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Tax Law

I. Fiscal Sovereignty and Constitutional Principles

1. Federalism and Fiscal Sovereignty

a) Distribution of Fiscal Sovereignty

As a consequence of Swiss federalism,[1] Switzerland's tax system incorporates three levels of taxation: taxes are imposed by the federation, the cantons and the municipalities.[2]

According to Article 3 of the Federal Constitution of the Swiss Confederation (Constitution),[3] the cantons retain law-making power except in areas where the Constitution expressly delegates this power to the federation. Therefore, the federation is only allowed to levy those taxes which the Constitution exclusively grants its competence over. These are the following:

- Federal direct tax (Article 128 Constitution)
- Value added tax (Article 130 Constitution)
- Stamp duty on securities, receipts for insurance premiums and certain other commercial deeds (Article 132 I Constitution)
- Withholding tax on income from moveable capital assets, lottery winnings and insurance benefits (Article 132 II Constitution)

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1 See for more explanations on Swiss federalism the Chapter on Constitutional Law, pp. 135.

2 See for the following and for more details on the whole chapter: Madeleine Simonek, Tax Coordination between Cantons in Switzerland - Role of the Courts, in Michael Lang/Pasquale Pistone/Josef Schuch/Claus Staringer (eds.), Horizontal tax coordination, Amsterdam 2012 (cit. Simonek, Tax Coordination), pp. 221.

3 Federal Constitution of the Swiss Confederation of 18 April 1999, SR 101; see for an English version of the Constitution www.admin.ch (https://perma.cc/M8UJ-S369).

- Taxes on commodities such as beer, tobacco and mineral oil etc. (Article 131 Constitution), customs duties (Article 133 Constitution), and traffic taxes (Articles 85 and 86 II Constitution)
- Taxes on gambling houses (Article 106 III Constitution)

Conversely, the cantons are essentially free to levy any taxes, except those which are exclusively reserved to the federation.[4] The cantonal constitutions further delegate and organise the division of tasks and powers between each canton and its communes. Although the cantons have original taxing powers and are even permitted to create new taxes, they do not have unfettered discretion over the design of their tax system. They are limited by the Tax Harmonisation Act[5] which obliges them to levy certain types of taxes. Further, they are generally restricted by the fact that the Constitution and all federal laws take precedence over any conflicting cantonal and municipal law.

b) Federal Tax Harmonisation Act

For a long time, fiscal federalism resulted in the existence of 26 (often very) different cantonal tax laws. This situation hindered personal and economic mobility within Switzerland.[6] Taxpayers who were liable to be taxed in two or more cantons were subjected to different assessment principles and procedures in each canton, for example, in the case that a taxpayer lived in one canton and owned real estate property in another canton. Furthermore, an exit tax could be imposed if an individual or a legal entity relocated from one canton to another canton.

In order to remove these obstacles, on 12 June 1977, the Swiss people accepted a new federal competence in a referendum to harmonise cantonal and federal direct tax law. Subsequently, the Tax Harmonisation Act entered into force on 1 January 1993, and after a transition period of 8 years has actually applied from 1 January 2001.

4 According to Article 134 Constitution, value added tax, stamp duty, withholding tax as well as special consumption taxes are exclusively reserved to the federation. In contrast, income taxes are levied on the federal and cantonal levels and depending on the cantonal order on the communal level as well.

5 Federal Act on the Harmonisation of Direct Taxes at Cantonal and Communal Levels of 14 December 1990, SR 642.14.

6 See for the following and for more details on the whole chapter: Simonek, Tax Coordinations, pp. 236.

The Tax Harmonisation Act significantly improved tax coordination in Switzerland, introducing tax harmonisation with regard to direct taxes between the federation and the cantons (vertical tax harmonisation) as well as between the cantons themselves (horizontal tax harmonisation). It is a legal framework that contains rules on the tax subject, the tax object, the tax base, the tax period and the tax procedure. Some of these rules go into minute details, whilst others leave a certain scope of action and some room for interpretation to the cantons. The Tax Harmonisation Act, however, does not harmonise tax rates and tax allowances. In this regard the cantons remain fully sovereign. Hence, tax competition between the cantons and also between the communes is not hindered by the Tax Harmonisation Act.[7]

2. Main (Constitutional) Principles

a) Principle of Legality

The principle of legality (Article 5 Constitution) is of fundamental importance in Swiss tax law. Article 127 I Constitution ensures its application to tax matters and states that "*the main structural features of any tax, in particular those liable to pay tax, the object of the tax and its assessment, are regulated by the law*".

Swiss courts as well as academic literature demand strict adherence to the principle of legality. The principle requires that tax laws are be put to an optional referendum. Furthermore, the law must be appropriately detailed in order to comply with the constitutional requirement of legality.

b) Principle of Universality

The principle of universality is enshrined in Article 127 II Constitution. It demands that each member of a community should contribute to the community's financial burdens and denotes that all taxpayers or groups of taxpayers should be subject to the same taxes and taxation rules. However, although the principle of universality aims to prevent the application of any privileges or discrimination, Swiss tax law does contain certain privileges which are considered justified due to their fulfilment of other constitutional principles and

7 See p. 260.

goals. In particular, certain tax incentives granted to foreign wealthy taxpayers, such as the lump-sum taxation, [8] or to foreign companies are considered justified by the goal to foster the Swiss economy.

c) Principle of Uniformity and Ability-To-Pay Principle

The principle of uniformity and the ability-to-pay principle share similar content, requiring that each taxpayer must contribute to the fiscal burdens of the state according to his or her economic, financial and personal resources (Article 127 II Constitution).

The Constitution demands both horizontal and vertical equality of treatment of individuals. Horizontal equality requires that taxpayers living in the same economic and personal circumstances and deriving the same amount of taxable income should be subjected to equal taxation. Vertical equality, on the other hand, requires that taxpayers living in different economic and personal situations and/or deriving a different amount of taxable income should be subjected to different levels of taxation. Vertical equality particularly refers to the design of the tax scale and to the question on whether progressive, proportional or degressive tax rates should be chosen.[9]

d) Prohibition of Inter-Cantonal Double Taxation

Since 1874, the Constitution explicitly prohibits inter-cantonal double taxation. Today, the prohibition is enshrined in Article 127 III Constitution. Inter-cantonal double taxation arises if a taxpayer is simultaneously subjected to the same or similar taxes on the same tax object by two cantons, for example, if the taxpayer is considered to be a tax resident of two cantons. No law on the prevention of inter-cantonal double taxation has ever been enacted. Instead, the Federal Supreme Court developed a dense network of rules covering the allocation of taxing rights between the cantons. Some of these rules have in the meantime been enacted by the Tax Harmonisation Act, but still most of the inter-cantonal allocation rules is based on case law.

The basic rules are the following: any income from real estate, permanent establishments and fixed places of businesses may only be taxed by the canton wherein the property is situated. The same rules apply for the taxation of

8 See pp. 254.

9 See p. 266 for a leading court decision with regard to degressive income tax rates.

net wealth. All other income or net wealth, including income from employment or income from moveable property, may only be taxed by the canton where the taxpayer has his or her main tax residence (usually the taxpayer's centre of living).

The constitutional prohibition on inter-cantonal double taxation also embodies a kind of non-discrimination rule: A taxable person who is only liable to have part of his or her income taxed in a certain canton may not be treated less favourably than a taxpayer whose whole income is taxable in that canton.

e) Principle of Good Faith

The Constitution expressly requires that "*state institutions and private persons shall act in good faith*" (Article 5 III Constitution). Additionally, Article 9 Constitution states that "*every person has the right to be treated by state authorities in good faith and in a non-arbitrary manner*". Whereas Article 5 III Constitution demands honest and trustworthy behaviour from every person, Article 9 Constitution explicitly focuses on the relationship between the individual and the state. Every person has a legally enforceable right to be treated in accordance with the principle of good faith by legislative bodies as well as by those who apply the law.[10]

In tax law, the principle of good faith is of high relevance. In particular, it is considered to be the legal basis for the prohibition of an abuse of rights and the Swiss doctrine of preventing tax avoidance. According to the constant jurisprudence of the Federal Supreme Court, the criteria for defining tax avoidance are the following:

- the transaction structure or legal set-up chosen by the taxpayer is inappropriate or unusual, and completely inappropriate to the economic facts; and
- the taxpayer's primary goal for utilising the chosen legal form was to achieve substantial tax savings; and
- the taxpayer will in fact achieve substantial tax savings if the legal form chosen is accepted by the tax administration.

10 See for the following and for more details Madeleine Simonek, The principle of good faith in Swiss domestic and international tax law, in Cécile Brokelind (ed.), Principles of Law: Function, status and impact in EU tax law, Amsterdam 2014, pp. 319.

If the criteria for tax avoidance are met, the real facts are disregarded and replaced by those facts that would have been considered as the usual and appropriate approach. For example, if the taxpayer tries to convert taxable dividend income into tax-free capital gain by using a completely inappropriate transaction structure, no tax free capital gain, but taxable dividend income will be recognised.

In practice, moreover, the principle of protecting a legitimate expectation that is also based on the principle of good faith is important in the context of the Swiss tax ruling practice.[11]

11 See for more details on the Swiss tax ruling practice pp. 267.

II. Most Important Taxes and Tax Codes

1. Federal Taxes

a) Federal Direct Taxes

aa) Introduction

The first federal direct tax was introduced during World War I to meet the increasing financial needs of the federation. In the following, the federation's right to levy a direct federal tax was prolonged ever since, today the competence is enacted in Article 128 Constitution.[12] The authorisation is still limited in time, relying on repeated extensions by popular vote (currently the federation has been granted the competence until 2035; Article 196 No. 13 Constitution).[13] As a consequence, the federation is forced to reconsider its financial regime on a regular basis, particularly since the federal direct tax makes up approximately one third of the federal revenue.

Based on Article 128 Constitution, the federation enacted the Federal Direct Tax Act[14] which regulates the federal individual and corporate income tax and provides for the imposition of a source tax on the income of certain individuals and legal entities.

12 Madeleine Simonek, Kommentierung zu Artikel 128 BV in Bernhard Waldmann/Eva Maria Belser/Astrid Epiney (eds.), Basler Kommentar Bundesverfassung, Basel 2015, N 1 et seq., also for additional information on the history of the federal income tax.

13 In a popular vote of 4 March 2018, the federation's competence was prolonged for another term of 16 years.

14 Federal Act on the Federal Direct Tax of 14 December 1990, SR 642.11.

bb) Federal Individual Income Tax

The federal individual income tax is levied from Swiss tax residents as well as from non-residents who have economic attachment to Switzerland. Income taxes are generally considered as the most appropriate indicator for the ability to pay taxes.

Tax residency is deemed to exist if an individual intends to live permanently in Switzerland, stays in Switzerland for at least 30 days during which he is engaged in a gainful activity, or stays in Switzerland for at least 90 days without partaking in any gainful activity (Article 3 Federal Direct Tax Act). Swiss tax residents are subject to unlimited tax liability on their world-wide income, with exceptions for enterprises, permanent establishments and immoveable properties which are situated abroad. Income derived from one of these sources is unilaterally exempt from taxation in Switzerland (Article 6 I Federal Direct Tax Act).

Non-residents with an economic relationship with Switzerland are subject to a limited tax liability. Limited tax liability means that taxation is restricted to income that is derived from Swiss sources such as income from real estate, permanent establishments situated in Switzerland, or from gainful activity carried on in Switzerland (Article 6 II Federal Direct Tax Act).

The individual income tax is levied on the taxpayer's overall income. This includes income derived from employment and businesses as well as income from immoveable (e.g. rental income) and moveable property (e.g. interest, dividends, royalties, lottery winnings etc.), pension schemes and any other income that is realised on a single or regular occasion. Exempt from individual income tax are capital gains realised on privately held moveable and immoveable assets such as securities, works of art, or real estate (Article 16 III Federal Direct Tax Act). In contrast, capital gains realised on business assets, for example on assets belonging to an individual business, are fully taxable. The distinction between private assets and business assets is hence a rather weighty one, and in practice often a cause for dispute between the taxpayer and the tax authorities, particularly in cases in which a taxpayer incidentally acts as a professional trader, for example of securities or real estate, without having registered a business.

Families are considered to form an economic unit for income tax purposes. The income of spouses living in an intact marriage, meaning not legally or effectively separated, or of registered partnership are jointly assessed (Article 9 Federal Direct Tax Act).

There are various deductions which may be made from the taxable income (Articles 33, 33a and 35 Federal Direct Tax Act). For example, professional expenses are deductible from the gross income if they were closely enough linked to or caused by the earning of the income, e.g. expenses for (public) transportation, even though capped at a certain amount[15], expenses for any special clothing required for work, meals taken outside of the home, costs for professional development, etc. General deductions are also available for private debt interest, alimony or child support payments, donations to tax-exempt charities, contributions to social security institutions and pension plans, self-owned real estate maintenance costs, and medical expenses if not reimbursed. This list is non-exhaustive. Further, lump-sum allowances are granted for each dependent child, for married couple and for individuals who are providing financial support to a person in need.

The overall taxable income is taxed as a whole at the applicable tax rate. There are no baskets or schedules with different tax rates for certain kinds of income. Two different tariffs apply: on the one hand for single persons and on the other hand for married couples and/or families and single persons living together with minor children or with persons requiring support (Article 36 Federal Direct Tax Act). The tax rate for the federal income tax currently starts at a taxable income of CHF 17'800 per tax year for those who are single and CHF 30'800 per tax year for married couples. Income which falls below this level is not taxed. The tax scale is progressive. For example: the tax rate for a single person with a taxable income of CHF 100'000 amounts to 2.87 % and with a taxable income of CHF 200'000 to 6.78 %. A married couple with the same taxable income would pay federal income tax at a rate of 1.97 % or 6.28 % respectively. The maximum tax rate is 11.5 %: it applies to a taxable income of over CHF 755'200 (for singles) and CHF 895'000 (for married couples).[16]

Swiss residents with foreign citizenship who are not engaged in any gainful activity in Switzerland may request that they are not taxed according to the ordinary assessment principles, but instead on a lump-sum basis (Article 14 Federal Direct Tax Act). The income tax in these circumstances is not based on the effective world-wide income, but – with some exceptions – on the annual living costs of the taxpayer and his or her family (Article 14 III Federal

15 Costs for private transportation are only deductible if no public transportation is available.

16 Tax rates for the tax year 2017.

Direct Tax Act). The justification of the very favourable lump-sum taxation is disputed, but is mainly seen in the goal to attract very wealthy people to Switzerland. On the cantonal level, in recent years, some cantons have removed lump-sum taxation in order to better ensure equality (e.g. Zurich and Basel Stadt).

Tax assessment is generally based on a personal tax return filed by each individual taxpayer. Switzerland's system does not provide for a general salary tax (commonly referred to as a "pay as you earn" system). However, a source tax is levied in some circumstances (see below). The due date for filing the tax return is usually 31 March of the calendar year following the tax year. The assessment procedure for assessing the federal income tax is delegated to the cantons: they assess the federal income tax together with the cantonal income and net wealth taxes.

cc) Federal Corporate Income Tax

Legal entities that have their statutory seat or their place of effective management in Switzerland are subject to the federal corporate income tax , so called net-profit tax (Article 50 Federal Direct Tax Act). A corporation is considered to have its statutory seat in Switzerland if it is registered with the Swiss Register of Commerce. For determining the effective place of management, the decisive criterion is where the activities which serve to achieve the company's business purpose are taken in their entirety. Thereby, the day-to-day business decisions taken by the company as opposed to strategic or pure administrative decisions are the most important consideration in this regard.

Swiss income tax law generally follows the so-called separation principle: legal entities and their shareholders are taxed separately. For that reason, Swiss income tax law does not provide for group taxation. However, a so-called participation exemption is available to avoid triple or multiple taxations within a group (Article 69 Federal Direct Tax Act). Partnerships are principally treated as transparent and the net profit of the partnership is attributed to each partner according to the partnership agreement (Article 10 Federal Direct Tax Act).

Similar to the situation with the federal individual income tax, taxpayers with a personal attachment to Switzerland (i.e. statutory seat or effective place of management) are unlimitedly liable to pay tax on their world-wide income, except for income arising from permanent establishments, enterprises or real estate located abroad (Article 52 I Federal Direct Tax Act). Non-resident legal entities with an economic attachment to Switzerland are subject to a limited tax liability. This mainly includes income derived from permanent

establishments, business enterprises or real estate located in Switzerland (Article 52 II Federal Direct Tax Act).

The federal corporate income tax is levied at a flat rate of 8.5 %. However, because paid taxes are deductible, the effective tax rate is actually lower and may range from approximately 7 to 7.8 %, depending on the deductible amount of federal, cantonal and communal taxes. A reduced tax rate of 4.25 % applies for associations, foundations and other legal entities.

The required filing date for the tax return depends on the balance sheet and reporting date of the legal entity. The tax return generally has to be filed 6 to 8 months after the reporting date.

dd) Source Tax Levied on Income of Certain Individuals and Legal Entities

Because the ordinary tax assessment procedure is considered too complicated for taxpayers who are only living in Switzerland for a short period of time, Swiss tax residents with foreign citizenship and who do not have a Swiss residence permit are taxed at source for their employment income provided that their taxable salary does not exceed an amount of CHF 120'000 per year (Articles 83–90 Federal Direct Tax Act). This means that the employer of such an individual is obliged to deduct the source tax directly from the salary and to forward it on to the tax administration. The source tax is principally a final tax replacing the ordinary income tax.

Source taxation also applies to certain non-residents who have an economic attachment to Switzerland and derive income from Swiss sources, such as cross-border commuters, artists and sportspersons, or board members and company directors (Articles 91–101 Federal Direct Tax Act).

b) Withholding (Anticipatory) Tax

The law covering the federal withholding tax is the Federal Act and Ordinance on Withholding Tax.[17] Withholding tax is levied on the revenue from certain moveable capital assets (particularly dividends and interest on bonds and bank accounts), on Swiss lottery winnings (including commercial bets) and on certain insurance benefits (Article 1 Federal Withholding Tax Act).

17 Federal Act on Withholding Tax of 13 October 1965, SR 642.21; Ordinance on Withholding Tax of 19 December 1966, SR 642.211.

The tax is withheld at source by the Swiss debtor of the revenue (e.g. a Swiss bank paying out interest on bank accounts or a Swiss company distributing dividends) and then forwarded on to the Federal Tax Administration.

The tax rate for the withholding tax varies depending on the category of item at hand. It amounts to 35 % for moveable capital revenue and lottery winnings, 15 % for life rents and 8 % for other insurance benefits.

The purpose of the withholding (anticipatory) tax is to secure correct income tax declaration and to avoid tax evasion and tax fraud. For that reason, Swiss resident beneficiaries can request a full reimbursement of the tax provided that they fully comply with their income tax reporting obligations in due time.

In contrast, for non-resident beneficiaries the withholding tax is principally a final tax. Non-resident beneficiaries may only ask for a full or partial refund of the withholding tax if they are entitled to the benefits of the respective double taxation treaty concluded between Switzerland and their country of tax residence.

c) Federal Value Added Tax

The Federal Value Added Tax (VAT) was introduced in Switzerland on 1 January 1995. The current Value Added Tax Act entered into force on 1 January 2010.[18]

The Swiss VAT is a general consumption tax aiming at the taxation of non-business related domestic consumption of goods and services. Therefore, VAT is levied on supplies of goods and services by a taxable person within Switzerland as well as on the import of goods and the acquisition of certain services from abroad. Because only consumption within Switzerland should be taxed, an exemption applies for the export of goods as well as the providing of certain services to recipients abroad.

VAT is typically levied at all stages of the value chain. Since only final consumption should be taxed, registered businesses are allowed to deduct paid VAT as input VAT (net all-phase principle). This system avoids an accumulation of tax within the value chain. Because the tax must be shifted to the consumer, the business itself should – systematically – not bear any final tax costs.

18 Federal Act on Value Added Tax of 12 June 2009 (Value Added Tax Act, VAT Act), SR 641.20; see for an English version of the Value Added Tax Act www.admin.ch (https://perma.cc/6P3Q-AXMW).

With regard to VAT, a taxable person is anyone who carries on a business activity in Switzerland. Exemptions exist for businesses that generate a turnover of less than CHF 100'000 per year or resp. CHF 150'000 per year in case of non-profit and charitable institutions (Article 10 Value Added Tax Act). Upon registration with the Federal Tax Administration, the taxable person must self-declare and self-assess the VAT amount due generally on a quarterly or semi-annual basis.

From 1 January 2018, the VAT rates amount to 7.7 % for all supplies not subject to a special VAT rate, 3.7 % for accommodation services and 2.5 % for certain goods and services typically used in daily life, for example, items like food, water, drugs and newspapers (Article 25 Value Added Tax Act). The maximum VAT rates are set out by the Constitution (Article 130 I Constitution). Any increase or decrease of the VAT rates thus requires the approval of the majority of the Swiss people and the cantons in a referendum. Past experience of referenda in this area demonstrates that the Swiss people tend to agree to a VAT increase if this is linked to special expenditures, for example the development of railway infrastructure (Article 130 III^{bis} Constitution) or the devoting of increased finance to the social security system.

d) Other Taxes

According to the Federal Act on Stamp Duties,[19] the federation levies three types of stamp duties purposing to tax the constitution or transfer of rights: an issuance stamp duty on the issuance of shares as well as participation and dividend certificates in companies and cooperatives, a transfer stamp duty on the transfer of securities and a stamp duty on insurance premiums.

Pursuant to Article 131 Constitution, the federation is also permitted to levy further consumption taxes, for example a tobacco tax, a beer and a spirits tax, a mineral oil tax on crude oil, other mineral oils, natural gas, the products obtained from the processing thereof and motor fuel, a mineral oil surtax on motor fuel, and an automobile tax on the value of imported or domestically manufactured automobiles. Moreover, the federation levies a CO^2 tax and a federal casino tax.

19 Federal Act on Stamp Duties of 27 June 1973, SR 641.10.

2. Cantonal and Communal Taxes

a) Taxes on Income and Net Wealth

aa) Individual Income Tax

The cantons are obliged to levy an individual income tax based on the principles and framework outlined by the Tax Harmonisation Act (Articles 3 et seq. Tax Harmonisation Act). Because the Tax Harmonisation Act harmonises not only the tax laws of the 26 cantons (horizontal harmonisation), but also the federal direct tax law and the cantonal tax laws (vertical harmonisation), the cantonal tax laws largely follow the system of the federal direct tax law and contain very similar, sometimes even identical provisions.

There has been however no harmonisation in the area of tax allowances and tax rates. As such, the income tax rates vary considerably between the cantons and also between the communes of a canton. Traditionally, the municipalities with the lowest income tax rates are located in the Canton of Schwyz and Zug. The more expensive regions are traditionally found in the French part of Switzerland. For example, a single person with a taxable income of CHF 100'000 per year pays cantonal and communal income taxes at a total rate of 8.1 %[20] if he or she lives in Wollerau (Canton Schwyz) and at a total rate of 23.5 %[21] if he or she lives in Les Verrieres (Canton Neuchâtel). If such a person lived in the City of Zurich the income tax burden (cantonal and communal levels) would amount to 13.8 %.[22]

Up to this day, political efforts to restrict the cantons' sovereignty to autonomously determine their income tax rates have been consistently unsuccessful. The positive effects of tax competition have so far been weighted higher than equality concerns, in particular since tax competition is considered to foster the spending discipline of the cantons (and communes) and to uphold their right of fiscal self-determination. A fiscal equalisation system on both the cantonal and the federal level aims to balance out to a certain extent the different burdens, financial strengths and financial needs of the 26 cantons (and communes), but has not the purpose to prevent tax competition.

20 Including the federal income tax the total rate amounts to 11.0 %.

21 Including the federal income tax the total rate amounts to 26.4 %.

22 These calculations include the usual deductions and tax allowances that may however vary from canton to canton, and represent the average tax rates for the tax year 2017.

bb) Net Wealth Tax for Individuals

Based on Article 2 Tax Harmonisation Act, the cantons are obliged to levy a tax on the net wealth of individuals. In general, individuals' worldwide net wealth is subject to the tax, including for example bank deposits, securities, cars and real estate, but not household goods and personal effects (Article 13 Tax Harmonisation Act).

Assets are usually assessed at fair market value at the end of the tax year (Article 14 and Article 17 Tax Harmonisation Act). All debts are deductible. Further, different personal deductions are available. Some cantons further provide for tax-free minimums in terms of net wealth (e.g. Canton of Obwalden CHF 25'000, Canton of Zug CHF 100'000).[23]

Most of the cantons provide for a system of progressive tax rates. The maximum cantonal and communal net wealth tax rates range from between approximately 0.1 % in the Canton of Nidwalden to 1 % in the Canton of Geneva.[24]

b) Taxes on Net Profit and Capital of Legal Entities

aa) Net-Profit Tax of Legal Entities

The cantons are also obliged to levy a tax on the net-profit of legal entities. Due to horizontal harmonisation, the relevant provisions with regard to the tax subject, the tax object, the tax period, the tax procedure, and the tax penal law are again very similar or even identical to the federal net-profit tax.

As already mentioned, the tax rates are however not harmonised and for that reason the cantonal and communal corporate income tax rates differ quite significantly. Today, for corporations, the effective cantonal and communal tax rates including the federal direct tax rate range from approximately 12 % in the Canton of Lucerne to 24 % in the Canton of Geneva (for the tax year 2017).[25]

As a consequence of the ongoing so-called tax proposal 17 that aims at abolishing several cantonal preferential tax regimes which the international community considers harmful, many cantons intend to considerably reduce their corporate income tax rate. In future, in order to remain internationally attractive, most of the cantons aim at reaching an income tax rate for

23 For a single person without children for the year 2017.

24 Maximum tax rate for a single person without children for the tax year 2017.

25 "Effective tax rate" means the applicable tax rate before deduction of the taxes.

corporations of 13 to 15 % (total of effective federal, cantonal and communal tax rates).

bb) Capital Tax

The cantons are also obliged to levy a capital tax on a legal entities' equity. For corporations, the taxable equity includes the paid-in share capital, any capital contributions made by the shareholders, and both disclosed and taxed hidden reserves. In almost all cantons the tax rate is proportional and ranges from approximately 0.001 % in the Canton of Uri to 0.5 % in the Canton of Basel Stadt.

c) Further Cantonal Taxes

aa) Inheritance and Gift Taxes

Inheritance and gifts are not subject to the income tax, neither on the federal nor the cantonal level. However, almost all cantons levy a special inheritance and/or gift tax.[26] Inheritance and gift taxes are not subject to the Tax Harmonisation Act and are therefore not harmonised.

The inheritance tax is levied on the transfer of assets to heirs and legatees (statutory and designated), and the gift tax comprises gifts inter vivos. The surviving spouse is exempted from inheritance and gift taxes in all cantons, and most cantons also fully exempt all children and grand-children. The tax is generally calculated on the market value of the assets at the time of the decedent's death or the gift minus any transferred debts. Other relevant factors in calculating the tax rate are the total amount of the assets transferred and the relationship between the heir and the deceased (degree of relationship) or the donor and the done respectively.

bb) Real Estate Capital Gains Tax

As outlined above, capital gains realised on moveable and immoveable private assets are tax-free on the federal level. Capital gains realised on moveable assets are also tax-free on the cantonal level.

The cantons are however obliged to levy a real estate capital gains tax on privately held immoveable property. This tax qualifies as a special kind

26 The Canton of Schwyz and the Canton of Obwalden levy neither an inheritance nor a gift tax; the Canton of Luzern does not levy a gift tax.

of income tax. Even though the real estate capital gains tax belongs to the harmonised taxes (Article 2 Tax Harmonisation Act), there is much less harmonisation here as compared to the individual and corporate income taxes. However, the Tax Harmonisation Act demands that short-term real estate capital gains are subject to a higher tax burden in order to combat property speculation (Article 12 V Tax Harmonisation Act).

cc) Other Property and Expenditure Taxes

Due to the fiscal sovereignty of the cantons, the cantons or their communes provide for various further taxes. Most cantons levy a real estate transfer tax on the transfer of ownership of immoveable property (house and land) including any associated rights located in Switzerland. Some cantons levy a special real estate property tax that is assessed on an annual basis and calculated on the tax value of the property at the end of the tax period.

All cantons levy a motor vehicle tax on all motor vehicles and trailers located in Switzerland. Such motor vehicles must be duly registered in the respective canton in order to receive the registration papers and a number plate.

Further cantonal or communal taxes include dog taxes, entertainment taxes levied on the ticket price of public events, lottery taxes, stamp duties and register duties as far as not covered by the federal stamp duties, city taxes or visitor's taxes for overnight stays, tourism promotion taxes, fire brigade exemption taxes, water taxes, etc.

3. International Tax Agreements

a) Multilateral Conventions

One key multilateral convention recently ratified by Switzerland is the Convention on Mutual Administrative Assistance in Tax Matters entered into force on 1 January 2017. Drafted by the OECD and the Council of Europe, the convention is today the most comprehensive multilateral instrument applicable to all forms of tax co-operation in order to tackle tax evasion and avoidance.

Subsequently, Switzerland also ratified the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information. This agreement provides a standardised mechanism to facilitate the automatic exchange of financial account information between tax

authorities. It has been in force in Switzerland since 1 January 2017 with the consequence that the Swiss banking secrecy does no longer apply to holders of Swiss bank accounts living abroad.

Switzerland also actively participated in the OECD's working groups of the Base Erosion and Profit Shifting ("BEPS") project. The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS was signed by Switzerland on 7 June 2017 and shall be ratified in the course of 2018. This instrument should allow countries to easily implement the minimum standard outlined in the BEPS final reports.

b) Double Taxation Treaties

Switzerland has signed a total of approximately 95 double taxation treaties covering individual and corporate income taxes as well as withholding taxes. Some of them also include net wealth and capital taxes. Swiss double taxation treaties principally follow the OECD model convention with just a few Swiss-specific deviations. Unlike the situation regarding income taxes, currently, Switzerland has only concluded 8 double taxation agreements covering inheritance taxes.

c) Bilateral Agreements with the European Union

Switzerland is not a member state of the European Union. Nevertheless, a close relationship exists between the two parties on political, economic and cultural levels. Over the years, countless bilateral agreements have been concluded to govern these relations. From a tax perspective the most important agreements are the Agreement on Free Movement of Persons that prohibits amongst others discrimination of EU nationals in Switzerland and vice versa,[27] and the Agreement on Automatic Exchange of Information in Tax Matters that replaced the former Agreement on the Taxation of Savings Income as of 1 January 2017.

27 See for a landmark case on the application of the Agreement on Free Movement of Persons p. 268.

III. Landmark Cases

1. Principle of Equality: Taxation of Married and Non-Married Couples

In 1982, Mr. and Mrs. Hegetschweiler filed a complaint to the Swiss Federal Supreme Court, alleging that their canton of residence (Zurich) applied an income tax rate scheme that resulted in a non-justified higher or at least different tax burden for married couples as compared to unmarried taxpayers.

The Federal Supreme Court upheld the complaint, deciding that there had been an infringement of the Constitution.[28] According to the court, the principle of equality requires that a married couple must not be taxed at a higher rate than an unmarried couple living in the same circumstances and deriving the same taxable income.

As already mentioned, Swiss income tax law applies family taxation. The joint assessment in connection with the progressive income tax rates may often lead to a so-called "progression effect", meaning that the spouses pay higher taxes just because of their joint taxation.

As a consequence of the decision in the Hegetschweiler case, all the cantons had to amend their laws. The cantons introduced different measures to ensure equal treatment such as splitting spouses' income to define the applicable tax rate, making special deductions for dual-income households, having various applicable tax rate schemes etc. Today, unequal treatment of married and unmarried couples is largely abolished on the cantonal and communal level. On the federal level, however, unequal taxation is not fully abolished. In particular, married couples with a high taxable income are still affected by the progression effect.

28 BGE 110 Ia 7.

2. Ability-To-Pay Principle: Degressive Income Tax Rates

In 2007, the Federal Supreme Court had to decide on the constitutionality of degressive income tax rates.[29]

The people of the Canton of Obwalden approved, in a popular vote, a new income tax scale that included degressive tax rates. The tax scale combined progressive tax rates applicable to a taxable income of up to CHF 299'999 with degressive tax rates starting at a taxable income of CHF 300'000. The income tax scale was hence as follows:

Taxable Income	Tax (in CHF)	Tax Rate
50'000	5'784	11.57 %
100'000	3'834	13.83 %
300'000	46'311	15.43 %
500'000	65'824	13.16 %
1'000'000	117'650	11.77 %

Figure 1: Tax Income Scale

A majority of 86 % of the people of the Canton of Obwalden voted in favour of this new income tax scale, most likely being convinced by the government's argument that low income tax rates for higher taxable income could attract very wealthy new taxpayers to the canton.

However, some taxpayers in the Canton of Obwalden argued before the Federal Supreme Court that such a partially degressive tax scale infringes the ability-to-pay principle as well as the principle of uniformity. The Federal Supreme Court upheld this complaint. They particularly considered that the conversion from a progressive to a degressive tax scale at a taxable income of CHF 300'000 is arbitrary and cannot be reasonably justified. As a consequence, the new law did not enter into force. This judgement clarified that, in Switzerland, income tax rates must be progressive or at least proportional.

29 BGE 133 I 206.

3. Principle of Good Faith: Swiss Ruling Practice

A Swiss company belonging to a Swiss group set up a permanent establishment in the Cayman Island. The permanent establishment's purpose was carrying on financing functions for the whole group. In 1999, the cantonal tax administration approved the chosen structure in an advance tax ruling and confirmed that the income allocated to the Cayman permanent establishment will be exempted from Swiss income tax. A few years later, the Federal Tax Administration took the view that the Cayman permanent establishment did not have enough substance and that therefore the income previously attributed to the Cayman permanent establishment will be attributed to the Swiss company. The cantonal tax administration informed the Swiss company about this position in February 2005. The dispute was brought before the Federal Supreme Court.

Advance tax rulings are of high practical importance in Swiss tax practice. Taxpayers have the possibility of asking the competent tax authority to assess the tax implications of a proposed structure or transaction before implementing the structure or carrying on the transaction. Such assessments have a binding nature, based on Article 9 Constitution and the principles of good faith and the prohibition of the abuse of rights.

The Federal Supreme Court confirmed in the mentioned decision the basic requirements for a tax ruling to have binding effect:

- the planned transaction and the accompanying facts must be described in detail and must be correct (including the name of the taxpayer);
- the ruling must be approved by the competent authority;
- the information provided by the tax administration must not be obviously incorrect;
- the taxpayer, based on the information provided in the ruling, has taken steps that cannot be easily undone;
- the law has not changed; and
- the public interest does not require a strict application of the law where this is contrary to the content of the tax ruling.

In the case at hand, the Federal Supreme Court established that the Swiss company's trust in the tax ruling should be protected for as long as its trust

in the tax ruling was not destroyed.[30] However, from the moment the Swiss company received the letter from the cantonal authorities informing them of the opinion of the Federal Tax Administration, the Swiss company could no longer rely on the ruling and the protection of his good faith.

4. Principle of Non-Discrimination: Salary Withholding Tax

X, a Swiss national living in France, commuted every day to Geneva for work. According to the double taxation treaty concluded between Switzerland and France, Switzerland was allowed to tax X's income from employment.

Since X was a Swiss non-resident, his employment income was taxed at source. Under the Swiss source tax system, the source tax that was deducted from X's salary by his employer did not allow for the deduction of individual expenses, such as commuting costs, contributions to pension funds, and personal tax allowances. Instead, only flat-rate deductions were included in the source tax scale. X complained that such taxation infringes the principle of equality and the Agreement on the Free Movement of Persons concluded between Switzerland and the European Union.[31]

The Federal Supreme Court upheld X's complaint. The court referred to the Schumacker doctrine of the European Court of Justice (C-279/93), deciding that the principles developed by the European Court of Justice in that decision are also applicable to the Swiss source tax. In the case at hand, X earned more than 95 % of his taxable income in Switzerland. According to the Schumacker doctrine, Switzerland thus had to take into account his personal situation and was not allowed to tax X less favourably than a Swiss tax resident.

Due to this decision, the law on the source taxation of employment income was amended. The new law does not fundamentally change source taxation as such, but gives taxpayers who are taxed at source the possibility to request, under certain conditions, an ordinary tax assessment. The new law will most likely enter into force on 1 January 2021.

30 BGE 141 I 161.
31 BGE 136 II 241.

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