Dear reader

On 17 June 2016, the Swiss Parliament adopted the Corporate Tax Reform III package to strengthen Switzerland’s attractiveness as a business location. The cantons are now required to adjust their cantonal tax laws in accordance with the new legislation. Several Cantons have already presented their strategy for the implementation of Corporate Tax Reform III into their cantonal tax law.

In this issue of our quarterly newsletter we will inform you on this important topic and further current tax developments.

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Abuse of DTTs - Developments and tendencies in light of BEPS Action Point 6

BEPS Action Point 6
Combatting abuse of DTTs in general and treaty shopping in particular is one of the most important aspects of the entire BEPS project. Taxpayers should no longer be able to make abusive claims under existing DTTs unhindered.

In Action 6 the OECD defines the measures intended to prevent future abuse of DTTs. The countries involved have agreed to adopt a minimum standard on abuse provisions in their treaties while also allowing a degree of flexibility in how these are structured. This is to make allowance for the individual legal traditions and specificities of each country. At the same time, the title and preamble to the treaties are also to be changed to reflect the new circumstances and intentions.

Minimum standard on the prevention of treaty abuse
In Action 6 the OECD has developed three options for meeting the minimum standard:
- A PPT rule
- A PPT rule with a LOB clause
- A LOB with special additional provisions (especially as regards conduit financing arrangements)

Like nearly all European countries, Switzerland too is going to introduce into its DTTs a principal purpose test ("PPT") rule. The object of this very generally worded rule is to deny treaty benefits if, taking into account all relevant facts and circumstances, it can be reasonably assumed that one of the principal purposes of the transactions or arrangements is to directly or indirectly obtain them. The taxpayer can however demonstrate that obtaining treaty benefits is compatible with the object and purpose of the treaty.

The PPT rule therefore contains a two-step check. The first step is to analyse the primary purpose of the transaction or arrangement giving rise to treaty benefits, taking into account all relevant facts and circumstances. The next step is then to assess whether it is a reasonable assumption that obtaining treaty benefits is at least one of the main reasons for the transaction or arrangement selected.

Changing the title and preamble in the DTTs
The existing treaty titles only state the avoidance of double taxation as the purpose of the treaty. In order to emphasise that the prevention of tax evasion and tax avoidance is a central aim of the treaty, this will now be explicitly stated in the title of the DTTs. The preamble to the agreements will also be amended, as well as the title. The current preamble to the OECD Model Tax Convention has a footnote specifying that the specific preamble in the DTT shall be drafted in accordance with the constitutional procedure of both contracting states. Now the prevention of DTT abuse will also be included in the preamble. The OECD's objective is to take the prevention of treaty abuse into account when applying and, above all, interpreting the treaty.

Implementation
Action 6 is one of the treaty-based measures. In theory, all DTTs will have to be renegotiated to implement these measures. Under Action 15 the OECD is creating a multilateral instrument ("MLI") for amending DTTs by a simplified procedure. The final draft of the agreement is not yet publicly available. It can however be assumed that the states will sign the MLI in the first half of 2017.

Conclusion and assessment
With the implementation of Action 6, in future all DTTs entered into by Switzerland will contain an abuse clause that at least covers the minimum standard required by the OECD. Switzerland will implement Action 6 with the inclusion of the PPT rule, and at the same time will probably replace all existing abuse clauses in DTTs with a PPT rule. This change will make BRB 62 obsolete, so it will be withdrawn by the Federal Council in the near future.

It is to be welcomed that abuse provisions have been declared the standard at international level for the first time, and that at the same time many states have committed to adopting them. It remains to be seen, however, how the objective and subjective criteria to be assessed under the PPT rule will be treated and reviewed in practice. The practice of the Federal Tax Administration as regards the substance test in connection with the question of beneficial ownership will be of central importance. The assumption at present is that these may be tightened up after Action 6 is implemented (e.g. by not recognising the physical presence of other group companies). This would ultimately mean that in future foreign companies might face tougher conditions for full relief from Swiss withholding tax.
Taxation of start-up companies - Update regarding the practice of the Canton of Zurich for valuing securities with no market value for the purposes of wealth tax

With the directive issued by the Finance Department on 1 November 2016, the Canton of Zurich made it clear that, for the purposes of wealth tax, the value of shares in start-up companies with no market value will in future correspond to net asset value until representative business performance figures are available. Investor prices paid in financing rounds will therefore not apply to the valuation of shares in start-up companies with no market value until the start-up phase is over.

Development in the Canton of Zurich

In recent years it has become apparent that the Canton of Zurich Tax Office has increasingly based its valuations for the purposes of wealth tax of securities with no market value (including for start-up companies) on the prices paid in financing rounds or capital increases and not net asset value in accordance with the "mean value method". As a result, business founders and investors whose companies were still in the foundation or start-up phase have faced wealth tax burdens that were not proportionate to the incomes generated on their assets.

Various initiatives launched by start-up companies, IFJ Institut für Jungunternehmen AG and the Zurich Development Board sparked a heated debate on the practices of the Canton of Zurich in relation to the valuation of securities with no market value for start-up companies for the purposes of wealth tax. This prompted the Canton of Zurich Tax Office to amend its practices so that the prices paid by investors in financing rounds or capital increases are not taken into account at all or only in part in the calculation of the securities' value for the purposes of wealth tax for a certain period of time. This practice has once again been overhauled by the latest directive issued by the Finance Department of the Canton of Zurich regarding the valuation of securities and credit balances for the purposes of wealth tax, which applies as of 1 November 2016.

Change in practice - Directive issued by the Finance Department of the Canton of Zurich regarding the valuation of securities and credit balances for the purposes of wealth tax

The directive issued by the Finance Department of the Canton of Zurich on 1 November 2016 states that the value of unlisted securities is to always to be determined in accordance with Circular No. 28 dated 28 August 2008 "Guideline for valuing securities with no market value for the purposes of wealth tax". The value of shares in start-up companies with no market value is equivalent to their net asset value. According to Circular No. 28, this principle is only to drop when a start-up company first achieves representative business results.

Outlook

In terms of promoting Zurich as a place to do business, the directive issued by the Finance Department of the Canton of Zurich and the associated definition of practice are to be welcomed. At the same time, it remains to be seen how the Canton of Zurich Tax Office will implement the Finance Department's directive. Specifically, there is a question mark over what criteria will be used to assess whether representative business results are available, and under what special circumstances the Canton of Zurich Tax Office will judge a tax assessment to be inappropriate and therefore drop taxation on the basis of net asset value.
Canton of Solothurn releases plan for implementation of Corporate Tax Reform III

Executive summary

Following the recent adoption of the federal tax reform package by the Swiss parliament, the Swiss cantons are now outlining their corporate tax strategies for local implementation.

In June 2016, the Swiss parliament approved the final bill on the third series of corporate tax reform (“CTR III”), foreseeing 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 corporate income tax rates to 11.5%-14% (including federal taxes) in most relevant cantons. The reform aims to ensure that Switzerland remains attractive for multinational corporations while being fully aligned with international taxation standards in a post-Base Erosion and Profit Shifting (“BEPS”) world.

The cantons are required to adjust their cantonal tax laws in accordance with CTR III. Whilst some measures are mandatory and must be implemented by the cantons, others are optional. Each canton will implement the CTR III by tailoring its individual cantonal tax legislation to its specific needs and circumstances.

On 31 October 2016, the Government of the canton of Solothurn presented its strategy to implement CTR III into its cantonal tax law. Inter alia, the plan includes the introduction of a patent box, research & development (“R&D”) super deduction and a notional interest deduction (“NID”) on surplus equity. Additionally, the headline corporate income tax rate is to be reduced from 21.8% to 12.9% (including federal tax).

Detailed discussion

In order to improve its attractiveness as a business location, the canton of Solothurn plans to introduce the following core measures for the local implementation of CTR III:

Tax rate reductions

The corporate income tax rate is to be reduced from the current maximum rate of 21.8% to 12.9% (including federal tax).

The capital tax rate shall be reduced from 0.8‰ to 0.2‰. In addition, a further capital tax relief on the company’s net equity related to participations, patents and similar intangibles as well as intercompany loans shall be provided.

Patent box and R&D super deduction

As mandated by the federal draft legislation, the canton of Solothurn will introduce a patent box (modified nexus approach). The patent box will be available at the cantonal level and the resulting tax relief for income related to the patent box will be set at 90%, which may result in an effective tax rate of as low as 8.3% for qualifying income.

The introduction of an R&D super deduction is considered to be of great importance for corporations established in the canton of Solothurn. Hence, qualifying R&D expenses should become eligible for an increased cantonal tax-deduction of 150%.

1. See EY Global Tax Alert, Swiss Parliament approves Corporate Tax Reform III, dated 17 June 2016. Further information on Swiss Corporate Tax Reform III is also available under www.ey.com/ch/CTR-III

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NID on surplus equity

The canton of Solothurn plans to introduce the NID on the cantonal level in addition to the NID that will be enacted on the federal level in order to incentivize group financing activities.

Limitation of cantonal tax relief

According to federal law, the total reduction of taxable income on the basis of the patent box, the R&D super deduction and the NID must not exceed 80% of the taxable profit (before offsetting tax loss carry-forwards and without considering participation income). The cantons are free to limit cantonal benefits to a lower percentage. The Government of the canton of Solothurn has decided that the cantonal tax relief resulting from the patent box, R&D super deduction and the notional interest deduction shall be limited to approx. 60 to 70% of the taxable profit. It should be noted that the NID at the federal level is not affected by this restriction and may provide additional relief in excess of the cantonal limitation.

Transitional measures

In the case of a company transitioning from privileged taxation to ordinary taxation, the canton of Solothurn intends to set the cantonal tax rate for the reduced taxation of existing built-in gains at 1.5% (so-called “two-tax rate model”). By applying the two-tax rate model during a five-year transition period, an abrupt increase of the respective corporations’ income tax burden is avoided.

Outlook

A cantonal draft bill is in development and the public consultation process in the canton of Solothurn is expected to begin in early 2017. Thereafter, the Parliament of the canton of Solothurn is required to formally adopt the bill.

The federal bill is subject to a popular referendum, which is scheduled to take place on 12 February 2017. Provided Swiss voters formally approve the reform package in the upcoming vote, the Swiss corporate tax reform will enter into force on 1 January 2019.
The Swiss Corporate Tax Reform III (CTR III) will see certain preferential tax regimes replaced by a new package of internationally accepted measures. The changes in the law are intended to be accompanied by a broad reduction in cantonal corporate income tax rates to ensure that Switzerland remains attractive for international companies in an environment which in future will be less driven by base erosion and profit shifting (BEPS). There is also a desire to give companies planning certainty for the future and at the same time ensure compliance with international taxation standards.

On 17 June 2016 the Swiss parliament approved the final CTR III package aimed at making Switzerland a more attractive place to do business. The new law will be subject to a public vote on 12 February 2017 and is likely to come into effect on 1 January 2019.

On 19 September 2016 the Government of the canton of Fribourg presented its plan for implementing CTR III in cantonal tax law. The central feature is to be a cut in the corporate income tax rate to around 13.72% (depending on the municipality, including federal tax). The tax plan also provides for the introduction of a patent box and a super deduction for research and development expenses (R&D).

In order to maintain its attractiveness as a business location, the Government of the canton of Fribourg is planning the following measures for the local implementation of CTR III:

**Tax rate reduction**
The corporate income tax rate is to be reduced from the current maximum rate of 20.85% to 13.72% (including federal tax). The cantonal capital tax rate for all ordinarily taxed legal entities will also be cut from 0.16% to 0.04%. Together with the municipal tax rate, this gives an effective tax rate of 0.077% (city of Fribourg). An additional reduction in capital tax on net equity related to participations, patents and comparable intangible assets is also planned. However, the ordinary capital tax rate applies to net equity related to intercompany loans. The canton of Fribourg will also maintain its current position not to offer the possibility of offsetting capital taxes against income taxes.

**Patent box and R&D super deduction**
A patent box and an R&D super deduction are to be introduced as part of the package, as a way of encouraging innovation and R&D activities in Switzerland. The cantonal tax relief for deductible patent box income is 90%, and an increased cantonal tax deduction of 150% is granted for deductible R&D expenses.

**Notional interest deduction**
The government in Fribourg is not planning to introduce a notional interest deduction (NID) on surplus equity at cantonal level. It believes this would result in a considerable loss of tax receipts for the canton and is incompatible with the cantonal strategy.

Restriction on cantonal tax relief

A cap on tax relief is being introduced to ensure there is a certain minimum level of tax levied on a company's tax base. The Fribourg government intends to limit the maximum cantonal tax relief under the patent box and the R&D super deduction to a total of 80% of a company's net profit.

Other measures and financing

Partial taxation of dividend income for individuals will be raised from 50% to 60%. The canton therefore remains attractive for shareholders and generates an estimated additional CHF 3.4 million in receipts.

Cutting the tax rates is expected to result in a shortfall in receipts, however. The federal government will compensate the cantons and give them a higher share of direct federal taxation.

In exchange for the favorable overall framework, the government is proposing that employers provide increased family allowances, other training and development measures and day care for children.

Outlook

The proposal put forward by the government of the canton of Fribourg on 19 September 2016 is currently subject to a public consultation procedure that will conclude on 21 December 2016. The cantonal parliament will then have to decide on the implementation of CTR III.

The federal bill is subject to a public vote, which will take place on 12 February 2017. The whole reform package should come into effect on 1 January 2019.
The Swiss Corporate Tax Reform III (CTR III) will see certain preferential tax regimes replaced by a new package of internationally accepted measures. The changes in the law are intended to be accompanied by a broad reduction in cantonal corporate income tax rates to ensure that Switzerland remains attractive for international companies in an environment which in future will be less driven by base erosion and profit shifting (BEPS). There is also a desire to give companies planning certainty for the future and at the same time ensure compliance with international taxation standards.

On 17 June 2016 the Swiss parliament approved the final CTR III package aimed at making Switzerland a more attractive place to do business. The new law will be subject to a public vote on 12 February 2017 and is likely to come into effect on 1 January 2019. The cantons have to bring their cantonal tax laws into line with CTR III. Some measures are mandatory and must be implemented by the cantons; others are optional. Any reduction in cantonal tax rates is entirely at the discretion of the cantons. Each canton will therefore implement CTR III individually, tailoring the changes in cantonal tax laws to its own specific circumstances.

On 22 November 2016 the government of the canton of Berne expressed its views on implementing CTR III in cantonal tax law. CTR III is to be implemented within the framework of the canton of Berne's tax strategy. The central feature is to be a cut in the effective corporate income tax rate to around 16.37% (depending on the municipality, including federal tax). The plan also includes a patent box and a super deduction for research and development costs (R&D). The cantonal government has not yet addressed all the measures planned, however.

In order to maintain its attractiveness as a business location, the Government of the canton of Berne is planning the following measures for the local implementation of CTR III:

**Tax rate reduction**

The (effective) corporate income tax rate is to be reduced from the current maximum rate of 23.35% to 16.37% (including federal tax). This cut will take place in stages out to 2022, as shown in the table below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
</tr>
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<tbody>
<tr>
<td>2019</td>
<td>20.03%</td>
</tr>
<tr>
<td>2020</td>
<td>18.65%</td>
</tr>
<tr>
<td>2021</td>
<td>17.16%</td>
</tr>
<tr>
<td>2022</td>
<td>16.37%</td>
</tr>
</tbody>
</table>

The cantonal capital tax rate for all ordinarily taxed legal entities will also be cut from 0.03% to 0.01%; it will still be possible to offset capital tax against corporate income tax in the canton of Berne.

**Patent box and R&D super deduction**

A patent box and an R&D super deduction are to be introduced as a way of encouraging innovation and R&D activities in Switzerland. The canton of Berne is planning to introduce a patent box and an R&D super deduction of 150% of deductible R&D expenditure. This will make full use of the scope provided under federal law. The cantonal government has not yet released any further details on the patent box.

**Notional interest deduction**

The Berne cantonal government has not yet reached a final view on a notional interest deduction (NID). It will express its opinion in the draft for consultation.

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Outlook

The canton of Berne was planning to revise its tax law as part of its tax strategy regardless of CTR III. This is now taking place in a way that reflects CTR III. The draft for consultation is set to be submitted to the parties and associations for their response in the second quarter of 2017, and the consultation will definitely start after the public vote on 12 February 2017. Even if the voters reject CTR III, the measures in the cantonal government's tax strategy (especially the intended cut in corporate income tax rates) will be implemented in the canton of Berne anyway.
Implications of FABI for salary statements, employers and employees – changes applicable to company cars

In a referendum on 9 February 2014, the Swiss electorate voted in favour of the Federal Council decision to fund and expand railway infrastructure (FABI). The implications of FABI for salary statements, employers and employees have already been discussed in detail in an earlier Tax News article. The Swiss Federal Tax Administration (FTA) published a statement on employees with company vehicles on 15 July 2016. Since then, most of the cantons have come to their own decisions on whether, from what date and to what amount, limits on deductions should be implemented. This article describes these changes and their implications for employees.

Provision of a company car free of charge

Under the current regulations, private use is recorded in the salary statement as a non-cash benefit. This generally takes the form of a fixed monthly imputation of 0.8% of the purchase price (excluding VAT), subject to a minimum of CHF 150 a month. Social insurance contributions, VAT and withholding tax (in the case of employees subject to the latter) must be paid on this by the employer, who must also tick box F on the salary statement. This tick means that the employee cannot claim any business expenses in their personal tax return in connection with their journey to work.

The employer now (from 2016 onwards) also has to confirm a proportion of business travel for each employee in section 15 of the salary statement (“Comments”). This proportion of business travel is calculated on the basis of the actual business days spent travelling over a total of 220 working days, thus already taking vacations, days off work because of illness, etc. into account. The employer has the option of listing days spent travelling for business purposes as flat-rate figures for different functions/professions, as publicised by the Confederation in its statement of 15 July 2016 or on the basis of its own calculations.

A day spent traveling for business purposes is defined by reference to whether the employee travels, using the company vehicle, directly from his/her home to the client and directly back again or vice versa. Where the employee uses the company vehicle to travel from the office to the client and then straight home, the day on which he/she does this is to be certified as a half-day’s business travel. The decisive criterion is that employees do not travel by company vehicle to their usual permanent place of work before or after visiting clients, and therefore cannot be said to be traveling to work. It follows that, given the absence of any journey to work, regular working in a home office, unpaid leave, working abroad, release, travel to training courses/seminars, etc., must also be counted as days traveling on business.

From 2016, employees will have to declare additional taxable income for use of a company car for travel to work (number of kilometres multiplied by CHF 0.70 per kilometre) in their personal tax returns. If the salary statement indicates a proportion of business travel, the employee may reduce this amount accordingly. Where the employer certifies the proportion of business travel using the flat-rate figures prescribed by the Confederation, the employee has the option of providing evidence, in his/her tax return, or in any subsequent review of withholding tax, that the number of days of business travel was actually greater.

Employees can claim a deduction for the costs of traveling to work. Under Art. 26 DBG, this deduction will now (from 2016 onwards) be limited to CHF 3,000 annually for direct federal taxes.

The cantons, on the basis of Art. 9 para.1 of the Tax Harmonisation Act, have imposed the following limits on the deduction of travel costs:
A company car is becoming less attractive to employees, especially where distances travelled between home and workplace exceed 10 kilometres, as this results in additional taxable income. The declaration of a proportion of business travel also means more administrative work for the employer, unless it makes use of the fixed figures for functions/professions. Some employers are making use of a special tracking tool that enables employees to record the actual days of business travel.

Aargau: max. CHF 7,000, with effect from 1 January 2017
Appenzell-Ausserrhoden: max. CHF 6,000, with effect from 1 January 2015 (!)
Appenzell-Innerrhoden: no limit on deduction planned
Basel-Land: max. CHF 6,000, with effect from 1 January 2017
Basel-Stadt: max. CHF 3,000, with effect from 1 January 2016
Berne: max. CHF 6,700, with effect from 1 January 2016
Freiburg: no limit on deduction planned
Geneva: max. CHF 500, with effect from 1 January 2016
Glarus: no limit on deduction planned
Graubünden: no limit on deduction planned
Jura: no limit on deduction planned
Lucerne: still being discussed
Neuchâtel: no limit on deduction planned
Nidwalden: max. CHF 6,000, with effect from 1 January 2016
Obwalden: no limit on deduction planned
Schaffhausen: max. CHF 6,000, with effect from 1 January 2016
Schwyz: max. CHF 8,000, with effect from 1 January 2017
Solothurn: no limit on deduction imposed at present
St. Gallen: max. CHF 3,655, with effect from 1 January 2016
Ticino: no limit on deduction planned
Thurgau: max. CHF 6,000, with effect from 1 January 2016
Uri: no limit on deduction planned
Vaud: no limit on deduction planned
Valais: no limit on deduction planned
Zug: max. CHF 6,000, expected to take effect from 1 January 2017. Yet to be confirmed by the canton’s parliament.
Zurich: max. CHF 6,000, expected to take effect from 1 January 2018. Yet to be confirmed by the canton’s parliament.
Globalization, increasing opportunities in developing countries and an urgent need for talent are just some of the factors that have driven the huge rise in international business travel over the last two decades.

With stricter cross-border tax and social security regulations, tightening immigration controls and the emergence of increasingly transformational workplace technology, business travel is now a key strategic topic for many organizations to discuss. Furthermore, as the OECD's final recommendations for the Base Erosion and Profit Shifting Action Plan begin to come into force, organizations are being pushed towards greater transparency on their global business activities, not excluding their business traveler population.

Just as the implications associated with business travelers are multifaceted, the responsibility of managing this population is often spread across several functions, whether that being Finance, Tax, Human Resources, Risk or Executive Operations. How to categorize and manage these mobile individuals is therefore a key question for many organizations. 76% of EY's 2015 Global Mobility Effectiveness Survey participants stated that they either have a formal policy in place to manage short term business travel, or intend to implement one. Participants also confirmed that this population was their number one area of concern in their broader People Agenda, emphasizing the growing importance of this topic.

Despite implementing business travel policies, organizations are still facing the challenge of maintaining a real-time overview of their business traveler populations. Capturing accurate data is one of many barriers to effectively monitoring this group of individuals, as well as having considerably limited internal resources to dealing with such a project. Whilst having a proactive, cross-functional approach will certainly help put a company in a better position to address the challenges associated with their business travelers, questions around initial operational set-up and ongoing case management remain on the table.

What is clear however, is that organizations will reap the benefits from actively managing this population. Indeed, it is through this initial data collection that companies can gain valuable insights into their own employees, which can in turn be used for internal projects and HR strategy setting, including global workforce planning, mobility program optimization, talent management and cost forecasting; all of which go far beyond regulatory compliance.

However, is it realistic to say that it is only business travelers who are creating a headache for organizations in the global workforce landscape? Or rather should we be extending the discussions to the broader internationally mobile groups and asking ourselves how organizations can structure their People Agenda in a time of an increasingly digital and monitored economy? Given the ongoing regulatory drive and constant need for data collection on a global scale, it surely will be (or rather already is) the latter.

Is this the final call for the cross-border business traveler? Or is this the beginning of a perfect storm...
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