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In an Emergency…Fax Form 911

In our prior articles on the IRS, we covered standard notices, the audit process, and the various avenues to resolution including going to Appeals and Tax Court.

However, what does a taxpayer do when they have a compelling argument but navigating the normal channels at IRS has proven impossible? It is usually at this point that a taxpayer should consider involving the Taxpayer Advocate's Office.

In 1979, the Internal Revenue Service created The "Taxpayer Ombudsman." The Ombudsman was considered to be the primary advocate within the IRS, for taxpayers. However, because the Ombudsman answered to IRS Commissioner, Congress felt that it could not be impartial. Therefore, in 1996, Congress replaced the Ombudsman with "The Office of the Taxpayer Advocate" (TAO).

The TAO reports directly to Congress. Therefore, although housed within IRS, it is an independent organization. The TAO has two primary functions:

1. To assist taxpayers who are having problems dealing with IRS; and
2. To use these experiences to propose changes to IRS to help alleviate similar problems in the future.

Sometimes, IRS cannot resolve a dispute because the issue at hand is novel or highly contentious. IRS also may not have a procedure to deal with the issue and the taxpayer could get "lost in the bureaucracy" being transferred from one department to another while still receiving collection notices in the mail. Alternatively, IRS may not be able to take into account extenuating circumstances and force upon the taxpayer an unfavorable resolution. TAO was established to deal with these types of issues.

The TAO is highly effective when dealing with taxpayer's cases but they will only take on cases that meet certain criteria. They encourage taxpayers to utilize their services if after doing a thorough job working with IRS, an issue is still unresolved and meets the following criteria:

1. The problem is causing financial difficulties for the taxpayer, their family or business;
2. The taxpayer is faced with an immediate threat of adverse action; and
3. The taxpayer has tried repeatedly to settle an issue. However, IRS is either non-responsive, an unusual amount of time has passed without a resolution or IRS made an error that cannot be corrected without the TAO's intervention.

The TAO expects that a taxpayer who has received a notice in the mail or is under audit, will respond in accordance to IRS' established procedures. This usually requires that the taxpayer respond to IRS timely and provide all requested information. A request for assistance from the TAO before doing so will most likely be denied.

If after complying with the various IRS requests, IRS responds adversely and begins to issue notices demanding payment, it may be advisable for the taxpayer to utilize the IRS appeals system rather than requesting assistance from the TAO. (For more information on the appeals process, please see our previous article entitled "Help! The IRS is Auditing Me!") However, the Appeals process may not be the appropriate venue for the issue at hand (i.e., an uncontested refund is significantly delayed or an erroneous lien is placed on the taxpayer's assets). If the issue remains unresolved, IRS will continue to demand payment or withhold a refund and could perfect their lien and levy against the taxpayer's property.

In a real-life emergency, you would dial 9-1-1 to get help. In the tax world, when faced with an untenable situation, you complete the appropriately titled Form 911, "Request for Taxpayer Advocate Service Assistance," to request help from the TAO. If the request for assistance by the TAO is approved, the assigned Advocate can be inserted into the process and hopefully resolve the dispute quickly.

Form 911 is a two-page form that requires basic taxpayer information, a description of what the issue is and what relief/assistance the taxpayer is requesting. The more information provided with the form, the more likely the TAO can be instrumental in settling the issue quickly. Once the request is granted, unlike IRS help line where a taxpayer will be connected with the first available agent and subsequent calls are never with that original agent, a specific Advocate is assigned who will be responsible to take the issue to resolution.

The TAO is a taxpayer friendly organization designed to help resolve issues in dealing with IRS. It further submits data to Congress that will help IRS improve their processes. Assistance from the TAO is available if the proper criteria are met. In order to qualify for assistance the taxpayer must show imminent financial harm and have attempted to resolve the issue through the regular IRS channels. It is important for taxpayers to know that there is assistance available should he or she be unable to resolve their dispute with the IRS.

Our experience with the TAO has been extremely positive. We have found that the Advocates have tremendous influence and can effectively break through IRS gridlock. It is good to remember that although IRS is a formidable organization, help can be only one Form 911 away.

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The Netherlands, a Tax Haven? No! A Gateway to Europe (and beyond)

This article was written by Diederik Hauser, Ruben van Aarle and Sam Abbing of Taxperience.

The Netherlands has some potentially beneficial features in the core of its tax system which make it a gateway to Europe and beyond, particularly, as an ideal international holding company.

Introduction

There has been heightened sensitivity to tax havens, more so recently, but clearly over the past few years – likely augmented by the recent collapse of the Cypriot banking system. The Netherlands was also incorrectly referred to as a tax haven by President Obama (which was quickly corrected).

The Netherlands is not a tax haven at all. For its small size, it has a strong manufacturing base, and is a well-established global banking and financial center. Due to its seaport location, it is also an excellent shipping entry and exit point for goods to and from Europe. The statutory corporate income tax rate is 25% and tax holidays or other special regimes are not available.

Some of the more salient features of the Dutch tax system are as follows which can make it an ideal international holding company:

1. The Dutch participation exemption;
2. Low withholding tax rates; and
3. Ruling practice.

Dutch Participation Exemption

Using a Dutch holding company in a European or Global structure potentially provides the following:

- No Dutch tax on foreign (distributed) profits;
- No Dutch capital gains tax on a future disposal of a foreign investment; and
- A blocker from U.S. taxation is created, thereby allowing for the tax efficient use of cash generated overseas for further foreign expansion.

Low Withholding Tax Rates

In its domestic tax law, the Netherlands does not levy withholding taxes on interest, royalties and technical service fees. The Netherlands has concluded over 90 double tax treaties that reduce or eliminate foreign (i.e., non-Dutch) withholding tax rates on these types of items. Multinational companies have used the Netherlands to reduce or eliminate withholding taxes using back-to-back structures.

The general domestic Dutch withholding tax rate on dividends is 15%. This may be reduced (mostly to 5% or 0%) under double tax treaties concluded by the Netherlands or under the EU Parent/Subsidiary directive (to 0%) for distributions to or from European companies. Therefore, the Netherlands can be used to reduce or eliminate foreign withholding taxes and, in certain instances, Dutch companies can distribute dividends to the U.S. free of Dutch withholding tax under the U.S./Dutch tax treaty.

Ruling Practice

Taxpayers can obtain a relatively high degree of tax certainty through Advance Tax Rulings and Advance Pricing Agreements in the Netherlands. These rulings are fairly common to obtain in the Netherlands, and they are generally not as complicated, costly, or as potentially adversarial to obtain when compared to the U.S. tax ruling system.

In summary, the Netherlands is very well suited as an International/European Holding company or headquarters for multinationals.

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Investing in Floating Rate Loans

In today's investment landscape, the mounting uncertainty about growth and income from traditional investment sources has created a conundrum for yield-seeking investors.

In order to produce sufficient yield, investors have several options which include the following: increase the duration of their fixed income portfolio; reduce the credit standards of their fixed income portfolio; or increase their exposure to the equity markets with the hopes of enhancing a modest dividend yield with capital gains. The prolonged near-zero interest rate environment has increased the risk of rising interest rates and inflation, reducing the attractiveness of increasing fixed income duration. High-yield bonds are producing the lowest yields on record and may not sufficiently compensate investors for taking on more credit risk. Equity markets have recently displayed diminishing equity premiums and heightened volatility. Increasing exposure to equities in many cases does not fit into an investor's risk profile. As a potential solution, floating-rate loans ("FRNs") may provide a compelling yield alternative. FRNs come with near-zero duration, price protection against rising rate scenarios, an income boost in the face of low/flat rates, and portfolio risk reduction in the form of historically low correlations to other asset classes.

FRNs (also known as bank loans, syndicated loans, leveraged loans, and loan-participation funds) are below investment-grade corporate debt secured by collateral such as the issuer's accounts receivable, inventory, property, plant, equipment and/or stock. Unlike a plain-vanilla bond with a fixed interest rate, an FRN offers variable coupons typically based on LIBOR (London Interbank Offer Rate) plus an added "spread." FRN yields typically reset quarterly to the prevailing market rate, but can reset as often as daily. FRNs, which are typically issued by corporations, municipalities, and some foreign governments, represent a well-protected senior layer of the issuer's capital structure and therefore typically have higher priority of claims compared to high-yield bonds and equity. The ability of FRNs to reset their coupon (the interest rate paid to the lender/investor) gives the sector a distinct advantage over other bonds by essentially removing interest rate risk from the equation. Because of the inverse relationship of bond price to yield, as interest rates rise, the market value of bonds with fixed coupons will generally fall. FRNs avoid that issue and do a better job of protecting principal due to the reset of yields to prevailing rates. Conversely, if rates were to fall, FRNs could underperform plain-vanilla bonds because of the reduced attractiveness after resetting to the lower prevailing market rates. Due to the concerted effort by the Federal Reserve and central banks around the world to artificially suppress rates, the current interest rate environment appears to be near a lower bound, leaving very little room for rates to fall significantly further.

The near-zero duration characteristic of FRNs provides income potential that can compete with or even surpass longer-duration fixed-income investments without the interest rate risk. Duration is commonly defined as the price sensitivity of a bond to changes in the level of interest rates. Since FRN rates regularly reset, their prices are relatively stable when rates fluctuate. To achieve the same effect with U.S. Treasury notes, for example, an investor would need to invest in extremely short-term bonds, which are currently offering negative inflation-adjusted returns. In contrast to high-yield corporate bonds which share similar credit profiles and current absolute yields, FRNs exhibit a higher yield per unit of duration. Stated differently, FRNs currently offer more return per unit of interest rate risk than other fixed income alternatives.

This near-zero duration characteristic also contributes to FRNs' negative correlation to U.S. Treasuries and low-to-negative correlation to other fixed-income sectors such as investment grade corporates, agency bonds, and mortgage-backed securities. This provides FRN investors the opportunity to achieve diversification and risk reduction benefits within their fixed income portfolios - lowering volatility and increasing risk/reward efficiency. It should be noted, however, that due to their credit profiles, FRNs exhibit higher correlations to equity investments when compared to their investment-grade counterparts.

FRNs are by definition credit instruments, and their performance is highly susceptible to swings in market perceptions, strengthening or weakening economies, and investor sentiment. If credit conditions weaken significantly, there is considerable risk of tremendous volatility in FRN pricing. For instance, the Financial Crisis of 2008-2009 provided the backdrop for one of the worst credit downturns in history. This was a time that did not bode well for credit sensitive investments, including FRNs, as they were down 29%. Despite today's interest rate environment, FRNs must always be evaluated in the context of the issuer's ability to satisfy its obligations. Similar to high-yield debt investing, credit research is a critical aspect of participating in the FRN market. Although FRNs are typically comprised of senior level debt, issuers tend to have relatively high levels of leverage. The minimal interest rate risk associated with FRNs must be weighed against the magnitude of credit risk.

As the market continues down the path of low-to-flat interest rates with traditional fixed-income strategies providing less yield and protection from inflationary expectations, FRNs may present a persuasive yield alternative. Given their low duration, yield advantage, and diversification benefits, FRNs deserve consideration as a strategic portfolio position in today's investment landscape. Investors must exercise caution, however, as the mitigation of price sensitivity to interest rate fluctuations and attractive absolute yields come at the cost of increased credit risk.

Please feel free to contact a WTAS investment consultant should you have any questions relating to this newsletter article or your investment portfolio.

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Common Gifts and Factors Influencing Their Value

The American Taxpayer Relief Tax Act of 2012 (the "Act"), enacted on January 2, 2013, ended an 11 year period of uncertainty relating to estate tax exemptions and rates by making the agreed upon exemptions and rates "permanent". [1]

For those of you who still have the assets and inclination to make gifts in 2013, we offer the following summary to help you identify potential assets to gift and factors influencing the value of the gift.

Brief Background on Gift Tax

IRS defines a gift as "any transfer to an individual, either directly or indirectly, where full consideration (measured in money or money's worth) is not received in return."[2] A gift may be taxable or nontaxable. Gifts are generally taxable for IRS purposes except in the following cases:

- Gifts that are not more than the annual exclusion for the calendar year;
- Gifts to a political organization for its use;
- Gifts to charities;
- Gifts to one's (U.S. citizen) spouse; and
- Tuition or medical expenses one pays directly to a medical or educational institution for someone.

Under current law, an individual can transfer up to $5.25 million (as of 2013, and inflation-adjusted) over his or her lifetime without being subject to the gift or estate tax. This is referred to as the *basic exclusion*. However, an individual can also transfer up to $14,000 tax-free under the *annual exclusion*.

Types of Gifts

The types of assets that an individual can gift are numerous and diverse. The table below compares some traditional and non-traditional assets that can be gifted outright.

Traditional Assets	**Non-Traditional Assets**
Cash	Life insurance policies and annuity contracts
Publicly-traded stocks and bonds	Patents and other intangible assets
Real estate	Promissory notes
Jewelry and gems	Qualified conservation contribution [3]
Art and other collections	
Vehicles such as cars, boats, and aircraft	
Other personal property	

In addition to gifting assets outright, an individual can gift a fractional interest in an asset or entity. Examples of fractional gifts include the following:

Fractional Gifts
Interests in closely held operating businesses
Interests in entities such as Family Limited Partnerships and Limited Liability Companies that hold investments and/or real estate
"Vertical slices" of private equity/hedge funds
Oil and gas interests
Undivided interests in real estate
Undivided interests in art

Factors that Impact Value for Fractional Gifts

Market prices, cash flow expectations, and risk can obviously affect the value of an asset or business. However, what may not be as obvious are the factors that influence the value of a fractional interest in an asset or business. For example, a fractional interest may be subject to certain discounts for lack of marketability ("DLOMs") and/or control ("DLOCs"). DLOMs may be appropriate to reflect the lack of a ready market for the interest. A DLOC may be appropriate to reflect the fact that a non-controlling fractional interest cannot manage or control the entity or asset, determine distributions, or force liquidation.

As an example, consider a common gift suggested by estate planners – a fractional, non-controlling interest in an FLP. An FLP will typically be guided by a partnership agreement, which specifies rules and restrictions that apply to its partners. The existence of various restrictions within the partnership agreement can influence the value of such a gift.

Key factors influencing an FLP interest include:

Factor	**Lower Discount / Greater Value**	**Higher Discount / Lower Value**
Size of the FLP	Larger, more profitable	Smaller, less profitable
Nature of the FLP	More diversified / lower-risk assets	Less diversified / higher-risk assets
Leverage	Low debt	High debt
Distributions	Large, frequent	Minimal, infrequent
Time to liquidity	Short term	Long term
Transfer restrictions	No restrictions	Existince of restrictions / right-of-first refusal
Size control of interest	Controlling interest	Non-controlling interest
Redemption rights	Existence of rights	No rights
Competence of management	Competent management	Incompetent management
Voting rights	Voting interest	Non-voting interest

Although similar in concept to the above example, an undivided (i.e., fractional) interest in property is influenced by slightly different factors. Unlike an FLP interest, an undivided interest reflects a direct interest in the property itself. Although the property may be readily marketable, an undivided interest lacks the ability to sell the property, make decisions related to the property such as maintenance or leasing, or obtain normal bank financing without the other owners' consent. Additionally, although no partnership agreement exists, per se, the owners may have signed a tenants-in-common ("TIC") agreement, specifying restrictions on owners of the property.

Regardless of the existence of a TIC agreement, factors that can influence the valuation of an undivided interest include the following:

Factors	**Lower Discount / Higher Value**	**Higher Discount / Lower Value**
Type of property	Developed / leased property	Vacant land
Cash flows	Income producing	Non-income producing
Number of owners	Fewer owners	More owners
Market forecast	Strong real estate market	Weak real estate market

Restrictions in TIC agreement removing right to legal partition	Retained right to partition	Removed right to partition
Other factors such as dissention among owners, foreclosure, etc.	Existence of negative factors	Lack of negative factors

Conclusion

Although the Act made estate tax exemptions and rates "permanent", future tax reform, including eliminating valuation discounts for interests in family-owned entities, are still possible. Under current legislation, however, opportunities exist for gifting assets/interests at discounted values. Understanding your gifting options and the value of your potential gift are critical components of the gift and estate planning process.

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[1] Despite the Act, the Obama administration has proposed to amend the tax code to further restrict transfers by gift and other significant changes, outlined in our Tax Release dated April 22, 2013

[2] *Frequently Asked Questions on Gift Taxes*, Internal Revenue Service

[3] See *IRS Publication 561* for a description of this asset and others.

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Dealing with the Secondary U.S. Tax Consequences Of Transfer-Pricing Adjustments

Imagine this: the transfer pricing report that has been in process is received after year-end (but before the tax return is due) and the conclusion is that the price the U.S. parent has charged its foreign subsidiary for intercompany transactions throughout the year is too high and needs to be adjusted downward.

What do you do? Let it go and post a make-up adjustment next year, or, affirmatively adjust the year to follow the transfer pricing report and include the corrected amounts in the tax return? You should do the latter because you cannot make beneficial transfer pricing adjustments to the U.S. parent after the tax return is filed. This is not an uncommon situation and this article will provide a summary of the issue, and what to do.

The overall tax consequences of this type of adjustment are a bit more complex than may first meet the eye. Proper planning can mitigate adverse consequences and reporting errors especially in situations where estimates were used during the year but not finalized until after year-end when the transfer pricing study is issued. In situation referred to above, the U.S. parent adjusts downward what it charged its foreign subsidiary. This is referred to as a "primary adjustment." Since the U.S. parent overcharged its foreign subsidiary, the primary adjustment decreases U.S. taxable income of the U.S. parent. An additional adjustment is necessary, which in this case, creates a distribution (possibly resulting in a dividend from the foreign subsidiary), for U.S. tax purposes. This distribution (or contribution if it goes the other way) is commonly referred to as the "secondary adjustment."

The following example illustrates this. Assume the U.S. parent charged its foreign subsidiary $100, but the arm's length amount should have been $90. The $100 is reflected in the books and records of the U.S. parent as of year-end. Before the tax return is filed, the finalized transfer pricing report reflects $90 as the appropriate charge. U.S. parent reduces the price it charged the foreign subsidiary by $10 so that the tax return, as filed, reflects $90. Since the year has ended, and the U.S. actually charged $100 but should have only charged $90, the $10 difference, the secondary adjustment, is a treated as a distribution from the foreign subsidiary (possibly a dividend).

Revenue Procedure 99-32 contains some potential relief from the adverse impact of secondary adjustments ($10 in the above example) when there are taxpayer-initiated transfer pricing adjustments on the tax return. Revenue Procedure 99-32 revised Revenue Procedure 65-17, which did not contain relief for taxpayer initiated adjustments (it potentially applied to only IRS initiated adjustments). Further, Revenue Procedure 99-32 was issued to encourage taxpayers to affirmatively adjust transfer prices with the filing of their timely filed U.S. tax returns although it can still possibly be used for IRS initiated adjustments as well. What Revenue Procedure 99-32 does, is allow a taxpayer to record the affirmative transfer pricing true-up secondary adjustments in its U.S. tax return as an interest bearing loan which has to be repaid within 90 days of the adjustment. If it is not repaid in 90 days, the secondary adjustment stands.

Revenue Procedure 99-32 is elective. The interest bearing loan treatment does not happen automatically unless the taxpayer makes the election. Therefore, taxpayers have to affirmatively elect on their timely filed U.S. tax returns (including extensions), to take advantage of this Revenue Procedure. Section 5 of the Revenue Procedure outlines how to make the election (which cannot be done on an amended return).

Should taxpayers just automatically make a Revenue Procedure 99-32 election on their return? The answer is not necessarily. For example, if the foreign subsidiary does not have current or accumulated earnings and profits, the distribution on the secondary adjustment might be treated as a tax-free return of capital. Further, the loan that is created when electing under the Revenue Procedure, might be treated in this situation as a section 956 loan from the foreign subsidiary (and a deemed dividend). Or, there may be withholding tax on the loan that is created. (Generally, the U.S. exempts less than 183 day loans from U.S. withholding tax.) So, the facts need to be analyzed, to determine if this election is beneficial.

Further, note that making a transfer pricing primary adjustment can have import and customs duty, VAT and withholding tax implications where refunds might be obtained, or payments made, depending upon which way the adjustment goes. Some foreign jurisdictions do not follow these provisions and will need to be analyzed in conjunction with the U.S. implications.

This Revenue Procedure can be applied to U.S.-owned multinationals, foreign-owned U.S. subsidiaries, or foreign-to-foreign controlled party transactions of U.S. multinationals. Revenue Procedure 99-32 can be beneficial, but, may not always be. It should be considered when transfer pricing adjustments arise when filing the U.S. tax return. And, when making a transfer pricing adjustment with the U.S. tax return, there could be secondary adjustments that should to be considered.

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Reforming Beneficial Taxation in Switzerland

This article was written by Kerstin Heidrich and Stefan Widmer of PrimeTax.

The contemplated Corporate Tax Reform III (CTR III) will be a key element for the attractiveness of Switzerland as a location for multinational enterprises. It will be influenced by the ongoing tax controversy with the EU and the growing concern of the OECD with regard to profit shifting and base erosion, presenting challenging and dynamic circumstances.

The EU-Swiss Tax Controversy and its Impact on the CTR III

Since the early 1990s, numerous multinational enterprises have chosen Switzerland as their EMEA headquarters, trading, R&D, management or financial center, or their regional or even global holding company hub. While low tax rates have certainly been a factor in determining where to centralize these mobile activities within a multinational group, other aspects such as excellent infrastructure, frequent worldwide flight connections, qualified workforce and easily accessible support from competent authorities are other significant factors that position Switzerland as one of the leading locations for housing the worldwide headquarters.

In the past few years, Switzerland has been under increased pressure from the EU which demands conformity of the Swiss taxation principles with EU standards even though Switzerland is not a member of the EU. The focus of the CTR III, which was initially announced in 2008, aimed at abolishing share issuance tax, improving the mechanism of granting tax exemption for dividend income, and eliminating fiscal obstacles relating to group financing with a view to strengthening Switzerland's financial center. However, the scope of the CTR III was extended to also include the abolition of the existing cantonal (i.e., state or local) tax regimes and the implementation of new, EU compatible tax regimes, which has resulted in the postponement of the official launch.

Although part of the CTR III (in particular the possibility for group financing free of stamp duties and withholding tax) was implemented separately, the centerpiece of the CTR III was adjusted to focus on safeguarding the attractiveness of Switzerland as a tax location while ensuring the international acceptability of the Swiss corporate tax regimes.

At present, an optimized design of the CTR III with a view to further strengthen Switzerland's position within the international tax competition and achieving positive economic growth effects is a top priority of the Swiss Federal Council. The Swiss corporate tax regimes, which form the main subject of the tax controversy with the EU, are the beneficial cantonal taxation regimes for holding, administrative and mixed companies, which have encouraged numerous foreign companies to move their mobile corporate activities and shift the respective profits to Switzerland.

Below is a brief overview of the existing Swiss cantonal tax regimes and some background information on why the EU is pushing for their abolition. Should Switzerland not present concrete progress by this summer, the EU threatens with a blacklisting or other (unilateral) steps and measures.

Beneficial Cantonal Tax Regimes under Pressure from the EU:

Holding Company Regime

Swiss legal entities or branches of which the main statutory purpose is the permanent administration of investments and which do not perform any business activities in Switzerland are exempt from corporate income tax at cantonal and municipal level provided their investments or their income from investments amounts to at least two-thirds of the balance sheet total or total income.

As a secondary purpose and if within the limits of the so-called "tax free holding third" additional permitted activities include management services, group financing and reporting, cash pooling, IP exploitation, etc.

A thorn in the EU's side and the reason why this tax regime is assessed to constitute unlawful state aid is the fact that not only the income from qualifying investments, but also any income from the above secondary activities, is taxed solely at federal level and is subject to an effective tax rate of 7.83%.

Administrative Company Regime

With regard to their income from foreign sources, Swiss legal entities and branches which solely perform administrative activities in Switzerland are subject to cantonal and municipal corporate income tax only for a certain quota of their foreign sourced income. As a result, the taxable basis for cantonal and municipal tax purposes is usually reduced to something between 0% (no own infrastructure and personnel) and 20% (significant administrative activities), and the overall effective tax rate including federal taxes on the net profit from foreign sources amounts to only approximately 8% – 10%.

The EU's criticism with respect to this regime mainly relates to the unequal treatment of domestic vs. foreign sourced income which is assessed ring-fencing and distorting competition.

Mixed Company Regime

In contrast to administrative companies, the mixed company is allowed to also perform business activities in Switzerland. These activities, however, may only be of a subordinated nature; for example, income and expenses related to business activities in Switzerland must not exceed 20% of both total income and expenses (bi-dimensional approach). Should this requirement be met, the taxable basis for cantonal and municipal tax purposes is reduced to usually between 10% and 20% leading to a combined effective tax rate on the net profit from foreign sources including federal, cantonal and municipal tax of approximately 8.5% - 11%.

This tax regime is applied by most international groups that have established their trading, financing, IP, management, or other group internal services companies in Switzerland, and it is also the regime that is applied for purposes of cantonal and municipal taxation by e.g., regional headquarter companies such as the countless EMEA headquarters of U.S. based groups.

While the official criticism of the EU, equivalent to the administrative companies, relates to the unequal treatment of foreign versus domestic income, the major concern is the fact that by way of establishing such a structure profits in the group's home country are decreased and shifted to Switzerland.

Substitute Measures to Ensure Sustainable International Tax Attractiveness

Given the ever shorter time available for drafting solutions which could serve as a substitute for the existing cantonal tax regimes and at the same time are tolerable also from a Swiss political and financial budget point of view, the process of developing alternative (EU compatible) tax measures possibly combined with a general reduction of corporate income tax rates is at full speed. Common to all endeavors is the imperative of providing attractive compensatory measures to the directly concerned companies, avoiding the transfer of existing Swiss business activities abroad, and maintaining a top position in international location competition.

Of high importance to companies worldwide, the solutions presented within the scope of the CTR III must aim at offering long-term planning and legal certainty. Given the dynamics of the current international tax environment, legal certainty at this stage means that substitute measures must be in line with the EU's claim against Switzerland to waive the cantonal tax regimes assessed "selective" and/or "ring fencing".

Since an actual implementation of any concrete measures prospectively taken by the OECD as a result of the more recent discussions concerning base erosion and profit shifting can neither be assessed in their technicalities nor with respect to timing yet, the in-charge group of experts in Switzerland have mainly discussed taxation models as also offered by a number of EU member states (e.g., Luxembourg, Netherlands, Belgium, United Kingdom, etc.).

Besides a license and interest box regime and a more flexible approach to the general "tax follows accounting" rule when determining the taxable basis, other innovative and completely new solutions are being analyzed to determine if they are compliant with (current) EU rules. To put it bluntly, the new taxation models which shall replace the existing cantonal tax regimes in the future and provide for a sustainably attractive environment for mobile, high value-adding activities such as IP exploitation, group financing, trading, R&D and other central group functions, can be expected to be derived from a "best-of" collection from what is already offered by member states of the EU and further spiced-up with certain beneficial particularities with a view to succeeding in future location competition.

In order to provide for real solutions to the companies already located in Switzerland, the challenge is to create a newly designed taxation system that at least maintains the combined federal, cantonal and municipal effective tax rates currently applicable (i.e., amount to between 8-10% for IP exploitation, 2-4% for group financing, and 9-12% for trading activities).

Expected Timing and Medium-Term Impact

Based on the experience of the two previous corporate tax reforms and due to the direct democracy and federalism in Switzerland, the Corporate Tax Reform III can certainly not be implemented overnight. All potential substitute measures firstly need to be evaluated with respect to their compatibility with EU regulations as well as regarding their consequences on the cantonal financial budgets and any necessary adjustments to the system of financial equalization between the cantons.

Once final measures are designed by the Swiss Federal Council, the political approval process will start and, due to the significance and media presence of the topic, can be expected to culminate in a referendum. If asked for a best estimate on when the CTR III will actually enter into force, the authors would assume 2016 to be a reasonable guess, although this date is rather ambitious. Moreover, even after an implementation of the CTR III into the Federal Law on the Harmonization of Direct Taxes of the Cantons, it can be expected that a transition period will be granted to the cantons to allow for sufficient time to adjust their own tax laws. As a result, the authors expect no material changes to the existing system to incur prior to 2019.

Finally, due to the importance to the economy and labor market of foreign companies in Switzerland, it is evident that Swiss politicians together with tax technical experts will ensure that once the current beneficial cantonal tax regimes are abolished there will be substitute taxation models providing for comparable benefits.

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