Tax Residency of Companies in Switzerland

by *Christoph Suter* and *Julian Hodel*, Bär & Karrer, with *Practical Law Global*

Practice notes | Law stated as at 20-Apr-2023 | Switzerland

A Practice Note setting out the situations where a company is subject to Swiss corporate income tax. It discusses when a non-Swiss resident company has a permanent establishment in Switzerland and how permanent establishments are taxed under Swiss law. It also describes how the right to tax a company's profit may be allocated under a double tax treaty if a company is tax resident in two jurisdictions.

Basis of Taxation: Tax Residence

Tax Residence under Swiss Law

- Place of Effective Management of Foreign Companies
- Presumption of Residence

Taxation of Swiss Tax Resident Companies

- Taxable Base
- Adjustments to Tax Profits
- Tax Rates

Dual Tax Residence

- Double Tax Treaty Protection
- OECD Model Tax Treaty
- Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)
- No Double Tax Treaty Protection

Non-Swiss Tax Resident Companies with Permanent Establishment (PE)

- Permanent Establishment
- Permanent Establishment under Swiss Law
- Permanent Establishment under Double Tax Agreements
- Permanent Establishment as Fixed Place of Business
- Dependent Agent as Permanent Establishment
- How to Allocate Profits to a Permanent Establishment in Switzerland

Taxation of Non-Resident Companies with Permanent Establishment in Switzerland

Non-Resident Companies Without Permanent Establishment in Switzerland

© 2023 Thomson Reuters. All rights reserved.

This Note describes the cases where resident and non-resident companies must pay Swiss corporate income tax. It also describes how the right to tax a company's profits may be allocated between different jurisdictions under a double tax treaty in case of double residence.

Basis of Taxation: Tax Residence

In broad terms Swiss corporate income tax applies to:

- Companies resident in Switzerland for tax purposes (which in general includes companies incorporated in Switzerland and foreign companies which are tax resident in Switzerland due to their place of effective management in Switzerland).
- Non-resident companies which have a permanent establishment (PE) in Switzerland (see *Permanent Establishment*).
- Non-resident companies which source income through a form of economic presence in Switzerland other than a PE (see *Non-Resident Companies Without Permanent Establishment in Switzerland*).

Tax Residence under Swiss Law

Under Swiss law, only corporate entities, such as corporations, associations and foundations (company or companies) are subject to corporate income taxation, whereas partnerships are generally treated as tax transparent (*Article 49, Federal Direct Tax Act* (FDTA)). A company is considered tax resident in Switzerland if any of the following applies:

- It is incorporated under Swiss law, that is, if the company's statutory seat (seat designated in the company's bylaws) is in Switzerland.
- Its place of effective management is located in Switzerland (see *Place of Effective Management of Foreign Companies*).

(*Article 50, FDTA*)

Place of Effective Management of Foreign Companies

Swiss tax law does not (apart from in case law) provide for a definition of "place of effective management". The place of effective management of a company is determined based on factual circumstances.

Generally, the following criteria are considered key to establish the place of effective management of a foreign company:

- The place of the company's actual economic centre of existence, that is, where the company's current business activity is predominantly managed to achieve the company's statutory purpose.
- The main place of decision making by directors and other persons who effectively play an important part in the decision-making process of a company.

© 2023 Thomson Reuters. All rights reserved.

Presumption of Residence

There is no presumption of residence under Swiss tax law. However, the company's statutory seat criterion for the purpose of determining its residency is considered to be evidenced through its commercial register entry.

In case, however, residence at the place of effective management is claimed in deviation of the place of statutory seat of the company, the burden of proof lies with the claiming party (company or tax authorities). A foreign incorporated company which is a potential Swiss tax resident company due to being effectively managed in Switzerland has a duty to cooperate with the tax authorities (*Article 126, FDTA*).

Taxation of Swiss Tax Resident Companies

Taxable Base

Swiss corporate income tax of a Swiss resident company is calculated on its total net income after taxes. The taxable net income is calculated in accordance with the profit and loss account results (according to Swiss bookkeeping standards) and considering certain tax adjustments under Swiss law.

Switzerland also levies an annual tax on the net equity of the Swiss company.

Adjustments to Tax Profits

Under Swiss tax law, no controlled foreign corporation (CFC) rules apply. Thus, if not solely established for tax avoidance schemes (in which case they might be disregarded, or become themselves subject to Swiss tax residency), foreign subsidiaries are recognised for Swiss tax purposes, and their income is not taxed in Switzerland.

Tax Rates

Swiss corporate income tax is composed of the direct federal income tax as well as a cantonal and a communal income tax. Consequently, the effective income tax rates vary strongly depending on the place of residence (canton and municipality). The applicable effective tax rates range from approximately 11.2% in the canton of Lucerne to approx. 22.8% in the canton of Berne.

In most cantons reduced corporate income tax rates apply to legal entities such as associations and foundations as well as collective investment schemes with directly held real property (*Article 71, FDTA*).

Income from qualified participation rights (minimum 10% in a company's share capital / participation with a fair market value equal to a minimum of CHF1 million) is largely exempt from income taxation by way of a reduction of the income tax in proportion of the net participation income to the total net income.

Dual Tax Residence

Dual tax residence may occur where a company's place of effective management is in Switzerland, but the company is also considered resident in another jurisdiction by virtue of the local rules (for example, due to its incorporation in another jurisdiction), or vice versa.

© 2023 Thomson Reuters. All rights reserved.

Dual tax residence may lead to double taxation of the same profits.

Domestic law and double tax agreements (DTAs) (also known as double tax treaties or conventions) aim to prevent or solve this double taxation issue.

Double Tax Treaty Protection

In the case of dual tax residence, the country of tax residence is determined by the DTA existing between Switzerland and the other country. For an introduction to the purpose and interpretation of DTAs in a UK context but relevant more widely, see *Practice Note, Double tax treaties: an introduction*.

It is necessary to look at the relevant DTA for the terms of the tie-breaker rule (that is, the rule of the DTA determining which of the two countries is the country of tax residence where the company will pay corporate income taxes).

Switzerland has concluded a network of DTAs with over 100 jurisdictions. DTAs are largely based on the *Organisation for Economic Co-operation and Development* (OECD) *Model Tax Treaty on Income and on Capital 2017* (OECD model tax treaty), a standard form that many countries use as a starting point when negotiating a DTA (for background on the OECD model tax treaty, see *Practice Note, Double tax treaties: an introduction: Interpretation of DTAs*). A general overview of how the issue of dual tax residence is typically dealt with based on the OECD model tax treaty and the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI) is set out in the following sections.

OECD Model Tax Treaty

The OECD model tax treaty (*Article 4*) states that a company is resident in a country if it is liable for tax in that country by reason of its domicile, residence, place of management, or any other criterion of a similar nature.

The OECD model tax treaty (before being amended by the MLI) provided that, should a company be resident in two countries according to the domestic tax laws of these countries, it should be treated as resident in the jurisdiction where its place of effective management is located (*Article 4(3)*). This is the place where key management and day-to-day commercial decisions which are necessary for the conduct of the company's business as a whole are made. To determine this, all relevant factual circumstances must be examined.

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)

The MLI is a multilateral treaty signed by more than 95 countries that amends and supplements existing DTAs with various anti-abuse provisions, depending on the elections made by the signatories. The MLI was published on 24 November 2016 (see *Legal Update, OECD publishes multilateral instrument on BEPS (detailed update)*). It was opened for signature on 31 December 2016. For further information, see *Practice Note, OECD multilateral instrument on BEPS*.

Switzerland is a party to the MLI (effective in Switzerland as of 1 December 2019).

Article 4 of the MLI changes the tie-breaker for dual resident companies by providing that the place of residence of a company resident in both countries according to their local rules is to be determined by the competent authorities

© 2023 Thomson Reuters. All rights reserved.

of both countries by mutual agreement, taking into account the place of effective management, the place where the company is incorporated, and any other relevant factors.

For jurisdictions in which mutual agreement procedures apply, a company is considered a dual resident until the competent authorities reach an agreement.

Switzerland has decided not to adopt Article 4 of the MLI in the DTAs with its treaty partners, and it is necessary consider the relevant DTA to determine the terms of the tie-breaker rule in each case (see *Double Tax Treaty Protection*).

No Double Tax Treaty Protection

Where there is no applicable DTA, the company will be resident in both Switzerland and the other jurisdiction. The company will therefore be subject to the tax laws of that other jurisdiction as well as to Swiss tax on its worldwide income and may be taxed twice on some or all of its income. This position is, obviously, highly undesirable and giving rise to this situation should be avoided whenever possible. To do so, any necessary measures should be taken to ensure that the requirements for residence either in Switzerland or in the other jurisdiction are not (or cease to be) met.

Non-Swiss Tax Resident Companies with Permanent Establishment (PE)

Companies which are not tax resident in Switzerland are still subject to Swiss corporate income tax if they have a permanent establishment (PE) in Switzerland (see *Permanent Establishment*).

For the taxation of a non-tax resident company that is located in Switzerland without a PE in Switzerland see *Non-Resident Companies Without Permanent Establishment in Switzerland*.

Permanent Establishment

The definition of PE is set out both under Swiss law and under the DTAs entered into by Switzerland, whereby the definition under the Swiss law and the OECD model tax treaty are not entirely congruent (see *Permanent Establishment under Swiss Law* and *Permanent Establishment under Double Tax Agreements*).

For income of a foreign company to be (partially) attributed to a Swiss PE and, therefore, to be taxed in Switzerland both PE definitions according to Swiss domestic law as well as according to the applicable DTA (if any) must be met.

By contrast, income of a Swiss company to be attributed to a foreign PE and, therefore, to be tax exempt in Switzerland, it is sufficient for the foreign PE to meet either the definition of PE under Swiss domestic law or the applicable DTA (if any).

A tax ruling may be obtained by the Swiss tax authorities in order to confirm the existence or non-existence of a PE, and to determine the profit and loss allocation to such PE.

Permanent Establishment under Swiss Law

According to Article 51, paragraph 1, lit. b in connection with Article 51 paragraph 2 of the FDTA a non-resident legal or natural person acts through a PE for Swiss tax purposes when that person holds legal or factual authority

© 2023 Thomson Reuters. All rights reserved.

to dispose over premises and facilities of any kind in the Swiss territory (fixed place of business) through which it carries out its business activities (in whole or in part) on a continuous basis. The premises and facilities need to fulfil the requirement of geographical (firm connection to the ground) and temporal consistency (approximately 6 months).

Premises that constitute a PE are non-exhaustively listed as follows:

- Branches.
- Factories.
- Workshops.
- Sales facilities.
- Permanent representations (for example, through agents), whereby such permanent representations are required to act through a fixed place of business as described above. Furthermore, a legal or economic dependency from the representee is required. The authority to conclude contracts, however, is not required.
- Mines and other sites of natural resources exploitation.
- Building sites or construction or installation projects that last for at least 12 months.

Under Swiss tax law there is no list for excepted ancillary or preparatory activities. Therefore, activities which are exempted for being of auxiliary or preparatory nature according to OECD model tax treaty may well constitute a PE if performed through fixed business premises in Switzerland. However, internal activities that contribute insignificantly to the added value such as financing or gathering and exchange of information often do not lead to a Swiss PE qualification, except for the case where such activities are crucial for the company's business purpose.

Permanent Establishment under Double Tax Agreements

Generally, DTAs entered into by Switzerland are based on the OECD model tax treaty. The OECD commentary to Article 5 of the OECD model tax treaty is generally considered an important aid to the interpretation of a DTA, in particular to establish whether a PE exists in Switzerland.

Under Article 5 of the OECD model tax treaty, a company has a PE in a jurisdiction if either:

- It has a fixed place of business in that jurisdiction through which its business is wholly or partly carried on (see *Permanent Establishment as Fixed Place of Business*).
- A person acting for the company has and habitually exercises authority to conclude contracts in the company's name in that territory (the dependent agent) (see *Dependent Agent as Permanent Establishment*).

For more information, see *Practice Note, Companies: UK residence and permanent establishments: Permanent establishments and double tax treaties*.

Permanent Establishment as Fixed Place of Business

© 2023 Thomson Reuters. All rights reserved.

Under the OECD model tax treaty, a fixed place of business through which the business of a foreign company is wholly or partially carried out can, in particular, be any of the following:

- A place of management.
- A branch.
- An office.
- A factory.
- A workshop.
- A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
- A building site or construction or installation project that lasts more than 12 months.

(*Article 5.1, OECD model tax treaty*)

Under the commentary to the OECD model tax treaty, "fixed" means that there must be both:

- A link between the place of business and a specific geographical point.
- A certain degree of permanency.

This requirement excludes any temporary place of business.

Activities that are purely preparatory or ancillary to the main business carried out by a non-resident company will not be considered as carried out at a PE even where they are carried out through a fixed place of business (*Article 5.3, OECD model tax treaty*). This includes:

- Storing, displaying or delivering the company's goods or merchandise.
- Maintaining the company's goods or merchandise for the purpose of:
    - storage, display or delivery; or
    - processing by another person.
- Purchasing goods or merchandise for the company.
- Collecting information for the company.

(*Article 5(4), OECD model tax treaty*)

Dependent Agent as Permanent Establishment

A dependent agent is a person acting for the company which habitually exercises in that territory authority to conclude contracts in the company's name.

© 2023 Thomson Reuters. All rights reserved.

The OECD commentary states that this includes contracts that bind the company even if they are not literally in the company's name. The commentary also specifies that this should be taken to refer to contracts that relate to the company's business proper (as opposed, for example, to contracts concerning only the company's internal operations).

However, the activities of an agent do not give rise to a PE if the agent is of independent status and is acting in the ordinary course of his or her business (*Article 5(6), OECD model tax treaty*).

The dependent agent definition under the OECD commentary deviates from the Swiss notion of permanent agents (see *Permanent Establishment under Swiss Law*).

How to Allocate Profits to a Permanent Establishment in Switzerland

Generally, Switzerland follows the authorized OECD approach for the attribution of profits to a PE, as described in *OECD 2010 Report on the Attribution of Profits to Permanent Establishments dated (22 July 2010)* (PE Report).

The authorized OECD approach, as contained in the PE Report, sets out a functionally separate entity approach, which entails that profits are attributed to a PE as if it were an independent enterprise.

Besides that, a quota approach may be conceivable for the attribution of profits in an international context where no or an older DTA is applicable. Under the quota method, the total income of a company is allocated according to a formula, either on the basis of the accounting results or on the basis of auxiliary factors.

Taxation of Non-Resident Companies with Permanent Establishment in Switzerland

Non-resident companies that generate income through a PE in Switzerland are subject to Swiss income taxation for the income attributable to the Swiss PE only, established according to the profit allocation rules (see *How to Allocate Profits to a Permanent Establishment in Switzerland*).

The effective tax rate applicable to Swiss PEs generally is between approximately 11.2% and 22.8% depending on the canton where the PE is located.

Please note that Switzerland also levies an annual tax on net equity attributable to the PE.

Non-Resident Companies Without Permanent Establishment in Switzerland

According to Article 51(1) of the FDTA, income sourced from an economic presence in Switzerland is subject to Swiss income taxation in case the non-resident company is:

- The owner of or a partner in a Swiss business enterprise in the form of a partnership or a sole entrepreneurship (requiring fixed installations or facilities on Swiss territory).
- The owner of Swiss real property or has similar rights of use of Swiss real property.
- A creditor or usufructuary of a claim secured by Swiss real property.
- Trading with Swiss real property or acting as an intermediary in transactions over Swiss real property.

© 2023 Thomson Reuters. All rights reserved.

It is also worth noting that non-resident companies may economically become subject to 35% Swiss withholding taxation without becoming an actual tax subject for Swiss income tax purposes. Based on an applicable DTA, the withholding tax burden may generally be lowered or entirely eliminated if the requirements under the DTA are met. Swiss withholding tax generally is, among others, levied on dividend distributions from Swiss companies or interest payments on certain debt titles issued by or held with a Swiss resident person (that is, bonds issued by Swiss persons or bank deposits held with Swiss banks).

END OF DOCUMENT

© 2023 Thomson Reuters. All rights reserved.