

Planned reform of the Swiss withholding tax

On December 17 2014 the Swiss Federal Council published new draft legislation on the reform of Swiss withholding tax, proposing an exemption for interest payments to non-residents and an extension of the taxable basis for Swiss resident individuals. The draft's consultation period ended on March 31 2015. [Alberto Lissi](#) and [Monika Gammeter](#) of **Tax Partner – Taxand Switzerland** outline the latest developments.

As early as 2011, the Federal Council submitted a first proposal to the Swiss Parliament as part of the ‘Too big to fail’ Bill (TBTF) on the reform of the withholding tax applied to interest payments on bonds and money market instruments. The Bill – which aimed at a systemic change from the current debtor principle to the paying agent principle – was referred back to the Federal Council by the Federal Assembly for a more detailed analysis of this fundamental system change to be carried out, taking account of the various other tax topics pending at the time, such as FATCA and final withholding taxes. In particular, the new proposal should enhance the attractiveness of national bonds for foreign investors, including, specifically, foreign funds and institutional investors, while an extension of the system change to cover dividend payments should also be considered.

Based on the above the Federal Council has issued the new draft legislation on the withholding tax reform – formally called ‘Federal Act on the debtor principle and the paying agent principle regarding withholding tax’ – and initiated the consultation process on December 17 2014. The consultation period lasted until March 31 2015.

Background and goal of the planned withholding tax reform

Under the existing system, Swiss withholding tax of 35% is levied on certain investment income such as interest on bonds and money market instruments, dividends of corporations and income from collective investment schemes. Withholding tax is only charged on securities issued by Swiss entities. Under applicable law, securities issued by foreign entities are generally not subject to withholding tax. Swiss investors can claim back the withholding tax by declaring the relevant income, while foreign investors can generally only claim back part of the withholding tax – according to the terms of an applicable double tax treaty. As a result of the Swiss withholding tax, Swiss corporate groups in need of debt capital regularly issue their bonds through foreign group companies and only a few collective investment schemes are domiciled in Switzerland at present.

According to the Federal Council, the planned withholding tax reform has the goal of enhancing the Swiss debt capital market while also strengthening the safeguarding function of withholding taxes *vis-à-vis* domestic investors, and thus bolstering national tax compliance.

Planned changes to the withholding tax

According to the latest draft legislation, the 35% withholding tax will be extended to include income from non-Swiss securities. Thus, according to

Box 1
Overview of the parallel methods for levying Swiss withholding tax according to the paying agent and debtor principles

Income subject to the paying agent principle	Income subject to the debtor principle
<ul style="list-style-type: none"> • Income from Swiss and foreign bonds • Income from bank accounts • Income from foreign shares and participation rights • Income from collective investment schemes and structured products (if originating from income from bonds, bank accounts or foreign participation rights and is accounted for separately) • Payments from pension funds and Swiss life insurance schemes 	<ul style="list-style-type: none"> • Income from Swiss shares and participation rights • Income from Swiss shares and participation rights that is distributed or retained by Swiss collective investment schemes • Lottery wins
Applies basically to individuals resident in Switzerland	Applies to Swiss and foreign individuals and corporate bodies

the draft legislation Swiss withholding tax will be levied on all income from Swiss and foreign bonds, bank accounts, dividends from Swiss and foreign participation rights, income from Swiss and foreign collective investment schemes and income from Swiss and foreign structured products. As before, withholding tax will also apply to income from Swiss lotteries and payments from pension funds as well as domestic life insurance payments. Therefore, for the purposes of the withholding tax, Swiss and foreign securities will largely be treated as equivalent, which fulfills the purpose of closing tax loopholes for Swiss residents.

According to the draft Bill, income that will be subject to the paying agent principle (such as interest from bonds, foreign shares and part of the income from collective investment schemes and structured products – see Box 1) and which will be paid to non-Swiss resident beneficial owners will be exempted from Swiss withholding tax in the future.

It should further be noted that the draft Bill also provides for the expansion of the tax base to income from bonds, collective investment schemes and structured products in relation both to withholding tax and to income tax. For example, accrued interest and returns capitalised upon the sale, repayment or redemption of such debt instruments, collective investment scheme units and structured products would, according to the draft legislation, be subject to income tax and withholding tax. The taxation of accrued interest has no tradition in Switzerland and should be regarded as part of the gradual trend to abolish tax-free capital gains on investments from private individuals that has been demanded by more left-leaning parties for years. At the same time, this change would lead to additional complexity in the taxation of every change in ownership, especially for collective investment schemes. Thus, the additional complexity and administrative burden with regard to an extension of the taxation on accrued interest is criticised by the Swiss Funds & Asset Management Association (SFAMA).

The paying agent principle versus the debtor principle

In future, withholding tax for certain categories of income should no longer be levied from the debtor of the taxable income, respectively from the body issuing the security, but rather from the Swiss paying agent (generally a Swiss bank), which pays out or credits the taxable income to the investor. This is the paying agent principle.

However, according to the draft, the paying agent principle would only be applicable to certain categories of income such as income from bonds, bank accounts, dividends from foreign participation rights, income from collective investment schemes and structured products (with the exception of dividends from Swiss participation rights received by these bodies).

In general, for these categories of income withholding tax will only apply to payments to individuals resident in Switzerland. Thus, with regard to income that falls under the paying agent principle, payments to foreign resident beneficial owners or other persons (for example, Swiss pension funds or Swiss corporate bodies subject to an ordinary or limited audit) will be exempt from withholding tax. In addition, Swiss resident investors subject to withholding tax will have the possibility to authorise the paying agent to inform the tax authorities about the respective income (notification procedure) in which case withholding tax will no longer be deducted and the reclaim procedure becomes obsolete. In the draft legislation the ‘beneficial owner’ is described as the person with factual decision power and economic ownership over the income generating assets. In this regard the SFAMA has criticised the fact that Swiss and foreign collective investment schemes have not been specifically mentioned under the exempted parties in the draft legislation, which leads to uncertainties over whether collective investment schemes would be regarded as beneficial owners and would be exempted from withholding tax on interest received.

On the other hand, dividends on Swiss shares and other participation rights – irrespective of whether they are received directly or indirectly by virtue of the holding of units in a col-



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lective investment scheme – as well as lottery wins will continue to be subject to the debtor principle. This means that these categories of income will continue to be subject to withholding tax, irrespective of residence and legal status of the recipient.

An overview of the parallel methods for levying Swiss withholding tax according to the “paying agent and debtor principles” is provided in Box 1.

Long overdue, but question marks remain

The Swiss withholding tax reform is long overdue. The introduction of the paying agent principle, compared with the applicable debtor principle, and in particular the exemption from withholding tax for foreign residents are to be welcomed. However, the parallel application of two levying systems depending on the kind of investment income does not help to simplify tax matters. Further, the paying agent principle would lead to increased complexity on the side of the paying agents.

The change from the debtor principle to the paying agent principle would – from a tax systematic point of view – make sense for all categories of investment income. If the Federal Council’s proposal does not recommend this step, this is due to the fiscal significance of the Swiss withholding tax on dividends from Swiss shares and participation rights as an important source of income for the federal budget.

The current taxation regime based on the due date of the income is pragmatic, efficient and well established and should

be maintained. Due to the complexity associated with calculation and the associated increased administrative and cost burden for the financial sector, the extension of the tax base to accrued or capitalised income must be considered as problematic in particular with regard to income from collective investment schemes.

While several parties involved in the consultation procedure welcome the draft legislation, in particular the Swiss Banking Association (SBA) has expressed its reservations to the introduction of a withholding tax under the paying agent principle on income to Swiss resident individuals. Due to the increased risks, cost and liabilities for the paying agents, the SBA supports the introduction of a compulsory notification procedure in such cases, since the SBA regards the withholding tax under the paying agent principle as an unnecessary interim step towards the automatic exchange of information. It is worth mentioning here that Switzerland will adhere to the implementation of the international automatic exchange of information as per January 1 2017, with first exchange of information in 2018 and the SBA apparently considers the introduction of an automatic exchange of information in the domestic environment as probable.

As the draft legislation of the Swiss withholding tax reform runs parallel to the introduction of the international exchange of information in Switzerland, the critical points expressed above as well as the sceptical view of the SBA put a question mark over the swift incorporation of the reform.

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