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Swiss Tax Reform: Referendum successfully called, public vote on 19 May 2019

On 17 January 2019 – the very last day of the 100-day referendum period, sufficient signatures were filed resulting in the referendum being successfully called. The Swiss Corporate Tax and Old Age Insurance Reform bill will therefore be put to a public vote by Swiss citizens on 19 May 2019. If the vote is successful, the reform will enter into force on 1 January 2020.

On 28 September 2018, the Swiss Federal Parliament approved the Swiss Corporate Tax and Old Age Insurance Reform, previously called Tax Proposal 17 (TP17) and relabelled the Tax Reform and AHV Financing bill (TRAF). Even though a strong majority in the Swiss Federal Parliament had approved the bill, a coalition of young left-wing parties – the Young Green-Liberal Party and the Young Swiss People's Party (Young SVP) – took the initiative to collect the 50,000 signatures from Swiss citizens needed for a referendum. The 100-day referendum period ended on 17 January 2019, and, despite some difficulties, more than 55,000 signatures were deposited according to the referendum committee. A Swiss public vote will hence be required on 19 May 2019, as set by the Swiss Federal Council.

Tax proposal 17 ("TP 17") intends to ensure international acceptance of the Swiss corporate tax system. With the amendments in the Federal Act on Direct Federal Tax (DBG) and the Tax Harmonisation Act (StHG), the cantonal tax regimes for holding, mixed and domiciliary companies, as well as the federal taxation rules for Principal companies and Swiss Finance Branches will be abolished. Regarding the two federal regimes, the Federal Tax Authorities already closed these regimes to new entrants on 15 November 2018, while existing companies can continue to benefit from these regimes, at least for now. In addition to the abolishment of the current regimes, the bill proposes introducing internationally recognized substitute measures. For an overview of the content of the TRAF and the substitute measures, please refer to our 8 June 2018 Newsalert here.

Strong reasons why the bill should be approved!

Despite the referendum, we strongly believe it is crucial for Switzerland as a business location to ensure the bill is approved by the majority of Swiss citizens through the popular vote.

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Our considerations are as follows:

1. Urgency of change

- Immediate alignment of the Swiss Tax System with new international standards and the introduction of measures to retain competitiveness is of utmost importance.
- For over 30 years, the current tax regimes have significantly contributed to Switzerland's excellent position as a business location and its current high levels of well-being.
- While not the only factor, the potential tax burden for a business is a major consideration when evaluating where to locate new and replacement investments. Especially in Switzerland, lower corporate taxes are an important counterweight to compensate for otherwise assumed higher general costs.
- Switzerland has seen substantial amounts of annual direct investments and, due to its excellent talent pool, economic and political stability in the middle of Europe, is an established location for numerous international businesses across different industries as well as many global and/or European headquarters, trading and hub companies managing international supply chains and providing high value management and other centralized services. Original Swiss multinational groups have grown successfully for the same reasons too, and due to their economic interlinkage, Swiss suppliers as well as domestic small and medium sized trading companies have prospered alike. Many new jobs have been created and maintained, resulting in full employment.
- International tax competition for promising new business activities and related jobs are a reality today, as is evidenced by the continuing downward trend in corporate tax rates around the globe and the introduction of tax incentives for innovative activities in many countries.
- Therefore, simply abolishing the internationally criticized current regimes is not a viable option.
- In order to maintain current level of public welfare, as a small and open economy, Switzerland must retain its ability to compete internationally. Hence, one of the key objectives of the reform is to retain fiscal attractiveness for businesses by introducing a toolbox of internationally accepted substitute measures, such as the patent box and additional deductions for domestic research and development activities – measures that the cantons can adapt and tailor to their individual circumstances and needs. These substitute measures are important to avoid highly mobile activities and jobs relocating elsewhere.
- The pressure is now becoming too high. Switzerland is being forced to abolish the current tax regimes, which are considered harmful from a foreign perspective. After a period of almost 15 years since the international tax dispute began, it is clear that the patience of the EU, OECD and individual foreign countries is running out, resulting in sanctions at various levels if the reform is not enacted in time.

2. Severe negative consequences if reform fails

- Without reform, the EU would move Switzerland from the grey list to the backlist of non-cooperative countries. A blacklisting would have severe consequences:
- Sanctions imposed by the EU on Switzerland and consequently on Swiss companies would significantly jeopardize their ability to compete in the EU. The planned sanctions are both tax and non-tax related and include: exclusion from public procurement orders; more stringent tax audits; denial of tax deductions for the cost of supplies and services from Switzerland into the EU; reversal of the burden of proof; and additional documentation requirements for Swiss companies etc.
- Without reform, the OECD would also encourage its members to take individual actions against Swiss companies benefitting from current tax regimes.
- The denial of deductions for the costs of supplies from Switzerland alone would drive up the cost to EU buyers of goods and services from Swiss suppliers by approx. 25% on average.
- The resulting significant loss of competitiveness would trigger the need to downsize Swiss business operations and prompt relocations abroad, coupled with a loss of jobs and tax revenues and a decline in living standards.

3. Demands of the opponents of the failed CTR III bill have been taken into account

- Significant amendments have been made in the new bill compared to the failed Corporate Tax Reform III (CTR III), and substantial concessions have been made to the opponents of CTR III.
- Not only was the AHV financing component totalling CHF 2 billion per year added, but also the tax portion was significantly adjusted and cut back e.g. the partial taxation for private dividend income was increased, the capital contribution principle for companies listed on the Swiss stock exchange was restricted and the scope of the possible relief through the new substitution measures was reduced. Furthermore, a municipality clause was added that obliges the cantons to adequately compensate the financial losses at municipality level.

4. The new bill is fair and beneficial for all

- With the new bill, all Swiss companies, small and large, will, in future, be taxed under the same rules. Companies that benefitted from the current regimes will pay more or significantly more income tax going forward. Conversely, the tax burden for more locally oriented, small and mid-sized businesses will be reduced significantly, depending on the canton. A substantial net reduction in the tax burden will remain in most cases, even after factoring in the modest increase in dividend taxation for Swiss owners.
- Legal and planning certainty for Swiss companies will be restored. Legal and planning certainty are key success factors to generate new investments and jobs, from large and small enterprises alike.
- The link between the tax measures and old age insurance funding is not inappropriate per se: Old age contributions above a certain limit do not generate an individual old age benefit but indeed have the character of a tax.
- The bill also favour the younger generation. Even if young people will face incrementally higher old age insurance contributions, they will be the ones who will benefit over-proportionally from more inward investment, higher salaries, more interesting jobs and lower unemployment triggered by the reform.
- Old age insurance underfunding must be resolved financially anyhow. The current bill simply accelerates a component of the solution that is needed whatever the case may be. It replaces a VAT rate hike of 0.8%, but does not prevent the need for further long-term financial and structural reforms, which will nevertheless be required.

5. No better alternative exists

- Work to find the best possible solution to the international tax dispute started eight years ago. Significant energy has been invested and many discussions have been held in expert circles concerning the options that best fulfil the widely agreed three main reform objectives:

  (1) to restore international acceptance of the Swiss corporate tax system;

  (2) to protect Switzerland's (fiscal) attractiveness as a business location; and

  (3) to secure financial affordability for the Federation and cantons/communes alike.
- None of the opponents have come up with a better alternative proposition to meet these objectives.
- Any alternative reform approach would simply be worse and more costly.

Impact on cantonal implementation

The cantons have started to push ahead with incorporating the new rules into their cantonal tax laws and have made differing levels of progress. Partial reforms have already been successfully approved in the cantons of Vaud and Ticino, while Basel-Stadt has made the most headway among the other cantons. On 19 September 2018, its Grand Council approved the cantonal implementation bill with a plan to put it into effect at the beginning of 2019. A referendum was also called successfully in Basel-Stadt, which will take place on 10 February 2019.

The other cantons continue to push ahead with their cantonal implementation process, all with the aim of rolling out the changes to the cantonal tax rules on 1 January 2020 simultaneously with those at the federal level. Hence, given that timing, they cannot afford to pause the process and wait for the outcome of the federal vote in May. Also depending on the canton, a cantonal vote may be required during the second half of 2019 or perhaps for some cantons, even in early 2020.

We continue to follow the developments at the federal and cantonal levels very closely and will keep you informed of any important developments.

Please contact us if you have any questions about TP17/TRAF and its effects on your company. Your usual PwC tax advisor or one of the contacts listed in this Newsalert will be happy to help.

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