Dear reader

On 17 June 2016, the Swiss Parliament approved the final bill on Corporate Tax Reform III after the two parliamentary chambers (National Council and Council of States) had resolved their remaining differences.

In this issue of our quarterly newsletter we will inform you on the Corporate Tax Reform III and further current tax developments.

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Swiss Parliament approves Corporate Tax Reform III

**Executive summary**

On 17 June 2016, the Swiss Parliament approved the final bill on Corporate Tax Reform III after the two parliamentary chambers (National Council and Council of States) had resolved their remaining differences and reached a final agreement a few days earlier.

The reform foresees the replacement of certain preferential tax regimes with a new set of internationally accepted measures. The legislative changes will go along with a broad reduction of the headline corporate tax rates and will ensure that Switzerland remains attractive for multinational corporations in a post-base erosion and profit shifting (BEPS) environment by providing planning certainty for the future and ensuring compliance with Organisation for Economic Co-operation and Development (OECD) standards.

The table below provides an overview of the corporate tax measures that will be introduced with the reform. Some of the cantonal measures are optional so that the cantons can tailor their legislation to their specific circumstances and needs. The overview also shows which cantonal measures will be subject to a restriction limiting the overall tax relief to a maximum of 80% (see details further below).

**Detailed discussion**

**Background**

A reform of Switzerland’s corporate tax system became necessary due to the changing international tax environment and the former controversy on business taxation with the European Union (EU), which was finally resolved by a joint statement between Switzerland and the EU in October 2014. The legislative process for the Corporate Tax Reform III was initiated with the primary goal to strengthen the attractiveness of Switzerland as a business location by aligning the Swiss corporate tax system with the latest international standards.

The bill on the Corporate Tax Reform III that has now been approved by the Swiss Parliament differs in various aspects from the initial version proposed by the Swiss Federal Council on 5 June 2015. In particular, the Swiss Parliament included in the reform package the interest-adjusted corporate income tax on surplus (above-average) equity, more commonly referred to as the notional interest deduction (NID), and restricted the overall tax relief of newly introduced measures at the cantonal level to a maximum threshold of 80%.

The abolition of the one-time capital duty has been postponed and will be addressed in a separate bill at a later stage; the same applies to the introduction of a tonnage tax which had been proposed by the National Council in the course of the parliamentary debate.

**Core measures**

- Abolition of preferential tax regimes

Certain preferential tax regimes or practices will end upon the entry into force of the Corporate Tax Reform III, while simultaneously an attractive set of replacement measures will be introduced. At the federal level, the taxation practices for principal companies and finance branches will be affected, whereas at the cantonal level, the holding, domiciliary and mixed company regimes will go away. It should be noted that these preferential tax regimes or practices will continue to be available as long as the amendments to the relevant tax laws have not been enacted with legal effect. The earliest possible date for the implementation of the legislative amendments and the abolition of the aforementioned regimes is 1 January 2019.

<table>
<thead>
<tr>
<th>Measures</th>
<th>Federal level</th>
<th>Cantonal level</th>
<th>80% relief limit*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patent box</td>
<td>-</td>
<td>✓</td>
<td>yes</td>
</tr>
<tr>
<td>R&amp;D super deduction</td>
<td>-</td>
<td>✓ (o)</td>
<td>yes</td>
</tr>
<tr>
<td>NID on surplus equity</td>
<td>✓</td>
<td>✓ (o)</td>
<td>yes</td>
</tr>
<tr>
<td>Two-basket approach</td>
<td>-</td>
<td>✓</td>
<td>no</td>
</tr>
<tr>
<td>Immigration step-up</td>
<td>✓</td>
<td>✓</td>
<td>no</td>
</tr>
<tr>
<td>Relief of capital tax</td>
<td>-</td>
<td>✓ (o)</td>
<td>no</td>
</tr>
<tr>
<td>CIT rate reduction</td>
<td>-</td>
<td>✓ (o)</td>
<td>no</td>
</tr>
</tbody>
</table>

(o) Optional * at cantonal level only
The final bill provides for the mandatory introduction of a patent box that is fully compliant with the modified nexus approach of the OECD. The patent box will only be available at the cantonal level and the maximum level of permissible tax relief for income related to the patent box has been set at 90%.

• Introduction of R&D super deduction
As one of the optional cantonal measures, the final bill allows for the introduction of an increased tax deduction for research and development (R&D) expenses. The R&D super deduction is restricted to a maximum percentage of 150% of qualifying expenses incurred in Switzerland. Expenses related to R&D activities performed abroad are excluded from the increased tax deduction.

• Introduction of NID on surplus equity
The NID on surplus equity constitutes a highly relevant and novel feature, as compared to the initial draft bill. The introduction is mandatory at the federal level and optional at the cantonal level. The optional introduction at the cantonal level is linked to a minimum taxation of dividends received by individual shareholders. The link foresees that a canton may only introduce the NID if at least 60% of dividend income derived from qualifying participations held by individuals as private assets is subject to personal income tax.

Under the NID provisions, companies with surplus equity are entitled to claim a deduction of a notional interest expense thereon. The amount of the surplus equity will be determined based on the company’s assets along the lines of the principles of the hidden equity calculation. The applicable notional interest rate conforms to the yield on 10-year Swiss federal state bonds. To the extent of receivables from related parties (intra-group financing) an arm’s length interest rate can be applied instead.

• Step-up upon change of tax status/transitional system
Comprehensive rules governing the transition from preferential taxation to ordinary taxation are highly relevant in connection with the phasing out of existing preferential tax regimes.

The final bill provides for a two-basket approach with two different tax rates to be applied during a five-year transition period following the abolition of the cantonal tax regime:

(i) The ordinary tax rate applies to profits derived from value created under the ordinary taxation scheme (first basket)

(ii) A reduced tax rate applies to profits related to the realization of built-in gains that were generated under the former cantonal tax regime (second basket)

Taxpayers may also voluntarily waive their cantonal tax privilege prior to the entry into force of the Corporate Tax Reform III. Such “premature” exit would typically allow, based on the current practices in most cantons, for a tax-neutral step-up of the built-in gains created under the preferential tax regime followed by a tax-effective amortization over a maximum period of 10 years. Unlike the two-basket approach under the Corporate Tax Reform III, the tax relief resulting from the step-up under the current practices will be subject to the aforementioned 80% overall tax relief limitation once the reform of the cantonal tax laws comes into force.

• Step-up upon migration to Switzerland
The final bill introduces consistent rules at the federal and cantonal levels that allow for a tax-neutral disclosure of built-in gains (including self-generated goodwill) upon relocation of a company, activities or functions from abroad to Switzerland with a corresponding step-up in tax basis. The subsequent amortization of the disclosed built-in gains will be tax-effective in accordance with the general amortization rules. Self-generated goodwill will have to be amortized over a maximum period of 10 years.

• Restriction of overall cantonal tax relief
The Corporate Tax Reform III grants discretion to the cantons with regard to the optional introduction of various core measures. In order to avoid zero-taxation or tax accounting losses, a maximum threshold has been defined in order to limit the effect of the cantonal tax relief. The overall cantonal tax relief provided by the patent box, R&D super-deduction, NID as well as the step-up under the current cantonal practices will, therefore, be restricted to a maximum of 80%. No such restriction applies at federal level.

Additional measures
• Relief measures for cantonal capital tax
The cantons will have the option to introduce targeted capital tax reductions on the company’s net equity related to participations, intangible assets and intercompany loans, aside from further relief measures such as general capital tax rate reductions or the possibility to credit income taxes against capital taxes.

• Partial taxation of qualifying dividend income
The rules governing the cantonal taxation of individuals are subject to cantonal tax laws. This includes the definition of the method and the extent to which a partial relief on dividend income taxation for private individual shareholdings is granted by the cantons. As mentioned above, the NID can only be introduced by cantons that levy personal income tax on at least 60% of the dividend income earned by individuals.

• Increased share in direct federal tax revenue
In order to compensate for the losses in cantonal tax revenues that are expected to result from the newly implemented measures as well as the anticipated broad reduction in corporate tax rates (summarized below), the share of the cantons in the direct federal tax revenue will be increased from 17% to 21.2%.
Related measures not directly included in the reform

- General tax rate reductions
  As a measure to further boost the attractiveness of Switzerland as a business location and to compensate the abolition of the cantonal tax regimes, most cantons will lower their ordinary corporate tax rates. Cantonal tax rate reductions are at the full discretion of the cantons. Based on official announcements already made by numerous cantonal governments, it is expected that the majority of the Swiss cantons will provide attractive low headline tax rates on pretax income between 11.5% and 14% (including federal tax) once the reform package enters into force.

- Abolition of one-time capital duty
  The Swiss Federal Council proposed the abolishment of the one-time capital duty in its initial draft bill. However, in order not to endanger public acceptance of the Corporate Tax Reform III, the National Council and the Council of States decided to postpone this measure and to include it in a separate bill at a later stage.

- Introduction of tonnage tax
  The introduction of a tonnage tax (applicable to the shipping industry at the federal and cantonal levels which would allow shipping companies to calculate their taxable profit based on shipping space rather than the result according to their profit & loss statement) was subject to some back-and-forth in the parliamentary debate. It was ultimately decided to address the introduction of such new regime also in a separate bill at a later stage.

Timing

The final bill is subject to an optional referendum. If, within 100 days of the final bill's publication in the Official Gazette, 50,000 voters sign a petition requesting a public referendum, the proposed Corporate Tax Reform III measures will be subject to a popular vote which may be expected to take place in the course of 2017. The target date for the entry into force of the reform package is currently 1 January 2019.

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This article was also published as an EY alert which you can find here.
Executive summary
On 3 June 2016, Switzerland’s Federal Council adopted revised regulations on the Swiss federal tax holiday scheme. The purpose of the reform is to improve the attractiveness of specific regional economic development areas and to strengthen the acceptance of the tax incentive program in Switzerland and abroad. The revised legislation provides for relief from federal corporate income tax for a maximum period of 10 years for industrial enterprises and production-related service providers. The federal tax incentives are linked to the number of newly created or maintained jobs by an enterprise domiciled in selected regional areas in Switzerland. It can lead to an annual tax credit of up to CHF95,000 (approx. US$98,000) for each newly created job and CHF47,500 (approx. US$49,000) for each maintained job. Depending on the number of newly created or maintained jobs, the cash tax rate may be substantially decreased to a low single-digit tax rate. The revised rules will come into force on 1 July 2016.

Detailed discussion
In October 2013, the Federal Council commissioned a reform initiative to modify the existing rules on federal tax holidays. Albeit several studies showed that the instrument generally proved its value and contributed to the creation or maintenance of jobs, the balance between number of jobs and granted tax relief as well as the qualifying areas were partially considered inadequate.

As a consequence, the main changes of the reform are:
1. Introduction of a maximum amount of tax relief in relation to the number of jobs
2. Adjustment of the qualifying areas taking into account strategic regional planning policies
3. Enhanced transparency

In addition, certain technical adjustments were introduced in the revised legislation.

Maximum amount of tax relief in relation to the number of jobs
The revised legislation introduces a formula which determines the maximum amount of tax credit based on jobs to be created or to be maintained by the enterprise in a qualifying area.

A federal tax holiday will only be granted if the canton also has granted a cantonal tax holiday for the same undertaking. Further, such undertaking must have a particular economic relevance. Beneficiaries are Swiss or foreign resident industrial enterprises or production-related service providers. Under the revised legislation, industrial enterprises not only include entities conducting manufacturing activities but also businesses providing information technology services.

The distinction between industrial enterprises and production-related service providers is important since the latter are only eligible for a federal tax holiday if they create at least 10 new jobs within the first five years. There is no such limitation for industrial enterprises.

According to the formula, each new job created can lead to a maximum tax credit of CHF95,000 per year and each job maintained can lead to a maximum tax credit of CHF47,500 per year. To qualify as a “maintained job,” the enterprise needs to substantially realign its business and such strategic realignment must trigger significant investments and should entail an improvement of products, processes or techniques. The new formula looks as follows (considering the maximum amounts per job):

(# New FTEs x CHF 95,000 + # Maintained FTEs x CHF 47,500) x duration of tax holiday (maximum 10 years) = Maximum permissible tax relief
The federal tax relief is limited by the amount of the cantonal tax relief, i.e., if the canton grants a tax holiday below the maximum permissible tax relief, the relief at federal level would not exceed the cantonal tax holiday.

**Sample calculation**

<table>
<thead>
<tr>
<th>Undertaking creates 50 new jobs over the next 10 years with annual profit of CHF80 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tax burden w/o tax holiday CHF137 million <em>(based on assumed 17.4% statutory tax rate)</em></td>
</tr>
<tr>
<td>Maximum federal tax relief 50 new FTEs * CHF95,000 * 10 years = CHF47.5 million</td>
</tr>
<tr>
<td>Cantonal tax relief (80%) CHF 64.6 million</td>
</tr>
<tr>
<td>Total tax burden w tax holiday CHF137 million - 47.5 million - 64.6 million = CHF24.9 million</td>
</tr>
<tr>
<td>Resulting cash tax rate 3.1% <em>(during 10-year tax holiday period)</em></td>
</tr>
</tbody>
</table>

The federal tax holiday will be granted in the form of a tax credit that can be offset against the federal income tax liability during the tax holiday period. Unutilized tax credits can be carried forward within the tax holiday period.

**Adjustment of qualifying areas**

The revised legislation includes an adjustment of the regional areas where qualifying enterprises can apply for a federal tax holiday. The new areas are much more attractive for businesses. While the former qualifying areas mainly included micro communities spread over Switzerland in very remote mountain and rural areas, the new selection of regional economic development areas takes into account more strategic regional planning considerations and includes locations with closer proximity to urban areas. The revised regulations describe the qualifying regions for federal tax holiday purposes as rural centers, small or medium sized urban centers including the surrounding areas, and smaller and less urban areas with a central function.

**Qualifying areas - 93 regional centers in the following 19 cantons**

- Aargau
- Appenzell Ausserrhoden
- Appenzell Innerrhoden
- Basel-Landschaft
- Berne
- Fribourg
- Geneva
- Grisons
- Jura
- Lucerne
- Neuchâtel
- Saint Gallen
- Solothurn
- Thurgau
- Ticino
- Uri
- Valais
- Vaud
- Zürich

**Transparency**

The State Secretariat for Economic Affairs will publish annually the information in relation to granted federal tax holidays including the name of the enterprise, its location, information on the maximum permissible amount of tax relief and the number of jobs to be created or to be maintained.

**Further details**

**Beginning of tax holiday**

The federal tax holiday generally starts at the time when the new enterprise becomes subject to income taxation, or in the case of an already existing enterprise - at the beginning of the calendar year in which the new undertaking (business realignment) begins to generate turnover. However, there are exceptions applicable for businesses involving construction measures to defer the beginning of the tax holiday by up to five years.

**Claw-back provision**

Similar to the current practice, a federal tax holiday is subject to claw-back provisions. The claw-back clause is generally triggered if the canton revokes the cantonal tax holiday or if the conditions and requirements laid down in the tax holiday decree are not or no longer met, e.g., if the envisaged number of jobs have not been created or have not been maintained within the given time frame. A partial or full cancellation of the federal tax holiday relief can only take place within a term corresponding to one-and-a-half times of the regular tax holiday period.

**International context**

During the reform process, Switzerland conducted an active dialogue with the European Commission and the Organisation for Economic Co-operation and Development Forum on Harmful Tax Practices (FHTP) in order to strengthen the understanding of the objective and functioning of this political instrument for regional development purposes. As a consequence, the FHTP declared in spring 2015 that taxation schemes, such as the Swiss tax incentives for regional development purposes with the aim to attract investments and jobs in economically underdeveloped regions, will not be subject to scrutiny. The legitimacy of the Swiss tax holiday scheme to incentivize and promote regional development is also recognized by the European Union.

This article was also published as an EY alert which you can find [here](#).
Switzerland implements spontaneous exchange of information

Executive summary
Switzerland has signed the Organisation for Economic Co-operation and Development (OECD)/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters (the MAC) and will introduce the international spontaneous exchange of information in tax matters into domestic legislation. The spontaneous exchange of information will be implemented by way of a revision of the Federal Act on International Administrative Assistance in Tax Matters (Revised Federal Act), which is set to come into force on 1 January 2017.

As a further step towards the spontaneous exchange of information, the Federal Council published the draft of the revised Ordinance on International Administrative Assistance in Tax Matters (Revised Federal Act), including an explanatory report, on 20 April 2016. The draft Ordinance contains detailed provisions on the spontaneous exchange of information relating to tax rulings.

Detailed discussion
Spontaneous exchange of information on tax rulings
According to the Revised Federal Act, Switzerland will follow international standards and the practices of other states as regards the spontaneous exchange of information. Therefore, the draft Ordinance focuses on the spontaneous exchange of information relating to tax rulings.

The draft Ordinance defines a tax ruling as (oral or written) advice, confirmation or assurance of a tax administration that: (i) is given to a taxpayer upon request; (ii) covers the tax consequences of a set of facts described by the taxpayer; and (iii) on which the taxpayer can rely.

In general, only information on tax rulings issued from 1 January 2010 and still applicable on 1 January 2018 may be exchanged.

In line with the recommendations of the OECD, the Federal Council has provided detailed guidance on the types of tax rulings covered by the spontaneous exchange of information. It refers to tax rulings relating to the following circumstances and tax regimes:

► Rulings relating to the taxation as a holding company, a domicile company, a principal company or a mixed company
► Rulings relating to the reduced taxation of revenue from intellectual property (Patent Box of the canton of Nidwalden and Patent Box proposed to be introduced as part of the Corporate Tax Reform III)
► Unilateral tax rulings covering cross-border transfer prices
► Cross-border rulings providing for a unilateral downward adjustment of the taxable income in Switzerland that is not directly reflected in the taxpayer’s financial accounts
► Cross-border rulings concerning the existence or absence of, and/or the attribution of profits to, a permanent establishment
► Cross-border related party conduit rulings

Within 60 days after having been issued, the rulings subject to the spontaneous exchange of information will be submitted together with a brief summary and further relevant information by the cantonal tax administration and the Swiss Federal Tax Administration (SFTA) to the Service for Exchange of Information in Tax Matters (SEI), which is a division of the SFTA.

The SEI analyzes the submitted rulings and forwards the information (but not the ruling itself) to the relevant recipient states within three months. The ruling as such may be exchanged upon a separate request for assistance.

In general, the SEI notifies the taxpayer before the exchange of the information with the recipient state takes place. The taxpayer may participate in the procedure and request the inspection of records. The procedure ends if the taxpayer agrees to the exchange of information or with a final decision of the SEI. The taxpayer can appeal the decision, and generally any information is exchanged only after the completion of the appeals process. In exceptional cases – where there is the risk of circumvention – the SEI may exchange the information before the taxpayer is notified.

The draft Ordinance provides taxpayers with some clarity. Nevertheless, a number of questions remain open. It is not yet clear if only information related to tax rulings will be spontaneously exchanged, or other information as well.
Furthermore, it is uncertain if and how the cantonal tax administrations and the SEI will take into account whether there is a supposed loss of tax revenue in the other state due to a tax ruling. Article 7 of the MAC provides that a state shall forward to another state\(^1\) information if e.g., the state providing the information has grounds for supposing that there may be a loss of tax in the other state. For the implementation of the Revised Federal Act, the explanatory report to the Ordinance refers to two interpretative documents:

- The OECD/G20 Final Report on Base Erosion and Profit Shifting (BEPS), Action 5\(^3\)

The documents contain different interpretations and emphasis regarding the question of whether the loss of tax revenue in another state is required to trigger the spontaneous exchange of information.

Finally, the final report on BEPS Action 5 provides a broader description of the term “ruling” than the draft Ordinance. Taxpayers should consider discussing proactively the application and interpretation of these central elements with the competent cantonal tax authority in order to determine the scope of the ruling information to be exchanged. Otherwise a court may have to assess at the appeals stage if Article 7 of the MAC is applicable in a particular circumstance.

**Legislative process**

The Federal Council invited the cantons and interested parties to comment on the draft Ordinance (the consultation process) by 10 August 2016. Based on an analysis of the comments received, the Ordinance will then be finalized so that it can enter into force at the same time as the Revised Federal Act, i.e., on 1 January 2017.

\(^1\) Switzerland can limit the exchange to states that have committed to the OECD’s Standard, particularly (i) the OECD states: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, The Netherlands, New Zealand, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States; (ii) the G20 States that are not part of the OECD: Argentina, Brazil, China, India, Indonesia, Russia, Saudi Arabia, South Africa; and (iii) other associated states: Colombia, Latvia.

\(^2\) Available at: [www.oecd.org/ctp/eoi/manual > (2) Spontaneous Information Exchange.](http://www.oecd.org/ctp/eoi/manual)


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This article was also published as an EY alert which you can find [here](#).
Switzerland released draft legislation on country-by-country reporting for consultation

Executive summary

On 13 April 2016, the Swiss Federal Council initiated the consultation procedure on the multilateral agreement on the exchange of country-by-country (CbC) reports as well as the federal act for domestic implementation.

The draft legislation for CbC reporting generally follows the recommendations of the Organisation for Economic Co-operation and Development (OECD) as presented on 5 October 2015 in its final report on Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting). The draft bill, however, does not adopt the three-tiered approach to transfer pricing documentation consisting of a master file, local file and CbC report.

It is expected that the new law will enter into force effective from 2018 so that Swiss headquartered multinationals with an annual consolidated group revenue of CHF 900m or more will be required to file the first CbC report for fiscal years beginning on or after 1 January 2018. The Federal Council will determine the states (Partner States) with which Switzerland agreed to conduct exchanges once the respective legal basis is implemented. The first automatic exchange of CbC reports with Partner States is expected to take place during the first half of 2020 with information related to fiscal year 2018.

Swiss groups will be allowed to file a CbC report for fiscal years 2016 and 2017 with the Swiss Federal Tax Administration (SFTA) for exchange purposes on a voluntary basis.

Detailed discussion

The draft legislation published with the consultation release for the automatic information exchange of CbC reports complies with the OECD minimum standards. Accordingly, CbC reporting obligations shall apply to Swiss headquartered multinationals with annual consolidated group revenue of at least €750m, which equals CHF 900m (based on the exchange rate as of 1 January 2015). The Federal Council will determine the exact threshold amount in an ordinance in accordance with international standards. It is expected that approximately 200 Swiss headquartered multinationals will become subject to the CbC reporting.

The CbC report can be prepared in English or in a Swiss official language (German, French or Italian). The figures can be presented in Swiss francs or in the main currency of the group. The CbC report must be filed with the SFTA within 12 months following the end of the reporting period. Non-compliance with the CbC reporting obligation may be subject to a penalty of up to CHF 250k.

The draft legislation includes a secondary filing mechanism according to which the SFTA can require a Swiss constituent entity of a foreign parented multinational to file a CbC report in Switzerland if the ultimate parent entity is resident in a foreign country that is not a Partner State or if there is a systemic failure in the foreign headquarters jurisdiction.

Subject to certain conditions, the draft legislation further provides to multinational groups, the option to appoint a foreign constituent entity as the surrogate parent entity which would file the CbC report in its country of residence on behalf of the group (surrogate filing).

CbC reports shall be automatically exchanged on an annual basis with the tax authorities of jurisdictions in which the Swiss group has constituent entities. The exchange will only take place if a treaty is available providing the legal basis for such exchange. The CbC data is transmitted exclusively to the foreign tax authorities and will not be published.

The following legal basis must be implemented before CbC reports can be exchanged with Partner States:

- OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters (already adopted by Swiss Parliament on 18 December 2015; to be ratified)
- Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (signed by the Federal Council on 27 January 2016; part of the consultation release; to be submitted to and approved by Swiss Parliament)
- Federal Act on the International Automatic Exchange of Country-by-Country Reports of Multinationals (part of the consultation release; to be submitted to and approved by Swiss Parliament)

Timing

The consultation phase will run until 13 July 2016. After the consultation, the legislation is submitted to the Swiss Parliament for approval. Once approved, the new law is subject to a facultative referendum. If no such referendum is called, the new CbC reporting legislation is expected to enter into force on 1 January 2018.

The first automatic exchange of CbC reports may take place during the first half of 2020 with respect to information related to fiscal year 2018.

For fiscal years 2016 and 2017, the draft legislation provides that Swiss headquartered multinationals may file a CbC report with the SFTA on a voluntary basis. The SFTA will exchange such reports with individual countries on the basis of a tax treaty or another international agreement with an exchange of information clause, without compromising the confidentiality. A formal request of the other country will not be required.

This article was also published as an EY alert which you can find here.
The work of the OECD’s Base Erosion and Profit Shifting (BEPS) Project began in July 2013 with the aim of limiting the avenues available to international corporations that use cross-border structures to minimize their tax burdens. Specifically, profits are to be taxed where the business activities that generate them are carried out. Although the focus is not on investments in real estate, the measures will still have an impact on certain real estate structures. For that reason, it will very probably be necessary to assess, and where possible, adjust existing investment structures, taking the BEPS Project’s Action Plan into account at this early stage as a precautionary measure for new transactions. This article provides a brief outline of the potential consequences of the BEPS Project for real estate investment.

Hybrid financing structures
Action 2 focuses on structures involving equity, debt capital or derivative contracts, where these instruments are treated as equity (or an equity investment) in one country and as debt capital in another for tax purposes. In the case of a hybrid loan, for example, the interest payments on the loan are tax-deductible for the company making them, while for the company receiving them these payments are treated as investment income and therefore qualify for tax relief on investments or some other form of preferential taxation (deduction for tax purposes with no corresponding taxation of income). That makes it important to assess whether a given structure results in double non-taxation.

If real estate investments are structured using hybrid financing instruments, potential changes in the law must be taken into account and restructuring variants may have to be prepared.

Limiting an “excessive” interest deduction
The focus of Action 4 is on limiting the interest deduction for loans issued between associated entities. The OECD’s proposal for limiting tax-deductible interest goes even further by also limiting the interest deduction with respect to third parties. According to the discussion draft on the subject of interest and other financial payments under Action 4, corporations often use financing structures that allow them to reduce the taxable profits of operating entities via interest payments even in cases where the group as a whole has little or no external debt. Debt finance is also often used to make investments from which the income is tax exempt or tax deferred. The interest expense on the debt capital used to finance the investment is, however, generally tax-deductible, which ultimately leads to the erosion of the tax base. As an alternative, the OECD suggests limiting the deduction of interest based on a group-wide perspective (“group-wide test”, net interest deduction limited to the group’s loans from banks) or a fixed ratio (“fixed ratio test”, interest deduction limited to 10% - 30% of EBITDA). This can have a considerable impact on the returns from real estate investments where shareholder loans are used to optimize the tax rate in other countries.

Preventing treaty abuse
This measure could have the greatest impact on real estate investors. Action 6 is a minimum standard (especially in connection with “treaty shopping”) that is mandatory for Switzerland (which already includes it in new double taxation treaties (DTTs), while corresponding amendments have already been made to more recent ones).

The aim of this measure is to prevent treaty benefits from being granted in inappropriate circumstances (claiming the benefits of more advantageous DTTs). To this end, the OECD is proposing a “limitation on benefits” (LOB) clause as well as a general abuse rule based on a “principal purpose test” (PPT). Criticism is primarily leveled at the LOB clause. This is aimed at limiting the granting of treaty benefits to qualifying parties. Certain structures that are common in practice, however, (most of which are not abusive in nature) would not qualify for treaty benefits based on the LOB clause currently being proposed. For this reason, the real estate associations are proposing that treaty benefits be granted to all real estate investments since most of them are made by investors who could claim such benefits in any case in the event of a direct investment (and not investments via a master feeder fund or joint venture).
One of the aims of the LOB clause and the PPT is to tie the forwarding of income within multi-level (holding) structures with exemption from (or reduction of) withholding tax to certain criteria such as substance or economic activity. For real estate funds, then, the limitation of the fund vehicle’s entitlement to treaty benefits could result in higher withholding tax charges for investments in other countries.

Definition of “permanent establishment” and transfer pricing

Action 7 provides for the broadening of the definition of a permanent establishment. Specifically, the definition is to be expanded to include establishment by a dependent agent; the exception provision with respect to independent agents (who can only establish a permanent establishment in certain circumstances) is to be amended and the list of exceptions is to be limited so that only assistance and preparation activities are considered exceptions to the creation of a permanent establishment. The changes could impact the structuring of domestic real estate investments via non-domestic real estate holding companies, and at a general level therefore affect the drafting of contracts with local property and asset managers as well as the on-site administration of properties. The interpretation of the permanent establishment concept could create a tax obligation for REIMs where previously there was none.

The requirements regarding transfer prices (Actions B-10) also need to be complied with for real estate investments. These are particularly relevant for assessing loan conditions/interest rates as well as the fees charged within a group of companies (asset management, investment advice etc.).

Transparency

Actions 13 and 5 are above all aimed at making investor and investment structures more transparent. These measures also form part of the “minimum standards” that Switzerland will implement.

The OECD is calling for “country-by-country reports” (CbCR) as part of Action 13 concerning the sharing of transfer pricing documentation. A framework Multilateral Competent Authorities Agreement (CbC MCAA, which is expected to be implemented in 2018) is to facilitate the sharing of country-by-country data. Specifically, the documentation consists of a master file (presentation of the group and its business unit), a local file (describing the local entity and its transactions), and the CbCR (which is to be completed by the group parent and contains certain information and financial indicators for each country that the group operates in). The documentation of the transfer pricing structure (especially with respect to interest rates for shareholder loans and the volume and charging of management fees) means a much higher workload for companies on the one hand but also transparency regarding internal performance relationships, cash flows and all tax payments at an international level on the other. This measure is not expected to be implemented until 2018. It is nevertheless important to ensure that the CbCR data of Swiss multinationals for 2016 is available by the start of 2017, as otherwise the OECD’s measures will not have been implemented in full. That is why it would be advisable for real estate investors and asset managers to already improve their internal documentation now.

More transparency is also to be provided by the spontaneous exchange of information for rulings (part of Action 5). Switzerland will spontaneously exchange information regarding provisional tax rulings issued after 1 January 2010 that are still in effect when the administrative assistance convention enters into force (2018).

Effectively countering harmful tax practices

Action 5 classifies regimes as harmful if they tax foreign and domestic income differently (“ring-fencing”). The focus here is above all on the cantons’ “Statusgesellschaften” (companies based in Switzerland whose operations are mainly based elsewhere, and that therefore enjoy preferential tax treatment). This is what prompted the decision to do away with the Statusgesellschaften as part of Switzerland’s Corporate Tax Reform III.

Finally, the OECD is demanding stricter substance-related requirements in the form of material business activity on the part of the entities involved in cases where preferential tax regimes are used. This also applies to real estate structures, which must be able to prove a material business activity in the state where the regime is in effect. The focus will therefore above all be on “shell corporations” based in states with preferential tax regimes.

Conclusion

The BEPS Project will entail a number of changes in tax legislation in the field of real estate investment. Implementation, particularly of the minimum standards into national law, is to be expected in 2017 at the earliest. However, real estate investors should clarify the potential impact on existing investments and the structuring of pending investments before they are implemented. The following measures in particular should be implemented before the changes take effect:

• Assessing real estate structures with respect to the risk of a permanent establishment;
• Assessing real estate investments and fund structures with respect to hybrid financing instruments, interest deduction requirements and requirements pertaining to the granting of treaty benefits;
• Assessing the requirements pertaining to the substance of investment structures;
• Improvements in the documentation of transfer prices for real estate investors and asset managers.
Mitigation of economic double taxation - hidden profit distribution

In a landmark ruling issued on 6 November 2015, the Swiss Federal Supreme Court specified the partial taxation of hidden profit distributions in greater detail. The Supreme Court of the Canton of Schaffhausen did not allow the half-rate procedure to be applied to a hidden profit distribution. The Supreme Court rightly revoked this ruling and allowed the half-rate procedure to also be applied to this income.

Facts and background

The tax administration of the Canton of Schaffhausen calculated a hidden profit distribution of CHF 72,579 in income for A. and B.A. in the 2009 tax period stemming from their limited company (GmbH).

Art. 7 (1) second sentence StHG (“Steuerharmonisierungsgesetz”: Swiss Federal Act on the Harmonization of Direct Taxation at the Cantonal and Communal Levels) (incorporated as of 1 January 2009) gives the cantons the ability to mitigate the economic double taxation of shareholders and their limited company or cooperative. According to that provision, the cantons can mitigate the economic double taxation of corporations and shareholders (physical persons) for dividends, shares of profits, liquidation profits and non-cash benefits, and therefore covers all kind of income from equity investments. In accordance with Section 2.2.3 of Circular 22/2008 issued by the Swiss Federal Tax Administration, this mitigation also applies to hidden profit distributions. In the case in question, the provision to mitigate the economic double taxation for the hidden profit distribution in 2009 would therefore apply at the federal level.

The Federal Supreme Court rejected the lower court's findings and reversed its decision

The cantonal tax administration Schaffhausen based its refusal to allow the half-rate procedure on two arguments: Firstly, it stated that Art. 7 (1) second sentence StHG includes a certain amount of scope for interpretation that allows cantons to exclude profit distributions from the mitigation of double taxation. In the administration's view, the freedom granted to the cantons in Art. 7 (1) second sentence StHG is not simply limited to providing for preferential treatment in cantonal law, but rather the preferential treatment may also be limited to certain parts of the assessment bases specified by Art. 7 (1) second sentence StHG. As a result, the cantonal legislation has only ever provided for the mitigation of open profit distributions in Art. 38 (3a) StG/SH. As described above, however, the Swiss Federal Tax Administration explicitly provides for hidden profit distributions being taxable using partial taxation in Sec. 2.2.3 of its Circular 22/2008 (also in keeping with the wording of the law). On the other hand, the Canton of Schaffhausen argued that the cantons were granted considerable scope for interpretation during the two-year period for adjustment pursuant to Art. 72h (2) StHG since the provision pursuant to Art. 7 (1) second sentence does not apply directly until after the two-year transition period. This opinion was also shared by the lower court: although it interprets Art. 7 (1) second sentence StHG to mean that the mitigation also has to include hidden profit distributions, it did not allow the half-rate procedure to be applied because it assumed that the provision did not yet apply to the year in question in this case (2009) due to the fact that Art. 72h StHG provides for a two-year transition period.
With regard to the scope for interpretation, the Federal Supreme Court found that while Art. 7 (1) second sentence StHG allows the cantons to decide whether, how and to what extent (percentage) they want to mitigate economic double taxation, the taxpayer and taxable object for the tax relief are however bindingly stipulated for the cantons by federal legislation. This means that StHG requires that all investment income from private assets (i.e. including hidden profit distributions) qualifies equally for any mitigation of economic double taxation. With respect to the applicability of Art. 7 (1) second sentence StHG to the 2009 tax period, the Federal Supreme Court has found that while the changes to the Tax Harmonization Act do not apply until two years after their entry into force at the latest (i.e. 1 January 2011), the cantons cannot use the two-year adjustment period to introduce temporary provisions or, as in the case of Art. 38 (3a) StG/SH, apply existing norms that comply with neither the old nor the new federal legislation.

Conclusion: In the Canton of Schaffhausen, also for the tax period 2009, the exclusion of hidden profit distributions from the mitigation of economic double taxation has been found to be in breach of federal law. The legal conclusion is the same for comparable arrangements in other cantons. The ruling is also relevant for other, non-ordinary profit distributions (such as extraordinary profit distributions (including partial and total liquidation), bonus shares or bonus par value increases, hidden profit distributions).
Mitigation of economic double taxation - unequal treatment of equity investments in foreign entities

On 29 September 2009, the Swiss Federal Supreme Court issued an important ruling regarding the unequal treatment of dividend income deriving from equity investments in foreign entities. According to the ruling, the preferential treatment granted to qualifying dividend income from Swiss entities but not granted to non-Swiss entities in cantonal tax legislation violates the requirement of equal treatment (Art. 8 (1) of the Swiss Federal Constitution). In response to an appeal filed against the Zug Administrative Court regarding the denial of tax relief on dividend income in connection with an equity investment in a foreign entity, the Federal Supreme Court revoked the Administrative Court’s ruling based on the aforementioned legal argumentation and specified the partial rate procedure or what has become customary practice since 2009.

Background: Ruling dated 25 September 2009 (BGE 136 I 49)

The Federal Supreme Court found that the regulations concerning the half-rate procedure in the tax laws of the Canton of Bern (Art. 42 (3) StG/BE) are unconstitutional. Deviating from the wording of the revised Art. 7 (1) StHG (“Steuerharmonisierungsgesetz”: Swiss Federal Act on the Harmonization of Direct Taxation at the Cantonal and Communal Levels), which entered into force on 1 January 2009, the tax laws of the Canton of Bern allowed the half-rate procedure for qualifying equity investments to be applied only to dividend income from companies based in Switzerland. The Federal Supreme Court found that the preferential treatment of investment income from a domestic entity over investment income from a foreign entity is not justified with a view to the prevention of economic double taxation. There is therefore no objective basis for the unequal treatment of domestic and foreign investment income at the level of the holders of such investments (physical persons), which unduly violates the principle of equal burden. It was therefore necessary to immediately revoke the unconstitutional provision or amend it so that it also applies to foreign investments. This was also applied for the most part in all cantons, and to direct federal taxes in any case. Circular 22/2008 issued by the Swiss Federal Tax Administration, for example, regarding the partial taxation of income from investments in private assets, refers to the provisions for domestic legal entities and physical persons with respect to taxation of dividend income deriving from foreign participation rights.

Ruling dated 19 January 2016 - clarification and confirmation of the customary practice of applying the partial rate procedure to dividend income from foreign investments

Based on the ruling of the Federal Supreme Court dated 25 September 2009, identical or similar regulations in other cantons that allowed the unequal treatment of domestic and foreign investments were also to be amended. Instead of immediately amending the law as described above, the government of the Canton of Zug elected to maintain the preferential treatment of qualifying equity investments in Swiss entities until the end of 2011 by means of an ordinance enacted on 7 December 2010. Zug's parliament enacted the articles of law that comply with BGE 136 I 49 (Art. 18bis and 19 (2) StG/ZG), which were incorporated into the canton's law books as of 1 January 2012. This means that the Canton of Zug did not allow the partial rate to be applied to the dividend income of A. and B.C. stemming from German equity investments, for the 2010 tax period. This contrasts with the federal level, where the economic double burden on the foreign equity investment was mitigated using the partial-rate procedure. The parties filed an appeal against their assessment with the Zug Administrative Court, which rejected it. Although the Administrative Court recognized that the continued existence of this kind of provision violated the principle of equal treatment, it judged the impairment of the taxpayers’ constitutional rights to be justified in accordance with Art. 36 of the Swiss Federal Constitution: Such impairment was justified if it had a basis in law, would be in the public interest and would be proportionate. The Federal Supreme Court did not judge this to be the case here. The Administrative Court also took the position of giving consideration to those taxpayers who accept their (unjustifiably) high assessments without contesting them. This standpoint on the part of the Administrative Court is not compelling in any way. The Federal Supreme Court rightly classed the cantonal regulation in agreement with BGE 136 I 49 as unconstitutional, and allowed the application of the partial-rate procedure to the dividend income stemming from a German equity investment in the 2010 tax period (between BGE 136 I 49 and 1 January 2012).

Conclusion: The Swiss Federal Supreme Court has now confirmed twice over that the economic double taxation of qualifying dividend income from domestic and foreign equity investments must also be mitigated at the level of investment holders domiciled in Switzerland (in private assets pursuant to Art. 7 (1) StHG / Art. 20 (1bis) DBG (“Gesetz über die direkte Bundessteuer”: Swiss Law on Direct Federal Taxes), in corporate assets pursuant to Art. 28 (1) StHG / Art. 69 DBG).
"Finalization" in the Swiss VAT system: reconciliation of turnover and input tax and correcting past returns

In the Swiss VAT system finalization for the tax period requires the taxpayers to check the VAT returns submitted during the tax period against their annual financial statements. Businesses often underestimate the complexity of reconciling their turnover or forget important parts of the finalization.

Finalization

Finalization refers to the process of a business checking the VAT returns it has submitted during the tax period for errors in the course of preparing its annual financial statements. Where discrepancies are found between the final accounts and the VAT returns submitted to the Swiss Federal Tax Administration (SFTA), these need to be resolved and corrections made where necessary.

Errors in VAT returns filed during the tax period must be corrected by submitting an adjusting return within 240 days of the end of the financial year, i.e. normally before the end of August of the following year. If an adjusting return is not submitted by that deadline, this is regarded by the SFTA as an implicit statement by the business that the VAT returns already submitted during the tax period were free from error. Inconsistencies that come to light at a later date may – in the absence of a voluntary declaration – result in prosecution.

Turnover reconciliation

The purpose of the turnover reconciliation is to illustrate that the VAT declared during the tax period reconciles with the final (statutory) financial statements. A taxable business can meet this requirement by comparing the relevant VAT returns with the VAT-relevant bookkeeping accounts while also evaluating and taking into account supplies that were either not booked or were booked in a non-VAT-compliant manner. Differences must be explained and any errors in previous returns declared by submitting an adjusting return.

To ensure continuity and completeness, it is advisable to draw up a checklist specific to the business before preparing the turnover reconciliation. Ultimately, the reconciliation represents more than just the performance of a legal duty or a useful preparation for the possibility of documentation being demanded by the SFTA in the context of an audit or otherwise. It is also in the interests of the business, for example, by correcting errors in the business's favor or verifying incorrect processes in the ERP system.

Input tax reconciliation

The purpose of input tax reconciliation as an element in finalization is to produce evidence that the input tax recorded in the annual accounts has been reconciled with the input tax declared in the VAT returns for the tax period. Under the wording of the VAT ordinance a full plausibility check on input tax – i.e. recalculating the input tax on the basis of the investments and expenses in the individual account ledgers and comparing this with the input tax declared – is not actually necessary. However, the wording of the law does oblige a business to correct all errors in its tax returns, and this naturally includes input tax, as this determines the correct amount of tax to be paid.

Frequent pitfalls in practice

In practice businesses often neglect to carry out a turnover or input tax reconciliation or perform them only in part. Documentation of the reconciliations is frequently inadequate, making them difficult or impossible to follow for a third party, e.g. an SFTA auditor. It is also not an infrequent occurrence for turnover or input tax reconciliations to be performed using inadequate tables that the business has itself created, which makes them time-consuming to process and prone to error. In many cases it is possible and advisable to at least partially automate the reconciliation process.

Conclusion

Finalization, with its sub-components of turnover and input tax reconciliation, needs to be carried out in a complete and verifiable manner within 180 days of the end of the financial year (usually by the end of June) and must be documented appropriately. Any adjusting returns required are then to be submitted within 60 days. Delayed or inadequate finalization can result in demands for payment of back VAT, the charging of interest or even prosecution. Especially where reconciliations are more complex, at least some of the work should be automated.

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Tax News - Summer 2016
Recent development in the practice of the Swiss VAT Authorities – a selection

This article aims at providing an overview of recent selected changes or proposed changes published by the Swiss Federal Tax Administration, Main Division VAT (SFTA). Where changes are proposed to the VAT info leaflets, the SFTA also publishes on its website draft info leaflets (still at the proposal stage), which are subject to change and should not be considered as reflecting the current practice.

VAT info 02, VAT liability, notion of entrepreneurial activity (Draft info proposed change)

On 19 April 2015, the Federal Court confirmed that an element of the practice of the SFTA relating to what constitutes an entrepreneurial activity – a condition to register for VAT – was contrary to the Swiss Federal VAT law. According to this previous practice, an entrepreneurial activity was deemed to be realized if the costs of an activity were covered on the long term by at least 25% of revenues from supplies of goods and supplies of services but not more than 75% by non-considerations such as subventions, donations etc. This concerns for example foundations or associations involved in fundraising who receive many subventions or donations considered as non-considerations from a VAT perspective.

Since this judgment of the Federal Court, the SFTA has not published a new practice on this topic and VAT registered persons are still in the dark as regards which approach/criteria will be adopted by the SFTA. In its proposed practice change, the SFTA gives information on some of the ongoing thinking around the notion of entrepreneurial activity by proposing the following two changes (i) the SFTA explicitly states that a charitable organization which only receives donations cannot be considered as having an entrepreneurial activity (ii) the SFTA slightly changes the wording with regard to activities, which it considers not to be of an entrepreneurial nature: “activities whereby the primary aim is not the realization of revenues from supplies” in the current info shall be replaced by “activities where the realization of revenues is of substantially minor importance”. This slight change would go in the direction of extending the notion of entrepreneurial activity.

VAT Info 08, Private use of company cars

The SFTA published the revised version of its VAT Info 08 “Private Shares” (“Privatanteile”) on 31 May 2016, covering a range of cases with practical relevance for the private use of company cars. A summary:

Where an employer provides employees with company cars that may also be used for private purposes, this constitutes a taxable supply and VAT is chargeable at the standard rate. The value of the private share can be calculated as a lump sum on the basis of 0.8% of the purchase price excluding VAT per month, subject to a minimum of CHF 150, provided the vehicle is used mainly (i.e. more than 50%) for business purposes. If the vehicle is not used mainly for business purposes, the private share must be determined using the effective costs. Where vehicles are leased, the cash value specified in the leasing agreement is used for the lump-sum calculation of VAT. If the vehicles provided to employees by their employer are rented, VAT is calculated on the basis of the market value of the vehicles at the beginning of the rental agreement. Appropriate documentary evidence of this value must be supplied by the taxable person (e.g. a Eurotax valuation). In the absence of such evidence, the lump-sum calculation of private use is based on the list price.

The SFTA also assumes that no employee requires more than one car for the performance of his or her work duties. Where an employee is provided with two or more vehicles, the employer must provide evidence that more than one company vehicle is actually required. If a business has a car pool from which employees can take cars and use them for private purposes, VAT is charged at the standard rate on the private use. The basis of assessment is the rental charge paid by the employee. Where employees are provided with vehicles free of charge, VAT must be charged on the basis of CHF 0.70 per kilometre.

It is common in practice for employees to use their own vehicles for business purposes with the employer reimbursing them for the ongoing operating costs (fuel, insurance, maintenance etc.). Employers can claim the input tax on these costs where they have been incurred exclusively for business purposes.

The private use of company cars by employees resident abroad may be exempted from VAT, on condition that the vehicle in question is mainly used abroad. Evidence of this must be provided in an appropriate form (e.g. journey recorder, logbook).

VAT industry info 13, Telecommunication and IT services (Draft info - proposed change)

The SFTA is currently working on a revised info relating to supplies of telecommunication and electronic services. The envisaged changes concern in particular acceptable means of proof for VAT exemption of electronic services for B2B and B2C customers. According to art B.1. of the Swiss VAT law, the place of supply for electronic services is the place at which the recipient of the service has its place of business or a permanent establishment for which the service is provided, or in the absence of such a place of business or such a permanent establishment, its domicile or the place of his normal abode.
In general, for services falling under art 8.1 of the Swiss VAT law, an invoice issued to an entity/individual domiciled abroad is sufficient to exempt the supply from Swiss VAT. When it comes to electronic services, proving the exemption becomes much more of a challenge. In this area encompassing gaming services, subscription to electronic magazines etc., the SFTA has experienced over time the following situations (i) at times there is no proper invoice as such available which includes the detailed address of the customer (ii) the address of the customer is not necessarily up-to-date and the situation may lead to the customer providing an address outside of Switzerland (e.g., France or Germany) and the IP address shows that the service is effectively consumed in Switzerland.

All these situations have led the SFTA over the last few years to develop a practice that takes into consideration the developments in this area. Among the proposed changes the SFTA is currently revisiting the acceptable means of proof to prove VAT exemption and suggests the following:

- If the services are consumed or paid for via mobile phone, the SFTA will accept as proof the IP address and the country code of the SIM card. If these two means of proof are conflicting and lead to different results, the SFTA will accept as a third means of proof the country code of the banking card or any other means of proof;

- If the services are not consumed or paid for via mobile phone, the SFTA will accept as proof the address of the recipient and the IP address. If these two means of proof are conflicting and lead to different results, the SFTA will accept as a third means of proof the country code of the banking card or any other means of proof.

In a nutshell, one can summarize the current thinking of the SFTA as follows: (i) one means of proof is clearly not acceptable (ii) two means of proof are required and if these two means of proof lead to conflicting results a third means of proof is required.
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