International Bar Association Annual Conference 2024

Recent Developments in International Taxation

Switzerland

Emilia Rebetez

Walder Wyss, Geneva/Zurich

emilia.rebetez@walderwyss.com

Introduction

Switzerland is a federal state, where both the federal government and cantons hold power to levy various taxes. In many ways, however, the direct income tax and wealth tax are harmonised under federal legislation, thus narrowing the cantonal taxing power accordingly.

The last 12 months have brought some changes and developments to the Swiss tax law, at both the domestic and international levels. This report aims to provide an overview of the main changes and a glimpse into possible future developments to look out for.

Developments over the past 12 months

Legislation

Organisation for Economic Co-operation and Development (OECD) Two-Pillar Solution Statements

Cognisant of the need to adapt tax rules to the digitalisation of the economy, Switzerland has adopted the OECD Two-Pillar Solution Statements.

On 18 June 2023, the Swiss people adopted by a large majority (78.5 per cent of Swiss elective citizens, as well as all 26 cantons) a federal constitutional amendment serving as the legal basis for the Swiss Federal Council and the Swiss Parliament to proceed with the implementation of the OECD/G20 Pillar One (market jurisdiction taxation) and Pillar Two (global minimum taxation) proposals.

While there are currently no concrete plans to implement Pillar One, the implementation of Pillar Two, taking validity as of 1 January 2024, was decided on by the Federal Council on 22 December 2023.

Pillar One

The first pillar aims at adapting the current international provisions regarding the allocation of large corporate groups' taxable profits (market state taxation). This change would affect companies with an annual turnover of more than €20bn and profit margins exceeding ten per cent. In Switzerland, very few companies would be impacted.

As the implementation of Pillar One is reliant on further international developments within the OECD, Switzerland will determine how to implement Pillar One in due course.

Pillar Two (Global Anti-Base Erosion Rules (GloBE))

The second pillar introduces a global minimum tax rate of 15 per cent for multinational companies with an annual worldwide turnover of at least €750m.

In order to implement the OECD/G20 project on taxing the digital economy, Switzerland will levy a supplementary federal tax, limited to large corporate groups falling within the above-defined scope. This supplementary federal tax will be assessed and levied by the cantons, and any revenue deriving therefrom will be shared among the cantons (75 per cent) and the Confederation (25 per cent). It is intended to protect companies from unnecessary tax procedures abroad, providing legal certainty and allowing Switzerland to collect additional tax revenue that would otherwise be collected abroad.

Following the acceptance of a constitutional amendment on 28 June 2023, the implementation of Pillar Two in Switzerland will be achieved first by a transitional provision allowing the Swiss Federal Council to enact a global minimum tax of 15 per cent for large multinational enterprises (MNEs) as of 1 January 2024 by means of a temporary ordinance. That temporary ordinance will be replaced by a federal tax bill issued by the Swiss Parliament under the ordinary legislative procedure with less time pressure, and once international developments in this matter are better defined.

On 22 December 2023, the Swiss Federal Council decided that the prerequisites to begin levying the supplementary tax in Switzerland with effect from 1 January 2024 had been met. The Federal Council highlighted in particular that the vast majority of European Union Member States, the United Kingdom and South Korea, had opted to implement the regulations as of the same date. However, the Federal Council refrained from applying the income inclusion rule (IIR) and undertaxed profits rule (UTPR) for now, leaving that decision for a future date depending on further international developments.

The ordinance generally refers as a rule to the OECD GloBE Model Rules of 14 December 2021 (the 'GloBE Rules') and specifically provides for a few exceptions. Subsequent adjustments to the GloBE Rules shall, however, not be automatically taken into account in Switzerland.

Swiss corporate income tax is generally determined and levied on a single entity basis (no tax grouping rule), whereas the GloBE Rules usually operate on a jurisdictional level. The Swiss federal ordinance implementing the GloBE Rules thus includes coordination rules for cases involving multiple Swiss constituent entities of the same MNE.

Additional complexity stems from the fact that the GloBE tax base relies on international financial accounting standards, which substantially differ from the Swiss Code of Obligations (CO). Therefore, a Swiss constituent entity of an in-scope MNE is likely to have to prepare two sets of financial statements for Swiss and GloBE tax purposes.

The scope of covered taxes for the purpose of the GloBE Rules includes corporate income taxes, capital taxes and real estate gains taxes, as well as residual Swiss withholding taxes (on intragroup dividends).

The temporary ordinance also includes criminal provisions, with fines of up to three times the evaded amount, as well as prison terms of up to three years. No penalties shall be issued for the negligent violation of procedural duties or GloBE tax evasion for all financial years beginning from 31 December 2026 and ending by 30 June 2028.

Pillar Two will impact in-scope companies exclusively and is currently expected to affect a low three-digit number of Swiss groups, plus a low four-digit number of Swiss subsidiaries of foreign groups.

This is nonetheless the second extensive tax reform that Switzerland has undergone within a few years following international pressure. While it is expected that most of the measures that Switzerland introduced on the occasion of the first Tax Reform and Alters-und Hinterlassenenversicherung (AHV) Financing (jointly referred to as the 'TRAF' reform), notably the reduction of cantonal profit tax rates will be at least partially obsolete for companies that will be affected by Pillar Two going forward. They will remain relevant for all other companies, especially small and medium-sized enterprises.

Furthermore, it is to be expected that the Swiss cantons will introduce local compensatory measures to better fit the GloBE general framework and ensure their attractiveness as a business location. For instance, the *taxe professionnelle communale*, a local tax specific to Geneva that would not have

qualified as a covered tax under the GloBE Rules, has recently been abolished and replaced by a slight increase of the cantonal corporate income tax rate.

Introduction of the Limited Qualified Investor Fund (L-QIF)

On 31 January 2024, the Swiss Federal Council decided to enact the revised Collective Investment Schemes Act (CISA) and Ordinance (CISO) with effect from 1 March 2024, thus creating the legal basis for L-QIFs. From a regulatory perspective, the L-QIF is neither subject to approval nor supervised by the Swiss Financial Market Supervisory Authority ('FINMA'). It is only open to qualified investors and must be managed by an institution approved and supervised by FINMA.

The L-QIF is a collective investment scheme (or, in other words, a fund) for Swiss tax purposes. Thus, the L-QIF is transparent for income and wealth tax purposes, and is not taxed (unless it holds real estate directly).[1] The taxable income and net asset value of the L-QIF are hence allocated to investors and taxable at their level. The capital gains and capital repayments of the L-QIF attributed to investors are, under certain conditions, tax-free for Swiss investors who hold their fund units as private assets.

However, due to a high withholding tax burden (35 per cent), Swiss investment funds are generally less attractive for foreign investors, unless they are mainly invested in foreign investments and benefit from what is referred to as the affidavit procedure. In the case in which a double taxation treaty (DTT) applies between Switzerland and the place of residency of the foreign investor, the foreign investor can generally obtain a partial (20 per cent) reimbursement of the Swiss withholding tax, although the tax refund process may be rather lengthy and complicated. Additionally, because funds are deemed transparent for Swiss tax purposes, L-QIFs are typically not able to benefit from the DTTs concluded by Switzerland to claim a refund of the foreign withholding tax on their income (except for certain jurisdictions with which Switzerland has concluded a memorandum of understanding allowing Swiss funds to benefit from these DTTs on behalf of Swiss investors). Therefore, it falls on the investor of the L-QIF to apply for a refund from the jurisdiction in which the withholding tax was withheld, usually based on the double taxation agreement concluded between that jurisdiction and its residence state (if any).

Swiss VAT

As per 1 January 2024, VAT rates have been increased in Switzerland. The new rates are as follows:

- standard rate: 8.1 per cent (previously 7.7 per cent);
- special rate: 3.8 per cent (previously 3.7 per cent); and
- reduced rate: 2.6 per cent (previously 2.5 per cent).

The date/period on which the goods or services are supplied (rather than invoiced) is decisive in determining which rate to apply.

Main tax-related popular votes

There have been no material tax-related popular votes in Switzerland since the constitutional amendment required for the implementation of the OECD/G20 Pillar One and Pillar Two proposals was accepted by the Swiss people on 18 June 2023 (see above for more details).

[1] There is an exception to the above transparency principle for investment funds that hold real estate directly.

Recent court decisions

No landmark international tax case law worth addressing in the present report has been issued in Switzerland since the last report.

Taxation of teleworking for cross-border workers

Due to the surge in teleworking following the outbreak of the Covid-19 pandemic and as part of advances in digitalisation, most cross-border workers now perform an increasingly significant part of their employment from their state of residence rather than from the state in which the employer is located. From a tax perspective, this tends to shift the right to tax from the state in which the employer is located to the state of residence of the employee. In the context of the Covid-19 pandemic, Switzerland had entered into several mutual agreements with neighbouring countries to ensure that the previous tax arrangement would continue to apply to cross-border workers, even if they had to temporarily work from home. Recently, these temporary measures have been replaced by permanent agreements.

In order to mitigate potential tax losses for the country, on 1 March 2024, the Swiss Federal Council published new regulations on the taxation of teleworking in an international context. These provide a domestic tax basis relating to employees of a Swiss employer who reside in neighbouring countries and telework. They allow taxation in Switzerland, even if the activity is carried out remotely from the country of residence, provided that international tax treaties allocate the right of taxation to Switzerland. These changes will affect the taxation of salaries of employees who are not resident in Switzerland for tax purposes but work in Switzerland and are subject to an international agreement regulating telework in a cross-border context. As of today, such agreements have been concluded with France and Italy.

FRANCO-SWISS CROSS-BORDER WORKERS

A specific system applies to 'cross-border commuters' who fall under the specific definition of the 11 April 1983 agreement between France and the cantons of Bern, Solothurn, Basel-Stadt, Basel-Landschaft, Vaud, Valais, Neuchâtel and Jura.

On 27 June 2023, Switzerland and France signed an additional agreement regarding cross-border commuters, containing new and permanent taxation rules for income derived from work performed in the state of residence. French and Swiss residents working for Swiss and French employers, respectively, may now work from home (including ten days of temporary assignment abroad) each calendar year up to 40 per cent (instead of 25 per cent prior to 2020 and the Covid-19 crisis) of the time without affecting their current tax status. In Switzerland, the tax status of the employee and whether source tax is levied on the salary still differ depending on the canton.

As this agreement is being approved following the ordinary legislative process in both countries, a temporary memorandum of understanding, dated 22 December 2022, and of substantially similar content, is applicable until 31 December 2024.

ITALO-SWISS CROSS-BORDER WORKERS

Based on a 3 October 1974 agreement between Switzerland and Italy, the state in which cross- border workers carried out their work had an exclusive right to tax their salaries. In return, the cantons of Valais, Ticino and Grisons paid a certain percentage (about 40 per cent) of the federal, cantonal and communal taxes they collected to adjoining Italian municipalities in which an appropriate number of Italian cross-border workers lived.

A new agreement on the taxation of cross-border commuters between Switzerland and Italy, of 23 December 2020, came into force on 17 July 2023 and has been applicable from 1 January 2024. Under this agreement, the definition of 'cross-border commuters' is narrower than that of previous practice. Furthermore, Switzerland will continue to tax Italian cross-border commuters, but only up to 80 per cent of the taxable income (instead of 100 per cent previously). The Italian tax authorities will henceforth tax all income earned in Switzerland and grant a tax credit to Italian cross-border commuters. In other words, there will no longer be any difference in taxation depending on whether the person works in Switzerland or Italy, and cross-border commuters will be taxed more heavily than in the past. A transitional provision applies to cross-border commuters who work or have worked in the cantons of Valais, Ticino or Grison between 31 December 2018 and 17 July 2023. These will continue to be taxed exclusively in Switzerland until the end of 2033.

In November 2023, Switzerland and Italy signed another agreement, specifying that cross-border commuters within the meaning of the 2020 agreement on the taxation of cross-border commuters will be able to work up to 25 per cent of their time at home from 1 January 2024 without losing their cross-border commuter tax status.

SOCIAL SECURITY AFFILIATION

Switzerland has also signed an agreement regarding its social security affiliation with certain countries in the EU and European Free Trade Association (EFTA), including Austria, France, Germany, Luxembourg, Liechtenstein, Malta and Italy. This new agreement aims to increase the maximum threshold of teleworking activity below which the employee can remain affiliated with the local social security of the state where the individual's employer is located. This threshold has been raised to 49.9 per cent (instead of the previous 25 per cent).

Future developments

Proposals in the pipeline to look out for

DRAFT LEGISLATION EXTENDING THE INTERNATIONAL AUTOMATIC EXCHANGE OF INFORMATION FRAMEWORK

In October 2022, the OECD published an update to the common reporting and due diligence standard for financial account information (Common Reporting Standard or CRS) and a new Crypto-Asset Reporting Framework (CARF). The associated recommendation of the OECD Ministerial Council states that both sets of rules constitute binding automatic exchange of information (AEOI) in tax matters standards that must be implemented globally. Subject to parliamentary approval, Switzerland intends to implement these standards.

Consequently, on 15 May 2024, the Federal Council launched a consultation on an extension of the international AEOI.

Set to apply from 1 January 2026, with a first data exchange in 2027, the extension concerns a new CARF, as well as amendments to the standard for the automatic exchange of financial account information that are expected to assist with the interpretation of the text and take into account lessons from ongoing experience with implementing the CRS. The consultation ran until 6 September 2024.

Draft legislation on the taxation of rental value

A parliamentary initiative aimed at reforming the current personal income tax system (under which real estate owners pay personal income tax on the deemed rental value of the real estate assets that they own) was introduced in 2017 with the aim to encourage home ownership.

While the National Council has yet to provide its position on the proposal, both the Federal Council and State Council have endorsed it, with a few modifications. The outcome of this legislative process is uncertain for now. If this initiative is accepted, and depending on the specificities of the final draft, the personal income tax position of real estate owners could be substantially improved.

Draft legislation introducing a Swiss trust

Under the current legal framework, it is not possible to establish a trust under Swiss law. Foreign trusts are, however, recognised, and the tax treatment applicable to them is explained in a published circular.[2]

On 12 January 2022, the Swiss Federal Council published a draft bill intending to introduce trusts into Swiss law. That bill contained, among others, provisions relating to the taxation of trusts (Swiss and foreign trusts alike). Said provisions largely differ from the current tax treatment as provided for under the circular, and notably considerably worsen the tax treatment related to the deemed 'irrevocable discretionary trusts'.

The bill is currently on hold and is likely to be abandoned.

Extension of the loss offset period

Swiss tax law currently contains a (commercial) loss carry-forward mechanism (no loss carry-back is available). Under the current tax system, losses can only be carried forward for a maximum period of seven years (ie, ordinary tax loss carry-forward), unless the company is undergoing financial restructuring, in which case previous losses can be offset against the financial restructuring income without a time limitation (ie, extraordinary loss carry-forward).

On 28 June 2023, the Federal Council opened a consultation to extend the loss carry-forward period from seven to ten years in Switzerland. This proposal aims to align the Swiss system with international standards and would facilitate the recovery of businesses that suffered important losses during the Covid-19 pandemic.

If accepted, this measure is set to come into force on 1 January 2028. It will cover losses for the fiscal year 2020, but not losses incurred in earlier fiscal years.

[2] CSI Circular No 30, of 22 August 2007, 'Taxation of trusts'.