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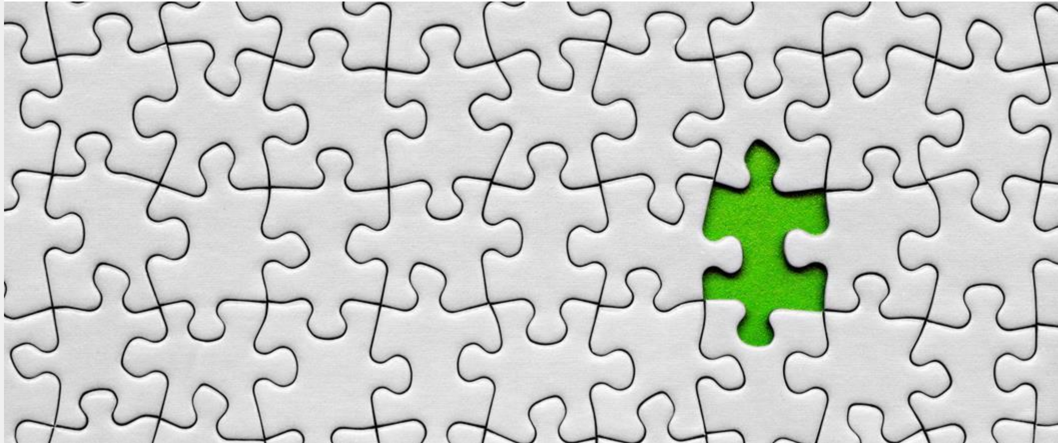
Switzerland | Tax | 8 June 2015



Switzerland Tax Alert

Revised draft legislation on Corporate Tax Reform III introduced into parliament

On 5 June 2015, the Swiss federal government introduced revised draft legislation, along with a detailed commentary on the Corporate Tax Reform III (CTR III), into parliament. The main objective of the CTR III is to align Swiss tax law with international standards and enhance Switzerland's attractiveness as a location for multinational companies. The CTR III likely will become effective on 1 January 2019.

The revised draft legislation takes into account the feedback received during the legislative consultation on the initial draft legislation issued on 22 September 2014, as well as developments under the OECD BEPS (base erosion and profit shifting) initiative (for prior coverage, see the alert dated 23 September 2014).

The CTR III would allow many Swiss companies that currently do not benefit from special tax privileges, as well as foreign companies that intend to migrate into Switzerland, to benefit from lower taxation. It also would phase out all special corporate tax regimes, such as the mixed, domiciliary, holding and principal company regimes, as well as the Swiss finance branch regime.

A number of measures are included in the revised draft legislation to compensate for the elimination of the beneficial tax regimes. Measures that would aim to improve the attractiveness of Switzerland as a location include the following:

- Reduction of the general tax rates (i.e. the cantonal/communal corporate tax rates) at the discretion of the individual cantons;

- Introduction of a patent box that would be mandatory for all cantons and applicable to all patented intellectual property (IP) for which the R&D spend occurred in Switzerland (the OECD modified nexus approach);
- Introduction of R&D incentives in the form of excess R&D deductions (super deductions) at the discretion of the individual cantons;
- Allowing a step-up (including for self-created goodwill) for direct federal and cantonal/communal tax purposes upon the migration of a company or of additional activities and functions to Switzerland;
- Allowing the tax-privileged release of hidden reserves for cantonal/communal tax purposes for companies transitioning out of tax-privileged cantonal tax regimes (such as mixed or holding companies) into ordinary taxation in a manner that would reduce the cantonal/communal tax rate over a five-year period, such that in some cantons the previous tax-privileged rate could be maintained for five years;
- Reduction of the cantonal/communal annual net wealth tax in relation to the holding of participations and of patented intellectual property at the discretion of the individual cantons;
- Abolition of the 1% capital issuance tax on equity contributions; and
- Extension of the eligibility for foreign tax credits to Swiss permanent establishments of foreign entities that are subject to ordinary Swiss taxation at both a federal and a cantonal/communal level.

Revenue-raising measures

The revised draft contains marginal revenue-raising measures to compensate for the expected shortfall of tax revenue as a result of the reform. To partly compensate for the abolition of the 1% capital issuance tax, the partial taxation of investment income, such as dividends, of Swiss resident individual shareholders of investment income from participations of at least 10% would be increased to 70% (currently 60% if such participations are held as private property and 50% if held as business property). The increased 70% partial taxation also would apply on a cantonal/communal level for all cantons.

Measures to attract multinational companies

Reduction of corporate tax rates: Many cantons would reduce their headline corporate tax rates that currently range from approximately 12% to 24% (combined federal/cantonal/communal rate). While, for example, the rates for the cantons of Lucerne and Schwyz (certain areas) already are at approximately 12%, Zug has announced plans to reduce its rate to approximately 12%, Geneva to approximately 13% and Vaud to approximately 13.8%.

Patent box: A patent box regime would be introduced for cantonal/communal tax purposes that would encompass qualifying patent income, provided the R&D spend in relation to the registered patent (or similar IP, such as supplementary protection certificates or first applicant protections) occurred in Switzerland. In addition, an uplift of up to 30% for actual related foreign R&D expense (e.g. removal and

acquisition costs) would be granted. The proposed regime, therefore, would follow the modified nexus approach under action 5 of the OECD BEPS initiative. Qualifying patent income would be calculated based on a residual method, i.e. all income of a company that is not specifically labeled as nonpatent income would be considered patent income.

Nonpatent income would include (i) financing income; (ii) income from manufacturing, trading and other services not relying upon patents; (iii) income from routine functions; and (iv) income from trademarks. The cantons would be able to exempt up to 90% of the patent income from taxation for cantonal/communal tax purposes, which generally would result in an effective tax rate of as low as 10% on qualifying patent income.

R&D incentives: Cantons would be able to introduce R&D incentives in the form of excess R&D deductions for tax purposes (i.e. super deductions). No information is available to date in regard to the potential extent of such deductions.

Step-up upon migration of a company or of activities and functions to Switzerland: A step-up would be allowed for direct federal and cantonal/communal tax purposes (including on self-created goodwill) for companies or additional activities and functions migrating to Switzerland. The step-up would have to be allocated to individual assets to the extent possible and amortized according to the individual amortization period pertaining to such assets. The portion of the step-up that exceeds the fair market value of assets, i.e. goodwill, would have to be amortized over a period of 10 years. The same method for establishing the fair value would be applied for determining the exit tax for companies or activities and functions leaving Switzerland. The rationale for the step-up is that Switzerland, while levying a tax on exit, would not tax any increase in value that occurred outside the Swiss taxing jurisdiction.

Tax-privileged release of reserves for companies transitioning out of tax-privileged regimes: Companies transitioning out of tax-privileged cantonal tax regimes (such as mixed and holding companies) into ordinary taxation could release hidden reserves (including self-created goodwill) in a tax-privileged manner for cantonal/communal tax purposes within a period of five years, based on the rationale that such hidden reserves were not or were only partially subject to cantonal/communal taxation under these regimes. The hidden reserves would be taxed at a reduced rate when released in a manner that would reduce the effective cantonal/communal tax rate over a period of five years, with a maximum reduction down to the level of the previous tax-privileged rate in certain cantons. The amount of hidden reserves (including goodwill) would have to be documented by a generally accepted valuation method and would be confirmed by the tax authorities. This mechanism is not expected to result in a requirement to set up a deferred tax asset under IFRS or US GAAP on the date of transition, so there would be a full effective rate benefit of the relevant tax rate reduction in the financial statements.

Comments

The revised draft legislation is both more attractive and more restrictive than the initial draft legislation presented in 2014. On the positive side are the abandonment of the introduction of a capital gains tax for individuals as the main revenue-raising measure, as well as the introduction of R&D incentives. The negatives include a

more restrictive patent box regime that would take into account the new OECD standards, and the dropping of the notional interest deduction.

The CTR III continues to be a work in progress, and the proposals still are subject to change. There is some speculation, for instance, that the parliament may reintroduce the notional interest deduction in the final version of the law.

The two chambers of the Swiss parliament are scheduled to vote on CTR III in the fall of 2015 and spring of 2016, respectively. There also may be a referendum and national vote on the legislation. Cantonal tax laws subsequently would have to be amended to reflect the changes, so the most likely date for the law to become effective would be 1 January 2019.

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