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# Switzerland 8th edition

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# New decade, new approach

Prin Shasiharan
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In May 2019, the people of Switzerland voted to adopt the Federal Act on Tax Reform and AHV Financing (TRAF), marking the most significant development in decades for the Swiss tax world.

The widespread impact of the reform will affect almost all businesses involved in Switzerland, while the swift implementation date of January 1 2020 has meant that the demand for tax experts has peaked.

The TRAF may have dominated the front pages, but in reality, it marks just one of the many tax-related changes that businesses face as they enter the 2020s. So much so that the EU's decision to remove the landlocked nation from its tax haven 'grey list' only makes a passing mention.

Thus, it should be of no surprise that *ITR* has partnered with leading tax advisors to provide insights into how businesses are adapting and evolving with the developments.

The need to ensure legal certainty forms the crux of burckhardt Ltd's article, which looks at the new provisions suggested by the upcoming Federal Act on the Implementation of International Tax Agreements (ITAIA).

The article by Prager Dreifuss discusses how the TRAF has paved the way for abolishing privileged tax regimes on a cantonal level and assesses the transitional measures in place to mitigate the expected tax burden.

The TRAF has also inspired a renewed culture of innovation through the offer of tax incentives on patents and R&D programmes. Tax Partner AG – Taxand's article examines how the benefits will keep investors interested in flocking to Switzerland for its well-renowned tax and business appeal.

The Swiss Federal Council has issued guidelines for reforming the existing withholding tax and stamp duty regimes. The article from Andersen Tax Switzerland explores the necessity of the developments and envisages how these strengthen the Swiss capital market.

Alongside reform, multinationals are actively embracing digital transformation. Deloitte's article looks at how tax departments are turning to next-gen systems such as S/4 HANA to prepare for future challenges and opportunities.

We hope the eighth edition of this Switzerland guide provides useful insight as taxpayers enter the roaring twenties.

# Switzerland

ITR

# Strengthening the Swiss capital market: Fundamental changes required for withholding tax

**Switzerland's efforts to enhance its global competitiveness are focused on increasing the attractiveness of the Swiss capital market. Lisa Airoldi and Marina Rezzin of Andersen Tax Switzerland discuss the proposed Swiss withholding tax reform and how this should attract foreign investors and encourage Swiss groups to keep their financing and treasury activities in Switzerland.**

## Current situation and the need for action

Switzerland levies a 35% withholding tax on certain income from movable capital assets, in particular interest from Swiss bonds and money market instruments, dividends from Swiss resident companies, as well as income distributions from Swiss collective investment schemes, but also on lottery gains and insurance benefits. Swiss withholding tax accounts for more than 10% of annual federal revenue (i.e. for approximately CHF 7.7 billion ($7.96 billion) in 2018).

The Swiss withholding tax regime follows the debtor principle: with respect to investment income, the debtor of interest or dividend pays 65% of the gross income to the beneficiary and transfers the 35% withholding tax to the Swiss Federal Tax Administration. The tax is owed regardless of the person of the investor. This means that Swiss resident and Swiss non-resident investors, as well as individuals and legal entities, are all affected in the same way. However, they are treated differently with respect to the reclaim of the Swiss withholding tax:

- For Swiss resident beneficiaries, the tax is normally fully refunded if the income subject to the Swiss withholding tax is correctly reported in the annual income tax return and if the refund is not abusive. In this case, the withholding tax has a safeguarding purpose incentivising the Swiss taxpayers to comply with their tax obligations.
- For non-resident investors, the Swiss withholding tax can be (partially or fully) reclaimed if the foreign beneficiary is tax resident in a state with which Switzerland has concluded a double tax treaty (or another agreement with similar provisions, like the agreement between Switzerland and EU for automatic exchange of information in tax matters in case of income payments to the parent company). If no double tax treaty is in force, the Swiss withholding tax represents a final tax burden. With respect to foreign investors the Swiss

withholding tax mainly pursues a fiscal purpose, i.e. the generation of tax revenue.

It should be noted that in case of intra-group dividends, on the basis of Swiss domestic law or the applicable double tax treaty (or similar bilateral agreement), the Swiss subsidiary may fulfil its withholding tax obligation by way of notifying the Swiss Federal Tax Administration of the dividend distribution instead of withholding and remitting the withholding tax (full or partial relief at source).

The collection process of the current withholding tax system is administratively simple. However, in particular for foreign taxpayers, the Swiss withholding tax can be a significant hurdle when investing in Switzerland. Compared with other countries, the rate of 35% is high and even though the withholding tax should be, at least partially, refundable for the majority of the investors, a request of reimbursement is associated with an important administrative effort and a (temporary) liquidity drain. Moreover, in certain cases, e.g. when Swiss securities are held by foreign collective investment schemes, the refund may not be possible because of practical reasons. As a result of this situation, bonds issued by Swiss debtors are not particularly attractive to foreign investors, while Swiss shares remain appealing despite the withholding tax on dividend distributions. Consequently, Swiss groups prefer to issue debt securities through foreign group companies located abroad, where they usually then place and carry out also their intra-group financing activities (cash pooling and treasury functions). Owing to this, Switzerland suffers a loss of value creation and of jobs associated with these activities but also of tax revenues. Besides these drawbacks of the Swiss withholding tax system, there are also gaps in its safeguarding purpose with respect to the Swiss resident individuals. This is because only Swiss source income is subject to this tax, while foreign income is not covered by the current withholding tax system, although it is subject to income tax in Switzerland.

The obstacles in the Swiss capital market and the gaps in the safeguarding purpose of the current system make a withholding tax reform inevitable. A first reform proposal with the objective to strengthen the Swiss debt capital market was launched by the Federal Council in 2010 but it was rejected by the Parliament in 2012. At the end of 2014, the Federal Council made another attempt to reform the withholding tax. The consultation draft on the new proposal, which contemplated the change from the debtor principle to the paying agent principle, did not receive the necessary support from the Swiss public and private bodies. In 2015, the Federal Council suspended the project but instructed the Federal Department of Finance (FDF) to establish a group of experts to develop suggestions for a withholding tax reform. At the same time, the Federal Parliament actively worked on this matter: the economic affairs and taxation committee of the National Council created a subcommittee with the task to prepare a preliminary draft bill on the implementation of the parliamentary initiative concerning the abolition of the Swiss withholding tax on bonds and money market instruments issued by Swiss debtors.

In 2019, the Federal Council resumed the suspended withholding tax reform and presented the main objectives and parameters of the reform. The reform proposal was prepared considering the suggestions of the subcommittee of the National Council's economic affairs and taxation committee. The consultation draft is expected in March 2020.

## Key elements of the Federal Council's reform proposal

On June 26 2019 and September 27 2019, the Federal Council provided information about the envisaged withholding tax reform which should primarily strengthen the Swiss debt capital market and extend the safeguarding purpose for Swiss resident individuals.

### Strengthening the debt capital market

The core element of this reform proposal is the exemption of Swiss legal entities, foreign investors and foreign collective investment schemes from the Swiss withholding tax on interest from bonds, money market instruments and bank accounts. This will enable Swiss groups to issue their bonds in Switzerland at competitive conditions and thus significantly increase the appeal of Swiss bonds to foreign investors.

In order to further encourage the foreign debt investment into Switzerland, the exemption from Swiss withholding tax for foreign investors will be supported by the abolition of the Swiss securities transfer tax (stamp duty) on transactions with Swiss bonds.

### Improving the safeguarding function

With respect to individual tax residents in Switzerland, the withholding tax on interest income from Swiss bonds, money market instruments and bank accounts will continue to be levied. However, according to the proposal of the Federal Council, also foreign interest income received by them through an account at a Swiss bank will be covered by the new Swiss withholding tax regime. This will in principle be possible by transforming the withholding tax on interest income into a paying agent tax on domestic and foreign interest income for Swiss resident individuals. Income from participation rights will remain subject to the current debtor principle and no Swiss withholding tax will be levied on dividends from foreign stocks.

Furthermore, from a Swiss withholding tax perspective, the Federal Council intends to treat direct and indirect interest-bearing investments equally. In other words, indirect Swiss and foreign interest-bearing investments held by Swiss resident individual investors will be subject


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Lisa studied business administration at the University of St. Gallen (BA HSG 2005 and MA HSG 2007) and graduated as Swiss certified tax expert in 2013. Before joining Andersen, she worked in the financial services tax division of a Big Four firm and at a tax consultancy firm in Zurich.


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Marina graduated as a Swiss certified expert in finance and controlling in 2004 and as a Swiss certified tax expert in 2008.

to the withholding tax. This means that when Swiss resident individuals invest in domestic or foreign (reinvesting or distributing) collective investment schemes, the tax will be levied on the interest income generated by these financial instruments. Should the income be reinvested instead of distributed, the tax consequences for the Swiss tax resident individual investors do not change. This situation could result in difficult implementation for the Swiss paying agent, especially in case of foreign reinvesting collective investment schemes because the administrator of these funds – unlike that of domestic funds – does not have to withhold and pay the tax to the Swiss Federal Tax Administration and in addition there will be no cash flow from the fund to the investor. In addition:

- The tax rate should remain unchanged at 35%.
- The threshold that triggers the withholding tax on interest from bank accounts should not be increased, but stay at CHF 200. No additional allowances are currently envisaged by the Federal Council.

### Further elements

- Existing too-big-to-fail instruments, such as contingent convertibles (CoCos), bail-in bonds and write-off bonds, have been exempted from the Swiss withholding tax until December 31 2021. As the new paying agent system will also apply to these financial instruments, transitional provisions for too-big-to-fail instruments must be introduced.
- A legal basis must also be created for structured products to make sure that payments which replicate or forward interest on bonds, dividends and similar will be subject to the withholding tax.
- With the planned withholding tax reform, the banks will assume new functions and responsibilities. This will increase the liability risk and cause implementation costs. The Federal Council suggests that the paying agents (i.e. banks and certain other financial services providers) should receive an adequate remuneration and that the criminal liability should be limited to intent. In order to

reduce the administrative burden, the Swiss banks should be allowed to outsource the processing of the withholding tax. However, no transfer of liability will take place.

The consultation draft expected for March 2020 should be prepared on the basis of the key elements described above.

It is expected that the implementation of the planned reform could lead to a shortfall in tax revenue of approximately CHF 250 million per year. However, according to the Federal Council, this shortfall should be offset by the positive fiscal effects of the strengthened debt capital market and of the improved safeguarding function.

## Strengthening the equity capital market?

The reform proposed by the Federal Council is limited to a withholding tax reform with respect to interest payments, while no change is envisaged for dividend distributions from Swiss corporations. In addition, in relation to stamp duties, the Federal Council intends to abolish only the Swiss securities transfer tax on transactions with Swiss bonds.

The financial sector would welcome a more comprehensive withholding tax reform. Furthermore, banks and the industry largely wish for the complete abolition of the Swiss stamp duties. Even the group of experts established by the Federal Department of Finance (FDF) recommended a wider reform. According to their report published in March 2019, measures should be urgently adopted not only to make bonds from Swiss issuers attractive to foreign investors and to improve the safeguarding purpose of the withholding tax, but also to strengthen the Swiss equity market. They suggested, among others, the reduction of the withholding tax rate on dividends from 35% to 15%. So far, the Federal Council has not included this additional measure in the planned reform, especially because of the estimated significant shortfall in tax revenue for approximately CHF 1.6 billion per year.

In November 2019, the economic affairs and taxation committee of the National Council recommended the Federal Council to consider two additional elements in the preparation of the consultation draft. On the one hand, for Swiss resident individuals holding participation rights of at least 10% in Swiss entities, a voluntary notification procedure instead of collecting the withholding tax on the dividends should be introduced. On the other hand, dividend distributions between legal entities should be exempted from the withholding tax.

The economic affairs and taxation committee of the National Council has also worked on the preparation of a preliminary draft bill on the implementation of another parliamentary initiative concerning the complete abolition of the Swiss stamp duties. The first part of this project consists of the abolition of the issuance stamp tax on equity. This has been under discussions for years but the law project was suspended in 2017 and postponed to a later stage. It is expected that the debate will be resumed by the Swiss Parliament by the end of March 2020. The second part of the project concerns the suppression of the Swiss securities transfer tax on transactions with Swiss securities in general and with foreign bonds with a residual time to maturity shorter than 12 months. The third part would then eliminate the Swiss securities transfer tax on transactions with the remaining, not yet exempted, foreign securities. At the same time, the stamp duty on insurance premiums would be abolished.

The consultation procedure on the second and third part of the law project (preliminary draft bill) started on January 16 2020 and lasts until April 23 2020. It is predictable that this project will encounter some resistance, in particular because the complete abolition of the Swiss securities transfer tax and of the stamp duty on insurance premiums would lead to an annual federal tax revenue decline of approximately CHF 2 billion. Depending on the result of the consultation procedure, the bill will be submitted to the Swiss Parliament.

## Outlook

The consultation procedure on the proposed withholding tax reform should start in March 2020 and the earliest possible entry into force would be January 1 2022. For the potential abolition of the Swiss stamp duties, it is not yet possible to define an entry into force date as the discussions are still at a very early stage.

The reform proposal of the Federal Council should be welcomed as it will make it easier for Swiss corporations to raise funds from foreign investors. However, in order to significantly improve the competitiveness of the Swiss capital market, it will be fundamental to implement measures which aim for the strengthening not only of the debt capital market but also of the equity capital market. In this regard, the abolition of the stamp duties together with the reform of the withholding tax, possibly combined with a reduction of the withholding tax rate, would give an important boost to the Swiss economy.