International tax and corporate information

July 2019 – n. 57

fidinam & Partners

Tax, Legal and Corporate Consultancy

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TAX REFORM AND AHV FINANCING (TRAF)

Introduction

On 19 May 2019, the public voted to adopt the Federal Act on Tax Reform and AHV Financing (TRAF), which was approved by 66.4% of the votes cast. For the voters, there were two important elements for the well-being of Switzerland: a competitive and internationally compliant corporate tax system and a reliable pension system. The reform of corporate taxation is necessary because certain tax privileges do not comply with international standards. Moreover, the financial situation of the AHV is deteriorating, both as a result of the development of financial income and, above all, as a result of demographic trends. In this sense, the scheme accepted by popular vote is an important improvement[1]. The scheme will enter into force definitively on 01.01.2020.

1 https://www.bsv.admin.ch/bsv/it/home/assicurazioni-sociali/ahv/riforme-e-revisioni/staf.html

The main changes at the Federal Level (LIFD)

The main changes in direct federal taxation (DFT) are as follows:

- Possibility of declaring hidden reserves at the time of transfer of registered office, transfer of businesses and/or branches to/from foreign countries;
- Extension of the overall tax credit for business establishments of foreign companies in Switzerland;
- Limitations on the principle of capital contributions, in particular for listed companies;
- Restrictions on dividend relief for participations qualifying as private assets and/or commercial assets of taxpayers domiciled in Switzerland;
- Adjustments relating to the transposition of profit generated by the sale of shares to a subsidiary.

Major changes in the level of harmonisation of Direct taxes (LAID)

The main changes in the harmonisation of direct cantonal and communal taxes (LAID - StHG) can be summarised as follows:

- Profits from patents and similar rights will be taxed at a reduced rate at cantonal level (Patent Box).
- Additional deductions for research and development activities;
- Deductions of imputed interest expense on capital;
- Capital tax adjustments;
- Possibility of declaring hidden reserves at the time of transfer of registered office, transfer of businesses and/or branches from/to foreign countries;
- Limitations on the principle of capital contributions, in particular for listed companies;
- Adjustments relating to the transposition of profit generated by the sale of shares to a subsidiary.
- Restrictions on dividend relief for participations qualifying as private assets and/or commercial assets of taxpayers domiciled in Switzerland;
- Abolition of cantonal tax privileges (Holding companies, financial branches, management companies etc);

What will change for the Canton of Ticino (LT)?

It should be remembered that with regard to the amendments to the law passed by the electorate, more specifically the abolition of the privileged tax statuses at cantonal level and the related amendments of LAID - StHG level, each canton can decide autonomously on the basis of its own cantonal finances, in accordance with the general guidelines of LAID - StHG.

At the beginning of the summer, the Canton of Ticino is expected to issue a message of compliance with the regulations issued by LAID - StHG .

Other planned changes

The reform voted by the electorate also provides additional funding for the AHV. From 01.01.2020 the AHV will receive an additional annual amount of approximately CHF 2 billion, of which about 800 million from the federal coffers and the remaining 1.2 billion from companies and insured persons. Companies and insured persons will contribute 0.3 percentage points (0.15% employee; 0.15% employer) on the gross salary. For the first time in 40 years, there will therefore be an increase in contributions to the AHV in order to reduce the financing gap of this health insurance.

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MAIL-ORDER SALES IN RELATION TO VALUE ADDED TAX (VAT) – LEGISLATION IN FORCE SINCE 01.01.2019

Introduction

Mail order was at the centre of strong criticism between Swiss and foreign retailers. Foreign retailers, who until 31.12.2018 had benefited, with small consignments, from an import tax exemption of CHF 5[2], because these imports were exempt from tax for small quantities.

The legislator wanted to tighten up this unfair competition with regard to national law. Essentially, duty-free imports for small consignments remain in place, but legal provisions have been introduced to combat this unfair competition.

2 Art. 53 para. 1 of the VAT Act

Place of supply in respect of mail order

Supplies of small consignments (import tax up to CHF 5[3]) that a mail order vendor (foreign or Swiss) transports or ships from abroad to Switzerland and achieving a turnover of at least CHF 100,000 are considered to be supplies on Swiss territory[4]. As a result, it becomes a taxpayer on Swiss territory and must be registered for VAT.

Therefore, not only small consignments, but also other consignments for which the import tax amounts to more than CHF 5 per consignment, are considered to be deliveries to Switzerland. As a result, all deliveries to Switzerland are subject to tax on services rendered on Swiss territory for a mail order taxpayer.

The beginning and end of subjugation

Companies that have already exceeded the turnover limit of CHF 100,000 in 2018 are required to apply from 1 January 2019.

If the turnover is exceeded during the current year, the liability begins the month after the turnover of CHF 100,000 is reached.

The taxpayer may submit voluntarily to the register of VAT payers, at the beginning of the calendar year.

The liability ceases at the beginning of the current year in which the turnover threshold is not reached, if the taxpayer does not report anything to the FTA on turnover of less than CHF 100,000, the taxpayer remains voluntarily liable.

Details

Foreign taxpayers who are subject to the tax on the basis of their turnover, must have a tax representative[5] and cannot prepare the financial statements using the declining-balance method[6].

Conclusion

This new rule, which mainly regulates small consignments made by foreign suppliers, has put a firm hold on unfair competition, since, from 01.01.2019, these foreign taxpayers will have to be subject to these conditions in the register of VAT taxpayers.

3 Art. 1 (d) OIVA
4 Art. 7 cpv. 3 lett. b LIVA
5 Art. 67 para. 1 of the VAT act
6 Art. 77 para. 2 (f) VAT Ordinance

TAX REPRESENTATION IN THE FIELD OF VALUE ADDED TAX – 2018 AMENDMENT

Introduction

Any person who, irrespective of his legal form, carries on an activity for the purpose of obtaining, by means of services, a stable income, shall be liable to the tax.

Companies with an annual turnover in excess of CHF 100,000 from taxable services in Switzerland and abroad are required to be registered as taxpayers for VAT purposes[7].

Foreign companies operating in Switzerland and invoicing taxable services in accordance with the aforementioned law are required to have a tax representative (individual or legal entity) resident in Switzerland if they achieve a worldwide turnover of more than CHF 100,000.

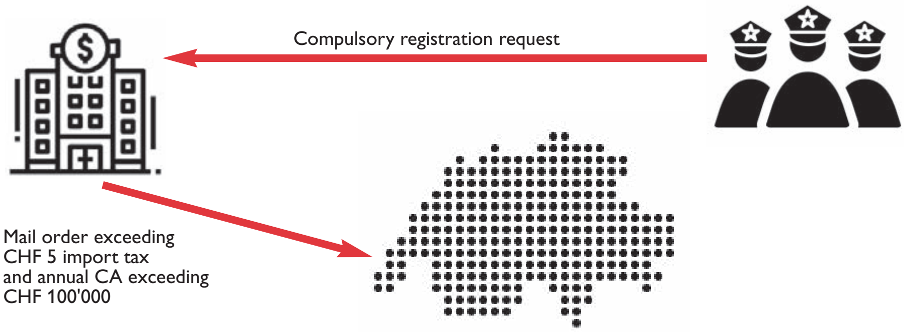
Which services are included in the listing?

All services and supplies carried out on Swiss territory (Swiss national territory and foreign customs enclaves)[8] are included in the listing.

In particular[9]:

- Cultural, artistic, sports, scientific, educational and entertainment performances;
- Catering services;
- Services in the transport of passengers (depending on the distance!);
- Services related to a fund such as, brokerage, administration, valuation and assessment of the fund, the provision of services in connection with the acquisition or establishment of real estate rights, the

7 Art. 10 para. 2 of the VAT act
8 Art. 3 (a) of the VAT Act
9 Art. 8 para. 2 of the VAT act



- provision of services in connection with construction preparation, architectural work and engineering.

The beginning and end of subjugation

The subjection shall commence for a foreign company at the time when it first performs a service on Swiss territory if, in the light of the circumstances, it can be assumed at that time that within the subsequent 12 months it achieves a turnover of more than CHF 100,000[10].

If it is not possible to assess at a specific time whether this turnover limit will be reached or not, a new assessment shall be carried out after no more than three months.

Whoever becomes a taxpayer in accordance with Art. 10 of the VAT Act must register voluntarily in writing with the FTA within 30 days of the start of the tax liability period[11].

The liability ends at the end of the calendar year in which they last perform a service on Swiss territory and it can be assumed that the turnover will not be reached even in the following period[12].

Tax representation in the field of vat

Tax payers without a domicile or registered office in Switzerland must appoint a tax representative with a domicile or registered office in Switzerland to fulfil their procedural obligations.

The FTA will require tax guarantees from the taxpayer:

- 3% of the presumed taxable turnover in Switzerland;
- Minimum CHF 2'000 and maximum CHF 250'000

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LUXEMBOURG: IMPLEMENTATION OF THE ATAD DIRECTIVE (ANTI TAX AVOIDANCE DIRECTIVE) AND INTRODUCTION OF THE CFC REGULATION (CONTROLLED FOREIGN COMPANIES)

On 18 December 2018 the Luxembourg Parliament approved draft Law No. 7318, which implements EU Directive 1164/2016, hereinafter referred to as the "ATAD Directive", into Luxembourg law. (acronym for "*Anti Tax Avoidance Directive*"), which introduced measures to combat tax avoidance practices.

This new law, which came into force from the financial year that began on January 1, 2019, introduced into the "LITL" (*Luxembourg Income Tax Law*) Article 164 ter, which regulates the new legislation on CFC (*Controlled Foreign Companies*). Luxembourg has introduced such legislation by opting for the approach provided for in Article 7(2)(b) of the ATAD Directive, which provides for the attribution to the Luxembourg taxpayer of undistributed income of the foreign subsidiary arising from non-genuine structures created essentially for the purpose of obtaining a tax advantage from locating the company in a country with a preferential tax status. The CFC rules apply to legal entities resident for tax purposes in Luxembourg and subject to income tax ("*Impôt sue le revenu des collectivités*") and to permanent establishments in Luxembourg of companies resident in another Member State of the European Union or in a third country. For a foreign company or permanent establishment to be considered a CFC, both of the following conditions must be met:

A. Control test:

According to Art. 164 ter (1) a company is considered a subsidiary if the Luxembourg parent company holds, alone or together with other associated companies, a direct or indirect shareholding of more than 50% of its capital or voting rights, or is entitled to receive more than 50% of its profits. In the case of a permanent establishment, of course, this condition will always be met.

According to Art. 164 ter (2) an associated company is considered:

- any entity (including a *partnership*), whether resident or not, in which the Luxembourg taxpayer directly or indirectly holds a participation in terms of voting rights or capital ownership of at least 25%, or is entitled to receive at least 25% of the profits of that entity;
- an individual, or any entity (including a *partnership*), whether resident or not, who directly or indirectly holds in the Luxembourg tax entity an interest in terms of voting rights or capital ownership of at least 25% or is entitled to receive at least 25% of the profits of the Luxembourg tax entity.

B. Effective tax rate test:

According to Art. 164b (1) comma (2) a foreign company or permanent establishment shall be deemed to be a CFC if the effective income tax paid by it is less than 50% of the income tax it would have paid in Luxembourg, in accordance with local tax law, had it been resident there. The comparison is made between the Luxembourg corporate income tax rate (18% in 2018) and therefore to a rate of 9%. In this calculation the contributions to the unemployment fund and the *Municipal Business Tax* are not considered, which bring the total effective tax rate of the income tax of Luxemburg to approximately 26%.

If a foreign entity or permanent establishment meets both of the above tests, the Luxembourg tax entity must include in its taxable income (subject only to *corporate income tax*), their undistributed income during the same financial year, provided, however, that it derives from non-genuine structures created essentially for the purpose of obtaining a tax advantage. Art. 164b (3) provides that a corporate structure is to be considered as non-genuine if it does not hold the assets that are the source of all or part of its revenues, nor assumes the risks associated with them, if it were not controlled by a Luxembourg entity, where persons holding significant functions play an essential role in the creation of the revenues of the foreign controlled company.

The new Law excludes from the CFC companies that realise an annual income of less than EUR 750'000 or those who make a profit of less than 10% of the operational costs of the same fiscal year. In this regard, it should be noted that the cost of assets sold outside the country where the CFC is located and payments to associated companies cannot be included in operating costs.

The income of the CFC shall be included in the income of the Luxembourg parent company in proportion to its participation percentage, but limited to that part of the income which may be attributable to the activity carried out by persons with significant roles within the Luxembourg shareholder and determined on the basis of the *arm's length principle*. In the event that the CFC has an operating loss, no liability will be charged to the Luxembourg parent company and the losses may be carried forward and used to offset future profits. The Luxembourg tax entity will be entitled to the credit for the tax paid by the CFC on that part of the income included in the Luxembourg tax base.

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10 Art. 9a VAT Ordinance
11 Art. 66 para. 1 of the VAT act
12 Art. 14 para. 3 of the VAT act

THE BRITISH VIRGIN ISLANDS ADHERE TO THE NEW INTERNATIONAL STANDARDS ON ECONOMIC SUBSTANCE

Much has been said in recent months about the new international standards wanted by the OECD and relaunched by the European Union regarding the requirements of economic substance that companies and entities will have to comply with in order to be considered tax compliant.

In this respect, and in order to avoid the listing of non-cooperative countries, the British Virgin Islands and other jurisdictions with similar characteristics including Bermuda, the Cayman Islands, Jersey, Guernsey and the Isle of Man, have therefore decided to adhere to the new regulatory framework by committing themselves to its implementation.

In the following article, we will examine the case of the British Virgin Islands.

At the moment, as confirmed by the measures actually undertaken, the behavior of the BVI appears to be aimed at maintaining international consensus by avoiding its inclusion in the list. In detail, those measures are as follows:

- On 1 January 2019, the law known as "The Virgin Islands Economic Substance (Companies and Limited Liability Partnership) Act 2018" (hereinafter referred to as "ESA") entered into force;
- On April 23, 2019, the International Tax Authority of the BVI published the "Draft Economic Substance Code" (hereinafter "Draft Code"). It is a non-legally binding text which provides guidelines for the correct interpretation of ESA.

First of all, the types of activities considered relevant for its application are defined. These activities include:

- banking business
- insurance business
- fund management business
- finance and leasing business
- headquarters business
- shipping business
- holding business
- intellectual property business
- distribution and service centre business

Companies and entities that carry out activities other than those indicated do not fall within the scope of application of the legislation. According to the interpretations provided, the mere holding of current accounts, the possession of real estate for personal use and the holding of equity investments are not restricted by the new economic substance requirements.

Three questions need to be asked in order to ensure proper application of the rules:

a) if the entity has a legal form that falls within the scope of the ESA;
b) if the entity performs one of the relevant activities referred to by the ESA;
c) if the entity is resident for tax purposes in another jurisdiction other than BVI, and that jurisdiction is not blacklisted for tax purposes.

If the answer to questions (a) and (b) is positive and (c) negative, the economic substance test will be used to assess whether the entity meets certain requirements, which vary depending on the following types of activities:

a) holding business;
b) intellectual property business;
c) another type of relevant activity.

To pass the test, the entity must have an adequate number of employees and premises available for its operations. For the activities of categories (b) and (c) only, it is also required that the relevant activity be directed and managed from the BVI and that management costs be generated there that are appropriate to the activity carried out.

The substantive requirements will be verified during the so-called "financial period", the terms of which should start no later than 30 June 2019 for companies existing as of 1 January 2019 and from the date of incorporation for all other companies.

Companies that do not meet the substance requirements will be subject to enforcement action that could go as far as the striking-off of the company.

We are closely following the implementation of the legislation and we remain available to customers and investors who wish to explore the subject further.

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