Switzerland's 2019 push for corporate tax reform

After Swiss tax reform failed to secure public support in 2017, lawmakers have revised key tenants to ensure it passes when it goes to a second referendum, this time in May 2019. **Lenz & Staehelin**'s Jean-Blaise Eckert and Frédéric Neukomm discuss the potential impact on corporations and shareholders.

For many years, Switzerland has been under intense international pressure, particularly from the EU as well as the OECD, to reform its corporate tax system and put an end to so-called harmful tax practices.

The first attempt at overhauling the system took the form of corporate tax reform (CTR) III, which was rejected by the Swiss electorate on February 12 2017.

Following this setback, the Federal Council and Parliament immediately drafted a new proposal called Tax Proposal 17, and renamed it as the Federal Act on Tax Reform and AHV Financing (TRAF).

The purpose of the proposal is to ensure compliance of the Swiss corporate tax system with international standards, while maintaining the competitiveness of Switzerland as a place of business. The proposal also includes AHV financing (Old-Age and Survivor's Insurance) measures as a way to help secure old-age pensions.

The TRAF will be put to a referendum on May 19 2019, and if approved by Swiss voters, will enter into force on January 1 2020. The main tax measures introduced by the TRAF affecting both companies and shareholders are discussed below.

Tax implications for companies

Key tenants of the TRAF to impact corporations will include the abolition of cantonal tax privileges, the emergence of lower corporate tax rates at cantonal level, a patent box, deductions for research and development (R&D) and self-financing, relief restriction, capital tax adjustments, disclosure of hidden reserves, and an extension to the flat-rate tax credit.

Abolition of cantonal tax privileges

Under existing rules, status companies (those that benefit from the mixed, domiciliary, holding or principal company regimes, or the Swiss finance branch regime) pay only a reduced profit tax (or none at all) at cantonal level.

The TRAF will put an end to this tax privilege, while providing for a five-year transition period during which the realisation of hidden reserves will be taxed under preferential rules. At federal level, status companies will continue to pay the full profit tax, as is already the case.

Lower corporate tax rates

In the wake of the abolition of cantonal tax privileges by the TRAF, and in order to avoid a mass exodus of status companies, most cantons are planning to substantially reduce their profit and/or capital tax rates.

For example, the canton of Geneva is set to reduce its effective profit tax rate from a combined federal, cantonal and communal rate of 24.16% to 13.99% (of which federal tax amounts to 7.83%, and cantonal and communal tax to the remaining 6.16%).

The lowest profit tax rate will be found in the canton of Nidwalden, with an effective federal, cantonal and communal rate of 11.97%.

Patent boxes

The TRAF requires all cantons to introduce so-called patent boxes, in compliance with the modified nexus approach set forth by the OECD. Under this measure, profits from patents and similar rights will be taxed at a reduced rate at cantonal level.

However, cantons will have to tax at least 10% of these profits. No such beneficial tax treatment will be granted at federal level. Upon entry into the patent box, related R&D expenses that were deducted during previous years will become retroactively taxable.

Research and development deductions

In order to promote R&D, cantons may introduce provisions providing additional deductions to R&D expenditure. This super deduction (with a maximum 50%, bringing the total deduction to a maximum of 150%), will be based on personnel costs directly relating to R&D performed in Switzerland, plus a premium of 35% for other R&D costs (or 80% of costs for R&D carried out by third parties in Switzerland).

Self-financing deductions

High-tax cantons with an effective federal, cantonal and communal tax rate of at least 18.03% will have the possibility of introducing a notional interest deduction on equity capital. The interest rate will be calculated on the basis of the 10-year Swiss government bond rate. Currently, only the canton of Zurich is entitled to introduce such a deduction.

Relief restriction

Tax relief based on the patent box, additional deductions for R&D, and the deduction for self-financing may not exceed 70%. In other words, a minimum taxable profit of 30% must be maintained. Cantons have the option to provide for a higher minimum taxation. Cantons which have set such a minimum at 30% include the cantons of Aargau, Grisons, Jura, Nidwalden, Schaffhausen, Schwyz, Zug and Zurich.

Capital tax adjustments

Cantons have the possibility to tax the capital attributable to financial interests, patents and similar rights, as well as intra-group loans, at a reduced rate in the context of capital tax. This measure is included in the TRAF as a compensation for the loss of the lower capital tax rate that status companies usually benefit from.

Disclosure of hidden reserves

Companies relocating their headquarters to Switzerland will benefit from the so-called step-up system. Hidden reserves, including any self-created goodwill, can be disclosed tax-free, and benefit from additional depreciation in the first few years. If a company relocates its headquarters abroad, an exit tax will be due, as is already the case.

Flat-rate tax credit extension

In the context of the prevention of international double taxation, Swiss permanent establishments of foreign companies will be entitled to benefit from the flat-rate tax credit as well.

Tax implications for shareholders

Key tenants of the TRAF to impact shareholders include increased dividend taxation and capital contribution restrictions.

Increased dividend taxation

Only 60% of income from qualifying participations which are held as private assets (at least 10% of a company's capital), and 50% of income from qualifying participations held as business assets, are taxable at federal level under existing rules.

At cantonal level, this proportion varies between 35-70%. This reduced taxation was introduced to mitigate the effects of the double taxation of dividends.

With the TRAF, shareholders with qualifying participations will now have to pay federal income tax on 70% of dividend income, and cantonal income tax on at least 50% of dividend income.

Capital contribution principle restrictions

Companies listed on Swiss stock exchanges may repay reserves capital contributions reserves to their shareholders tax-free only if they distribute at least the same amount of taxable dividends. Intra-group dividends and capital contributions reserves from assets transferred to Switzerland after February 24 2008 (and in the case of a liquidation) are not affected by this rule. The rule also applies to the issue of bonus shares and nominal value increases from capital contribution reserves.

The TRAF's impact on Switzerland

The TRAF recognises recent changes in the realm of international tax law, and aims to adapt Swiss tax law to this new reality. If this reform is accepted by the Swiss people on May 19 2019 and enters into force on January 1 2020 (as planned), it will allow Switzerland to adapt its legislative framework to meet modern tax standards, while remaining at the forefront of the European corporate tax landscape.

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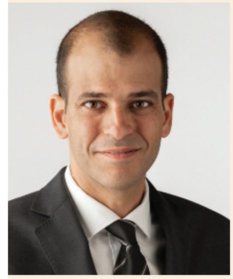

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