Dear reader

On 6 September 2017, the Swiss Federal Council initiated the consultation on the revised corporate tax reform (tax proposal 17) with the aim to submit the dispatch to the Swiss Parliament in spring 2018. The corporate tax reform is intended to establish a sustainable, internationally accepted and competitive corporate tax system.

Moreover, the Swiss Federal Tax Administration stated its position on the effects of the Automatic Exchange of Information on voluntary disclosures made after 31 December 2017.

In this issue of our quarterly newsletter we will inform you about these and some further important tax developments.

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Federal Council initiates consultation on tax proposal 17

On 6 September 2017, the Federal Council initiated the consultation on tax proposal 17 (TP17). The consultation will run for three months. The Federal Council is planning to submit the dispatch for Parliament in spring 2018. Consequently, TP17 will enter into force no earlier than 2020.

The draft consultation paper is based to a great extent on the cornerstones of TP17 as published in June 20171. The objective of the proposed tax reform remains to ensure that Switzerland continues to offer a sustainable, internationally accepted and competitive corporate tax system. In the following, we will briefly comment on the key tax measures involved.

Abolition of privileged tax regimes

The privileged tax regimes as currently in force are no longer in accordance with international standards. This may cause legal and planning uncertainties for the affected companies. Therefore, the abolition of cantonal tax privileges for domiciliary, mixed and holding companies is the pivotal element of TP17. At federal level, the taxation practices for principal companies and finance branches shall be set aside at the same time.

Transitional rules for privileged tax regimes

In connection with the phasing out of existing preferential tax regimes, disclosure of non-taxed hidden reserves including built-in gains will be available. In order to avoid excess taxation, the transitional rules provide for a special tax rate for a period of five years. Cantons will determine the applicable special tax rate. Further, cantons are free to introduce the respective measures prior to entry into force of TP17.

Alternatively, companies subject to a privileged tax regime may tax-neutral step-up their hidden reserves followed by a tax-effective amortization prior to entry into force of TP17.

Patent box

Profits generated from patents and comparable rights shall be separated from other profits and subject to reduced taxation through the mandatory introduction of a patent box at cantonal level. The maximum level of permissible tax relief has been set at 90%. The patent box will only be available at cantonal level.

Compared to Corporate Tax Reform III (CTR III), the proposed legislation is more narrowly defining what types of patents and comparable rights qualify for patent box taxation. In particular, non-protected inventions of SME and copyright protected software will not be included in the patent box.

Several European states are already applying the patent box instrument. It meets the OECD requirements2 regarding the so-called modified nexus approach. It meets the OECD requirements2 regarding the so-called modified nexus approach. Pursuant to this approach, profit derived from qualified rights may be subject to privileged taxation only at the the ratio of the tax payer’s domestic expenditures for Research and Development (R&D) to its overall R&D expenditures (so-called nexus quota).

For practical reasons, when calculating the qualifying profit in relation to products, the residual method applies. The residual method will start from either the profit from a specific product or an enterprise’s total profit. Thereafter, all parts of the profit, which are not derived from patents and comparable rights, will be deducted from the patent box and ordinarily taxed. The remaining profit within the patent box will then be further reduced by the trade mark costs alongside a lump sum deduction of 6% of the product related cost. The resulting net profit will be multiplied with the above mentioned nexus quota and subject to tax reduction.

Prior to the first application of the patent box, the relevant R&D expenditure of the preceding ten years will have to be taxed at ordinary rates.

R&D super deduction

With TP17, cantons would have the option to introduce an increased expense deduction for domestic R&D performed directly or through third parties. Such super deduction is limited to 50% of qualifying R&D expenditures.

For practical reasons, R&D super deduction is limited to personnel expenses. A lump sum deduction of 35% is added to compensate for further R&D expenses.

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Notional interest deduction

Following up on the discussions surrounding the referendum vote on the CTR III, the criticized notional interest deduction (NID) on surplus equity is not included in TP17.

Restriction of overall tax relief

The overall tax relief provided by the tax reduction measures may not go beyond a maximum of 70% of an entity’s taxable profit. Restriction of overall tax relief applies to R&D super deduction, patent box and amortizations relating to the step-up upon exit from privileged taxation. Cantons may enact a stricter limitation.

Capital tax

Some cantons are already crediting corporate income tax against capital tax. TP17 shall provide cantons additionally with the option to reduce the capital tax on qualified participations as well as patents and comparable rights. The same reduction would not be available for intragroup loans.

Increased taxation of dividend income for individuals

In order to reduce economic double taxation, dividend income of individuals from qualifying participations is currently partially exempt from taxation. The ratio subject to taxation for individuals shall be raised to 70% at the federal level and at least 70% at the cantonal level under TP 17 (i.e., individuals shall only benefit from a maximum exemption of 30%). This change for shareholders is directly related to the expected reduction of corporate income tax rates.

Increased family allowances

For (socio)political reasons, the monthly minimum amount for child and education allowances shall be increased by CHF 30 to CHF 230 and 280 respectively. The resulting additional cost would have to be covered by the employer. Therefore, this measure compensates for the expected reduction of corporate income tax rates.

Increased share in direct federal tax revenue

TP17 envisages to increase the cantonal share in the direct federal tax revenue from 17% to 20.5%. CTR III had aimed at a raise to 21.2%.

General tax rate reductions

The reduction of cantonal income tax rates is not part of TP17. However, most cantons plan to reduce their corporate income tax rate as a reaction to the abolishment of cantonal privileged tax regimes.

Conclusion

TP17 is addressing the issues discussed in the context of the declined CTR III and provides for less tax reductions and at the same time higher financial compensation.

To successfully implement the tax proposal, the reduction of cantonal income tax remains crucial. Cantons are called upon to communicate as soon as possible their plans to implement TP17.

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3 Taxable profit prior to reductions before offsetting tax loss carry forwards and excluding net participation income from qualified participations.

4 The economic double taxation derives from income tax levied, first, at the level of the corporation and, second, on dividend income at the level of the individual.
Effects of Automatic Exchange of Information on voluntary disclosures

In 2018, Switzerland will start executing the Automatic Exchange of Information (AEOI) since it will, for the first time, be transmitting to other countries the data collected from Swiss financial institutions in 2017, and also receiving from those countries information on the financial assets held outside Switzerland by Swiss taxpayers. The question has arisen as to what impact AEOI will have on Swiss taxpayers’ right to regularize their tax position by disclosing unreported income and wealth to their cantonal authorities.

On 15 September 2017, the Swiss Federal Tax Administration (SFTA) stated its position on the subject by publishing for the first time a position on the effects of AEOI on voluntary disclosures made after 31 December 2017. As the SFTA’s information document was drawn up in collaboration with the “fiscal criminal law” working group of the Swiss Tax Conference (CSI/SSK), it can be assumed that the cantonal tax administrations, which are responsible for handling voluntary disclosures, will follow these principles.

1. Information exchanged within a defined timeframe

In line with the commitment entered at international level, Swiss financial institutions have, since the start of 2017, been collecting bank account data (account number, name, address, date of birth, investment income and account balance) for the purpose of sharing these, from 2018 onwards, with those countries with which it has concluded a corresponding agreement. Starting 2019, the exchange will be extended to other countries and territories (the Swiss Parliament is currently additionally considering exactly which countries to enter into such agreements).

2. A unique opportunity for Swiss taxpayers to regularize their situation without incurring any penalty

Under the arrangements for non-punishable voluntary disclosure in place with effect from 1 January 2010 at federal, cantonal and communal level, Swiss taxpayers have the opportunity once in their lives to disclose income and assets not previously mentioned in their tax returns without incurring any fine or other criminal sanction, which would normally apply to additional tax assessments. Hence, the consequences of such voluntary disclosure are limited to payment of the additional tax with respect to the last ten years and to the resulting interest, if the following conditions are met:

- The evasion was not known to any tax authority;
- The taxpayer cooperates unconditionally with the authority in determining the amount of the tax assessment;
- The taxpayer endeavors to pay the amount of tax assessed; and
- It is the taxpayer’s first voluntary disclosure.

This right to regularize their tax position without penalty is accorded to taxpayers once only, and any subsequent voluntary disclosure will incur a fine. The fine for such a subsequent disclosure may, however, be reduced to one-fifth of the tax evaded if the first three of the conditions mentioned above are again met.

3. Effects of AEOI on voluntary disclosures

As the automatic exchange of information relating to 2017 takes effect from 1 January 2018, the SFTA announced on 15 September 2017 that:

- It is for the competent cantonal tax administration to judge whether the voluntary disclosure meets the conditions in law for the non-applicability of a penalty.
- The same cantonal administration is to judge whether the disclosure is voluntary on the basis of whether it already had any knowledge of the tax elements concerned.

1 The European Union (EU), Australia, Canada, Guernsey, the Isle of Man, Iceland, Japan, Jersey, Norway, and South Korea.

2 The AEOI agreement with the EU is binding on its 28 Member States and also applies to the Åland Islands, the Azores, the Canary Islands, French Guiana, Gibraltar, Guadeloupe, Madeira, Martinique, Mayotte, Réunion and Saint-Martin.

3 Andorra, Antigua and Barbuda, Argentina, Aruba, Barbados, Belize, Bermuda, Brazil, the British Virgin Islands, Chile, China, Colombia, Costa Rica, Curaçao, the Cayman Islands, the Cook Islands, the Faroe Islands, Greenland, India, Indonesia, Israel, Liechtenstein, Malaysia, the Marshall Islands, Mauritius, Mexico, Monaco, Montserrat, New Zealand, Russia, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, San Marino, Saudi Arabia, Seychelles, Singapore, South Africa, the Turks and Caicos Islands, the United Arab Emirates and Uruguay.
However, those tax elements to which the AEOI applies will to be known to cantonal administrations by 30 September 2018 at the latest. It follows that disclosures will not be regarded as voluntary after that date.

To sum up, it will no longer be possible to make a non-punishable voluntary disclosure in relation to foreign bank and investment accounts from the moment at which information about a taxpayer has reached the SFTA by way of AEOI, but in any case no later than 30 September 2018.

It follows from this that it will no longer be possible for the condition specified in Art. 175, para. 3 (a) and Art. 181a, para. 1 (a) of the FDTA, namely that no other tax authority shall have had knowledge of the relevant assets, to be met. Therefore, any disclosure made after 30 September 2018 in relation to assets held in jurisdictions with which Switzerland has agreed a starting date of 1 January 2017 for AEOI will necessarily attract a fine calculated as in a case of tax evasion by reference to the degree of misconduct involved, which may amount to anything between one-third and three times the amount of tax evaded.

Likewise, it logically follows that any voluntary disclosure in relation to assets held in jurisdictions with which Switzerland agrees a starting date of 1 January 2018 for AEOI will also necessarily incur a fine.

Finally, two exceptions must be noted: (1) only assets held in bank accounts are subject to the AEOI. Not covered are information on tangible assets located abroad (such as real estate, works of art, etc.). (2) this SFTA position, and the date of 30 September 2018, does not apply to the voluntary disclosure of assets held in Switzerland by Swiss taxpayers, as such assets are not reported under AEOI (a purely domestic situation).

4. How will voluntary disclosures made after 31 December 2017 be treated?

There is no change to the law regarding voluntary disclosures. In other words, it will still be possible to make disclosures after 1 January 2018, but subject to the risk of their not being recognized as voluntary if the country in which the assets disclosed are located has already sent the Swiss authorities information about the taxpayer before the latter made the disclosure.

As for bank accounts and investment income created after 2017 in states applying the AEOI after 2017, this rule will be applicable by analogy with effect from 30 September of the year during which the relevant information is first exchanged.

5. Simplified additional assessment for heirs

The SFTA communication makes no mention of the simplified additional assessment for heirs provided for by Art. 153a FDTA (estate voluntary disclosure). This states that in the case of an estate with unpaid or undeclared tax liabilities, the additional tax assessment for heirs is limited to the three tax periods preceding the death of the deceased. Since the conditions for such simplified additional assessment are the same as those applicable to the non-punishable voluntary disclosure, the probability is that taxpayers will also no longer be able to avail themselves of this procedure in respect of assets abroad after they have been notified to the Swiss authorities by way of the AEOI, but at the latest after 30 September of the year during which such information is communicated.

6. Comments and recommendations

The precise details of the timetable for the communication of information from countries with which the AEOI is already in force are not known. It would therefore seem risky to rely only on the date of 30 September 2018 and to delay a voluntary disclosure until then. In view of the above and for the sake of prudence, we recommend that potentially affected taxpayers should regularize their tax situation with the Swiss tax authorities before 31 December 2017.

It must nevertheless be borne in mind that the SFTA communication is not a legally binding directive and that the courts may be asked to rule on certain matters not mentioned in it (for example on the case of information forwarded by a state after 30 September of the year in question; on information that should have been reported but was not, on the requirement in law that the cantonal tax administration show that it has actually had knowledge of the information concerned; or in the event of a cantonal administration taxing a taxpayer on income or assets for the previous year without taking into account information received by way of the AEOI, etc.).

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4 The date specified in the Multilateral Competent Authority Agreement on AEOI, Section III ch. 3.
5 Federal Direct Tax Act.
Switzerland signs Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS

On 7 June 2017, Switzerland and 67 other jurisdictions signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the MLI) during a signing ceremony hosted by the Organisation for Economic Cooperation and Development (OECD) in Paris. In the meantime, three other jurisdictions signed the MLI.

At the time of signature, Switzerland submitted a list of 14 tax treaties that it would like to designate as Covered Tax Agreements (CTAs), i.e., tax treaties to be amended through the MLI. Together with the list of CTAs, Switzerland also submitted a provisional list of reservations and notifications (MLI positions) in respect of the various provisions of the MLI. The definitive MLI positions will be provided upon the deposit of its instrument of ratification of the MLI.

Since it has been announced that a public consultation in Switzerland will begin at the end of 2017, entry into force is not anticipated prior to 2019.

Detailed discussion

Background

The text of the MLI and explanatory notes were released on 24 November 2016 as a measure of the OECD’s Base Erosion and Profit Shifting (BEPS) Action Plan (Action 15).

Switzerland’s Covered Tax Agreements

As one of the 68 early signatories, Switzerland has submitted a list of 14 tax treaties that it wishes to designate as CTAs, i.e., to be amended through the MLI. All 14 identified jurisdictions have also signed the MLI and in turn declared their tax treaties with Switzerland as CTAs.

In line with its policy of implementing only the minimum standards of the BEPS Action Plan, Switzerland expressed reservations on the majority of the articles of the MLI.

Different from all other signatories, Switzerland made a general reservation that it might choose to implement the BEPS minimum standards by way of bilateral renegotiations of its tax treaties instead of the mechanisms introduced by the MLI.

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1 For more background on the global significance of the MLI signature, see EY Global Tax Alert, 68 jurisdictions sign the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, dated 7 June 2017.

2 Cameroon, Mauritius, Nigeria.

3 See EY Global Tax Alert, OECD releases multilateral instrument to implement treaty related BEPS measures on hybrid mismatch arrangements, treaty abuse, permanent establishment status and dispute resolution, dated 2 December 2016, for a more detailed analysis of the MLI related BEPS measures.

4 Andorra, Argentina, Armenia, Austria, Belgium, Bulgaria, Burkina Faso, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Fiji, Finland, France, Gabon, Georgia, Germany, Greece, Guernsey, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Monaco, Netherlands, New Zealand, Norway, Pakistan, Poland, Portugal, Romania, Russia, San Marino, Senegal, Serbia, Seychelles, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom and Uruguay.

5 For a detailed discussion of the structure and information on the individual provisions, see EY Global Tax Alert, Signing by 68 jurisdictions of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS highlights impacts for business to consider, dated 14 June 2017.

6 Argentina, Austria, Chile, Czech Republic, Iceland, Italy, Liechtenstein, Lithuania, Luxembourg, Poland, Portugal, South Africa and Turkey.
**MLI provisions**

1. Hybrid mismatches

Articles 3 to 5 of the MLI introduce optional provisions aimed at neutralizing certain effects of hybrid mismatch arrangements (BEPS Actions 2 and 6).

Switzerland has reserved the right for Articles 3 (Transparent entities) and 4 (Dual Resident Entities) not to apply to its CTAs.

Article 5 includes three options as methods for the elimination of double taxation in the case of hybrid mismatches. Switzerland notified to apply to its residents the switch-over clause (option A). Under the switch-over clause, provisions of a CTA that would otherwise exempt income derived or capital owned by a resident of a Contracting Jurisdiction do not apply where the other Contracting Jurisdiction applies the provisions of the CTA to exempt such income or capital from tax or to limit the rate at which such income or capital may be taxed. Instead, a deduction from tax is allowed subject to certain limitations.

Under option B, Contracting Jurisdictions would not apply the exemption method with respect to dividends if those dividends are deductible in the other Contracting Jurisdiction. Option C includes that the credit method should be restricted to the net taxable income. Contracting Jurisdictions may choose different options resulting in an asymmetrical application of this provision. Switzerland reserved its right not to permit the application of option C to the residents of its CTA Counterparties. This reservation will affect the CTAs with Argentina, Poland and Portugal.

2. Treaty abuse

Articles 6 to 13 of the MLI contain provisions related to the prevention of treaty abuse (BEPS Action 6). Articles 6 and 7 set out the “minimum standard” aimed at ensuring a minimum level of protection against treaty shopping.

**Article 6 - Purpose of a CTA**

Article 6 changes the preamble language of a CTA to expressing the common intention to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Switzerland did not express any reservations on Article 6 and decided to add optional wording to the preambles of its CTAs, referring to the desire to develop an economic relationship or to enhance cooperation in tax matters.

**Article 7 - Prevention of Treaty Abuse**

Article 7 articulates the Principal Purpose Test (PPT), a minimum standard which must be adopted by all MLI signatories, and which Parties are allowed to supplement by electing to apply a simplified Limitation on Benefits (LOB) provision in addition.

Switzerland notified the respective provisions in its CTAs but did not make an explicit choice. Thus, the PPT will apply as the minimum standard and default option.

Since Article 7 requires reciprocity between the contracting jurisdictions to a CTA, a jurisdiction that opted for the PPT in combination with a simplified LOB (e.g., India) cannot apply the simplified LOB in relation to a CTA that opted for a PPT only (e.g., Switzerland).

Furthermore, Switzerland has reserved the right for Articles 8 to 11 (specific anti-abuse rules on dividend transfer transactions, capital gains, permanent establishment (PE) in third jurisdictions as well as a saving clause to preserve the rights to tax its own residents) not to apply to its CTAs.

3. Avoidance of PE status

Switzerland has reserved its right not to apply any of the provisions regarding the avoidance of PE status (Articles 12 - 15).

4. Dispute resolution

Articles 16 and 17 aim to introduce the minimum standards for improving dispute resolution (BEPS Action 14) and a number of complementing best practices.

Article 16 of the MLI requires countries to include in their tax treaties the provisions regarding the Mutual Agreement Procedure (MAP) as described in the OECD Model Tax Convention.

In particular, an agreement reached within the MAP shall be implemented notwithstanding any time limits foreseen by domestic law in the respective jurisdictions. Switzerland reserved its right not to apply this part of Article 16. As an
alternative, Switzerland will meet the minimum standards by agreeing in its tax treaties on the maximum period of time during which jurisdictions can make adjustments to the profits of domestic taxpayers.\textsuperscript{13} The purpose of this provision is to ensure the availability of relief by the MAP.

**Article 17 - Corresponding adjustments**

This provision is meant to apply in place of or the absence of provisions in CTAs that require a corresponding adjustment where the other treaty party makes a transfer pricing adjustment.

Article 17 of the MLI applies “in place of or in the absence of” an existing provision. Article 17 is not a provision required to meet a minimum standard and therefore jurisdictions can opt out of this article entirely. However, BEPS Action 14 minimum standard requires that jurisdictions provide access to the MAP in transfer pricing cases and implement the resulting mutual agreements regardless of whether the tax treaty contains a provision dealing with corresponding adjustments. In light of this, a Party may reserve the right not to apply Article 17 of the MLI on the basis that in the absence of a corresponding adjustments provision, either (i) the Party making the reservation will make the corresponding adjustment as described in Article 17 of the MLI or (ii) its competent authority will endeavor to resolve a transfer pricing case under the MAP provision of its tax treaty.

Where one Contracting Jurisdiction to a CTA makes a reservation and notifies a CTA as being within the scope of the reservation but the other Contracting Jurisdiction does not, Article 17 of the MLI will not apply to the CTA.

In the case of Switzerland, its current CTAs with Austria and Italy do not contain a corresponding adjustment provision. Since neither Switzerland nor Austria or Italy made a reservation, the MLI introduces such provision into the Swiss CTAs with Austria respectively Italy.

Switzerland notified the existing provisions on transfer pricing adjustments in its other twelve CTAs, without any reservation. Five Contracting Jurisdictions did also not make a reservation\textsuperscript{14}, which means that the corresponding adjustment provision of the MLI replaces the existing provisions of the CTAs between these jurisdictions and Switzerland.

Out of the seven Contracting Jurisdictions who made a reservation\textsuperscript{15}, India and Poland did not notify the CTA with Switzerland as being within the scope of the reservation, and hence there is a mismatch in the notifications. Since Article 17 MLI is a provision that applies in place of or in the absence of an existing provision, the MLI provision would still apply to the CTAs with India and Poland to the extent of incompatibility.

### 5. Mandatory binding tax arbitration

Articles 18 to 26 of the MLI enable countries to include mandatory binding treaty arbitration (MBTA) in their CTAs in accordance with the special procedures provided by the MLI.

Currently, 25 countries, including Switzerland,\textsuperscript{16} have committed to adopting and implementing MBTA in their CTAs.

Switzerland reserves the right to replace the two-year period provided by Article 19 of the MLI\textsuperscript{17} to resolve a case by mutual agreement between the competent authorities within a three-year period. Switzerland did not comment on Articles 20 to 23 of the MLI (relating to procedural matters of MBTA), however, an explanatory statement by the OECD on Article 24 of the MLI notes that:

*In an arbitration procedure, the “final offer” approach will generally apply. Under this approach, the competent authorities of each jurisdiction submit a proposed resolution to a given case.\textsuperscript{18} One of these resolutions will be adopted by an arbitration panel by simple majority. As an alternative, parties may opt for the “independent opinion” approach. Under this approach, each competent authority provides to the arbitration panel any information necessary for the panel to adopt its decision.\textsuperscript{19}*

Article 24(2) of the MLI allows the competent authorities to depart from the arbitration decision and to agree on a different resolution within three calendar months after the decision has been delivered to them. Switzerland reserves the right to apply Article 24(2), but only with respect to its CTAs for which the

\begin{itemize}
\item \textsuperscript{12} MLI position of Switzerland on Article 16.
\item \textsuperscript{14} Argentina, Lithuania, Luxembourg, Portugal, South Africa.
\item \textsuperscript{15} Chile, Iceland, India, Liechtenstein, Poland, Turkey reserved not to apply Article 17 to already existing provisions. Czech Republic will not apply Article 17 MLI directly but renegotiate its DTTs with respect to corresponding adjustments.
\item \textsuperscript{16} Andorra, Australia, Austria, Belgium, Canada, Fiji, Finland, France, Germany, Greece, Ireland, Italy, Liechtenstein, Luxembourg, Malta, the Netherlands, New Zealand, Portugal, Singapore, Slovenia, Spain, Sweden, Switzerland and the United Kingdom.
\item \textsuperscript{17} Article 19(1)(b) MLI.
\item \textsuperscript{18} Explanatory Statement, paragraph 242.
\item \textsuperscript{19} Explanatory Statement, paragraphs 245-247.
\end{itemize}
above-mentioned “independent opinion” approach applies. The reason for not applying Article 24(2) of the MLI to final offer arbitration is that in such a case, the panel’s decision will be the position of one of the competent authorities and it will, thus, be unlikely that both authorities would agree to depart from the decision.20

Implications

In light of Switzerland’s selection of only 14 jurisdictions out of over 90 Swiss tax treaties and of the numerous reservations, the impact of the MLI on Switzerland’s tax treaty network will be limited. However, the early signature may be interpreted as an expression of Switzerland’s commitment to the BEPS Action Plan. Further, Switzerland’s adoption of the MBTA is evidence of its best efforts to resolve disputes involving other Contracting Jurisdictions as efficiently as possible.

The MLI will enter into force after five jurisdictions have deposited their instrument of ratification. With respect to a specific tax treaty, the measures will only enter into effect after both parties to the treaty have ratified the MLI and a specified time has passed. Given that public consultation is foreseen to begin at the end of 2017, entry into force for Switzerland is anticipated no earlier than 2019.21

20 Explanatory Statement, paragraph 253.
In a world of increased transparency in tax matters, Multinational Enterprises (MNEs) must be aware that there are only few limits to the scope of information that tax authorities may request to investigate transfer prices. Information requested may go well beyond the information already included in the transfer pricing documentation, which makes a coherent and consistent structuring of intercompany transactions a key priority.

**Summary of Supreme Court Decision of 13 February 2017 (2C_411/2016)**

Following a so-called business restructuring (Chapter IX OECD-Guidelines; business restructurings) of a multinational group into Switzerland, French tax authorities sent a request for information to the Swiss Federal Tax Administration (SFTA) on the basis of the information exchange procedure foreseen in art. 28 para 1 of the Double Tax Treaty (DTT) between France and Switzerland¹, asking for various documents to assess the transfer prices between Swiss and French group entities (e.g. regarding the nature of activities, substance in Switzerland, tax charge and tax status including the submission of tax rulings the Swiss taxpayer has). Despite the objections of the taxpayer, the Swiss Supreme Court considered the information request to be (1) foreseeably relevant (notwithstanding a transfer pricing study available to the French tax authorities); (2) well founded and in line with the principle of good faith; and (3) not constituting a fishing expedition. The Court discussed the criteria of ‘foreseeable relevance’ of tax information requests in detail, referring to the OECD Model Tax Convention and its commentaries, and deemed the conditions under which tax authorities may reasonably request information to be fulfilled if at the time of filing the request there is a reasonable possibility that the information requested will turn out to be relevant under the conditions of art. 28 and can be denied only if a connection between information requested and tax investigation seems implausible. This first important decision of the Court concerning the interpretation of the term foreseeably relevant in a transfer pricing context sheds light on the future approach of Swiss public administrations in the post-BEPS² world of increased transparency.

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¹ Convention between the French Republic and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital (as of 9 September 1966).

² Base Erosion and Profit Shifting project launched by the OECD in 2013 and resulting in the BEPS Action Items crystalized in fifteen reports addressing the general objective of aligning the attribution of profits with value creation.
Critical considerations of the Supreme Court Decision

It is accepted that existing tax rulings should per se not influence the pricing of intercompany transactions; i.e., as long as the tax payer can substantiate the arm’s-length character of the intercompany pricing applied the level of taxation in the other country should not be relevant (provided substance is given). It is to be assumed that the transfer pricing documentation filed by the French taxpayer documented that the transfer prices applied were in line with the arm’s length principle. The circumstances of the case do not indicate that it may have been insufficient, at least. In the case at hand, the French government analyzed to which extent the French Controlled Foreign Corporation (CFC) rules apply for the transactions between the French and Swiss taxpayers. The French CFC rules apply to low tax foreign recipients unless this income is generated through an industrial or commercial activity and - under additional circumstances - the taxpayer can prove that the objective of the entity located in the low-tax jurisdiction is other than taking advantage of the privileged tax regime for the income generated there. This raises the question to which extent the French request was indeed well founded and not a fishing expedition. Based on the facts of the case the Swiss Principal company maintained an active business and was not merely a conduit entity. The arm’s length nature of inter-company transactions has been substantiated based on an extensive transfer pricing study. Hence it is rather questionable for what purpose the tax rulings are of relevance for the French tax authorities in case the CFC rules do not apply.

Certainly, we see in practice that many countries are keen to obtain information about existing tax rulings Swiss taxpayers have. However, as long as they are not foreseeably relevant for the tax assessment in the other jurisdiction the Exchange of Information Article of the relevant tax treaty cannot serve as a legal basis for such exchange. Unfortunately the decision is silent on such aspect and only refers, without any further challenge, to the existence of the French CFC rules.

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4 Switzerland signed the Mutual Assistance Convention (MAC) and issued the Tax Administrative Assistance Ordinance, which came into effect on 1 January 2017. This will oblige the SFTA to spontaneously exchange tax ruling information with foreign tax authorities as of 1 January 2018. In connection with the spontaneous exchange of information certain general information about the ruling (such as the company name, the type of tax ruling, the tax periods for which a tax ruling is applicable) as well as a short summary of the ruling will be exchanged. However, as in the past the ruling itself may still be exchanged upon request based on a double tax treaty or by virtue of Master File / Local File requirements set out in BEPS Action 13.

Practical Implications for MNEs

A number of conditions must be met by tax authorities to reasonably request information: it must be foreseeably relevant and motivated (i.e. not constituting a fishing expedition) and covered by an information exchange provision under the applicable DTT. The recent Swiss Supreme Court decision cited above highlights that the term information is to be interpreted broadly and may include information in relation to financial data, preferential tax regimes, local substance, amongst others. Such interpretation is in line with the OECD Commentary on article 26, paragraphs 2 and 5 and a general trend towards increased transparency in tax matters. Most importantly, this case shows that the criteria of foreseeable relevance does not effectively limit the extent of the information that potentially needs to be provided.

The SFTA simply needs to verify whether all information requested by foreign tax authorities is indeed relevant (i.e. has a link with the facts) to the tax matters under investigation. However, based on the principle of faith, it must basically rely on the assessment of the relevance by the other contracting state and is generally bound to a comprehensive exchange of information that can only be limited to the extent that any link between requested information and investigation seems implausible. A transfer pricing documentation would not limit the scope of information that may be requested under the applicable DTT provisions in order to investigate a transfer pricing aspect. It is interesting that the Court did not discuss at all to which extent the transfer pricing documentation the taxpayer provided to the French tax authorities provided sufficient information for the tax auditors and thus limiting the scope of the information request.

For MNEs, this implies that a standard transfer pricing documentation may not be sufficient to satisfy the information needs of local tax authorities with the consequence that the wide interpretation of the term foreseeable relevance is expected to lead to an extensive exchange of information in transfer pricing cases.
Ruling of the Zurich Administrative Court concerning corporate cash pooling

Cash pooling has been under scrutiny by the Swiss tax authorities for quite some time. On the one hand, the tax authorities have increasingly challenged the distinction between cash pool receivables and long-term loans. On the other hand, there are outstanding questions concerning the acceptance of applied intragroup interest rates from a tax perspective. The Administrative Court of the Canton of Zurich tried to clarify these aspects in its final judgment of 7 December 2016.

Facts

A Ltd. which is tax resident in the canton of Zurich is a subsidiary of the multinational group B. The B Group has a finance company (C Ltd.) based in the UK. C Ltd. is responsible for global treasury and the management of the global cash pool of the B Group. According to the group-wide cash pooling agreement, cash pool receivables were interest bearing at the one-month LIBID rate (London Interbank Bid-Rate) minus 6.25 basis points, however at least 0.05%. As of 31 March 2010, A Ltd. had cash pool receivables with C Ltd. that amounted to approximately 70% of its total assets. As of 31 March 2011, this ratio further increased to around 84%.

Additionally, A Ltd. would have had the possibility to deposit funds with C Ltd. for a longer period and earn higher interest rates accordingly. In such case, A Ltd. would have received interest rates of about 0.6% (fiscal year 2009/10) and 0.4% (fiscal year 2010/11). These interest rates were slightly lower than the interest rates offered by two commercial banks for time deposits with a term of 12 months.

A Ltd. was then subject to a tax audit of the Zurich tax administration and the tax inspector argued that a portion of the cash pool receivable had to be treated, from an economic perspective, as a long-term loan bearing higher interest rates. The requalification of the cash pool receivable into a long-term loan was made based on the minimum cash pool receivable balance of each fiscal year. Initially, the tax inspector applied a Libor based interest rate on the requalified loan balance.

During the appeals process, however, this amount was – to the disadvantage of the taxpayer – further increased to the higher „Safe Haven Rates“ according to the annual circular letters published by the Swiss Federal Tax Administration (SFTA).

The Tax Appeal Court of the Canton of Zurich largely confirmed the decision of the tax administration. However, it reduced the applicable interest rate for the calendar year 2011 from 2.25% to 2.00%. The Tax Appeal Court argued that the SFTA had unreasonably deviated from its longstanding method when determining the 2011 safe haven interest rate, so that the 2.25% mentioned in the circular letter were too high.

A Ltd. appealed against the decision of the Tax Appeal Court of the Canton of Zurich and brought the case up to the Zurich Administrative Court. In its decision of 7 December 2016 (SB.2016.00008), the Administrative Court ruled as outlined below. The judgment has not been brought up to the Swiss Supreme Court and is therefore a final decision.

Distinction between cash pool receivables and mid- or long-term loan receivables

In its evaluation of the distinction between cash pool receivables and mid- or long-term loan receivables, the Administrative Court refers to the liquidity grade 2 (so-called “quick ratio”) put forward by the previous instances. This liquidity ratio amounted to 2,3 : 1 respectively 3 : 1 for A Ltd. during the years in question whereas business and accounting doctrine assumes a minimum ratio of 1 : 1. This fact shows, according to the Court’s ruling, that the liquid assets of A Ltd. were substantially higher than the minimum liquidity that is normally required in practice. Furthermore, the Administrative Court noted that the receivables deposited with C Ltd. constituted a cluster or non-diversified risk. A (commercial) cluster risk exists according to the Supreme Court’s jurisprudence when an unsecured loan amounting to at least 60% of the lender's assets is granted to a single borrower. In addition, A Ltd. had only minimal liquid assets outside the cash pool.

The Administrative Court also refused the argument of A Ltd. that it had planned to use these liquid assets to fund substantial business expansions during both years. The Court said that occasional larger acquisitions and investments are normal for all companies and that in case of additional liquidity requirements, A Ltd. would have had the opportunity to borrow funds at short notice within the group.

Based on the overall circumstances, the amount of the assets invested in the cash pool did not comply with the arm’s length principle according to the Administrative Court. In this respect, it was correct to requalify a portion of the cash pool receivable into a mid- or long-term loan.

Determination of the requalified amount

Concerning the precise amount that needs to be reclassified into a mid- or long-term loan, the Administrative Court makes a few interesting observations but finally refers the case back to the lower instance.
Initially, the Administrative Court states that the assessment of the precise amount is finally an estimate. The Administrative Court also believes that the minimal balance during the year could be reasonable, at least at first sight. However, this approach has one significant disadvantage as it represents a retrospective view whereas the preparation of a professional financial plan is a forward-looking exercise. Additionally, a company should be allowed, to a certain extent, to plan with higher liquidity needs than it subsequently effectively requires. In this respect, a range reflecting planning uncertainty needs to be taken into account. Making the requalification solely on a retrospective basis based on the minimum balance of each year would constitute an exceeding of the discretionary power of the fiscal authorities which could not be accepted by the judicial authorities.

Concerning the determination of a range or margin, the simple average of the cash pool receivable balance at the beginning and closing of the fiscal year could be taken as a starting point according to the Administrative Court. In a second step, it appears appropriate to take the planning aspect into account with a reasonable discount that is applied on the average balance in step 1. In a third step, the same discount could be deducted from the minimum balance of each year. The Administrative Court did not conclude on the appropriate margin (5%, 10% or for example 20%). This question was referred back to the lower instance. It will be interesting to see how the tax administration of Zurich will deal with this task.

Applicable interest rate on the requalified long-term loan

Concerning the applicable interest rate on the de facto and for fiscal purposes requalified long-term loans, the Administrative Court refers to the Supreme Court's view in the “Bellatrix” case (BG 107 1b 325 = ASA 51 [1982/83], p. 546) that the taxation of a “target gain” is against the law. According to the decision of the Administrative Court, the fiscal authorities are not entitled to make business decisions and to decide which efforts and actions a company should have undertaken to realize higher profits or to avoid a loss. A company needs to be entitled to invest its funds into investments providing a low return or even being unprofitable as long as this investment approach does not qualify as a deemed dividend distribution. Taking this into account, the tax authorities cannot in every case refer to the “Safe Haven Rates” that are published in the annual SFTA circulars as these interest rates are based on bonds with a (very) long maturity. The tax authorities cannot expect a company to invest excessive funds into financial investments with a maturity of up to 10 years.

According to the facts, the interest rates of 0.6%, respectively 0.4% offered by the intra-group finance company C Ltd. for long-term loans with a term of up to 12 months were only slightly lower than the interest rates offered by two commercial banks for 12 month fixed-term deposits. According to the Administrative Court, the cantonal tax administration was not in a position to proof an obvious discrepancy between the intra-group and third party interest rates. However, such obvious discrepancy is a requirement to assume a deemed dividend distribution. As a consequence, it had to be concluded that the interest rates offered by C Ltd. for long-term intra-group loans were in line with the arm's length principle and thus had to be taken into account for the calculation of the deemed dividend distribution.

Interest rate applicable for cash pool receivables

The Administrative Court confirms the view of most tax experts and practitioners that cash pool receivables (disregarding a potential requalification into a long-term loan) are not comparable with a long-term financial investment. As a result, it is not appropriate to use the SFTA safe haven rates as a benchmark. Furthermore, considering the international implications of group-wide cash pool structures, it is often impossible to fulfill all local tax regulations of the jurisdictions that are part of such global tax pool structure. A cash pool policy that is consistently applied over several jurisdictions may therefore be commercially justifiable and in line with the at arm's length principle according to the Zurich Administrative Court.

Additionally and in view of the cash pool in question, an Advance Pricing Agreement (APA) concluded by foreign jurisdictions is not binding for the Swiss tax authorities. However, if such APA is based on the OECD Transfer Pricing Regulations, the Zurich Administrative Court believes that it should at least be an indication for the Swiss tax authorities that the interest rates used in this cash pool are in line with the arm's length principle.

Comparison with regard to the withholding tax practice

The SFTA has developed a two-step approach for withholding tax purposes as regards the potential requalification of cash pool receivables into long-term loans. In a first step, it needs to be determined whether the cash pool receivable balance was negative or at least nil during at least five consecutive business days. In such case, there is no requirement to assume the existence of a long-term loan. However, should the balance not have been negative or nil during at least five consecutive business days, the SFTA is usually requalifying the minimum balance during each tax year into a long-term loan (without considering an additional deduction as ruled by the Zurich Administrative Court). Furthermore, the SFTA usually applies the interest rates outlined in the SFTA circulars unless a company can sufficiently proof that a lower interest rate is in line with the at arm’s length principle.

Recommendation

It is strongly recommended for companies and multinational groups to regularly monitor the development of cash pool receivables and to convert a portion of the receivable into a long-term loan if necessary. Furthermore, it is of increasing importance that every company is in the possession of a comprehensive and updated transfer pricing documentation that evidences compliance with the at arm's length principle of all long- and short-term interest rates.
Depreciations and provisions

The Swiss commercial law categorizes value adjustments in depreciations, valuation allowances and provisions. While depreciations lead to final impairment, valuation allowances only concern temporary value fluctuations and provisions account for probable obligations.

The Swiss tax law does not apply the same terminology, but distinguishes merely between depreciations (Art. 62 Swiss Federal Direct Tax Act (FDTA)) and provisions (Art. 63 FDTA). The distinction is made based on the perpetuity of the value adjustment. Consequently, for tax purposes depreciations are only possible on assets, which have a final or at least an enduring impairment in value and therefore have final character. Provisions on the other hand are defined by their provisional character.

Qualification of value adjustments

Depreciations in the sense of tax law generally have final character. The only exception is made with regard to qualifying participations, since Art. 62 para. 4 FDTA explicitly permits the revaluation of previous value adjustments up to the initial cost, in case the previous value adjustments are no longer commercially justified.

Outside of the above mentioned exception, depreciations in the sense of tax law may only be reviewed by the tax authorities during the assessment of the tax period in which the depreciation was made. This means, that tax authorities cannot demand a revaluation or add up previous depreciations after the final tax assessment has been issued.

Provisions in the sense of the tax law, however, are only temporary and can thus be reviewed by the tax authorities with regard to their continuance and amount and be added-up to the taxable profit, as far as they are no longer commercially justified.

Timing of the value adjustment qualification

According to the Swiss Federal Supreme Court in its decision dated 29 September 2016 (cf. 2C_1082/2014) the tax authorities’ task in the assessment procedure is limited to adding-up commercially booked value adjustments to the taxable profit, in case the respective value adjustment is either qualified as contrary to Swiss commercial law or not commercially justified. The tax authorities however do not review, whether a commercially justified value adjustment is final or provisional at the time of the assessment, as this question has no influence on the tax factors of the respective assessment.

The Swiss Federal Supreme Court states that the determination of whether a value adjustment has final or provisional character (qualification as depreciation or provision from a tax point of view) can only be made in the tax period, in which the qualification impacts the taxable factors, the tax rate or the tax amount. An exception from this would only apply in case of a preliminary tax ruling, i.e. an explicit confirmation by the tax authorities according to which the value adjustment will be treated as a final depreciation.

Burden of proof

With regard to the burden of proof, tax authorities generally have to prove facts, which constitute or increase tax while the taxable person has to provide evidence for facts, which suspend or decrease tax.

The add-up of previous value adjustments in a later tax period (following the final assessment) constitutes a taxable event. As a consequence, tax authorities have to prove that the previous value adjustment, which had been accepted by the tax authorities in the respective tax period, is no longer commercially justified. In case such argument is successful, it is up to the taxable person to prove that the value adjustment in question is no provision within the meaning of tax law, but a final depreciation.

Considerations of the Swiss Federal Supreme Court

As long as the impairment and thus the commercial justification are undisputed at the time of the value adjustment, the tax authority is not allowed to bindingly determine whether the respective value adjustment is of provisional or final nature. A corresponding request in connection with the tax declaration is therefore legally invalid. The accounting treatment is not relevant for the qualification of a value adjustment for tax purposes.

The relevant criteria for the distinction between depreciations and provisions from a tax point of view is the perpetuity of the value adjustment. In this context the Swiss Federal Supreme Court states that value adjustments made in a tense economic state due to an unfavorable economic phase are typically of a temporary nature and thus qualify as provisional value adjustments, i.e. provisions in the sense of tax law.

Impact on real estate

Although the Swiss Federal Supreme Court ruled regarding value adjustments on participations in its decision dated 29 September 2016, the general considerations on the definition and timing
of the qualification of value adjustments as well as regarding the burden of proof can also be applied to real estate and other assets.

In this context the question arises, how the Swiss Federal Supreme Court would assess value adjustments on real estate, which occur due to market distortions or omission of rental income relating to a major renovations (extraordinary depreciations).

The present Swiss Federal Supreme Court decision generally gives tax authorities the right to also qualify real estate value adjustments as provisions from a tax point of view, allowing the tax authorities to review these value adjustments with regard to continuance and amount at any time, leading to an add-up in the taxable profit if they are no longer commercially justified.

An opportunity for such a review of value adjustments would for example be the sale of a real estate company by way of share deal, since the purchase price is an indicator for the presumed market value of the real estate.

Conclusion

With its decision dated 29 September 2016 the Swiss Federal Supreme Court adopts a restrictive position towards the qualification of value adjustments as (final) depreciations from a tax point of view and thus gives tax authorities the option to qualify value adjustments as mere provisions from a tax point of view at any time. While depreciations are characterized by their final character, provisions in the sense of the tax law can be reviewed for commercial justification at any time, and, potentially be added-up to the taxable profit. It is then up to the taxpayer to prove that in the given case no provision within the meaning of tax law, but a final depreciation is at hand.

The implementation of such a practice would lead to a considerable loss of legal certainty and planning reliability. Especially in case of share deals of real estate companies, the risk of an immediate realization of deferred taxes, which are based on value adjustments, has to be observed adequately.
German loss forfeiture rules - Newest developments in German tax law

In Switzerland, the forfeiture of losses for changes-in-ownership is, at best, the consequence of what is typically called “trading of a shell company”. In Germany, however, there are clear legal restrictions that can lead to a partial or total forfeiture of losses in case of a transfer of shares. This could limit companies with re-structuring plans. Often overlooked is the fact that indirect changes of shareholders (abroad) can trigger the effects of § 8c of the Corporate Tax Act (CTA) as well. This means that, for example, a transfer of shares at level of a Swiss top-tier company can lead to a forfeiture of losses for a subsidiary or sub-subsidiary in Germany. In the last one and a half years, the regulations have gained a bit of dynamic. The following article gives a short overview.

Harmful changes-in-ownership according to § 8c CTA

With the corporate tax reform 2008, the rule regulating the loss forfeiture in cases of company shell purchases that applied hitherto was replaced by a regulation of harmful changes-in-ownership according to § 8c CTA.

According to it, it doesn’t matter anymore if, after a change-in-ownership, a corporation carries on with or resumes its business operations with mainly new company assets. The regulation of § 8c CTA stipulates that the losses are cancelled pro-rata, regardless of changes in the business operations, if within five years more than 25% and up to 50% of the shares are transferred (harmful acquisition of stock). The transfer of shares representing more than 50% of the issued capital or voting rights leads to a total forfeiture of current and carried-forward tax losses.

With the § 8c CTA, the legislator presumed that the “identity” of a company is changed by the financial engagement of another shareholder (or shareholder ring) and that the utilization of losses obtained before the harmful change in ownership should be restricted or disallowed.

The rule was not very specific and highly disputed at its implementation in 2009, which lead to unrelenting criticism and countless legal disputes. The German legislator has since touched up on it many times – and always retroactively – and yet still has taken a battering by the Federal Constitutional Court. Parts of the abuse regulation are unconstitutional! As if it had been anticipated, a further provision has been included into law as late as 2016 with § 8d CTA, that should limit the scope of § 8c CTA which is very broad.

Broadening of the intra-group exception in 2015

The first adjustments came only a few months after the implementation included in the Growth Acceleration Law of 22 December 2009. Next to a “restructuring exception” which turned out to be contrary to European law after the fact and which was overturned by the European commission and the European court of justice, the so-called “intra-group exception” was the last hope for loss-companies.

Under the intra-group exception, losses are not forfeited if the transferor and the transferee of shares are both 100% direct or indirect subsidiaries of the same shareholder. Unfortunately, based on the wording of this well-meant rule the scope was limited which was recently reformulated with the Tax Amendment Act of 2015. The law now states what the legislator had meant all along - therefore, also this clarification applies retroactively to all pending cases since the implementation of the original intra-group exception.

Decision of the Federal Constitutional Court of 12 May 2017

The German Federal Constitutional Court has released its long-awaited decision concerning the forfeiture of losses for harmful changes-in-ownership on 12 May 2017. The FCC declared the loss forfeiture rules of § 8c (Sect. 1) Clause 1 CTA (harmful acquisition of stocks of more than 25% and up to 50% in the shares) unconstitutional.

§ 8c Sect. 1 Clause 1 CTA covers the scenario in which the transfer of shares representing more than 25% but less than 50% of the issued capital in a company within a five years period results in a partial forfeiture of the losses on a pro-rata basis. The FCC does not consider this different treatment compared to corporations, where no harmful acquisition of stocks has happened, an objectively obvious reason and thus no justification for a worse position. From their point of view it is not reasonable that the rules anticipate partial loss forfeiture upon the transfer of qualified minority interest and do not take into account continuation of the company’s business.

The FCC has instructed the legislator that he has until 31 December 2018 to retroactively eliminate the identified infringement on the constitution for the time period between 1 January 2008 and 31 December 2015, as well as to revise the regulation of the loss deduction for transfers of shares of more than 25% and up to 50%. Should the legislator fail to implement new tax loss forfeiture rules, the unconstitutional rule will retroactively
declared void by 1 January 2019 (in the version valid until 31 December 2015).

The FCC has, however, explicitly avoided commenting on the question if § 8c Sect. 1 Clause 1 CTA is contrary to constitutional law for periods after 2016 as well, in which the rule of § 8d CTA allows the possibility of creating a business continuation losses, thus if the scope of § 8c Sect. 1 Clause 1 CTA has been reduced in a way that the rule can meet the requirements of Art. 3 GG by now.

**Law for the development of fiscal loss deduction for corporations 2016 - § 8d CTA**

With this law, the fiscal system of loss carry-forward in case of harmful changes-in-ownership is expanded by a new § 8d CTA. The new regulation restricts the scope of § 8c CTA upon application. A use of losses generally affected by the forfeiture of losses according to § 8c CTA should be possible in case where the same business operations are continued after a harmful changes-in-ownership and therefore no shell company has been sold (so-called “business continuation losses”). This resembles, in its basic concept, the idea of preventing the trading of loss-shell companies.

This creates a new possibility for the further utilization of existing losses for harmful changes-of-ownership in cases that do not meet the requirements for neither the group clause nor for the hidden reserve clause.

However, following events lead to the expiration of the business continuation losses, if they occur before the expenditure of the loss:

- Business operations are ceased, suspended or appointed to another purpose;
- the corporation takes up additional business operations;
- the corporation joins a partnership or becomes a controlling parent entity in a tax group.

The new business continuation loss is to be applied for the first time according to § 8c CTA for harmful changes-of-ownership that happened after 31 December 2015, if the corporation's business operations have been neither ceased nor suspended before 1 January 2016. To avoid the use of “old” shell companies, all corporations are exempted from the scope of application of § 8d CTA forever if their business operations have been either ceased or suspended before 1 January 2016.

**Conclusion**

From a Swiss point of view, the new regulations of both the intra-group exception and of § 8d are interesting in particular. In the future, they will allow Swiss top-tier entities with subsidiaries in Germany more leeway and more legal certainty in restructuring projects.

Additionally, on the basis of the FCC’s ruling, there exists, under certain circumstances, the possibility of healing a previous forfeiture of losses. We recommend the renewed examination of these cases.
Swiss Federal Council confirms Swiss VAT law amendments will come into force on 1 January 2018

On 2 June 2017, the Swiss Federal Council confirmed that the revised Swiss Value Added Tax (VAT) Law will come into force on 1 January 2018.

The key changes include:

- Effective elimination of the turnover threshold for foreign entities doing business in Switzerland. While a turnover threshold of CHF 100’000 (approx. US$103’381) annually will remain in force, it will cover companies’ global turnover, effectively resulting in an obligation for any non-established business with a global turnover of more than CHF 100’000 annually to register for Swiss VAT from the first franc of taxable turnover generated in Switzerland.

- Exemption from Swiss VAT of additional services in the field of insurance, such as social security related services and job training services.

- Clearer regulation of supplies between different public service organizational entities.

- Introduction of the VAT margin scheme to supplies of works of art, antiquities and collector’s items and application of the reduced VAT rate of 2.5% to supplies of electronic books and publications.

- Clarification of the rules regarding reverse charge liability for taxable as well as non-taxable persons acquiring services from abroad.

The most significant change is the effective elimination of the turnover threshold for foreign entities doing business in Switzerland. This change is expected to lead to an additional 30,000 foreign businesses having to register for Swiss VAT.

The supply of services subject to the reverse charge mechanism by foreign businesses will continue to be excluded from the turnover threshold. However, particularly for companies operating in the European Union, it is worth keeping in mind that Switzerland has never adopted the so-called non-established business principle. Consequently, once a foreign entity is required to register for Swiss VAT, it is obligated to levy Swiss VAT on any supplies in Switzerland, including services that would previously have been subject to reverse charge.

While the practice around the application of the rules still remains somewhat unclear, the elimination of the turnover threshold could have wide reaching implications for companies providing e.g., consultancy services to Swiss clients - a single supply subject to Swiss VAT, such as a local supply of hardware, or possibly the mere onward charge of expenses incurred in Switzerland, could trigger a liability to register for and levy Swiss VAT on all their supplies to Swiss clients.

Another anticipated amendment which would impact foreign businesses, will however only be introduced in 2019. Non-established entities supplying low-value goods to Swiss customers are expected to have to register for Swiss VAT once they exceed a turnover threshold of CHF 100’000. Low-value imports have previously not triggered an obligation for suppliers based abroad to register for Swiss VAT. With the introduction of the proposed amendment, foreign businesses supplying low value goods at a total of CHF 100’000 or more annually to Swiss customers will be required to register for Swiss VAT, import the goods, and charge Swiss VAT on the sale to Swiss customers. The purpose of the proposed amendment is to ensure that non-established online suppliers compete on equal terms with suppliers established in Switzerland. The introduction of the threshold has however been put off to 2019, and the rules surrounding it may still be subject to further amendments.
Amendment to the rules applicable to mail order companies by 1 January 2019

According to a study conducted by the Swiss Mail Order Association (Verband des Schweizerischen Versandhandels), private individuals ordered goods worth CHF 7.2 billion via online mail order in the year 2015, of which purchases from abroad amounted to CHF 1.1 billion. In order to ensure equal conditions for domestic and foreign online merchants from a VAT and customs perspective, the legislature has decided to amend the rules for mail order companies as of 1 January 2019.

Current rule for mail order companies

“Goods that are supplied domestically are subject to domestic tax. It would be a competitive disadvantage for (Swiss) taxable persons, if a rule were to render the importation of goods untaxed. They would be confronted with foreign competitors which supply goods directly to domestic consumers, without accounting for VAT.” This is how the legislator defines the purpose and meaning of import VAT. This statement however, does not reflect the current situation in the mail order business, as the Swiss Federal Customs Administration (SFCA) in fact does not levy import VAT for deliveries where the tax would amount to CHF 5 or less (Art. 53(1)Xa Value Added Tax Act, VATA).

Since Swiss mail order companies have to charge VAT on their domestic supplies, this disparity results in an advantage for foreign mail order companies which do not have to account for VAT on their deliveries.

Amended rule as of 1 January 2019

With the purpose of ensuring competitive equality for Swiss and foreign mail order companies, the legislator is introducing rules that reassign the place of supply of low value consignments (i.e. consignments where the amount of import tax is CHF 5 or less). Going forward, the place of supply of such deliveries will be in Switzerland, if the turnover generated by the foreign mail order company for deliveries of such supplies to Switzerland amounts to at least CHF 100’000 per annum. By shifting the place of supply of such deliveries to Switzerland, the foreign mail order company becomes liable to register for and charge VAT in Switzerland, once the turnover threshold of CHF 100’000 from domestic deliveries has been exceeded.

A foreign supplier will have a mandatory tax liability in Switzerland from the date of introduction of the rules (1 January 2019), if its turnover related to supplies low value consignments to Switzerland reached the threshold of CHF 100’000 in 2018. Furthermore, a prerequisite for the tax liability is that the supplier will continue to perform supplies of low value consignments in the first twelve months after 1 January 2019.

Foreign mail order companies already have the possibility of shifting the place of supply to Switzerland by voluntarily registering for Swiss VAT and by applying for a subordination license for supplies to Swiss customers (“Unterstellungserklärung Ausland”). By registering for Swiss VAT and importing goods with the use of the subordination license, foreign mail order companies can import the goods and sell them with Swiss VAT, while receiving the right to deduct the paid import VAT as input tax in the quarterly VAT return.

Switzerland as a pioneer in Europe

By introducing the mandatory tax liability for foreign online merchants who generate a turnover exceeding CHF 100’000 per annum from the supply of low value consignments to Swiss consumers, Switzerland plays a pioneer role, which will surely be of particular interest to the OECD. As a part of the BEPS action plan, the OECD has addressed the challenges of the use of tax exemptions as a business model. The recommendations in the reports published by the OECD on BEPS in September 2014 suggest that the OECD would like to see a development in the direction now proposed by the Swiss legislature. In the report, the OECD points out that the issues related to low value imports cannot be resolved by abolishing the low value import exemption itself, as this would lead to a significant administrative burden for customs administrations. Instead, the OECD favors the approach of subjecting the foreign mail order companies to a local VAT liability.

Conclusion

The proposed changes to the Swiss VAT Law will impact foreign mail order companies, supplying low value goods to Swiss consumers. We recommend that the concerned companies examine the implications of the new rules at an early stage, as the changes could trigger a tax liability in Switzerland. The option to preemptively register on a voluntary basis should also be taken into account, as it could limit the administrative burden and the associated costs.

1 Factsheet of the SFCA 52.01, cipher 4.1.
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