Switzerland: the ebb and flow of human capital

International Tax

01 November 2013

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Key Points

- When deciding whether to establish a presence in Switzerland, a primary consideration is invariably the choice of canton
- Considerable fiscal and regulatory changes are afoot that will alter the push and pull factors for Switzerland

Everyone loves to talk about Switzerland – a naturally beautiful country sitting at the heart of Europe. Economically, Switzerland seeks to offer something to everyone, particularly in the financial services and asset management industry. On the one hand, Switzerland wants to align itself with global political opinion, being perceived as tough on regulatory and tax 'excess', but on the other hand, it realises that in order to attract the brightest entrepreneurs, Switzerland must retain a competitive advantage. These two opposing drivers have meant that over the past five years or so Switzerland has seen a shifting tide of human capital and investment as the country has sought to find a balance between the two.

Comparing and contrasting

In the UK, the few years leading up to the 2010 general election, there was a period of fiscal change. In 2008, significant changes were made to the non-dom regime in the UK, for example bringing in the £30,000 remittance basis charge. Additionally, the UK saw uncertainty over residency rules, with the *Gaines-Cooper v HMRC* [2007] EWHC 2617 case demonstrating the lack of ability to rely on guidance published by

HMRC. This resulted in the statutory residence test (SRT) recently being introduced. In addition, the 50% marginal rate of tax was introduced for taxpayers generating over £150,000 of income (recently reduced to 45%), coupled with the clawback of the personal allowance for earners above £100,000 and of tax relief on pension contributions. During the same period, there was also a move away from taper relief on business assets held for at least two years, where previously entrepreneurs could benefit from an effective capital gains tax rate of only 10%. Even the main rate of corporation tax was comparatively high at 30% until 31 March 2008 (again, recently reduced). Accordingly, owner-managed businesses in the UK were suffering.

In contrast, many cantons in Switzerland were offering attractive advance tax rulings effectively fixing the corporate tax position for five years, assuming the structure of group operations remained materially unchanged over that period. Even cantons such as Geneva and Zurich were seeking to attract inward investment, through particularly favourable tax rulings. Other cantons were going to the extent of offering tax holidays and, in certain cases, combined tax rulings were being offered for both corporate and personal tax purposes. Unsurprisingly, a number of UK businesses took note.

Specifically in the asset management industry, a key driver for attracting inward investment into Switzerland, prior to the Amended Swiss Collective Investment Schemes Act (Amended CISA) that came into force on 1 March 2013, was that a Swiss manager of a foreign collective investment scheme was able to operate without being formally regulated by the Swiss Financial Market Supervisory Authority (FINMA). A light touch regulatory regime existed, whereby such a manager could register with a self-regulatory organisation, effectively self-imposing anti-money laundering procedures and a code of conduct, without a heavy compliance burden. By comparison, in order for a business to undertake any investment management activity in the UK, it would need to implement a suitable operational structure, submit a formal application to the Financial Services Authority (FSA) (now the Financial Conduct Authority) to obtain the relevant permissions and then also comply with ongoing UK regulation.

Considering both the fiscal and regulatory push and pull factors into Switzerland, the country has been able to successfully attract both large and small businesses in the financial services and asset management industry.

Swiss overview

When deciding whether to establish a presence in Switzerland, a primary consideration is invariably the choice of canton in which to establish a structure.

Switzerland comprises 26 cantons. Within each canton are many communes. Tax is imposed at all three levels, ie at a federal, cantonal and communal level. While tax policy and fiscal law are governed and set centrally and are standardised by the Swiss Federal Act on the Harmonisation of Direct Taxes of Cantons (1990), it should be noted that each canton and commune has the power to set its own rates of tax.

All cantons compete for foreign direct investment in different ways. A key distinction to be drawn between the different cantons is that the flexibility and pragmatism of each is influenced by whether the canton is more urbanised and potentially a financial or political hub (for instance, the cantons of Geneva, Zürich, Bern, Basel) or whether the canton has a more peaceful setting (for instance, the cantons of Schwyz, Zug, Valais, Neuchâtel).

Typically, the financial and political hubs tend to compete by attracting interest from foreign businesses looking to establish a presence in Switzerland that wish to base themselves close to the private banks and a significant high net worth investor base. Such hubs also have greater concentrations of highly qualified labour, which is also an attraction for foreign businesses. In such centres, there is greater pressure on housing, schooling and infrastructure, which clearly creates certain barriers to entry. Due to the attraction of the local network and infrastructure in these more urban cantons, there is less need for each cantonal tax administration to attract inward investment by setting low rates of tax and agreeing favourable fiscal terms in the form of tax rulings.

Conversely, those cantons in the most scenic of surroundings do not attract foreign direct investment in the same manner and thus have to compete with the financial hubs by playing to their strengths. The natural draw of the mountains and lakes can be a significant factor. There are also not the same pressures on housing, schooling and infrastructure as in the more urban cantons. In addition to these elements, local departments of the economy actively market their cantons. Each cantonal parliament invariably plays a vital part by setting lower rates of tax, with the cantonal tax administration showing greater pragmatism in agreeing favourable fiscal terms in the form of tax rulings.

While fiscal policy is a key consideration, with three main official languages (German, French and Italian), businesses are often drawn to a canton where they have inherent linguistic links.

Individuals

Individuals resident in Switzerland are subject to income tax on their worldwide income. Additionally, worldwide assets are taken into consideration for the purposes of net wealth tax in respect of Swiss resident individuals. Broadly, the total tax burden for an individual will be dependent on various factors, namely:

- the level of taxable income of the individual;
- the taxable net assets owned by that individual;
- the commune within a particular canton in which an individual resides;
- whether that individual is married;
- whether there are two earners in the family;
- whether that individual has children under 18 and, if so, the number of children;
- whether that individual has children aged 19 to 25 in initial training and, if so, the number of children; and
- the religious denomination of that individual.

In order to demonstrate the different effective rates of tax at a personal level in both the cantons of Geneva and Schwyz, we set out below a handful of examples, based on a controlled set of assumptions. The fixed assumptions are as follows:

- married individual;
- one earner;
- two children under the age of 18;
- none above the age of 18; and
- atheist.

Table 1 demonstrates the total tax burden (federal, cantonal and communal) and effective rates of tax, based on the above assumptions at taxable income levels of CHF 250,000, CHF 500,000 and CHF 2 million and taxable assets of CHF 100,000, CHF 300,000 and CHF 1 million. It demonstrates this at the lowest and highest tax communes in both the cantons of Geneva and the canton of Schwyz.

Readers interested in calculating potential income tax liabilities based on different inputs can use this website. Comparing the communes with the highest rates of tax in the respective cantons, the range is from 29.45% to 42.79% in Geneva and from 21.32% to 25.02% in Schwyz.

Wealth tax should also be considered and varies depending on where the principals of the business are resident, but rates range from under 0.1% to a little over 1%. An additional point to note is that, broadly, private capital gains in Switzerland are tax free, although this is not the case in respect of gains arising from the disposal of real estate.

As things currently stand, inheritance tax is also the subject of significant cantonal variation. In the canton of Schwyz, for instance, there is no inheritance tax charge. However, in the canton of Geneva, while no inheritance tax would fall due on bequests between spouses or partners, direct descendants or parents, bequests between independent third parties would typically be subject to inheritance tax of between 42% and 54.6%. It should be noted that a vote is expected on the potential retrospective application, dating back to 1 January 2012, of a 20% rate of federal inheritance tax on sums over CHF 2 million across Switzerland, which would override the cantonal inheritance tax regimes.

While comparing rates of taxation is a key consideration for individuals, other costs should also be borne in mind, such as social security contributions and compulsory private health insurance. Principals of businesses wishing to set up in Switzerland will also need to consider other factors, such as obtaining work permits, schooling for children and finding suitable accommodation.

Companies

Swiss resident companies are taxable on their worldwide income, whereas a Swiss permanent establishment of a non-Swiss resident company is taxable on the income attributable to the activity of the branch.

Effective rates of corporation income tax vary from canton to canton and range from approximately 11.5% to 24.5%, including the federal, cantonal and communal corporation tax. A multiplier is applied to the statutory tax rate depending on the tax year, the commune and canton. The highest rates of corporation tax at around 24.5% can be found in certain communes in the canton of Geneva, while the canton of Schwyz has corporation tax rates towards the bottom end of the range.

In addition to corporate income tax, a Swiss resident company or permanent establishment of its overseas parent may be liable to capital tax (which is broadly a wealth tax levied in relation to a company's level of capital). Cantonal tax laws often provide a credit for an element of capital tax paid to the extent that corporate income tax falls due.

It should be noted that Switzerland does not have specific transfer pricing legislation; however, OECD guidelines on transfer pricing are followed and it is in the tax administration's interest to ensure that appropriate levels of taxation are collected in Switzerland. Article 58 of the Federal Direct Tax Act 1990 and Article 24 of the Harmonisation of the Cantonal and Communal Taxes Act 1990 provide the tax administration with the ability to restrict excessive or commercially unjustifiable deductions and set out arm's length adjustment provisions. In addition, Swiss tax law provides for a general anti abuse rule (GAAR), which allows the tax administration to apply the provisions of the law in situations where there is perceived abuse of fiscal rules.

For businesses establishing operations in Switzerland, there is also the potential for preparing, negotiating and agreeing corporation tax rulings with the local cantonal tax administration (and perhaps also personal income tax rulings in certain circumstances). Such a tax ruling for corporation tax purposes would provide certainty for a five year period with regard to the level of taxable income and potentially convey preferential tax treatment. Such advance rulings only provide certainty to the extent that no material changes (economic or legal) to the structure arise during the period. As highlighted above, some cantons tend to offer more favourable corporation tax rulings, although the extent to which they might demonstrate their pragmatism might be dependent on such things as:

- how much capital is being injected into the business in Switzerland;
- the perceived relative value brought to the canton in terms of inward investment (for instance, hiring local employees and engaging with local service providers);
- understanding what activities are to be undertaken and the split between Swiss and non-Swiss functions;
- appropriate documenting of the business model to be presented to the cantonal tax administration; and

- effective negotiating with the cantonal tax administration.

There may also be the scope for a personal tax ruling or a ‘forfait’ depending on the activity undertaken from Switzerland, but the forfait is falling out of favour in certain cantons, for instance the canton of Zurich has banned the use of the forfait.
A forfait would typically be relevant for individuals resident in Switzerland, but who did not undertake any economic activity in or from Switzerland.

In respect of individuals wishing to establish a business in Switzerland, an attractive solution can be found in a canton that best suits both the commercial drivers of the business and the personal needs of the principals. But there are other factors to consider from both a tax transparency and regulatory perspective, where the landscape is changing.

Move towards transparency

The Global Forum on Transparency and Exchange of Information for Tax Purposes is mandated by the OECD to, very broadly, undertake peer reviews to assess the extent of transparency and exchange of information in respect of member states against the internationally agreed standard for transparency and exchange of information. Over 100 peer reviews have been undertaken by the Global Forum and a report has recently been published to the G20. Of those peer reviews undertaken for the purposes of the report, only 14 countries were unable to pass directly to the second stage of peer reviews, one of those being Switzerland.

The UK–Swiss agreement to cooperate on tax matters is an example of how Switzerland is moving towards greater tax transparency. Although the agreement retained the scope for some investors to remain anonymous in return for making the one-off payment on 31 May 2013, many investors were proactive and took the decision for voluntary compliance, making use of the extremely tax favourable terms of the Liechtenstein disclosure facility (LDF).

The agreement has just entered into a new phase, with the Swiss tax administration moving to provide information in respect of UK account holders on a monthly basis to HMRC from 31 July 2013, where, as mentioned, such investors elected for voluntary disclosure.

Even among those who sought the anonymous approach, both because of the continuing international pressure, particularly in relation to anti-money laundering, and in recognition of the particularly favourable terms available to become completely transparent (in terms of the UK via the LDF which runs until 5 April 2016), it is likely that many will opt for transparency in the coming years.

Move towards regulation

From a regulatory perspective, the Amended CISA was designed to better align Swiss rules governing collective investment schemes with the EU's Alternative Investment Fund Managers Directive (AIFMD). While certain potential regulatory compliance advantages (particularly in relation to AIFMD remuneration rules) may arise from appropriately structured businesses operating outside of the EEA (eg in Switzerland), since the enactment of the Amended CISA on 1 March 2013, there has been an extension of those circumstances in which firms require formal FINMA permissions in order to commence trading. Accordingly, depending on the specific circumstances of managers, there may be a trade off to be had, with Switzerland being appropriate for some businesses and not for others.

Additionally, a broader Swiss financial services act anticipated to come into effect within two years will serve to broaden the scope of FINMA's powers, yet again extending potential circumstances in which firms will need to be subject to formal FINMA supervision. While the specifics of such legislation has yet to be released in draft, it is clear that the days of light touch regulation in Switzerland are numbered, which will inevitably increase barriers to entry.

Conclusion

Through its cantonal system, Switzerland offers a balance between financial and political urban hubs and tax efficient solutions in scenic surroundings, that will provide businesses with a solution that suits their commercial needs. However, considerable fiscal and regulatory changes are afoot that will alter the push and pull factors for Switzerland.

One thing is certain – the democratic system in Switzerland can result in wheels turning slowly in legislative matters. Accordingly, individuals and businesses wishing to establish a presence in Switzerland should be able to enjoy and benefit from the relative stability that Switzerland has to offer.