

Switzerland, the door to Europe – tax aspects of inbound investments

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Thomas Graf and Daniela Schmucki-Fricker present an overview of the Swiss tax system

Switzerland has a long-standing tradition of offering attractive tax rates and structuring opportunities. In combination with its extensive net of double taxation treaties and its legal and economic stability, Switzerland is a prime location for international business activities.

Profit tax

Introduction to the Swiss corporate tax system

In Switzerland, corporate income taxes are levied at two levels: the direct federal tax (DFT) level and the cantonal and communal tax (CCT) level. At the DFT level, there is only one tax status, with a statutory flat tax rate of 8.5%. Since tax expenses are deductible business expenses, the effective tax burden under ordinary taxation at DFT level is 7.83%.

At CCT level, tax rates vary depending on the canton and commune of residence. Together with DFT, under the ordinary taxation regime the total profit tax burden ranges between 12% and 25%. In addition, each canton offers favourable tax statuses for holding companies and special purpose companies, as discussed below. Although profit taxes are harmonised to a certain extent across cantons and communes, the conditions and details of taxation under these tax statuses may vary considerably. It is therefore important to select carefully the best location of residence.

The tax environment in Switzerland is very business-friendly: tax authorities are responsive, reliable and typically adopt a common sense approach. It is common practice to discuss with them in advance potential tax issues resulting from new facts and to agree a binding advance tax ruling.

Ordinary taxation

Profit tax is levied on the worldwide net profit, excluding profits from foreign permanent establishments and from foreign real estate (irrespective of whether such foreign profits are subject to tax abroad). Profits of subsidiaries are not included. There is no consolidation for tax purposes and no Controlled Foreign Corporation legislation.

Business expenses are deductible if they are economically justified and recorded in the local statutory accounts. Since Swiss Generally Accepted Accounting Principles allow to build up hidden reserves, in many areas Swiss tax law and practice defer taxation of profits until realisation in third-party transactions. Losses may be carried forward for seven years.

Net dividends from substantial participations are tax-exempt due to a participation exemption mechanism. The dividend exemption applies on equity participations of at least 10% or with a fair market value of at least CHF 1 million. Under the same mechanism, capital gains arising from the disposal of participations of at least 10% (that have been held for at least one year) are also exempt. Other capital gains are subject to taxation at ordinary rates. Unrealised investment and other gains are not subject to profit tax, provided that they are not recorded in the local statutory accounts. Tax holidays are available to new businesses for a maximum of ten years, if the arrangement is in the economic interest of Switzerland.

Holding company status

At CCT level, holding companies may apply for holding company status, which exempts the holding company from cantonal and communal profit taxes on all income except income from Swiss real estate. The holding company status may be granted under the following conditions:

1. the main purpose of the company is holding and financing equity investments;
2. at least two thirds of the company's assets or two thirds of the company's income consists of participations or income from participations; and
3. no business activity is carried out by the company in Switzerland.

At the federal level, the holding company is subject to ordinary taxation whereby substantial dividends and capital gains on substantial participations are tax exempt. As a result, the total maximum effective tax rate for holding companies is 7.83%

Special purpose company status

All cantons offer a special tax status for special purpose companies with predominantly foreign-orientated activities. Under this tax status (the implementation of which may vary from canton to canton) the cantonal and communal profit taxes are considerably reduced. Together with DFT, the total tax burden of such companies is some 10% or lower.

Transfer pricing and documentation

Taxpayers have to follow the arm's length principle in their dealings with related parties. There are, however, no special transfer pricing laws or documentation requirements in Switzerland. Taxpayers may demonstrate that their payments are at arm's length on a case-by-case basis. The transfer pricing environment in Switzerland is usually business-friendly and based on common sense. In practice, for regional hubs and management companies, a cost-plus approach for group internal management services is usually accepted (e.g. cost plus 5%).

Withholding taxes

Dividend payments and deemed dividends are subject to 35% Swiss withholding tax. Under the double tax treaty between Switzerland and China the rate is reduced to 10%.

Switzerland has a wide and permanently growing network of double tax treaties that allow efficient inbound and outbound structures with most onshore jurisdictions. In addition, interest on ordinary inter-company loans, royalties, management fees and repayment of capital contributions are not subject to Swiss withholding tax, irrespective of the recipient's country of residence. Salaries paid to directors or board members who are resident abroad are subject to federal and cantonal/communal salary withholding tax.

Value-added Tax (VAT)

Swiss VAT is a consumption tax that is ultimately borne by consumers and VAT-exempt businesses. It is levied on each supply within the value chain, and calculated by reference to the total amount of consideration in combination with a recovery system for input VAT. Swiss VAT is essentially limited to goods delivered and services rendered within Switzerland.

Switzerland offers much lower VAT rates than the members of the European Union: the standard rate is 8% and the reduced rate for essential goods/services, such as food and medicine, is 2.5%. The revised Swiss VAT legislation is very entrepreneur- and export-friendly: every entrepreneurial undertaking is entitled to register for VAT in order to recover input VAT. For example, holding functions and exported goods and services are entitled to VAT recovery under the ordinary rules.

Other taxes

Annual net asset tax

At CCT level, profit taxes are levied together with a small annual net asset tax, which is levied on the equity of the legal entity or on the branch capital. The tax rates depend on the tax status and the canton and commune of residence, and range from virtually nil to 0.5%. In many cantons, the net asset tax is a minimum tax, insofar as profit tax may be credited against and up to the amount of net asset tax.

Capital duty

Capital contributions to a Swiss company above CHF 1 million are subject to 1% capital duty. Various exemptions apply, in particular for local and international reorganisations and relocations. The issuance of bonds is subject to capital duty at differentiated rates.

Payroll taxes and social security contributions

Swiss employers have to withhold and remit payroll taxes for certain non-Swiss employees and pay social security contributions for all employees.

Additional industry-specific taxes

In addition, there are a number of industry-specific turnover, transactional and consumption taxes, e.g. securities transfer tax for professional securities dealers and owners of large investment portfolios; stamp duty on insurance policies and withholding taxes on certain insurance payments; duties on gasoline, tobacco and alcohol; etc.

Taxation of branches

Most taxes apply both to resident companies and to Swiss branches of foreign companies. From a Swiss tax perspective, the main differences for branches are:

- > they are not subject to withholding tax on dividends;
- > there is no capital duty on branch capital; and
- > they are not deemed to be resident in Switzerland and thus not entitled to use the Swiss double tax treaties.

Whether a Swiss operation should be incorporated in Switzerland or operated as a Swiss branch of a foreign company also depends on the foreign tax regime. However, the majority of foreign investments in Switzerland are incorporated legal entities.



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