



[letter is addressed to the cantonal tax authorities]

**UNOFFICIAL ENGLISH TRANSLATION**

Bern, 6 March 2015

**Practice regarding Circular Letter Nr. 8 of 18 December 2001 in respect to international tax allocation for principal companies, addendum**

Dear Mr

In 2014, the Swiss Federal Tax Authorities (“SFTA”) has informed all cantonal Tax Administrations regarding the results of the review of principal companies (“PC”) carried out in 2012. In said letter, it was explained which of the specifications for the practice regarding Circular Letter Nr. 8 are to be considered and how such specifications should be implemented. Specifically, it was informed how the following aspects should be appraised and assessed in the future:

- *Outsourcing of principal functions*
- *Compensation of distribution companies – allocation quota*
- *Dependence of distribution companies*
- *Determination of profit from trade activities*
- *Calculation scheme for determination of taxable profit*
- *Transfer of functions and liquidation*

It has been noted that in connection with the setup of new PCs and in relation to reviews of rulings of existing PCs, especially aspects regarding compensation of distribution companies and their dependence have been subject to criticism by the business and advisors. Tax advisors as well as impacted companies have analyzed and discussed the specifications within the IG principal company (“IG”). In particular, the IG has criticized the minimum compensation of distribution companies (3% of gross revenues or higher costs) as well as the exclusivity of their activity (90% of the profit to be distribution related). Impacted companies as well as the IG became active on different levels, in order to put emphasis on their concerns. The

differing opinions of the SFTA and IG were discussed at two meetings. On the basis of these discussions, the SFTA has decided to modify the practice previously communicated in the letter from 2014 with respect to two controversial aspects, which shall be explained in this letter.

### *Compensation of distribution companies*

The permissible compensation of the distributions companies shall be determined as the higher of either 3% of the gross revenues or the higher costs of all distribution companies, including a **markup of 5%**. The higher costs include operative costs and taxes according to the local financial statements of all qualifying distribution companies. Should functions other than sales functions be performed by the distributions companies, divisional accounts need to be prepared for these distribution entities. The split of the distribution or sales division's costs into own costs (with markup on costs) and third-party costs (without markup on costs) can, considering the lump-sum allocation to be applied, be handled with some generosity by the assessing cantons.

Should the effective compensation of the distribution companies exceed the permissible compensation, this exceeding part of the compensation has to be considered in the international tax allocation. The international tax allocation will be corrected by 50% of the exceeding compensation of the distribution companies.

In this calculation, a holistic approach will be taken including all foreign distribution companies that are exclusively operating on behalf of the PC. Distribution companies which do not operate exclusively for the PC will not be considered in the determination of the costs and the markup on these costs. Trading profits of the distribution companies which stem from sales not exclusively made on behalf of the PC will be classified as direct sales and will be fully allocated to Switzerland for taxation.

These modifications are applicable for all PCs as of tax period 2016. For PCs which already perform their international tax allocation based on the new practice, these modifications will need to be applied with immediate effect. Rulings completed since 2014 can therefore be amended or complemented accordingly.

### *Dependence of distribution companies*

In principle, the distribution companies need to act as dependent agents exclusively for the distribution of goods on behalf of the PCs of the group. Subordinated activities on its own account are permitted. An activity is subordinated when at least 90% of the profit of the distribution company originates from the sale of goods for the PCs of the group on a long-term basis. This requirement needs to be fulfilled by each distribution company on a stand-alone basis. A short-term breach of this 90% rule is not harmful.

This is applicable for PCs which have completed a new ruling since 2014 or which apply for the international tax allocation for the first time. For all other PCs which do not meet the 90% quota for its distribution companies, an appropriate timeframe shall be allowed in order to enable it to perform the necessary restructurings in the countries of the distribution companies. If it turns out that such restructurings under the relevant commercial law rules cannot be achieved within an appropriate timeframe, especially if such restructurings cannot be achieved before the Corporate Tax Reform III comes into force, it shall be possible to apply the international tax allocation also in cases where the 90% quota is not fulfilled by some of the distribution companies. The PC needs to provide the necessary explanations and evidence.

All other aspects will not be modified.

Your responsible inspector for direct federal tax is at your disposal for any questions.

Sincerely,  
Division Oversight Cantons

Ralph Theiler  
Head of department

Alex Kalbermatter  
Inspector

Enclosures: Calculation scheme (newest version)