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Corporate tax reform report advocates strengthening of international tax competitiveness

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Switzerland's federal government published an interim report on 17 May 2013 that contains the initial recommendations of the steering committee in charge of what has been termed the "Swiss Corporate Tax Reform III." The overriding objective of this contemplated comprehensive reform is to secure and strengthen the tax competitiveness and attractiveness of Switzerland as an international location for corporations. To achieve this objective, the steering committee considers it an imperative that the tax system offer solutions that provide for competitive taxation and that are accepted internationally.

The recommended changes discussed below are in part a response to challenges raised by the European Commission to the effect that some of Switzerland's tax rules constitute unfair tax competition and are in violation of the 1972 Switzerland-EU Free Trade Agreement. The Commission has asked Switzerland to present alternative solutions by June 2013.

Replacement of holding, mixed and domiciliary company tax regimes within five to seven years

To improve the competitiveness of the Swiss tax regime and to provide taxpayers with certainty that the international community will accept Swiss tax measures in the long term, the steering committee recommends replacing the holding company, mixed company and domiciliary company regimes within the next five to seven years (i.e. as from 2018 or 2020). These tax regimes would be replaced by a variety of measures that are at least as attractive. The transition period is needed given the complexities of the Swiss legislative process for implementing a comprehensive tax reform.

The holding company regime allows for the non-taxation at a cantonal/communal level of activities such as the generation of interest and management fee income, in addition to the holding of participations. The mixed and domiciliary company regimes are considered to have elements of "ring-fencing" since they tax foreign profits at a lower rate than domestic profits. These regimes have been the particular targets of the European Commission.

The federal government emphasizes that it is critical for Switzerland to introduce alternative measures that are at least as attractive as the existing regimes. The holding, mixed and domiciliary regimes generate almost 50% of all Swiss federal corporate tax revenue and create many jobs, which Switzerland cannot afford to lose.

Replacement measures

The steering committee recommends several measures to replace the holding, mixed and domicilary company regimes that would accomplish the dual goals of tax competitiveness and international acceptance.

First, the committee proposes the introduction of two regimes that are already offered by several EU member states:

- A "license box" for income arising from the exploitation and use of intellectual property; and
- A notional interest deduction that would afford equal tax treatment to interest-bearing debt, non-interest bearing debt and equity equally.

It also is recommended that the headline tax rate (effective combined federal/cantonal/communal rate) be substantially reduced across the board from currently approximately 12% to 24%, depending on the canton, to between 12% and 14%, a rate that is currently offered by only a handful of Swiss cantons. The rate reduction would be achieved by lowering the cantonal/communal tax rates so that they are on a par with the most competitive locations internationally in this regard.

Other measures to increase the general tax attractiveness of the country are being considered, such as broadening the participation exemption from an indirect exemption to an outright exemption; making it possible for cantons to eliminate the annual net wealth tax for corporations; abolishing the capital issuance tax on capital contributions; and amending the withholding tax law to allow Swiss companies to issue bonds without adverse withholding tax consequences.

To ensure that Switzerland remains internationally competitive, the interim report states that the adopted measures would need to result in the following approximate effective tax rates for mobile income that is allocated to Switzerland: 0% for dividend income, 2%-3% for interest income, 5%-8% for licensing income and 10%-12% for trading income.

The interim report also acknowledges that any adopted measures must not contain elements of ring-fencing, must not aim to achieve international non-taxation and must be based on sound taxation principles or at a minimum be in effect in at least one EU member state. In addition, all measures should be as revenue neutral as possible from a Swiss perspective.

Comments

The proposed combination of measures aims to make Switzerland more attractive for international corporations, since the tax rates resulting from the alternatives would in many cases be lower than the rates under the existing regimes, and to ensure international acceptance of Swiss structures. The legal certainty and planning dependability from a Swiss tax perspective that is provided by the well-established advance tax ruling practice will remain intact. The proposed across the board reduction of the headline tax rate to as low as 12% itself will benefit many companies that, to date, may have been unable to benefit from existing regimes.

The steering committee will now finalize its proposals and is expected to issue its final recommendations in the fall of 2013 so that the official legislative consultation procedure can start in early 2014.