Annex 3: Tax Environment for Financial Transactions

Contents

List of abbreviations

AEOI	Automatic exchange of information
AMLA	Federal Act of 10 October 1997 on Combating Money Laundering and the Financing of Terrorism in the Financial Sector; Anti-Money Laundering Act; SR 955.0
BankA	Federal Act of 8 November 1934 on Banks and Savings Banks; SR 952.0
BEPS	Base erosion and profit shifting
BIS standard	Bank for International Settlements standard
CDF	Conference of Cantonal Directors of Finance
CoCos	Contingent convertible bonds
CRS	Common Reporting Standard
Cst	Federal Constitution of the Swiss Confederation of 18 April 1999; SR 101
CTR III	Third series of corporate tax reforms
DFTA	Federal Act of 14 December 1990 on Direct Federal Taxation; SR 642.11
DTA	Double taxation agreement
DTHA	Federal Act of 14 December 1990 on the Harmonisation of Direct Taxation at Cantonal and Communal Levels; SR 642.14
EU	European Union
EUR	Euro
EUT	EU taxation of savings income
FATF	Financial Action Task Force
FDF	Federal Department of Finance
FDFA	Federal Department of Foreign Affairs
FFA	Federal Finance Administration
FinIA	Financial Institutions Act
FINMA	Swiss Financial Market Supervisory Authority
FSB	Financial Stability Board
FTA	Federal Tax Administration
FTT	Financial transaction tax
G20	Group of the 20 most important industrialised and emerging countries
GBP	Great Britain pound, pound sterling
GLAC	Gone concern loss absorbing capacity
IncT	Income taxes
Model CAA	Model Competent Authority Agreement
NZZ	Neue Zürcher Zeitung
OECD	Organisation for Economic Co-operation and Development
RL	Radical Free Democratic Group FDP
SBA	Swiss Bankers Association
SCC	Swiss Criminal Code of 21 December 1937; SR 311.0
SIA	Swiss Insurance Association
SIF	State Secretariat for International Financial Matters
SIFI	Systemically important financial institution
SMEs	Small and medium-sized enterprises
SR	Classified Compilation of Federal Legislation
StD	Stamp duty
TBTF	Too big to fail
TLAC	Total loss absorbing capacity
TST	Transfer stamp tax
UBS	UBS AG
UK	United Kingdom
USA	United States of America
USD	US dollar
VAT	Value added tax
WT	Withholding tax

WTA	Federal Act of 13 October 1965 on Withholding Tax; Withholding Tax Act; SR 642.21
EATC	Parliamentary Economic Affairs and Taxation Committees
EATC-N	Economic Affairs and Taxation Committee of the National Council
EATC-S	Economic Affairs and Taxation Committee of the Council of States

1. Background

1.1. The Group of Experts

On 4 September 2013, the Federal Council decided to appoint a broad-based Group of Experts to analyse the framework conditions and future prospects of the financial centre and to derive recommendations for action. Apart from the Chairman, Professor Aymo Brunetti, the Federal Council had already appointed Professor Susan Emmenegger to the Group of Experts as a representative of academia. The FDF was authorised to confirm the members of the Group of Experts as soon as the public authorities and the private sector had nominated their representatives. One month later – on 10 October 2013 – the composition of the Group of Experts for the Further Development of the Financial Market Strategy appointed by the Federal Council was complete, and the FDF issued an appointment order as mandated by the Federal Council confirming the representatives of the private sector and the public authorities.

The mandate of the Group of Experts stipulated that the Group of Experts would, isolated from daily business, address the financial centre's challenges within Switzerland as well as its opportunities abroad based on the existing principles for financial market policy. In its work, the Group of Experts was to take account of the interests of the entire national economy. The focus of its work was on strengthening the competitiveness of Switzerland as a financial business location by improving the domestic framework conditions. One of the goals was to accompany the structural change in the financial sector and the real economy in the best possible way. The second focus was on preserving or improving market access abroad, with a view to preserving and promoting the added value of activities with an international orientation in the Swiss business location.

To perform this task in the optimal way, the Group of Experts decided at its first meeting on 2 December 2013 to form four subgroups that would carry out in-depth work on the cross-cutting topics of market access, economic risks, the tax environment for financial transactions, and the regulatory process and implementation of regulations for the attention of the Group of Experts.

1.2. The Subgroup on the Tax Environment for Financial Transactions

1.2.1. Composition

The Subgroup on the Tax Environment for Financial Transactions (hereinafter also "Subgroup") was composed as follows:

Co-Chairs:
- Michel Demaré, President of SwissHoldings
- Adrian Hug, Director of the FTA

Representatives of the private sector
- Urs Kapalle, SBA
- Andreas Risi, UBS
- Carl Emanuel Schillig, SIA
- Martin Zogg, SwissHoldings

Representatives of the public authorities
- Giancarlo Kessler (until June 2014) and Stefan Flückiger (from July 2014), both FDFA
- Christoph Schelling, SIF
- Fabian Baumer, FTA
- Martin Daepp, FTA
- Regine Loepfe, FTA, Scientific Secretariat

1.2.2. Mandate of the Subgroup

The mandate of the Subgroup on the Tax Environment for Financial Transactions was to examine whether and in which areas the tax treatment of financial transactions under Swiss tax law entails significant disadvantages compared with other countries. In particular, the Subgroup was mandated to analyse tax obstacles relating to the withholding tax and stamp duties and to examine the financial consequences for the national budget as well as more far-reaching implications of a possible redesign. At the same time, the Subgroup was mandated to analyse possible implications of upcoming strategic decisions in Switzerland and abroad.

To answer the question of which measures might be taken on an alternative or cumulative basis to improve the tax environment for financial transactions in Switzerland, the Subgroup was called upon to present options for action and proposals for reform in regard to the tax environment.

When evaluating the measures, the Subgroup took account of the benefits and costs from the perspective of the overall national economy. In this regard, it took account of the fiscal and foreign policy implications, including the question of how to compensate for any revenue losses, with a focus on the attractiveness and quality of Switzerland as a financial and business location.

In light of its findings, the Subgroup on the Tax Environment for Financial Transactions was asked to propose measures to the Group of Experts that would make economic sense. The Subgroup was also asked to develop recommendations for any need for amendments at the level of laws and ordinances.

1.2.3. Working methods of the Subgroup

General working methods

Number of meetings

The Subgroup on the Tax Environment for Financial Transactions held a total of ten meetings on the following dates: 5 February 2014, 21 February 2014, 19 March 2014, 24 March 2014, 22 May 2014, 20 June 2014, 18 August 2014, 5 September 2014, 1 October 2014, and 12 November 2014. All meetings were held in Bern.

Working methods

The Subgroup on the Tax Environment for Financial Transactions agreed that its discussions should be broad. Ongoing projects and legislative procedures were not bracketed but rather included.

To structure its working methods, the Subgroup on the Tax Environment for Financial Transactions prepared a list of topics during its first two meetings, already with a view to a possible structure for the final report. In order to fulfil its mandate, the Subgroup on the Tax Environment for Financial Transactions decided to address the following groups of issues:

Suboptimal tax framework conditions for bonds and collective investment schemes adversely affect the Swiss capital market. The focus was on the withholding tax.

Dynamic international developments in the banking business. The focus was on the following tax issues: the efforts toward automatic exchange of information (AEOI), the revision of the EU Taxation of Savings Income Agreement (EUT), the transfer stamp tax and the foreign financial transaction taxes, the withholding tax – and here especially the tax treatment of bail-in bonds to increase capital adequacy – as well as access by Swiss tax authorities to the financial data of persons in Switzerland.

For the insurance business, several industry-specific rules in current tax law were a challenge. The focus was on stamp duties, the income tax, and the value added tax.

In regard to regulatory provisions for banks and insurers, the challenge consisted in the higher capital adequacy requirements and market access. The withholding tax (including bail-in instruments) as well as the profit tax and the capital tax played a role.

The structure offered a common thread for the work of the Subgroup. The present final report of the Subgroup is also based on this structure.

Main meeting topics

For each meeting, one topic was selected as the focus of discussions. During the discussion, the topic was illuminated from all sides, analysed, and placed in an international context. For instance, one meeting each discussed the following topics in detail, after an introductory presentation: the withholding tax on bonds, concerns of the banking industry (including the European financial transaction tax and transfer pricing, but excluding bail-in bonds and the withholding tax), insurance-specific aspects, multiple taxation for corporate groups, and transfer pricing.

Hearing of experts

The Subgroup also invited experts on the various topics to its meetings. As part of the discussion on the withholding tax, a FINMA specialist was invited, who presented especially the bail-in bonds issue from the perspective of FINMA, as well as a withholding tax specialist of the FTA. Other FTA experts took part in individual meetings on the insurance business and transfer pricing.

Recommendations

On the basis of these discussions and the resulting findings, the Subgroup was able to formulate and adopt joint recommendations.

Specific working methods

Interim reports for the attention of the Group of Experts and the Federal Council

When it began its work, the Subgroup noted that it would address certain topics in depth that were already further advanced politically than the discussion in the Subgroup or the Group of Experts. Since it did not make sense to expound on a topic in the final report on which the Federal Council had already taken a decision, the Subgroup discussed with the Group of Experts how input might be given to the Federal Council at an earlier point in time. It was agreed that the Subgroup would be able to prepare an interim report on each of the topics concerned – *"Reform of the withholding tax"* and *"Automatic exchange of information"* – and submit the interim reports to the Group of Experts so that it could adopt them for the attention of the Federal Council.

The two documents were transmitted by the Scientific Secretariat of the Subgroup to the Group of Experts on 7 May 2014.

Interim Report on Automatic Exchange of Information

In the meantime, the Federal Council adopted the negotiating mandates on 8 October 2014 for the introduction of automatic exchange of information in tax matters with Switzerland's partner countries.

Interim Report on Reform of the Withholding Tax

After deliberation in the Group of Experts and various modifications, the Interim Report on Reform of the Withholding Tax was transmitted to the Head of Department on 16 June 2014. On 2 July 2014, the Federal Council mandated the FDF, in consultation with the Group of Experts for the Further Development of the Financial Market Strategy, to draft a consultation proposal that would redesign the withholding tax in a more differentiated way and that would specifically facilitate the raising of capital in Switzerland, including issuing of bail-in bonds by the big banks.

2. Objectives

The primary objective of tax policy is to obtain public revenue as part of the fiscal objective. But as part of a rational tax policy, taxes are not collected in a haphazard manner; they are instead collected in light of allocation, tax equity, and distribution objectives. The aspect of allocation can be divided into a location objective and an efficiency objective. Tax equity and the distribution objective are about a balanced distribution of tax burdens and a balanced secondary distribution of income and wealth.

One of the focuses of the work on the financial market strategy is to improve the framework conditions for financial transactions on Swiss financial markets. For this purpose, tax rules may have to be adjusted that are currently obstacles to optimal fulfilment of the location or efficiency objective. But the other tax policy objectives – namely tax equity and distribution on the one hand and the fiscal objective on the other – must also be taken into account, or at least these objectives should be interfered with as little as possible.

2.1 Location objective

A good tax system is successful in competing for mobile tax bases. It prevents the exodus of mobile tax bases into other jurisdictions, and it permits the settlement of new tax bases. It offers favourable tax conditions for

- the choice of location by businesses;
- the choice of residence by natural persons;
- the investment of financial resources;
- and the sale of goods and services.

While the focus of this report is not on the question of the choice of residence by natural persons, the tax framework conditions for financial transactions have an impact on the other three aspects.

Another important location factor is legal and planning certainty. Legal certainty exists if it is known in advance what the tax consequences of a certain transaction are. Planning certainty exists if an economic operator can count on the fact that the tax rules will not suddenly change and in particular that there will be no retroactive changes. In the case of persons engaged in cross-border activities, not only legal and planning certainty at home is relevant, but also legal and planning certainty abroad.

2.2 Efficiency objective

The objective of efficient taxation has several dimensions: low excess burdens, low enforcement burdens, correction of existing market failures, and macroeconomic stabilisation. The most important tax effects assume excess burden of taxation. Lowering excess burdens of taxation is therefore a top priority.

In the present report, the focus is on lowering excess and enforcement burdens:

- *Low excess burdens:* In markets where there are no externalities, the tax system should interfere with performance incentives as little as possible and should distort the entrepreneurial decisions of economic operators as little as possible. This means the excess burden of taxation is low, so that a high level of welfare is ensured.
- *Low enforcement burdens:* The enforcement costs of taxation should be kept low. This is true both for collection costs, which are incurred by the tax authorities, and for compliance costs, which are incurred by the taxpayers.

The present report does not focus on the following:

- *Internalisation of externalities (incentive objectives):* Where externalities occur, they can be internalised through an incentive tax. By correcting market distortions resulting from externalities, incentive taxes also contribute to welfare.
- *Macroeconomic stabilisation:* Taxes can also make a contribution to optimal utilisation of factors of production and to dampening of economic fluctuations.

2.3 Tax equity and distribution objectives

Balanced distribution of tax burdens and balanced secondary distribution of income and wealth under the tax equity and distribution objectives.

In the present report, the focus under the aspect of tax equity and distribution objectives is on horizontal tax equity. Horizontal tax equity demands that similar circumstances and similar performance must be taxed similarly.

On a subsidiary basis, vertical tax equity and the intragenerational redistribution objective are also considered:

- Vertical tax equity: Natural persons with higher performance should be taxed more heavily than natural persons with lower performance.
- Redistribution objective: Correction of primary income and wealth distribution through more even secondary distribution of income and wealth.

2.4 Fiscal objective

The fiscal objective should facilitate funding of activities of the state, which in turn are derived from the allocation and distribution objectives. Tax revenue can be adjusted flexibly to changing funding needs.

The discussion of the fiscal objective in the present report focuses on being able to secure existing tax revenue at least at today's level.

3. Framework conditions in the national and international environment and resulting problems (overview of the current tax situation), with a focus on the importance of the tax environment

3.1. Capital market – Challenge: Suboptimal tax framework conditions for bonds and collective investment schemes adversely affect the Swiss capital market; Focus: Withholding tax

National environment

With reference to the Interim Report on Reform of the Withholding Tax by the Group of Experts for the Further Development of the Financial Market Strategy,[1] the Federal Council mandated the FDF at the beginning of July 2014, in consultation with the Group of Experts, to draft a consultation proposal for a reform of the withholding tax.

With the revision, the Federal Council aims to eliminate the current adverse effects and to strengthen the Swiss capital market. Because of the administrative burden of the withholding tax and the only partial possibility of claiming a refund, the Swiss capital market is currently not attractive for foreign investors.

- *Adverse effects on the business location:* Because of the restrictions, foreign investors avoid Swiss bonds, which is a significant damper on the demand volume for new Swiss bond issues. Major Swiss corporations therefore often try to avoid the burden associated with the tax by carrying out their financing transactions through foreign companies. This also allows them to avoid having to pay higher yields to creditors as compensation. As a consequence, the corporations incur additional costs for maintaining foreign structures. In many cases, the guarantee function of the withholding tax misses its mark. On the other hand, Swiss SMEs without international representative offices are unable to carry out international capital market transactions directly from Switzerland, in particular not in order to obtain EUR, GBP, or USD, for instance, since the income on the raised capital is subject to the withholding tax if the resources are used in Switzerland. Swiss SMEs therefore rely on alternative financing instruments.

- *Adverse effects on the financial centre*: A capital market for domestic corporate bonds exists only to a very limited extent today. A stronger capital market in Switzerland would be attractive for numerous domestic financial institutions, since they would be able to offer the associated services and generate additional value added in Switzerland. The withholding tax is also a problem in connection with the issue of loss-absorbing capital instruments from Switzerland. Due to regulatory requirements as part of the TBTF countermeasures, the two big banks are already required to issue loss-absorbing capital instruments such as CoCos (contingent convertible bonds) and write-off bonds from Switzerland. To place these bonds with international investors, CoCos and write-off bonds have been exempted from the withholding tax until the end of 2016. The expiry of this withholding tax exemption as well as additional, more burdensome demands on loss-absorbing borrowed capital at the international level (bail-in bonds) necessitate in the near future that the issue of the withholding tax must be approached as a whole in connection with the regulatory TBTF requirements (see point 3.5.1).

- *Settlement of international services/products*: Compared to other markets internationally, the management of cash pools from Switzerland is subject to tax disadvantages, which is why these activities have predominantly migrated to foreign countries. Swiss banks do not have sufficient commercial banking activities abroad and are unable to manage foreign cash pools comprehensively, even of Swiss enterprises. Collective investment schemes also suffer from the difficulties in claiming refunds. For details on capital investment schemes, please refer to the report entitled "The Debtor Principle and the Paying Agent Principle in Tax Law" by the Joint Working Group of February 2014.[2]

- *Loopholes in the guarantee function for Swiss investors*: The current design of the withholding tax leaves loopholes open in guaranteeing taxation of the interest income

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[1] http://www.news.admin.ch/NSBSubscriber/message/attachments/35502.pdf (German).

[2] See report entitled "The Debtor Principle and the Paying Agent Principle in Tax Law" by the Joint Working Group of February 2014, p. 48 et seq.

of Swiss investors. For instance, interest income from foreign bonds is not subject to the withholding tax and thus offers possibilities for tax dishonesty.

Due to the current tax regulations, Swiss corporations mainly issue their bonds abroad. This means Switzerland loses value added and potential profit and income tax bases that would result from this additional value added in financial intermediation.

International environment

In light of the Swiss withholding tax and the limited attractiveness of the Swiss capital market compared to other countries, bonds – also for Swiss creditors and guarantors – have until now largely been issued in foreign countries, where no residual taxes are levied on interest.

Special problems arise in regard to the issue of bail-in bonds from Switzerland and the future treatment of CoCos and write-off bonds. Moreover, these problems are urgent. It can be expected that the bail-in bond concept of the Financial Stability Board (FSB) will be adopted in the near future.[3]

Challenges

In light of the problems illustrated above, the Federal Council and the Group of Experts recommend a switchover to the paying agent principle, with the exception of domestic investment income. The Group of Experts recommends advancing the project with a high priority. This reform has the potential to make a substantial contribution to the attractiveness of the financial centre and thus of the Swiss business location by eliminating a crucial obstacle to the establishment of a domestic market for the issuing of debt capital. Additionally, the reform would be an important building block to supplement the Swiss TBTF regime with bail-in bonds; only the issuing of such instruments in Switzerland that this reform would make possible would ensure that in the event of crisis, a write-off or conversion of these bonds into equity capital could occur with sufficient legal certainty. This reform is also favoured by the fact that the introduction of automatic exchange of information (AEOI) at the international level makes circumvention via foreign banks significantly more difficult. Under the paying agent principle, the tax can be levied in a more differentiated manner. This allows the following challenges to be addressed in particular:

- *Limited attractiveness of the capital market:* The lack of attractiveness of the Swiss capital market for foreign investors necessitates a reform of the withholding tax in order to eliminate the current disadvantages. Today, foreign investors hardly buy bonds from Swiss borrowers, because they are unable to claim a full refund for the withholding tax or are able to do so only with substantial administrative effort; for this reason, major Swiss companies almost without exception refrain from issuing bonds in Switzerland. The switchover to the paying agent principle would eliminate this disincentive and thus make a significant contribution to the development of a competitive Swiss capital market. The major potential of this reform has been evident for quite some time. Current developments in AEOI and bail-in bonds (see below) are now, however, opening a window of opportunity that encourages rapid advancement of this reform and its political adoption. This will benefit the business location and the financial centre.

- *Access to international capital markets:* By abolishing the withholding tax for cross-border capital flows, especially corporate group financing, capital market access specifically for large and medium-sized enterprises in Switzerland is to be promoted.

- *Problem of bail-in bonds:* The future role of bail-in bonds for TBTF regulation is an additional key driver of the reform. Only once bail-in bonds are issued in Switzerland

[3] At the G20 summit in Brisbane on 15 and 16 November 2014, the ESB published a proprosal for a qualitative and quantiative minimum standard for loss absorbing capital (total loss absorbing capacity, TLAC) (see also the report of the Subgroup on National Economic Risks).

can they play their role in the resolution of a Swiss big bank. So that this concept can be realised in a timely matter and so that the systemically important banks can in future issue bail-in bonds from Switzerland, an exemption from the withholding tax is necessary. At the same time, the temporary exemptions for CoCos and write-off bonds should be extended until a paying agent tax is applied.

- *Cash pools:* The disadvantageous tax treatment of cash pools compared to other countries, with the risk that cash pools migrate abroad, can also be addressed by the withholding tax reform. Large Swiss industrial groups can then be given the possibility to focus their financing activities within Switzerland.

- *Guarantee function:* To encourage tax honesty, the taxation of foreign securities of Swiss investors should also be guaranteed. To achieve the objective mentioned above – switchover to the paying agent principle – it is not absolutely necessary to make domestic equity investment income subject to the paying agent principle as well. With this exemption, companies in the Swiss business location would not be burdened with additional paying agent responsibilities, and the financial risk to public finances posed by the reform could be reduced.

Against this backdrop, the Group of Experts recommends embedding the change in system from the debtor to paying agent principle into an overall strategy and a general approach to tax policy. Whether or not the paying agent principle can fulfil the objectives will depend to a large extent on how it is designed. Given the highly complex interrelationships, a single rule in the arrangements for the paying agent principle could have negative repercussions for Switzerland as a business location.

The Group of Experts emphasises the following objectives in this reform:

1. strengthening the capital market for debt capital;
2. a timely solution for bail-in bonds and the extension of the existing exception for CoCos and write-off bonds;
3. defending the tax-specific interests of the Confederation, cantons, and communes.

Based on the impacts of a general or partial switchover to the paying agent principle in relation to withholding tax and in recognition of the associated opportunities and risks, the Group of Experts has focused on the following parameters. To the extent there are (still) different opinions or the specific design must be discussed in detail, this will be mentioned under the individual parameters.

1. *Switchover to the paying agent principle with the exception of income from domestic equity investments:* The proposed solution is a general switchover to the paying agent principle. With the switchover to the paying agent principle, withholding tax becomes payable also on foreign investments held with Swiss paying agents.

   The only exception to this switchover to the paying agent principle is income from domestic equity investments, which could retain the debtor principle. The reasons for this exception are:
   - Companies in Switzerland are not subject to paying agent obligations in association with the withholding tax.
   - The additional benefit from the liability of dividends under the paying agent principle for the domestic equity capital market is significantly lower than for the domestic debt capital market.
   - Moreover, the financial risks to public finances can be kept low because the current substantial tax revenues generated by the withholding tax on income from domestic equity investments remains unchanged.

. Given that the system change is only partial, special attention should be paid to the treatment of the distribution and reinvestment of income from *domestic collective investment schemes*. Several variants are conceivable in this regard:
   a. Preservation of the debtor principle;
   b. General switchover to the paying agent principle:
   c. Partial switchover to the paying agent principle while maintaining the debtor principle for income passed on from equity investments.

2. *Tax collection limited to domestic natural persons:* Tax collection on income under the paying agent principle is limited to beneficial owners who are domestic natural persons, for whom the guarantee function must in fact take effect. As is already the case today with the final source taxes in relation to Austria and the UK and the future AEOI at the international level, Swiss paying agents treat certain structures as transparent such as domiciliary companies, trusts and insurance wrappers by way of the know-your-customer rules, which are already in use as part of anti-money-laundering regulations. In principle, accounts and securities portfolios held with foreign banks do not fall within the scope of application of the paying agent concept for the withholding tax.

3. *Examination of the introduction of voluntary disclosure:* Domestic natural persons could be given a right of election and thus elect whether their income is to be subject to withholding tax under the paying agent principle or instead the income is to be disclosed to the tax authorities. While such a disclosure option is not mandatory for realisation of the project, it would avoid the unattractive tax deduction for tax-compliant Swiss investors at their request. As withholding tax will continue to be levied according to the debtor principle on income from (directly held) equity investments, there is by definition no possibility of voluntary disclosure on such income.

4. *No residual tax on interest income:* No residual tax is levied internationally on domestic income from debt capital, including interest on bank assets. Income from (directly held) equity investments remains liable to 35% withholding tax, with offsetting of the residual tax by the country of domicile in accordance with the DTA. The reason for the waiver of the residual tax on interest is, on the one hand, the fear that the Swiss capital market would otherwise not be attractive enough for debt capital and, on the other hand, the fact that the loss in revenue due to waiver of the residual tax on interest is relatively low.

   The FTA believes that the complete waiver of residual tax on debt capital income gives rise to considerable risk of tax evasion if the future international AEOI system (see point 5 below) were to reveal substantial loopholes in geographical or material terms. Therefore, a network of AEOI agreements should be sought internationally that comprises the countries with the most important market participants.

5. *Alignment of the switchover from the debtor principle to the paying agent principle with the introduction of AEOI internationally:* Swiss taxpayers could be tempted to deposit undeclared assets with foreign banks/paying agents and thereby circumvent the tax guarantee mechanism envisaged under the paying agent principle. The planned introduction of AEOI internationally will prevent any such incentives to use foreign paying agents for this purpose. Implementation of the switchover from the debtor principle to the paying agent principle must therefore be aligned with the introduction of AEOI internationally.

6. *Abolition of self-limitation in mutual administrative assistance in tax matters:* The Swiss tax authorities should be allowed to make use of notifications received from abroad. The existing self-limitation in mutual administrative assistance in tax matters should be abolished as a prerequisite for the paying agent concept.

7. *Abolition of the existing practice on foreign bonds guaranteed in Switzerland:* Given that (a) both domestic and foreign bonds are subject to withholding tax under the paying agent principle, (b) no residual tax should be levied on interest, and (c) AEOI is envisaged internationally, the distinction between domestic and foreign bonds loses its significance for the withholding tax. Consequently, the current practice of guaranteeing foreign bonds in Switzerland may be abolished and not replaced. Moreover, bonds guaranteed by Swiss-based parent companies that are raised by a subsidiary abroad are not attributed to the domestic guarantor. This creates advantages for groups operating in Switzerland.

8. *Temporary exception for bail-in bonds until entry into force of the revision:* For bail-in bonds, a temporary exception – until entry into force of the other provisions of the revised Withholding Tax Act – is envisaged as part of the overall paying agent proposal, similar to the prevailing rule to be extended for CoCos and write-off bonds, which includes an exemption from withholding tax. This exception as part of the proposal on the partial switchover to the paying agent principle for withholding tax should come into effect earlier in the form of a transitional provision.

9. *Transitional period for paying agents:* Paying agents should be given a period of two years in order to allow them sufficient time to implement the paying agent principle. The proposed legislation should then come into effect on the following 1 January. Upon introduction of the paying agent principle, the effort and costs for paying agents should be kept as low as possible. For this purpose, the modalities (e.g., concerning default interest, subsequent reporting instead of tax payment) for correcting a tax that mistakenly was not levied should be defined in close consultation with the industry, and compensation for the costs incurred by the paying agent as a consequence of the tax deduction procedure should be considered.

3.1.1. Economic potential of a switchover to the paying agent principle

Introduction of the paying agent principle facilitates capital market access for the entire economy, increases the attractiveness of the Swiss financial centre (capital and money market), and makes it possible to manage cash pools in Switzerland. Overall, the following positive effects are the result:

- *Improved attractiveness of the financial centre (capital and money market)*.[4] The income potential resulting from intensified capital market activity is about *CHF 280 million* in total. The potential of CHF 280 million refers to the gross income (i.e., before deduction of any costs) along the entire value chain. For income on the capital market (approx. CHF 180 million), this especially concerns lead IB and syndicate, legal and tax advisors, and auditors on the *primary market* and the stock exchange and banks on the *secondary market*. For income on the money market (approx. CHF 100 million), this especially concerns fiduciary fees for placement and the generation of passive margins for treasury. From the perspective of the capital-market-related activities of the big banks, the estimated potential refers to the entire capital market (all types of issues, all issuers). This means additional positive one-off effects, for instance for medium-sized and cantonal banks (cross-border issues) and for the real economy (multipliers of

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[4] Estimate by big banks, under four key assumptions:
1. A level playing field is created compared with guarantee taxes on other financial markets.
2. Swiss companies domiciled in Switzerland have an enhanced interest to issue bonds in the Swiss financial centre in future that are currently issued abroad.
3. The interest of foreign investors in tax-free bonds and deposits in Switzerland (mobility of foreign capital flows) increases, because a tax-free, fixed-interest Swiss investment (espectially Swiss bonds compared with international bonds) is internationally attractive.
4. Many clients desire a simplification of the investment structure and direct investment of liquid assets in Switzerland, with the consequence that part of the fiduciary investments would be transferred to Swiss investments that would be exempt from the withholding tax for foreign investors.

simplified financing), are not fully captured. Also, any displacement effects (substitution of credit market financing by capital market financing) are not taken into account.

The drivers of the potential are as follows:

– Thanks to simplified capital market access and improved attractiveness of the capital market (especially higher foreign demand), the Swiss capital market will generate income of *CHF 180 million* through new issues:
  - From new business in the real economy, the big banks expect additional income on the financial centre of approx. *CHF 70 million* (additional total volumes of CHF 10 to 15 billion per year). This includes CHF 60 million of income from additional volumes for bonds issued by Swiss issuers listed in Switzerland (additional total volume of approx. CHF 5 to 10 billion per year) and CHF 10 million from additional new business with cross-border listing of bonds of Swiss companies (additional total volumes of up to CHF 5 billion per year).[5]
  - Another *CHF 70 million* of additional income from the issue of bail-in capital instruments required by regulation (total additional volume of approx. CHF 10 to 20 billion per year, for a total of approx. CHF 50 to 80 billion).
  - The repatriation of existing foreign bond issues to the Swiss financial centre, thanks to the higher attractiveness of the capital market, will generate higher issue volumes and accordingly higher trading volumes in the short to medium term with additional income potential of approx. CHF 40 million (total additional volume of approx. CHF 5 to 15 billion per year).

– The repatriation of fiduciary assets invested abroad opens up an income potential of approx. CHF 100 million; from the perspective of the big banks, this refers to the entire financial centre. The amount includes CHF 80 million in additional income from the repatriation of fiduciary investments, of which CHF 75 million are from foreign investors (total volume of approx. CHF 80 to 90 billion) and CHF 5 million from domestic investors[6] (total volume of up to CHF 10 billion). CHF 20 million in additional income will be generated by assets of foreign investors newly invested in Switzerland (total volume of approx. CHF 5 to 10 billion).

- *The income potential* also triggers value added that benefits workers. Based on an assumed EBIT margin of 25% and a share of personnel costs of 75% compared with overall costs, the value added amounts to approx. CHF 100 million for the capital market and approx. CHF 55 million for the money market.

- *Possibility of managing cash pools in Switzerland.* The switchover to a paying agent model makes it possible to manage cash pools of Swiss companies from Switzerland. Until now, enterprises were forced to settle cash pools abroad in order to design them in a tax-efficient way; this allowed companies to avoid the levy of a withholding tax and a corresponding cash flow disadvantage. Swiss companies are, however, interested in managing cash pools from Switzerland: On the one hand, the Swiss financial centre offers greater legal certainty and comprehensive services; on the other hand, operational advantages arise by (physically) combining treasury functions.

- *Repatriation of business from corporate group financing.* If business relating to corporate group financing returns to Switzerland, positive effects are likely to arise for jobs and value added.

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5 Estimate by big banks

6 Resulting from the extension of the guarantee function to cover foreign income

3.1.2. Fiscal potential of a switchover to the paying agent principle

In recent years, the withholding tax on average generated revenue of approximately CHF 5.0 billion per year. In 2013, revenue was even CHF 5.7 billion.[7] Most of the withholding tax revenue arose on equities, which would not be affected by a partial switchover to the paying agent principle. The financial impact will be quantified to the extent possible for purposes of the consultation proposal.

3.2. Banking business – Challenge: Dynamic international development; Focus: AEOI, EUT, TST and foreign financial transaction tax, withholding tax, access to financial data of persons in Switzerland

3.2.1. Automatic exchange of information (AEOI)

International environment

As part of its work on the development of a global AEOI standard, the OECD published the basic information on this standard in February 2014. In June 2014, the OECD concluded its work on the remaining documents. The entire package was approved in mid-July 2014 by the OECD Council, the highest body of the organisation. The standard consists in:

- the Model Competent Authority Agreement (Model CAA)
- the Common Reporting Standard (CRS)
- commentaries on the Model CAA and CRS
- basic information technology modalities

At the OECD Ministerial Council Meeting on 6 and 7 May 2014, the 34 member countries of the OECD (including Switzerland) as well as 14 other countries[8] and the European Union adopted a common declaration on AEOI. This political declaration confirms the will to combat tax fraud and evasion using AEOI and the determination to implement the standard rapidly. 48 states and territories have committed to data exchange by September 2017.[9]

The finance ministers of the G20 confirmed the new AEOI standard at their meeting in September 2014. The members of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) were invited to announce at the Global Forum plenary in October 2014 whether and by when they intend to implement the AEOI standard of the OECD. The Global Forum has meanwhile incorporated this information into its annual report. In the annual report, states (and territories) are listed according to the following three categories: (i) jurisdictions undertaking first exchanges of data in 2017, (ii) jurisdictions undertaking first exchanges by 2018, and (iii) jurisdictions that have not indicated a timeline or that have not yet committed.[10] In November 2014, the Global Forum will also present this information in a report to the G20.

National environment

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[7] The Current Taxes of the Confederation, Cantons, and Communes, 2014

[8] Argentina, Brazil, Colombia, Costa Rica, India, Indonesia, Latvia, Lithuania, Malaysia, the People's Republic of China, Saudi Arabia, Singapore, South Africa. Andorra subsequently joined the declaration on 18 June 2014.

[9] JOINT STATEMENT BY EARLY ADOPTERS GROUP: Argentina, Belgium, Bulgaria, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Faroe Islands, Finland, France, Germany, Greece, Hungary, Iceland, India, Ireland, Italy, Korea, Latvia, Liechtenstein, Lithuania, Malta, Mauritius, Mexico, Netherlands, Norway, Poland, Portugal, Romania, Seychelles, Slovakia, Slovenia, South Africa, Spain, Sweden, UK; Isle of Man, Guernsey, Jersey; Anguilla, Bermuda, BVI, Cayman Islands, Gibraltar, Montserrat, Turks & Caicos.

[10] See 2014 annual report of the Global Forum, p. 35 (http://www.oecd.org/tax/transparency/GFannualreport2014.pdf)

Switzerland actively contributed to the development of the AEOI standard. On 14 June 2013, the Federal Council took note of the report of 6 June 2013 by the Group of Experts I for the Further Development of the Financial Market Strategy appointed by the Federal Department of Finance, and it formulated its requirements for a global AEOI standard. The Federal Council requires that the standard:

- be global
- cover all legal forms including trusts and domiciliary companies
- meet the high demands on compliance with the principle of speciality and data protection
- be reciprocal.

In mid-May 2014, the Group of Experts II issued its opinion for the attention of the Federal Council. In light of the fact that the standard would be presented in summer 2014 and numerous countries had committed to the AEOI, the Group of Experts II believed it made sense for Switzerland to initiate its work on implementation of the AEOI already at that time. Internationally, the expectation exists that once adopted, the global AEOI will be implemented rapidly, especially also in regard to financial centres such as Switzerland. To do justice to this expectation and so as not to end up on the defensive again, it makes sense to rapidly take up the implementation work on the AEOI. On 8 October 2014, the Federal Council adopted negotiating mandates on introduction of the AEOI standard with the EU, the United States, and other countries. Additionally, implementing legislation should be crafted to establish the domestic legal foundations for implementation of the AEOI. The Federal Council intends to introduce the legal foundations for AEOI in a timely manner so that Swiss financial institutions can begin to collect the account data of foreign taxpayers in 2017 and so that an initial exchange of information can begin in 2018. All of this is subject to the timely approval of the necessary laws and treaties by Parliament and possibly by voters. The Federal Council issued a statement in this regard to the Global Forum as well (see above).

Challenges

- AEOI should have a global effect and reduce the risk of asset movements beyond the scope of application of AEOI. It should therefore be applied globally and uniformly, especially also by competing financial centres (creation of a level playing field).

- It must be ensured that all legal forms are covered, so that structures such as trusts and domiciliary companies also become transparent (including disclosure of beneficial owners).

- The partner countries must meet high demands in regard to the principle of speciality, the rule of law, and data protection.

- For the purpose of ensuring a level playing field and in order to prevent tax evasion by domestic taxpayers by way of foreign banks, reciprocity must be agreed.

- AEOI should be introduced as quickly as possible. The political procedures in Switzerland, the implementation plans in other countries, and possible counter-demands should be taken into account appropriately. It must be ensured that Switzerland does not become a target of international criticism due to slow introduction of AEOI. The political processes in Switzerland are such that the financial institutions have sufficient time to implement AEOI.

- When *selecting partner countries* for AEOI, several criteria must be taken into account. These include the possibility for taxpayers to regularise their taxes before entry into effect of automatic data exchange, concessions in regard to market access, importance of the market, containment of risks for banks and their employees, and the probability that other countries will introduce AEOI with the partner country in question. Switzerland's partner countries should agree to reciprocal data delivery not only with

Switzerland, but also conclude AEOI agreements with other financial centres engaged in cross-border asset management. Otherwise, these financial centres might continue to manage untaxed assets from those countries.

3.2.2. Transfer stamp tax

National environment

Going back to a parliamentary initiative referred by the Radical Free Democratic Group FDP,[11] a proposal to abolish the transfer stamp tax is currently pending in the Economic Affairs and Taxation Committee of the National Council (EATC-N). The committee decided to consider a draft to this effect in February 2014. After the decision to consider the draft, the EATC-N decided on grounds of fiscal policy to defer further consideration until the Federal Council dispatch on the CTR III is available.

International environment

With respect to the taxation of securities transactions, Switzerland is increasingly confronted with foreign taxation regimes with extraterritorial effects. Already in 2012 and 2013, respectively, France and Italy introduced their own financial transaction taxes on acquisitions of shares; in the case of Italy, the tax also affects derivatives of Italian shares. Currently, 11 EU member states are now planning to introduce a common financial transaction tax (EU FTT) within the framework of "enhanced cooperation". There is no agreement yet among member states regarding the details of the planned EU FTT. Introduction will probably be step-by-step and at the beginning of 2016 at the earliest.

Given the extraterritorial effects of this taxation regime, Switzerland is directly impacted. Both the French and the Italian transaction tax are based on the issuance principle. The tax is therefore due as soon as a French or Italian security is traded, irrespective of the residence of the contracting parties.[12] In the case of the planned EU FTT, it is still uncertain whether the establishment principle will supplement the issuance principle, as provided in the original draft. This establishment principle would additionally entail that the tax would be levied if a financial intermediary is involved that is "established" in an FTT state (where "established" is interpreted very broadly, so that a party is already considered "established" if a branch, permanent address, or usual residence exists in an FTT state).

Challenges

- As a consequence of the extraterritorial effect of the FTT regime, Swiss financial institutions have a tax withholding obligation for the participating countries. On the one hand, this means multiple taxation might occur for transactions on which both a foreign FTT and the Swiss transfer stamp tax is due. On the other hand, conflicts may arise between Swiss and foreign legal provisions.

- Already today, banks are experiencing such a legal conflict: To pay the tax on transactions involving Italian securities, the banks require an exemption from the Federal Council in respect of the provision in Article 271 SCC.[13] Several banks have requested such an exemption. However, based on a weighting and balancing of all

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[11] (09.503) Parliamentary initiative: Step-by-step abolition of the stamp duty and creation of jobs. Submitted by the Radical Free Democratic Group FDP on 10 December 2009

[12] In the case of the French and Italian FTT, the tax affects equity instruments issued by a company domiciled in the respective country, and in the case of Italy also derivatives whose underlying securities are shares subject to the Italian FTT.

[13] Unlike in the case of the French FTT, the Italian FTT makes the client subject to the tax, not the bank, which makes such an exemption necessary.

affected interests, especially the economic interests of the affected banks and the economic and political interests of Switzerland, the Federal Council denied these applications in February 2014. The affected Swiss banks submitted a request for reconsideration. They see themselves in legal conflict because on the one hand, they have to respect the decision of the Federal Council to this effect, and on the other hand, they have to comply with the FINMA rules which include compliance with Italian law.

- The described problem of multiple taxation should be addressed during consideration of the described proposal to abolish the transfer stamp tax.

- As soon as it is clear how the FTT is designed, Switzerland should examine whether agreements should be sought to avoid double taxation in this domain. Double taxation agreements offer greater legal certainly in regard to adjustments of internal law in partner countries. In parallel, it should be examined immediately whether the existing links for the stamp duties on securities sales, but also on non-life insurance, should be adjusted and modified in such a way that double taxation arising from foreign stamp duties/FTTs can effectively be avoided.

3.2.3. Tax-related banking secrecy, criminal tax law, other proposals

Tax-related banking secrecy and criminal tax law

The term "banking secrecy" has several meanings. Actual banking secrecy as defined in Article 47 of the Banking Act governs the relationship between the bank and its clients. Alongside this, there is tax-related banking secrecy, which applies to the relationship between the bank and the state in regard to taxpayers' assets held at the bank.

What is tax-related banking secrecy? Swiss tax law does not recognise financial privacy. Every taxpayer is required by the tax laws of the Confederation and the cantons to disclose all financial circumstances to the tax authorities (Articles 124 et seq. of the Federal Act on Direct Taxation and Article 42 of the Direct Taxation Harmonisation Act). All banking relationships, including a list of securities, must be declared each year.

Financial privacy consists in the fact that the tax authority does not have direct access to banking data via the financial institution, even in the case of simple tax evasion. Access is granted only in cases of tax fraud or "continued evasion of large amounts of tax" in accordance with Article 190, paragraph 2 of the Federal Act on Direct Taxation. Between May and September 2013, the Federal Council circulated a revision of the criminal tax law for public consultations. Under the proposal, the cantonal tax authorities would be given access to banking documents even in cases of tax evasion. The cantonal tax authorities would also be able to employ the coercive means of administrative criminal law even in cases of tax evasion, i.e., they would be able to officially question taxpayers, carry out house searches, summon and question third parties – especially bank employees – as witnesses, demand banking documents, and obtain them by force where necessary.

In July, the Federal Council announced that it would adopt a dispatch on the revision for the attention of Parliament by the end of 2015.

Digression – Information obligations vis-à-vis tax authorities

Tax-related banking secrecy applies to persons residing in Switzerland who have a relationship with a bank in Switzerland. The introduction of AEOI with foreign partner countries will change nothing about this. Declaration of these assets vis-à-vis Swiss tax authorities can continue to be ensured using the withholding tax. The introduction of AEOI internationally thus does not interfere with any political decisions regarding information obligations within Switzerland.

In contrast, there will be changes for persons residing in Switzerland who have a relationship with a bank abroad. With the introduction of AEOI, Swiss tax authorities will receive reports about these client relationships.

Money laundering and criminal tax law

In February 2012 the FATF revised its 40 recommendations, and in February 2013 it adopted a methodology for assessing technical compliance with the FATF recommendations and the effectiveness of the AML/CFT system. With a view to implementation of the revised FATF standards, the Federal Council mandated an interdepartmental working group under the leadership of the SIF in April 2012 to prepare a draft. In February 2013, a consultation proposal was circulated to interested parties, the results of which were published on 4 September 2013. Based on these results, the Federal Council transmitted a dispatch and draft law to Parliament on 13 December 2013 on implementation of the FATF recommendations, including classification of serious tax offences as predicate offences to money laundering.

For indirect taxes, the draft law envisages extending the scope of application of Article 14, paragraph 4 of the Federal Act on Administrative Criminal Law – which defines elements of the offence – so that not only cross-border movement of goods is covered, but also other taxes levied by the Confederation, such as value added tax levied on deliveries in Swiss customs territory and on services, or the withholding tax. For direct taxes, the draft law recommends – rather than revising tax law to include elements of the offence – modifying the approach contained in the Swiss Criminal Code that governs predicate offences to money laundering. Henceforth, not only felonies, but also tax fraud under Article 186 of the Federal Act on Direct Federal Taxation or under Article 59 of the Direct Taxation Harmonisation Act – which are misdemeanours – would be deemed a predicate offence to money laundering if the evaded taxes exceed CHF 200,000 per tax period. This proposal has the advantage of being based on current criminal tax law and would not prejudice the revision thereof, unlike the proposal that had been circulated for consultations. This means that both proposals are completely separate from each other.

Article 11 of the FinIA

The consultation draft of the Financial Institutions Act (FinIA) adopts, in a concentrated form, the amendments to the Anti-Money Laundering Act (enhanced duties of due diligence to prevent the acceptance of untaxed assets) which the Federal Council circulated for consultations as part of its implementation of the 2012 Financial Centre Strategy. Entry into force of this provision should be timed by the Federal Council in such a way that it does not apply prior to obligations arising from AEOI agreements, but rather on a complementary basis.

Popular initiative "Yes to the Protection of Privacy"

The popular initiative "Yes to the Protection of Privacy" aims to enshrine financial privacy in the Federal Constitution. According to the initiative, third parties should be authorised to access tax data only as part of criminal proceedings and then only when there is a well-founded suspicion of tax fraud or intentional and continued evasion of large amounts of tax, or if such an offence is aided and abetted or incited.

3.3. Insurance business – Challenge: Various industry-specific rules in current tax law; Focus: StD, IncT, VAT

General remarks

One of the factors making the Swiss financial centre attractive is when Swiss insurers are able to offer attractive products – in both life and non-life insurance. This attractiveness is supported by attractive tax conditions as well.

The Constitution requires the Confederation to encourage private pension provision (Article 111 of the Federal Constitution). This is achieved by measures in property policy as well as tax measures (tax privileges). For instance, lump sums in non tax-qualified provision (Pillar 3b) are not taxed for the purpose of income tax as long as the payments are used for pension provision, i.e., the income is tax-free. As a corrective measure to this tax exemption, single premiums for non tax-qualified provision are subject to the stamp duty in certain circumstances, which leads to a tax burden on private pension provision because insurers as a practical matter pass this stamp duty onto policyholders.

Within the framework of restricted pension provision (Pillar 3a), lump sums receive privileged tax treatment, following the constitutional requirement to encourage private pension provision. In contrast, life annuities are taxed at 40%.

In summary, current tax law provides a system of both tax relief for private pension provision in the form of tax exemptions as well as tax burdens.

Challenges

- *Stamp duties on life insurance premiums in Pillar 3b:* Originally, the stamp duty on life insurance premiums was introduced with the argument that the lack of income tax on private redeemable capital insurances should be compensated. In addition to the developments especially in the interest rate environment – and concomitantly the reduction of the maximum permissible technical interest rate in life insurance – the stamp duty's tax burden on single premiums has entailed that the market for life insurance products funded by single premiums has shrunk considerably in recent years. The constitutional objective of encouraging private pension provision thus also appears to be at risk.

- *Impact of the stamp duty on non-life insurance*: The Swiss stamp duty on insurance premiums in non-life insurance is based on the assessment principles of the Swiss insurer and Swiss policyholder. In foreign countries, however, the power of taxation internationally is allocated to the state in which the risk is located (risk location principle). These different systems may lead to undesired double taxation or double non-taxation in the international insurance business.

- *Transfer stamp duty/EU FTT*: As a consequence of the extraterritorial effect of the FTT regime, Swiss insurers have a tax withholding obligation for the participating countries. This raises the threat of multiple taxation in the case of transactions for which both a foreign FTT and the Swiss transfer stamp tax is due. Insurers are affected by this issue in respect of their investments. Especially when using derivatives to hedge risks, the transactions may trigger a (multiple) FTT, entailing additional costs for the insurers – and ultimately for policyholders.

- *Income tax on pension insurance policies*: Periodic benefits (pensions) arising from pension insurance policies are taxed at 40%. This flat-rate rule has, due to the strong decline in interest rates and the demographic developments, increasingly resulted in undesired over-taxation. Because the role of pension insurance policies for non tax-qualified provision (Pillar 3b) should not be underestimated for purposes of continuing the accustomed living standard at retirement age, this over-taxation should be corrected. This would contribute to the competitiveness of these products and thus help enhance the attractiveness of the Swiss financial market.

- *Income tax on lump sums:* At the same time, it should be noted that the existing tax rules governing lump sums in occupational pensions (including Pillar 3) may, under certain circumstances, lead to privileged taxation.

3.3.1. Possible adjustments to existing tax law

Promotion of the Swiss financial market can also be achieved with an attractive design of insurance products. However, the fact should not be ignored that this promotion cannot occur solely at the expense of tax revenue. Instead, a balanced system must be created and maintained. While over-taxation should be reduced, under-taxation should at the same time be compensated. The reduction of over-taxation necessarily leads to revenue losses for public finances, which is why the question of how to compensate these revenue losses must be addressed. The following discussion presents several tax measures that can contribute to the promotion of the Swiss capital market.

3.3.2. Stamp duty on life insurance premiums in Pillar 3b

In the view of the SIA, the stamp duty on life insurance premiums prevents flexible forms of financing and attractive insurance products. Since the introduction of the stamp duty on single premiums in 1998, the premium volume has fallen dramatically. The stamp duty now generates only an annual tax volume of approx. CHF 20 to 30 million (2013: CHF 23,244,047). The SIA also identifies a high administrative burden both on the part of the FTA and on the part of insurers that is no longer proportionate to the tax volume generated.
The FTA is aware of the current situation regarding the stamp duty on life insurance premiums and in principle is in favour of eliminating this tax in cases where the insurance benefit is covered by the income tax.

3.3.2.1. Risk location principle

With the introduction of the risk location principle in non-life insurance, all Swiss risks would be covered by the stamp duty. The unequal treatment of Swiss and foreign insurers and policyholders would be eliminated. In the view of the SIA, the stamp duty would generate additional tax revenue.

On the contrary, the FTA believes that the introduction of the risk location principle would tend to lead to revenue losses rather than revenue gains for public finances, because no stamp duty could be levied anymore on asset insurance with risks located abroad – in contrast to current law. On the other hand, stamp duties are not covered by double taxation agreements, so that any double taxation could be eliminated at most in mutual agreement procedures.

The Federal Council has mandated the FDF to examine the transition to the risk location principle in the area of asset insurance. The FTA has meanwhile suspended this mandate due to parliamentary initiative 09.503 "Step-by-step abolition of the stamp duty and creation of jobs", which is currently being considered by Parliament and which calls for the abolition of all stamp duties.

3.3.3. Transfer stamp tax/EU FTT

In the view of the SIA, insurance premiums should in principle not be affected by the envisaged "EU FTT". However, the investments of all insurers (in life and non-life insurance) and all pension schemes would be affected.

In the view of the SIA, the additional burden on investments does not make sense either for policyholders or for insurers. The origins of the EU FTT were not triggered by insurance companies. In light of the low interest rate level, insurers in particular are bearing the consequences of the unstable financial market situation. The additional costs can be passed on only for new policies, not old policies (where insurance policies cannot be cancelled).

The rise in the costs of pension products clearly contradicts the international development, according to which private and occupational provision should be encouraged due to the demographic development (see "White Paper on Pensions").

Already the first envisaged step of the EU FTT applicable to equities and equity derivatives clearly entails additional costs for insurance and pension products. If further steps follow, especially if the FTT should apply to bonds, the negative consequences can hardly be estimated.

In principle, the FTA understands the SIA's fears. At the current time, however, it is still too early to undertake specific legislative adjustments. Instead, the international developments should be observed very carefully at this point.

3.3.4. Income tax on pension insurance

In the view of the SIA, annuity insurance is the only product that allows policyholders to hedge their longevity within the framework of Pillar 3b. Accordingly, the elimination of excessive tax burdens on annuity payments is recommended in light of the demographic development and necessary for the acceptance of self-responsible old-age provision.

The FTA is willing to discuss the income tax consequences of annuity insurances in order to further develop their existing income tax treatment in an appropriate way. It is currently preparing an administrative report to this effect. This report shows in particular what the appropriate taxation of annuity payments might look like in future. Possibilities include lower flat-rate taxation or the effective taxation of the share of the return paid out with an annuity.

If the over-taxation of annuities is eliminated, the FTA believes that an elimination of the privileged taxation of lump sums in non tax-qualified provision should be discussed at the same time, to the extent this appears permissible in light of the constitutional mandate to encourage private pension provision. Since the taxation of lump sums in Pillar 3a is identical to the taxation of lump sums in Pillar 2, the question must also be raised whether the reduction or elimination of privileged taxation should also apply to lump sums in Pillar 2.

3.3.5. Withholding tax

The existing rules governing the withholding tax on insurance benefits have proven their value. The SIA and the FTA agree that – at least until automatic exchange of information is introduced internationally – there is no need for a fundamental change of system in regard to insurance products.

3.4. Export of services in banking and insurance

Insurance services and most banking services are exempt from the value added tax. The reasons for this tax exemption include the desire to avoid double taxation with the stamp duty (insurance sector) and the transfer stamp tax (banking sector) and also the lack of an appropriate assessment basis for individual services, without which deduction of the input tax is hardly possible. For this reason, current law also rules out the voluntary taxation of services in the insurance and banking sectors. The tax exemption and the lack of a possibility of voluntary taxation lead to a "hidden tax" in *insurance* totalling about CHF 760 million,[14] because insurers are unable to reclaim the input tax paid on their expenses due to

[14] Based on 2005 FTA figures, recalculated to current tax rates

the tax exemption. This makes insurance services more expensive that are rendered abroad. In *banking*, the tax exemption and the lack of a possibility of voluntary taxation lead to a hidden tax totalling about CHF 1,005 million,[15] because banks are unable to reclaim the input tax paid on their expenses due to the tax exemption. This makes banking services more expensive that are rendered to recipients abroad.

Both the abolition of the tax exemption for insurance services and the voluntary taxation of such services have been discussed repeatedly in the past, especially in connection with the proposal for a uniform rate. To avoid double taxation with the stamp duty and because there is no appropriate assessment basis for the individual service, no tax has been levied on these services so far.

If, analogously to the rule in the EU, the input tax deduction were permitted in connection with insurance and banking services rendered to recipients abroad (option only for services rendered abroad), this would lead to tax revenue losses in the insurance sector of about CHF 250 million since an estimated third of the hidden tax of about CHF 760 million[16] would be lost. In the banking sector, this would result in tax revenue losses of about CHF 330 million, since an estimated third of the hidden tax of about CHF 1,005 million[17] would be lost. This lost revenue would probably have to be compensated within the VAT.

The input tax deduction for services abroad is made possible with the voluntary taxation of these services (option). While the services themselves are not subject to tax even if the option is elected – because the place of performance is a foreign country – the share of deductible input taxes would have to be determined that is associated with this performance abroad. Because there is no appropriate assessment basis for the service itself, this is very difficult and entails a considerable burden for insurances and banks.

Because this makes insurance and banking services more expensive, the banking and insurance sectors are calling for a way to ensure competitiveness in this area as well.

The Subgroup on the Tax Environment for Financial Transactions was, however, not able to agree on a common recommendation for action on this point.

3.5. Regulation of banks and insurers – Challenge: Increased capital requirements, market access; Focus: Withholding tax (incl. bail-in instruments), profit tax, capital tax

Since the financial crisis in 2008, numerous regulatory requirements have been introduced in the financial sector, such as the entire TBTF legislation in Switzerland for systemically important banks. These rules also provide ratios to be upheld for equity capital and liquidity. It is therefore foreseeable that the tax rules and regulatory rules will contradict each other in certain areas and that proper positioning will be a great challenge, given all the different rules applicable to international financial groups.

3.5.1. Increased capital requirements

On this issue, please also refer to the detailed report of the "Too big to fail" subgroup. The following discussion is limited to specific tax-related aspects and the general embedding thereof.

In the international environment, further measures in the direction of increased capital requirements are being discussed. Especially in regard to capital requirements, it must be assumed that alongside the existing provisions on the issuing of CoCos, additional loss-

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[15] Based on 2005 FTA figures, recalculated to current tax rates

[16] Based on 2005 FTA figures, recalculated to current tax rates

[17] Based on 2005 FTA figures, recalculated to current tax rates

absorbing capital in the form of senior unsecured debt ("bail-in bonds") will have to be obtained.

While CoCos are subject to a temporary withholding tax exemption until 31 December 2016, an analogous rule for the bail-in bonds that must be issued in a timely manner as part of TLAC requirements has not yet been established. For both instruments, a timely solution is necessary in order to ensure that they can be placed internationally. In the context of an increase in international issuing activities of CoCos, a competitive tax environment is moreover indispensable.

Larger banks are striving to adjust their structures so that resolution options can be improved. The old parent company and sub-parent company structures are disappearing and making way to holding structures and the separation of systemically important Swiss business into separate companies. From the tax perspective, this increases the demands on a transfer pricing network that complies with and documents the third-party price principle. In the international environment, there is a shift from relationships between a Swiss parent company with foreign subsidiaries or branches to legal relationships between Swiss and foreign *sister companies* or affiliates. Every possible transfer pricing adjustment in the complex banking environment is henceforth subject to the threat of non-reclaimable withholding taxes (basic withholding tax in relation to the partner countries under the DTA, see point 3.5.3).

The current withholding tax at source is levied on capital gains from instruments issued by domestic borrowers, irrespective of the identity of the recipient of the benefit. Recipients domiciled in Switzerland are given the option by the Confederation to claim a refund of the withholding tax. The withholding tax levied on investors domiciled abroad, however, is in principle final, because it can only be (partially) refunded if a double taxation agreement so provides.[18] But even if a DTA provides for such a refund, investors often invest in withholding-tax-free foreign bonds instead, since many international financial centres do not have a similar tax and thus do not impose the administrative burden necessary to claim a refund.[19] This makes it substantially more difficult to place bonds issued in Switzerland internationally when stabilising measures become necessary in the event of a crisis.

In order to avoid the legal uncertainties associated with the issuing of CoCos abroad, a temporary withholding tax exemption is envisaged for the issuing of CoCos (contingent convertible bonds) and write-off bonds. The preconditions have already been set out in the Banking Act and the Withholding Tax Act. The withholding tax exemption for interest income from these instruments applies only to instruments issued before 31 December 2016, unless the law is amended.[20] Without an extension of the withholding tax exemption, international placement of these instruments could no longer be ensured.

Irrespective of the further specifications of the TLAC expected to be issued by the FSB in 2014, the Swiss big banks are additionally confronted with the challenge of being able to place bail-in bonds internationally in order to fulfil the TLAC requirements, in light of the current withholding tax situation.

With the Federal Council's mandate to prepare a consultation draft on a differentiated design of the withholding tax in the form of a paying agent principle, the described problem of domestic issuing of bonds, including bail-in bonds, would be addressed.[21] Establishing rules

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[18] http://www.estv.admin.ch/verrechnungssteuer/themen/00166/index.html?lang=de

[19] http://www.admin.ch/opc/de/federal-gazette/2011/6615.pdf

[20] While Articles 11-13 of the Banking Act govern the conditions on the issue of contingent convertible bonds and write-off bonds, Article 5(1)(g) of the Withholding Tax Act grants withholding tax exemptions for interest payments resulting from these instruments, provided that FINMA – based on Article 11(4) of the Banking Act – has permitted the contingent convertible bond or the write-off bond to be counted as allowable equity capital, and the contingent convertible or write-off bond is issued within four years of entry into force of Article 5(1)(g) of the Withholding Tax Act.

[21] https://www.news.admin.ch/message/index.html?lang=de&msg-id=53642

for tax treatment is urgent, since it is doubtful whether international requirements will take account of the special features of national tax systems. Under this aspect, a consultation on withholding tax reform is advisable already in 2014. Moreover, adequate exemption rules for CoCos and bail-in bonds – or even a change in the system – are urgently necessary to address the TBTF problem in an adequate way.

3.5.2. Market access

On this question, please refer to the detailed report of the Subgroup on Market Access.

3.5.3. Transfer pricing

In addition to the increasing focus by national tax authorities in recent years on issues involving transfer pricing as part of their business tax audits, the current transfer pricing rules – which are primarily based on the arm's length principle, i.e., the compensation of services within the corporate group at prices that would be paid by mutually independent third parties – have recently come under pressure.[22] In mid-2013, the OECD drafted a plan with 15 individual measures to prevent multinational corporations from paying "too little" tax in their home countries (base erosion and profit shifting, BEPS).[23] 4 of the 15 measures directly concern transfer pricing rules, namely Action 8 in relation to intangibles, Action 9 in relation to risks and capital, Action 10 in relation to other high-risk transactions, and Action 13 in relation to documentation requirements. Completion of this work is expected by the end of 2015.

Multinational corporations usually have many group-internal flows of services which, according to the arm's length principle, should be compensated. Because of the new regulatory requirements intended to improve the resolvability[24] of banking groups, the group-internal flows of services will increase even further due to the creation of separate entities.

Quite similarly to insurance companies, the banks are facing special challenges. According to their business activities, the individual group companies have different maturities for their financial assets and liabilities, even if matching is achieved across the group as a whole. The different interest rates on the different maturities must be compensated across the group as a whole, which is difficult especially if a premium over risk-free investments must be paid for raising funds through long- term liabilities. Another problem consists in the correct distribution of risk premiums for CoCos and similar instruments. Some countries such as the United States treat these instruments for tax purposes as equity capital instruments, while for instance Switzerland and the United Kingdom recognise them as debt capital for tax purposes. Additionally, liquidity buffers must be made available for banking activities, some of which at the level of the individual group companies and others at the level of the group as a whole. There is no internationally recognised distribution key for these costs. Finally, hedging activities are as a rule centralised within the group, which is why it may be the case that the hedging gains and losses are generated in a different legal unit or different country than the hedged operating results. Due to the lack of clear international tax allocation rules and the high degree of complexity, allocation conflicts cannot regularly be eliminated in advance with the tax authorities.

If a Swiss company renders a service in kind to a foreign group company, where that service does not meet the arm's length principle, and if the Swiss company receives compensation for the service that is too low, then the tax authority will – in addition to profit tax offsetting – also levy a withholding tax of 35%. Since the foreign group company is generally not able to request full reimbursement of the withholding tax (basic withholding tax under the DTA), the tax burden will as a rule be higher from the perspective of the group, even if the foreign tax authority carries out a corresponding tax adjustment in the domiciliary state of the foreign affiliate.

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[22] See, e.g., http://www.reuters.com/article/2012/10/15/us-britain-starbucks-tax-idUSBRE89E0EX20121015

[23] See http://www.oecd.org/tax/beps-about.htm

[24] See also point 3.5.1.

In the view of the big banks, Switzerland should therefore find rules from a unilateral perspective that allow the market participants to adopt a position suitable for rapid resolution of any disputes.

3.5.4. Taxation of group companies in Switzerland

As part of the further development of TBTF rules, systemically important banks in various countries have increasingly been induced to divide up their corporate structure into smaller, ring-fenced, resolvable entities. This will lead to a higher number of companies and accordingly a higher number of taxable entities in Switzerland as well. Consequently, the allocation of these companies' profit taxes to the different cantons and communes and hence tax revenue will change in future, and the volatility of tax payments might increase. The disadvantages of having different taxable entities within the same group concern not only the systemically important banks, but also other financial institutions with a group structure.

From a business perspective, it can make sense to consolidate companies within a single country for tax purposes – such as Switzerland – and to pay taxes on the "consolidated" result of the operating activities within Switzerland (not "consolidated" on a worldwide basis). This will be referred to as group profit taxation. The consolidation may refer to individual elements (e.g. intercantonal allocation of taxes on the basis of results across all legal entities, treatment of certain or all activities of one group company as a permanent establishment of the others) or, *de lege ferenda*, group profit taxation of Swiss activities. Not least of all, the consolidation allows more rapid offsetting of profits and losses within the group. This is already possible today in many countries in very different ways (e.g. UK, US, and various EU countries). Switzerland also already uses group taxation for the value added tax.

From the perspective of the banks, the introduction of group profit taxation for operating activities in Switzerland would, depending on the design (e.g. introduction of a minimum tax), lead to more stable and predictable tax payments of corporate groups in Switzerland and allow the corporate groups to exploit losses more quickly.

From the perspective of the FTA, group profit taxation cannot be introduced in the short term, however, but it should be considered as an option in the medium to long term.

3.6. Priorities of the Federal Council

On 30 November 2011, the Federal Council discussed its tax policy priorities. It considers two reforms with major financial consequences to be urgent, namely the elimination of the unconstitutionally higher tax burden for married couples compared with unmarried couples living together, and the third series of corporate tax reforms (CTR III).

In principle, the Federal Council also favours abolition of the issue tax on equity capital, but it wants to include this in CTR III. If abolition of the issue tax on equity capital were separated out of the CTR III package, this might disturb the balance between the tax-reducing and tax-increasing elements of the CTR III proposal, thus diminishing its chances of acceptance. On fiscal policy grounds, the Federal Council wants to retain the other stamp duties – the transfer stamp duty and the insurance tax.

The Federal Council confirmed the priorities it established on 30 November 2011 during the discussion on 23 January 2013 of its opinion on the report of the EATC-N on abolition of the issue tax and again on 20 September 2013 during consideration of the report on "Pending business with significant financial consequences" for the attention of the Economic Affairs and Taxation Committee of the Council of States.

As a consequence of the report on financial market policy adopted on 19 December 2012, the Federal Council also mandated the FDF to consider a reform of the withholding tax within the framework of a joint working group (FDF, CDF, academia). The task of the working group was to show how a reform of the withholding tax might strengthen the Swiss capital market and the Swiss tax location while preserving Switzerland's fiscal interests. The working group delivered its report to the FDF at the beginning of 2014. The FDF will now present the item of business to the Federal Council and propose next steps.

3.7. Fiscal policy restrictions

The current Financial Plan 2016-2018 was adopted by the Federal Council in August 2014. It show strongly rising fiscal surpluses. The reason for this lies primarily in the assumed dynamic development of revenue. At the same time, spending growth is moderate. This positive budget outlook must be put into perspective, however. The political and economic risks remain large.

Due to the assumed good economic constitution of the Swiss national economy, the debt brake requires surpluses in the financing statement until 2017. The debt brake requirements are met in all financial plan years. The structural surpluses reach up to CHF 2.7 billion.

Table 1: Current fiscal policy outlook

million CHF

	2014	2015	2016	2017	2018
Ordinary receipts	66'245	67'527	71'514	74'134	76'064
Ordinary expenditure	66'124	67'003	70'906	72'710	73'710
Extraordinary receipts		139	145		
Extraordinary expenditure					
Overall fiscal balance	121	662	753	1'424	2'681
Room for manoeuvre (+) / need for adjustment (-) according to debt brake	452	186	179	1'201	2'681

Source: FFA: Financial Plan 2016-2018

The possible additional burdens in the form of additional expenditure or lower receipts that have not yet been included in the financial plan's figures is considerable. The bulk of the possible additional burdens can be found on the revenue side: the CTR III and the reform of the taxation of married couples. The most important elements on the expenditure side are the possible elimination of the Consolidation and Review of Tasks Package 2014 (CRT 2014), an increase in expenditure for the Armed Forces, and earmarking of the automobile duty.

Table 2: Possible additional burdens on the receipts and expenditure side

million CHF

	Financial Plan 2016	Financial Plan 2017	Financial Plan 2018	later
Total additional burdens (rounded)	>600	>900	>1'000	>2'000
Tax reforms				
CTR III				*900
Reform of taxation of married couples				1'000-2'300
Continuation of special VAT rate for accommodation services			170	170
All task areas				
No or incomplete implementation of CRT 2014	<550	<460	<340	<340
Various task areas: Agreements with the EU				
Health, EU Media, opening of the milk market, Erasmus+, Horizon 2020	n.q.	n.q.	n.q.	n.q.
International relations				
International Geneva (improvement of framework conditions)	7	9	11	11
International Geneva (building contributions)	<15	<50	<70	<70
National defence				
Increase of expenditure ceiling for Armed Forces		n.q.	n.q.	≤300
Culture and recreation				
Culture Dispatch 2016-2019	13	14	14	14
Sport promotion (incl. winter sport centre)	n.q.	n.q.	n.q.	n.q.
Health				
Various health policy projects	5	10	22	22
Social welfare				
Investments to accelerate asylum procedures	n.q.	n.q.	n.q.	n.q.
Continuation of financial aid for child-care outside the family	30	30	30	30

Transport				
Motorways and urban transport: Earmarking of automobile duty		≤400	≤400	≤400
Environment and spatial planning				
Climate change adjustment, biodiversity, green economy	n.q.	n.q.	n.q.	n.q.

n.q.: non-quantifiable
* Interest-adjusted profit tax, adjustments to the investment deduction, capital gains tax on securities, adjustments to partial taxation procedure, vertical countervailing measures and supplementary contribution (totalling CHF 1.5 billion) minus expansion of tax inspectorates, interest savings thanks to debt reduction and expiry of NFE hardship subsidy (totalling CHF 0.6 billion). Abolition of the issue tax on equity capital (CHF 0.2 billion) is included in the financial plan starting in 2017.

Source: FFA: Financial Plan 2016-2018; Explanatory Report on the Consultation Draft for the Federal Act on Tax-Related Measures to Strengthen the Competitiveness of the Swiss Business Location (Corporate Tax Reform Act III) of 19 September 2014

4. Economic analysis

4.1. Capital market

4.1.1. General switchover to paying agent principle for withholding tax

Location objective: Under the location objective, the opportunity to differentiate tax collection according to the category of beneficial owner is the crucial advantage of the paying agent principle over the debtor principle. For domestic beneficial owners, the tax or voluntary disclosure can be limited to natural persons without any diminishment of the guarantee function. In regard to foreign beneficial owners, the tax does not have to be collected on interest income.

In this way, the reform makes the framework conditions for the Swiss capital market in bonds and money market instruments attractive and eliminates the withholding tax obstacles that stand in the way of centralised financial management in Switzerland. The improved framework conditions make the Swiss capital market more efficient, so that the margins are likely to fall somewhat. The expected increase in securities issues on the Swiss capital market and the relocation of additional financing functions to Switzerland are likely to create additional value added and jobs (see point 3.1.1).

The paying agent principle also marks an improvement in the case of collective investment schemes marketed domestically. It strengthens the competitiveness of Swiss collective investment schemes to the extent they are determined by tax-related factors. Since the chances of success of Swiss collective investment schemes do not depend only on the withholding tax but also on other regulatory questions concerning market access in foreign countries as well, the development potential of Swiss collective investment schemes is likely to lag behind that of the Swiss capital market for bonds and money market investments, however.

The expansion of the withholding tax to include securities held by domestic natural persons at domestic paying agents may give affected investors an incentive to relocate their paying agent abroad. The consequence would be a loss of value added and jobs in Switzerland. To avoid these undesired consequences, the reform should enter into force only once this incentive is eliminated for non-tax-compliant investors with the help of a sufficient network of international agreements on automatic exchange of information. For tax-compliant natural persons, the incentive to relocate the paying agent abroad can be countered with the disclosure option (see also the discussion under point 4.2.1).

Efficiency objective: The positive aspect under the efficiency objective is that financing costs tend to become less expensive for companies raising funds from Switzerland both within and outside their corporate group.

The negative aspect of the switchover to the paying agent principle is the increase in enforcement costs associated with the transition. These transition costs are limited, however, to the extent that paying agents have already implemented the paying agent principle as part of the Savings Tax Agreement and the international source tax agreements. However, two systems have to be administered in parallel, since either the debtor principle or the paying agent principle applies depending on the object of taxation. Moreover, the paying agents and the tax authority must administer both the disclosure system and the tax collection system with refund.

The transition to the paying agent principle reduces the administrative burden on debtors because the paying agents rather than the debtors are responsible for delivering the withholding tax. Conversely, the administrative burden and settlement risks increase for paying agents.

Tax equity and distribution objective: The guarantee function serves the objective of tax equity (universality and uniformity of taxation and taxation according to the ability to pay). If the guarantee function is designed effectively, compliant taxpayers can assume that other taxable persons meet their tax obligations even if their tax honesty is less developed.

Mindful of the fact that opportunity creates tax evaders, more and larger loopholes in the guarantee function mean that persons with less developed tax honesty evade more taxes. If tax evasion becomes more pervasive, this may also undermine the tax honesty of tax-compliant persons, so that they also begin to evade part of their taxes.

The transition to the paying agent principle closes the loopholes in the guarantee function under the debtor principle, to the extent the assets are located at a paying agent in Switzerland. The paying agent principle also guarantees taxation of income from foreign sources that are held at domestic paying agents by natural persons residing in Switzerland. This closes a loophole in the guarantee function, thus limiting the opportunities to evade taxes. The tax equity objective is thus completely met, as long as a functioning automatic exchange of information at the international level eliminates the incentive for non-tax-compliant persons to relocate their investments to a foreign paying agent.

As envisaged in the switchover to the paying agent principle, the general restriction of the scope of application of the withholding tax to the category of natural persons residing in Switzerland as beneficial owners is acceptable from the perspective of the guarantee function, given that the guarantee function only has to be effective in regard to such persons. For domestic legal persons, accounting requirements fulfil a guarantee function, and the guarantee function does not apply at all to institutional investors because they are generally exempt from income and profit tax.

Fiscal objective: Revenue losses within the entirely or partially tax-exempt scope of application of the withholding tax for domestic legal persons and for interest paid abroad are counterbalanced first of all by increased revenue from the expanded object of taxation for domestic natural persons holding foreign investments at a Swiss paying agent. This effect depends crucially on the flanking measures, however (see point 4.2.1). Further revenue increases are generated by the additional value added from financing activities both within and outside the corporate group.

The financial impact will be quantified to the extent possible in the consultation draft.

4.1.2. Temporary product-specific tax exemptions for officially regulated products

Location objective: Bail-in bonds, CoCos and write-off bonds can be issued from Switzerland under tax-competitive conditions. This keeps the financing costs of TBTF banks low as they build up a larger equity base.

Efficiency objective: The TBTF regulation objective can be met.

Tax equity and distribution objective: By prolonging the tax exemption for income from CoCos and write-off bonds, the existing gap in the withholding tax system is extended in time and expanded to income from bail-in bonds. This means that the withholding tax will not fulfil its guarantee function in this area.

Fiscal objective: When these instruments are placed with natural persons subject to taxation in Switzerland, the additional opportunities for tax evasion may entail revenue losses.

4.2. Banking business

4.2.1. Retail client business: Utilisation of AEOI reports received

If the switchover to the paying agent principle for the withholding tax is flanked by AEOI agreements and effective utilisation of reports received by the Swiss tax authorities, this will have the following impact:

Location objective: The measure eliminates the incentive inherent in the paying agent principle for non-tax-compliant taxpayers in Switzerland to relocate their paying agent abroad. This can prevent a migration of value added in domestic private banking.

Efficiency objective: The measure makes a contribution to the reduction of distortions currently existing due to the unequal tax treatment of different investment instruments. This positive efficiency effect is counterbalanced by the additional administrative effort to make use of the reports.

Tax equity and distribution objective: The measure makes a contribution to combating tax evasion.

Fiscal objective: By preventing migration of value added to foreign countries, the measure secures the existing tax base. Further revenue will also be generated as a consequence of the additional discovery of tax evasion and the long-term prevention thereof.

4.2.2. Retail client business: Disclosure option in Switzerland

If the guarantee mechanism of levying a withholding tax on domestic banking clients is supplemented by a voluntary disclosure option in Switzerland, this will have the following impact:

Location objective: The incentive for tax-compliant persons to relocate their paying agent abroad due to the loss of liquidity entailed by the withholding tax deduction is eliminated. In this way, the measure prevents a competitive disadvantage for domestic banks and secures the attractiveness of their location.

Efficiency objective: A positive aspect from the perspective of efficiency is that the investor can avoid the temporary loss of liquidity due to the withholding tax. A negative aspect is that two systems – the tax deduction and the disclosure system – must be maintained, which increases enforcement costs.

Tax equity and distribution objective: The measure does not have any effect on the tax equity and distribution objective.

Fiscal objective: If a person makes use of the disclosure option, this results in lower revenue as a one-time effect, because the person in question still receives refunds from previous tax periods, but no new tax is collected.

4.2.3. Retail client business: Automatic exchange of information internationally

If Switzerland implements the AEOI standard in a timely matter, if the standard is applied globally, uniformly, and on a reciprocal basis, if all legal forms are covered, and if Switzerland's partner countries satisfy the demands of the principle of speciality, the rule of law, and data protection, then this will have the following impact:

Location objective: The measure contributes to the level playing field in dealing with tax evasion and is thus able to avoid disadvantages for the Swiss financial centre.

Efficiency objective: No impact.

Tax equity and distribution objective: The measure makes a contribution to curtailing the possibilities of tax evasion via foreign countries.

Fiscal objective: By making tax evasion via foreign countries more difficult, the measure will have a positive impact on the fiscal objective.

4.2.4. Securities trading: Fighting the extraterritorial effects of the financial transaction tax

If fighting extraterritorial effects of the financial transaction tax (FTT) is successful in international bodies, this will have the following impact:

Location objective: The financial centre and its clients are protected from extraterritorial additional taxation, so that the Swiss financial centre incurs no competitive disadvantage.

Efficiency objective: Multiple taxation that would interfere with financial intermediation can be prevented. The financial centre avoids additional tax payment costs.

Tax equity and distribution objective: Clients remain protected from multiple taxation.

Fiscal objective: Competition through access to the Swiss tax base by foreign tax authorities is prevented.

4.2.5. Securities trading: Dealing with any extraterritorial effects of the financial transaction tax

If the FTT should be introduced within individual EU countries with extraterritorial effect, the following strategies are conceivable to prevent double taxation: (1) adoption of the foreign FTT system, (2) unilateral measures relating to the transfer stamp tax, or (3) avoidance of double taxation through DTAs.

Location objective: Excessively high tax burden for clients that would negatively impact the competitiveness of the financial centre can be avoided. This goal is achievable autonomously by way of strategy (2). Strategy (1) is presumably not able to prevent certain transactions covered by the FTT from relocating to FTT-free financial centres. Strategy (3) would likely turn out to be difficult and protracted.

Efficiency objective: Multiple taxation that would interfere with financial intermediation can be avoided in principle by way of all three strategies.

Tax equity and distribution objective: Clients remain protected from multiple taxation.

Fiscal objective: Major or minor revenue losses would likely be the result. These are likely to be the highest under strategy (2) and the lowest under strategy (1).

4.3. Insurance business

4.3.1. Congruent system of taxation of insurance products

A congruent system of taxation of life insurance benefits upon establishment, during the term, and upon payment will have the following impact:

Location objective: No impact.

Efficiency objective: Existing distortions arising from the unequal tax treatment of different insurance forms and of insurance policies compared with other investments are reduced.

Elimination of the tax on life insurance policies reduces the enforcement costs of taxation.

If the flat-rate solution for pension insurance is replaced with a solution based on the effective share of income, this increases the enforcement costs of taxation.

Tax equity and distribution objective: Over-taxation and under-taxation are reduced. This makes taxation more uniform.

Fiscal objective: The net impact on the fiscal objective depends on the specific implementation of the individual measures.

4.3.2. Examination of a transition to the risk location principle for the stamp duty

Location objective: The location disadvantage for domestic insurance providers of group-wide insurance solutions – resulting from double taxation due to the Swiss insurance tax and the foreign insurance tax levied on the basis of the location of the risk – is eliminated.

The risk location principle removes the location disadvantage for domestic insurance providers in the constellation of policyholders residing abroad who want to insure risks located in Switzerland.

In contrast, an additional tax burden is incurred from the perspective of the Swiss business location because the tax exemption for policyholders abroad with risks located in Switzerland is eliminated.

Efficiency objective: The Swiss business location loses the tax exemption for risks located in Switzerland which is common today for many international group insurance relationships.

Tax equity and distribution objective: The change of system would avoid both zero taxation and double taxation.

Fiscal objective: Insurance tax receipts decrease for risks located abroad, to the extent domestic insurance providers are involved in the cross-border insurance of such risks. These revenue losses are likely moderate, given that policyholders already have a strong incentive today to avoid such disadvantageous insurance structures.

Conversely, insurance tax receipts increase in the constellation of foreign policyholders insuring risks located in Switzerland.

Indirectly, tax revenue is increased thanks to the business in group-wide insurance solutions, since higher profit taxes for insurers and income taxes for employees in the insurance sector can be expected.

4.4. Export of banking and insurance services

If an option for the taxation of banking and insurance services abroad is provided, with a corresponding deduction of the input tax, this has the following impact:

Location objective: The following table shows for Switzerland, the EU countries, and other foreign countries as the destination of an insurance service whether a hidden tax arises or not when the service is performed by a provider from Switzerland or an EU country. A distinction is made in the case of the Swiss provider between the status quo without an option for taxation of the exported service and the reform scenario with such an option.

		Destination of the service		
		Switzerland	EU country	Other foreign countries
Origin of the service	EU country	No hidden tax	Hidden tax	No hidden tax
	Switzerland (status quo)	Hidden tax	Hidden tax	Hidden tax
	Switzerland (reform scenario)	Hidden tax	No hidden tax	No hidden tax

Under the status quo, a provider from an EU country has a competitive advantage against a provider from Switzerland if the destination of the service is in Switzerland or a non-EU foreign country, because – unlike for the Swiss provider – there is no hidden tax on the service. If the destination of the service is an EU country, however, a hidden tax is incurred in the constellation of both providers, which is higher depending on the value added tax rates in the country of origin of the service.

Under the reform scenario, the competitive position of the Swiss providers improves. If the destination of the service is in an EU country, there will always be a competitive advantage, because no more hidden tax is incurred on the service performed by the Swiss provider. In the case of services exported to non-EU foreign countries, the playing field is level for providers from Switzerland and for providers from the EU, because both providers are able to offer their services without a hidden tax. Swiss providers are still at a competitive disadvantage if the destination of the service is in Switzerland, because the hidden tax on the service performed by the Swiss provider remains.

For the insurance industry, the improvement of competitiveness under the reform scenario would have an impact especially in regard to cross-border reinsurance business: The competitive advantage of the foreign reinsurer of the risks of a Swiss primary insurer is now counterbalanced by the competitive advantage of the Swiss reinsurer of risks of a primary insurer domiciled in the EU.

Efficiency objective: By removing the hidden tax, the associated distortions are eliminated, especially those involving investment decisions. In return, the additional option increases the enforcement costs of the value added tax.

Tax equity and distribution objective: The measure entails a double zero taxation of cross-border banking and insurance services. The result is a stronger privileging of these industries compared with others. While the exporters of physical goods taxable in Switzerland also benefit from the zero rate, these goods are then taxed with the foreign value added tax in the importing country.

Fiscal objective: The revenue loss is CHF 580 million, of which CHF 330 million are attributable to banking services and CHF 250 million to insurance services. This revenue loss is opposed by possible additional direct tax revenue.

4.5. Regulation of banks and insurers

4.5.1. Limitation of transfer pricing risks

The measure proposed in this regard does not provide a sufficient basis for an economic analysis.

4.5.2. Avoidance of multiple taxation in corporate groups

The introduction of group profit taxation for operating activities in Switzerland would have the following impact.

Location objective: With respect to the profit tax, the measure permits more rapid offsetting of losses with profits within the corporate group, and it eliminates multiple taxation by the capital tax. In this way, the average effective tax burden is reduced, thus increasing the appeal of Switzerland for corporate relocations.

Efficiency objective: The more rapid offsetting of losses with respect to the profit tax reduces the marginal effective tax burden, which tends to have a positive effect on investment activity and growth.

The measure makes allocation of taxes between cantons considerably more complicated and thus increases the enforcement costs of taxation.

Tax equity and distribution objective: Group taxation entails greater tax neutrality in regard to the structuring of a corporate group and should therefore be considered positive under the aspect of horizontal tax equity.

Fiscal objective: Revenue losses occur, the magnitude of which cannot currently be estimated.

5. Recommendations for action in regard to further development of the tax framework

On the basis of the above analysis of the current state of affairs and the economic analysis, strategic directions for the further development of Swiss tax policy are defined. Subsequently, various measures or elements of measures are enumerated that should be examined in more detail in order to achieve the suggested strategic direction.

5.1. Capital market

Strategic direction

The strategic direction in relation to the capital market must aim at, on the one hand, achieving competitive tax framework conditions for all products and, on the other hand, closing the loopholes for guaranteeing the taxation of income of Swiss investors from foreign sources under the prevailing withholding tax law.

Measures
To realise this strategic direction, the Federal Council should, in its parliamentary dispatch on the withholding tax, request implementation of a general switchover to the paying agent principle with exceptions for domestic equity income.

As a transitional provision of this reform project, product-specific tax exemptions should be envisaged for officially regulated products such as bail-in bonds, CoCos or write-off bonds. These tax exemptions should be limited in time until the entry into effect of the reform. The paying agents must be given sufficient time to switch over under the reform. The possibility of compensation for the costs incurred by the paying agent for the tax-deduction procedure should be examined.

> **Concerns of the banking industry relating to the export of services**
> Because its exported services would become more expensive, the banking industry calls for measures to ensure its competitiveness in this area as well. If, analogously to the rule in the EU, the VAT input tax deduction were permitted in connection with banking services rendered to recipients abroad (option only for services abroad), an estimated one third of the hidden tax would be eliminated. The Subgroup on the Tax Environment for Financial Transactions could not agree on a common recommendation for action on this point, however.

5.2. Banking business

5.2.1. Attractive framework conditions for tax-compliant bank clients

Strategic direction
The framework conditions for the banking business should be designed in such a way that they are attractive and advantageous for tax-compliant bank clients.

Measures
To realise this strategic direction, the Federal Council should align the switchover to the paying agent principle for the withholding tax with the planned introduction of AEOI internationally, so that non-tax-compliant domestic bank clients do not switch their paying agent abroad without securing the tax base. Additionally, the Swiss tax authorities should be able to make use of the AEOI reports received from partner countries.

Additionally, the Subgroup on the Tax Environment for Financial Transactions recommends that for domestic bank clients, a source tax should still be levied in Switzerland as a guarantee mechanism. The source tax could take the form of a tax under the debtor or paying agent principle, preferably in combination with a disclosure option. Tax-compliant persons and institutional investors would have no incentive to switch their paying agent abroad if they had the disclosure option available to them in Switzerland. The loss of interest associated with the withholding tax and the administrative burden would be eliminated. This would also have a positive impact on value added in Switzerland.

5.2.2. Adoption of international standards

Strategic direction
Switzerland implements the internationally recognised standards. It participates actively in the development of such standards and safeguards Swiss interests.

Measures

The Subgroup on the Tax Environment for Financial Transactions welcomes the Federal Council's commitment to take up work on implementation of AEOI in a timely manner; to advocate at the international level that AEOI is implemented globally and uniformly, that it covers all legal forms (including trusts and domiciliary companies), that it is designed in a reciprocal manner, and that the partner countries meet the high demands on compliance with the principle of speciality, the rules of law, and data protection; and to prepare implementing legislation that creates a domestic legal basis for AEOI. The Subgroup also welcomes the Federal Council's adoption of the definitive negotiating mandate on introduction of the new global standard for automatic exchange of information in tax matters on 8 October 2014.

5.2.3. Financial transaction tax (FTT)

Strategic direction
With regard to the financial transaction tax (FTT), Switzerland should oppose extraterritorial measures.

Measures
At the international level, the Federal Council should oppose the extraterritorial effect of any future financial transaction tax and use bilateral measures (conclusion of agreements with the partner countries concerned) or unilateral measures (relating to the transfer stamp tax or harmonisation with foreign FTT systems) to avoid double taxation effects.

5.3. Insurance business

Strategic direction
With regard to the insurance industry, a congruent system of taxation of insurance products should be achieved upon establishment, during the term, and upon payment of the insurance product.

Measures already taken in the insurance industry

In the EU area, the power of taxation for insurance taxes (the international term for "stamp duty") is allocated to the state where the risk is located ("risk location principle"). The FTA has been mandated by the Federal Council to examine the transition to the risk location principle in the area of asset insurance. Additionally, the FTA is currently working on an administrative report on the income tax consequences of pension insurance policies, in order to show how an appropriate taxation of annuity payments might look in the future.

Other concerns of the insurance industry

From the perspective of the Swiss Insurance Association, the principles of taxation of pension products embedded in the Swiss three-pillars system should be further developed in an appropriate manner in these areas in order to realise this strategic direction. In particular, the stamp duties on life insurance premiums in Pillar 3b and the income tax treatment of annuity payments are up for discussion. If an over-taxation of annuities is eliminated, the FTA believes that the elimination of the privileged taxation of lump sums in non tax-qualified provision and Pillar 2 should be discussed as well. The demographic and macroeconomic changes must be taken into account appropriately.

Additionally, because its exported services would become more expensive, the insurance industry calls for measures to ensure its competitiveness. If, analogously to the rule in the EU, the VAT input tax deduction were permitted in connection with insurance services rendered to recipients abroad (option only for services abroad), an estimated one third of the hidden tax would be eliminated. The Subgroup on the Tax Environment for Financial Transactions could not agree on a common recommendation for action on this point, however.

5.4. Regulation of banks and insurers

Strategic direction
In regard to the regulation of banks and insurers, multiple taxation within corporate groups should be avoided under tax law, and transfer pricing risks should be limited to the extent possible.

Measures
From today's perspective, the following elements of measures should be considered in order to realise this strategic direction:

- **Capital tax**
  An investment deduction or offsetting within the corporate group for the capital tax could be introduced. Due to the regulatory changes, the Swiss banks are adjusting their structures and are establishing new legal companies (e.g. holding companies) for this purpose. In this way, multiple taxation might be avoided in respect of the capital tax. As part of the CTR III, the introduction of an investment deduction and offsetting within the corporate group are being considered.

- **Avoidance of withholding tax risks in the case of transfer pricing adjustments**
  In light of the remarks in the previous chapter on the foreseeably more intensive transfer pricing discussions between international corporate groups and local tax authorities, it should first of all be noted that the issue is of the utmost importance to the capital market in Switzerland. Switzerland should therefore address the transfer pricing problems it faces. The FTA should hold detailed discussions with the sectors affected by withholding tax risks associated with transfer pricing adjustments in order to identify and consider possible solutions, taking account of the international developments.

- **Taxation of group companies in Switzerland**
  The banks assert that under current law, the legally provided leeway for tax consolidation should be exploited in a sensible way. To the extent sensible, intercantonal allocation of taxes on the basis of results across all legal entities should be used. Certain or all activities of one Swiss group company should be considered a permanent establishment of the other group companies. Additionally, group taxation of Swiss activities, as has already been implemented successfully in regard to the value added tax, should be considered *de lege ferenda* for the profit tax. For investments within the tax group, the investment deduction would be eliminated, and parent companies would not be able to claim a deduction for their investments in other companies of the legal entities consolidated within the Swiss tax group, because any operating loss of these other companies would already have been included in the profit and loss calculation of the tax group.

  From the perspective of the FTA, group profit taxation cannot be introduced in the short term, but it should be considered as an option in the medium to long term.

  The Federal Council should therefore mandate the Federal Department of Finance to consider group taxation of Swiss activities for the profit tax in existing law.

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