

Update

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Swiss Corporate Tax Reform III – Release of the Draft Proposal

On 22 September 2014, the Swiss Federal Council launched the consultation process for the Swiss Corporate Tax Reform III (“CTR III”) and released a draft proposal regarding the revision of the Swiss corporate tax system. Interested parties and in particular the Swiss cantons have until 31 January 2015 to comment the consultation draft. If accepted, the proposed changes to various Swiss tax laws are expected to enter into force between 2018 and 2020. This draft proposal is, however, likely to be heavily disputed so that the legislation that will ultimately enter into force may be substantially different from the draft proposal.

I. 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.

II. 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. A reallocation of the current financial equalization measures among the cantons and the Confederation shall partly provide for the required financial means. In fact, 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% (Geneva), 14% (Vaud) or 14% (Zurich) for instance, in order to maintain their attractiveness.

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

> *License Box* at cantonal level:

According to the draft legislation, income deriving from qualifying intangible property may be separated from other income of an enterprise through a license box and thus be subject to reduced taxation (up to 80% of the qualifying income could be exempt). Qualifying intangible property shall include patents, supplementary protection certificates and exclusive licenses of a patent. There are additional requirements regarding the substance, as companies have to make a significant contribution to the development or prospective development of the intellectual property;

> Notional interest deduction on surplus equity at federal and cantonal level:

The Federal Council settled on a model limiting the notional interest deduction on equity capitalization exceeding a certain minimum level. Therefore, the draft legislation distinguishes between core capital and security capital. Core capital is defined as minimum long-term capital which is needed by a company in order to pursue its business activity. Any additional equity qualifies as security capital. Deduction of notional interest is only allowed on the so-called security capital. Regarding the notional interest rate, the draft proposes that the notional interest shall be calculated on the basis of 10-year Swiss government bonds with a mark-up of a maximum of 50 basis points and provides for a minimum rate of 2%.

III. 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 hidden reserves

- In case of emigration of companies, Swiss legislation already provides for the counting of hidden reserves and the levying of exit tax on all hidden reserves that are not anymore subject to Swiss tax liability. Moreover, in several cantons, it is already possible to disclose hidden reserves 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, hidden reserves will be taken into consideration at the moment of change of status or of arrival in Switzerland. Thus, hidden 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;

> Adaptation of capital tax;

> Abolishment of the stamp tax on equity capital;

> Unrestricted use of offsetting of losses with limitation of taxable amount;

> Adjustments to the participation exemption system;

> Taxation of capital gains on securities held by individuals;

> Adaptation of the partial taxation regime for dividends paid to individuals.

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

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