nière illimitée en Suisse, comme une société helvétique. Il lui appartient donc de payer un impôt sur le capital et sur le bénéfice. Par ailleurs, les dividendes, vu que la société est considérée comme une entité fiscalement suisse, sont soumis à un impôt anticipé de 35%. Si l'impôt anticipé n'a pas été prélevé par la société, ce qui est évidemment le cas vu que ses propriétaires la considéraient comme domiciliée à l'étranger, l'administration fiscale suisse peut procéder à un gross-up qui conduit à un impôt anticipé d'environ 53,85%.

Par ailleurs, une requalification du lieu d'imposition d'une société détenue par une personne imposée d'après la dépense en Suisse peut avoir d'énormes conséquences pour elle. En effet, les actions et les créances à l'encontre de la société détenue par des forfaitaires sont considérées comme de la fortune suisse entrant dans le cadre du calcul de contrôle.

Il en va de même de toutes distributions de dividendes ou de versements d'intérêts qui seraient considérés comme des revenus de source suisse. En résumé, toute la fortune et les revenus qu'une personne imposée d'après la dépense penserait être couverts par son forfait seraient entièrement en réalité dans son calcul de contrôle. Il y a lieu de rappeler qu'en droit suisse le délai de prescription est de dix ans.

Conclusion

Pour conclure, nous recommandons à toutes sociétés et à toutes personnes imposées en Suisse, surtout si elles le sont d'après la dépense, de s'assurer que les sociétés étrangères dont elles sont propriétaires n'ont pas le risque d'être requalifiées comme sociétés suisses. Comme nous l'avons présenté ci-dessus, la situation est complexe. Trop souvent, des personnes « raisonnant à l'ancienne » considèrent qu'il n'y a pas de problème dès le moment où les réunions du conseil d'administration sont faites à l'étranger. Or, comme nous l'avons vu ci-dessus, ce n'est pas à ce niveau que se pose le problème.

Taxation of a **foreign legal entity** in Switzerland
The concept of effective management

Philippe Kenel
[Doctor of Law, lawyer in Pully-Lausanne, Geneva and Brussels, Partner, Valfor Avocats]

Daniel Gatenby
[LL.M. Tax, lawyer in Pully-Lausanne and Geneva, Valfor Avocats]

Introduction

The purpose of this article is to examine the conditions under which a legal entity with its registered office abroad is nonetheless liable to tax in Switzerland. As we shall see, such a requalification has important consequences not only for the company in question, but also for its shareholders, particularly if they are subject to lump sum taxation.

Applicable Swiss and international legal provisions

Under Swiss domestic law, according to article 50 of the Federal Act of 14 December 1990 on Direct Federal Taxation (FDTA), "legal entities are subject to tax on the basis of their personal nexus when they have their registered office or effective management in Switzerland". Similarly, article 20 paragraph 1 of the Federal Act of 14 December 1990 on

the Harmonisation of Direct Taxes of the Cantons and Municipalities (FHTA) stipulates: "joint stock corporations, cooperative companies, associations, foundations and other legal entities are subject to tax when they have their registered office or effective administration in the canton". Paragraph 2 of the same article specifies that "foreign legal entities, commercial companies and communities of persons are assimilated to Swiss legal entities which they most closely resemble by their legal form or their effective structures". The fact that a company is taxed in Switzerland by virtue of these provisions means that it is subject to tax on capital and profits in Switzerland. Furthermore, article 9 of the Federal Act of 13 October 1965 on Withholding Tax (FWTA) also provides that "legal persons or commercial companies without legal personality whose registered office is abroad, but which are effectively managed in Switzerland and carry on business there" are deemed to be domiciled in Switzerland. If this is the case, the Swiss Confederation levies withholding tax, normally at a rate of 35%, on income from securities (e.g. a dividend distribution).

At the international level, Article 4 of the OECD Model Tax Convention on Income and on Capital (2017 version) (OECD MC) provides as follows:

"For the purposes of this Convention, the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State […]" (par. 1). "Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors […]" (par. 3).

As for the conventions signed by Switzerland, by way of example, Article 4 paragraph 1 of the Convention concluded on 21 January 1993 between the Swiss Confederation and the Grand Duchy of Luxembourg for the avoidance of double taxation with respect to taxes on income and on capital provides that "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of the person's domicile, residence, place of management or any other criterion of a similar nature'. Paragraph 3 specifies that "where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, he shall be deemed to be a resident of the State in which his place of effective management is situated".

Definition of effective management

Two preliminary remarks must be made before analysing the meaning to be given to the concept of 'effective directive' under Swiss law. Firstly, given that Switzerland is a federal state made up of twenty-six cantons, the Supreme Court has also had occasion to rule on the question of the place of taxation of a company in intercantonal matters. The main difference between the case law handed down by the Supreme Court in intercantonal and international matters is that in international matters the Supreme Court considers that effective management is an alternative connecting factor to that of the registered office. On the other hand, in intercantonal relations, effective management is taken into consideration only if the legal entity is a simple "letter box" company and no activity is carried out at the registered office.

Secondly, in recent years there has been a tightening of the practice of the tax authorities in relation to the concept of effective management in international relations. However, most academic writers consider that the case law developed in intercantonal relations, to which we will return below, can be applied by analogy (Xavier Oberson, Précis de droit fiscal international, 5th edn, Berne 2022, p. 92; Peter Locher, Einführung in das internationale Steuerrecht der Schweiz, 4th edn, Berne 2019, p. 294). Nevertheless, there is little case law on the subject.

The first international case law on the subject was the X. Corporation v. Geneva Cantonal Tax Administration on 4 December 2003, which is considered to be the leading case on the subject. It was followed by X. L. LTD. v. Tax Authorities of Canton Zug on 16 May 2013. In this judgment, the Supreme Court ruled as follows:

"According to practice, the place of effective management is the place where the effective and

economic centre of its existence is located (SCR 54 I 301 c. 2 p. 308 ff.) resp. the place where the management which normally takes place at the company's registered office is carried out, at the place where the acts which, taken as a whole, serve to achieve the purpose of the articles of association are performed (SCR 50 I 100 c. 2 p. 103 ff.). If day-to-day business is conducted from several different locations, this will be the place where the preponderant part of the company's activity is carried out. In this respect, it is unthinkable that the actual management could be carried out by third parties appointed for this purpose […]. This practice, which was originally developed primarily for the purpose of determining tax sovereignty in disputes between cantons, is now used by the Supreme Court to determine tax liability under art. 50 FDTA. In this respect, the Supreme Court distinguishes between 'purely administrative administration' on the one hand, and the activity of the company's organs on the other, insofar as the latter is limited to exercising control over the actual administration and taking certain decisions of principle. On the other hand, the places where decisions are taken by the board of directors, general meetings or the domicile of shareholders have no bearing on the matter' (RDAF 2013 II p. 500, 502).

As Robert Danon summarises, "the concept of effective management thus includes both a qualitative and a quantitative element. On a qualitative level first, it appears that the criterion of effective management focuses on the place where the day-to-day management of the business is carried out. From this point of view, the effective management test does not coincide with the 'management and control' test. In other words, the functions performed in relation to the company's general policy and strategy are not decisive. The same applies to decisions and measures of a purely administrative nature (bookkeeping, preparation of statutory documents, general meetings, etc.). Thus, as summarised in administrative practice, effective management lies between the 'higher' level (strategic policy) and the 'lower' level (administrative decisions and measures). Finally, the question of whether the effective management of a company is in Switzerland is examined on the basis of economic reality. It is therefore not the prerogatives formally exercised but those actually exercised that are decisive. Finally, from a quantitative point of view, the application of the 'preponderance' criterion is confirmed. Consequently, there is effective management in Switzerland only when a predominant part of the day-to-day management is exercised from Switzerland. According to the Swiss approach, the fact that the shareholder(s) of an offshore company reside(s) in Switzerland is in principle not decisive. However, this is only true where the shareholder(s) do not exercise any functions that are part of day-to-day management. On the other hand, if the shareholder is also (legally or in fact) a managing director and takes management decisions, then effective management should coincide with the place where he or she is resident. Generally speaking, the same reasoning applies to any person to whom all or part of the day-to-day management could be entrusted" (Robert Danon, Article 4, in, OECD Model Tax Convention on Income and Capital – Commentary, Basel, 2014, p. 170).

In practice, two essential questions arise:

Who are the bearers of effective management?
It should be emphasised that only an individual can be the bearer of effective management. As the legal doctrine points out, 'it is of little importance to know in what capacity the individuals carrying out the effective management are acting. Indeed, there may be many causes under cover of the general designations of commercial law. What matters is that these individuals

conduct the day-to-day business' (Frédéric de le Court, Administration et direction effectives, Steuer Revue, 2016, 404, 409-410).

What acts qualify as effective management?

Case law and doctrine show that there are three types of activity within a company. On the one hand, there are senior management activities, consisting of supervision and strategic decisions. Secondly, there are the day-to-day management activities, which consist of running the business and making the main decisions relating to day-to-day operations. Finally, there are the administrative activities, i.e. secretarial work, bookkeeping, keeping records and answering the telephone. Only day-to-day management activities constitute effective management.

According to legal doctrine, 'effective management is a subtle combination of the power to make decisions and its regular use. It is therefore necessary to have the power to make decisions, which limits the circle of those who can exercise effective management. Admittedly, directors, managers or partners with unlimited liability have this power by virtue of their position. However, the mere fact of having this power is not enough to be the bearer of effective management. The power to enter into agreements must be used on a regular basis according to the needs of the company itself, to bind the company to third parties in day-to-day transactions. This means two things:

- The power to conclude eliminates any purely administrative activity (administration, organisational activity exclusively internal to the company which does not require such a power) from the scope of effective administration. In our view, the need for the power to conclude is therefore a criterion of distinction from subordinate activities.
- On the other hand, the regular use of the power to conclude distinguishes routine business from strategic business. Of course, regular use refers to multiple facets of the same reality. In practice, routine matters are much more frequent than strategic matters. Consequently, the regularity of the use of this power is an is a criterion for distinguishing senior management activities (which are less frequent than those of effective management)' (Frédéric de le Court, op. cit., p. 412).

The relevant case law emerging from inter-cantonal doctrine and case law can be summarised as follows regarding holding companies and finance companies:

There is no case law on holding companies in international situations. However, some authors believe that the case law in intercantonal matters can be applied by analogy (Xavier Oberson, op. cit., p. 92). The Swiss Supreme Court has held in previous decisions that the effective management of such a company is located at the place where the shares are physically held, dividends are received, accounts are kept, decisions to buy and sell shares are taken and shareholder rights are exercised, and at the place where the subsidiaries are controlled (SCR 45 I 190, 199 ff; SCR of 21 October 1964 published in: ASA 34 [1965/1966] 312 ff). However, according to some authors, the first three activities mentioned, which are at the 'administrative' level, should be put into perspective and the place where the last three activities are carried out, which are really day-to-day management activities, should be considered as the place of effective management (Stefan Oesterhelt/Susanne Schreiber, Kommentar zum Schweizerischen Steuerrecht DBG, 4th ed., Basel 2022, pp. 1008-1009).

For finance companies, these are strategic decisions relating to loans, i.e. setting the contractual terms and conditions of investments, checking solvency, market analyses, maintaining banking relationships and refinancing, processing and concluding loan agreements, holding guarantees, controlling and monitoring financial flows, managing exchange rate and interest rate risks […] (Frédéric de le Court, op. cit. 415-417, as well as the doctrine and case law cited).

Consequences of requalifying a company's place of taxation in Switzerland

The main consequence of locating the effective management of a company in Switzerland is that the entity is treated as a Swiss company and, consequently, is taxed indefinitely in Switzerland, as a Swiss company. It must therefore pay tax on its capital and profits. In addition, since the company is considered a Swiss tax entity, dividends are subject to 35% withholding tax. If the withholding tax has not been deducted by the company, which is obviously the case given that its owners considered it to be domiciled abroad, the Swiss tax authorities may carry out a gross-up, resulting in withholding tax of around 53.85%.

Furthermore, a reassessment of the place of taxation of a company owned by a person taxed on the basis of expenditure in Switzerland can have enormous consequences for that person. This is because shares and claims against the company held by lump-sum taxpayers are considered to be Swiss assets for the purposes of the control calculation. The same applies to any dividend distributions or interest payments that would be considered Swiss-source income. In short, all the assets and income that a person taxed on the basis of expenditure would think were covered by his lump sum would in reality be entirely included in his control calculation. It should be remembered that under Swiss law the statute of limitations is ten years.

Conclusion

In conclusion, we recommend that all companies and individuals taxed in Switzerland, especially if they are taxed on the basis of expenses, ensure that the foreign companies they own do not run the risk of being requalified as Swiss companies. As explained above, the situation is complex. All too often, 'old-fashioned thinkers' consider that there is no problem as long as board meetings are held abroad. However, as we have seen above, this is not where the problem lies. ■