# INTERNATIONAL ONSHORING TREND: IMPACT OF THE AEOI AND THE BEPS PROJECT - THE ROLE OF SWITZERLAND

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Two projects that are on the international tax agenda have accelerated the onshoring trend:

- Automatic Exchange of Financial Account Information in Tax Matters («AEOI»);
- Base Erosion and Profit Shifting («BEPS») Project.

## 1. International Tax Agenda

### 1.1. Global Forum and OECD/G20

The Global Forum on Transparency and Exchange of Information for Tax Purposes is the multilateral framework within which work on transparency and exchange of information for tax purposes has been carried out by both OECD and non-OECD economies.

OECD and G20 countries along with developing countries that participated in the development of the BEPS Project are establishing a international tax framework under which profits are taxed where economic activity and value creation occur. The Inclusive Framework on BEPS brings together over 115 countries and jurisdictions to collaborate on the implementation of the BEPS Project.

### 1.2. AEOI Standard

The AEOI Standard counteracts international tax evasion. It provides for the exchange of non-resident financial account information with the tax authorities in the account holders' country of residence. Participating jurisdictions that implement AEOI send and receive pre-agreed information each year, without having to send a specific request. The Standard is very similar to the Model 1 IGA that many jurisdictions use for implementing the United States Foreign Account Taxpayer Compliance Act («FATCA»).

The Common Reporting Standard («CRS») sets out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions. As of November 2018, 104 jurisdictions having committed to exchanging information with each other under the CRS while over 3'400 bilateral exchange relationships have been yet activated with respect to more than 90 jurisdictions committed to the CRS.

### 1.3. BEPS Project

The BEPS Project provides 15 Actions that equip states with domestic and international measures needed to counteract BEPS. The Action Plan includes in particular:

- Action 3 sets out recommendations to strengthen the rules for the taxation of *controlled foreign corporations* («CFC»).
- Action 5 revamps the work on harmful tax practices with a focus on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring *substantial activity* for preferential regimes, such as IP regimes.
- Action 6 develops model treaty provisions and recommendations regarding the design of domestic rules to prevent *treaty abuse*.
- Actions 8, 9 and 10 contain transfer pricing guidance to assure that *transfer pricing* outcomes are in line with value creation in relation to intangibles, including hard-to-value ones, to risks and capital, and to other high-risk transactions.
- Action 12 contains recommendations regarding the design of mandatory disclosure rules for *aggressive tax planning schemes*.
- Action 13 contains revised guidance on transfer pricing documentation, including the template for *country-by-country reporting*, to enhance transparency while taking into consideration compliance costs.

Action 5 requires *substantial activity* for any preferential tax regime. Seen in the wider context of the BEPS Project, this requirement contributes to the BEPS Project, which is to align taxation with substance by ensuring that taxable profits can no longer be artificially shifted away from the countries where value is created. The Anti-BEPS principle says: Income shall be taxed where *economic activities* generating the income are and where *value is added*. The BEPS Project has a significant impact on the international taxation of offshore structures. The BEPS Project will not only have an impact on international taxation of multinational enterprises, but also on private corporate investment structures. The Final Report on Action 5 has not yet said what «*substantial*» means in the context of holding, finance and asset (portfolio) management companies which mainly derive passive income such as interest, inter-company dividend and portfolio dividend.

The concept of *place of effective management* is not a specific countermeasure of one of the BEPS Actions. However, it plays an increasingly significant role in international taxation of offshore structures. Offshore companies that have been interposed between taxpayers and underlying assets or underlying business have been increasingly scrutinised. Offshore companies may be subject to residence taxation if the offshore company is not effectively managed abroad. In international taxation, place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made. It goes without saying that a letter-box company incorporated in an offshore jurisdiction is obviously not managed offshore. Local board members who act in a fiduciary role and act upon instructions of the controlling taxpayer do not effectively manage the offshore company.

## 2. The Role of Switzerland

### 2.1. One of the most European States

Switzerland is one of the most European states. Switzerland is integrated into Europe geographically (Switzerland is in fact in the middle of Europe), culturally (it has four national languages: German, French, Italian, and Romanic), economically, and legally. Switzerland is not Member of the European Union, but it has access to the Internal Market through bilateral agreements:

- The first package of bilateral agreements was signed in 1999. This package includes the extension of the European Free Movement of Persons to Switzerland. EC nationals and Swiss nationals can cross the Swiss border without restrictions in both directions.
- In 2004, the second package of bilateral agreements was signed. This package includes the extensions of the European Parent-Subsidiary and the European Interest-Royalty Directives to Switzerland. Dividends, interest, and royalties can cross the Swiss border without restrictions in both directions.
- In 2007, the Lugano Convention on Jurisdiction, the Recognition and the Enforcement of Judgements was signed. This Convention extends the European Free Movement of Judgments in civil and commercial matters to Switzerland. Judgements can cross the Swiss border without restrictions in both directions.

### 2.2. Swiss tax system

#### 2.2.1. Choice of best tax home

Switzerland has three levels of tax jurisdictions: Federal Government, 26 cantons and 2'225 communes. Individuals and companies are subject to individual income and wealth taxes and corporate income and capital taxes respectively and gift and inheritances taxes.

There are high tax jurisdictions and low-tax jurisdictions. The choice of the best tax home is an important pre-immigration tax planning issue. The choice of the best tax home is the choice of a particular commune.

#### 2.2.2. Simple set of tax rules

Swiss tax law is simple, straightforward and not complex to comply with. Corporate income taxation is linked to the statutory financial accounts. Taxable corporate profit equals the annual profit as reported in the annual financial statements unless a specific tax provision applies (e.g. thin cap rules, arms length's principle, etc.).

### 2.2.3. Individual taxation

Depending on the canton and the commune, total individual income tax rates vary between 22.5% and 46% and total wealth tax rates between 0.11% and 1.03%. Dividends from substantial participations in domestic and foreign companies are preferentially taxed («Shareholder Relief»). Capital gains from private movable domestic and foreign assets are tax-free (e.g. capital gains from portfolio investments).

Switzerland provides foreign nationals a preferential tax regime for HNWI («Forfait Taxation»).

### 2.2.4. Corporate taxation

Depending on the canton and the commune, total corporate income tax rates vary between 11.2% and 24.5% and total capital tax rates between 0.001% and 0.525%. Inter-company dividends from substantial participations in domestic and foreign companies are exempted («Participation Relief»).

An increasing number of communes provide a total corporate income tax rate of 12% without the benefit of a preferential tax regime.

### 2.2.5. Swiss international taxation

Switzerland has concluded an extensive double tax treaty network. Swiss tax treaty law provides for a zero outbound dividend withholding taxes and notification procedures for inter-company dividends. Further, Swiss companies have access to the EC Parent-Subsidiary and Royalty-Interest Directives that provide zero withholding tax on cross-border dividend, interest and royalties.

Switzerland does not have CFC legislation according to which profits generated by controlled foreign companies are fiscally attributed and taxed in the hands of a Swiss parent company.

Income from foreign real estate and foreign permanent establishments are exempted. Foreign withholding taxes on dividends, interest and royalties are credited to Swiss income taxes («Foreign Tax Credit»).

### 2.2.6. Business Tax Reform

On 28 September 2018, the Federal Parliament adopted the Business Tax Reform Act. It shall abolish the preferential corporate tax regimes (holding companies, domiciliary companies, mixed companies, principal companies, finance branches). Holding companies will still benefit from the participation relief that avoids multiple taxation of inter-company dividends. Further, it will introduce a patent box, super R&D deduction and notional interest deduction. It is expected that the act will enter into force and become applicable on 1 January 2020.

As a respond to the abolishment of the preferential corporate tax regimes, some cantons have already and other cantons have announced to reduce the total corporate income tax rates. The total corporate income tax rate of many cantons will be in the range of 12% and 14% while other cantons will provide higher tax rates. Such tax rate (without the benefit of a preferential tax regime) has become the lower threshold of an international accepted playing field.

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