THE TAXATION OF HOLDING, DOMICILIARY AND AUXILIARY COMPANIES IN SWITZERLAND

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I. TAXATION OF THE INCOME AND CAPITAL OF CORPORATIONS

A. General

In Switzerland, direct taxes on income and on capital are levied at three levels: by the federal Government, the 26 cantons (states) and the communes. Whereas the federal tax laws are applicable throughout the country, each of the 26 cantons has its own tax law. The cantonal tax laws differ considerably from each other and from the federal Law on Direct Taxes (DTL). In order to achieve a greater uniformity a federal Tax Harmonization Law (THL) was introduced and has been in force since 1 January 1993. The principal objectives of this legislation are to reduce the inter-cantonal differences in tax laws and to make cantonal tax laws more similar to the DTL in certain respects, such as the rules governing the determination of taxable income and capital as well as the provisions dealing with certain corporate tax privileges.

All the cantons will have to adapt their respective cantonal tax laws to the THL by 1 January 2001. After this date, the THL will apply directly to cantonal and communal taxation whenever the respective provisions of the cantonal tax laws are not in conformity with it.

Swiss resident corporations[1] are liable to taxes on their worldwide income as well as on their capital at the federal, the cantonal and the communal level. Income and capital which is, however, attributable to either a permanent establishment maintained abroad or to foreign real estate is exempt from Swiss taxation; although such income and capital is taken into account for determining the applicable tax rates.

A corporation is considered resident in Switzerland for tax purposes, if it is incorporated or effectively managed in Switzerland. This means that even a corporation incorporated outside of Switzerland may be held to be Swiss resident if its effective management is performed in Switzerland. Switzerland has not (yet) adopted in its tax laws any "controlled foreign corporation" (CFC) rules, nor do rules for the tax consolidation of a group of companies exist in the field of direct taxation.[2]

The taxable income and capital of a corporation are primarily determined on the basis of its statutory annual balance sheet and profit and loss account, provided that the commercial financial statements are established in accordance with the accounting rules contained in the Swiss Code of Obligations and generally accepted accounting standards. The tax authorities do however have the power to make certain adjustments to the commercial net profit and net equity for tax purposes, e.g. for excessive depreciation, liability provisions and interest deductions on related party debt, etc.

B. Federal income and capital taxes

1. Income taxes: general rules

Switzerland has a classical corporate tax system insofar as corporate profits are first subject to corporate income taxes and subsequently, upon distribution to the shareholders, taxed once more in the hands of the shareholders upon receipt of a dividend. Corporate shareholders receiving dividends from substantial corporate participations are, however, relieved from such economic double (or multiple) taxation of the same profits through a special mechanism.[3]

The taxable net income is subject to federal tax at graduated rates ranging from 3.63 per cent to a maximum 9.8 per cent.[4] Net losses of a tax period can be carried forward for seven years; losses cannot be carried back.

2. Special relief for dividend income from substantial participations

Dividend income from substantial participations[5] in other corporations qualifies for a relief from federal income tax.[6] A participation is considered substantial if it represents control of at least 20 per cent of the share capital of another corpora-

1. More precisely, joint stock corporations, limited liability companies, and cooperative societies.
2. However, a consolidation of a controlled group of tax subjects is possible in the field of the Value Added Tax (VAT).
3. The "participation deduction", as discussed below.
4. The maximum corporate income tax rate applies if the ratio between the net income and the net taxable equity exceeds 23.15 per cent.
5. Participations include shares of a joint stock corporation or a corporation with unlimited partners, including non-voting shares ("participation certificates"), quotas of limited liability companies, and share certificates of cooperative societies, Art. 69 DTL. *Inter alia*, the following are not treated to be qualifying participations: debt instruments such as bonds and notes, intercompany loans and advances, hybrid financing tools such as subordinated or profit-sharing loans, as well as shares in Swiss investment funds (fiduciary relationship).
6. The relief is available to Swiss joint stock corporations, limited liability companies, and cooperative societies, as well as Swiss branches (permanent establishments) of foreign corporations, provided that the participation and the dividend are to be attributed to the permanent establishment.

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tion or has a fair market value of at least CHF 2 million. The relief for qualifying dividend income is in the form of a reduction of the corporate income tax owed by the receiving corporation (*Beteiligungsbezug*) which is computed based on the ratio between the "net participation income" and the company's total taxable net income.[7] The "net participation income" is defined as gross dividend income from substantial participations less:

- non-refundable foreign withholding taxes;
- a lump sum of 5 per cent of the gross dividend for administrative costs;
- interest and similar financing costs attributable to the respective participations;[8] and
- any depreciation of participations in connection with a dividend.

Dividends for the purposes of the participation deduction include all ordinary and extraordinary profit distributions, liquidating dividends, stock dividends (if recognized as income in the books), as well as constructive dividends and other financial benefits transferred to the holder of a participation by a transaction the terms of which fail to meet an arm's length standard, provided that the party granting the benefit suffered a corresponding adjustment of its taxable income.[9] Other income connected with substantial participations, such as the repayment of the nominal value of corporate shares, capital and appreciation gains, and any income that qualifies as a deductible expense in the hands of the payor[10] is not considered "dividend" income and therefore does not qualify for the tax relief.

3. Federal capital tax

The annual federal capital tax is levied upon the net equity, consisting of the paid-up share capital, contributed surplus (if any) and all other open reserves and retained earnings, as well as those hidden reserves that have been taxed as income. The federal capital tax is levied at a flat rate of 0.08 per cent.

C. Cantonal and communal income and capital taxes

As indicated above, each of the 26 Swiss cantons has its own tax law. The communal taxes are either governed by communal ordinances or by cantonal laws; they are usually assessed together with the cantonal taxes, often as a fraction thereof. Whereas the provisions of cantonal laws regarding ordinary corporate income and capital taxes are more or less similar to the respective federal provisions, the tax treatment of corporate entities performing special functions within an affiliated group[11] is very different under cantonal law as compared to federal law. The provisions of the cantonal tax laws regarding the principles of taxation (including the rules relating to holding and other base companies), taxable objects, tax periods as well as the procedural rules will have to be harmonized and brought in line with the THL by the year 2001. However, the cantons will continue to be free under the THL in the setting of their tax rates and tariffs as well as in providing for certain tax exemptions.

There is a wide variation in the ordinary corporate income tax rates of the cantons, which range from approximately 11 per cent to 35 per cent.[12] The actual cantonal and communal corporate income tax rates that apply in any particular case are in most of the cantons determined, within upper and lower limits, by the ratio of the corporation's taxable income to its equity. The additional combined cantonal/communal capital tax burden may range from 0.05 per cent up to 1 per cent.

Ordinary cantonal income and capital taxes are usually calculated in the same or a similar way as the respective federal taxes. The cantonal tax laws also provide for similar mechanisms as the DTL to relieve dividend income from (domestic or foreign) substantial participations from taxation. Some cantons[13] further provide for a comparable relief on such dividend income to individual shareholders resident in the same canton as the corporation distributing the dividend.

II. INCOME AND CAPITAL TAXATION OF HOLDING AND OTHER BASE COMPANIES

A. General remarks

Unlike the DTL, the cantonal tax laws provide for a considerable variety of additional tax privileges to specified categories of corporate taxpayers, such as holding companies and some other types of special purpose or base companies that are mainly active outside Switzerland.[14] These cantonal tax privileges are generally not only available to resident corporations, but also to branches (permanent establishments) of foreign corporate entities.

Notwithstanding the above, once the THL has been implemented into the cantonal tax laws, the special tax regimes offered by the cantons to special purpose or base companies will be limited to two different types, the holding company

7. The taxable net income for the purposes of calculating the participation deduction excludes the results generated by foreign permanent establishments, income from foreign real estate and the deduction of any losses carried forward from earlier taxable years.
8. Generally, the portion of financing costs attributable to a participation is determined by the ratio between the participation's book value and the total book value of all assets.
9. In case of constructive dividends or similar financial benefits received from a *foreign* participation, the qualification for the participation deduction is made subject to the additional alternative condition that either the Swiss tax authorities come to the conclusion that they, in lieu of the foreign tax authority, would have made essentially the same adjustment of the taxable income, or an agreement has been reached in a competent authority procedure under an international tax treaty.
10. Such as interest on loans granted to the company in which a participation is held.
11. In particular, holding companies and various types of base companies performing special activities such as international trading, group financing and all kinds of other services and functions within an affiliated group of companies.
12. Whereas federal taxes are deductible, cantonal/communal income and capital taxes may or may not be deductible depending upon the tax legislation of the relevant canton.
13. E.g. Nidwalden, Appenzell Innerrhoden.
14. Domiciliary, Mixed, Auxiliary, Administration and similar special purpose companies.

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privilege and the administration company tax regime. (See below).

B. Holding companies

The tax laws of all the cantons provide for a special holding company tax privilege, under which a qualifying "pure" holding company is usually fully exempt from cantonal and communal income taxation. The exemption from income taxation does not only apply to dividends, but extends to interest, royalties, capital gains and any other income.[15] Furthermore, the cantonal holding company tax privileges generally provide for a substantially reduced annual capital tax. In some cantons[16], the capital tax on holding companies is levied only upon the paid-up nominal share capital. The special capital tax rates for holding companies may be as low as 0.042 per cent per annum and are, in some cantons, subject to negotiations with the local tax authorities.

The holding company privilege is also provided for under the THL. According to the THL, a holding company pays the annual capital tax: on the paid-up share capital and all open reserves as well as on those hidden reserves that would have been taxed as income, had the holding company been subject to income taxation.[17] The THL does not contain any rules that would prevent the cantons from further granting privileged capital tax rates to holding companies.

The test to qualify as a "pure" holding company varies from one canton to another. The THL provides that the cantons shall grant the holding company tax privilege to those corporations and cooperatives whose purpose as stated in their articles of incorporation is mainly the permanent administration of participations and which do not perform any business activity in Switzerland, provided further that either the total income of a holding company or the fair market value of its investments in the capital of other corporations represents at least two thirds of its total income or its total assets, respectively.[18] Under the THL, income derived by holding companies from real estate located in Switzerland shall be taxable at the ordinary corporate income tax rates. Deductions within the limits of a "usual" mortgage charge are to be admitted.[19]

Most of the cantons require that the participations be substantial as a prerequisite to qualifying for the holding company tax privilege.[20] The qualification criteria are often the same as for the purposes of the participation deduction under the DTL, i.e. the participation should either represent an interest of at least 20 per cent in the share capital of another corporation or a value of at least CHF 2 million. Although the THL does not contain any specific rule in this regard, it is the general view that, for the purposes of this requirement, the participations have to be taken into account at their fair market values.[21]

The main purpose of administering participations must not only be stated in the articles of incorporation, but also be a factual one. A distinction must further be made between those business activities which can be carried on in Switzerland without jeopardizing the tax privilege and those which cannot. As a rule, manufacturing, trading and service activities are prohibited. However, a holding company may perform activities or render services that are directly connected with the management of a group of affiliated companies. Hence, a holding company may, to a certain degree, provide debt financing to its subsidiaries and affiliates, hold and exploit intellectual property and provide other services, if such activities remain within the limits of a mere ancillary company purpose. In order to fulfil these functions a holding company may employ a limited number of staff and have its own infrastructure, such as an office with the necessary equipment.

C. Other cantonal special tax regimes (Domiciliary, Mixed, Auxiliary and Administration companies)

1. General

Many cantons try to attract corporate taxpayers with international operations by offering them advantageous local tax regimes. These cantons expect that in return for accepting much reduced cantonal tax revenues[22] the relevant entities will enhance their local services industry (banks, accountants, lawyers, etc.). It must again be emphasized that, at the federal taxation level, no special tax privileges for companies with mainly international operations are available; such companies are subject to the ordinary federal taxes on income and capital.

The cantonal tax privileges are generally offered to companies which have their seat (registered office) in Switzerland, but perform the bulk or all of their business activities outside Switzerland and therefore derive most of their income from foreign sources or at least from transactions with foreign parties. Such entities may benefit from a special cantonal tax status as a domiciliary, mixed, auxiliary, or administration company, depending upon the legislation of the canton in question. The privileged cantonal tax status is often not only available to resident corporations, cooperatives and even foundations, but also to Swiss branches (permanent establishments) of foreign legal entities or even foreign partnerships.

At present, the cantons still have full discretion in defining the conditions and features of these tax privileges in their laws; under the THL, however, such discretion will be limited to a significant degree insofar as the only admitted cantonal tax privilege will be the administration company regime as

15. Income derived from immovable property located within the territory of the canton may, however, be subject to normal taxation.
16. E.g. Zug and Schaffhausen.
17. Art. 29 THL.
18. The canton of Zug, which at present still has a very liberal holding company tax regime, requires alternatively that either at least 51 per cent of the assets consist of substantial participations, or 51 per cent of the income is derived from dividends received from such participations.
19. Art. 28 (2) THL.
20. No such requirement exists, however, under the existing tax laws of the cantons of Zurich, Basel-City, Lucerne, Schwyz, Obwalden and Grisons.
21. Some cantons only take the book values into account. A few cantons still accept a lower capital interest or a lower minimum value of the participations. Furthermore, a few cantons (Schaffhausen, Glarus, Schwyz, Valais) include certain long-term loans to affiliated companies in the participations.
22. These entities also contribute to federal direct tax revenues.

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defined in Article 26 et seq. THL. The application of these cantonal tax privileges to a taxpayer must usually be negotiated with the cantonal tax authorities, who are generally ready to issue binding private letter rulings, if all relevant facts are disclosed.

2. Domiciliary companies

"Pure" domiciliary companies are usually fully exempt from cantonal income taxes[23] and pay only a reduced capital tax according to the same rules as apply to holding companies.

Pure domiciliary companies may be characterized as corporations which have their statutory seat (registered office or domicile) in Switzerland, but perform substantially all their commercial activities outside Switzerland. Accordingly, substantially all the income of a domiciliary company is derived from foreign sources. Most of those cantons which provide for a "pure" domiciliary company tax privilege do not allow the corporation to have any staff or operational office premises within Switzerland. However, management decisions made by the corporation's board of directors may be taken at board meetings held in Switzerland without jeopardizing the tax privilege.[24] Some cantons require that a domiciliary company be controlled by foreign resident shareholders. Domiciliary companies are not restricted in respect of their business activities carried on abroad and their staff employed and infrastructure maintained abroad.

The domiciliary company tax privilege is typically used for entities with foreign trading or agency activities (purchases and sales performed abroad) and for various types of services rendered to foreign parties, such as financing, management and exploitation of intellectual property, leasing, consultancy and similar services. The domiciliary company tax privilege can also be granted to those entities whose exclusive function and activity is the holding and management of their own movable assets, e.g. a portfolio of securities.

It should be noted that at the federal taxation level a pure domiciliary company (or branch meeting the respective criteria) pays the ordinary income taxes; it may, however, deduct up to 50 per cent of its gross profit as a lump-sum allowance for expenses incurred abroad without having to substantiate such expenses in detail. The remaining 50 per cent of the gross profit, after deduction of minor Swiss administration costs and taxes, must be reported as taxable income in Switzerland. If a domiciliary company claims an expense deduction which exceeds the 50 per cent limit, it has to provide full evidence and justification for all its expenses.

3. Mixed companies

The mixed company tax privilege is offered by a few cantons, such as Zug and Schwyz, as a substitute privilege for those Swiss entities or branches of foreign entities which have operations similar to a pure domiciliary company, but which need to maintain a certain infrastructure, (such as an office with employees) in Switzerland. Mixed companies may derive a small portion of their income, usually up to 20 per cent, from commercial activities within Switzerland; they are, however, not allowed to carry on any industrial or manufacturing activities. The laws of those cantons which provide for a mixed company tax status usually require that a mixed company be controlled by non-resident shareholders.

Normally mixed companies are subject to the ordinary cantonal and communal income taxes on all income from Swiss sources or commercial activities carried on within Switzerland. However, they are entitled to a partial exemption, usually 70-90 per cent, in respect of their income from foreign activities or foreign sources. Certain reliefs, such as the application of a reduced tax rate to a portion of the retained earnings, may also be available for capital tax purposes.

The mixed company tax privilege is predominantly used by international trading and sales companies with only limited or no commercial activities on the Swiss market that need to employ a certain number of staff in Switzerland.

4. Auxiliary companies

Several cantons offer the tax status of an auxiliary company to such entities which, although they may have an office and employ staff in Switzerland, do not carry on within Switzerland any commercial transactions or "genuine" business activities with or for independent third parties. Auxiliary companies typically perform mere subordinated service or auxiliary functions for foreign affiliated companies including the management of foreign subsidiaries or affiliated companies, the provision of debt financing and the rendering of marketing, publicity, research, technical assistance, accounting and various other services.

The exact conditions and features of the tax status of an auxiliary company vary from canton to canton and must be individually negotiated. As a rule, auxiliary companies benefit from a partial cantonal/communal tax exemption of their income from foreign sources, whereas they pay ordinary cantonal/communal income taxes on any income from Swiss sources. In the canton of Fribourg, the auxiliary company is fully exempt from income taxation on its income from foreign sources and on passive income from Swiss sources, while active income from Swiss sources (which must not exceed 20 per cent of the total income) is ordinarily taxed. Under the auxiliary company regime of the canton of Basel-Stadt, any income, including income from "subordinated" Swiss business activities (the volume of which must not exceed 10 per cent of the total income,) is taxed at a special rate that equals 10 per cent of the ordinary corporate income tax rate. However, a Basel-Stadt resident auxiliary company has to pay a minimum income tax even if it shows a net loss; the minimum taxable income corresponds to either 10 per cent of the total Swiss costs or one sixth of the total payroll expenses.

23. Except for taxes in relation to real property located in the canton, if the respective canton allows a domiciliary company to own real estate located in its territory.

24. Swiss corporate law requires that the majority of the members of the board of directors (*Verwaltungsrat*) of a Swiss corporation be Swiss Nationals resident in Switzerland. Similarly, at least one director (*Geschäftsführer*) of a limited liability company needs to be resident in Switzerland.

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For federal tax purposes, a company whose activity essentially consists of providing services to foreign affiliated enterprises is required to show an arm's length net profit. Such intra-group services are generally deemed to produce a minimum taxable net profit of either 10 per cent of the total Swiss costs or one sixth of the total payroll expenses in Switzerland, unless the taxpayer can prove a bona fide loss. The same standard with regard to intra-group services is generally applied by the cantons for the assessment of cantonal/communal income taxes.

5. Administration companies

The administration company tax regime was first introduced by the canton of Zurich[25] and subsequently by a number of other cantons. This regime also served as the model for the only cantonal tax privilege (besides the holding company regime) provided for under the THL.[26]

The statutory provisions define the administration company as a corporate entity which only carries on administrative activities in Switzerland i.e. the company must not undertake any commercial business activity. Thus, an administration company is not allowed to actively appear in the (Swiss) market as a seller of goods or services or as a purchaser or manufacturer of goods. The admissible administrative activities include the mere administration and management of those assets which the company already owns or acquires without conducting any commercial activity in Switzerland, as well as auxiliary or servicing activities for the benefit of affiliated enterprises, such as performing research, rendering technical assistance or marketing advice, the management of patents, trademarks and other intellectual property, (re-)invoicing, debt collection, factoring, leasing, financing, accounting and other services. Other, genuine business activities may be conducted in Switzerland, if they are of minor and subordinate importance. The rendering of management services to affiliated companies is usually regarded to be a commercial and not a subordinate activity. Generally, no restrictions whatsoever apply with regard to commercial activities conducted outside Switzerland. It is further generally not required that the foreign business activities be carried on through branches (permanent establishments) maintained abroad.

An administration company can be legally structured as a Swiss corporate entity or as a branch (permanent establishment) of a foreign entity. The tax laws of e.g. the cantons of Zurich and Thurgau, do not require that the administration company be controlled by foreign-resident shareholders. Under the THL, the tax privilege is available to corporations, cooperatives and foundations, there is no requirement that the entity be controlled by foreign shareholders.

The typical cantonal/communal tax treatment of an administration company may be summarized as follows:

- Income from substantial participations[27] (open and constructive dividends) as well as any capital or book gains on participations are fully exempt from taxation.[28]
- Other income from Swiss sources is taxed at ordinary tax rates.
- Other income from foreign sources is partly exempt from taxation, the degree of the tax exemption depending upon the importance of the administrative activity conducted in Switzerland. The non-exempt portion of the foreign-source income is subject to tax at ordinary tax rates. According to the taxation practice of the cantons, the taxable portion may range from zero per cent to 40 per cent. The law of the canton of Zurich provides that a minimum of 10 per cent of the foreign-source income be subject to tax.

It is further provided that an administration company has to set off bona fide expenses, which are connected to a specific category of income, against such income. Financing costs and general administrative expenses must be allocated to the different categories of income. Capital losses on participations cannot be deducted, but have to be set off against tax free dividend income or capital gains on participations. Finally, the tax privilege is not applicable to those categories of income for which the taxpayer claims a relief from foreign withholding taxes pursuant to a Swiss tax treaty, if the respective treaty requires the ordinary taxation of such income in Switzerland not only at the federal, but also at the cantonal/communal level.[29]

The administration company is liable to capital taxes, under the THL, the taxable capital has to include the paid-up capital, open reserves and retained earnings, as well as those hidden reserves that, without application of the income tax privilege, would have been taxed as income.

D. Tax holidays

Foreign industrial or commercial enterprises moving into Switzerland may in a number of cantons be granted a partial or even a full exemption from the cantonal/communal and, in certain defined geographical areas of economic depression, also from the federal income and capital taxes for a maximum period of ten years. Such exemptions must be negotiated with the cantonal authorities and generally require that a substantial number of new jobs are created in a region with high unemployment.

III. FEDERAL WITHHOLDING TAX

A. Swiss domestic law

The Swiss federal government levies a withholding tax at a rate of 35 per cent on the gross amount of:

25. § 50bis Zurich Tax Code.
26. Art. 28 (3) THL.
27. Participations representing either 20 per cent or more of the capital stock of other corporations or a fair market value of at least CHF 2 million, cf. § 50bis Zurich Tax Code.
28. The tax law of the canton of Thurgau also exempts all income from the exclusive administration of the taxpayer's own movable assets, such as a portfolio of marketable securities; § 88 Thurgau Tax Code.
29. Cf. § 50bis(2) and (3) Zurich Tax Code.

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- dividends, including constructive dividends[30] and liquidation dividends (i.e. the excess of the net liquidation proceeds over the nominal share capital) distributed by a Swiss corporation to its shareholders or persons actually or deemed to be related to the shareholders;
- interest paid on publicly offered bonds, debentures and other instruments of indebtedness issued by a Swiss resident borrower;
- distributions by a Swiss investment fund; and
- interest on customers' deposits held with a Swiss bank.

No federal withholding tax is levied, however, on interest paid in connection with straight loans as well as on rents, royalties, licence, management and technical assistance fees etc.[31] Furthermore, the repatriation of profits derived by a foreign corporation through its Swiss branch (permanent establishment) to the foreign head office is not subject to the federal withholding tax, unless the branch/permanent establishment qualifies as a "domestic enterprise" for withholding tax purposes. A branch of a foreign corporation qualifies as a domestic enterprise if (i) the foreign corporation is effectively managed in Switzerland and (ii) the foreign corporation, through its Swiss branch, conducts a commercial activity in Switzerland.

The withholding tax must be withheld by the payor of the taxable payment (or in-kind benefit) and charged to the recipient of such income.[32]

Swiss resident persons (individuals and corporate entities) are entitled to a full refund of the withholding tax, if they duly report the underlying income, are the beneficial owners and meet certain further conditions. Foreign resident persons, on the other hand, suffer the Swiss withholding tax as a final burden, unless they are entitled to partial or full relief under an applicable tax treaty between Switzerland and their country of residence.

B. Impact of double taxation treaties concluded by Switzerland

Switzerland has concluded bilateral tax treaties with more than 50 countries including the United States, Canada, Japan and most of the European countries. These tax treaties usually provide for a partial or even full relief from the Swiss withholding tax on outbound dividends and certain interest payments made to residents of the Contracting States. Whereas under many Swiss treaties a full relief is provided for interest payments, a full relief from the Swiss withholding tax on dividends is only provided for corporate recipients under the Swiss treaties with the Netherlands, Luxembourg, Sweden, Finland and Denmark, if certain conditions, depending upon the treaty in question, are met.[33]

The Swiss tax treaty with the Netherlands contains in its Article 9(2) an express anti-abuse clause, according to which full relief from the dividend withholding tax shall not be granted, if the relationship between the payor and the payee of a dividend has been established or maintained primarily for the purpose of obtaining such relief. Although the Swiss tax treaties with Luxembourg, Sweden, Denmark and Finland do not contain such explicit anti-abuse rules, it is the clear tendency of the FTA (Federal Tax Administration) to apply similar criteria to applicants from these countries seeking a full refund of the Swiss dividend withholding tax.

The focus of the FTA in regard to the entitlement of foreign shareholders of Swiss corporations to a full refund of the withholding tax lies undoubtedly on beneficial ownership. A corporate shareholder resident in a convenient treaty jurisdiction, which is controlled by residents of another, non-treaty jurisdiction and which cannot prove any "substance"[34] at its place of incorporation runs the risk of not being acknowledged as the beneficial owner of the Swiss shares.

IV. USE OF TAX TREATIES BY SWISS RESIDENT CORPORATIONS

As a rule, Swiss resident corporations, including holding companies and other entities enjoying cantonal tax privileges as domiciliary, mixed, auxiliary or administration companies may benefit from the Swiss double tax treaty network and, in particular, claim relief under such treaties from foreign taxes withheld on dividend, interest and royalty income. However where control is exercised by non-residents, certain conditions must be met in order to qualify for foreign withholding tax relief. These conditions are set forth in a unilateral Decree of the Federal Council concerning measures against the abuse of Swiss tax treaties, dated 14 December 1962. Similar anti-treaty abuse provisions are included in the Swiss tax treaties with Germany, France, Italy and Belgium. The most important conditions to be met are the following:

- *Capitalization.* A minimum equity capitalization of the Swiss corporation is required. Interest-bearing debt of the corporation may not exceed six times stockholders' equity. In addition, such debt shall not bear a higher than an arm's length rate of interest, the maximum rates of which are from time to time published by the FTA.
- *Use of income.* Not more than 50 per cent of the income[35] benefiting from foreign withholding tax relief under a

30. Constructive dividend situations include, *inter alia*, domiciliary companies which use more than 50 per cent of their gross profit for payments of any kind which they treat as expenses in their profit and loss account, as well as the providing of services to an affiliated person or company for a consideration which is less than 10 per cent of the total cost incurred in connection with such services.
31. Except in the case of excessive, not at-arm's-length amounts paid for such items, where the excessive portion of such payments is re-characterized as a constructive dividend, subject to the withholding tax.
32. This means in fact that the Swiss corporate entity, which is treated as the taxpayer and obligee of the withholding tax, must not bear the burden of the tax, but rather charge it on to the (direct) recipient of the taxable benefit. If the Swiss taxpayer fails to charge the withholding tax to the beneficiary, the latter can be regarded as having received a benefit net of the Swiss withholding tax, i.e. 65 per cent of the actually taxable benefit. Accordingly, the taxable amount can be grossed up to 100 per cent, which brings the effective withholding tax burden up to some 53.8 per cent.
33. Under the Swiss tax treaty with Denmark, not only Danish corporations holding a qualifying participation in the Swiss dividend payor, but also any Danish-resident individual shareholder can qualify for the full refund of the Swiss dividend withholding tax.
34. Such as an own office with the necessary infrastructure and a minimal staff and the presence of a commercial activity.
35. Typically dividend, interest or royalty income.

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Swiss bilateral tax treaty shall be passed directly or indirectly to non-residents.[36]

- *Expense allocation*. Any expenses not related to the treaty-benefited foreign income must be covered by such other income.
- *Minimum distribution*. At least 25 per cent of the treaty-benefited income must be distributed by the Swiss resident corporation as a dividend, subject to the federal withholding tax.

In addition to these conditions, the Swiss tax treaties with Germany, France, Italy and Belgium require that treaty-benefited interest and royalty income be subject to full, ordinary Swiss taxation not only at the federal, but equally at the cantonal/communal level; otherwise, no treaty relief for such income shall be granted. In most of the Swiss cantons, corporations with cantonal tax privileges can elect to either pay full Swiss tax on interest and royalty income from these countries and to be granted the tax treaty relief or to renounce the tax treaty relief and enjoy the cantonal tax privilege. Far-reaching anti-treaty-shopping rules have reportedly been included in a new income tax treaty between Switzerland and the United States, which is expected to be signed in August 1996. The new Switzerland–United States income tax treaty will substantially limit the ability of foreign-controlled Swiss corporations to benefit from the treaty with respect to relief from US income taxes withheld at source.

V. FEDERAL STAMP DUTIES

A. Capital issuance stamp duty

Any contributions of cash or other assets to the capital of a joint stock corporation, limited liability company or cooperative corporation incorporated under Swiss law, whether or not made in exchange for an issue of shares, participation certificates or similar equity securities are subject to a federal stamp duty of 2 per cent of the net amount of the capital contribution. In the case of a contribution of non-cash assets, the tax is payable on the fair market value.

Exemptions from the capital issuance stamp duty apply in a number of situations:

- the initial contribution to the capital of a corporate entity incorporated in Switzerland in connection with its formation, if the net amount of the contribution does not exceed CHF 250,000;
- share issues in connection with transactions which qualify, for stamp duty purposes, as corporate reorganizations (mergers of corporate entities, merger-like transactions[37], spin-offs, certain corporate transformations);
- share issues in connection with the transfer of the corporate domicile (registered office) of a foreign corporation, which originally was incorporated abroad, into Switzerland, if the foreign law does not require a formal liquidation of the emigrating corporation.

In addition to the above exemptions, the contribution of assets to the Swiss branch of a foreign corporation is not subject to the capital issuance stamp duty, unless the branch is to be regarded as a domestic enterprise.[38]

Furthermore, the issuance of certain debt instruments (debenture or cash bonds, notes, money market instruments) by a Swiss debtor is subject to a special stamp duty at the rate of 0.12 per cent for each full or partial year of the maximum term (bonds, annuity bonds, mortgage bonds, debt register claims), 0.06 per cent (cash bonds, certificates of deposit), and 0.06 per cent prorated at $^1/_{360}$ of the tax rate per day in the case of money market papers.

B. Securities transfer stamp duty

The transfer of the title to certain debt or equity securities[39] issued by a Swiss or foreign issuer for a consideration is subject to the securities transfer stamp duty, if at least one of the parties to or an intermediary in the transaction is a Swiss securities dealer as defined in the Stamp Duty Law. The transfer stamp duty is measured by the amount of consideration paid in return for the securities transferred; the tax rates are 0.15 per cent for Swiss and 0.30 per cent for foreign securities. The term "securities dealer" includes professional securities traders, banks, brokers and similar financial institutions, as well as any corporation that holds, according to its last annual balance sheet, taxable securities in excess of CHF 10 million.[40] The securities dealer owes 50 per cent of the stamp duty for himself and another 50 per cent if the other party to the transaction is not a securities dealer.

The law provides that certain transactions be exempt from the securities transfer stamp duty, these include, *inter alia*, the transfer of Swiss or foreign equity securities in exchange for the issue of shares of a Swiss corporation and the issue of shares of a foreign corporation to a Swiss corporation, e.g. a holding company. All transactions that are subject to a capital issuance stamp duty are likewise exempt from the transfer stamp duty.

VI. VALUE ADDED TAX (VAT)

A. General

Effective 1 January 1995, Switzerland introduced a modern, mostly EU-compatible VAT system in replacement of the former sales tax, which was levied on the domestic turnover and

36. This condition applies not only to foreign-controlled, but also to any Swiss corporations.
37. For example, the contribution of shares representing qualifying majority interests in at least two active, Swiss or foreign corporations to the share capital of a Swiss holding company in connection with the formation or a capital increase of such holding company.
38. This is the case if the foreign corporation (i) is effectively managed in Switzerland and (ii) carries on a commercial activity within Switzerland.
39. Simple acknowledgments of debt in writing are not considered taxable instruments. Therefore, normal commercial loans, including those made between affiliated companies, are not subject to the transfer stamp duty.
40. Accordingly, most of the larger Swiss holding companies and other Swiss corporations qualify as securities dealers for stamp duty purposes.

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importation of goods only, i.e. services remained untaxed. Until such time as a federal statute has been drafted and passed by the federal parliament, VAT is being levied on the authority of an Ordinance of the Swiss Federal Council. The tax is charged on the domestic supply and own use of goods and services by persons or enterprises whose relevant annual turnover amounts to at least CHF 75,000. It is also chargeable on the importation of goods and services into Switzerland.[41] The standard rate of Swiss VAT is at present 6.5 per cent; a special rate of 2 per cent applies to food, beverages and certain other products.

The turnover from certain categories of services is exempt from, or outside the scope of, VAT, in particular, capital-related payments such as interest and dividends. The receipt of payments of this kind does not cause a person or enterprise to become a taxpayer for VAT purposes and if a person or enterprise otherwise liable to Swiss VAT receives such payments, it will not be entitled to credits or deductions of input VAT suffered on services or goods purchased that are used to perform VAT-exempt activities.[42]

The taxable supply of a service includes, *inter alia*, the transfer of any intangible asset or a right for valuable consideration (especially, royalties). If a taxable supply of goods or services is made to a foreign recipient and consumed abroad, such supply is generally zero-rated, i.e. no Swiss VAT is due. Zero-rated supplies fully entitle the VAT taxpayer to deductions, credits or reimbursements, as the case may be, for input VAT suffered, including VAT payable upon the importation of goods or services from abroad.

If a foreign enterprise operates in Switzerland through a branch and if the operations of the Swiss branch are liable to Swiss VAT, the Swiss branch must register for Swiss VAT. The branch will then for VAT purposes, be regarded as an entity separate from the foreign head office (and any branches in other countries).

It should be noted that the definition of the place where a taxable service is rendered is not exactly the same under Swiss law as under the VAT legislations of the EU Member States. Under the Swiss VAT Ordinance the place of supply of services is generally defined as the place where the supplier has its registered office or permanent establishment and from which the service is rendered. In the absence of any such registered office or permanent establishment, the place of supply of a service is deemed to be the place at which the supplier is domiciled, or from which it carries out its activity.[43] Hence, if such services are provided by a Swiss resident company or a Swiss branch of a foreign company to a foreign customer, the services are deemed to be provided in Switzerland. However, notwithstanding a Swiss place of supply of a service, a zero per cent Swiss VAT rate may be applicable in many cases, if the service is considered to be used or consumed outside Switzerland.[44] The same may be true in regard to services imported from abroad, if they are considered to be used or exploited abroad.

B. VAT position of Swiss holding companies and other entities with cantonal tax privileges

Article 19(1)(d) of the VAT Ordinance excludes from the scope of VAT corporations, cooperatives and foundations with a cantonal tax privilege according to Article 28 THL, as well as Swiss permanent establishments of foreign enterprises with such a cantonal tax privilege. However the FTA only applies this provision, to pure holding and domiciliary companies which do not perform any commercial activity at their corporate seat in Switzerland. As soon as a resident entity or a permanent establishment of a foreign entity maintains a infrastructure (own office, staff) in Switzerland[45], it will not fall under the exclusion of Article 19(1)(d) of the VAT Ordinance.

As a consequence, pure holding and pure domiciliary companies suffer any input VAT as a final charge. On the other hand, an entity that conducts its activities through a certain physical presence in Switzerland will not fall under the exclusion of Article 19(1)(d). This is the case even where its income is derived exclusively from the export of goods or services, which are deemed to be consumed abroad. In these circumstances if the entity's sales of goods or services to foreign customers are zero-rated, it can claim a credit for its input VAT suffered, which may result in excess VAT credits and corresponding periodic VAT reimbursements to the taxpayer.

41. Even persons who are otherwise not subject to VAT independently owe VAT on the value of imported services, if such value in any year exceeds CHF 10,000.

42. A company other than a holding company, which makes taxable supplies of goods or services and, in addition, receives *dividend* income will not suffer a reduction of its right to credit or deduct input VAT. On the other hand, if a *holding company* (holding purpose stated in the Articles of Incorporation) derives e.g. royalty or services income which makes it subject to VAT, then its dividend income is treated as exempt turnover, which leads to a proportional reduction of the input VAT credit. Furthermore, the receipt of *interest* income by a VAT taxpayer leads to a reduction of the input VAT credit.

43. Art. 12 (1) VAT Ordinance.

44. The FTA has issued a special circular containing guidelines as to the determination of the place of use of various categories of services. Whereas services related to real estate are deemed to be used where the real estate is located, some other types of services are considered to be used where they are actually rendered (e.g. teaching, cultural, sports, artistic performance, safekeeping of things, appraisals of movable objects, etc.). A further category of services is deemed to be *supplied at the place of the recipient's place of business or domicile*. This category includes banking, publicity, consultancy, asset management, collecting, engineering (other than real estate related), research, legal, accountancy, auditing and fiduciary services, translation, EDP, information supply, assignment and granting of copyrights, patents, licences, trademarks, model and pattern rights, manufacturing rights etc., undertakings not to perform a professional activity or not to claim a right and making manpower available.

45. Which is, within certain limits, possible for mixed companies, auxiliary companies and administration companies as well as for holding companies.

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