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Tax, Legal and Corporate Consultancy

NEWS

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NEW AGREEMENT BETWEEN SWITZERLAND AND HONG KONG

Following the G20 summit in London, held in April 2009, and the subsequent pressure exercised by the OECD with regard to fiscal transparency and international collaboration in combating treaty abuse and cross-border tax evasion have resulted in an increase in the number of agreements in place. The new agreements, which implement new global standards, have even been adopted by jurisdictions such as Hong Kong, up to 2009 very reluctant to sign agreements with exchange of information. Consequently, Hong Kong has increased the number of conventions signed from five during the period 2003–2008 to a total of 16 signed between April 2010 and June 2011.

On the one hand, although an extension to the network of international agreements is usually welcome by the business community and the tax consultants in general, a series of practical issues is now emerging with regard to the application of the conventions themselves. In particular, the following issues have arisen:

1. the interaction between the Hong Kong sourcing rule and the provisions on the taxation of business profits within the agreements;
2. the implementation of the domestic general anti-avoidance rules within the agreements;
3. uncertainties surrounding the application of limitations of benefit (LOBs) within the agreements.

This article will only consider this last aspect, with particular reference to the agreement

signed on 6 December 2010 between the Swiss Confederation and Hong Kong. Although the new convention has been initialized, it has not yet come into force, as it still has to complete the process of approval by the Swiss Parliament.

In general, Hong Kong has introduced two main LOBs into the agreements: identification of the beneficial owner (BO) with regard to passive income, and an anti-treaty shopping rule based on main purpose, which is designed to affect specific back-to-back arrangements in particular.

Unfortunately, however, the agreement itself does not include any definition of beneficial owner in relation to passive income. This aspect can only complicate the proper implementation of its provisions, as there is no un-



equivocal definition of a beneficial owner. The new discussion draft issued by the OECD in April 2011 – still far too vague – will help little in this respect.

With regard to the back-to-back arrangements, article 10(8) of the new DTA between Switzerland and Hong Kong excludes any such benefit under the agreement in cases where:

1. a Hong Kong company receiving passive income from Switzerland and distributing, directly or indirectly, all or substantially all of the income received at any time, in any form, to another person not resident in either jurisdiction, and who if receiving that income directly from Switzerland would not be entitled to the same (or more favourable) benefit in respect of that income available under the HK-Switzerland DTA, and where
2. the main purpose of structuring such a transaction is to obtain benefits under the agreement in question.

We can take as an example a company (TOPCO) based in Jurisdiction A, which controls HKCO, which in turn controls CHCO. Under the agreement, the net rate for dividends distributed between Switzerland and Country A is 10%, while the rate between Switzerland and Hong Kong is 0%, by virtue of application of the DTA. In accordance with the anti-abuse provisions of the new DTA, the HKCO could be denied benefits if it intends to distribute all or substantially all of the dividends received from the Swiss subsidiary, at any time, or in any form.

It is therefore essential to understand whether the terms *substantially all* and *at any time and in any form* are interpreted by both fiscal authorities. Only then will it be possible to draw conclusions as to the effective benefit sought by the taxpayers within the network of agreements between Hong Kong and Switzerland.

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NOTICE 2011-34: ADDITIONAL GUIDANCE ON THE “FOREIGN ACCOUNT TAX COMPLIANCE ACT” (FATCA) PROVISIONS

Under FATCA certain US taxpayers holding financial assets outside the United States will have to report those assets to the IRS. Moreover FATCA will require foreign financial institutions to report directly to the IRS certain information relative to certain financial accounts held by US taxpayers or by foreign entities in which a US taxpayer holds a substantial ownership interest.

In order to avoid suffering withholdings under FATCA a participating Foreign Financial Institution (FFI) will have to enter into an agreement with the IRS in order to identify US accounts, report certain information to the IRS relative to such accounts and withhold a 30% tax on certain payments to non-participating FFIs and account holders who are not willing to provide the requested information.

The Foreign Financial Institutions that do not enter into the above mentioned agreement with the IRS will suffer withholdings on certain types of payments such as US source interest and dividends, gross proceeds from the disposition of US securities and “passthru” payments.

The IRS has provided further guidance in Notice 2011-34 which supplements and expands previous Notice 2010-60.

Notice 2011-34 offers direction with respect to the following issues:

- procedures to be followed by participating FFIs in identifying U.S. accounts among their preexisting individual accounts;
- definition of the term “passthru payment” and obligation of participating FFIs to withhold on passthru payments;
- certain categories of FFIs that will be deemed compliant;
- obligation of participating FFIs to report with respect to U.S. accounts;
- treatment of Qualified Intermediaries or Withholding Foreign Partnership or Trust under the Qualified Intermediary regime;
- application of the FFI regime to expanded affiliated groups;
- the effective date of FFI Agreements.

On July 14th 2011 the IRS issued Notice 2011-53 that provides a workable timetable for FFIs and US withholding agents to implement the various requirements established by FATCA.

According to Notice 2011-53 an FFI has to enter an agreement with the IRS by June 30 2013, to ensure that it will be identified as participating FFI with enough time to allow withholding agents to refrain from withholding beginning on January 1st 2014.

Under this agreement a participating FFI will be obliged to:

- undertake certain identification and due diligence procedures with respect to its account holders;
- report annually to the IRS on its account holders who are US persons or foreign entities with substantial US ownership, and;
- withhold and pay over to the IRS 30% of any payment of US source income, as well as gross proceeds from the sale of securities that generate US source income, made to (i) non-participating FFIs, (ii) individual account holders failing to provide sufficient information to determine whether or not they are a US person or (iii) foreign entity account holders failing to provide sufficient information about the identity of its substantial US owners.

As mentioned above withholding on US source dividends and interest paid to non-participating FFIs will begin on January 1st, 2014, and withholding on all withholdable payments (including on gross proceeds) will be fully phased in on January 1st, 2015.

Moreover, due diligence requirements for identifying new and pre-existing U.S. accounts (including certain high-risk accounts that include private banking accounts with a balance that is equal to or greater than USD 500,000.00) will begin in 2013. Reporting requirements will begin in 2014.

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CYPRUS: AUSTERITY MEASURES – AMENDMENTS TO TAX LAWS

On 26th August 2011 the Cyprus Parliament voted a number of amending laws which were presented by the Government as a first package of austerity measures to combat the effects of the financial crisis. These measures became imperative following the tragic accident occurred on 11th July at an army base which resulted in the complete destruction of the island's main electricity supply plant.

It is noted that as the laws are yet to be published in the official Gazette of the Republic, they are not considered as official and effective at the moment.

The Company law

A fixed annual levy of EUR 350 is imposed on each Cyprus company, payable to the Registrar of companies and capped at EUR 20'000 for companies belonging to a group, as defined in the companies Law. The above-mentioned levy will not apply to dormant companies and companies that do not own any assets.

The levy is payable by 31st December 2011 in relation to this year and by 30th June in respect of each subsequent year. Late payment of the levy will give rise to the following penalties:

- in case of up to a 2-month delay: a 10% of penalty;
- in case of a delay between 2 and 5 months: a 30% of penalty;
- in case the levy is not paid within the 5 months period the company will be struck off by the Registrar of companies; The company will continue to exist but it will not be able to submit to the Registrar of companies any document covering corporate actions as well as that it will not be able to request certificates from the Registrar.

The Special Contribution for the Defence (SCD) of the Republic law

The Cyprus Parliament voted some changes to the Special Contribution for the Defence Law relating to the rates of contribution, while the basis of taxation remains unaffected. More specifically, the following changes have been voted:

- an increase in the rate of SCD from 10% to 15% for interest taxable under this Law, which will be effective on all interest arising, accruing or deemed to arise or accrue from the date the Law is published in the official Gazette of the Republic;

It is reminded that Interest derived from the ordinary carrying on of a business or which is closely connected to the ordinary course of a business (known as “active interest”) is exempt from special Contribution for the Defence and it is taxed under Corporation Tax at the standard rate of 10%. Interest considered as deriving from the ordinary carrying on of a business includes interest earned by banks, leasing companies, financial companies and other organizations of a similar nature.

The two most important types of interest considered as closely connected to the ordinary course of a business are:

- interest from bank current accounts;
- interest (including notional interest) received by a company considered as the financing vehicle of its group.

On the contrary interest taxed under SCD (known as “passive interest”) is:

- interest from bank deposit accounts;
- interest on loans to third parties;
- notional interest income calculated for taxation purposes on loans provided by a Cyprus company to its shareholders and/or directors if they are physical persons.

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PLANNED CHANGES IN LUMP-SUM TAXATION

On 30 June, the Federal Council submitted a bill to Parliament proposing changes to the current system of lump-sum taxation.

If approved, the amendment will increase the minimum tax calculation base and will also introduce an obligation for the Cantons to include wealth tax in the lump-sum tax levied.

The current system

The lump-sum taxation is governed by article 14 of the Federal Direct Tax Law (DTL), a law which stipulates special rules for individuals who, without exercising a profit-making business in Switzerland, become domiciled or resident for tax purposes in the country, for the first time or after an absence of at least 10 years.

Under this system, foreigners deciding to relocate to Switzerland without coming to work here can decide to be taxed according to expenses, instead of under the ordinary system. Swiss citizens are only allowed this option during the tax year in which they arrive in Switzerland.

The advantage of lump-sum taxation consists of the fact that the tax is calculated on the basis of the annual expenses which correspond to the lifestyle of the taxpayer and his family (“expenses”), rather than on the income actually earned. This explains the advantage for F1 racing drivers *et al.* in choosing this system. Under the existing rules, expenses cannot be less than a certain limit. The limit varies in each Canton, and in any event, is five times the

rent or rental value of the property in which the taxpayer lives.

The law also stipulates that tax determined in this way cannot be less than the tax calculated according to a “control calculation” - the ordinary rate on all the pre-tax items listed in article 14(3) DTL, i.e. mainly income from Swiss or foreign sources for which the benefit of an anti-dual taxation agreement has been requested.

The proposed changes

Under the new bill, article 14 DTL would undergo three key amendments. First, the scope of application of the lump-sum tax, from which only foreign citizens can benefit, would be limited.

The second change concerns the rules on married couples. Under the current law, even if only one of the partners is a Swiss national, both can obtain expenses-based taxation. This would not be possible if the bill proposed by the Federal Council comes into force, in which case, neither partner could have Swiss citizenship in order to qualify.

The third important change relates to the determination of the basis for tax calculation. The proposed bill has introduced the term “universal expenses”. This includes the annual expenses incurred during the calculation period, in Switzerland or abroad, by the taxpayer and his dependents. In this way, foreign expenses are also taken into account.

Again, with reference to the taxation base, there has been an increase to certain minimum thresholds which the universal expenses must exceed in order to be taken into account. First, the expenses must be higher than seven times the rent or rental value of the property in which the taxpayer has his household. A new minimum threshold of CHF 400'000 has also been introduced (article 14(3)(a) of the proposed bill).

The new bill provides for a five-year transitional period, during which taxpayers who had been taxed according to expenses prior to the entry into force of the new rules could maintain the previous system (article 205d of the proposed bill). However, this transitional provision would only apply to foreign citizens.

The Cantons would remain free to determine the minimum threshold for the tax calculation base, but would be obligated to include a tax on assets in the expenses-based taxation, something which was optional in the past.

Assessment

When compared with the systems in place in other countries relating to tax planning for individuals, the Swiss system of lump-sum taxation presents benefits as well as disadvantages.

The proposed changes would make residence in Switzerland much more expensive for a number of people, and in some cases, they would have to consider whether or not ordinary taxation was preferable (and possibly restructure their assets), or even leave Switzerland altogether.

We hope therefore that the status quo can be maintained.

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FIDINAM PART OF ECONOMIC FORUM TICINO–RUSSIA

The project “Russia 2011” has seen exciting developments in the recent months. Launched as an initiative to follow up on the presentation of Ticino’s economy in Moscow in September 2010, it aims at dealing with requests from Russian companies interested in the cooperation with the canton’s economy as well as with the interest shown by Ticino businesses towards exploring the opportunities the Russian market has to offer.

Supported by Canton Ticino and sponsored by Ticino’s Chamber of Commerce, Industrial Association and **Fidinam**, the project intends to promote the local economy and businesses in Russia and to help Russian companies establish their activities in Ticino. To do this, the project’s participants are eager to offer all the expertise necessary to assist and support businesses in their undertakings.

The first step was to launch “ECONOMIC FORUM TICINO – RUSSIA”, a multi-lateral support platform for investors to and from Russia. **Fidinam** through its Russian Desk headed by Marco Com-



pagnino has continued to implement its strategy of penetration and expansion into the Russian market through growing its activities and initiatives. The company supported the events in Russia to promote Switzerland as a platform for business in Europe, organized by OSEC agency and the Swiss Embassy – in Moscow on June 23 and in Nizhny Novgorod on September 22, with future similar events planned to take place in Novosibirsk in October and in Moscow in November.

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