

Tax Relief in Switzerland

Switzerland is in many respects an ideal location for taking up residence and doing business. An environment of high legal and political stability and best economic infrastructure combined with low tax rates and a well developed DTT network form the framework for safe and efficient activities. Switzerland is a confederation of 26 cantons and about 2'800 communities. Taxes are levied at Swiss federal, cantonal and communal levels. Although the tax harmonization law brought conformity under the 26 cantons, there are still many substantial differences to take into consideration when selecting the best location for tax reasons.

1. Individuals

1.1 Lump-sum taxation

Lump-sum taxation is a special tax regime where Swiss income tax is levied on the basis of expenses (i.e. standard of living).

Foreign nationals who take up Swiss residence for the first time or after an absence of more than 10 years, and who do not undertake a lucrative activity in Switzerland, may qualify for lump-sum taxation. Swiss nationals returning to Switzerland as taxpayers for the first time in 10 years and who do not take up a lucrative activity in Switzerland may also qualify for this regime, but only during the year of arrival and the following year. The amount that serves as basis of taxation is generally negotiated with the competent authorities. The amount of the payable tax must exceed the income tax which would be due on certain Swiss source income and income for which exemption of foreign taxes is requested by virtue of a double tax agreement.

As a rule, Swiss residents who take advantage of the lump-sum taxation are considered residents and thus qualify for treaty relief.

1.2 Capital gains

Capital gains can be defined as the income realized on the sale, exchange or re-evaluation of assets. The tax treatment varies depending on whether the gains are derived from the realization of personal or business assets.

Capital gains realized on the sale of personal movable assets are tax exempt. However, any capital losses sustained are not deductible. With regard to immovable assets, all cantons levy a tax on capital gains realized on the disposition of immovable property, while for Swiss federal tax purposes also capital gains on immovable property are tax exempt.

Capital gains realized on business assets, movable and immovable, are always subject to income tax. The transfer of business assets into private assets or to affiliates or a foreign

permanent establishment is a deemed realization. For capital gain purposes, independent business activities must be clearly distinguished from the management of personal wealth. The former are subject to income tax on capital gains. Transactions performed in a professional manner are always deemed to be an independent business activity.

2. Corporations

2.1 Qualifying dividend income and capital gains

Switzerland has a classical corporate tax system that results in economic double taxation. Shareholders are charged a second time on dividend income, only dividend income from substantial participations is shortened to partly reduce this effect. Nevertheless, Switzerland has low tax rates and the aggregate tax burden may anyway be lower than in other countries.

To avoid multiple taxation, intermediate companies receiving dividends or capital gains derived from qualifying holdings may apply for tax relief. This relief is available to Swiss corporations, cooperatives as well as to foreign companies of a similar nature who maintain a permanent establishment in Switzerland and the dividends or capital gains are linked to the Swiss operations. The relief is available regardless of the nature of the activities and the country of residence of the shareholders.

To qualify for relief on dividend income, the participation must represent at least 10% of the registered capital of the paying company or the market value of the participation must exceed CHF 1 million. To qualify for relief on capital gains, the participation must represent at least 10% of the registered capital of the company and must have been held for at least one year.

A reinvestment relief is also granted on the disposal of qualifying participations. The relief applies in such a way that capital gains may be transferred on new qualifying participations that are acquired in replacement. It is a tax deferral up to the time of the ultimate disposal of a participation without a subsequent reinvestment.

2.2 Holding companies

Holding companies obtain relief on qualifying dividend income for Swiss federal tax purposes (see above). A pure holding company is therefore more or less exempt from Swiss federal taxes. However, relief does not apply to interest on loans or other types of income.

For cantonal tax purposes, companies who qualify for holding company status are widely tax exempt, if the main purpose as per bylaws and as a matter of fact is the management of long-term financial investments in affiliated companies. At least 2/3 of the assets (or income) must be derived from long-term participations. Furthermore a holding company may not be engaged in commercial activity in Switzerland.

According to the tax situation in the Canton Zug, any stock holding is considered to be a participation. At least one participation must have a substantiation of at least 10% of the registered capital of the company concerned or alternatively have a market value of at least CHF 2 million.

However, regardless of the presence of a cantonal holding company status, certain Swiss source income remains taxable at ordinary rates (e.g. income from real estate property located in Switzerland, and treaty favored income if required by the relevant tax treaty).

2.3 International commercial companies

As a basic principle, domiciliary companies perform only administrative activities in Switzerland and the commercial activities are exclusively or at least predominantly (80% and more) performed abroad.

The Swiss federal tax law does not provide for any particular relief for domiciliary companies, but there are special rules for cantonal and communal income tax purposes.

Under the definition of 'administrative companies' the tax law of the Canton Zug distinguishes between domiciliary companies and mixed companies. While domiciliary companies are disallowed to do any business in Switzerland (i.e. no staff and no localities), the so-called mixed companies may do that to a certain degree, i.e. at least 80% of both sales and purchases must take place outside of Switzerland.

In case of a domiciliary company, any income derived from foreign sources and any net income from substantial participations (see holding companies) is tax exempt. All other income is taxable at ordinary rates. Offsetting of net losses from participations with other income is prohibited. Administrative expenses and taxes are usually considered in the form of a standard lump-sum deduction (about 25%).

The taxation of 'mixed companies' is basically equal to that of domiciliary companies with the exception that income derived from foreign sources is taxed on a reduced basis calculated in accordance with the number of fulltime employees engaged in Switzerland.

2.4 Service companies

Service companies generally provide activities to other companies within the same multinational group. Services to third parties do not qualify.

Profit assessable in Switzerland is generally deemed to be at least 5% of total expenses incurred on the twelfth (8.33%) of total local payroll costs. For cantonal and communal tax purposes it may be combined with the rules applicable to domiciliary companies. Depending on the facts in a given case, the Cantonal Tax Authorities are often open for rulings simplifying the methods of calculating the corporate income tax.

2.5 Principal companies

A Swiss principal company engaged in foreign manufacturing and sales activities will preferably do this on a contractual basis with limited risk manufacturers and distributors. The foreign limited risk contractors are thereby usually compensated on a cost-plus basis, so that the large part of the profit remains with the Swiss principal company.

Relief is granted through the allocation of large portions of the profit to the foreign activities (deemed foreign establishments). The residual profit is taxable at ordinary tax rates. This highly favourable tax regime can lead to very low tax burdens of less than 10% on overall profits.

2.6 New businesses

Relief is often granted to newly established businesses and essential reorganizations to attract investments. Nearly all cantons encourage certain establishments within their territories by granting tax privileges for periods of up to 10 years. The establishment or restructuring of a business must be in the interests of the regional economy in order to qualify for relief. This depends on the appreciation and approval of the competent authorities. Reorganizations such as mergers, demergers etc. do not automatically qualify.

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