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The board: duty calls

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Winds of change sweeping the tax landscape: an overview of the most important developments

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Foreword

Dear Reader,

There have been some seismic shifts in the international tax landscape. In the after-shock of the financial crisis, growing tension has arisen between public demands for transparency and tax justice on the one hand, and intense ongoing tax competition on the other. The current wave of tremors might well leave a deeper mark than many of those we have experienced before. Swiss businesses and the economy as a whole find themselves confronted with new challenges.

With a company's tax contribution and the effective group tax rate gaining currency as barometers influencing a corporation's public reputation as a 'fair' taxpayer, companies are being forced to rethink and adapt their tax strategy. This will also mean tax functions will have to be realigned and restructured to meet the emerging challenges efficiently.

This brochure is designed to give you an overview of the most important developments in Switzerland and internationally that could be relevant for your organisation in a climate of global change. We will be looking at the following themes:

- Corporate tax planning in the media: walking the line between ethics, reputation and the law
- Set-up of the tax function: tax strategy and managing tax risks
- Corporate Tax Reform III: what next for Switzerland?
- Brief survey: the most important international developments
- Transparency: country-by-country reporting and the international exchange of rulings
- Tax expenses and provisions: financial reporting and effective tax rate
- Indirect taxes: the board bears responsibility

As Switzerland's leading tax advisory firm, PwC plays an active role in the debate on the latest fiscal developments and we are committed to ensuring that the Swiss tax regime is attractive and internationally acceptable.

You will find explanations of the specialist terms used in this brochure in the appendix. We would be pleased to talk to you in person if you have questions on issues raised in this brochure or other tax-related topics.

We wish you stimulating reading!

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1 Corporate tax planning in the media: ***Walking the line between ethics, reputation and the law***

"Tax: dodging the taxman. They have all sorts of tricks for minimising their tax burden: Apple, Amazon, Glencore and other multinational corporations."[1] How would you, as a board member, react if a headline like this featured the name of your organisation? How would you counter the allegations, even though your company had complied with all the relevant tax laws?

What is it all about?

The media plays a considerable role in influencing public opinion, and can shape the way an organisation is viewed by the public. Media coverage of cases like Apple, Amazon, Starbucks and the 'Panama Papers' has led to a widely held view that large international companies adopt aggressive tax planning and shift their profits so that they have to pay as little tax as possible, or none at all, and thus fail to make a reasonable contribution to the common good. With tax firmly planted on the radar, it will continue to receive coverage in the media and help shape public opinion. At the same time, multinationals are finding themselves having to justify their strategy to non-governmental organisations (NGOs), which have evolved into a highly influential stakeholder group.

Negative reports in the media on legally compliant, but allegedly morally repugnant structures, are raising public pressure and damaging one of the most precious resources companies have: their reputation. This can be very detrimental in terms of sales, the trust of suppliers and customers and the wellbeing of the organisation. It raises the question of how far a corporation can undertake tax planning that harnesses tax advantages and nevertheless meets public expectations of tax compliance, one of the measures on which corporate tax strategy appears to be judged. All of this means that, in terms of tax, boards now have the key task of striking a balance between the law, ethics and reputation.

1 «http://www.bilanz.ch/unternehmen/steuern-am-fiskus-vorbei»

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What action does your organisation need to take?

There is is no general recipe for successfully meeting this challenge. However, managers and decision makers might find it useful to think about the following ideas:

- When you formulate your tax strategy you should define how far you intend to take account of public attitudes to tax compliance. If you operate in an industry of great public interest such as consumer goods you will have to put the legitimacy of your tax structure at the centre of your strategy. Regardless of your business, tax structures without economic substance or proper business justification are a thing of the past.
- International companies can positively influence public perception of their tax compliance by actively reporting their tax practice. It makes good sense to publish details of your tax strategy or the amount and breakdown of taxes paid in your annual report on your website. Remember that your organisation's contribution to the public good is not limited to the taxes it pays on earnings. You should think about publishing your total tax contribution: the entire amount of tax paid by the company in the form of social security contributions, withholding taxes, value-added tax, stamp duties, property gains tax, property transfer tax, vehicle tax and so on.
- In the wake of increasing tax transparency demands we recommend formulating a strategy to communicate your tax policy; your board, top management, tax and communications departments should all be involved. This ensures consistent communication aligned with both your corporate and tax strategies.
- Given the sometimes negative public image of international corporations purportedly pursuing aggressive tax planning, an additional challenge for companies is to redress the balance. While NGOs have a clear strategy here and often discredit multinationals, the companies themselves have failed to respond with a communication strategy of their own. You should be going on the offensive more when it comes to communicating the significance of your organisation's tax contribution, for example within the framework of the industry and business associations to which you belong.

In short

Growing demands for transparency are putting pressure on companies to critically review the moral legitimacy of their tax strategy and tax contribution. It is crucial to find the right tax and communications strategy.

2 The set-up of the tax function: *Tax strategy and managing tax risks*

What is it all about?

In the future, cross-border exchange and the sharing of detailed tax information among tax authorities in different countries will be intensified, for instance in the form of country-by-country reporting of tax and other financial information and the stepping up of mutual administrative assistance on tax matters (see section 5). These new regulatory developments will have a major impact on the responsibilities, priorities and job profiles of your tax people. With everyone calling for greater transparency, the challenge for your tax department will be to communicate tax information clearly to a range of different stakeholders within and outside your organisation.

Cross-border access to tax information and automatic exchange will become increasingly easy for tax authorities, and internationally coordinated tax audits with direct access to taxpayers' IT systems will become routine. All this means that it is crucial for your tax function to ensure excellent tax reporting, deliberate and considered disclosure of tax information and adequate documentation of tax risk management and compliance as a whole, including transfer pricing documentation. This is the only way to meet the challenges of a growing interest in tax information, conflicts in taxation arising from the cross-border flow of information, and the related reputational pitfalls.

The OECD's Forum on Tax Administration has formulated guidance designed to enable tax authorities to assess the robustness and effectiveness of tax control frameworks within organisations. Multinational corporations must heed this guidance when setting up their tax organisation. The guidance draws on principles for risk management defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). It is based on six pillars covering areas going beyond corporate income taxes to include tax strategy, tax risk management, and powers and responsibilities in all areas of tax. Various levels of maturity for tax control frameworks have been defined, which will be key in terms of an entity's risk profile and future tax audits. Certain countries, including the UK, are already requiring companies to disclose details of their tax control framework.

Possible implications

In the future the role of the tax function will not be limited to providing accurate tax information for a company's financial reports. It will have to be able to demonstrate to the tax authorities and other stakeholders that the company's tax organisation, processes and responsibilities are adequate in terms of the size and complexity of the company. The tax function will also have to work well and enable effective tax management. In the future the way your tax department works, in other words how tax management processes are handled, will be at least as important as the quality of the tax information it reports.

This means organisations will have to modernise their tax control framework and align it to the COSO principles. They will have to make sure that their tax risk management processes also include components such as risk identification and management, governance, controls and communications, or that these components are enhanced. Companies have to be able to communicate timely, understandable and structured tax information to the authorities, investors and members of the public. Otherwise they risk double taxation or allegations that they are not making a fair contribution to public finances.

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What action does your organisation need to take?

Regardless of the risk management approach you ultimately adopt and your tax risk appetite, your tax control framework will have to provide the following:

- Clear tax governance: this should be on the basis of a tax strategy aligned with your overall corporate strategy
- A detailed inventory of tax risks (including those not related to corporate income tax) to enable these risks to be actively managed and documented
- A communications strategy geared to active and transparent communication on tax-related matters
- Documented roles, responsibilities and processes in relation to tax
- Technologies enabling you to create an efficient, reliable and clearly assignable audit trail when it comes to calculating taxes and preparing and analysing tax information
- Permanent monitoring and standardised controls to keep track of the effectiveness and efficiency of your tax function.

In the future the people in your tax department will have to bring a much broader range of specialist knowledge to the table than is currently the case. Besides pure tax know-how you will need to have people with a knowledge of data evaluation and analysis, statistics, IT, process and change management.

In short

An effective tax strategy has to start with an assessment of whether, and to what extent, your current tax function fulfils the requirements of a modern tax control framework. Depending on how you rate the level of maturity of your current function and the kind of tax control framework you are aiming for, you then have to work out what action needs to be taken and formulate the necessary business model. Finally, steps to transform your tax department into a modern function meeting current and future requirements in terms of efficiency, transparency and auditability should be taken.

3 Swiss Corporate Tax Reform III: *What next for Switzerland?*

What is it all about?

Everyone is talking about Corporate Tax Reform III (CTR III), and rightly so, as it is set to be the most important reform of Swiss tax law for decades. Increasing internationalisation and tax competition are forcing Switzerland to adapt its corporate taxation in line with global standards and abolish preferential tax regimes such as the cantonal taxation of holding companies and the notion of the mixed company.

CTR III is designed to make sure that companies currently enjoying this type of preferential regime remain in this country and continue to invest here. To this extent, the reform will create the basis for ensuring that Switzerland can provide an attractive tax framework for doing business, now and in the future. The way the reform is designed means that it will affect all organisations from national SMEs to multinational corporations.

The Swiss parliament's final vote on the CTR III package on 17 June 2016 marked the culmination of a process that has been going on for years. However, the reform is still subject to a referendum before the new federal tax rules and the necessary implementation measures in the cantons can enter into force, probably on 1 January 2019.

With a new era of tax about to begin, it is time to take action to prepare.

The most important reforms

The CTR III package approved in parliament's final vote foresees the following measures:

- The introduction of a cantonal patent box. This will allow part (up to 90%) of a company's income from patents and similar rights to be exempted from corporate income tax.
- The introduction of a special cantonal deduction for Swiss research and development expenditure (a deduction of up to 150% of the actual costs)
- The introduction of a notional interest deduction on surplus or excess equity (risk capital) for all companies, at the federal level and optionally in cantons that tax at least 60% of dividends on qualified interests held by natural persons as part of their private assets
- Recognition of hidden reserves in the tax accounts when an entity enters into tax liability, or separate taxation of hidden reserves released when a cantonal tax privilege is lost
- An overall maximum exemption limit to ensure that the new rules result in relief that is limited to, for example, a maximum of 80% of cantonal corporate income tax.

Options for reducing cantonal tax on capital, the introduction of a tonnage tax, a type of taxation for shipping companies, and the abolition of issuance stamp tax, are to be debated as separate items.

The situation in individual cantons varies. For this reason, the Federal Council and parliament have decided to set up CTR III on a modular basis. This gives the cantons considerable flexibility when it comes to designing and implementing CTR III measures and basically allows them to design new instruments to match the specific circumstances in the canton. Worthy of mention in this respect is the fact that in the course of the parliamentary debate, the core measure, the notional interest deduction, was also included in the reform package. This involved a political compromise including the condition that a canton must provide for the partial taxation (of at least 60%) of dividends from qualified interests held privately by individuals. Therefore, any canton debating its tax law must also take account of the fact that the notional interest deduction is linked with the partial taxation of natural persons.

In the context of CTR III many cantons have already announced their intention of reducing their general corporate income tax rate. Vaud Canton, for example, has already confirmed a reduction in the rate from 21.8% to 13.7%; the cantons of Zug and Schaffhausen have announced reductions to 12% or 12.5% respectively. Other cantons are likely to follow suit. Cantons such as Zurich and Aargau, however, will not be able to reduce their rates by as much. Zurich Canton has announced that the rate will only be cut from 20.1% to 18.2%. We are therefore likely to see an increase in competition between the cantons to attract businesses.

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What action does your organisation need to take?

Does your organisation benefit from preferential tax regimes? What effect will the upcoming changes have on your corporate income tax contribution? How will the cantons that are most relevant for you implement CTR III? Losing one of the tax privileges described could substantially increase your tax burden in Switzerland. However, CTR III will not just affect tax expense and after-tax profits; it may also impact on your liquidity and investment planning.

Companies that currently enjoy preferential tax regimes can basically take advantage of specific transitional rules. The reform will also create new opportunities both for companies that currently have privileged tax status and those subject to regular taxation. Is your organisation innovative? Have you filed for patents or similar rights, or could you have rights of this type registered? Do you do research and development in Switzerland? The various measures contained in CTR III, for example the patent box and the special deduction for R&D costs, will open new avenues for innovative businesses of all sizes.

The new notional interest deduction is designed to help companies with solid internal financing and substantial financing activities. With this in mind, you should consider whether your organisation has strong equity funding and whether you currently conduct your group financing activities via, for example, an SME holding company. You should also be thinking about the best way to structure your company's financing activities going forward.

In short

We recommend thoroughly analysing the situation and formulating scenarios. This way you can prepare your organisation properly for the new tax set-up in Switzerland and reap the maximum benefit from the measures implemented as part of CTR III.

4 Brief survey: *The most important international developments*

BEPS Action Plan

The OECD's Action Plan on Base Erosion and Profit Shifting (BEPS) contains comprehensive guidelines on limiting legal tax avoidance. It is a response to the growing budget deficits in many industrial nations in the wake of the financial crisis and media coverage of particularly aggressive tax planning at some large corporations. Published at the end of 2015, the BEPS Action Plan pursues three main objectives:

- Avoiding the double non or reduced taxation of income (eliminating so-called hybrid structures)
- Taxing the profits of corporate groups where the value is generated
- Creating transparency by means of country-by-country reporting and the spontaneous exchange of tax rulings.

The OECD is currently working on a multilateral instrument designed to speed up the implementation of the BEPS actions. The aim is the coordinated modification of existing double tax treaties to enable tax treaty-related BEPS measures to be implemented rapidly, without the need to renegotiate treaties. If the instrument is signed at the end of 2016 or in early 2017 as planned, the relevant BEPS measures could be implemented by 2019. Until recently such early implementation was considered unrealistic.

Transfer pricing

It comes as no surprise that transfer pricing figures so largely in the BEPS Action Plan, especially in terms of ensuring that tax is paid where the value is generated and the related matter of economic substance. One of the criteria for assessing substance is the location of so-called significant people functions. Income from intellectual property should be taxed where the IP development, enhancement, maintenance, protection and exploitation (DEMPE) actually take place. New, broader rules on documentation and country-by-country reporting will give tax authorities an insight into an organisation's value chain and enable them to assess whether income and taxes paid have been allocated in line with the transfer pricing rules. Now the OECD is requiring that documentation be split into a master file containing standardised information relevant for all group companies and a local file referring specifically to transactions of individual entities. Many countries are already enforcing the detailed OECD rules for 2016 transfer pricing documentation. In our experience the most efficient way of drawing up consistent documentation for all group companies is to do it centrally.

Tighter rules in the EU

To coincide with, and based on, the OECD's BEPS Action Plan, in 2016 the European Commission presented the first draft of guidelines designed to counter the concrete tax avoidance practices of corporations based in EU member states, the Anti Tax Avoidance Directive (ATAD). In certain areas the guidelines go further than the OECD recommendations.

The ATAD is basically designed to limit the tax deductibility of interest on debt, introduce exit taxation for corporate taxpayers, introduce controlled foreign corporation (CFC) rules for low-taxed entities and new rules to tackle hybrid mismatches. In addition, each EU member state will have to have a general anti-abuse rule (GAAR).

The EU Commission is also conducting a thorough review of existing EU tax regimes and rulings to make sure that EU member states have not granted illegal state aid. If the European Court of Justice confirms the EU Commission's conclusion that in investigated cases (including McDonald's, Starbucks, Amazon and Fiat) illegal state aid has been provided, the companies affected will have to pay back taxes for a period of up to ten years to reimburse the unjustified tax savings.

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Action for action's sake: cutting tax rates versus combating abuse

In March 2016, the UK government published plans to reduce tax rates, including a cut in the corporate tax rate to 17% by 2020. The aim is to put the UK at the forefront of the G20 nations and create a favourable climate for investment. At the same time the UK is taking the lead in terms of adopting the BEPS recommendations in its tax legislation and adding additional anti-abuse rules of its own. For example, the diverted profits tax introduced in April 2015 (also known as the Google Tax) is designed to make sure that artificially diverted profits are taxed at a rate of 25% in the UK. The UK is expected to stick to this even following the decision to leave the EU. After the Brexit referendum George Osborne announced that the corporation tax rate would be reduced further to less than 15%.

Another example is Luxembourg, which will be reducing its corporate income tax rate from 21% to 18% over the next two years (before surtaxes) to remain tax-competitive and to compensate for the loss of ruling options. At the same time the country is introducing new anti-abuse and BEPS rules to broaden its tax base and generate additional tax revenues.

There is a fine line between combating abuse and positioning a state as an attractive location for investment. This is also evident in the United States, which is considering plans to reduce corporate tax rates and completely overhaul a complicated, unattractive tax system in an effort to stimulate the economy. All in all, this would probably be tantamount to the most thorough review of the tax system in the history of the country. At the same time, draft legislation was published very recently that would drastically limit US companies' scope to have tax efficient debt. This is only one of many measures that will lead to a tightening of the United States' international tax rules. The new US model income tax treaty released in early 2016 will also lead to much more stringent conditions for claiming treaty benefits in the future.

At the moment we are seeing a global trend with many nations enacting complex rules, often not coordinated, or only coordinated to a limited extent, with rules in other countries, designed to limit tax avoidance and broaden their tax base. At the same time, they are reducing tax rates and helping certain industries and sectors with attractive tax solutions, such as patent boxes, in the hope of retaining companies already based there or luring businesses from abroad.

Developments in Switzerland

Switzerland has already taken account of various aspects of the BEPS project in its rules or is doing so as part of CTR III. For example, it is abolishing the internationally frowned-upon holding, domiciliary and mixed companies, and the principal allocation (see section 3). The ratification, also by Switzerland, of the Convention on Mutual Administrative Assistance in Tax Matters developed by the OECD and the Council of Europe has created the basis for greater transparency and the spontaneous exchange of information. Switzerland, and other countries, must now introduce a number of new, additional, minimum standards, notably the automatic exchange of country-by-country reporting (see section 5) and the inclusion of anti-abuse rules in double tax treaties.

What action does your organisation need to take?

Multinational corporations currently face rapid and far-reaching changes in the tax landscape. This means the only way of avoiding double and multiple taxation is for you to review your existing structures on an ongoing basis and adapt them to new tax rules in good time. We recommend formulating a clear tax strategy and making sure your company has a simple, manageable and easy-to-explain structure. Since the BEPS measures place great emphasis on economic substance, you also have to ensure that your tax structure and local profits match actual value generation.

5 Transparency: *Country-by-country reporting and the international exchange of rulings*

One of the aims of the OECD's BEPS initiative is to improve international transparency. The idea is that tax authorities should have access to additional information to be able to assess the risks in connection with transfer pricing, and base erosion and profit shifting more effectively. Besides obliging multinational corporations to produce transfer pricing documentation, the BEPS measures require them to provide detailed information in the form of country-by-country reporting (CbC reporting, BEPS Action 13). BEPS also facilitates the spontaneous cross-border exchange of tax rulings (BEPS Action 5).

Country-by-Country-Reporting

What is it all about?

All OECD and G20 nations have undertaken to introduce CbC (country-by-country) reporting. This means that multinational corporations will have to produce a CbC report in addition to the transfer pricing documentation requirements that apply in some cases. A CbC report contains information on the global distribution of sales, taxes paid and other figures on the group in individual countries, as well as information on the economic activities of all legal entities within the group. Tax authorities all over the world can use the CbC report to compare the most important financial figures and circumstances in each country. For example, the taxman is likely to start asking questions in cases where certain countries have a comparatively low EBIT/sales ratio with a relatively high incidence of intragroup transactions.

Implementation in Switzerland

Switzerland will introduce country-by-country reporting as of 1 January 2018. This means that at the end of 2019 Swiss groups will have to submit a CbC report to the Federal Tax Administration for the 2018 financial year for exchange with tax authorities in other countries.

In Switzerland the new rule will affect multinational corporations (MNCs) with consolidated annual sales of more than CHF 900 million. The Swiss Federal Council reckons there are around 200 such MNCs in this country. Under the current draft legislation, a failure to submit, or submitting an inaccurate or incomplete CbC report, will give rise to a fine of up to CHF 250,000.

Some countries require the submission of a CbC report from 2016. For this reason, the draft legislation allows Swiss parent companies (and Swiss subsidiaries of a foreign group if they are nominated as such) to voluntarily submit a CbC report for 2016 and 2017 to the Federal Tax Administration.

Publication in the EU

The EU wants to go even further with CbC reporting by waiving confidentiality rules and requiring that reports be made public. The European Commission has produced draft legislation that will also apply to larger EU subgroups of corporations from third countries, including Switzerland. If the law is passed, corporations based outside the EU could come under pressure to also publish their CbC reports.

What action does your organisation need to take?

CbC reports will create a whole new level of transparency in terms of multinational corporations. Tax authorities around the globe will get an overview of how a group's sales, profits and economic substance are distributed around the various countries involved. This means that tax authorities will increasingly be able to audit multinationals if they believe they are at a disadvantage compared with other countries. Swiss groups are therefore well advised to start producing a CbC report now to pre-empt potential inconsistencies and queries from the taxman and be able to take appropriate countermeasures as required.

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Spontaneous exchange of tax rulings

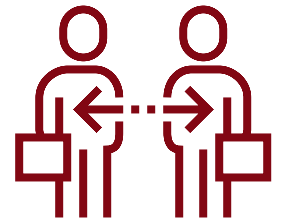
What is it all about?

The spontaneous exchange of information means that one tax authority spontaneously passes on information (for example on tax rulings) to another state because it suspects that the other party might have an interest in the information, and not because the information was explicitly requested. Such an interest may be foreseeable if the information in question is likely to be relevant to the other state in terms of applying and enforcing its tax laws.

BEPS Action 5 sets out the standard for the spontaneous exchange of information on tax rulings. A tax ruling is deemed to be "any advice, information or undertaking provided by a tax authority to a specific taxpayer or group of taxpayers concerning their tax situation and on which they are entitled to rely". The action mentions various categories of tax rulings of international relevance which are to be subject to the spontaneous exchange of information, including rulings related to preferential regimes (which in Switzerland could mean a holding company, mixed company or principal company), unilateral rulings covering transfer pricing or permanent establishment rulings.

Implementation in Switzerland

In Switzerland the Convention on Mutual Administrative Assistance in Tax Matters, the revised Tax Administrative Assistance Act, and the revised Tax Administrative Assistance Ordinance form the legal basis of the spontaneous exchange of rulings as per BEPS Action 5. Switzerland will adopt the practice as of 1 January 2018.[2] Information will be exchanged with the tax authority of the counterparty or counterparties of the transactions covered by the ruling and with the foreign parent company and the foreign ultimate (top) holding company of the corporate group. New rulings and rulings agreed since 2010 and still applicable in 2018 will be exchanged.



What action does your organisation need to take?

The spontaneous exchange of rulings and information will give foreign tax authorities access to information they previously did not have. This could lead to competing taxing rights abroad and increase the risk of double taxation.

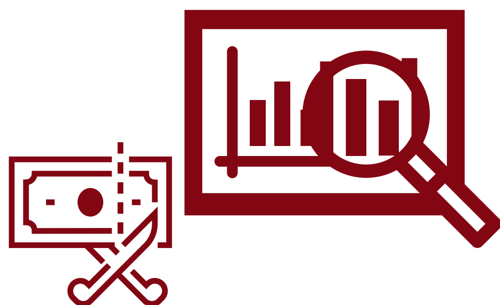
Companies have new questions to answer: What exchangeable rulings have been agreed and are still in force, not only in Switzerland, but anywhere in the world? How can information made available abroad affect taxation of your group? Therefore, the possible alternatives for your group should be determined. To avoid international transparency or unnecessary discussions with foreign tax authorities it should be decided whether a ruling should be annulled prematurely or reformulated. Any changes to rulings must be implemented before the end of 2016.[3]

2 Theoretically Switzerland could negotiate separately with individual states for the Convention on Mutual Administrative Assistance, and thus the exchange of rulings with these states, to be applicable as early as 2017. But there is currently no sign of efforts in this direction.

3 Even though the Convention on Mutual Administrative Assistance is only applicable from 2018, given the requirements governing the content of transfer pricing documentation, rulings could be made available abroad earlier than this.

6 Tax expenses and provisions: ***Financial reporting and effective tax rate***

Given the international developments outlined and their adoption in domestic law, the question sometimes arises as to what impact they will have on your financial reporting and the effective group tax rate. Shareholders and analysts will follow your group's effective tax rate with great interest, as an increase or decline in the rate has a direct impact on earnings per share.



How does the effective group tax rate break down?

In simple terms, the effective group tax rate is the product of a group's taxable income in each country and the local tax rate applicable in each case. Tax expense consists of both current and deferred taxes.

Current taxes are the taxes on income incurred each year on the basis of the current results. Deferred taxes represent future tax expense or income resulting from differences in the valuation of assets or liabilities in the tax accounts and consolidated balance sheets (for example because the carrying amount of assets in the consolidated balance sheet is higher than the amount attributed to them for tax). The tax rate used to measure deferred tax is the rate that is likely to be applied if the differences are actually realised and thus taxed from the group point of view.

The impact of changes in tax law on effective group tax rate

The BEPS project estimates current tax revenue losses from BEPS at 4% to 10% of global income tax revenues. The BEPS measures are designed to prevent these losses from occurring. If these efforts succeed, on a purely statistical basis the average effective group tax rate would have to increase. Therefore, we can expect to see an overall increase in the corporate income tax burden.

For many corporate groups in Switzerland the abolition of preferential tax regimes as part of CTR III will, in the medium term, lead to an increase in the tax burden in Switzerland and thus in the effective group tax rate. Each case, and the extent to which compensatory measures in the CTR III package might make up for this increase, should be analysed.

Basically the question is when CTR III will impact your financial reporting and thus your effective group tax rate. The following points are relevant in this context:

- The preferential tax regimes that currently exist are likely to be abolished with effect from 1 January 2019. Most of the compensatory measures will also enter into force on this date. Changes in tax rates will only affect current taxes once the new rules come into force.
- In terms of deferred tax, however, the new tax rules and rates should be taken into account from the moment the changes are definitively enacted. This also applies if they only enter into force in the future, provided the differences described above are likely to be subsequently realised in tax terms. This can mean that your deferred tax expense, and by extension your effective group tax rate, will have to be adjusted before the new rules actually come into force.

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What action does your organisation need to take?

The latest changes in international and domestic tax will start to affect your financial reporting from the moment they are enacted. Thanks in large part to CTR III, Swiss corporate groups will have to take a close look at the issue of applicable tax rates to calculate deferred tax and the impact on the effective group tax rate.

We recommend checking the extent to which the IFRS Interpretations Committee's draft guidance will affect the recognition and measurement of tax risks in your group. If you want to be able to review and reassess the risks systematically on a regular basis, the corresponding processes will need to be established.

New rules for recognising tax risks in the consolidated financial statements

There are new challenges for companies in terms of both accounting for new local tax rates and recognising tax risks. The IFRS Interpretations Committee recently published draft guidance on the question of whether or not a provision even has to be booked.

This guideline specifies that tax risks now have to be recognised and measured as a provision under International Accounting Standards (IAS 12). The provision should be booked if the risk is likely to materialise. In a second step the amount of the tax risk provision should be assessed in accordance with specific and sometimes very complex rules. The probability of whether the risk will materialise is relevant. Since you also have to assume that the tax authorities have access to all the relevant information, the risk of discovery will not be a factor in your assessment.

Until now there has been relatively broad scope for interpretation when it comes to recognising provisions for tax risks in practice under the existing rules. For this reason, tax risks are often not recognised systematically. The new interpretation of IAS 12 will mean that in the future corporate groups will have to recognise and measure their tax risks more systematically. This will require processes to enable a thorough and systematic review and reassessment on a regular basis.

7 Indirect taxes: *The board is responsible*

Indirect taxes such as value-added and sales tax, stamp duties and customs duties never used to be a priority for the board. However, that has now changed at many large companies, not least because of tax audits resulting in hefty tax bills. In jurisdictions with VAT rates of up to 27%, a demand for back payment of tax can result in a considerable extra burden. Even if a company is able to pass this on to its customers or rectify errors in invoices, in many countries the fines and interest can far exceed the amount of tax owed. With senior staff personally liable, the risks for the managers responsible are even greater. Many countries have now introduced personal liability, and management can face criminal proceedings if processes in connection with indirect taxes do not come up to scratch.

While by its very nature VAT should primarily be borne by the consumer, the main burden of responsibility lies with the company, which has to collect the tax on behalf of the state. Dishonest suppliers and customers could even put the organisation at risk of tax fraud, and in such cases it may end up facing a tax audit, heavy tax bills and fines, plus damage to its reputation, even though no tax advantage accrued to it. To effectively prevent such risks an internal tax control framework for indirect taxes should be set up. While this is primarily the job of the group's tax officers, ultimate responsibility lies with the directors.

Increasing importance in an environment of change

The debate on VAT usually revolves around steady rises in the rates of value-added tax. This stems from the fact that in almost all major economies, apart from the United States, indirect taxes are a key component of taxation and are used to cover growing public spending requirements. China has just introduced VAT. Despite this, global corporations already face new changes in this area, with countries in the Middle East and India about to radically reform their indirect taxes.

While this is an area where, for once, the United States is not the centre of attention, with different rules at state, county and even city level, the American system is so complex that companies can hardly keep track of all the variants. Other countries with a federal system, such as Brazil and India, also have complex, multi-tiered systems. In these markets the tax risks are much greater than in countries with more familiar European-inspired systems of VAT.

For a long time, the set-up of value-added and sales tax systems was a domestic matter for individual countries or single markets (such as the EU). However, now, particularly in the wake of growing economic activity related to electronic services, countries are being forced to harmonise their systems. This is reflected in the guidelines on VAT and GST recently published by the OECD. It all means that tax authorities are likely to step up cooperation on indirect taxes as well. This is basically a new development, as for a long time local tax authorities' reach in terms of indirect taxes was limited to companies generating sales domestically.

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Digitisation with consequences

The digital revolution is fundamentally changing the way consumers shop for products and services and spawning new value chains and offerings. Thanks to apps and digital communication channels, companies are able to reach customers around the globe.

To generate higher tax revenues or prevent erosion of the tax base despite digitisation, more and more countries are levying VAT at the place the customer is located and taxation in accordance with the host country principle is gaining widespread currency all over the world in the business-to-consumer (B2C) realm. This means that offering digital products and services may result in the provider becoming liable for VAT in the countries where their customers live. In some countries the thresholds for compulsory VAT registration are very low. In Germany, for example, there is no minimum threshold, and a company is liable to pay VAT from its very first euro in sales. Especially in countries that have only recently introduced VAT, providers of electronic services typically create a tax liability – this is the case in countries such as Japan, Australia and South Africa.

However, the digital revolution is also creating opportunities for multinationals in terms of indirect tax. For example, in many countries they can register for VAT electronically, issue invoices electronically and archive business documents in digital form.

Tax control framework for indirect taxes

Setting up a tax control framework is of key importance, especially when it comes to indirect taxes. It is the only way of adequately safeguarding against tax-related risks if you have global business operations. Unlike direct taxes, problems related to indirect tax will impact on multiple process within your organisation, since it is not only the finance function, but buying, sales and logistics, that are affected by VAT. This means that you should clearly demarcate the responsibilities for indirect tax between these departments. To reconcile the different interests to the benefit of the group as a whole you also have to assign overall responsibility for indirect taxes. The person or office with overall responsibility will also have to be consulted before new business flows are implemented. This way you can determine the tax treatment of each transaction in advance and make sure it is handled in line with clear rules. Subsequent changes only tie up additional resources and make matters more complex.

It is crucial to take the initiative when it comes to indirect taxes, and it is just as important to then provide thorough responses to questions from the tax authority in connection with future tax audits. Since there are comprehensive obligations to produce proof for transactions in relation to indirect tax, you have to take appropriate steps to make sure your company keeps complete, traceable archives.

In short

Given these changes and the possibility of criminal proceedings in the event of non-compliance, boards are well advised to keep a very close eye on developments related to indirect taxes. Active VAT risk management can help protect your organisation from the risk of back taxes and fines and avoid personal legal action for individual decision makers. Setting up a tax control framework for indirect taxes should be a key component of this.

8 Glossary

Anti-Tax Avoidance Directive (ATAD)
The ATAD is a package of European Union (EU) measures designed to combat tax avoidance. It is based on the Action Plan on Base Erosion and Profit Shifting issued by the Organisation for Economic Co-operation and Development (OECD). The aim is to make corporate taxation in the EU fairer, simpler and more efficient. The ATAD is designed to prevent aggressive tax planning and ensure that corporations are taxed at the place where they earn their profits.

Base Erosion and Profit Shifting (BEPS)
Base erosion and profit shifting refers to the perceived practice among multinational corporations of deliberately reducing their taxable base and shifting profits across borders. The term was coined by the OECD task force responsible for tax matters.

Committee of Sponsoring Organizations of the Treadway Commission (COSO)
COSO's guidance, recognised as an international standard for internal control over financial reporting, is designed to improve financial reporting, primarily by means of good corporate governance, ethical conduct and effective internal controls. COSO also wants to build trust in the non-financial information companies provide on their operations.

Forum on Tax Administration
The Forum on Tax Administration (FTA) was created in 2002 for tax commissioners from 46 OECD and non-OECD countries, including members of the G20. Its key aim is to improve taxpayer services and tax compliance.

G20
The G20 (Group of Twenty), a group comprising the 19 most important industrial and emerging nations plus the EU, serves as a forum for cooperation and consultation in matters relating to the international financial system. Its goal is to coordinate political efforts and its members to achieve international economic stability and sustainable growth.

Mixed company/domiciliary company
Mixed companies are entities whose business is primarily focused abroad, with business in Switzerland playing only a subordinate role. In contrast, auxiliary companies, also called domiciliary companies, are only permitted to perform an administrative function in Switzerland, but not conduct business. Both forms qualify for preferential tax regimes for incorporated companies and cooperatives at the cantonal level and in practice are primarily used as a means of taking advantage of attractive taxation of income from financing, licencing and trading activities. Income from holdings and capital and revaluation gains on such holdings are tax-free. The rationale is that the regular taxation of income earned from foreign sources by mixed and auxiliary companies is reduced in line with the significance of their business or administrative activity in Switzerland.

Holding company privilege/taxation of holding companies
This refers to a tax privilege granted to incorporated companies and cooperatives by Swiss cantons and municipalities. To avoid economic multiple taxation, holding companies pay no tax on profits, and as a rule pay tax on capital at a reduced rate. To quality for this regime the articles of association must state that the company's purpose is the holding of participations (i.e. no business activity in Switzerland). Additionally, either two-thirds of the total assets must consist of qualifying participations or two-thirds of the total income must be derived from qualifying participations. No holding company privilege is granted at federal level. However, a participation exemption may be granted for income from participations and capital gains on the sale of participations if certain requirements are met.

International Financial Reporting Standards (IFRS)
International Financial Reporting Standards (IFRS) are the standards issued by the International Accounting Standards Board (IASB). They are designed to enable and govern the preparation of internationally comparable financial reporting independent of specific national rules. In many countries IFRS is mandatory, at least for entities oriented to the capital markets. IFRS consists of standards and official interpretations of these standards.

Notional interest deduction (NID)
Corporate Tax Reform III (CTR III) includes the introduction of a so-called notional interest deduction on the surplus (or excess) equity of all companies. It will apply at federal level and optionally at cantonal level. To adjust tax on profits for interest, both a deduction of debt interest and a notional interest deduction on equity (NID) are permissible. For tax purposes this represents a justifiable business expense which reduces the taxable base for corporate income tax. The actual deduction depends on two variables: the qualifying equity, and the applicable interest rate.

Organisation for Economic Co-operation and Development (OECD)
The Organisation for Economic Co-operation and Development (OECD) is an international organisation of 35 member states committed to democracy and the market economy.

Panama Papers
The Panama Papers are confidential documents created by Panamanian offshore service provider Mossack Fonseca that were made public on 3 April 2016 in a 2.6-terabyte leak. According to media reports these documents constitute evidence of legal tax avoidance strategies, tax and money laundering offences, violation of UN sanctions and other criminal offences committed by the company's clients. In many countries these revelations have triggered public debate on tax loopholes, brassplate companies, tax havens, tax offences and tax compliance.

Patent box
Under a patent box regime, income from intellectual property rights and other comparable rights is put in a special 'box', in other words, separated from the entity's other income and taxed at a reduced rate. It is a way of promoting output in research and development (R&D). The patent box

(also known as an IP or licence box) is used in many countries, and Switzerland will also introduce the regime with CTR III. An important component will be the so-called modified nexus approach, required by the OECD for a patent box to be accepted. Under this approach, income from qualified rights can only be taxed at a preferential rate to the extent that the R&D expenditure spend occurred in Switzerland. A so-called uplift of 30% will also be granted to cover the funding and control of foreign R&D, provided the entity really has done this amount of R&D abroad.

Principal company (principal structure)
A principal company is a legal structure centralising and bundling the functions, responsibilities and risks of a multinational corporation. For example, a principal company might take care of buying for its global markets, R&D and production planning, inventory management and logistics planning, developing marketing strategy, sales planning and management, treasury and finance, and administrative functions. Taxation of the principal company's taxable profit at the federal level is subject to an international allocation of taxing rights. At the cantonal level, a principal company is generally taxed according to the principles that apply to mixed companies.

Privileged tax regimes
Privileged tax regimes are tax regimes where the rate of taxation or the basis used to calculate taxation diverges from the regular rules governing taxes on profits and capital. The term is often used as a cover-all for the special tax rules applying to holding, domiciliary and mixed companies, or to describe the tax rules for principal companies or other entities benefiting from tax relief.

Advance tax ruling
An advance tax ruling is a notice, confirmation or assurance from a tax authority in advance of the actual tax assessment regarding the taxation of a concrete transaction or circumstances presented by the taxable entity, with the proviso that the transaction or circumstances come to pass as presented. From the taxable entity's point of view, the primary aim of seeking an advance ruling is to gain legal certainty prior to a planned transaction or action. From the tax authority's point of view an advance ruling also simplifies the subsequent assessment because it is already aware of the transaction or circumstances in question and has looked into the legal and tax implications.

Tax strategy
One of the keys to an effective tax compliance organisation is having a tax strategy aligned with overall corporate strategy, setting out at the very least the relevant framework and goals, the tax risk profile and the remit of the tax function. Tax strategy is the responsibility of corporate or group management.

Tax structures without economic substance
Tax structures are deemed to be without economic substance if they have been created for purely tax purposes and the entity in question does not conduct any material business. One of the main goals of the BEPS initiative is to ensure that taxation is geared to economic substance and to prevent taxable profits from being artificially shifted out of countries where the value was created.

Tax control framework (TCF)
A tax control framework is an internal control instrument specifically geared to a company's tax processes. It does not just cover the tax function. The TCF is a component of internal controls and is related to all controls that are relevant in terms of tax. The TCF is designed to enable control of all tax processes, for example in relation to taxes on income, imports, consumption and pay, or value-added tax. The framework is also designed to ensure correct, timely payment of tax liabilities.

Partial taxation of dividend income
The partial or preferential taxation of dividend income is an attempt by the tax authorities to mitigate so-called economic double taxation. This occurs because distributed profits are first taxed at the company in the form of corporate income tax and then at the recipient of the dividend in the form of income tax. For this reason, both the Swiss Confederation and the cantons only tax part of dividends on qualifying investments (interests of greater than 10%).

Total tax contribution (TTC)
TTC is an approach developed by PwC to create transparency on the entire taxes paid or collected by a company. It focuses on the company's total tax burden. Taxes include mandatory payments to the state (the federation, cantons and municipalities), to state organisations or authorities reporting directly to the state, provided that no directly attributable considerations can be claimed in return and that the payments are used to finance public services. The TTC distinguishes between taxes borne and taxes collected.

Taxes borne …
… are taxes paid by the company itself as a taxable entity that are recognised in its financial statements as an expense and impact its after-tax profits. These include:

- Corporate income tax
- Taxes on capital
- Non-refundable VAT
- Employer social security contributions
- Property gains tax
- Issuance stamp tax
- Property tax
- Property transfer tax

Taxes collected …
… are taxes collected by the company from third parties and remitted to the state. They are purely transitory items that do not represent financial expenses or influence the company's results. However, the company does have to cover the administrative expense and bear the risk of error involved in collecting taxes. Taxes collected include:

- Employee social security contributions
- Withholding tax
- Value-added tax (VAT)
- Pay-as-you-earn tax
- EU tax on interest

Corporate Tax Reform III (CTR III)
The Swiss Federal Council wants CTR III to eliminate differences in the taxation of domestic and foreign corporate income by the cantons, and at the same time ensure that the Swiss tax system remains attractive. Until now income generated by international companies abroad has been taxed in the cantons at a more moderate rate. These preferential tax regimes for holding, domiciliary and mixed companies have come under heavy criticism internationally. In June 2016 the Swiss parliament accepted the bill drafted as part of CTR III. Subject to a referendum, the package of reforms is likely to enter into force on 1 January 2019.

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