2020 WILL MARK THE END OF AN ERA: SWISS CORPORATE TAX REFORM ACCEPTED

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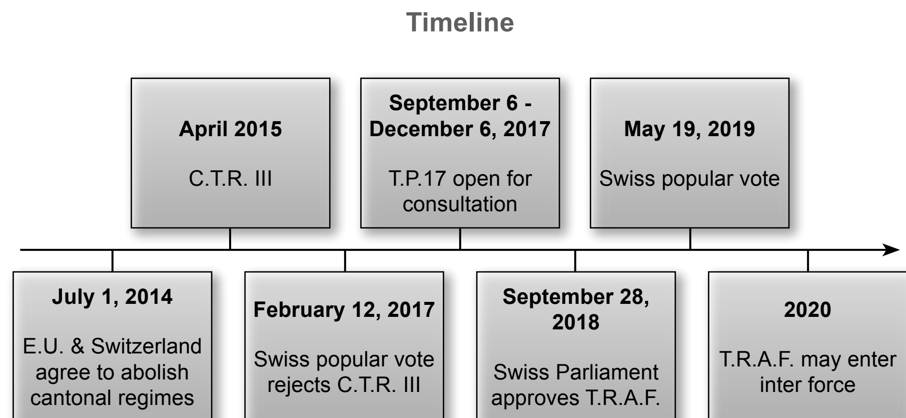
INTRODUCTION

On May 19, 2019, Swiss Federal and Genevan cantonal voters accepted the 2020 Swiss Federal and Genevan cantonal corporate tax reforms by a large majority. As explained below in detail, as of 2020, Switzerland will, on one hand, abolish its widely criticized cantonal special tax regimes and certain Federal regimes. On the other hand, Switzerland and the cantons will introduce generally applicable reduced and attractive corporate income tax rates as well as several new special regimes, meeting current international standards and requirements. In sum, Switzerland is expected to remain attractive for existing and new corporate ventures.

CHANGES TO THE SWISS AND GENEVAN CORPORATE TAX SYSTEMS AS OF 2020

Timeline



In response to international criticism and strong pressure from the E.U. and the O.E.C.D., the Federal Act on Tax Reform and A.H.V. Financing ("T.R.A.F.") abolishes the current corporate tax privileges for (i) base, auxiliary, domicile, and mixed companies; (ii) holding companies; (iii) finance branches; and (iv) principal companies as of December 31, 2019.

At the Federal level, the Swiss Parliament previously accepted the law on June 14, 2016, as the so-called 3rd Corporate Tax Reform ("C.T.R. III"). However, the Swiss electorate rejected the C.T.R. III by referendum in February 2017. The general view was that C.T.R. III provided benefits for large corporations without benefitting ordinary individuals. The Swiss Federal Council originally intended to solve this issue by increasing family allowances. However, since this measure would not have

benefited the entire population by any stretch, Parliament instead decided in favor of linking corporate tax reform with supplementary financing for A.H.V. (*i.e.*, the first pillar of old age pension insurance).

In the spring of 2018, the T.R.A.F. proposal was introduced in Parliament. It was subsequently adopted there in a final vote on September 28, 2018. Finally, on May 19, 2019, the Swiss voters accepted T.R.A.F. by a large two-thirds majority. The reform can now enter into force on January 1, 2020.

At the cantonal level, the Geneva State Council adopted the draft law to implement T.R.A.F. on October 17, 2018. On December 11, 2018, the tax commission of the Genevan Parliament approved the cantonal draft law, which was accepted by voters on May 19, 2019.

As a result, the following measures are introduced as of 2020:

- **Tax Privileges:** As previously mentioned, T.R.A.F. abolishes the current corporate tax privileges for (i) base, auxiliary, domicile, and mixed companies; (ii) holding companies; (iii) finance branches; and (iv) principal companies as of December 31, 2019. In this context, please note that the Swiss Federal Tax Administration ("F.T.A.") no longer applies the practices of principal companies and Swiss finance branches to new companies beginning in 2019.

- **Effective Corporate Income Tax Rates:** The cantons have the option to reduce the effective cantonal corporate income tax rate. Each canton should decide which rate should be applicable.

  As of 2020, the canton of Geneva will provide an effective general cantonal corporate income tax rate of 13.99%, with an absolute minimum of 13.48%.

  Ahead of this, the canton of Vaud already reduced its corporate income tax rate from 23.5% (Lausanne) to 13.79% beginning in 2019 and approved by popular vote on March 20, 2016, with an astonishing majority of 87%.

- **Capital Tax for Companies:** T.R.A.F. allows cantons to introduce reduced capital tax rates for qualifying participations, patent box assets, and intra-group loans. Cantons were already allowed to credit the corporate income tax against the capital tax.

  As of 2020, the canton of Geneva will provide (i) a special reduced capital rate of 0.0012% for the above-mentioned qualifying assets and (ii) a progressive credit of corporate income tax against capital tax. As of the tax year 2024, 100% of the corporate income tax will be available for credit against the capital tax. In other words, no capital tax will be due as long as sufficient profits are maintained.

  Today, the canton of Vaud already provides for a full credit of corporate income tax against capital tax.

- **Patent Box:** As of January 1, 2020, a patent box will be introduced at the cantonal tax level to provide privileged taxation on income from patents and similar intellectual property ("I.P.") rights. The tax privilege will consist of an exemption from cantonal tax on up to 90% of qualifying I.P. income. The cantons are free to apply a lower exemption.

The O.E.C.D.'s nexus approach for I.P. regimes will be applied in the sense that I.P. income will qualify for benefits only to the extent that the taxpayer demonstrates the income results from R&D expenses that it has incurred in developing the I.P. This means that income derived from acquired I.P. will not qualify for the patent box exemption.

Individual enterprises ("Independents") will also be able to benefit from the new Swiss patent box regime.

The canton of Geneva will also introduce the new O.E.C.D.-compliant restricted patent box, but the cantonal reform provides that qualifying income from patents would benefit only from a reduction of up to 10%.

- **Cantonal Research & Development ("R&D") Incentives:** With the aim to promote Swiss-based R&D activities, the cantons are given the option to apply a super-deduction for Swiss R&D expenses up to a maximum of 150% of qualifying expenditures. The cantons are free to enact the new R&D tax incentives from January 1, 2020. If adopted, incentives will also apply to Independents. As of January 1, 2020, the canton of Geneva will introduce a super-deduction of 150% for Swiss R&D expenses.

- **Notional Interest Deduction ("N.I.D."):** As of 2020, T.R.A.F. will allow cantons to introduce an N.I.D., provided the effective overall corporate income tax rate in the capital city of the canton is at least 18.03%. Based on current legislation and proposals, it is expected that this will be the case only in the canton of Zurich, which plans to adopt an effective rate of 18.2%.

- **Hidden Reserves:** Hidden reserves and goodwill that were created when a company was abroad, or that relate to the relocation of assets or functions to Switzerland, can be capitalized (stepped-up) in the tax balance sheet without immediate taxation. Similarly, such hidden reserves and goodwill will be taxed immediately if the company, its assets, or its functions leave Switzerland or are otherwise no longer subject to Swiss tax (*e.g.*, in the case of liquidation).

  For newly arriving companies, the step-up remains tax-free and the hidden reserves can subsequently be amortized in the following years (*e.g.*, goodwill depreciation over ten years), resulting in substantial tax reductions. For existing Swiss-resident companies currently enjoying a cantonal tax privilege, the hidden reserves must be determined by way of a special assessment by the cantonal tax authorities at the time T.R.A.F. enters into force on January 1, 2020. At that time, hidden reserves will be separately taxed at reduced rates if and to the extent they are realized within a five-year transition period following the entry into force of T.R.A.F., *i.e.*, the tax day of tax year 2024. Geneva provides for a special reduced rate of 13% applicable to the above-mentioned hidden reserves.

- **Dividend Taxation:** The tax on dividend distributions to individual substantial shareholders (10% or more ownership) is increased to 70% of the tax base at the Federal level and a minimum of 50% of tax base at the cantonal level as determined by the cantons and using financing and compensation in connection with the measure. The reform accepted in Geneva provides for a base of 70% for private assets and 60% for business assets.

- **A.H.V.:** T.R.A.F. includes supplementary financing of around CHF 2.0 billion for A.H.V. – CHF 1.2 billion due to the increase in salary contributions (0.3%) and CHF 0.8 billion due to the increase in the Federal A.H.V. contribution and waiver of the Confederation's share of the percentage point of V.A.T. earmarked for demographic change.

- **Transpositions:** Anti-abuse provisions in the law treat a transposition as a taxable private capital gain by exception. Ordinarily, private capital gains are exempt from tax in Switzerland. "Transposition" is the term used for a sale to one's self. It occurs when an individual sells participation rights to a company in which he or she holds a controlling stake, which is at least 50%. The current statutory regulations provided for a *de minimis* rule under which tax is imposed only when at seller transfers at an interest of at least 5%. Apparently, major repetitive transfers were effected on interests below the 5% threshold. Parliament perceived that the *de minimis* transfer rule was prone to abuse. Consequently, the threshold has been abolished under T.R.A.F. as of 2020. At that point, the gain on a transposition will be taxed.

- **Capital Contributions:** As of 2020, Swiss listed companies must also distribute a taxable one-franc dividend for each franc distributed free of tax because they are paid from the capital contribution reserve. This will result in additional receipts for the Confederation, cantons, and communes. In Parliament, these additional receipts were estimated at CHF 150 million. Certain exceptions apply to restructurings and to foreign companies moving to Switzerland.

CONCLUSION

Approval of T.R.A.F. marks the end of an almost 14-year tax dispute between Switzerland and the E.U. As of 2020, Switzerland will generally provide attractively low corporate income tax rates to all economic actors, whether Swiss or foreign, while at the same time introducing some new special tax regimes that are fully compliant with today's strict international standards and requirements.

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