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Chambers of parliament agree on details of Corporate Tax Reform III

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On 14 June 2016, the two chambers of the Swiss parliament reconciled their differences relating to the Corporate Tax Reform III (CTR III) (for prior coverage, see the *World Tax Advisor* article dated 8 April 2016). The main objectives of the reform, which likely will become effective on 1 January 2019, are to align Swiss tax law with international standards and to enhance Switzerland's attractiveness as a location for multinational companies.

The reform 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. Federal and cantonal tax holidays would not be affected by the reform and would continue to be granted. Many Swiss companies that currently do not benefit from special tax privileges, as well as foreign companies that intend to migrate into Switzerland, could benefit from lower taxation under the reform.

A number of measures are included in the legislation on CTR III to compensate for the elimination of the beneficial tax regimes. The measures that 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 of 150% of qualifying expenditure, at the discretion of the individual cantons;
- Allowance of 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;
- Allowance of 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;
- Introduction of a notional interest deduction (NID) regime at the discretion of individual cantons (however, such cantons would be required to introduce a revenue-raising measure (discussed below) to partially compensate for introducing an NID); and
- Reduction of the cantonal/communal annual net wealth tax in relation to

the holding of participations and of patented IP, at the discretion of the individual cantons.

Main measures to attract multinational companies

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). For example, Zug would reduce its effective tax rate to approximately 12%, Schaffhausen to 12.5%, Geneva to 13%, Fribourg to 13.72%, Vaud to 13.8% and St. Gallen to somewhere between 12% and 14.5%. Other cantons, such as Appenzell IR and Appenzell AR, Lucerne, Nidwalden, Obwalden and Schwyz already have very low effective tax rates for companies, of roughly between 12% and 14%.

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 Swiss patent box regime, therefore, would follow the modified nexus approach, as provided under action 5 of the OECD BEPS project.

Qualifying patent income would be calculated based on a residual method, i.e. all income of a company that is not specifically labelled 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 could introduce R&D incentives in the form of excess R&D deductions for tax purposes (i.e. super deductions), to the extent of 150% of the R&D spend in Switzerland (the deduction for tax purposes would be 150% of the actual expense).

Step-up upon migration: 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 migrated 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: 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 cantonal/communal tax rate of the company over a period of five years. 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; such confirmation would be binding. This mechanism could allow for favorable financial statement treatment, since no deferred tax asset should have to be set up under IFRS or US GAAP accounting standards.

NID: An NID would be granted on “surplus equity” (which would be defined per asset class) at the discretion of individual cantons. While many companies likely could benefit from the regime, it is designed to favor financing companies in particular. The permitted NID rate would equal to the 10-year Swiss government bond rate.

Cantons that opt to introduce an NID on equity would be required to tax at a cantonal/communal level at least 60% of the dividend income received by individuals from qualifying participations of at least 10%, under the partial taxation regime for dividends. (Cantons currently tax 50% or less of such dividends at a cantonal/communal level.)

The combined tax reduction available through the patent box, the release of hidden reserves and the R&D super deduction would be limited to 80% of the cantonal/communal taxes.

Comments

The CTR III should help to attract more multinationals to Switzerland, as well as to keep existing multinationals in the country. The legislation would introduce a competitive corporate tax regime that is internationally accepted and fully takes into account the requirements of the OECD BEPS agenda.

The two chambers of the Swiss parliament are scheduled to take a final vote on CTR III on 17 June 2016, which is expected to be largely a formality to approve the legislation. However, there likely will be a referendum and national vote on the legislation. Cantonal tax laws subsequently would have to be amended to reflect the changes, so that the most likely date for the law to become effective would be 1 January 2019.
