



SWISS CORPORATE TAX REFORM III – THE SWISS PARLIAMENT APPROVES THE TAX REFORM IN THE CORPORATE SECTOR

On 17th June 2016, the Swiss Parliament approved the final bill on Corporate Tax Reform III. Both chambers of Parliament (National Council and Council of States) had resolved their remaining differences and reached a final agreement a few days earlier. As a referendum had already been announced by certain political parties, it is not expected to enter into force before 1st January 2019.

Background to the Corporate Tax Reform III

The “fair” taxation of companies, i.e. in particular taxation that is “fair beyond the country’s borders”, is currently the focus of international political interest. In a nutshell, the OECD, G20 and EU want to rectify existing weaknesses in the international tax system. There is particular emphasis on international non-taxation and tax-motivated movement of mobile capital. Countries with tax systems in accordance with the “no or low taxation” model are increasingly in their sights. Switzerland is therefore coming under pressure regarding its cantonal tax status for holding, domiciliary and mixed companies, principal company taxation and the practice of Swiss finance branches. The criticism of such tax systems is based in particular on the partly different treatment of domestic and foreign income/companies (so-called “ring-fencing”). Against this background or international pressure, the Swiss Federal Council adopted the draft law on 5th June 2015 as well as the explanatory memorandum on the Corporate Tax Reform III (“CTR III”). The main objective of CTR III is to abolish the above-mentioned privileged tax regimes with the simultaneous introduction of internationally recognised tax (replacement) measures, which are intended to continue to maintain or even increase the attractiveness of Switzerland as a location for business.



Main components of CTR III

The adopted reform package contains the following measures:

- **Abolition** of privileged cantonal **tax regimes** (holding, domiciliary and mixed companies) as well as certain **taxation practices** at Federal level (principal taxation and Swiss finance branch).
- Introduction of **interest-adjusted income tax** at Federal level as well as on an optional level for the cantons (so-called notional interest deduction "NID"). Under the NID provisions, companies with surplus equity are entitled to claim a deduction of a notional interest expense thereon.
The optional introduction at the cantonal level is linked to a minimum taxation of dividends received by individual shareholders. The link foresees that a canton may only introduce the NID if at least 60% of dividend income derived from qualifying participations held by individuals as private assets is subject to personal income tax. The partial tax rate currently stands at 50% in many cantons, in other words these cantons would have to envisage an increase in the rate in order to be able to introduce the interest-adjusted tax rate on income.
- Introduction of a cantonal **Patent Box**: Income from the use of licences and comparable intellectual property rights are to be taxed in a privileged manner at cantonal level. The new provision reflects the "Nexus" approach of the OECD. The maximum level of permissible tax relief for income related to the patent box has been set at 90%.
- Introduction of an optional **deduction on research and development expenditure** at cantonal level up to a maximum of 150%, i.e. more than 100% of the R+D costs that have actually been incurred.
- **Privileged taxation of existing hidden reserves** (so-called "step-up"): This regulation is intended to appropriately define the transition from privileged taxation to ordinary taxation, as well as other cases of entry into, or exit from, tax liability. Should the current regime cease to apply, the previous law for the taxation of reduced tax hidden reserves would apply for a transitional period of five years, at a lower tax rate defined by each canton.
- **Limitation** of the entire tax relief at cantonal level: The preferential treatment from the patent box, the special reduction on R+D expenditure, the interest-adjusted corporate income tax and the step-up are permitted to lead to a maximum **of tax relief of 80%**.
- **Adjustment of corporate income tax**: The cantons are given the option of reducing corporate income tax on participations, intra group loans and rights to intellectual property, which qualify for the patent box.
- **Expansion of flat-rate tax crediting** to Swiss permanent establishments: The CTR III also introduces tax credits for Swiss permanent establishments of foreign corporations for withholding taxes on certain income from third countries.
- **Increasing the canton's share in the income from** direct Federal tax to reduce cantonal tax rates on income: The cantonal proportion of direct Federal tax is being increased from the current 17% to 21.2%. This means that the cantons receive



additional funds of approx. CHF 1.1 billion from the Federal Government than previously. The Federal Government wants to use these funds to (partly) support the cantons in financing the reductions in the cantonal corporate income tax rate. Certain cantons have already announced that they will reduce their corporate income tax rates to between 12-14% (the average corporate income tax in 2016 for companies totals approx. 17.8%).

The abolition of the one-time capital duty and the introduction of a "tonnage tax" for companies involved in maritime shipping proposed by the Swiss Federal Council will be discussed in a separate proposal.

Further action

The CTR III will have a major influence on the taxation of company structures with a tax link to Switzerland, in one direction or the other. The parameters in this respect for the attractiveness of Switzerland as a business location will change and current business models will have to be reconsidered from a tax point of view.

It is unlikely that the new provisions will come into force before 1st January 2019. However, we recommend already taking some measures today:

- Review the status quo (privileged taxed companies affected, existing tax rulings regarding a privileged cantonal tax regime)
- Determination of the effects of the removal of privileged taxation and making (replacement) plans
- Analysis of the consequences of a premature change (prior to implementation of CTR III) to ordinary taxation or a change as part of CTR III using the envisaged "step-up" solution
- Analysis of the new provisions, undertaking example calculations and investigating applicability in specific individual cases
- Verification of the effects for shareholders in the event of an increase in partial taxation of qualifying dividend income to 60%
- Examination of possible consequences of the reduced tax rates in an international context (e.g. impact on CFC rules)
- Cost/ benefit analysis (reorganization costs vs. tax savings, tracking and tracing of patent income, potential tax costs entering into patent Box)
- Assessment of the corporate governance of a group structure on the basis of international developments such as BEPS of the OECD and the EU Action Plan

Links:

<https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20150049>

<http://www.oecd.org/tax/beps/>



http://ec.europa.eu/taxation_customs/taxation/company_tax/fairer_corporate_taxation/index_en.htm

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