

# Update

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## Swiss Corporate Tax Reform III – Federal Council's Dispatch ready to be presented to Parliament

On 5 June 2015, after having set the main lines of the Swiss Corporate Tax Reform III ("CTR III") on the basis of the results of the consultation process, the Federal Council issued the Dispatch relating to the Federal Act on improvement of tax conditions for strengthening the competitiveness and international acceptance of Switzerland as a business location. The Dispatch is now ready to be presented to Parliament. If accepted by the Parliament, the proposed changes to various Swiss tax laws are expected to enter into force between 2018 and 2020.

### Introduction

The CTR III aims at enhancing the attractiveness of Switzerland for companies at the international level while consolidating international acceptance of Switzerland as a business location. At the same time, the Federal Council proposes a package of additional measures in order to improve the Swiss corporate tax system and to safeguard the financial performance of income taxes for the Confederation, cantons and communes. In many aspects, these different goals are in contradiction. Therefore, the global tax strategy consists of three elements designed to attain the objectives referred to in the draft:

- > Introduction of new regulations corresponding to international standards for income deriving from moveable property;
- > Lower cantonal tax rates for corporate income tax;
- > Other measures aiming to increase the systematic of Swiss tax law.

### Key points

The key points of the proposal are to abolish:

- > The special cantonal tax regimes (i.e. holding companies regime, as well as domiciliary and auxiliary/mixed companies regimes) at the latest two years after the entering into force of the new legislation along with a

step-up of hidden reserves (including goodwill) for tax purposes allowing substantial depreciation allowances in the years after the abolishment;

- > The special federal tax treatment of the so-called Swiss principal companies and Swiss finance branches.

In addition to the specific measures that will be described below and in order to compensate the abolishment of these regimes, it should be noted that reductions of ordinary corporate income tax rates are planned at cantonal level even if this is not as such part of the CTR III. Any decision on the amount of such rate falls under the sole responsibility of the cantons. While a few cantons already have low corporate tax rates (such as Lucerne, Schwyz and Zug), some cantons have announced prospective reductions to overall corporate income tax rates of approximately 13%-15% (Geneva), 13.79% (Vaud) or 14% (Zurich) for instance, in order to maintain their attractiveness.

According to the reform, the above-mentioned regimes would be replaced by measures with increased international acceptance, meaning:

- > *Patent Box* at Cantonal level

Income deriving from qualifying intangible property may be separated from other income of an enterprise

through a patent box and thus be subject to reduced taxation (up to 90% of the qualifying income could be exempt). The Federal Council refers to the “Modified Nexus” approach, which has been developed for patent boxes as part of the OECD BEPS project. Some points relating to the Modified Nexus Approach are still in discussion at the OECD level. Hence, the Federal Council’s Dispatch presents the initial situation as in force on 5 June 2015 with regard to patent boxes. Once the OECD sets the relevant standards, it is planned to include them in a Federal Ordinance of the Federal Act on the harmonization of the direct taxes of cantons and/or to specify the final standards during parliamentary deliberations. As for now, qualifying intangible property shall include patents, supplementary protection certificates and exclusive licenses of a patent. There are also additional requirements regarding the substance, as companies have to make a significant contribution to the development or prospective development of the intellectual property;

- > Enhanced tax deductions on expenses incurred for R&D and tax relief for taxation of equity

The Federal Council granted the cantons the opportunity to raise the amounts of deductions on expenses incurred for research and development. This constitutes a non-binding regulation, which means that the cantons are free to introduce this “upstream” tax incentive. However, the Federal Council set basic principles to be respected by the cantons:

- The incentive takes place at the principal’s level – in particular as regards basic research – and is limited to R&D activities conducted on Swiss territory;
- The incentive cannot be combined with a payment in case of loss, as it would more be considered as a subsidy;
- The incentive must be conceived as an enhanced tax deduction.

Moreover, in the field of patents and similar rights, the cantons may introduce targeted reliefs from annual equity tax. Hence, this measure aims at encouraging R&D activities through reduction of tax on equity.

- > General decrease of cantonal profit tax rates

Although technically speaking, this is not part of the CTR III proposal of the Federal Council, it should be noted that reductions of cantonal corporate tax rates are planned at cantonal level to bring down the overall effective tax rate for corporations to a range of 12%-15%. While the corporate tax rates of certain cantons such as Lucerne, Schwyz and Zug already are comparably low and, thus need less of a cut, the tax rates of other cantons, such as Geneva and Vaud are proposed to be cut substantially to come down to 13%-15% (Geneva) or 13.79% (Vaud), respectively in order to maintain their attractiveness.

#### **Additional measures**

Moreover, further measures are designed to improve the systematic of Swiss tax legislation and partly compensate for the expected loss in tax revenues resulting from the abolishment of the cantonal tax regimes. Some of these measures are, therefore not technically linked to the recent international developments:

- > Rules regarding systematic realization of unrealized reserves
  - In case of emigration of companies, Swiss legislation already provides for the levying of corporate income tax (“exit tax”) on all unrealized reserves that are not anymore subject to Swiss tax liability. Moreover, in several cantons, it is already possible to include unrealized reserves in the tax books without tax consequences at the time of change of tax status (from privileged to ordinary taxation);
  - The current draft proposes that, in case of modification of tax status, transfer of seat or place of effective management from abroad to Switzerland in particular, unrealized reserves will be taken into consideration at the time of change of status or of arrival in Switzerland. Thus, unrealized reserves (including goodwill) will be reported in the tax balance sheet without tax impact at the beginning of the Swiss tax liability (step-up in basis). Reported hidden reserves will then mean higher tax deductible depreciation potential for all concerned companies;

- > **Abolishment of the issuance stamp tax on equity capital**  
The current reform also results in the abolishment of the issuance stamp tax on equity capital, as sought by the Parliament. It should, however, be noted that this measure was rejected by the majority of the Swiss cantons during the consultation process and that some political parties already threaten to use the referendum against this measure.
- > **Adjustments to the partial taxation regime for dividends paid to individual**

In order to mitigate double economic taxation of Swiss resident individuals holding participations in Swiss companies, Swiss legislation provides for a partial taxation of individuals. The CTR III aims at adjusting and standardizing the partial taxation regime, both at the Federal and Cantonal levels. Hence, this measure will be binding on the cantons, which are currently free to implement partial taxation regarding the basis of calculation and the amount. According to the Dispatch, the tax relief on dividends will be limited to 30% of the

dividends received (tax relief at the level of the calculation base). Currently, the relief at Federal level and in most cantons is 40%.

Finally, it should be noted that several changes occurred in comparison with the legislation draft presented during the consultation process. Indeed, based on the results of the consultation procedure, the Federal Council decided not to maintain the following measures:

- > Notional interest deduction on surplus equity at federal and cantonal level;
- > Unrestricted use of offsetting of losses with limitation of taxable amount;
- > Adjustments to the participation reduction system;
- > Taxation of capital gains on securities held by individuals.

**Please do not hesitate to contact us in case of any questions.**

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