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Switzerland

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2008
YEAR IN REVIEW

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Swiss international tax news in 2008 was dominated by the dispute between the IRS and Swiss banks and by German Finance Minister Peer Steinbrueck's suggestion that Switzerland be labeled a tax haven. However, on a more positive note, Switzerland continued to expand and improve its tax treaty network, and important domestic tax reform was approved.

Approval of Corporate Tax Reform

The core element of the corporate tax reform, which was approved by voters February 24 and will be effective as of January 1, 2009, is the reduction of economic double taxation of dividends. Under current Swiss tax law, corporate profits are taxed twice — first at the level of the corporation realizing the profits and again in the hands of the shareholders that receive the profits as a dividend distribution. Under current law, this can lead to a significant tax burden for the owners of small and medium-size enterprises. (For prior coverage, see *Tax Notes Int'l*, Mar. 3, 2008, p. 720, *Doc 2008-3988*, or *2008 WTD 39-1*.)

The reform lowers the threshold from 20 percent to 10 percent for qualifying dividends and capital gains that benefit from the corporate participation deduction rules. Also, dividends distributed to individuals owning at least 10 percent of a Swiss-resident corporate entity will be subject to a special tax relief. Only 60 percent of that dividend must be recognized as taxable income.[1]

Other features of the corporate tax reform won't become effective until January 1, 2011, including a broadened concept of shareholders' equity that can be repaid tax free. Under current law, the exemption applies only to nominal share capital. The new law provides that the exemption will also apply to paid-in surplus (share premiums, or *agio*), which increases the flexibility of capital contributed to and retrieved from a Swiss corporate entity.

Proposed Changes to VAT Regime

In response to ongoing problems with the VAT regime, Switzerland's Federal Council on June 25 approved and submitted to parliament a two-part draft version of a new VAT law that contains some controversial provisions, including the adoption of a single VAT rate and the revocation of most of the existing VAT exemptions. It is not yet clear when the parliament will debate the draft law. However, because some influential Swiss industries could be negatively affected by some aspects of the legislation, it is likely that the new law, or at least some of its more controversial aspects, would not become effective before 2012. (For prior coverage, see *Tax Notes Int'l*, July 21, 2008, p. 237, *Doc 2008-15118*, or *2008 WTD 134-2*.)

Calls for Tax Reform

During 2008 the legal and tax framework around the Swiss fund industry was the topic of high-level political and administrative debate. Swiss Finance Minister Hans-Rudolf Merz and the Swiss financial services industry are seeking income tax reform to aid private equity and hedge fund managers. The intent is to compete with financial centers such as New York and London. Early in 2007, the Swiss Bankers Association suggested that Switzerland introduce a flat income tax rate of 10 percent for hedge fund managers. In light of recent jurisprudence and the current Swiss economic and political climate, that is unlikely, if not impossible. More recently, however, important changes were announced, and on September 2 the Swiss Financial Centre Dialogue Steering Committee approved a first package of measures to strengthen Switzerland's position as

[1]Only 50 percent if the shares are held as business assets rather than as private property.

AP Photo/Anja Niedringhaus

Pierre Mirabaud, head of the Swiss Bankers' Association, announced that his members will not police their foreign clients' tax affairs and rejected German demands for greater cooperation to catch tax evaders.

an international financial center. (For prior coverage, see *Tax Notes Int'l*, Feb. 25, 2008, p. 631, *Doc 2008-3438*, or *2008 WTD 34-3*.)

The Swiss Federal Tax Administration (FTA) is preparing a circular letter to clarify the tax treatment of performance fees and carried interest. Because the FTA has consistently taken the view that carried interest is connected to the (dependent or independent) lucrative activity of the fund manager, the new circular would treat carried interest as fully taxable income and not partially or wholly tax-free capital gain. However, based on a practice already applied by, for example, the Zurich tax authorities, it is likely that the circular would exempt the ordinary capital gain, which is the gain a manager makes with his own investment in the fund to the extent that gain does not exceed what any normal, third-party investor in the fund realizes. Any gain in excess thereof would be fully included in the taxable base of the manager and be taxed at the ordinary (progressive) Swiss income tax rates. This is generally not very attractive in an international context, but it is rumored that the new circular would allow for some investment manager structures (for example, stapled structures or structures with special classes of shares) that would increase the tax-exempt part of the carried interest or performance fees for the fund managers to achieve an overall attractive and competitive tax rate. And, although not addressed in the federal circular, other benefits can be obtained at the cantonal and municipal tax levels.

Tax Treaty Developments

In 2008 Switzerland continued to expand and improve its already extensive tax treaty network, with a special focus on exchange of information and the abolition of withholding taxes (as agreed on with the European Union) under its new treaty policy of 2007. Since the end of 2007, Switzerland has signed first-time income tax treaties with Bangladesh, Chile, Colombia, Ghana, and Turkey, and first-time income tax treaties with Armenia and Azerbaijan came into force January 1, 2008. Switzerland is negotiating first-time income tax treaties with Brazil, Libya, Peru, Senegal, and Syria, and it intends to take up discussions with Hong Kong, the United Arab Emirates, and selected EU and OECD member states for new treaties, updates, or revisions. To date, the Swiss treaty network counts 72 income tax treaties and is complemented by the parent-subsidiary and the interest and royalty provisions in the EC-Switzerland savings tax agreement. (For prior coverage of the Swiss treaty network, see *Tax Notes Int'l*, Sept. 29, 2008, p. 1107, *Doc 2008-18403*, or *2008 WTD 193-10*.)

The most important bilateral developments go back to 2007, when protocols amending the treaties with

France, the Netherlands, and the United Kingdom were initialed. None of these protocols have been ratified yet. In all these cases, Switzerland agreed to an enlarged exchange of information provision. On February 12 an agreement entered into by the U.K. and the Swiss competent authorities on January 18, 2006, was modified regarding the taxation of collective investment vehicles. Swiss investment funds and U.K. authorized unit trusts, as well as U.K. unauthorized unit trusts and open-ended investment companies, are authorized to invoke the treaty and to claim back withholding taxes levied by the other country. This benefit is, however, restricted to resident holders of fund certificates (or shares).

Tax Dispute With the United States

The tax dispute between the IRS and Swiss banks on the improper handling of qualified intermediary responsibilities reached new heights when a top-level Swiss manager was served with a subpoena. (For prior coverage, see *Tax Notes Int'l*, Dec. 15, 2008, p. 838, *Doc 2008-25638*, or *2008 WTD 235-5*.)

How and under what conditions Swiss-source information can be shared with the IRS is unclear. As the U.S. seeks administrative assistance in a tax matter, it is likely that article 26 of the Switzerland-U.S. treaty will apply. According to the federal decree implementing the treaty, procedural rules dictate how Swiss-source information can be exchanged with the U.S. competent authority. According to these procedural rules, a U.S. taxpayer that is affected by the exchange of information has the right to appeal to the Swiss Federal Administrative Court before the information is released to the IRS. The only condition for such an appeal, which serves to suspend the exchange of information,[2] is that the U.S. taxpayer concerned has appointed a Swiss representative that can act on his behalf (as the taxpayer is typically a nonresident person).

Whether information gathered in Switzerland under a John Doe summons conforms with article 26 of the Switzerland-U.S. treaty is an open question, one on which the Swiss Federal Administrative Court will eventually have to issue an opinion.[3] ◆

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[2]Article 55 of the Swiss Federal Law on Administrative Proceedings.

[3]A further appeal to the Swiss Federal Supreme Court seems excluded. *See* article 83, lit. h of the Swiss Federal Court Law.