Swiss Commissionnaire Structures: Latest Tax Developments

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1. Introduction

Commissionnaire structures have been widely used in recent years by multinationals. Switzerland is often selected as a location for the principal company, due to relatively low tax rates and favorable tax regimes available for that kind of activity.

Over the past few years, the details, advantages and risks of this popular tax scheme have been discussed at length in various seminars and articles. On 18 December 2001, the Federal Tax Administration released a circular letter which, while confirming the existing administrative practice, also introduces new peculiarities in this area. The present contribution therefore aims to briefly describe these new developments.

2. Swiss tax treatment of principal companies

A. Cantonal and communal income tax

Most Swiss cantons provide special tax regimes for so-called 'auxiliary companies', that carry out purchase and sale activities mainly or exclusively outside of Switzerland without interfering in Swiss economic circles. Under these regimes, foreign source income is taxed in accordance with the ordinary rules but in proportion to the administrative activities performed in Switzerland. As a result, a significant part of such income is allocated outside of the Swiss jurisdiction and thus exempted.

The portion of exempted foreign source income varies from one canton to the other. It generally corresponds to 80 per cent or 90 per cent. As a consequence, the margins realized by principal companies on foreign operations are subject to cantonal and communal effective income tax rates (to be applied to net profit before direct taxes) ranging from 2 per cent to 5 per cent.

B. Federal income tax

No such tax regimes exists at the Federal level. Consequently, income realized by 'auxiliary companies' is subject to Federal income tax at a flat rate of 7.8 per cent (to be applied on net profit before direct taxes), unless such companies have a permanent establishment outside of Switzerland. In such case, Art. 52(3) of the Federal Direct Tax Law of 14 December 1990 provides that the share of the total income attributable to the permanent establishment shall be exempt from Federal income tax.

3. The circular letter of 23 November 1999

In recent years, cantonal tax authorities, which are responsible for assessing the Federal income tax, started to grant favorable tax ruling to principal companies, in order to give consideration to the peculiarities of principal–commissionaire structures. With a view to harmonize the cantonal practices, the Federal tax administration prepared a circular letter, in conjunction with the Cantonal tax administrations, dated 23 November 1999.

This circular letter, which was never published, contained clear guidelines on the tax treatment of principal companies. These guidelines are based on the assumption that the commissionaire constitutes a permanent establishment of the principal. According to the interpretation given by Swiss tax authorities to Art. 5(5) of the OECD MC, a commissionnaire constitutes a permanent establishment of the principal where it is economically dependent on the principal company and where business risks are born by the latter. In such case, Swiss tax laws require that a share of the principal's net profits be attributed to such foreign permanent establishment and exempted from Swiss income tax.

Under the circular letter of 23 November 1999, *principal companies could not, however, avail of the Cantonal 'auxiliary company' regime*. The principles governing the international apportionment of profit were thus the same for the purpose of Federal, cantonal and communal income taxes.

This allocation takes due consideration of the fact that the functions performed by the commissionaire generate a significant added value for the principal. Thus according to the circular letter 70 per cent of the *net profits pertaining to the sale* of finished products

Notes

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INTERTAX, Volume 30, Issue 4

(trading profits) are to be attributed to the foreign permanent establishment and, as a result, are exempted from Federal income tax. To the extent that the principal undertakes both trade and manufacturing activities,[3] trading profits are deemed to represent 50 per cent of the total trading and manufacturing profits. In that case, only 35 per cent of such profits are exempted. Other items of income such as finance income are furthermore exclusively taxable in Switzerland.

Assuming a total net profit of 2,000 units, of which 20 stem from financing and other activities, the taxable income of the principal working exclusively with foreign resident manufacturers and commissionaires would be computed as follows.

Table 1 The principal company only undertakes trading activities

Elements of profit	Total	Foreign	Swiss
Trading profits	1,980	1,386 (70% of 1,980)	594 (30% of 1,980)
Finance income	10	0	10
Other income	10	0	10
Taxable income	2,000	1,386	614

Table 2 The principal company undertakes both manufacturing and trading activities

Elements of profit	Total	Foreign	Swiss
Manufacturing profits (50% of 1,980)	990	0	900
Trading profits (50% of 1,980)	990	693 (70% of 990)	297 (30% of 990)
Finance income	10	0	10
Other income	10	0	10
Taxable income	2,000	693	1,307

4. The circular letter of 18 December 2001

On 18 December 2001, the Federal Tax Administration released a new circular letter on the international allocation of profits in the context of principal–commissionaire structures. Under this new circular, the general principles governing the taxation of principal companies remain unchanged. However, the circular letter introduces two significant changes to the existing administrative practice.

- The application of the above allocation method for Federal income tax purposes does not anymore preclude the availability of the 'auxiliary company' regimes at cantonal and communal level. In this respect, the income of the principal company should be allocated in accordance with the rules governing this particular type of rulings.
- To the extent that the principal undertakes both sales and production activities, trading profits are now deemed to represent 70 per cent of the total trading and manufacturing profits, instead of 50 per cent under the circular letter of 23 November 1999. On the other hand, the share of trading profits attributable to the foreign permanent establishment has been lowered to 50 per cent.

Based on the above example, the impact of this new allocation method for Federal income tax purposes would be the following:

Table 3 The principal company only undertakes trading activities

Elements of profit	Total	Foreign	Swiss
Trading profits	1,980	990 (50% of 1,980)	990 (50% of 1,980
Finance income	10	0	10
Other income	10	0	10
Taxable income	2,000	990	1,010

Table 4 The principal company undertakes both manufacturing and trading activities

Elements of profit	Total	Foreign	Swiss
Manufacturing profits (30% of 1,980)	594	0	594
Trading profits (70% of 1,980)	1,386	693 (50% of 1,386)	693 (50% of 1,386)
Finance income	10	0	10
Other income	10	0	10
Taxable income	2,000	693	1,307

5. Concluding remarks

This new practice applies as of January 2002. As far as Federal income tax is concerned, the new allocation method appears less favorable for principal companies solely carrying out trading activities. This disadvantage is, however, widely offset by the possibility to avail of the cantonal 'auxiliary company' regime. These companies may nevertheless apply the method described in the circular letter of 23 November 1999 until the fiscal year 2003.

With regards for the existence of a permanent establishment, it is furthermore recommended to carefully examine the tax treatment of the principal company in the state of residence of the commissionaire.

Notes

[3] The principal undertakes both trade and manufacturing activities when the production of the goods is subcontracted to other group companies or third parties, that act for the account of the principal. On the contrary, the principal undertakes only trade activities the goods are purchased from other group