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Switzerland

– today an even more attractive business location?

During the past three decades thousands of multinational groups have chosen Switzerland as a location to establish a European headquarter, trading or R&D center, regional or even global holding, management or finance company. Even though Switzerland's low effective tax rates may have primarily prejudiced their choice, a variety of other criteria have also played a decisive role in attracting the groups' management and families.

As an example, according to the annual Mercer's quality of living study Zurich and Geneva are ranked top three worldwide since eight years, Zurich in 2009 for the first time ousted by Vienna. The entire country, however, still ranks number one in quality of life according to IMD's World Competitiveness Yearbook. Of key importance for a number of multinational groups is certainly also Switzerland's innovation performance i.e., its strong research-intensive institutions both in the business and the public research sector, that position the country among the best in the world.

Finally, Switzerland's central location within Europe, its infrastructure and worldwide flight connections, its highly skilled and international labor market as well as its authorities' flexibility and supportive attitude have contributed to the country's internationally acknowledged ranking as one of the world's top business locations.

Since a couple of years, however, Switzerland has come under international pressure for its beneficial taxation models or 'harmful tax practices' as called by the OECD. Furthermore, the country's inclusion in the 'grey list' of tax havens following the G20's meeting in April this year have led to a slight impairment of Switzerland's image in the world.

However, based on various political and regulatory efforts things have turned to good account and now offer an even more attractive environment for foreign investors. A brief description of the most important changes is given below:

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International information exchange

Not long ago, on 25 September 2009, following the signing of its 12th tax information exchange agreement according to OECD's standards, Switzerland left behind its last day as a tax haven. But what gave rise to the country's entry in the 'grey list', and what has changed?

As per Swiss domestic legislation a difference exists between tax evasion and tax fraud, the latter only being criminally prosecuted and based on a respective request for legal assistance subject to information exchange with contracting states. Tax evasion is solely pursued based on the provisions as included in the tax laws and as such not abrogating the banks obligation to maintain their secrecy. In particular, the US, Germany, France and Italy have made great efforts to counter tax evasion and battled against the caveat on information exchange as until now included in most of Switzerland's double taxation treaties.

However, even though the OECD's standard article on information exchange shall now be included step-by-step in the Swiss double taxation treaties, the protocols as signed with the first 12 contracting states still limit the foreign state's prospects to abrogate the banking secrecy. All protocols, even if slightly differing in their wording, only allow for an exchange of information in cases where the requesting state amongst others provides for:

- (i) the name, address and/or other information sufficient to identify the person under examination or investigation,
- (ii) the tax purpose for which the information is sought, and
- (iii) the name, address and/or other information sufficient to identify the person [bank] believed to be in possession of the requested information.

'Fishing expeditions' and requests for spontaneous or automatic administrative assistance will be refused, and also no information will be made available for periods preceding the treaties' date of entry into force (standard), the date of signing of the information exchange agreement i.e., 23 September 2009 (US), or the 1st January 2010 (France).

In addition, until their date of entry into force the amended treaties need to pass two further political stages: their enactment by the parliament and, at least for the first treaty to be put into force and if requested by a minimum of 50'000 people/signatures, a voluntary public vote.

Finally, the taxpayers procedural rights will be observed i.e., no information will be provided to any requesting state unless (i) the Swiss tax authorities have reviewed the case at hand and decreed that it constitutes tax fraud or a similar act aiming at the deception of the tax authorities, and (ii) the taxpayer was given a time limit to review his or her allegation and to decide whether or not to take legal proceedings.

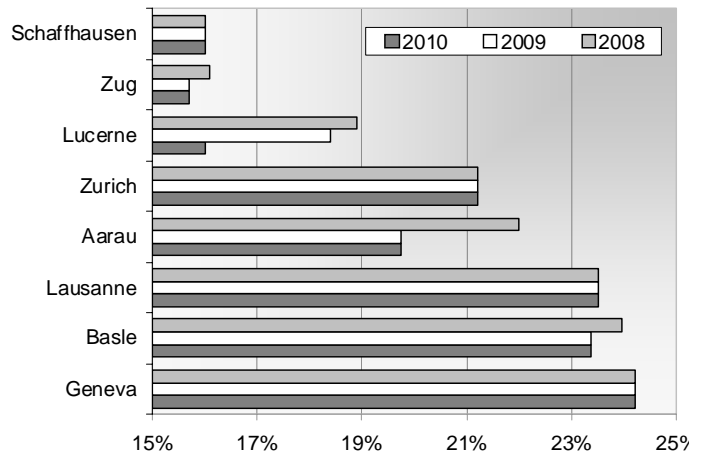
For Swiss resident tax payers the differentiation between tax fraud and tax evasion remains unchanged – so does the Swiss banking secrecy.

'Healthy' internal tax competition

Whilst named 'unfair' and 'harmful' by quite a number of OECD member states, tax competition between the Swiss cantons (political regions) and municipalities is assessed to have positive effects on the economic development, to maintain a low overall tax burden and to encourage local governments to efficiently manage their public expenditures.

No race to zero rates has yet been detected, but cantons as well as municipalities avail themselves of their financial scope and reduce their tax rates and/or tax multipliers where possible. Recent and/or already announced adjustments result in the below overall effective corporate income tax rates including federal, cantonal and municipal tax of ordinarily taxed companies located in the capitals of selected cantons:

Effective corporate income tax rates in Switzerland



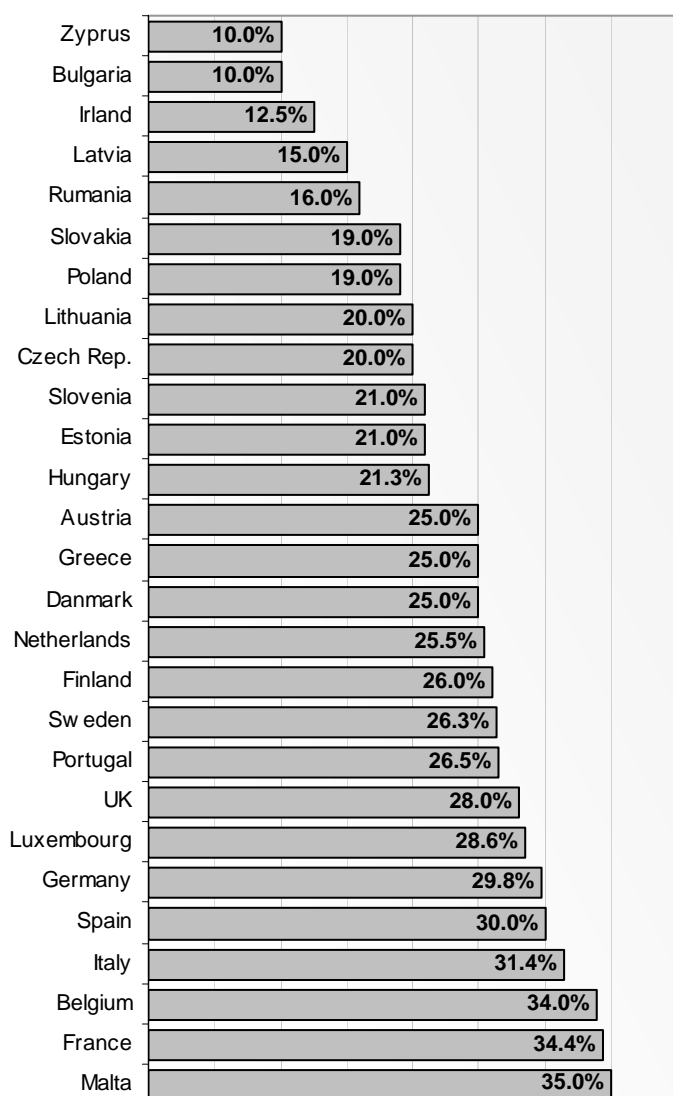
Ordinary taxation, 2010 data based on tax multipliers 2009



As one may see, the canton of Lucerne will substantially reduce its tax rate in 2010, with an announced overall effective corporate income tax rate of 12% in 2012 even underbidding Ireland. Whether or not other cantons will follow, is not yet known to the public.

In the average, the corporate income tax rate in Switzerland still amounts to just over 20%, thus being a good midfielder within the member states of the European Union. Based on the privileged taxation regimes as nationwide available to companies performing headquarter functions, foreign-to-foreign business or administrative activities, Switzerland is indeed very well positioned.

Corporate income tax rates 2009 in the EU



For these types of companies the corporate income tax rates may further be reduced to the following:

- around 5% – 8% for headquarters or so-called Principal Companies,
- around 8% - 11% for companies primarily performing foreign-to-foreign business such as international trade, the financing of group companies or the exploitation of intellectual property,
- just under 8% for any non-participation income of holding companies as well as for companies solely performing administrative functions in Switzerland, whereby any potential business activity is performed abroad, and
- close to 0% for pure holding companies.

Influenced by the above differences in the overall corporate income tax burden, the possibility to benefit from additional regional tax incentives as well as by their specific needs in the infrastructure and business environment industry clusters have developed over the past two to three decades. As an example, countless trading companies have settled in the area in and around Zug, globally trading all kinds of goods from commodities to consumer products and from large machinery to tiny devices and components. Further examples include chemical and pharmaceutical industry groups that have clearly built their own cluster in and around the city of Basle and financial services companies that can mainly be found in Zurich and Geneva. European or global headquarters have mainly settled in areas surrounding these cities, Schaffhausen and Lausanne, the two latter areas of specific interest to multinational groups due to the possibility of applying for regional tax incentives but still being located close enough to major cities to benefitting from their labor market and infrastructure.

Developments in the corporate tax environment

In March 2007 the Swiss parliament has passed the Corporate Tax Reform II. The date of entry into force of the various changes is dispersed over a period of two years starting on 1 January 2009.



In contrast to the Corporate Tax Reform I in 1998, when different forms of relief for multinational groups were introduced, this tax reform primarily aims at mitigating the tax burden of small and midsize companies and their Swiss resident entrepreneur shareholders. Some changes, the majority of them entering into force on 1 January 2011, positively impact the tax environment also for foreign companies in Switzerland.

These are:

- The crediting of capital tax against corporate income tax;
- The possibility of a withholding tax free repayment of share premium and/or reserves if formerly contributed by the shareholder;
- An extended applicability of participation exemption to income from participations of at least 10% in the capital, profit or reserves (alternatively a minimum fair market value of CHF 1 million);
- An extended applicability of participation exemption to capital gains from the sale of participations of at least 10% in the capital, profit or reserves (should partial sales result in a quota lower than 10%, participation exemption will still be granted if the participation's fair market value prior to the sale amounts to at least CHF 1 million).

Moreover, a Corporate Tax Reform III is already thought about. According to current considerations of Swiss economic opinion leaders such future tax reform should aim at a further enhancement of Switzerland's attractiveness as a global financial center and include amongst others:

- A substantial decrease in the unilateral withholding tax rate to 20%, 15% or less;
- The abolishment of share issuance tax;
- A further reduction or even abolishment of share transfer tax;
- The abolishment of stamp duties on the issuance of bonds;
- The abolishment of withholding tax on coupon rates;

- A decrease in the substance requirements as currently required for the application of the reduced treaty rate on dividends distributed to foreign parent companies;
- The abolishment or further reforming of the unilateral anti treaty shopping provisions.

Finally, a major goal of the Swiss federal council before year end and inevitable for the Corporate Tax Reform III is the settlement of the EU-Swiss tax dispute and as such the reconstitution of legal certainty on the continuation of the beneficial taxation regimes.

Simplification of regulatory requirements

After a substantial revision of the Swiss Code of Obligations which entered into force on 1 January 2008, company rules and regulations are based on their economic size rather than the legal form. These changes mainly reduce the requirements regarding audit and internal controls for small and medium sized enterprises (SME).

More specifically, companies with a headcount of less than 10 full time employees (FTE) have the possibility of "opting-out" of all audit requirements if all shareholders or partners agree.

The next important quantitative hurdle is set at sales of CHF 20 millions, total assets of CHF 10 millions and 50 FTE. As long as operations stay under this threshold, the annual accounts are subject only to a "limited statutory examination" and the internal control system is not subject to a review or audit at all.

After the revision, a full audit is very similar to a full audit according to the International Standards on Auditing (ISA) and also requires an in-depth analysis of the internal control system along with a comprehensive report of the auditors to the board of directors. These enhancements clearly bolster the strive for a good corporate governance in Switzerland.





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These changes have proved to be a real success and have further improved the attractiveness for new ventures and start-up companies. Over three quarters of all newly founded companies in 2008 have made use of the opting-out clause. On the other hand, Switzerland is taking the international move towards even better corporate governance and a robust regulatory environment for major and quoted companies very seriously.

Currently, a new revision of the Swiss Code of Obligations is under discussion, which will bring further requirements for quoted companies but will still make a clear exemption for SME to avoid unnecessary administrative burden.

Conclusion

Even though Switzerland has made the headlines recently, the major challenge of being included in the 'grey list' of tax havens as drawn up by the OECD has been dealt with successfully. Apart from further enhancing the favorable tax environment the today's focus is indeed also on other competitive advantages. We therefore believe that based on the substantial efforts made and the improvements already achieved Switzerland will emerge stronger out of the global financial crisis. ■

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