS Project: BEPS provides for the denial of deduction at the level of the payer as a primary response, and only in the case where the primary rule was not adopted in the jurisdiction of the payer, a secondary defensive rule could be applied being the inclusion of the payment as ordinary income at the level of the recipient. Hence, it appears that the EU has curiously opted in its draft proposal for the secondary defensive rule as its primary rule. This deviation from the guidance under BEPS may constitute the reason why the proposed rule is limited to mismatches between Member States. The preamble stipulates explicitly that hybrid mismatches between Member States and third countries need further examination before a rule will be drafted. One could interpret this hybrid mismatch rule limited to the EU as an attempt for further integration of the tax systems within the internal market with one aim being a collective, unified EU strategy for treating third countries.

Conclusion

It becomes clear that future implementation of the Anti-BEPS Directive by the EU Member States - be it in its current form or in a modified version - could have significant influence on a broad range of structure of MNEs with European exposure. At this stage, the Anti-BEPS Directive only constitutes a draft, requiring unanimous agreement of all Member States before it can be implemented. The current deadline for agreement is set to July 2016, which is rather ambitious. However, recent history has shown that the current political momentum regarding Anti-BEPS measures makes the delivery of rules under ambitious timeframes possible. Hence, it is important to attentively monitor how the proposal is moving forward and to analyse its probable impact.
"Naming and shaming" - divulging confidential tax information

The principle of tax confidentiality is a core principle in Swiss tax law. Taxpayers are required to cooperate fully in the assessment process (as the law states: "taxpayers must do all that is necessary to facilitate complete and accurate tax assessments"), while the tax authorities can deploy a wide range of powers to obtain evidence. As part of the tax assessment process, detailed personal and financial information pertaining to taxpayers is disclosed to the state. For its part the state is required to ensure that this information is only used for tax assessment purposes and does not enter the public domain. The individuals responsible for tax assessment are therefore required under tax legislation to keep confidential and not to disclose any information obtained.

However, tax confidentiality is not absolute. The law places a number of limitations on the obligation to maintain confidentiality, with inter-cantonal, national and international administrative assistance being a prime example. However, there are other aspects in which confidentiality may be limited in Switzerland, which are less well known and can expose taxpayers to the glare of publicity. Three of these anomalies are discussed in more detail below.

Notification of tax assessments and decisions

The Swiss tax system operates on a strict territoriality basis, which means that the Swiss authorities are not allowed to perform administrative acts outside Switzerland. Accordingly, tax legislation does not permit decisions to be served on taxpayers outside Switzerland, even if service abroad is not precluded under international law. However, the tax authorities may require taxpayers resident or having their registered office abroad to appoint a representative in Switzerland to facilitate the assessment process. Under the rules of procedure of certain cantons, and in the case of value added tax, taxpayers are even legally required to provide an address for service in Switzerland (i.e. without prior request from the authorities).

If the taxpayer's place of residence is unknown, or they are located abroad but have not appointed a representative, notices of any tax assessments or decisions may be published in the official cantonal gazette. The cantons may stipulate other methods of publishing decisions for individuals or entities that do not have an address for service in Switzerland. As a result, individuals or entities that are resident or have their registered office outside Switzerland, but are liable to tax in Switzerland (e.g. because they hold Swiss real-estate), run the risk that notices of tax assessments relating to them will be published in the official gazette. Individuals or entities that are resident or have their registered office outside Switzerland are therefore strongly advised to nominate a tax representative in Switzerland.

A Russian national evidently neglected to do this, even though the authorities had asked him to appoint a representative. In accordance with the cantonal rules of procedure, the Tax Appeals Court of the Canton of Zurich notified the taxpayer of a decision by placing this on file (sic!), rather than sending it by post. A few days later, the decision was given to him in person. In the proceedings that followed, one of the points of contention was when exactly the decision had been notified by the Tax Appeals Court and whether the appeal against that decision had been filed in time.

The case was ultimately referred to the Federal Supreme Court. Unfortunately, the judgment did not expound on whether filing the notice of assessment was a valid method of notification, since the appeal had been filed on time in any case. However, it was held that there was no discrimination against non-Swiss residents where a taxpayer who had failed to specify an address for service, notwithstanding a request to this effect, suffered a degree of detriment in respect of the publication of a decision.

It is therefore unlikely that the courts will impose any restrictions on publishing decisions in the official gazette in the near future.

Right to be heard in mutual administrative assistance matters

The issues affecting assessments and decisions are similar to those arising in administrative assistance procedures. Where a foreign government requests administrative assistance in tax matters, the Swiss Federal Tax Administration (SFTA), as the body
leading the process, must afford a fair hearing to any persons who are entitled to object to the request. However, it is not just the party in possession of the requested information that is entitled to object, but also any other parties who would be specifically affected by the release of the information and have a legitimate interest in preventing this. In addition to the actual taxpayer, this may include other parties (e.g. a foreign company potentially subject to a tax investigation relating to transfer prices with a Swiss company).

If the party entitled to object is not resident, or does not have their registered office, in Switzerland, the SFTA will request the party in possession of the information to specify an address for service for the party entitled to object. If no address is provided, the objecting party will be advised of their rights through the publication of a notice in the Federal Gazette. Although done out of the best of intentions, publishing such a notice can often be detrimental to the objecting party. Publishing such a notice in the context of a request for international administrative assistance can often cause reputational damage to the party concerned. Hence, Switzerland has faced intense criticism over this practice of "naming and shaming".

This is one of the main reasons for the Swiss government initiating (limited) remedial action. In implementing the new tax transparency rules (which introduce the automatic and spontaneous exchange of information), it is also envisaged that the SFTA will serve notices abroad by post in the course of administrative assistance procedures, where this is permitted by international law. In all other cases, it is still essential for parties outside Switzerland to ensure that they provide an address for service to the SFTA on time to avoid the publication of a notice in the Federal Gazette.

Public access to the tax register
A number of cantons implement a policy of public access, i.e. that members of the public should be permitted access to information held by the government (usually without having to demonstrate special interest). Some cantons have even extended the principle of public access to the tax register. The Cantons of Bern, Fribourg, Neuchâtel and Valais, for example, allow public access to certain information in the tax register, i.e. the names of taxpayers and their taxable income / assets or taxable profits / capital.

In the Cantons of Bern, Fribourg, Neuchâtel, St. Gallen, Vaud, Valais and Zurich, third parties can also apply for access to tax records for specified taxpayers by submitting a request for information. In certain cantons, information is only disclosed if the party submitting the request is able to demonstrate an economic interest. In Fribourg, it is only possible to access information on tax amounts paid in respect of the income and assets of individuals. There is no right to access information pertaining to legal entities.

In some cases, the disclosure of information may be subject to time limits and fees may also be chargeable. In addition, certain cantons give taxpayers the option of blocking the information held on them in the register.

Conclusion
In summary, the information disclosed to the tax authorities will generally be subject to tax confidentiality rules. However, this is not an absolute principle. For example, authorities may exchange information in the context of inter-cantonal, national and international administrative assistance. Moreover, in certain circumstances, official directions and decisions may be publicized, or, in the context of international administrative assistance proceedings, parties may be informed of their right to a fair hearing by publishing a notice in the Federal Gazette. Finally, certain cantons permit public access to the tax register.

To avoid the risk of inadvertent publication of sensitive data, taxpayers resident or having their registered office outside Switzerland should, where possible, nominate a tax representative in Switzerland. In cantons operating a public tax register, it should be verified whether the conditions for blocking the information in the register are met, in order to limit the publication of confidential information as much as possible.
Treasury shares under the new accounting law

Tax neutrality was one of the main aims of the new accounting law, which applies to local financial statements for the 2015 financial year for the first time. This article looks at the tax impact of the new way of presenting treasury shares, and in particular at how capital contribution reserves need to be presented in connection with treasury shares in order to comply with both tax and accounting regulations.

Background

The new accounting law introduced a major change in the way treasury shares are presented. In accordance with Art. 959a (2) No. 3 (e) CO (Swiss Code of Obligations) they now have to be presented as a negative line item in equity rather than as an asset. Moreover, the Swiss Auditing Manual, for example, in its accounting and financial reporting volume also now allows share price gains and losses on resale to be booked directly in equity rather than exclusively through profit or loss.

Tax impact

In its analysis of the new accounting law (version dated 26 November 2014), the Swiss Tax Conference comes to the conclusion that the changes only relate to presentation and have no effect on the tax practice.

• An adjustment is therefore required for tax purposes during the holding period of the treasury shares. Unrealized losses between the market value and acquisition costs of treasury shares can be deducted for tax purposes in an entity's tax accounts, even if they can no longer be recognized for accounting purposes under the new accounting law. Subsequent write-ups are taxable up to the acquisition costs.

• Effective gains and losses on the sale of treasury shares are taxable / tax deductible irrespective of their accounting treatment. In the opinion of the Swiss Tax Conference, the presentation of treasury shares as a negative line item in equity does not reduce taxable equity.

Presentation of capital contribution reserves

Since the capital contribution concept was introduced it has been possible to create the reserve for treasury shares required under the accounting rules out of capital contribution reserves. One of the effects of this was to benefit from related tax advantages both for income and withholding tax purposes in the event of their cancellation or the expiry of the maximum holding period pursuant to Art. 4a WTA (Withholding Tax Act).

The introduction of the new accounting law created some issues in achieving this effect while remaining compliant with both tax and accounting rules. Under the minimum breakdown mandated by the CO treasury shares are presented as a negative line item at the end of equity, while in its Circular No. 29a dated 9 September 2015 the Swiss Federal Tax Administration (SFTA) stipulated that treasury shares would only benefit from related tax advantages in the event of their cancellation or the expiry of the maximum holding period pursuant to Art. 4a WTA if they were presented as a negative line item under statutory capital reserves.

EXPERTsuisse has now worked with the SFTA to find a way around this that satisfies the requirements of both tax and accounting law, and came up with a solution that meets both criteria. The solution can be applied provided two conditions are met:

• The company has capital contribution reserves that are recognized for tax purposes in accordance with Art. 5 (1bis) WTA and that have been duly booked and are presented in the statutory capital reserves;

• When the treasury shares were acquired, the available capital contribution reserves were at least equal to the total amount of treasury shares to be offset against the capital contribution reserves.
Presentation in the balance sheet

The SFTA and EXPERTsuisse consider the presentation below to meet the requirements of both the tax and accounting rules (example taken from the extended version of Circular No. 29a):

<table>
<thead>
<tr>
<th align="center">Capital contribution reserves</th>
<th>40</th>
</tr>
</thead>
<tbody>
<tr>
<td align="center">- Other statutory capital reserves</td>
<td>160</td>
</tr>
<tr>
<td align="center">Statutory retained earnings</td>
<td>30</td>
</tr>
<tr>
<td align="center">Voluntary retained earnings/ accumulated losses</td>
<td>50</td>
</tr>
<tr>
<td align="center">Treasury shares</td>
<td>-50</td>
</tr>
<tr>
<td align="center">- Offset against capital contribution reserves</td>
<td>-40</td>
</tr>
<tr>
<td align="center">Other</td>
<td>-10</td>
</tr>
<tr>
<td align="center"><strong>Total equity</strong></td>
<td><strong>250</strong></td>
</tr>
</tbody>
</table>

Capital contribution reserves are still presented in a separate account in the balance sheet under statutory capital reserves. Treasury shares that are to be treated in accordance with Art. 5 (1bis) WTA for tax purposes and are therefore to be “offset” against the capital contribution reserve are disclosed as a separate negative line item at the end of equity. In the example given, the entire capital contribution reserves are allocated to treasury shares.
Hidden equity for companies keeping their accounts in foreign currencies

The new accounting law allows accounts to be kept in foreign currencies, although the figures in the financial statements are also to be stated in Swiss francs as required by commercial law. The Swiss Federal Supreme Court has judged in various rulings that differences resulting from translation are neutral for income tax purposes. In its ruling dated 30 September 2015, the Federal Supreme Court commented on the calculation of hidden equity and the interest on hidden equity in case the accounts are kept in a foreign currency (2C_560/2014).

Facts and circumstances

The Zug-based branch of a Singaporean company keeps its accounts in US dollars. Upon its establishment in 2006, the branch received a loan of USD 77.9m from its head office. Interest of USD 3.9m was charged on this loan in the first (extended) fiscal year.

In its assessment, the Zug tax administration counted interest on hidden equity amounting to CHF 221,000 toward the branch’s taxable earnings. For the calculation of hidden equity and tax deductible interest the tax administration applied the following mechanism:

• The maximum permissible debt capital was calculated on the basis of the balance sheet figures translated to Swiss francs using the exchange rates in effect at the end of the year. The loan from the head office was therefore partially reclassified as hidden equity.

• The maximum permissible interest expense was calculated on the basis of the maximum permissible debt capital from relates parties (total debt from relates parties minus hidden equity) by multiplication with the interest rate in accordance with the circular published by the Swiss Federal Tax Administration.

• This maximum permissible interest expense was compared with the interest expense disclosed in the income statement, which was translated using the average exchange rate for the year. Since the actual interest expense was higher than the maximum permissible interest expense, the difference was counted toward taxable earnings as interest on hidden equity.

The taxpayer objected to this approach, and ultimately appealed to the Swiss Federal Supreme Court. It was argued that the tax administration should have first translated the permissible interest expense calculated using the above formula into the functional currency using the interest rate in effect at the end of the year, and then back into Swiss francs using the average exchange rate for the year. This would eliminate the excess interest expense and any need for it to be added to taxable earnings.

Ruling of the Federal Supreme Court

The Federal Supreme Court upheld the taxpayer’s complaint.

Hidden equity is a corrective provision for tax purposes according to which interest on borrowings that is owed on the proportion of debt capital that functions as equity for commercial purposes is added to a company’s taxable earnings. The phrase “functions as equity for commercial purposes” is an indefinite legal term that is subject to interpretation. The issue needs to be considered in the round, from a commercial perspective, and on the basis of “unadulterated” figures. That is why the calculation should be carried out using market values without regard for the principle of prudence, for example.

However, adulteration is unavoidable when translating commercial financial statements from a functional currency into Swiss francs. This is because the balance sheet is translated as of a particular cut-off date while the income statement is translated on the basis of a period of time. The exchange rates used for items of the balance sheet and income statement usually differ.

The resulting discrepancies are not due to operating factors and should therefore have no effect for tax purposes. Hidden equity and the interest on hidden equity are therefore to be calculated on the basis of the figures in the functional currency.

Conclusion

The Federal Supreme Court’s ruling is consistent with past rulings according to which translation gains and losses resulting from the translation of financial statements from a functional currency into Swiss francs are immaterial for tax purposes (please refer to our Tax News from fall 2015).

Hidden equity and any interest on it are therefore to be calculated on the basis of the financial reports in the functional currency.

Although the Federal Supreme Court considered the rules of the hidden equity in the case at hand, it deliberately made no comment on the discussion regarding whether the respective circular no. 6 dated June 6, 1997 can in general be adopted for permanent establishments. It also did not comment on the classification of an interest-bearing loan between the head office and its branch for legal and tax purposes.
Classification of a US LLC for the purposes of taxation in Switzerland

In its ruling issued on 18 September 2015, the Swiss Federal Supreme Court looked at the classification of a US LLC for the purposes of taxation in Switzerland (2C_984/2013, 2C_895/2013). It stated that a US LLC's treatment for tax purposes in the foreign country is also to be taken into account as a crucial factor for determining its classification for tax purposes in Switzerland. Existing structures with a US LLC should be examined in light of this.

Facts and circumstances

In the case at hand, an individual resident in Switzerland holds a share in a US LLC together with an individual resident in the US.

Both shareholders concluded an option agreement in 2007 granting the shareholder in the US the exclusive right to acquire the Swiss shareholder's shares as of 31 December 2007 for USD 3m. The parties agreed to a premium of USD 687,500 for the option. The option agreement was then extended for a year, for which the parties agreed on another premium of USD 687,500.

The US LLC paid USD 682,500 and USD 694,845 to the Swiss shareholder in 2007 and 2008 respectively. The American shareholder did not exercise his purchase option.

In its assessment, the tax administration of the canton of Thurgau classified the two payments from the US LLC as income from self-employment, which the tax payer objected to.

The Federal Supreme Court's considerations

The Federal Supreme Court ruled in favor of the tax administration and classified the payments as income from self-employment.

Specifically, the Federal Supreme Court assessed the question of whether the US LLC is equivalent to a partnership or corporation for the purposes of taxation in Switzerland. It first of all stated that if the civil law of the country in which the entity is incorporated rules out classification as a corporation, it was also impossible to classify it as such in accordance with Swiss tax law. A pragmatic mix of methods was to be applied when classifying a foreign entity. On the one hand, it was necessary to assess what tax status the structure would have under Swiss law if it existed in Switzerland or were to be incorporated in Switzerland (similarity method). On the other hand, the entity's treatment for tax purposes in the foreign country was also to be taken into account as a “crucial” / “material” factor.

The Federal Supreme Court justifies this approach by arguing that it avoids double taxation or double non-taxation as a result of attribution conflicts, and refers to pertinent literature relating to classification conflicts, hybrid mismatch arrangements and BEPS.

The Federal Supreme Court recognizes that a US LLC can have aspects of both a partnership and a corporation. An assessment is therefore to be made on the basis of the US LLC's exact structure. In the case at hand, the Federal Supreme Court endorsed the view of the lower court that the US LLC was to be treated as equivalent to a Swiss partnership. Some of the arguments in favor of this view were that the US LLC does not have any capital stock; that profits and losses are allocated via the two shareholders' capital accounts; and that all bookings are carried out separately for each shareholder. The fact that the US LLC is treated as indisputably transparent for tax purposes in the US was also taken into account.

As a result, the two payments from the US LLC were attributed to the Swiss shareholder as a partner in a partnership. Income from a partnership can be taxed only in the partner's country of residence unless the business activity is carried out in another country via a permanent establishment. The existence of such permanent establishment in the US was denied in the case at hand, and the Federal Supreme Court concluded that the respective payments are fully taxable in Switzerland in the hands of the Swiss partner.

Conclusions

The ruling very much relativizes the September 2011 Practice Note of the Swiss Tax Conference regarding the treatment of US LLCs with respect to direct taxes. According to the Practice Note, a US LLC should be treated as equivalent to a GmbH in accordance with internal law, even if it is taxed as a partnership in its country of residence. However, according to the Federal Supreme Court, the taxation in the resident country is a crucial factor that must be taken into account for the purposes of classification.

As a result of this ruling by the Federal Supreme Court, it is to be expected that the Swiss tax authorities could investigate existing structures with US LLCs (or comparable hybrid mismatch arrangements that are treated as transparent for tax purposes in the country of domicile).

US LLC structures in Switzerland and existing rulings should be assessed in light of the new Federal Supreme Court ruling.

Tax News – Spring 2016
Effective 1 May 2016 the new customs legislation, the so-called “Union Customs Code” (UCC), will enter into force in the European Union (EU). The UCC entails a number of new regulations in the field of customs law, which are intended to simplify, streamline and expedite customs processes. However, many of the new regulations not only involve adjustments for companies based in the EU but could also require action for Swiss companies who do business in the EU.

The Union Customs Code

On 1 May 2016, the existing Customs Code of the European Community (CC) will be replaced by the UCC, which, together with its accompanying acts, contains a large number of changes to the law. The new code will be introduced gradually, as many changes cannot be implemented until the EU Member States have built up their national IT infrastructures. This is especially true for procedural simplifications, which shall become effective by 2020 at the latest.

There are significant changes for companies and customs administrations. In the medium term, however, the UCC will simplify customs-related processes, lead to cost savings and allow to potentially correct errors. On the other hand, various other regulations will result in additional customs duties, extra costs, additional administrative effort or increase the risk for customs debtors. Nevertheless, Swiss companies with limited cross-border commercial activities with the EU are unlikely to feel the impact of the changes directly, especially if they have simple customs processes handled by customs and logistics service providers and do not hold any authorizations or licenses for simplifications in the EU themselves. In the future, for instance, customs declarations will still have to be lodged via familiar customs IT systems such as Atlas, NCTS etc. Furthermore, many procedural regulations are also being retained, customs nomenclatures will remain unchanged, and any customs authorizations and licenses for simplifications already granted keep their validity even after 1 May 2016. However, changes have been made in the field of customs valuation that could have a major impact depending on a company’s situation.

Although it is mainly companies based in the EU that will have to assess their future customs situation and implement any necessary measures, Swiss companies could also be affected by the changes triggered by the UCC, for example in connection with the importation of goods to the EU, serving customers from distribution centers in third countries etc.
Exporter under customs law

Foreign customs administrations in other countries had previously allowed Swiss companies with business operations in the EU to act as the exporter for the purposes of customs law provided that certain conditions were met. According to the wording of the UCC, being domiciled in the EU by means of a permanent establishment is now a requirement in order to act as the exporter under customs law after 1 May 2016. Assuming that this regulation should be applied strictly, the effect would be that a company based in the EU would have to export the goods of a Swiss company out of the EU in its own name. It would be necessary to assess on a case-by-case basis what impact this kind of export activity would have for example on the Swiss company's mandatory export documentation for the purposes of EU VAT, or the handling of import customs clearing in the countries of destination. However, the future practice of the national customs authorities is currently still unclear, although there are signs that various Member States including Germany, Austria, Italy and the Netherlands would like to keep the status quo.

Authorized Economic Operators (AEOs)

The entry into force of the UCC imposes stricter requirements for AEOs. At the same time, however, AEO status increases its attractiveness as many simplifications (such as the reduction of securities) will be the sole preserve of AEOs. Swiss companies working with service providers in the EU should therefore check whether these have been granted AEO status or whether service providers with AEO certification can meet the stricter requirements in order to be able to continue benefiting from simplifications in the future.

Submitting customs declarations

The UCC does, however, also offer a number of opportunities for Swiss companies. Swiss companies that are not domiciled in the EU, for example, had previously only been able to lodge customs declarations in their own name as e.g. in Germany, according to national common law. Said common law will, as from 1 May 2016, be replaced by the principle of reciprocity, according to which Swiss companies will still be able to lodge customs declarations in bordering EU Member States in their own name provided that the third country (i.e. Switzerland) also accepts customs declarations filed by EU declarants. In practice, this new regulation is likely to mean that customs declarations will no longer need to be submitted in France, Italy and Austria via local representatives.

Need for action

The UCC entails a lot of changes, most of which are expected to affect companies in the EU. Nevertheless, Swiss companies that do business in the EU will have to deal with the changes and review the customs procedures within their supply chains for potential consequences and/or additional costs. This is also true in cases where "EU customs clearing" has until now been carried out by external customs and logistics service providers, since responsibility for the purposes of customs law remains with the engaging party and cannot be outsourced. Any measures that are required should therefore be identified and implemented now.
Recent VAT practice publications – Overview

This article aims at providing an overview of recent selected changes published by the Swiss Federal Tax Administration, Main Division VAT (SFTA).

VAT group info

Late 2015 the SFTA released two relevant changes to its previous practice.

• Members of a VAT group
  Under its former practice and based on the VAT Ordinance the SFTA always denied a pension fund (as per the Swiss Pension Fund Law) the right to be a member of a VAT group. Further to a decision of the Federal Court, the SFTA adapted its practice to allow a pension fund to be a member of a VAT group if it carries out uniform control or is placed under the supervision of another pension fund exercising uniform control. Consequently, a pension fund can be a member of a VAT group if holding directly or indirectly the participations of the other VAT group members.

• Creation of a VAT group
  It is now possible to retroactively register a VAT group as of the beginning of the current tax period if none of the future VAT group members submitted the first VAT return of the tax period and the VAT returns submission deadline is not yet expired. This means that for the current tax period the application to form a VAT group as of 1 January 2016 can be filed until 31 May 2016 provided the VAT group members have not yet filed their individual VAT returns. This is a considerable change to the prior practice of the SFTA, under which it was required to file the application by the last day (31 December) of the previous tax period. If not filed in time, the VAT group was only registered as of the next tax period (in the example above 1 January 2017).

Aircraft industry info

In October 2015 the SFTA finally published the last outstanding industry info after the coming into force of the “new” VAT Law on 1 January 2010. This practice shall be applicable as of 1 January 2010.

• Business use of an aircraft
  For more than ten years so called “aircraft cases” have regularly been subject to decisions of the Federal Court. In fact, the SFTA’s practice with regard to tax avoidance has been developed based on such cases. What attracted the attention of the SFTA was usually the recovery of import VAT (due at the import of an aircraft) by a company with an aircraft as its only asset and with the sole activity to provide zero-rated transport services to its (individual) shareholder. In many cases such structures were considered as tax avoidance and the entitlement for the company to VAT register and recover input VAT was denied.

Based on the developments in the past in general every tax subject, owning or leasing an aircraft, which is used by closely related parties is under general suspicion of the SFTA. Therefore, also groups of companies who operate an aircraft which is used by Swiss based management / employees, should become familiar with the published practice to ensure that they comply with the Law and SFTA’s (and SFCA’s) practice in this highly complex area and prevent from high assessment risks.

According to the published practice aircraft structures are in general accepted by the SFTA if the aircraft is used for less than 20% for the shareholder and related parties’ private use. By “private use” the SFTA understands any transport, which is not related to a business purpose (e.g. flight to a business meeting with a client, board meeting, etc.). The taxable person must be able to prove the business related purpose, e.g. with extracts of the agenda of the passengers of the aircraft, minutes of meetings, etc. When the aircraft is used for more than 20% by the shareholder and related parties for private purposes, the SFTA can view such structures under a tax avoidance angle and investigate the actual business use of the aircraft. When business use cannot be proven, the tax subject will need to pay back all input VAT deducted in the past, plus late payment interests.

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New regulation on cross-border coordination of social security systems between Switzerland and the EFTA Member States

EU Regulations 883/04 and 987/09 entered into force between Switzerland and the EU Member States on 1 April 2012. Regulations (EEC) 1408/71 and 574/74 were still valid between Switzerland and countries in the European Free Trade Association (EFTA). As from 1 January 2016, EU Regulation 883/04 and its supplementary regulations now also apply between Switzerland and the EFTA member states (Norway, Iceland and Liechtenstein).

The agreement on the free movement of persons (FMP) between the European Union (EU) and Switzerland, which also applies to EFTA member states, regulates amongst others the transnational coordination of social security systems. The purpose of this coordination is to ensure that individuals are subject to the social security system of only one member state.

Regulation (EEC) 1408/71 was hitherto applicable for EFTA member states. Effective 1 January 2016, EU Regulations 883/04 and 987/09 came into force between Switzerland and EFTA member states. The application of Regulation (EU) 465/12 - which supplements the provisions of Regulation 883/04 – was simultaneously also expanded to include the EFTA member states.

The most important changes relate to assignments and multi-state workers.

Assignments

The new Regulations extend assignment periods from 12 to 24 months. Employees with Swiss or EFTA-country citizenship, who are assigned within the EFTA-area by their employer for up to 24 months, can remain in their home country’s social security system. The employer no longer has to complete Form E 101, but can now apply with Form A1 to the relevant compensation fund. This application is essential in order to ensure that the employee can remain in the home country’s social security system during an assignment. Should the assignment period exceed 24 months, it is still possible to apply for a special agreement (Ausnahmevereinbarung).

Multi-state Workers

Employees who perform gainful employment in multiple countries must now perform a substantial part of their work in their country of domicile (25% of their working hours or employment income), in order to qualify for social security coverage inclusion in their country of residence. This means that multi-state workers are no longer necessarily subject to the social security system in their country of residence. For example, should an employee work for an employer in the country of residence as well as for an employer in another member country, the social security liability in the country of residence would only apply if a substantial part of the work is performed there. If this is not the case, the employee would be subject to the social security system of the other member state.

An exception is made, however, for work performed for two employers domiciled in different member states other than the employee’s country of residence. In these cases, even though a substantial part of the work is not carried out in the country of residence, the liability remains in the country of residence.

The new Regulation also stipulates that marginal (insignificant) employment is no longer considered for social security insurance liability. Marginal tasks are tasks which account for less than 5% of normal working hours and/or total employment income. It must be noted that Directorships or Company Board activities are not considered as marginal employment. An Executive role is a significant function which needs to be coordinated.

The liability remains unchanged in cases where employment and independent functions are performed in numerous countries. In these cases, the social security liability remains in the country where dependent (employed) work is performed, regardless of the country of residence. Whether a function is considered as employment or as independent is decided by the rules of the country in which the work is performed. For example, should a Board of Directors position in Switzerland and a Governing Body position in Germany be performed, each country will determine whether the function is considered as employment or self-employment. In a next step it will be determined in which country the social security liability rests. In this particular case, the social security liability will fall to Switzerland, as a Board of Directors position in Switzerland is always considered as an employment function, whereas under German law a Governing Body function is generally classified as self-employment or independent.

Validity of the Regulations

The EU Regulation 883/04 is mandatory for all cases as from 1 January 2016. Cases which were coordinated under the old regulations can be continued for maximum 10 years, provided that the underlying facts do not change. An application can be made for the new regulations to be applied.

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1 The agreement (FMP) has not yet been extended to include Croatia, therefore Regulation No. 883/04 is currently not applicable between Switzerland and Croatia.
Many organizations strive for improvement in their global mobility programs and they try to understand how competitive their approach is in the market, what their cost optimization opportunities are as well as what is being done by their peers. Clients often measure their programs by benchmarking themselves against peer companies but also internally. Our EY Mobility Performance Improvement (MPI) team has developed two innovative tools to conduct an initial analysis of a company’s global mobility program. MPI is currently building out the tools and is therefore offering them free of charge to clients who choose to participate.

Please reach out to Siobhan Cummins or Valentina Manca, if you would like to participate.

Long Term Assignment Policy Database

MPI has developed a policy benchmarking database that allows clients to quickly and effectively measure the terms and conditions of their global mobility policies relative to other policies in the database. We currently have approximately 70 policies in the database, from a range of client regions and industries.

The database uses a catalogue of 73 long-term international assignment policy elements organized across 13 benefit families including Tax, Family, Relocation and Health. At present, the database is set up to capture information on long term policies but in future will also encompass short-term, transfer and tax equalization policies.

Benchmarking global mobility policies with external data ensures that changes are implemented with minimal resistance and that the business can offer competitive terms to aid recruitment and retention.

MPI Index

Often the first stage of an MPI project begins with a small-scale health-check of the overall mobility program. The MPI team has developed the ‘MPI Index’ to help companies assess the tangible value of their program. It uses an online questionnaire to survey a mobility program’s three global mobility stakeholder groups: assignees, global mobility team members and principle business contacts. The results are used to assess the internal performance of the program.

The EY MPI Index:

• Measures stakeholder satisfaction levels and engagement
• Evaluates company performance against industry and sector competitor data
• Identifies opportunities for greater cost efficiency
• Isolates areas in need of greater governance and control

Results are collated and a report is generated, summarizing the results and recommendations for improvement. Global Mobility leaders can use the MPI Index as a one-off assessment, or run the survey annually to provide a clear year-on-year program evaluation.
About the global EY organization

The global EY organization is a leader in assurance, tax, transaction and advisory services. We leverage our experience, knowledge and services to help build trust and confidence in the capital markets and in economies all over the world. We are ideally equipped for this task - with well trained employees, strong teams, excellent services and outstanding client relations. Our global purpose is to drive progress and make a difference by building a better working world – for our people, for our clients and for our communities.

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