Release of dispatch and bill for tax proposal 17

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The Federal Council drew up the bill based on responses received during the consultation process on the revised tax proposal (TP17). This bill is supported by the cantons as well as the cities and communes and was forwarded to parliament for discussion on Wednesday, 21 March 2018.

If the reform proposal can be dealt with in Swiss parliament expeditiously and without referendum, it is anticipated that some measures of the bill will already enter into force in 2019 with the remaining provisions in 2020.

The objectives

The overall objectives of TP17 remain unchanged, i.e. abolition of special forms of corporate taxation (Swiss tax regimes) and improve the attractiveness of Switzerland as a business location for domestic and foreign companies, maintain and create jobs, adjust the corporate tax law to the new international standards and enhance international acceptance of it. In addition and to take into account the learnings from the negative vote on corporate tax reform III in February 2017, the bill puts more emphasis on the financial impact of the tax reform on the federal as well as on municipalities' and cities' budgets.

In detail, the bill includes the following measures:

Measures to sustain international acceptance and competitiveness

i) Abolition of criticised Swiss tax regimes

In line with its international commitments, Switzerland will abolish the holding, domicile and mixed company privileges at cantonal level as well as the practices regarding principal taxation and the Swiss finance branches at federal level.

ii) Introduction of a patent box (cantonal level only)

The patent box regime shall be mandatory for the cantons. The law outlines that Swiss or foreign patents will qualify for the patent box, but also comparable rights, such as certain protection certificates (thereafter "IP" or "IP rights"). In line with international OECD standards, the modified nexus approach (nexus ratio) will apply by patent, by product or by group of products.

Where the IP right is embedded in a product, the residual profit method shall apply. The net profit from such products shall be reduced by a (routine) profit component of 6% on attributable costs as well as by a trademark related profit component. The maximum allowable relief amounts to 90%, applied to net residual profits from patented products post nexus ratio. Cantons may further reduce the maximum relief.

Upon the first application of the patent box to a specific IP, any related R&D expenses that were deducted in Switzerland as tax deductible expenses in the past must be added back to the taxable income. Cantons are free to determine the entry taxation modalities within the first five years after entrance into the patent box.

An ordinance to be issued by the Federal Council will provide more detailed implementation guidance including details on the calculation of the qualifying patent net income, documentation rules and begin / end of the reduced taxation.

iii) Additional deduction for R&D (cantonal level only)

The introduction of an additional deduction for R&D expenditures is optional for the cantons. The deduction can amount to a maximum of 50% of the R&D costs incurred by the tax payer or the amounts paid to a domestic third party. R&D is defined by reference to article 2 of the Federal law from December 14, 2012 on promoting research and innovation.

The cost basis is defined i) by reference to the direct R&D labour costs increased by a 35% up-lift for R&D related indirect costs plus ii) 80% of R&D costs invoiced by domestic third parties.

iv) Maximum relief limitation (cantonal level only)

The aggregated reductions of the tax basis through the patent box, additional deduction for R&D expenditures and a step-up tax depreciation stemming from an early exit from a current tax regime in accordance with current cantonal practice shall not exceed 70%. Cantons may introduce lower thresholds of the relief limitation.

v) Increase of cantons' share of direct federal tax and reduction of cantonal income tax rates

In order to support cantons in connection with the implementation of the measures of TP17 it is envisaged to increase the cantons' shares of direct federal tax receipts from currently 17% to 21.2%. Although not earmarked for specific purposes it is expected that the cantons will use the additional funds to implement the measures of TP17 according to their needs but also to finance (significant) reductions of corporate income tax rates. The latter element is not directly included in the newly issued bill, since the determination of the magnitude of the cantonal corporate income tax rate reduction is subject to individual decision and approval process for each of the cantons.

The lowered overall effective income tax rates (federal and cantonal) is to be expected in the range of approx. 12% to 18%.

vi) Annual capital tax (cantonal level only)

The cantons may implement a reduction of the portion of taxable equity relating to investments and qualifying patents.

vii) Transitional rules for previous special-regime companies (cantonal level only)

The transitional rules foresee, that hidden reserves (including goodwill) will be subject to a separate reduced taxation during a 5 year period to the extent they have not been subject to income taxes in Switzerland to date. The relevant applicable tax rate is at the discretion of the cantons. This rule is not subject to the ordinary entry into force provision and may be applied by the cantons already somewhat earlier than the ordinary effective date of the other provisions of the reform.

Companies will have to report the hidden reserves (including goodwill) with the last tax return prepared and filed under the old (currently applicable) law in order to benefit from the five year transition rule.

viii) Step-up of hidden reserves upon migration to Switzerland

Companies or business functions migrated to Switzerland from abroad may benefit from a step-up of hidden reserves (including goodwill) up to the fair market values in the tax balance sheet in the first tax return. Such a step-up will not trigger Swiss income tax consequences. The tax deductible amortisation of the stepped-up assets must be in line with applicable Swiss safe harbour rates. Capitalised goodwill will have to be amortised over a period of 10 years.

Further measures

i) Broadening of the lump-sum tax credit

According to the bill, it is also the intention to provide a new legal basis to enable ordinarily taxed Swiss branches of foreign companies to claim a lump-sum tax credit for foreign withholding taxes under certain circumstances. Respective details will be part of a new ordinance.

ii) Transposition threshold abolished

The 5% threshold applicable to shares transferred to a self-owned company will be abolished. Accordingly, the transfer or sale of any shares, regardless of the amount or stake held, could result in taxable income at the level of the individual shareholder.

Measures to balance the reform

i) Increased taxation on dividends for Swiss individual residents

Dividends from qualifying investments should be taxed at 70% on the federal level and at least 70% on the cantonal level. Currently, on the federal level, a taxation of 50% for business assets and 60% for private assets applies. At the cantonal level, it cannot be excluded that the minimum taxation threshold will even be higher than 70%.

ii) Family allowance

The minimum children's and education allowances shall be increased by CHF 30 per month to a minimum of CHF 230 and CHF 280 per child respectively.

iii) Notional interest deduction

Despite the recognised importance of this measure for the attractiveness of Switzerland as a business location, the measure of a notional interest deduction – at least as a voluntary measure at cantonal level – is not included in the bill. It is possible that during the parliamentary debate some stakeholders may request a reintroduction of a notional deduction on qualifying equity into the reform package.

The takeaway

The starting point for the tax reform is the alignment of Swiss corporate taxation rules with international standards. TP17 and the cantonal implementation plans shall, however, also ensure that Switzerland remains an attractive business location.

Against the background of the rejected corporate tax reform III, the published bill is a political compromise which is supported by the cantons, as well as by the cities and communes with the objective of avoiding a referendum. Ultimately, according to the Federal Council's assessment, TP17 means that status companies will have to pay some more taxes although new/transitional measures and reduced ordinary income tax rates may limit the increase – while local SMEs pay less taxes, despite the moderate increase in dividend taxation and the increase in family allowances.

The elimination of the notional interest deduction, the further limitation of the additional deduction for R&D expenditure and a stricter maximum relief limitation rule will put greater emphasis on the reduction of the cantonal corporate income tax rates. Further, it is possible that the final version of the legislation, which needs to pass the Swiss parliament, differs from the currently proposed version and it might be feasible, that it will be (even) more favorable to businesses.

Companies are well advised to prepare in good time for the changes and identify necessary actions.