

SWISS FEDERAL COUNCIL OPENS CONSULTATION PROCESS ON TAX PROPOSAL 17

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Tags

Corporate Tax
Switzerland
Tax Reform

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INTRODUCTION

Swiss voters rejected the Corporate Tax Reform Act III ("C.T.R. III") in a referendum on February 12, 2017. But Swiss tax reform was not derailed, only delayed. This article addresses events that took place in September of this year that are intended to move the process forward. This article provides an overview of the most important aspects of tax reform that are under consideration currently.

T.P. 17

Recommendations regarding the implementation of a modified corporate tax reform were presented to the Swiss Federal Council on June 1, 2017, under the title Tax Proposal 17 ("T.P. 17"). At its meeting on September 6, 2017, the Federal Council presented a new version of the project.

The proposal provides for the abolishment of existing cantonal tax privileges, as agreed with the E.U. Additionally, the Federal Council proposes the following compensation measures: (i) mandatory introduction of a patent box by all cantons and (ii) voluntary introduction of additional deductions for research and development ("R&D") expenses by the cantons. Further, the proposal provides for the possibility of a tax-neutral realization (*i.e.*, a step-up in basis) of hidden reserves that were created under the old tax regimes or before immigration to Switzerland. The previously-proposed notional interest deduction is no longer part of the reform package. In order to finance T.P. 17, the privileged taxation of dividends from qualifying participations will be limited to 30% (currently: 40% on the Federal level and usually up to 50% on the cantonal level).

General reductions to cantonal corporate income tax rates are not part of the proposal because the cantons may independently decide on reductions. In order to provide the cantons with more fiscal flexibility, the proposal provides for an increase of the canton's share in income from the direct Federal tax.

ABOLITION OF CANTONAL TAX PRIVILEGES

With the Federal Act on T.P. 17, the existing legal basis for cantonal tax privileges available to holding, domicile, and mixed companies will be abolished. As soon as it is definitive that T.P. 17 will be implemented (*i.e.*, once it is clear that there is no referendum against T.P. 17 or once T.P. 17 has been accepted in a referendum by the Swiss voters), the cantons will have until the time T.P. 17 comes into force to adapt the cantonal tax laws to the new Federal requirements. The cantons are free to abolish the cantonal tax privileges before the whole T.P. 17 comes into force.

When the cantonal laws come into force, companies that benefit from cantonal tax privileges will be subject to ordinary taxation. T.P. 17 provides for a five-year transition period during which the realization of hidden reserves established during the old regime are taxed separately. Alternatively, hidden reserves of a tax-privileged company may also be realized tax-neutrally in the course of giving up the privileged tax status before the new rules come into force. Such realization of hidden reserves may then be amortized over the following years (the so-called previous-law step-up). Further, special practices regarding the tax allocation of principal companies and finance branches will be abolished by the Swiss Federal Tax Administration.

Pursuant to a statement by Federal Counselor Maurer, Switzerland agreed to abolish cantonal privileges by 2019. Since the Dispatch for T.P. 17 will only be provided to the Federal Council by the Federal Department of Finance in the spring 2018, the new law may not come into force until 2020 at the earliest, and therefore, abolishment of the tax privileges by 2019 is impossible. It is conceivable that this may entail sanctions by the O.E.C.D. or unilateral anti-avoidance measures by individual states.

Further, it should be noted that information on tax rulings regarding privileged tax regimes that are still applicable on January 1, 2018 may be spontaneously exchanged with other jurisdictions in the course of the spontaneous exchange of information.¹ Even if the respective rulings are retracted before January 1, 2018, the privileged taxation may still be claimed by the taxpayer until the cantonal tax laws are changed or until tax-privileged status is given up by the taxpayer, provided that the requirements for the privileged tax status are still fulfilled.

PATENT BOX

A patent box will be introduced under T.P. 17 and will be mandatory for all cantons. This patent box provides that taxable income derived from patents and comparable rights is taxed with a reduction of up to 90% upon request. At the Federal level, such profits are taxed without a reduction.

The patent box regime fulfills the requirements provided by the O.E.C.D. (the so-called modified nexus approach). Pursuant to this modified nexus approach, income from qualifying rights may only be subject to a privileged regime in proportion to the extent overall R&D expenses are allocable to the taxpayer. Allocable R&D expenses consist of expenses for R&D performed by the taxpayer in Switzerland, expenses for R&D performed by third parties, and expenses for R&D performed by group companies in Switzerland.

ADDITIONAL R&D DEDUCTIONS

The cantons are authorized in T.P. 17 to provide an additional deduction from the cantonal corporate income tax base for R&D that is performed in Switzerland. This additional deduction must not exceed 50% of the qualifying R&D expense.

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¹ See “Spontaneous Exchange of Tax Rulings – The Swiss Angle,” *Insights 9* (2017).

LIMITATION ON TAX RELIEF

As was the case with C.T.R. III, T.P. 17 proposes the introduction of a limitation on tax relief. The limitation on tax relief provides that at least 30% of the taxable profit of a company must be subject to tax before the application of any special regimes, such as the patent box and the additional R&D deductions. In addition, no losses may result from the application of the special regimes.

INCREASED DIVIDEND TAXATION

T.P. 17 proposes that dividend taxation for individuals with qualifying participations should be increased to at least 70% at the Federal and cantonal levels. Currently, only up to 60% of such dividends is taxed on the Federal level and only up to 50% is taxed in most cantons. This measure is intended to finance the tax deficits connected with T.P. 17 and the cantonal tax rate reductions.

INCREASED CANTONAL SHARE IN DIRECT FEDERAL TAX

To the extent possible, T.P. 17 aims at keeping Switzerland fiscally attractive for mobile activities. However, the tax incentives of T.P. 17 affect only certain kinds of mobile income. The profits not covered by these incentives are subject to the ordinary corporate income tax rate after the abolishment of the current tax privilege system. In order to prevent Swiss companies that currently enjoy tax privileges from moving aboard, the cantons must reduce – in certain cases drastically – their corporate income tax rates. This is illustrated in the chart at the end of the article. In order to provide the cantons with more flexibility in this regard, T.P. 17 provides for an increase of the cantonal share of income from direct Swiss Federal tax. The reduction of the cantonal corporate income tax rates, which is made possible by this measure as well as the revision of the inter-cantonal financial equalization, is by far the most important part of T.P. 17.

RELIEF FOR CAPITAL TAXES

Companies benefitting from a privileged tax regime currently pay capital tax at a reduced rate. T.P. 17 proposes that the cantons should provide appropriate compensation measures to maintain their attractiveness once the privileged tax regimes are abolished.

REALIZATION OF HIDDEN RESERVES

T.P. 17 provides for a tax-neutral realization of hidden reserves upon relocating to Switzerland and tax-effective amortization in the following years. This produces a symmetry with the tax treatment of a relocation abroad, which triggers the taxation of hidden reserves.

It should be noted that the hidden reserves are not realized on the tax balance sheet but are instead determined by the tax administration through decree.

CANTONAL TAX RATE REDUCTIONS

The reduction of cantonal corporate income tax rates is not directly part of T.P. 17. With regard to the planned implementation under C.T.R. III, most of the cantons that did not already have low tax rates planned to implement rate reductions. Various cantons developed different strategies based on facts and circumstances unique to each canton. The cantons of Vaud and Geneva, for example, propose to implement compensation measures only to a limited extent while substantially reducing the general tax rates. Other cantons, like Zurich, would reduce the tax rate by a relatively small amount and make more extensive use of compensation measures.

It is assumed that the announced proposals at the cantonal level will not fundamentally differ at the time of implementation of T.P. 17. Furthermore, with an increase in the cantonal share in the income from the direct Swiss Federal tax and changes in the inter-cantonal financial equalization, cantons will be able to proceed with tax rate reductions in a more or less fiscally neutral manner.

TRANSPOSITION

T.P. 17 further provides that all sales of participation rights to a company in which the seller holds an interest of at least 50% will be subject to tax, to the extent the consideration for such transfer exceeds the sum of share capital and capital contribution reserves. This applies also if several people act in concert with regard to the transfer and collectively fulfill the 50% requirement.

A tax-free private capital gain is therefore no longer possible under T.P. 17 with regard to a transfer of participation rights to a controlled company. This is to be compared to the current provision, which provides that only transfers of at least 5% to a controlled company are subject to taxation.

TIMING FOR IMPLEMENTATION

The Federal Council's Dispatch on T.P. 17 is expected in the spring of 2018, hence the new provisions cannot come into force before 2020. Afterwards, the cantons must adapt their cantonal tax laws to the new provisions of the Federal Act on the Harmonization of Cantonal Taxes. Current tax privileges are therefore expected to continue for several years.

CONCLUSION

Within a relatively short period of time, a compromise has been achieved politically regarding tax reform. T.P. 17 contains the most important points of the C.T.R. III in a hopefully majority-backed proposal. Nonetheless, the absence of a notional interest deduction in T.P. 17 is troubling. It would have been an important tool for Switzerland to attract group financing activities. Whether this will be corrected in the course of parliamentary consultation remains to be seen.



CHART

Standard Corporate Income Tax Rates by Canton (incl. Federal)		
Canton	Current	Under T.P. 17
Aargau	18.6%	Open
Appenzell Ausserrhoden	13.0%	Open
Appenzell Innerrhoden	14.2%	Open
Basel Country	20.3%	14.0%
Basel City	22.2%	13.0%
Berne	21.6%	16.4 – 17.7%
Fribourg	19.9%	13.7%
Geneva	24.2%	13.5%
Glarus	15.7%	14.2%
Grisons	16.1%	Below 15%
Jura	20.9%	Open
Lucerne	12.3%	No Reduction
Neuchâtel	15.6%	Open
Nidwalden	12.7%	No Reduction
Obwalden	12.7%	Open
St. Gall	17.4%	14.0%
Schaffhausen	16.0%	12 – 12.5%
Schwyz	15.3%	Open
Solothurn	21.5%	12.9%
Thurgau	16.4%	13.0%
Ticino	20.7%	17.5%
Uri	15.1%	Open
Valais	21.6%	15.6%
Vaud	22.1%	13.8%
Zug	14.6%	~ 12%
Zürich	21.2%	18.2%

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