THE EVOLUTION OF TAX ENFORCEMENT IN SWITZERLAND

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INTRODUCTION

In this article we describe the most recent developments in the Swiss tax enforcement arena:

- Attacks by Swiss federal and cantonal tax authorities on the use of offshore structures utilized by Swiss tax residents.
- Increased scrutiny, questioning, and tax audits directed at Swiss taxpayers.
- The active exchange of information program by which Switzerland provides and receives administrative assistance within the framework of the more than 100 double tax treaties.

ATTACKS ON OFFSHORE COMPANIES USED BY SWISS TAXPAYERS

Basis for Challenge

Based on established jurisprudence, there are three ways by which offshore structures are attacked by the Swiss tax authorities:

- The offshore company is considered effectively managed in Switzerland.
- The offshore company is deemed to act on behalf of a Swiss resident by means of an agency mandate, and as a result, the income is attributed to the Swiss principal.
- The offshore company is not recognized because it is a sham that is utilized for tax avoidance purposes.

Effect of Successful Challenge

If the Swiss tax authorities are successful in their attack on the offshore structure, the following Swiss tax consequences may arise:

- Swiss corporate income tax could be due on all income derived by the offshore structure. No special tax regime or ruling would be applicable. Consequently, the full corporate income tax rates would apply, which in most cantons, fall within the range of 12% to 15%.
- Swiss dividend withholding tax could be due on all distributions made or deemed made by the offshore company. This triggers a 35% Swiss dividend

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withholding tax. The tax is grossed up to about 54%[1] if the offshore company fails to collect the tax from the person considered to have benefited from the dividend. In practice, it is difficult to apply reduced treaty rates as the recipient is generally not able to benefit from an income tax treaty.

- 8.1% Swiss V.A.T. may be due on services invoiced to the offshore company by Swiss service providers or even on any service the offshore company imported from abroad. In practice it will be difficult to obtain a refund because of factual and formalistic requirements under Swiss V.A.T. law.

- 1% Swiss stamp duty on the capital contribution would likely not become due, because the stamp duty law is rather formalistic in nature and generally requires a company to be (i) incorporated or domiciled in Switzerland or (ii) registered in the Swiss trade register. In cases of capital contribution tax avoidance, a risk would continue to exist.

- Swiss securities transfer tax of 0.15% or 0.30% on an actual or deemed transfer of Swiss or foreign securities if the company can be considered a Swiss securities dealer under the Swiss stamp duty law. This can be a real risk for a fund investing in equities and debt instruments.

Attack Based on Effective Management

In practice, the attack directed to an offshore company by Swiss tax authorities is based on the concept of effective management in Switzerland. In Switzerland, the concept of effective management is not based on formalisms. In recent jurisprudence, the key element is where the day-to-day management of the business takes place. The location of board meetings, annual shareholder, place of strategic decisions, or the location of the books and records, by themselves, no longer carry much weight when Swiss tax authorities assert that effective management is in Switzerland.

To reduce the risk of a successful attack by the Swiss tax authorities on an offshore company related to a Swiss tax resident, the following recommendations need to be considered:

- The statutory and actual purpose of the offshore company should be defined precisely, and the object clause should not be cluttered by irrelevant filler purposes.

- The day-to-day business of the offshore company, as defined, must actually take place in the offshore jurisdiction where the company employs qualified personnel who work at adequately equipped office space.

- No part of the day-to-day business should take place in Switzerland.

- To eliminate inconsistencies that weaken a taxpayer's position, board meetings and annual general meetings should be held in the offshore jurisdiction. While holding those meetings in the offshore jurisdiction is not controlling, the failure to hold those meeting in the offshore jurisdiction weakens the position of the Swiss company as to the substance of the offshore company.

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[1] The gross up formula is as follows: 35% * 100/65 = 53.85%.

- Preferably, no Swiss residents should serve on the board of the company or carry on other important functions as an employee, agent, or representative. If this cannot be avoided, the Swiss resident could be appointed as an agent or representative with limited authority that is precisely drafted and impeccably followed.
- Preferably, the books and records of the company should be kept at its place of domicile, never in Switzerland. Regarding electronically accessible systems, preferably no access should be allowed from Switzerland.
- The bank accounts of the offshore company should be in the jurisdiction of domicile. Bank relations maintained by the offshore company should not be the same as the bank relations of Swiss resident individuals related to the Swiss shareholder.
- Swiss residents should not have signing authority on the bank accounts of offshore companies, and they should also not have indirect access, *e.g.* by way of electronic banking systems or credit cards etc.

Attack Based on Mandate Concept

Even if an offshore company is not effectively managed in Switzerland but is clearly acting on behalf of a Swiss principal, and is heavily financed by the Swiss principal, the Swiss tax authorities may assert that the offshore company is an agent acting on the basis of a mandate for the risk and account of the Swiss principal. Under this approach, the offshore company would be entitled to a service fee, but the bulk of the profits would be attributed to the Swiss principal. At least one Swiss Federal Court decision has adopted this view, although it is criticized by commentators.

Attack Based on Nonrecognition and Tax Avoidance

In cases of tax avoidance, the Swiss tax authorities will not recognize the existence of the offshore company. This theory has been successfully applied by the authorities with respect to direct corporate income taxes and for dividend withholding tax.

Based on established Swiss jurisprudence, the following conditions must be met for a finding of tax avoidance:

- The form or structure chosen by the taxpayer is unusual, inappropriate, or strange, and is not adequate for achieving any economic objective.
- The form or structure was set up for the sole purpose of avoiding the payment of taxes that would otherwise be payable.
- If accepted by the tax authorities, the form or structure chosen by the taxpayer would have led to significant tax savings.

The following steps should be considered by a taxpayer concerned about a potential challenge based on tax avoidance. All involve hiring staff in the foreign country to carry on the business with only moderate direction from Switzerland:

- The offshore company should have sufficient staff with sufficient experience to demonstrate that it has sufficient substance to carry on the activities of its business.

- Closely aligned with the foregoing step is the need to ensure that local staff members carry on the activity that is required to run the business in the country where resident; in other words, effective day-to-day management of the business takes place abroad.
- The performance of economic modeling in advance of adopting the structure demonstrating the pre-tax economic benefits that are anticipated through the adoption of an offshore structure; the elimination of Swiss taxes should not be the principal economic benefit.
- Closely aligned with the foregoing step is the need to demonstrate that the same opportunity for economic benefit is not available if operations were carried on in Switzerland.

INCREASE OF DOMESTIC TAX AUDITS

In the past, the Swiss federal and cantonal tax authorities carried out tax audits mainly for simple and obvious cases where the profits that should accrue to a Swiss company were shifted to empty shell companies located in low-tax jurisdictions. Customary targets were Swiss residents forming companies in Panama or comparable jurisdictions that posted high annual profits without an operational infrastructure, staff, or premises.[2]

Today, Swiss tax audits have evolved towards more complex cases involving intragroup transfer pricing issues. Swiss tax authorities now look at the details of operational activity, examining the prices charged for intragroup transactions, such as interest,[3] royalties,[4] management fees and commissions. The emphasis is on analyzing the substance of the operation and ensuring compliance with the arm's length principle for intercompany transactions.

From 2009, Switzerland gradually extended and intensified exchanges of information with foreign countries, in line with international standards of tax transparency. In some instances, Switzerland transmits information to foreign tax authorities, and in others, it receives information for use in its own internal tax audits. This includes information on foreign bank accounts, country-by-country ("C-b-C") reporting by multinationals, and administrative assistance on request. As a result, the effectiveness of Swiss tax audits measured in terms of lost tax recovery is now significant.

Exchange of C-b-C Reports

Exchange of C-b-C reports[5] enables tax authorities to gain a better understanding of the profit distribution and economic activity of multinational groups with sales in excess of €750 million.

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2 In particular cases 2C_1073/2018 and 2C_508/2014.

3 "Ikea a Caché Des Millions Au FISC Suisse: Deux Personnes Inculpées." Gotham City, November 30, 2022; Decision of the Criminal Court of Appeal of the Canton of Vaud of August 24, 2023 - Jug/2023/432.

4 Federal Court ruling of October 12, 2022 (2C_824/2021).

5 Swiss Law on the Exchange of CBC Reports ("C-b-C Act").

Automatic Exchange of Foreign Bank Account Information

Under the Federal Act on the Automatic Exchange of Information in Tax Matters, ("A.E.O.I."), Swiss tax authorities automatically receive information on the foreign bank accounts of Swiss tax residents. As a result of A.E.O.I. rules now in force, Swiss taxpayers with foreign accounts can no longer take advantage of nonpunishable voluntary disclosure concerning undeclared foreign accounts.[6] It is not surprising that information furnished to Swiss tax authorities resulted in an increase in the number of audit procedures initiated against individual taxpayers resident in Switzerland.

Nonetheless, banking secrecy remains in force for Swiss residents. This means that, barring certain legal exceptions, Swiss banks are not authorized to disclose information on Swiss residents' bank accounts to the Swiss tax authorities.

Spontaneous Automatic Exchange of Rulings

Agreements concluded between a company and the tax authorities, notably on intra-group transfer pricing, are automatically communicated without prior request.[7]

Exchange of Information on Request

Switzerland generally responds to requests from foreign tax authorities in accordance with Swiss law.[8] In Switzerland, the taxpayer that is the subject of the request has the right to participate in the procedure, thus guaranteeing a degree of transparency and the possibility of asserting.

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However, practice shows that Switzerland transmits various items of data, including financial statements, tax returns, tax rulings and other relevant documents relating to the target taxpayer, regardless of the taxpayer's participation.

Switzerland does not currently participate in multinational tax audits coordinated among several countries, as recommended by the O.E.C.D.[9] and applied by the European Union.[10] However, it has become known that a working group within the Federal Tax Administration is studying the possibility of future participation in coordinated audits. This could mark an evolution in the way Switzerland collaborates in international tax matters and would strengthen its alignment with international practices in terms of transparency and tax cooperation.

Despite the movement toward information exchanges and tax audits, Switzerland remains an attractive jurisdiction for companies and individuals. Advance tax rulings are available in matters related to transfer pricing, restructuring, and taxation according to expenditure for those individuals benefitting from a *forfeit* arrangement. These advance agreements, negotiated between the taxpayer and the Swiss tax

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6 Art. 175 para. 3 LIFD.

7 Swiss Ordinance on Administrative Assistance in Tax Matters ("T.A.A.O.").

8 Swiss Law on International Administrative Assistance in Tax Matters ("T.A.A.A.").

9 O.E.C.D., Recommendation of the Council Concerning an O.E.C.D. Model Agreement For Simultaneous Tax Audits, O.E.C.D./LEGAL/0269.

10 Council Directive (EU) 2021/514 of March 22, 2021, amending Council Directive 2011/16/EU on Administrative Cooperation in the Field of Taxation.

authorities, offer legal certainty. They enable taxpayers to better anticipate their tax burden and reduce the risk of discrepancies or unpleasant surprises during Swiss tax audits, thus reinforcing a climate of trust.

THE LONG, STEADY SHIFT TO TRANSPARENCY

Switzerland, long known for its commitment to banking secrecy, has historically resisted international demands for transparency and tax information exchange. This principle came under increasing challenges following the 2008 financial crisis. Under sustained international pressure, Switzerland adopted the O.E.C.D. standards on tax assistance in 2009, initiating a significant transformation of its legal framework.

Expanding the Scope of A.E.O.I.

Implemented in Switzerland on January 1, 2016, the A.E.O.I. framework stems from the Federal Act on the International Automatic Exchange of Information in Tax Matters (the "A.E.O.I. Act"), which incorporates the Multilateral Competent Authority Agreement ("M.C.A.A.") into domestic law.

The Swiss Federal Tax Administration (the "F.T.A.") operates with no discretionary authority regarding the transmission of data under A.E.O.I., except in cases where such actions could infringe fundamental rights, such as human rights violations or significant procedural breaches. By October 2024, the F.T.A. exchanged information on approximately 3.7 million financial accounts with 108 jurisdictions,[11] underscoring A.E.O.I.'s role as a central pillar of international tax cooperation.

While initially focused on financial accounts, the A.E.O.I. framework is expanding to include new areas such as crypto assets and salary data, reflecting Switzerland's ongoing legislative developments announced this year.

Incorporating Crypto Assets into A.E.O.I. via C.A.R.F.

Switzerland is actively preparing to integrate crypto assets into the A.E.O.I. framework by adopting the O.E.C.D.'s Crypto Asset Reporting Framework ("C.A.R.F."). Scheduled to take effect in 2026, the draft bill complements the existing Common Reporting Standard ("C.R.S.") by imposing targeted obligations on Reporting Crypto Asset Service Providers ("R.C.A.S.P.'s") operating in Switzerland. Under the proposed legislation, R.C.A.S.P.'s which fall under the C.R.S. are obligated to comply with the C.A.R.F. requirements. While this dual compliance approach broadens the regulatory scope, it also presents significant administrative challenges for such businesses.

Crypto services are defined as a business if the provider qualifies as a financial intermediary under Article 2, Paragraph 2 of the Swiss Anti-Money Laundering Act, or if it offers crypto services as specified in Articles 7 to 10 of the Swiss Anti-Money Laundering Ordinance, meeting any of the following thresholds:

- Annual gross revenue exceeding CHF 50,000
- Managing over 20 client relationships per calendar year

[11] "Echange de Renseignements Avec 108 États Sur Environ 3,7 Millions de Comptes Financiers." Confédération Suisse, Département fédéral des finances, October 10, 2024.

- Discretionary authority over assets from third parties exceeding CHF 5 million
- Execution of transactions exceeding a total volume of CHF 2 million per calendar year

R.C.A.S.P.'s will also be required to collect and report user information, mirroring C.R.S. processes. However, practical questions remain, particularly regarding nexus criteria for specific cross-border entities such as trusts.

Switzerland's adoption of C.A.R.F. underscores its leadership in aligning international standards with the growing significance of digital assets.

Integrating Salary Data into A.E.O.I. for Cross-Border Workers

Switzerland's newest double tax treaties with Italy and France establish specific rules for taxing cross-border workers. These new agreements rely on the automatic exchange of salary data to ensure accurate taxation in the worker's country of residence.

To implement these agreements, Switzerland proposed new federal legislation governing the exchange of salary data with partner jurisdictions. This law, which may also serve as a legal framework for future agreements with other states, sets the terms for data transmission between cantonal tax authorities and the F.T.A. The procedures for the exchange of information between the F.T.A. and foreign authorities are governed by the relevant tax treaty.

The legislation, expected to take effect in 2026, aims to cover income earned during the 2025 fiscal year. Employers will be required to electronically submit detailed data on employees, including identity, gross income, residency, and remote working percentages. Employers must also inform employees of this exchange, enabling them to exercise their data protection rights.

These legislative developments reflect Switzerland's growing commitment to combating tax evasion through increased transparency. However, they also raise questions about the balance between Switzerland's tradition of confidentiality and international demands for greater openness. While these reforms enhance fiscal transparency, they impose additional administrative burdens on businesses and raise concerns about data protection. Furthermore, the expansion of A.E.O.I. to new domains could very well set a precedent for including other sensitive areas, such as real estate or precious metals.

Handling Information Requests: A Swiss Balanced Approach

Switzerland's international tax cooperation is governed by double tax treaties incorporating Article 26 of the O.E.C.D. Model and Tax Information Exchange Agreements ("T.I.E.A.'s"). Domestically, it is regulated by the T.A.A.A., which is the Federal Act on International Administrative Assistance in Tax Matters mentioned at n. 8, above, and its ordinance, in force since 2012. These laws have been revised to include the Convention on Mutual Administrative Assistance in Tax Matters ("M.A.C."), ratified by Switzerland in 2015.

The F.T.A.'s Exchange of Information Service, acting as the central authority, evaluates all information requests for legal compliance before obtaining the requested data from third parties, such as banks or companies. The process is underpinned

by the principle of foreseeable relevance, established in Article 26 of the O.E.C.D. Model, which limits the exchange to targeted and justified requests. Fishing expeditions, requests based on illegally obtained information, or those violating the principle of good faith are systematically rejected.

Requests must include sufficient details to identify the taxpayer or group concerned. For group requests, the Swiss Federal Supreme Court has ruled that the requesting state must describe the group in detail and demonstrate why the taxpayers may be noncompliant.[12]

Additionally, the principle of subsidiarity requires that the requesting state exhaust all domestic avenues for obtaining information before seeking international assistance.[13] The principle of proportionality ensures that data transmission is limited to what is strictly necessary, without excessively infringing taxpayer rights.

Procedural safeguards are integral to Switzerland's framework. Under Article 14 of the T.A.A.A., affected individuals must be notified of requests and given the opportunity to respond before their data is transmitted. This right to be heard, enshrined in Article 29 of the Swiss Constitution, is fundamental. Its violation can render a procedure invalid, as confirmed by the Swiss Federal Supreme Court.[14]

The exchanged information must be used by the requesting state exclusively for the fiscal purposes outlined in the request and can include

- banking documents,
- corporate tax data, or
- personal information, such as tax declarations or residency details.

In cases involving specific regimes, such as lump-sum taxation, the relevance of the information depends on the context and purpose of the request, as determined by Swiss courts.[15]

The introduction of A.E.O.I. and spontaneous data exchanges has significantly increased the volume of information requests. In 2023, Switzerland received 853 requests for assistance while issuing only 75 requests.[16] Most inquiries pertain to transfer pricing audits or intra-group profit adjustments involving Swiss banks or companies.

Despite its robust framework, Switzerland maintains limits on its cooperation. It refrains from assisting with the recovery of foreign tax claims and prohibits foreign partners from conducting notifications on its territory. These restrictions, aimed at preserving the integrity of Switzerland's fiscal system, are increasingly questioned, notably by the European Union, which seeks to extend agreements to include tax claim recovery.

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12 2C_1174/2014 24.09.2015.

13 2C_703/2019 16.11.2020.

14 2C_653/2017 13.05.2019.

15 2C_1053/2018 22.07.2019.

16 "Chiffre Indicatifs Assistance Administrative Internationale." Administration fédérale des contributions AFC, October 28, 2024.

CONCLUSION

The balance between Switzerland's adherence to international cooperation standards and its protection of national fiscal sovereignty remains a pivotal issue. As the global push for transparency continues, Switzerland's ability to navigate these challenges will define its role in the evolving international tax landscape.

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