



COMMISSION OF THE EUROPEAN COMMUNITIES

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**COMMISSION DECISION**

**of 13 February 2007**

**on the incompatibility of certain Swiss company tax regimes with the  
Agreement between the European Economic Community and the Swiss Confederation  
of 22 July 1972**

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### on the incompatibility of certain Swiss company tax regimes with the Agreement between the European Economic Community and the Swiss Confederation of 22 July 1972

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Agreement between the European Economic Community and the Swiss Confederation of 22 July 1972<sup>1</sup>, hereinafter referred to as “the Agreement”, and in particular Articles 23(1)(iii) and 27(3)(a) thereof,

Having regard to the declaration by the European Economic Community of 22 July 1972 concerning Article 23(1) of the Agreement<sup>2</sup>,

Having regard to Regulation (EEC) No 2841/72 of 19 December 1972<sup>3</sup> on the safeguard measures provided for in the Agreement between the European Economic Community and the Swiss Confederation, and in particular Article 2(1) thereof,

Whereas:

#### I. PROCEDURE

1. By letter D/520905 dated 26 September 2005 to the Swiss Ambassador and Head of the Swiss delegation to the Joint Committee under the Agreement, the Commission departments concerned raised the question of the compatibility of certain Swiss corporate tax regimes with the Agreement and asked the Swiss authorities, pursuant to Article 27 of the Agreement, to provide the EC delegation with all relevant information in order to be able to examine the regimes in the framework of the Joint Committee meetings.
2. By letter A/39306 dated 29 November 2005 the Swiss authorities responded to the Commission’s request and provided information about the Swiss tax system and the special tax regimes in favour of management, mixed and holding companies in Switzerland.
3. On 15 December 2005 the issue was discussed between the EC and the Swiss Confederation at the 50th meeting of the Joint Committee on the Agreement in Brussels.

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<sup>1</sup> OJ L 300, 31.12.1972, p. 189.

<sup>2</sup> OJ L 300, 31.12.1972, p. 281.

<sup>3</sup> OJ L 300, 31.12.1972, p. 286.

4. By letter A/7655 dated 9 March 2006 the Swiss authorities replied to the requests made by the Commission at the Joint Committee's meeting on 15 December 2005.
5. On 4 May 2006 experts from the Commission and Switzerland met in Brussels to discuss further the tax regimes and their compatibility with the Agreement.
6. The matter was discussed again on 5 May and 14 December 2006 at the 51<sup>st</sup> and the 52<sup>nd</sup> meeting of the Joint Committee on the Agreement in Brussels.

## II. DESCRIPTION OF THE MEASURES

7. The fiscal system of the Swiss Confederation consists of the Swiss Federation, 26 sovereign cantons and approximately 2 900 municipalities, having a variable fiscal sovereignty except for certain taxes (including customs, excise duties and value-added tax) which are allotted to the Federation.
8. The Federal company tax is levied at a flat rate of 8.5% of taxable income, pursuant to the Direct Federal Tax Law of 14 December 1990 (DFTL). Each of the three levels of government in Switzerland levies direct company taxes. The overall company tax rate, counting Federal, cantonal and municipal taxes, varies from 14% to 30%, depending on the canton or municipality in which companies are established. Cantonal and municipal company taxes therefore make up a substantial part of direct company taxation in Switzerland.
9. A Federal law lays down the principles on which cantonal legislation must base these taxes. The cantonal and municipal rules on company taxation fit into a common framework of Federal legislation with the aim of limiting tax competition between the different tax jurisdictions within the Swiss Confederation, pursuant to the Federal Tax Harmonisation Law of 14 December 1990 (THL).
10. Under this common company tax framework, several preferential tax regimes are available, at cantonal and municipal levels, to companies which are established in Switzerland to reduce the company tax levied to the sole Federal tax of 8.5% of taxable income. Cantonal tax legislation provides for three special company tax regimes for multinational undertakings with activities in Switzerland: the management company, holding company and mixed company regimes. These allow favourable effective tax rates to be applied to profits derived from business activities outside Switzerland and from participations in foreign companies by management, holding and mixed companies.
11. Under the same company tax system, each canton follows its own adaptation of the common framework, implementing the tax regime applicable in the canton. Although this decision takes as examples specific tax regimes laid down by the legislation of the cantons of Zug and Schwyz, it applies to all the cantonal regimes in favour of management, holding and mixed companies in Switzerland, pursuant to the THL.

### *The management company regime*

12. Under the tax regime for management companies, any company established in Switzerland or any Swiss branch of a company established outside Switzerland and solely or primarily with an international focus may register as a management

company and benefit from more favourable cantonal taxation than ordinarily applicable to other companies in Switzerland. Under this cantonal tax regime, the business income received by management companies from sources outside Switzerland (income from business activities performed abroad such as foreign sales) is taxed only in proportion to the management activities effectively exercised in Switzerland. Management companies also benefit from the special cantonal tax regime for holding companies (described in detail below) for their income from participations in other companies, including foreign companies<sup>4</sup>.

13. In particular, pursuant to paragraph 3 of Article 28 of the THL, special tax rules apply at cantonal and municipal levels to the income of management companies from business activities exercised abroad. Income from business activities exercised abroad is taxed in Switzerland only in so far as the income stems from management functions performed in Switzerland. The tax regime for management companies also stipulates that their income from participations in foreign companies, including all dividends, income and capital gains, is exempt from taxation in Switzerland. This provision specifically reduces the income from business activities exercised abroad which is taxable in the Swiss cantons, while keeping intact the income taxable for Federal purposes.
14. As a result of application of the special tax regime outlined above, management companies are liable to taxation based only on their income from (a) management and administrative activities performed in Switzerland and (b) Swiss real estate owned by such companies. Therefore, unlike income from activities in Switzerland which are liable to ordinary cantonal and municipal taxation on the entire income earned, management companies are subject to much lower taxation in the Swiss cantons.
15. Each canton has enacted its own rules to transpose the general framework of tax incentives for management companies, whereas Swiss law provides for no particular Federal tax relief for management companies.
16. By way of illustration, under Article 69 of the Tax Law of the canton of Zug and Article 76(c) of the Tax Law of the canton of Schwyz, management companies are defined as profit-making companies, cooperatives and any other legal persons engaged in management activity but not in business activity in Switzerland. Such entities are liable to company tax as follows:
  - (a) income from holdings and capital and gains from increase in capital value on such holdings are exempt;
  - (b) other income from Switzerland, including real estate income and profits, is taxed at the ordinary rate;
  - (c) other income from abroad is taxed at the ordinary rate, in so far as it can be attributed to management activities performed in Switzerland.

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<sup>4</sup> The difference between a holding company and a management company is that a management company does not earn its income exclusively from foreign participations; instead, foreign holdings are an ancillary activity in addition to the management company's main commercial and business activities exercised abroad.

### *The holding company regime*

17. Paragraph 2 of Article 28 of the THL provides that income earned by holding companies may be entirely exempt from cantonal and municipal company taxes in Switzerland. Under this regime a holding company is defined as a company (i) whose main activities consist of managing participations in affiliated companies, (ii) which carries out no commercial activities in Switzerland and (iii) either (a) has participation revenue equal to two thirds or more of the total revenue earned or (b) has participations with a book value equal to two thirds or more of the total assets on its balance sheet, independent of the amount of commercial revenue earned.
18. The conditions for the cantonal tax exemptions in favour of holding companies are broader in scope than those applied at Federal level under the holding reduction for participation revenue regime provided for by Articles 69 and 70 of the DFTL. The Federal tax exemption applies only to the earnings distributed by Swiss or foreign corporations to entities liable to tax in Switzerland, whereas the cantonal exemption concerns all income earned by beneficiaries, provided they qualify as holding companies. Pursuant to Article 28 of the THL, participation revenue exempt from cantonal taxation typically includes dividends, capital gains and any other extraordinary distributions and dividends. Income received by the holding company that is a deductible expense for the paying company, including interest income, and which therefore reduces the taxable income of the paying company is not normally considered income from participation for the holding company. However, depending on the specific canton where the beneficiary is established, complete tax exemption is granted on income from dividends, interest, royalties, capital gains and commercial activities, provided the company meets the conditions to be considered a holding company.
19. At cantonal level, in certain cantons not only shares in the capital of other companies (without any percentage limit) but also long-term loans to affiliated companies can be considered participations. Affiliated companies are usually defined as companies in which a holding company holds 20% of the share capital. Under paragraph 2 of Article 28 of the THL, capital gains on participations and gains from the increase in capital value of participations are also exempt from company taxes at cantonal and municipal levels<sup>5</sup>.
20. In conclusion, under the holding company regime all earnings from a qualifying participation in a company are exempt from tax at Federal, cantonal and municipal levels, while other earnings obtained from foreign sources, including commercial revenue, are exempt from tax at cantonal and municipal levels. The only revenues of a holding company liable to taxes at cantonal and municipal levels are the ones from Swiss real estate.

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<sup>5</sup> Furthermore, certain cantons grant special tax relief for group financing to finance branches of foreign companies in Switzerland, provided three quarters of the branch's gross profits stem from financing the foreign companies, including trade, and three quarters of its assets are invested in such financing activities. In order to qualify for tax relief, the other non-financing income must account for less than one quarter of the branch's activities. If, however, the trading income exceeds this threshold, it may be possible to establish two branches in order to obtain the benefit.

21. By way of illustration, Article 68(b) of the Tax Law of the canton of Zug and Article 75(b) of the Tax Law of the canton of Schwyz provide that holding companies whose principal registered business activity is permanent management of holdings and which engage in no business activity in Switzerland are not liable to pay tax on profits as long as the holding or income from the holding accounts for at least two thirds of their entire assets or income. The combined company taxation on income from participations, including royalty income from licensing use of intangible property to sell products abroad (licensing fees, royalties, etc.), interest income from group financing activities and income from services rendered abroad, including those connected with trading activities abroad, is therefore limited to 8.73% (the Federal company tax rate) as such income is exempt from cantonal taxation.

*The mixed company regime*

22. Mixed companies are companies holding interests in other companies and which, in addition to earning income from participations like a holding company (primary activity), carry out manufacturing, commercial and trading activities in Switzerland and abroad.
23. Under paragraph 1 of Article 28 of the THL, a mixed company benefits from the cantonal exemption for its earnings from any participations qualifying on the same conditions set for exemption at Federal level. In addition to the exemption regime for holdings, since mixed companies also carry out production, commercial and trading activities Article 28 of the THL provides that the commercial (non-holding) income that such companies earn from sources outside Switzerland is taxable in the canton only in proportion to the volume of business activity performed in Switzerland.
24. Each canton autonomously implements the general framework of tax incentives for such companies and grants partial exemptions for commercial income from foreign sources. Income from foreign sources typically includes revenue from use of intangible property abroad (licence fees, royalties, etc.), interest on loans provided to group companies (intra-group financing) and income from services rendered abroad, including those connected with trading activities abroad. Therefore, under this cantonal tax regime, business income earned by mixed companies from sources outside Switzerland (income from business activities performed abroad) is taxed only in proportion to the business functions exercised in Switzerland, unlike income from sources within Switzerland which is taxed in its entirety.
25. For example, under Article 69 of the Tax Law of the canton of Zug and Article 76(c) of the Tax Law of the canton of Schwyz, mixed companies which engage in activities with an international focus but not in business activity in Switzerland and conduct only a small proportion of their business activity in Switzerland are liable to company tax as follows:
- (a) income from holdings and capital and valuation gains on such holdings are exempt;
  - (b) other income from Switzerland, including real estate income and profits, is taxed at the ordinary rate;

- (c) other income from abroad is taxed at the ordinary rate in proportion to the volume of business activity in Switzerland.

### III. ASSESSMENT OF THE MEASURES

#### *Scope of the assessment*

26. Before assessing the Swiss cantonal tax measures in favour of management, holding and mixed companies under the State aid provision in Article 23(1) of the Agreement, the Commission observes, by way of preliminary, that establishment and maintenance of fair conditions of competition for trade between the Community and the Swiss Confederation is indisputably one of the objectives of the Agreement, as specifically mentioned in Article 1 thereof. The State aid provision in Article 23(1) of the Agreement very clearly declares incompatible with the proper functioning of the Agreement any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, in so far as it may affect trade between the Community and Switzerland.
27. The wording used in the State aid provision in Article 23(1) of the Agreement is very similar to Article 87(1) of the EC Treaty. Neither the terms nor the purpose of the Agreement indicate that Article 23(1) should be interpreted narrowly. On the contrary, the Commission considers that the important role which the Agreement ascribes to the principle of fair competition in the economy and the specific language used to express the principle of incompatibility of State aid are arguments in favour of giving broad scope to that provision. It should also be noted that on signature of the Agreement the EC annexed a declaration that it would assess any practices contrary to Article 23(1) on the basis of criteria arising from application of the EC competition rules, and that Switzerland did not challenge that declaration.
28. Moreover, the Commission considers that, in the context of the Agreement, the traditional strong economic and geographic links between the Community and the Swiss Confederation, plus the fact that Swiss companies already enjoy privileged access to the common market, require correct application of the competition rules, including prohibition of State aid incompatible with the Agreement.
29. The Commission's assessment is therefore based on accepted definitions and common criteria, such as those already in place at the time of signature of the Agreement and those applied by international organisations<sup>6</sup>.

#### *Advantage*

30. The Commission considers that advantages which could favor certain undertakings, in line with the definition of State aid provided by Article 23(1) of the Agreement, can take many forms, including not only a direct subsidy but also indirect relief from charges normally borne by beneficiary undertakings. It is clear that an advantage in the form of a tax reduction is the economic equivalent of a direct subsidy. The Commission accordingly considers that a tax reduction which favors certain beneficiary undertakings and the groups of which they form part by relieving them of

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<sup>6</sup> Cf. Article I.1(a)(1)(ii) of the WTO Agreement on Subsidies and Countervailing Measures.

charges which would normally have been borne by their budgets may constitute State aid under Article 23(1) of the Agreement.

31. The Commission considers that the cantonal tax regimes described above, such as those provided by the cantonal Tax Laws of Zug and Schwyz, confer on management, holding and mixed companies tax advantages that derogate from normal operation of the Swiss tax system and accordingly reduce the costs which the beneficiary companies would normally bear in the course of their business.
32. Under the definition of State aid in Article 23(1) of the Agreement, to be termed state aid, a tax measure must provide an exception, in favor of certain undertakings, from the application of the relevant tax system. The first issue, therefore, is whether an exception has been made and whether such an exception is justified by the nature or general set-up of the system.
33. The Commission notes that, as acknowledged by the Swiss authorities, the common framework of Federal legislation, pursuant to the THL, is the reference tax system. Under this common cantonal tax framework, several preferential tax regimes are made available to management, holding and mixed companies, which are clearly conceived as exceptions to the ordinary tax system as they concern only income from business activities exercised abroad and income from foreign participations by management, holding and mixed companies.
34. The Commission notes that, under certain tax regimes, holding, mixed and management companies benefit from the following cantonal tax reductions:
  - (a) tax exemption for the part of the income, including trading income, earned abroad by management or mixed companies based in Switzerland and not corresponding to activities effectively managed in Switzerland;
  - (b) tax exemption for income from participation interests held abroad by holding companies based in Switzerland having participations with a book value equal to two thirds or more of the total assets on their balance sheet, independent of the amount of trading income earned.
35. The Commission considers that the tax advantages in favour of management and mixed companies do not stem from the nature or general set-up of Switzerland's tax system, because that system does not typically differentiate between Swiss and from foreign source earnings, while only in the case of management and mixed companies is the part of income from foreign sources not corresponding to activities effectively managed in Switzerland exempt. More specifically, the management and mixed companies regimes provide that income earned from sources outside Swiss jurisdiction is liable to the ordinary tax rate only in proportion to the volume of management activity performed in Switzerland. Such regimes therefore confer an advantage since such companies are not taxed on their income which can not be attributed to management activities performed in Switzerland.
36. The Commission further considers that the regime in favour of holding companies also provides exceptional tax advantages in that all income earned by holding companies is exempt from cantonal taxation irrespective of the typical requirements in order to be considered income from participations under the general exemption



system. The Commission notes that, under the Swiss tax system, tax imposed on a company resident in Switzerland can be reduced only to avoid multiple taxation of income distributed along a chain of companies under the exemption regime for participations, where such income has already been taxed. The Commission notes, however, that this justification is not relevant to the cantonal tax reduction in favour of holding companies, as this provides a full exemption for income, based solely on the fact that the beneficiaries fulfil the conditions to be considered a holding company and, most notably, hold participations with a book value equal to two thirds or more of the total assets on their balance sheet, independent of the amount of trading income earned and of the tax possibly paid on the income earned. The holding company regime accordingly provides for exemption of all income earned by companies and cooperatives whose principal registered business activity is permanent management of holdings and which engage in no business activity in Switzerland. Such exemptions constitute economic and financial advantages for the recipients in the form of lower taxation of such companies' earnings and lower tax payments to the cantons' treasuries.

37. The Commission concludes that because of the favourable tax treatment in Switzerland of foreign revenue and revenue from participations, trading and trading-related activities exercised from Switzerland by management, holding and mixed companies, the abovementioned cantonal regimes reduce the costs that certain beneficiary companies bear in the course of their business and therefore provide advantages to them and to the groups of which they form part within the definition of State aid provided by Article 23(1) of the Agreement.

#### *Imputation and public resources*

38. The Commission considers that the advantages under the management, holding and mixed companies regimes are granted by the Swiss Confederation and its cantons, such as Zug and Schwyz, in the form of lower revenue accruing to the public treasuries.
39. The Commission notes that the cantonal tax breaks are an integral part of the Swiss tax system and are imputable to the Swiss Confederation as contracting party to the Agreement. The Commission concludes, therefore, that the loss of tax revenue for the cantons equates to direct subsidies in the form of forgone fiscal expenditure by the Swiss cantons granting such tax reductions, including Zug and Schwyz.

#### *Specificity*

40. The Commission considers that the management, holding and mixed company regimes are specific or selective, in the manner proscribed by Article 23(1) of the Agreement, in that they favour certain undertakings or production.
41. More specifically, the tax reductions provided by the management and mixed company regimes apply only to beneficiaries which earn income from business activities outside Switzerland, whereas income earned from sources in Switzerland, such as real estate income, is liable to ordinary taxation at cantonal and municipal levels. The Commission concludes that only companies engaged in business activities abroad may benefit from the tax reductions in question and that the tax

advantages are therefore not open to all undertakings in comparable situations following the logic of the tax system in Switzerland.

42. In the case of the holding company regime, the Commission considers that the tax exemptions in question are available only to companies whose principal activity is management and holding of participation interests or which hold participations with a book value equal to two thirds or more of the total assets on their balance sheet, whereas other companies are excluded from the exemption and liable to ordinary taxation at cantonal level. The Commission concludes, therefore, that only companies satisfying the conditions to be considered holding companies under the relevant cantonal and municipal tax laws may benefit from the tax reductions in question.
43. The Commission notes that the tax reductions in question can benefit only one category of undertaking, namely undertakings which have export activities or make certain investments allowing them to earn income from abroad or which fulfil the conditions to be considered holding companies. This finding suffices to show that this tax deduction fulfils the condition of specificity which is one of the characteristics mentioned in the definition of State aid, i.e. the selective nature of the advantage in question.
44. The Commission considers that although the aforementioned tax advantages are granted on the basis of objective requirements and are not formally limited to certain sectors of the economy or industries, in order to confirm the selective nature of the contested measures it is not necessary for the competent national authorities to have any discretionary power over application of the tax reductions at issue. The Commission in fact considers that the regimes in question are specific because they are available only to Swiss companies earning income from abroad or from activities carried out with respect to foreign persons or fulfilling other specific conditions in terms of assets or participations. In any event, the Commission considers that they do not constitute general tax measures available to the entire Swiss economy and are therefore selective.
45. The Commission considers that the measures in question are also specific because their advantages are effectively limited to companies carrying out certain business functions such as management and coordination activities, including activities related to trade, either exclusively or primarily. The Commission also notes that such activities typically include intra-group financing, trade licensing (of patents, trademarks, copyrights and other intangible assets) and provision of intra-group services such as coordination or (re-)invoicing which can all be detached from the production and sales functions to be performed locally (i.e. outside Switzerland) and can be allocated across borders (in this case in Switzerland). The Commission notes that these activities constitute a well-defined economic sector relating to the market in cross-border financing, licensing, (re-)invoicing and coordination and management services to affiliate and non-affiliate corporate clients. The Commission therefore concludes that the cantonal tax schemes in question effectively favour the abovementioned economic sector defined by reference to the corporate services market.
46. Such regimes discriminate against multinational enterprises which do not establish their holding or management activities in Switzerland. Specifically, any corporation

currently doing business (including trading) in the EU, and therefore paying company tax in one of the Member States, can reduce its tax liability by locating significant new or existing business functions (including supplying goods and coordinating trade activities) within Switzerland, but will receive no such reduction in tax liability if it locates comparable activities elsewhere. Moreover, out of two businesses in an otherwise similar situation and each liable to Swiss taxation, the business that chooses to expand its outside presence (while leaving the coordination and management functions in Switzerland) will bear a lower tax burden, based directly on its new investments outside Switzerland, whereas a competitor which invests completely in Switzerland will face a comparatively higher tax burden because it will be ineligible for any tax reduction with respect to its income earned outside Switzerland.

### *Justification*

47. The Swiss authorities consider that the cantonal tax system is based on use of the cantonal infrastructure and therefore the lower use of such infrastructure would justify the cantonal tax reductions in favour of management, holding and mixed companies. However, they have not submitted any evidence to substantiate the claim. The Commission considers that use of cantonal infrastructure does not constitute a distinctive characteristic of the cantonal company tax system because it does not apply, for example, to companies which do not take the specific form of management, holding and mixed companies. The Commission observes that, in fact, the cantonal company tax liability of all other companies in Switzerland may not be reduced if they make less use of the cantonal infrastructure. The Commission concludes that this criterion does not justify the more favourable tax treatment granted to management, holding and mixed companies.
48. The Commission also finds that the same criterion is not applied in Switzerland to tax companies at Federal level, whereas, by admission of the Swiss authorities, company taxes are effectively harmonised at Federal, cantonal and municipal levels and therefore could not take a different territorial approach. Secondly, the Commission notes that tax neutrality between income earned, irrespective of the source (local or foreign), is a fundamental principle of the equity of the Swiss company income tax system.
49. The Commission considers that it is unjustified, in the light of the general set-up of the Swiss tax system, for the regimes under review to impose substantively different nominal and effective taxation on Swiss companies generating income from sources placed outside Switzerland, as opposed to their competitors being in comparable legal and factual situations. The Commission therefore concludes that the scheme is selective, in that it favours only certain undertakings conducting business abroad and that this specific feature is not justified by the nature of the scheme.
50. The Commission also considers that the out-of-canton effect of the exemptions conflicts with the territorial scope of cantonal jurisdiction. If a tax measure is to be considered general (and accordingly non-specific) it must be effectively open to all undertakings in comparable business situations, as described by the cantonal laws in question, on the basis of equal access, and its scope may not be reduced by factors that restrict the practical effects of the advantages conferred. These conditions are not fulfilled by the abovementioned cantonal tax reduction regimes, which discriminate

between undertakings subject to company tax depending on their place of establishment and the activities performed outside Switzerland, rather than outside of the canton<sup>2</sup>, without there being any apparent justification by the nature of the territorial scope of cantonal taxation.

#### *Distortion of competition*

51. The Commission considers that the cantonal tax reductions in question favour only certain undertakings and effectively distort or threaten to distort fair competition between Swiss and Community's undertakings. The advantages in question, which relieve the beneficiaries from operating costs normally borne in the course of their business activities, strengthen the position of the beneficiaries and the groups of which they form part and are susceptible to improve their competitive position vis-à-vis their competitors operating on the same markets.
52. The Commission further notes that the advantages in question are likely to affect cross-border competition between the Community and the Swiss Confederation, considering that they are granted specifically with respect to cross-border activities carried out by Swiss-based undertakings and taking account of the geographic proximity and the high economic integration of the Swiss market with the common market.
53. The Commission considers that the markets affected by the scheme include the wholesale and retail sale of products and services, the provision of services related to the supply of products and the supply of financial and corporate services. The typical activities performed by management, holding and mixed companies include direct sales and supplies of services related to such supplies, as well as financing, leasing and the provision of other services, such as and the management of trade licences. These activities can be either detached from the production and sales functions in the Community market and be supplied from the cantons, or be included in production of goods, traded from Switzerland to the Community, and vice-versa. According to the Commission, the tax reductions granted to the management, holding and mixed companies result in a financial benefit strengthening not only the single beneficiary companies but also the groups to which they belong, which may also be active in markets open to cross-border competition.

#### *Effect on trade between the European Community and Switzerland*

54. The Commission considers that the management, holding and mixed company regimes may affect trade in the manner proscribed by Article 23(1) of the Agreement, by influencing existing cross-border trade patterns concerning third-country origin products sold on the common market via the establishment of special-purpose intermediaries in the Swiss cantons granting the tax reductions to carry out trade and trade-related activities from Switzerland instead of from the Member States of the European Community in order to benefit from the company tax reductions granted by the management, holding and mixed company regimes. As the tax advantages in question specifically concern the income earned by such companies from foreign sources, including trading income or income from participation interests held abroad, they may affect cross-border prices in dealings between the European Community and the Swiss Federation and therefore distort trade.

55. The Commission considers that management and mixed companies typically carry out business activities including trade between the Community and Switzerland, as the tax advantages are provided specifically to certain Swiss companies earning income from abroad and taking account of trade between the European Community and the Swiss Confederation. The tax advantages in favour of management and mixed companies effectively take the form of exempting income earned from sources outside Switzerland, including income from sales on the common market, and accordingly favour Swiss-based undertakings by improving their trading conditions vis-à-vis their competitors based in EU Member States carrying out comparable cross-border activities. The Commission therefore concludes that when the business activities carried out by the beneficiary management and mixed companies in Switzerland involve trade between the European Community and the Swiss Federation the tax reductions in question may directly affect trade in a manner prohibited by Article 23(1) of the Agreement.
56. The tax exemptions in favour of holding companies are conditional upon the requirement that the holdings are not engaged in business activity in Switzerland. Such holding companies must necessarily belong to economic groups directly engaged in business activities within and/or outside Switzerland, for which they perform management activities and provide coordination services, including licensing and financing functions. By strengthening the economic position of such economic conglomerates in relation to those with no Swiss holding, the tax exemptions in question may affect trade between the Community and Switzerland in all cases where the groups carry out an economic activity involving trade in goods.

#### *Compatibility of the aid with the functioning of the Agreement*

57. The Commission considers that the tax preferences in question constitute State aid and are incompatible with the proper functioning of the Agreement. The Commission considers that the tax advantages granted by the regimes under review are not related to specific investments which could justify granting an advantage to compensate for specific costs incurred by the beneficiaries but, instead, constitute a reduction of charges that should normally be borne by the firms concerned in the course of their business. They must therefore be considered as public operating aid. As explained above, this type of operating aid has a negative effect on competition as it improves the trading conditions of the beneficiaries by influencing the prices they are able to set in their trade between the European Community and the Swiss Confederation, without achieving any objective of common interest under the Agreement.
58. The Commission takes the view that such aid cannot be considered compatible with the proper functioning of the Agreement. In addition, it does not facilitate the development of certain economic activities of common interest to the parties to the Agreement, nor are the incentives in question limited in time, degressive or proportionate to what is necessary in order to remedy a possible economic handicap or market failure related to trade between the European Community and the Swiss Confederation. The Swiss authorities have not presented any argument in this respect. The Commission concludes that the company tax incentives in question therefore may not be considered compatible with the proper functioning of the Agreement.

#### **IV. ARGUMENTS OF THE SWISS AUTHORITIES**

59. The Swiss delegation to the Joint Committee contested that the tax regimes in question fall under the scope of the Agreement as the competition rules in the Agreement could not be compared with those in the EC Treaty. According to the Swiss authorities, the tax regimes did not constitute public aid and did not distort competition or trade in goods between the EC and Switzerland.
60. Switzerland claimed that the tax measures in question did not fall within the scope of the Agreement, as it could not be interpreted in the same way as the corresponding articles of the EC Treaty. Furthermore the tax measures could not be described as public aid under Article 23(1)(iii) of the Agreement, as the Agreement contains no operational rules on State aid. Switzerland argued that the Commission had in the past abstained from intervening with operators on the basis of the Agreement. In any case Article 23(1)(iii) applied only to taxation at Federal or national level, but not at cantonal or municipal level.
61. According to the Swiss authorities, the tax exemptions were justified as they avoided multiple taxation and the companies in question made only minimum use of Swiss infrastructure. The tax regimes were not selective as any business activity could benefit from the exemptions, irrespective of whether the company was in Swiss or foreign hands.
62. In addition, the trade in goods covered by the Agreement was not affected; either the companies in question did not engage in trading activities or, where they did so, their trading activities were taxed in the normal way. Consequently, there could be no distortion of competition. Finally, the Swiss rules on company taxation had already been in force for over 50 years, and therefore traders could invoke the principle of protection of legitimate expectations.

## **V. THE COMMISSION'S VIEWS ON THE SWISS ARGUMENTS**

63. The Commission considers these arguments to be either unfounded or irrelevant and maintains its assessment outlined above. In particular, concerning the scope of the Agreement, its applicability is obvious from the fact that competition rules are an essential part of the Agreement. Competition is mentioned in the Preamble and in Articles 1(6), 18 and 23, and public aid is covered by Article 23.
64. It is generally acknowledged that tax measures count as public aid if they meet certain criteria. Therefore it must be possible to address the Swiss tax schemes under the Agreement. A perceived answer to the question whether the tax schemes meet these criteria cannot be used as an argument against application of the Agreement. The same applies to the question whether the tax regimes threaten to distort competition and may affect trade and are therefore to be regarded as incompatible with the proper functioning of the Agreement. The facts that these regimes have existed for a long time and that Article 23 has not been invoked before are irrelevant, as forfeiture does not exist in international law.
65. As for the interpretation of Article 23, its wording mirrors Article 87 of the EC Treaty, the only difference being that under the Agreement it suffices that trade between Switzerland and the EC "may be affected", whereas Article 87 of the EC Treaty requires that the aid actually "affects trade between Member States". It should also be noted that the definition of public aid was already in place at the time of

signature of the Agreement in 1972 and corresponds to that generally accepted at international level.

66. The criteria for establishing incompatibility with the proper functioning of the Agreement are listed in Article 23 itself: 1) public aid; 2) distortion or threat of distortion of competition by favouring certain undertakings or production of certain goods; and 3) possibility of affecting trade between the Community and Switzerland. All these criteria are fulfilled, as outlined above.
67. Any inaction against operators or public declarations by Commission representatives about the lack of direct effect of competition rules under the Agreement may not deny the Agreement general validity and may only concern the operators in question. They are irrelevant as far as qualification as State aid is concerned.
68. The classification of the tax regimes as public aid has been explained in detail above. The advantage for the economic operator takes the form of avoidance or reduction of company taxation. This advantage is granted by the State or through State resources in the form of reductions of tax payments which would be due under the generally applicable rules. The alleged distinction between the Federal and local levels is irrelevant as generally all layers of State organisation are concerned. The Federal tax law provides for these regimes and company tax is a typical source of State revenue.
69. The regimes are selective as only certain companies, mainly earning income from outside Switzerland and only companies fulfilling the conditions to be considered holding companies and not primarily active on the Swiss market, are eligible. This is sufficient to consider the schemes selective. The fact that the regimes are granted to branches of foreign, including Community, companies is irrelevant.
70. Avoidance of double taxation is no justification, as the mechanisms for such avoidance are set out in the respective double taxation agreements and, in any case, no proof of taxation in other countries is required. Nor is the marginal use of local infrastructure any justification as this is no general rule and would also apply to companies active on the Swiss market.
71. As for distortion or the threat of distortion of competition, all tax reductions selectively granted to certain operators are by definition liable to distort competition because they amount to financial and economic advantages and tilt the level playing field which is the precondition for fair competition between undertakings operating on the relevant markets. A tax advantage favouring certain undertakings, by its very nature, distorts, or threatens to distort, competition.
72. As regards the possible effect on trade in goods between the Community and Switzerland, the Commission considers that the cantonal tax advantages in favour of management and mixed companies specifically favour activities carried out with respect to foreign persons, including trading activities, and accordingly affect trade. With respect to holding companies, the Commission considers that they also benefit from the exemption for income regarded as similar to income from participations, even if this is trading income. Furthermore, the Commission considers that the exemption of the income from participations granted to holding companies may also affect trade because it indirectly favours the trading companies of the group to which the holding company belongs. To the extent that other companies in the group

produce or trade in goods which are imported from the Community to Switzerland or exported from Switzerland into the Community, trade between the Community and Switzerland is affected.

## VI. CONCLUSIONS

73. The Commission therefore concludes, on the basis of the information available, that the company tax regimes in favour of management, holding and mixed companies of the type applied in the cantons of Zug and Schwyz constitute State aid incompatible with the proper functioning of the Agreement, in particular Article 23(1) thereof. The specific tax breaks in question may directly affect trade between the Community and the Swiss Federation in a manner proscribed by the Agreement, where such companies are actively engaged in such trade activities. The tax advantages in favour of management, holding and mixed companies of the type applied in the cantons of Zug and Schwyz, as well as the other tax practices outlined above, may also indirectly affect trade between the Community and Switzerland in a manner proscribed by the Agreement, where the economic group to which the beneficiary company or holding belongs is actively engaged in such trade.
74. The Commission stresses the great importance of this issue in view of the key role of the Agreement and its proper functioning for the overall relations with Switzerland. It reserves the right to propose the adoption of safeguard measures to the Council in accordance with Article 27(3)(a) of the Agreement and with Article 2 of Regulation 2841/72.,

HAS DECIDED AS FOLLOWS:

### *Article 1*

The State aid schemes implemented by Switzerland in the form of special company tax regimes for management, mixed and holding companies which grant favourable tax rates for income generated abroad are incompatible with the proper functioning of the Agreement.

### *Article 2*

Switzerland should abolish or amend these tax regimes by removing the differentiated tax treatment of domestic and foreign source income.

### *Article 3*

The Commission reserves the right to propose the adoption of safeguard measures to the Council in accordance with Article 27(3)(a) of the Agreement and with Article 2 of Regulation 2841/72.



*Article 4*

This decision shall be communicated to the Swiss Confederation.

Done at Brussels, 13.2.2007

*For the Commission*  
*Benita FERRERO-WALDNER*