

TAX FACTS



INNOVATION
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Swiss Corporate Tax Reform III

The biggest revolution in the Swiss tax landscape for 60 years

Switzerland is about to abolish special tax regimes introduced 60 years ago with the upcoming so-called "Corporate Tax Reform III" ("CTR III"). The famous holding company tax regime and the privileged tax regimes for mixed companies and domiciliary companies (all on the cantonal and communal tax level) will disappear, rather sooner than later, due to increasing international pressure, in particular from the European Union and the Base Erosion and Profit Shifting ("BEPS") project of the Organisation for Economic Co-operation and Development ("OECD").

The CTR III aims to

- maintain and improve Switzerland's position as one of the most attractive business locations worldwide;
- increase the international acceptance of Swiss corporate tax legislation; and
- secure sustainable adequate tax revenues for public finances.

The CTR III focuses on providing companies with a very attractive tax environment based on the following pillars:

1. **Cantonal Corporate income tax rate reduction:** Not being formally within the parliamentary discussion of the CTR III it is the intention - as one of the cornerstones of the CTR III - that the Cantons will reduce their ordinary corporate income tax rates due to their autonomy in determining corporate income tax rates.
2. **Patent Box (cantonal level):** Through the - mandatory - introduction of a cantonal patent box regarding the development and the use of intellectual property rights (IPs) Swiss companies will benefit from a specific tax relief of up to 80%. The Swiss patent box will adhere to the modified nexus approach of the OECD.
3. **R&D super deduction (cantonal level):** The CTR III introduces an - optional - cantonal tax incentive for research and development activities. The Cantons should receive the possibility to allow - in addition to the patent box - increased tax deductions for research and development expenses of more than 100% (i.e. an increased tax deduction for R&D costs at the cantonal level). They should freely decide on the extent of this super deduction. Furthermore, the Cantons should have the opportunity to grant an increased tax deduction also for R&D costs of a Swiss company incurred from R&D activities carried out abroad.

4. **Step-up mechanism for hidden reserves including goodwill (federal and cantonal level):** Upon migration of foreign companies to Switzerland hidden reserves need to be dissolved. The same applies when domestic companies change from a privileged tax status to ordinary taxation.

Due to the abolition of the beneficial cantonal tax regimes, the companies must be allowed to transfer from privileged to ordinary taxation without an immediate increase of their tax burden. The CTR III provides comprehensive rules for the tax-neutral step-up mechanism to reveal hidden reserves including goodwill upon migration to Switzerland or upon change of tax status from a preferential taxation regime to ordinary taxation.

As already mentioned, the disclosure of hidden reserves is especially highly relevant in connection with the abolishment of the cantonal tax regimes. The latest discussion considers two different models to ensure a competitive income tax burden during a five-year transitional period:

- The original step-up applies to the corporate migration to Switzerland, which means that the disclosure of hidden reserves at the entry into and the exit from Switzerland are treated equally.
- A two-basket approach, which applies two different corporate income tax rates during the transition period from the privileged taxation regime to ordinary taxation. Under this approach, the ordinary tax rate applies to profits relating to value created under the ordinary taxation (first basket) and a lower tax rate applies to profits on the realisation of built-in gains that were generated under a privileged tax regime (second basket).

The proposed step-up mechanism to reveal hidden reserves is mandatory for all cantons and the two-basket approach is applicable for a transition period of up to five years.

5. **Notional Interest Deduction ("NID") (federal and cantonal level):** The introduction of an interest-adjusted corporate income tax should be mandatory at the federal level and optional at the cantonal level. The tax relief under the NID shall be subject to the overall combined tax relief threshold of 80% as mentioned above. The NID aims to an equal treatment of debt and equity financing for tax purposes, which shall be achieved with the deductibility of interest on equity. Companies will benefit from the introduction of an interest-adjusted corporate income tax.
6. **Restriction of tax relief (cantonal level):** The latest discussion on the CTR III grants a high level of discretion to the cantons on the above mentioned measures. The only limiting factor set by the National Council is the already mentioned restriction that the overall combined tax relief of the above mentioned measures (i.e., patent box, R&D super deduction, NID and step-up) shall be restricted to a maximum percentage of 80%.

The CTR III is discussed within the parliamentary chambers and commissions over the coming months. A referendum is expectedly taken against the final CTR III which will result in a public vote. Therefore it may be assumed that the new act will come into force not sooner than by January 2018 and will be implemented into cantonal law until January 2020 at the latest. Should you wish to discuss the CTR III (and BEPS) and its huge impact on tax planning, we are pleased to outline how you may benefit from such changes.

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