Current tax topics in the Financial Services industry
VAT updates, withholding tax reform & transfer pricing developments
02 June 2021
Welcome and introductions

Brandi Caruso
<table>
<thead>
<tr>
<th>Time</th>
<th>Session</th>
<th>Speakers</th>
</tr>
</thead>
<tbody>
<tr>
<td>09:00</td>
<td>Welcome and introductions</td>
<td>Brandi Caruso, Partner</td>
</tr>
<tr>
<td>09:05</td>
<td>Swiss VAT update and CJEU decisions</td>
<td>Matthias Hoehn, Senior Manager &amp; Constant Dimitriou, Director</td>
</tr>
<tr>
<td>09:20</td>
<td>Withholding tax reform</td>
<td>Robin King, Senior Manager &amp; André Kuhn, Director</td>
</tr>
<tr>
<td>09:35</td>
<td>Transfer pricing implications of the COVID-19 pandemic</td>
<td>Georgy Galumov, Director</td>
</tr>
<tr>
<td>09:50</td>
<td>Q&amp;A and closing</td>
<td>Brandi Caruso, Partner</td>
</tr>
</tbody>
</table>
Swiss VAT update and CJEU decisions

Matthias Hoehn & Constant Dimitriou
A law firm rendered some of its legal services to offshore companies.

- The law firm disclosed only limited information regarding these clients and the beneficial owners behind these companies, claiming the information falls under the attorney-client privilege.
- The SFTA assessed VAT over the amount charged for services to these offshore clients, due to insufficient proof of domicile abroad. Asking for the city of domicile of the clients backed by official identification documents indicating the domicile.
- Since the requested information had not been provided, the SFTA assessed VAT on these services.

The Swiss Federal Administrative Court held among others the following conclusions:

- The law firm may conceal the names and addresses of their clients or replace them with codes, but not their domicile, registered office or permanent establishment. Documents must be presented that allow the SFTA to verify the VAT treatment by the taxable person.
- For proof of the place of supply, the domicile of the beneficial owner including the city must be provided.
- The analysis of an expert entrusted by the law firm falls does not reveal the required information and therefore the SFTA is not obliged to accept the analysis as final proof.

The law firm appealed the decision and has taken it to the Supreme Court.

- The key aspect from a general perspective should be whether the city of residence must be provided by a Swiss service provider.
- In the case at hand it seems that the respective evidence is not available at the law firm.
- The information required is less than what is usually provided by financial institutions with Form A regarding the economic beneficiary as they are not covered by art. 68 para. 2 VATL according to the updated practice of the SFTA.
Swiss VAT – Update in the written practice
Selection of recent developments

MBI 14
Financial Services

• With respect to collective investment schemes the wording has been amended to “offering of collective investment schemes” in line with the amendment of art. 21 para. 19 ciph. 2 VATL (based on the changes in the Collective Investment Schemes Act and the new Financial Institutions Act). There are however no material changes in this respect and the SFTA continues its practice.

• Adaptions with respect to new FINMA regulation -> no material changes

• The granting of credits and assumption of liabilities that are secured by the federal government in connection with the covid-19 measurements do not lead to a correction of input VAT (for received subsidies) at the level of the bank.

• Banks and other financial institutions may not conceal name and address of their clients in a VAT audit. However, for banks art. 78 para. 6 VATL applies and accordingly, findings regarding third parties may only be used for VAT assessment purposes.

MI 11
Notification Procedure

The written practice has been updated with respect to the tax succession liability according to art. 16 para. 2 VATL in the light of the supreme court decision 2C_923/2018 dated 21 February 2020.

• The SFTA interprets the court decision restrictively. In case only an independent part of a business is transferred, the VAT succession liability is only triggered if the transfer is between closely related parties.

• Up to date there is no information available how the SFTA would intend to audit the transferred assets at the receiving entity.
**EU VAT - VAT grouping - CJEU Case Danske Bank A/S (C-812/19)**

**Background**
- Danske Bank A/S (‘Danske’) is a Danish headquartered bank and operates in Sweden through a branch.
- Danske’s head office is a member of a Danish VAT group while its branch is not part of a Swedish VAT group.
- Danske’s head office provided services to its Swedish branch and no Swedish VAT was declared under the reverse charge.
- The Swedish Tax Authority argued that Swedish VAT was due under the reverse charge.

**Decision**
- *Morgan Stanley (C-165/17)* and *FCE Bank (C-210/04)* - A branch and its head office must be treated as a single taxable person in the absence of legal relationship, which depends on whether the branch carries on an independent economic activity or not. **BUT** the existence of a VAT group must be considered as well.
- In line with *Skandia (C-7/13)* decision, the Danish head office and its Swedish branch could not be considered as a single VAT taxable person. Hence, the services between them must be considered for VAT purposes.
- Territoriality principle: a VAT group can only include local entities/establishments.

**Consequences**
- EU Member States to review how they implemented *Skandia* and check whether it is in line with *Danske*.
- Impact in EU Member States having a ‘whole legal entity’ approach (e.g. Ireland and the Netherlands) and about to implement VAT grouping (France).
- Impact assessment on businesses present in the EU.
- Other impacts? What about non-EU VAT groups (e.g. Swiss VAT group)?
EU VAT - VAT grouping - CJEU Case M-GmbH (C-868/19)

Background

• The German tax authority rejected a VAT group between M-GmbH and PD GmbH & Co. KG (a partnership under German civil law ("PD")) due to the lack of financial integration, and because in addition to M-GmbH, natural persons also held shares in PD

• A partnership can only be financially integrated into the VAT group as a controlled company, if all other partners of the partnership are also financially integrated into its business. M-GmbH disagreed and the matter was referred to the CJEU

Decision

• The VAT group is not limited to VAT taxable persons or legal persons only (in line with previous decisions)

• The limited conditions under which partnerships can be part of a VAT group in Germany were in breach of Art. 11 (1) VAT Directive

• EU Member States cannot (as Germany did in this case) rely on specific features in national law in order to add a condition, additional to those laid down in Art. 11 (1) VAT Directive (uniform interpretation throughout the EU)

• The CJEU held that the principle of proportionality precluded German legislation systematically excluding all partnerships which include natural persons among their partners from the benefit of the VAT group and went beyond what was necessary to prevent abusive practices

Consequences

• Businesses present in Germany may have to reassess their position in case VAT grouping was rejected

• This decision may also create opportunities in EU Member States where the national legislation foresees additional conditions and/or restricts certain persons to form/join a VAT group (although not longer in the EU, cases are pending in the UK)
Withholding tax reform

Robin King & André Kuhn
Overview

Withholding tax reform (1/3)

Background

- Federal Council proposed to extend withholding tax exception for TBTF instruments by five years
- Pending parliamentary initiative to abolish stamp taxes
- Abolition of withholding tax on interest income
- Exception: Interest on customer deposits held with banks and insurance companies by natural persons domiciled in Switzerland
- Creation of legal basis for application of withholding taxes on substitute payments
- Abolition of the transfer stamp tax on domestic bonds (Stamp Tax Act)
- Access for Federal Tax Administration to data collected by the trade repository about derivatives transactions (Financial Market Infrastructure Act)
- Parliamentary discussion in 2021 and planned entry into force on 1 January 2024

Overview of current reform proposal

- Goal: Strengthening the Swiss debt capital market
- 2010: First attempt to reform withholding tax regime
- 2014: Next reform proposal by the Federal Council
- 2018-2020: Revival of reform efforts, publication of key parameters and formal consultation with stakeholders
- 2021: Publication of dispatch of the Withholding Tax Act (and consultation proposal for simplification of withholding tax notification procedure)

Related proposals

- Federal Council proposed to extend withholding tax exception for TBTF instruments by five years
- Pending parliamentary initiative to abolish stamp taxes
Withholding tax reform (2/3)

Withholding tax on interest on customer deposits held with banks and insurance companies by natural persons domiciled in Switzerland

**Interest on customer deposits held with banks and insurance companies**

- Customer deposits with regulated banks and insurance companies (i.e. does not include employee accounts)
- Customer deposits must be revocable and accessible at any time (e.g. savings or payroll account at banks, payment accounts or premium deposits at insurance companies)
- Time deposits and term deposits do not qualify as customer deposits
- Exception for interest not exceeding CHF 200 continues to apply

**Natural persons domiciled in Switzerland**

- Includes sole proprietorships but not partnerships
- Handling of other special cases (e.g. joint accounts) will be agreed at a later point in time
- Determination of domicile based on AML/KYC rules (i.e. CDB for banks and SRO-SVV regulations for insurance companies)
- Domicile at the point in time when interest is due is relevant
- In case of late notifications by clients about their domicile change, banks and insurance companies will need to make necessary corrections
Withholding tax reform (3/3)
Aspects that remain unchanged

**Collective investment vehicles**
- Indirect interest income received through Swiss collective investment vehicles remain subject to withholding tax
- Justification of Federal Council: Increased complexity in case of a more differentiated approach

**Dividends**
- Dividends remain subject to withholding tax at 35% (no abolition and no reduction to 15%)
- Justification of Federal Council: Poor cost-benefit ratio
- However, Federal Council supports abolition of issuance stamp tax

**Debtor principle**
- Except for customer deposits held with banks and insurance companies (where paying agent is usually also the debtor), paying agent regime is not implemented
- Justification of Federal Council: Complexity and operational risks for paying agents

**Participation deduction**
- No amendment to participation deduction to further incentivize Swiss debt market, i.e. holding companies still need to consider bonds and respective interest paid for the calculation of the net participation income even if the funds are transferred to a subsidiary (exception: TBTF)
- Justification of Federal Council: Current fiscal situation
Consultation proposal for simplification of withholding tax notification procedure

Overview

<table>
<thead>
<tr>
<th>Current rules</th>
<th>Proposed new rules</th>
</tr>
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<tbody>
<tr>
<td><strong>Domestic</strong></td>
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<td>• Participation of at least 20%</td>
<td>• Participation of at least 10%</td>
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<td><strong>International</strong></td>
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<tr>
<td>• Minimum participation ratio defined in treaty (normally 10-25%)</td>
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<tr>
<td>• If no minimum participation is defined in treaty: at least 20%</td>
<td>• If no minimum participation is defined in treaty: at least 10%</td>
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<tr>
<td><strong>Advance authorisation</strong></td>
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<tr>
<td>• Advance authorisation required</td>
<td>• Advance authorisation required</td>
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<tr>
<td>• Authorisation remains valid for 3 years</td>
<td>• Authorisation remains valid for 5 years</td>
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<tr>
<td><strong>Effective date</strong></td>
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<tr>
<td>• Effective date still unknown (but will be 1 January 202?)</td>
<td>• New participation ratio applied to requests submitted after effective date</td>
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<td>• New validity period for requests submitted or renewed after effective date</td>
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Transfer pricing implications of the COVID-19 pandemic

Georgy Galumov
Transfer Pricing Implications of COVID-19
New OECD Guidelines

On 18 December 2020, the OECD released Guidance on the transfer pricing implications of the COVID-19 pandemic (‘the guidance’). It focuses on how the arm’s length principle and OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (‘OECD Guidelines’) apply to issues that may arise or be exacerbated by the COVID-19 pandemic.

The Guidance provides clarifying comments on, and illustrations of, the practical application of the arm’s length principle in four priority areas:

- Comparability analysis
- Losses and the allocation of COVID-19 specific costs
- Government assistance programmes
- Advance pricing agreements

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations should continue to be relied upon.
OECD Guidelines – Four priority areas

Comparability analysis

• The pandemic may have a significant impact on the pricing of some third party transactions - reliability is reduced.
• Adjustments to existing transfer pricing policies will be driven by whether unrelated parties would try to renegotiate such arrangements.
• Practical approaches to address information deficiencies regarding FY 2020 could include:
  ➢ allowing for the use of reasonable commercial judgement, supplemented by contemporaneous information to set a reasonable estimate of the arm’s length price;
  ➢ allowing, where feasible, for an arm’s length outcome testing approach which incorporates information that becomes available after the close of the taxable year; or
  ➢ use of more than one transfer pricing method (although it is emphasised that this is not required).
• A comparability analysis must specifically delineate the related party transaction, including its actual economic circumstances.
• Separate testing periods (and periods considered for price setting) may be appropriate for the duration of the pandemic, or for the periods when the material effects were most evident.
• Allowing for the inclusion of a price adjustment mechanism in related party transactions may give flexibility while maintaining an arm’s length outcome.
• Where a business rolls forward an existing set of comparables it may be necessary to review and potentially revise the set based on updated search criteria.
• Loss-making comparables are appropriate where the comparables assume similar levels of risk and have been similarly impacted by the pandemic.
OECD Guidelines – Four priority issues

Losses and the allocation of COVID-19 specific costs

• The allocation of risks affects how profits or losses are determined at arm’s length.
• The existing guidance on the analysis of risks in Chapter I of the OECD Guidelines will be particularly relevant.
• Exceptional, non-recurring operating costs arising as a result of COVID-19 should be allocated between group companies based on an assessment of how independent parties operate.
• The functions performed, assets used and risks assumed by ‘limited-risk’ entities vary and therefore it is not possible to establish a general rule to determine whether losses should be incurred.
• Careful consideration should be given to the commercial rationale for any change in the risks assumed.
• The accurate delineation of the intra-group transaction will determine whether any revision of intercompany agreements in response to the COVID-19 pandemic is consistent with the behaviours of third parties in comparable circumstances.
• Operational or exceptional costs should be allocated between group companies in line with risk assumption and the manner in which third parties would treat such costs.
• Some operating costs may not be considered exceptional or non-recurring where they relate to long-term or permanent changes to the business.
• Associated parties may consider whether they could apply force majeure clauses – this can affect the allocation of losses and COVID-19 specific costs.
• The terms and conditions of government programmes need to be considered when determining the impact on related party transactions.
• The extent to which the receipt of government assistance is an economically relevant characteristic may vary.
• In line with the OECD Guidelines, government interventions should generally be treated as conditions of the market in the particular country. An analysis of the implications of the receipt of government assistance should consider:
  ➢ whether the receipt of government assistance provides a market advantage;
  ➢ the amount of any increase in revenues/decrease in costs and the duration of the assistance;
  ➢ the degree to which the benefits are passed on to independent customers/suppliers; and
  ➢ the manner in which independent parties would allocate any remaining benefits between themselves.
• The potential effect of the receipt of government assistance on the pricing of a transaction will depend on the economically relevant characteristics.
• Government assistance does not change the allocation of risk in a transaction for transfer pricing purposes, but it may reduce the quantitative negative impact of a risk.
• It may be necessary to take into account the receipt of government assistance when reviewing potential comparable.
• The impact of different types of government assistance available in each market may create additional challenges obtaining suitable comparables.
• A comparability adjustment may be required when applying a one-sided method (such as the cost plus method, or the TNMM) where accounting treatments of the same type of assistance differ between the related party and the comparable.
Existing advance pricing agreements

• It is recognised that the COVID-19 pandemic has led to material changes in economic conditions that were not anticipated when many APAs were agreed.

• Neither businesses nor tax authorities can automatically disregard or alter the terms of existing APAs due to the change in economic circumstances.

• However, it is acknowledged that the effects of the COVID-19 pandemic and the responses of governments are likely to qualify as a breach for some businesses. In other situations, tax authorities may have more discretion:
  - Revision – retain the benefit of the APA but with different terms for any year(s) subject to the COVID-19 pandemic;
  - Cancellation – for example, if there is a material breach in an APA’s critical assumption as a result of the economic circumstances;
  - Revocation – treated as if the APA had never been entered into. This has not altered and the number of revocations should remain limited.

• Businesses are encouraged to adopt a collaborative and transparent approach.

APAs under negotiation

• It is recognised that businesses may be reluctant about continuing or initiating new APA applications.

• Businesses and tax authorities are encouraged to adopt a flexible and collaborative approach to minimise delays in concluding APAs.
Q&A

Your moderator: Brandi Caruso
Your presenters
We would like to hear from you

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