
The New Tax Credit Ordinance

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18 May 2021

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Tax credit method applied by Switzerland

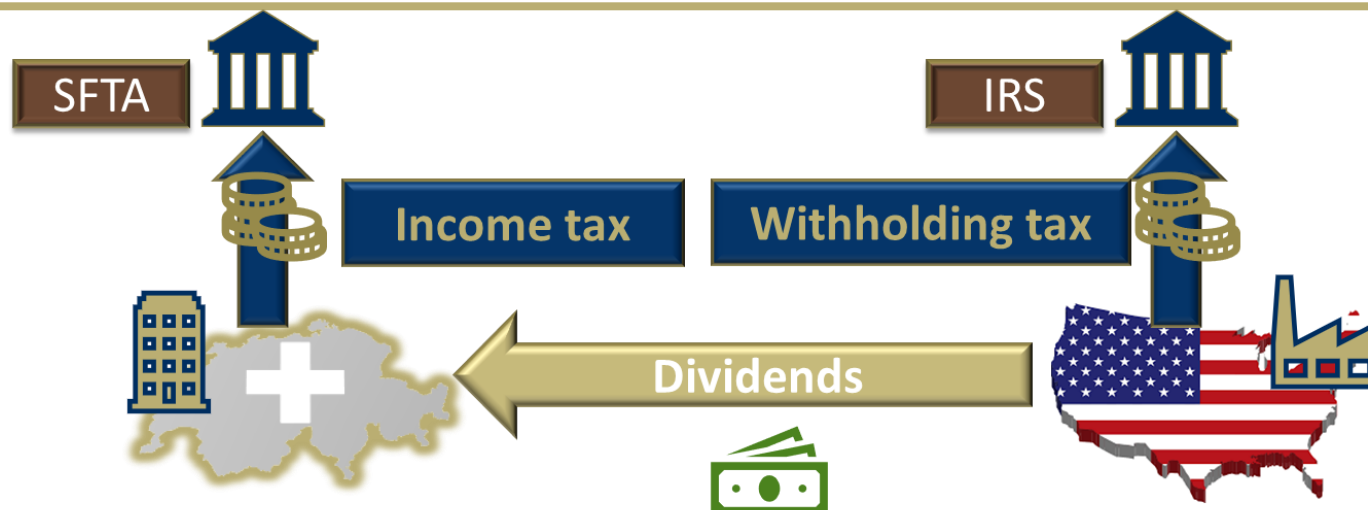
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Tax credit method applied by Switzerland

General remarks

Overview

- Swiss taxpayers
 - may suffer foreign non-recoverable withholding taxes (**WHT**) on passive income (dividends, interests, royalties etc.) derived from foreign sources;
 - are generally subject to Swiss tax on their worldwide income, including the foreign sourced income.
- **Double taxation:** Elimination / Reduction by a tax credit



Tax credit method applied by Switzerland

Method article (Art. 23A and 23B OECD MTC)

– Typical Wording of the Swiss method article

(e.g. Art. 23 (2) (b) DTA Switzerland - Principality of Lichtenstein)

“(b) Where a resident of Switzerland derives dividends [or interests or royalties] which, in accordance with the provisions of Article 10 [Art. 11 or Art. 12, resp.] may be taxed in Liechtenstein, Switzerland shall allow, upon request, a relief to such resident. The relief may consist of:

(i) a tax credit from the tax on the income of that resident of an amount equal to the tax levied in Liechtenstein in accordance with the provisions of Article 10 [Art. 11 or Art. 12, resp.]; such tax credit shall not, however, exceed that part of the Swiss tax, as computed before the tax credit is given, which is appropriate to such dividends [interests or royalties]; or

(ii) a lump-sum reduction of the Swiss tax; or

(iii) a partial exemption of such dividends from Swiss tax, in any case consisting at least of the tax credit of the tax levied in Liechtenstein from the gross amount of the dividends [interests or royalties].”

Tax credit method applied by Switzerland

Method article (Art. 23A and 23B OECD MTC)

- Swiss method article:
 - Different wording to OECD-MTC and UN-MTC
 - Lump sum reduction added by Swiss legislation

➤ tax credit

➤ Lump sum reduction

➤ Partial exemption

Tax credit method applied by Switzerland

Case Law

Decision of the SFSC, 26.9.2014, 2C_64/2013/ 2C_65/2013



– Facts:

- ❖ Complainant: Insurance Company with its headquarter in Basel-Stadt (**BS**)
 - Profit in the insurance division (due to a capital gain derived from real estate in Geneva (**GE**))
 - Loss in the non-insurance division
- ❖ Intercantonal tax allocation: profit is attributed to GE; no taxable income in BS
- ❖ BS refuses to credit the non-recoverable foreign WHT on interests and dividends with the argument that based on a divisional calculation the foreign interest and dividend income is not subject to Swiss profit tax.

Tax credit method applied by Switzerland

Case Law

Decision of the SFSC, 26.9.2014, 2C_64/2013/ 2C_65/2013



– Considerations:

- ❖ Switzerland applies “**ordinary credit**”-method;
- ❖ Tax credit is limited by the maximum amount;
- ❖ Tax credit must be granted to a legal entity, even if income subject to WHT is attributable to the loss-making division.

Tax credit method applied by Switzerland

Case Law

Decision of the FSC, 9.10.2014, 2C_750/2013/2C_796/2013



Partial taxation of private dividend income / Considerations of the SFSC:

- ❖ Reduction of tax credit amount violates the obligations under treaty law → Switzerland is not free to determine the amount of the tax credit domestically
- ❖ Switzerland applies **lump sum-reduction method**
- ❖ Inconsistencies in the argumentation: the usage of the maximum amount indicates the application of the ordinary credit-method

Tax credit method applied by Switzerland

Case Law

Decision of the SFSC, 3.7.2019, BGE 145 II 339



– Considerations

- ❖ The reduction of the maximum amount by 2/3 due to the holding privilege is compatible with the obligations under treaty law.
- ❖ Switzerland applies the **lump sum reduction-method**
- ❖ Due to the Swiss federal structure, no treaty override if the double taxation is not eliminated

Tax credit method applied by Switzerland

Case Law

Conclusion



- ❖ According to the latest jurisprudence, Switzerland applies the lump sum reduction-method
 - Partial contradiction with older jurisprudence
- ❖ No precedents since the New Ordinance replaced the Old Ordinance
 - Elimination of some lump-sum reductions may indicate the application of the ordinary tax credit method under the New Ordinance
- ❖ Inconsistencies in jurisprudence are due to the wording of the Swiss method article

Key features of the new tax credit regime

- Overview of the amendments
- Subjective scope: who has access to a tax credit?
- Objective scope: Which income is subject to tax credit?

Key features of the new tax credit regime

Overview of the main amendments

New Ordinance

- Deletion of specific rules concerning holding and mixed companies
- Expansion of the tax credit system for permanent establishments of foreign companies in Switzerland
- Per Basket Limitation
- New calculation of maximum tax credit amount

Key features of the new tax credit regime

Subjective scope: who has access to a tax credit?

Entities entitled to tax credit

Individuals

Legal Entities

Partnerships

Permanent Establishment

With tax residency in
Switzerland (subject to
unlimited tax liability)

“Resident of a contracting state”

See next slide

Key features of the new tax credit regime

Subjective scope: who has access to a tax credit?

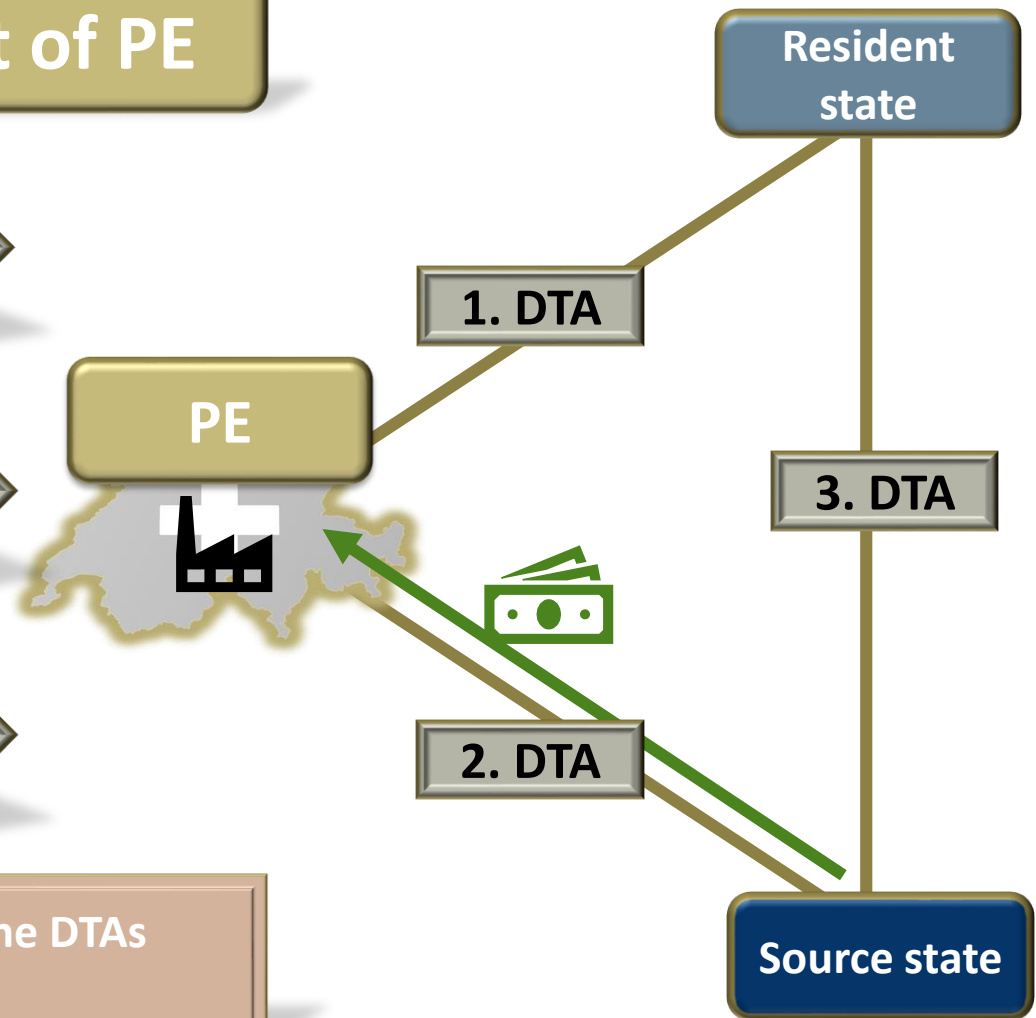
Required DTAs for tax credit of PE

1. Switzerland and the resident state of the company

2. Switzerland and the source state of the income

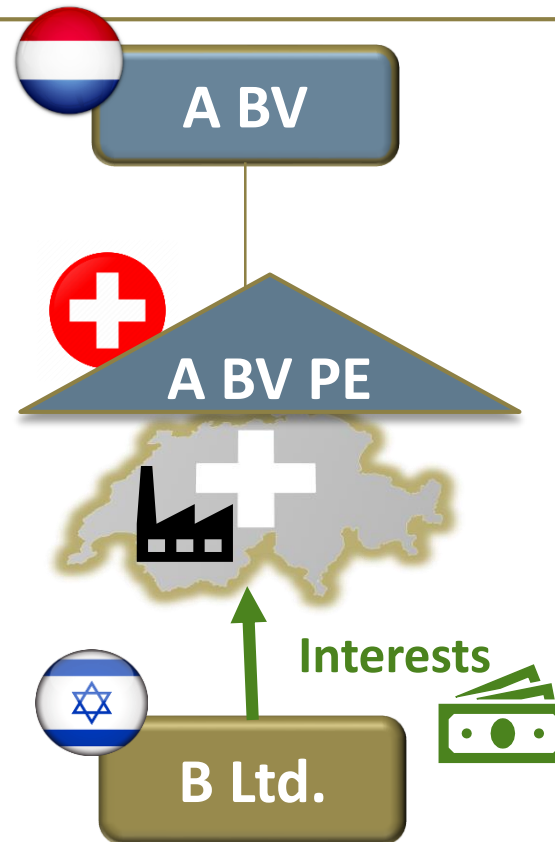
3. The resident state of the company and the source state

Only the lower residual tax rate laid down in the DTAs with the source state (2. or 3.) can be credited



Key features of the new tax credit regime

Subjective scope: who has access to a tax credit?



Can A BV PE claim a tax credit? If so, to what extent?

Key features of the new tax credit regime

Who has access to a tax credit?

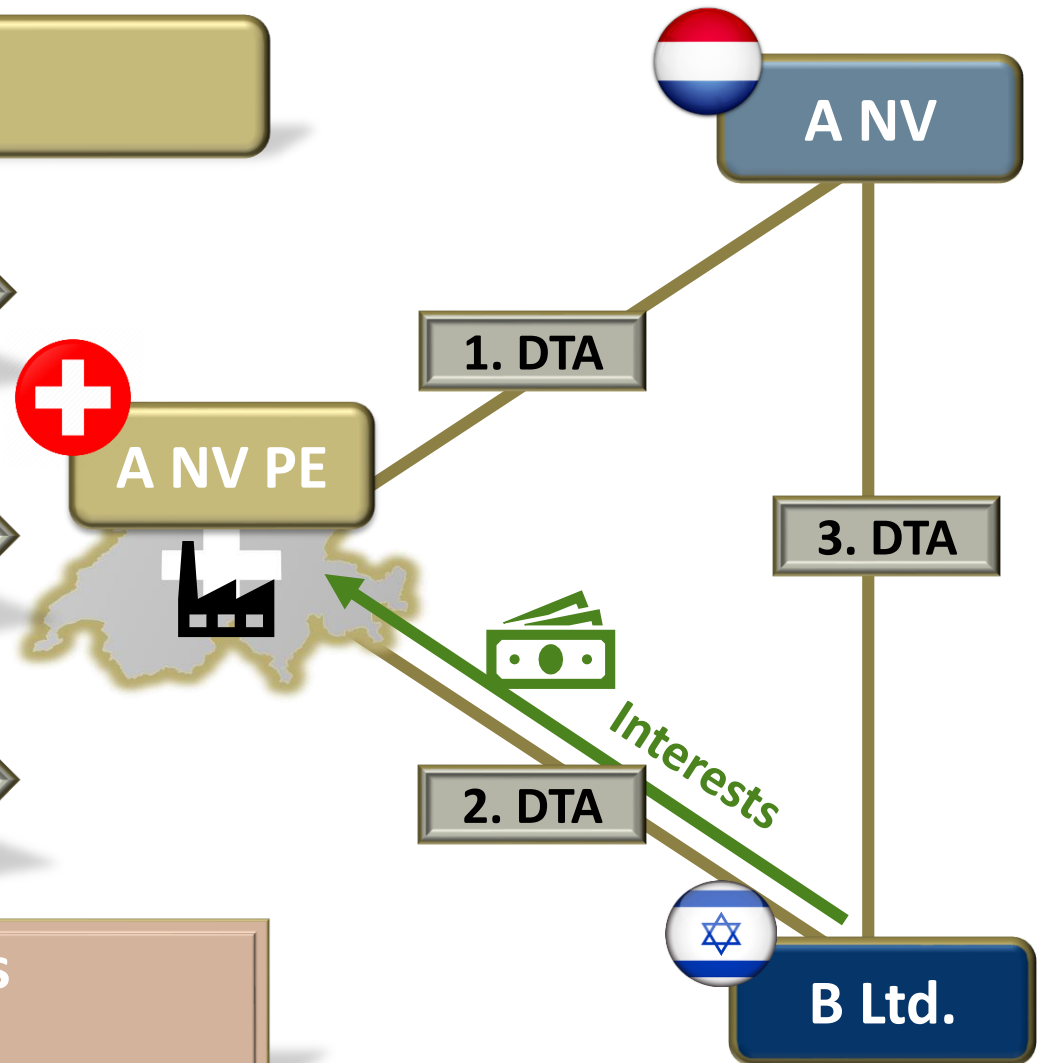
Example

1. DTA CH – NL
Residual tax rate: 0%

2. DTA CH – ISR
Residual tax rate: 10%

3. DTA NL – ISR
Residual tax rate: 15%

The lower residual tax rate (10%) is creditable to Swiss tax



Key features of the new tax credit regime

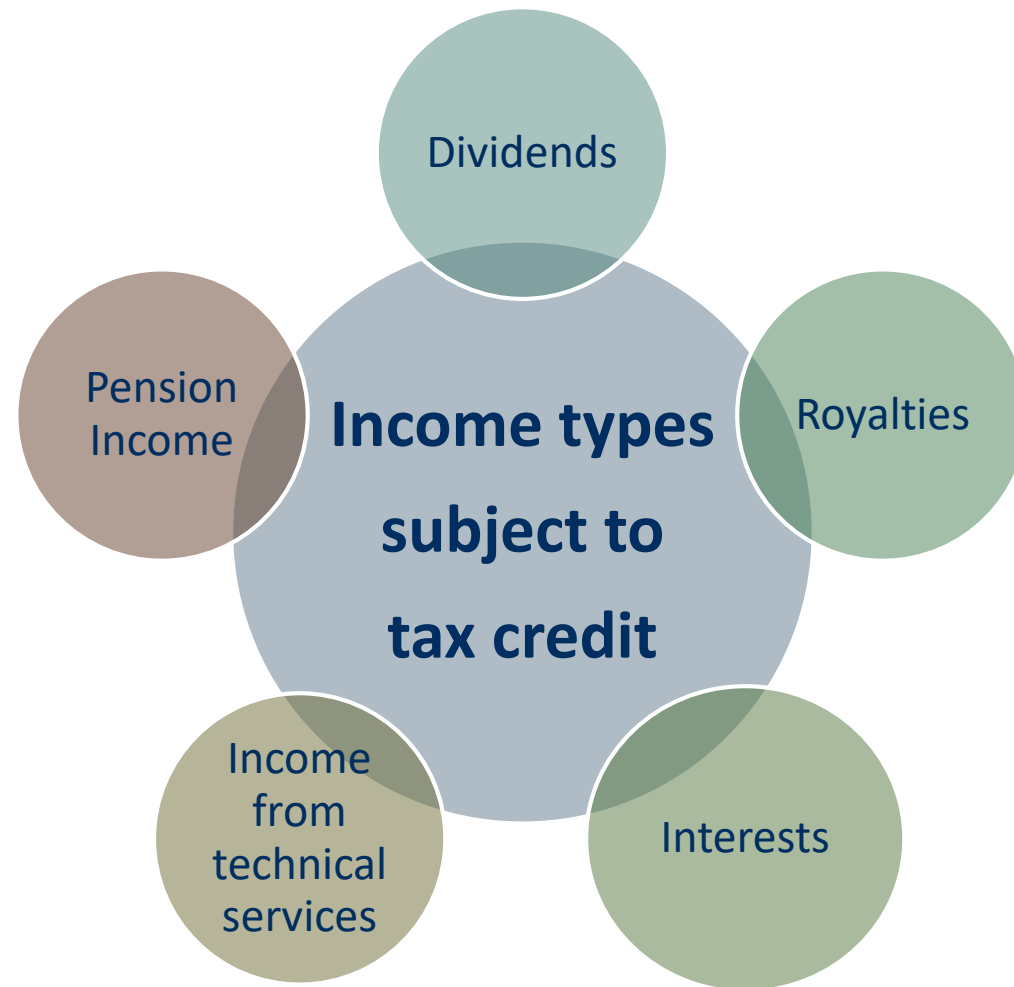
Objective scope: Which income is subject to tax credit?

Conditions

1. DTA between Switzerland and the source state
2. Income must be subject to WHT under the national law of the source state
 - *Exception:* fictitious tax credit according to individual DTAs with developing countries
3. Income must be subject to tax in Switzerland
 - E.g. no tax credit if dividend income is subject to participation exemption

Key features of the new tax credit regime

Objective scope: Which income is subject to tax credit?



Calculation of the maximum amount

Maximum amount

Corporate income tax

Calculation of creditable amount

Starting point of calculation

**Non-recoverable WHT, collected in
another DTA-state**

Withholding must be DTA-compliant

Maximum amount

Formula

Art. 10 New Ordinance

- ² Der Teilbetrag der Gewinnsteuer, der auf die aus den Vertragsstaaten stammenden Erträge entfällt, wird ermittelt, indem die Steuer im Verhältnis der aus den Vertragsstaaten stammenden Erträge nach Abzug der Schuldzinsen und Aufwendungen nach Artikel 11 zum gesamten dieser Steuer unterliegenden Reingewinn des Fälligkeitsjahres aufgeteilt wird. Der Teilbetrag kann nicht höher sein als die tatsächlich geschuldete Steuer.
- **Corporate income tax (federal) * (net basket income / taxable (periodic) corporate income)**
- Proportional method (approved by the SFSC)
- Calculated for each body (federal, cantonal, municipal and church)

Maximum amount Corporate income tax

- Corporate income tax = taxable corporate income (incl. losses carried forward) * tax rate
- No proportional allocation of losses carried forward

Maximum amount

Net basket income

- According to new ordinance, Switzerland applies a per basket limitation, maximum amount is separated by income categories (no per country limitation)
- Income categories:



Dividends

Royalties in
the patent
box (PB)

Income from
technical
services

Interests

Royalties not
in the patent
box (nPB)

Pension
income

Maximum amount

Net basket income

Consequence

separate crediting
surpluses can no
longer be offset

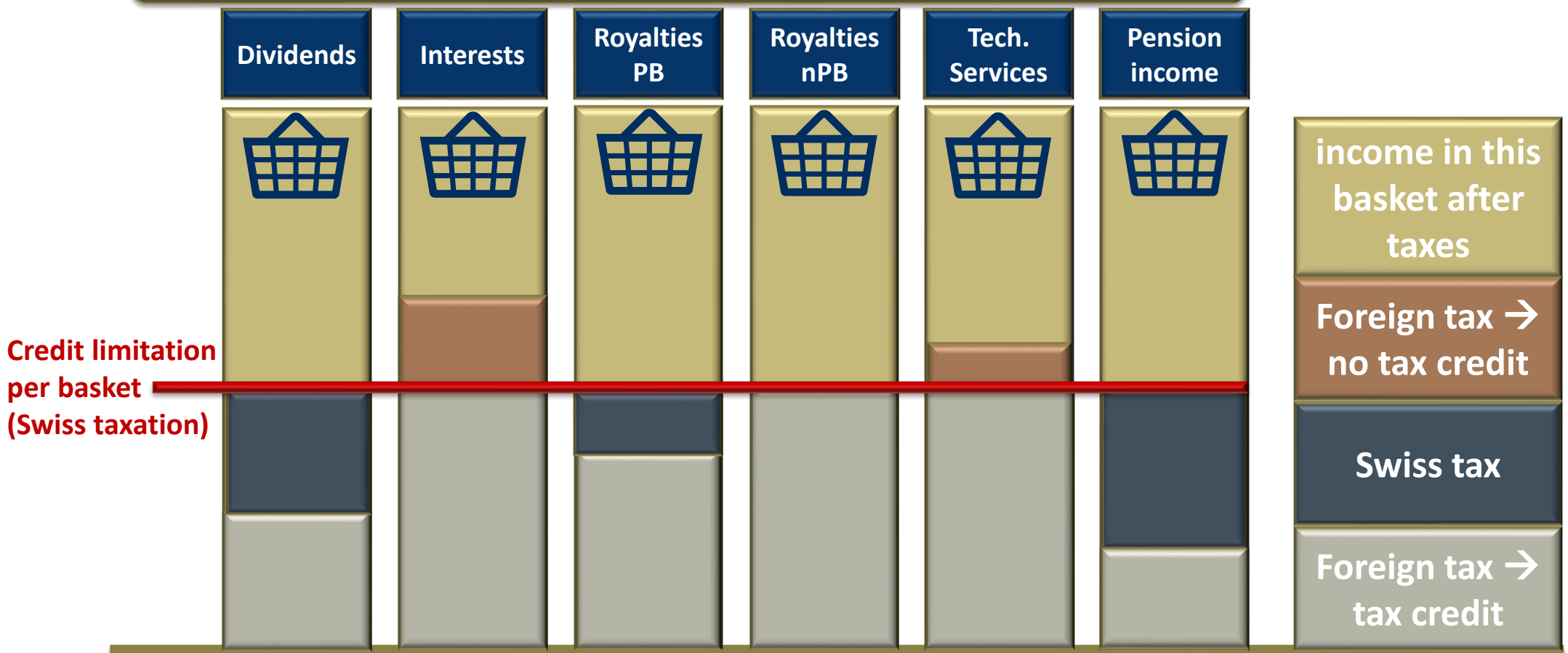
The total credit
amount might be
lower

DTA provisions are relevant for the delimitations of the categories

Maximum amount

No offsetting of surpluses

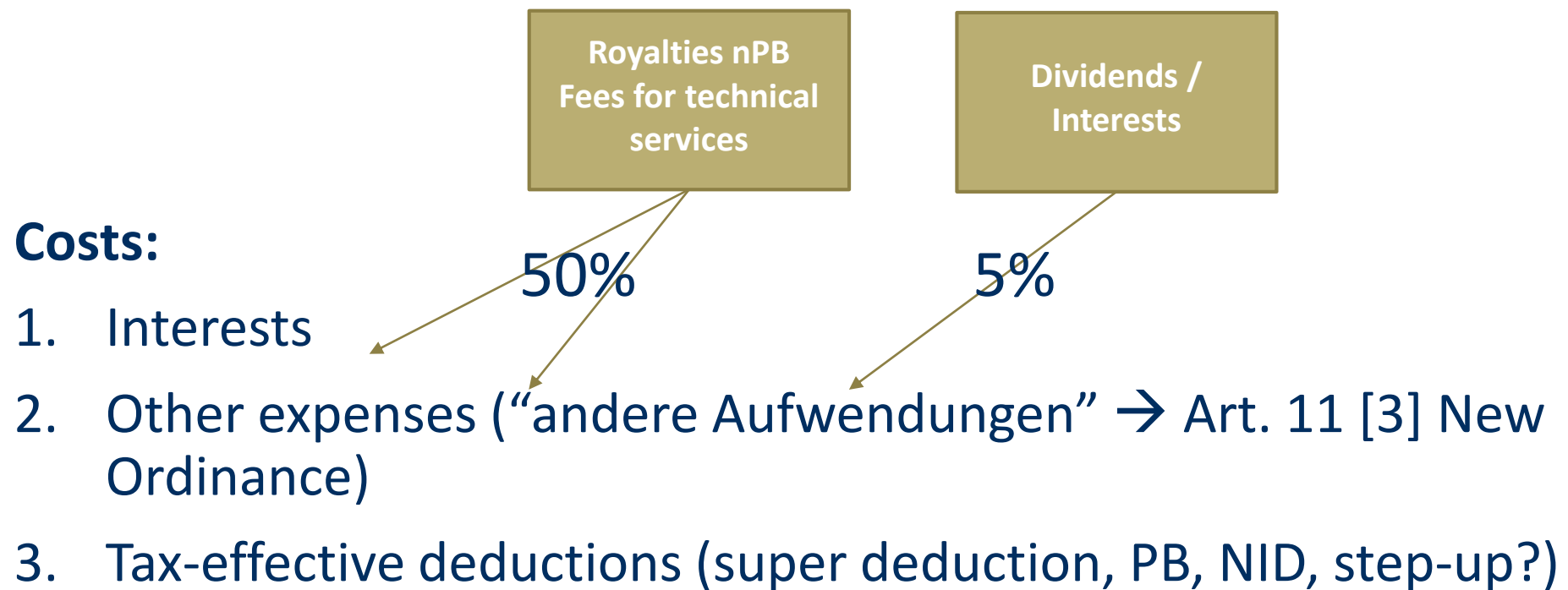
Per Basket Limitation



Maximum amount

Effective vs. lump-sum calculation

1. Either effective calculation; or
2. Lump-sum calculation



Maximum amount

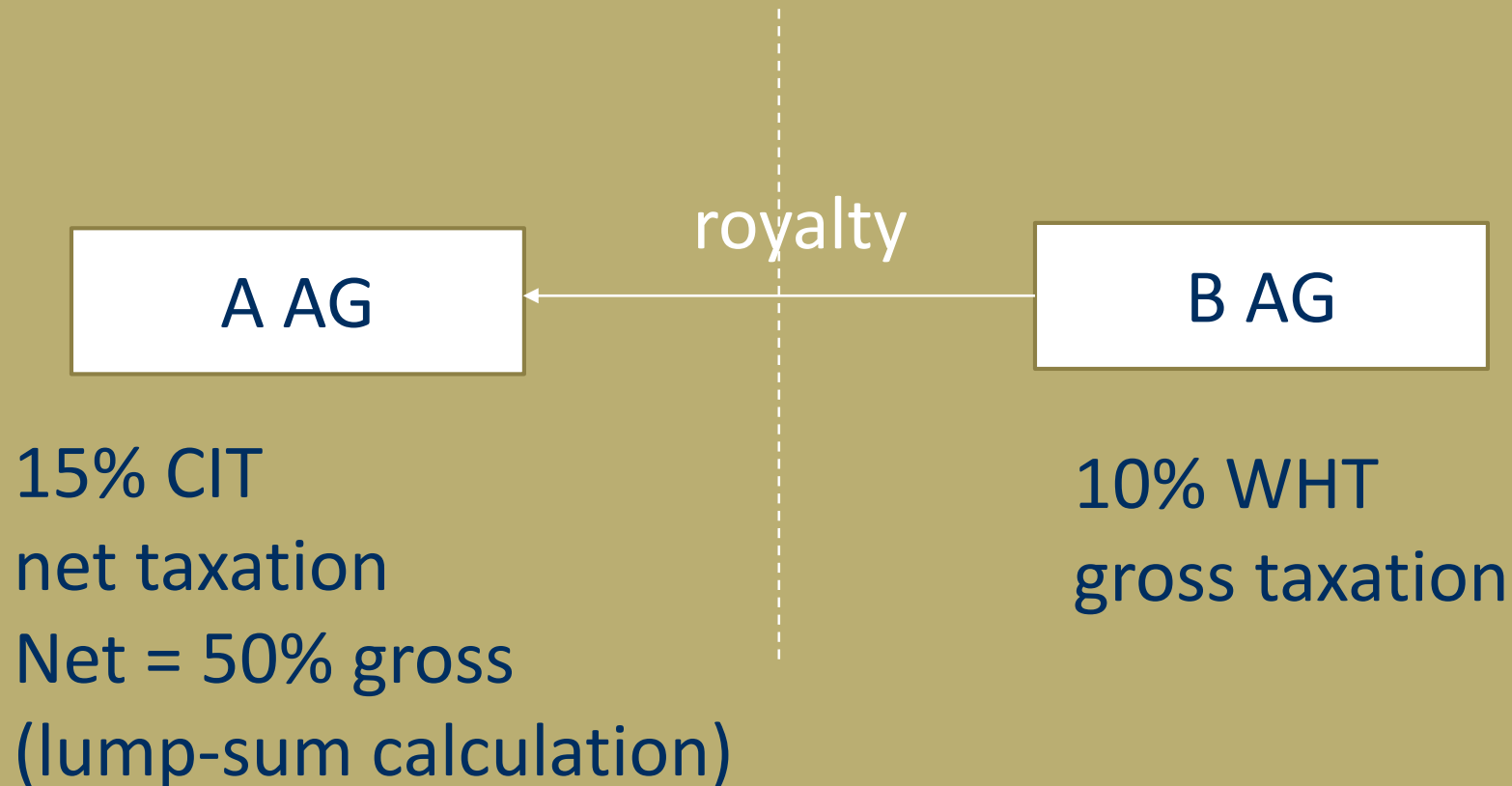
Allocation of costs

Allocation of costs (Art. 11 [2] New Ordinance)

1. Interests → proportional allocation according to the assets
2. Direct “other expenses” → direct allocation
3. Indirect “other expenses” → proportional according to the income
4. Direct “tax-effective deductions” → direct allocation
5. Indirect “tax effective deductions” → proportional allocation according to the income

Effective calculation

The forgotten question!



Effective calculation

Swiss Federal Supreme Court, 22 May 2017,
2C_573/2016, 2C_574/2016

Decision

«Die Kürzung ist bei Schuldzinsen anteilmässig ("die auf sie entfallen") und bei Unkosten kausal ("die mit der Erzielung der Erträge zusammenhängen") vorzunehmen. Hätte der Gesetzgeber für Schuldzinsen und Unkosten dieselbe Regelung gewollt, wäre die Kürzung nicht in zwei verschiedenen Nebensätzen umschrieben worden.»

What does causation mean?

Effective calculation

Financial Court Münster (Ger) Decision of 21.11.2018

Facts

- In question whether Chinese WHT (10%) on royalties is creditable to German Corporate Tax
- Tax office deducts current R&D-expenses from royalties → no tax credit due to net losses on royalties
- Per country limitation
- DTA between Germany and PRC

Effective calculation

Financial Court Münster (Ger) Decision of 21.11.2018

Decision

- The claim was approved
- Only economically attributable operating expenses can be deducted from royalties
- R&D-expenses are economically related to future potential royalties, not to current royalties
- Chinese WHT is creditable to German corporation tax

Conclusions

- The topic is technical and underestimated
- Unclear case law of the SFCS
- PEs have access to the tax credit
- Per basket limitation since 1 January 2020
- Allocation of costs is important
- Restructuring of IP might lead to higher creditable amount

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