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**Inside: Special country
guide - Switzerland**

How Switzerland attracts international headquarters

Switzerland's tax regime has a lot of advantages for any multinational corporation thinking of locating a headquarters there, explain [Thierry Sauvaire](#) and [Andreas Müller](#) of KPMG

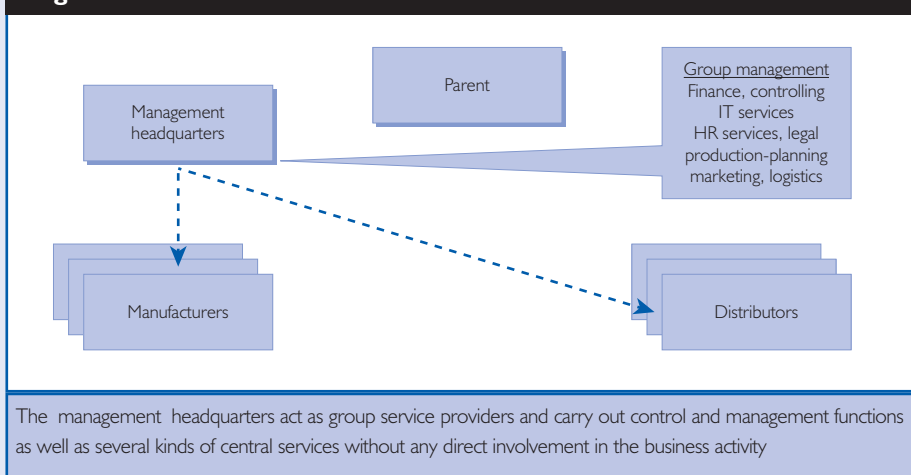
It is not just the convenient location in the heart of Europe, but also a number of other reasons that make Switzerland an attractive, if not the most attractive, location for the global or regional headquarters of European, American and Japanese groups. The most recent survey carried out by the Swiss American Chamber of Commerce and the Boston Consulting Group in 2005, as well as an earlier survey carried out by Arthur D Little in 2002, show that Switzerland offers clear advantages in terms of location compared with other European countries. Location advantages that cause more than half of the American, European and Japanese companies to choose Switzerland as the location of their respective headquarters and management centres.

What makes Switzerland attractive as a location for global or regional business centres?

Clearly, the high quality of possible local suppliers of high-tech products, Switzerland's highly motivated and qualified employees, its flexible employment market and employment law are regarded as advantageous. Furthermore, with regard to marketing, the attractiveness of Swiss markets as test markets and Switzerland as the gateway to the markets of its European neighbours puts Switzerland on the top of the list of possible headquarters locations in Europe. However, it is not just the quality of markets and infrastructure that are regarded as clear benefits of Switzerland but also the high degree of security and political stability, the close and supportive cooperation with Swiss authorities and above all, the favourable Swiss tax regime.

Finally soft factors such as high living standards, a multicultural, multilingual and international living environment as well as international schools and universities that are among

Diagram 1



the best in the world convince the group's top managers and employees to accept a transfer of their workplace to Switzerland.

All of these reasons, which any other alternative location can hardly offer in a comparable quality, are the decision-making criteria which can lead to the choice of Switzerland as the ideal headquarter location.

When American, European or Japanese companies relocate their regional or global headquarters to Switzerland, in principle, a distinction must be made between two main types of headquarters: (i) Management headquarters and (ii) Principal headquarters.

Management headquarters

In the case of pure management headquarters, the business management and often the financial management of the group are the main functions of such headquarters. In addition to these core functions, the headquarters often take on other functions and services along the value chain of the group, such as marketing & sales services, human resources services, legal advice, communications and information technology.

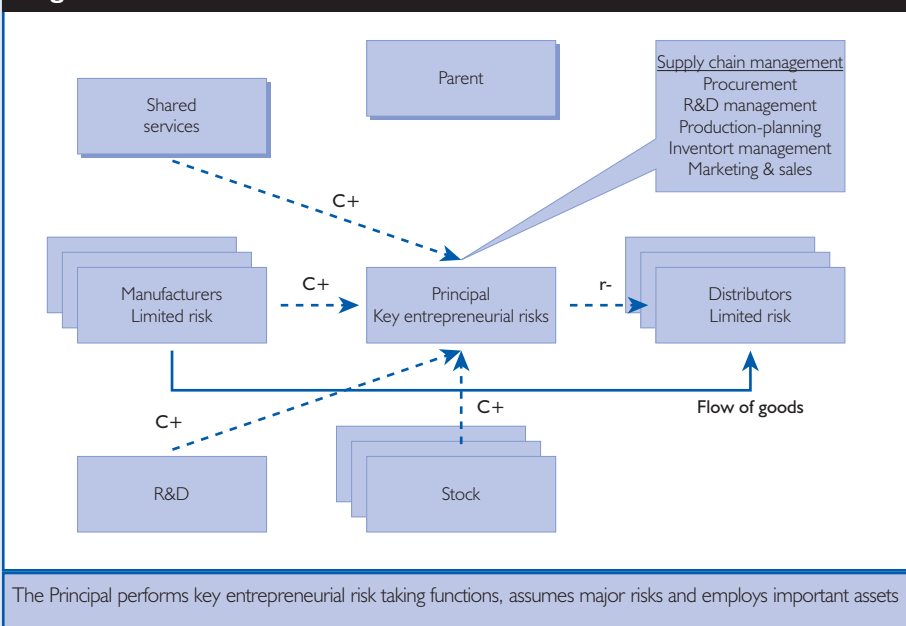
As a further and often central component of the value chain, the development and utilization of IP, such as patent and trade mark rights, are transferred to the management headquarters. Whether the headquarters act as pure management headquarters or are expanded to a service centre with additional central services (shared service centre), primarily depends on how a group structures its business model and how the various functions, including central support services, are organized along the value chain.

Principal headquarters

Headquarters that are involved in the business activity of the group must be regarded quite differently as they do not just take on important functions but also crucial risks and the legal ownership of the products.

The principal headquarters is no longer only the management, control and central service centre that renders services, but the group companies within the responsibility of such headquarters themselves become the service providers of the principal headquarters. Consequently, former

Diagram 2



manufacturing companies are converted to toll manufacturers or contract manufacturers and fully-fledged distribution companies to commissionaires or stripped buy-sell distributors.

Swiss tax facts

- Effective overall income tax rate (range depends on company's cantonal/communal domicile):
 - Ordinary taxed companies: about 13% to 28%.
 - Companies with statutory tax privileges: about 8% to 12%.
 - Principal company: about 6% to 7%.
- Participation exemption on dividend income and capital gains on disposal of qualifying participations (no subject to tax clause).
- Tax holiday up to 10 years available.
- No domestic transfer pricing legislation but arm's-length principle according to OECD Guidelines.
- No CFC rules.
- 1% issuance stamp duty, however, wide range of statutory exemptions (first CHF1 million [\$776,000] tax free).
- Swiss withholding tax:
 - 35% on dividend and interest payments on Swiss bonds.
 - No domestic withholding tax on royalties and interest payments on Swiss loans.
 - Withholding tax relief at source for qualifying investors (no refund system anymore).
 - Tax credit on foreign withholding taxes.
- 7.6% VAT – by far the lowest rate in Europe.
- About 70 tax treaties and de facto access to EU parent-subsidiary and royalty/interest directives.
- Binding and basically timely unlimited advance tax rulings.

In contrast to the revenue of the actual management headquarters, which solely basically consists of the guaranteed cost reimbursement for the services rendered, including an appropriate profit mark-up, the Principal generates its own sales in the market. In addition to the reimbursement for its own costs and the costs of its services providers, including an appropriate profit mark-up, these sales should enable the Principal to achieve a substantial profit for the functions performed and the risks assumed.

Taxation of global or regional management headquarters and principal headquarters in Switzerland

Besides the various factors mentioned above, Switzerland is especially due to its favourable tax regime an attractive location for global or regional headquarters.

Income tax treatment of management headquarters in Switzerland

With respect to a management headquarter the basic questions is how the taxable income of such headquarter is to be determined. Switzerland has no specific transfer pricing legislation. However, in the circular letter of March, 2004 the director of the federal tax authority informed the cantonal tax authorities, that when taxing multinational enterprises they had to take into account the OECD Transfer Pricing Guidelines. The mark-ups of services companies must be determined in accordance with the arm's-length principle, on the basis of comparable uncontrolled transactions and with appropriate ranges of mark-

ups for any individual case. The arm's-length principle is also applicable when choosing the method to determine an arm's-length remuneration. Consequently, all kind of services rendered by the global or regional headquarters to group companies have to be remunerated at arm's-length and based on an appropriate pricing method. Nevertheless, a Swiss-domiciled headquarter is usually taxed on a cost plus-basis. Tax authorities in Switzerland grant written confirmation for a cost-plus taxation ruling.

For a management headquarter with only limited activities in Switzerland and mainly foreign sourced income, normally a statutory privileged tax status applies. The overall applicable tax rate on all foreign sourced income is about 8% to 12% depending on the cantonal/communal domicile of the company.

The set-up of a company can be achieved without substantial Swiss tax consequences. But possible exit taxes in countries from which tax bases are shifted to Switzerland have to be considered.

Income tax treatment of a principal headquarter in Switzerland

While a management headquarter with centralized management functions in Switzerland may benefit from the general statutory tax privileges, a sophisticated and even more attractive taxation mechanism applies to a Swiss principal headquarter.

In case of a Swiss principal headquarter it is argued with the Swiss tax authorities that the sales affiliates are from an economic perspective fully dependent on the Swiss Principal and should thus be regarded as foreign branches of the Swiss Principal. To sustain that argument, it is crucial that the contractual arrangements between the Swiss Principal and the sales affiliates are drafted in a way to demonstrate this economic dependency. All risks related to the product sales (that is, obsolescence risk, credit risk, currency risk) and consequently also all the responsibilities need to be allocated to the Swiss Principal. It is therefore necessary for the Swiss Principal to employ a number of key people in charge of coordinating and supervising the sales activities carried out by the sales affiliates on behalf of the Swiss Principal.

Such functions performed by employees of the Swiss Principal may include manager sales, chief financial officer, head of logistics and chief human resources officer.

Whether the sales affiliates are organized as commissionaires or as buy-sell companies does from a Swiss point of view not matter.

On a federal level the income tax treatment of principal headquarters is governed by the circular letter No 8 dated December 18 2001 (the Circular). The tax treatment stipulated in the Circular, which is binding for federal tax purposes in Switzerland, determines under what condition an international profit allocation between a principal company and its foreign sales affiliates needs to take place.

The international income allocation between the Swiss Principal and its foreign sales affiliates applies exclusively to profits derived from the marketing activities of the sales affiliates. Basically, 100% of a Swiss Principal's sales profit benefits from the foreign branch exemption. Any other income (for example, passive income) is in general entirely allocated to the Swiss Principal and thus fully taxable in Switzerland. According to the Circular, up to 50% of the sales profit of the Swiss Principal can be attributed to the functions performed by the foreign sales affiliates. Consequently, only 50% of such sales profits are to be allocated to the Swiss Principal and therefore subject to taxation in Switzerland.

In cases where the goods sold are manufactured under a contract manufacturing agreement, 30% of the sales income are considered to be related to the manufacturing process and are thus not eligible for the foreign branch allocation.

In a typical cost sharing structure, the Swiss Principal will likely generate substantial amounts of cash from the sales activities of its sales affiliates. Passive income realized by the Swiss Principal from the investment of any surplus cash (for example, interest income) is not part of the international income allocation and is thus based on the tax rules fully attributable to Switzerland. Such passive income will hence be subject to 8% to 12% income tax (privileged tax status).

The use of offshore subsidiaries (no Swiss CFC rules) or Swiss-Luxembourg financing structures may lower the tax burden on the passive income within a cost sharing structure.

Although the Circular also contains language concerning the cantonal/communal tax treatment of principal companies, the cantons are not bound by the rules stipulated therein. Most cantons recognize the factual branch exemption concept stipulated by the Circular. With regard to the international profit allocation, some cantons even exceed the federal rules on the allocation to the foreign sales affiliates and only attribute between 10% and 20% of the income to the Swiss Principal. The remaining 80% to 90% will be allocated to the foreign branches and will thus not be subject to cantonal/communal income taxes.

Table 1: Some American, European and Japanese companies that have relocated their regional or even global headquarters to Switzerland either traditionally many years ago or more recently in the past 3 to 4 years

Company	Country of origin	Established	Geographical importance
Traditionally relocated headquarters			
Kühne & Nagel	Germany	1954	Global
DuPont	US	1959	Europe, Middle East and Africa
Eurotax	Germany	1970	Europe
Hitachi Medical Systems	Japan	1980	Europe
General Motors	US	1986/2003	Regional
Hewlett-Packard	US	1993	Europe
Oracle	US	1996	Regional
Procter & Gamble	US	1999	Regional
3Com	US	2000	Europe
More recently relocated headquarters			
Phillip-Morris	US	2001	Global
Unisunstar	Japan	2002	Europe
Zimmer	US	2003	Europe & Asia
Polo Ralph Lauren	US	2003	Europe
eBay	US	2003	Global
Biogen Idec	US	2004	Europe
Honeywell Turbo Technology	US	2004	Europe
Clinical House	Germany	2005	Europe
Google	US	2005	Europe
Unilever	UK/Netherlands	2005	Europe
American Vanguard	US	2005	Regional
Hercules	US	2005	Global
Electronic Arts	US	2006	Global

Furthermore, most cantons will apply the international income allocation to the entire profit of the Swiss Principal including income related to the manufacturing process and income from passive investments.

The overall income tax burden of the Swiss Principal in a cost-sharing structure can thus generally be limited to around 6%

to 7%. If the investment in Switzerland is considerable, a federal and/or cantonal/communal tax exemption or an even lower Swiss allocation may further reduce the applicable income tax rate. If the goods are manufactured under a contract manufacturing agreement with the Principal, the tax rate on the income from sales will be around 7% to 8%.

Biography



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Thierry Sauvaire joined KPMG in 1989. Since 1995, he has been head of the Geneva tax and legal department and tax partner of the Geneva office since 1997.

He graduated from the University of Geneva, Switzerland with a degree in law and is an attorney-at-law as well as a Swiss certified tax expert.

Sauvaire provides tax consulting to various corporate groups mainly in the areas of corporate finance, the establishment of Swiss-based international headquarters operations, restructuring and M&A. He has been in charge of the restructuring of international clients in various fields. He led the restructuring of various groups owning many subsidiaries and also worked extensively on the implementation of a Principal structure in Geneva of a large multinational. He has substantial expertise in conducting tax and legal due diligence, especially in industry field.

Sauvaire has written and published on matters of tax policy, M&A, taxation of private investment and portfolio, taxation of new financial instruments.

Set-up of a Swiss principal headquarter – business focus as the prerequisite

Generally, a Swiss Principal can be set up avoiding major stamp duty and income tax consequences.

The implementation of a fully-fledged supply chain management strategy leads to a substantial change of business processes and responsibilities within the group and can include substantial exit tax issues in the countries from which tax bases are shifted to Switzerland.

Therefore, such strategies should only be implemented based on and following a

clear business focus. The very beneficial tax treatment of the Swiss Principal, however, should not be the main driver of the implementation of such a strategy. Experience shows that groups which are not capable of implementing the strategy properly have to face considerable negative tax consequences as foreign tax authorities are keen on participating in the taxation of the profit of the Principal based on a assumed permanent establishment of the Principal in their respective jurisdictions. This mainly happens in the case where the business reality of the group is not in line with the contractual agreements of the Principal.

VAT – a hurdle not to be underestimated

Another important aspect to address already at first sight on the evaluation of the restructuring of the supply chain towards a Principal is the value added tax (VAT) treatment throughout all involved parties. It is not only the multiplied VAT liability of the Principal but also the difficult treatment of a sales affiliate as commissionaire for VAT purposes. A correct VAT treatment of purchases, sales and physical deliveries along a supply chain build-up around a Principal, whether established in Switzerland or somewhere else in the world, asks for close attention and quite some changes to the systems involved.

An attractive location for headquarters in the future?

There are various reasons that make Switzerland an ever increasingly attractive location for international headquarters and thus many companies have established their global or regional management headquarter or even the principal of a restructured supply chain there. Whether Switzerland can remain such an attractive place depends on many developments. Besides the continuous enhancement of the political, economical and social environment how Switzerland will develop its taxation system on a communal and cantonal as well as on the federal level is important, as is how Switzerland will be positioned and is positioning itself within more and more global tax competition among jurisdictions and multinational organizations such as the EU.

Biography



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Andreas Mueller has been with KPMG since 1999.

He graduated from the University of Zurich, Switzerland with a degree in law, is an attorney-at-law and is a Swiss certified tax expert.

Mueller provides tax consulting to various corporate groups from different industries regarding international as well as Swiss corporate tax matters.

Between September 2004 and January 2006 he worked in New York as head of the KPMG Tax Desk of Excellence.



We congratulate Katherine Linke on her successful performance at the Savoy-Bar.

Katherine Linke, Zurich
Tax

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