

Swiss Federal Council released Tax Proposal 17 for formal consultation

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On 6 September the Federal Council initiated the consultation procedure with respect to the Tax Proposal 17 (formerly "Corporate tax reform III"; CTR III). The overall objectives of the reform remain unchanged, i.e. improve the attractiveness of Switzerland as a business location, maintain and create jobs and adjust the corporate tax law to the new international standards. In addition, in order to take into account learning points from the negative vote on CTR III in February 2017, the Tax Proposal 17 puts more emphasis on the financial impact of the tax reform on the Federal as well as on municipalities' and cities' budgets.

The consultation period will last until 6 December 2017. It is foreseen, that the draft bill will make its way back to the Federal Council, for further submission to the Parliament, in spring 2018. The earliest anticipated entry into force would be 2020.

Apart from the draft bill, the package also includes an ordinance on the reduced taxation of profits from patents and similar rights (clarification of the patent box). The different proposals are outlined hereafter.

Abolition of the Swiss tax regimes

In line with its international commitments, Switzerland will abolish the auxiliary (domicile, mixed) company and holding regimes.

In addition, the finance branch and principal company practice shall also be abolished.

Transitional rules for previous special-regimes companies

The transitional rules foresee, that hidden reserves (including goodwill) will be subject to a separate taxation during a 5 year period. The relevant applicable tax rate is left to the discretion of the Cantons. This rule is

not subject to the ordinary entry in force provision and may be applied by the cantons already somewhat earlier than the ordinary effective date of the other provisions of the reform.

Patent box (cantonal level only)

The box regime is mandatory for the Cantons. The law foresees a precise definition of patents and comparable rights (thereafter "IP" or "IP rights") and the ordinance provides some detailed implementation guidance including documentation rules. In line with international OECD standards, the modified nexus approach may be applied 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 above net residual profits from patented products post nexus ratio.

Upon the first application of the patent box to a specific IP, the related R&D expenses of the last ten years must be added back to the taxable income (including a potential additional R&D super deduction – discussed hereafter).

Super R&D deduction (cantonal level only)

The introduction of an R&D super deduction is optional for the cantons. The deduction can amount to a maximum of 50% of the R&D costs incurred directly by the tax payer or indirectly by 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.

Maximum relief limitation

The aggregated reductions of the tax basis through the patent box, R&D super deduction 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.

Annual Capital tax

The Cantons may foresee a reduction for the portion of equity represented by investments and qualifying patents.

Notional interest deduction

Despite the recognized importance of this measure for the attractiveness of Switzerland as a business location, this measure has been eliminated in the Tax Proposal 17 project. You may read more on the importance of that measure to Zurich taxpayers at the following link: <http://news.pwc.ch/de/35760/befragung-von-unternehmen-im-kanton-zuerich-zur-bedeutung-der-steuerbelastung-fuer-ihre-finanzierungsaktivitaeten-im-kanton>. It may be expected that during the consultation process the canton of Zurich will request, that an interest deduction on certain parts of the equity be reintroduced into the Proposal, at least on an optional basis at cantonal level.

Increased taxation on dividends for Swiss individual residents

Dividends and capital gains from

qualifying investments should be taxed at 70% at Federal level (currently 50% or 60%). At the cantonal level, this threshold represents a minimum, i.e. a reduction of the taxation quota below 70% will not be allowed.

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.

Financing of the cantonal corporate tax rate reduction

In order to remain attractive, certain cantons plan to propose a tax rate reduction following the abolition of the tax regimes. Indeed, ordinary rates above 14% will not be seen as internationally competitive. Since the Confederation currently is the prime beneficiary of the taxes generated by status companies, it is also in its interest to maintain this income stream. Thus, it is proposed to increase the canton's portion of the Federal taxes collected in its territory from 17% to 20.5% (compared to 21.2% as per CTR III). The Cantons are invited to take into account the impact of the regimes' abolition on municipalities' and cities' budgets by sharing their increased participation in Federal tax revenues accordingly.

The takeaway

The proposal is clearly a political compromise with the goal of avoiding a second referendum. The elimination of the notional interest deduction, the further limitation of the R&D benefits and a stricter maximum aggregated relief limitation rule puts further pressure on the reduction of the cantonal corporate profit tax rates. The

clarifications in connection with the practical application of the patent box are welcomed.

Companies that enjoy lower rates of taxation due to current tax regimes may, depending on the canton of residence, choose between i) taxation of hidden reserves not previously liable to taxation at a special separate (low) rate for a limited period of five years or ii) application of the tax-free disclosure of hidden reserves in their tax balance sheet (cantonal step-up practice; details can be found here

[\[http://www.pwc.ch/en/2017/pdf/disclosure-of-hidden-reserves.pdf\]](http://www.pwc.ch/en/2017/pdf/disclosure-of-hidden-reserves.pdf)). The step-up also applies at the federal level in certain cases. Particularly in high-tax cantons, these rules should help special-status companies obtain temporary relief and a smoother transition into the new measures.

Based on the proposed text the step-up practice (option ii) may not be available anymore once the reform enters into force. Consequently, it is important to assess the course of action a regime company shall follow. To determine the possible advantage of the application of the step-up transitional rules, PwC Switzerland is developing an app that calculates the 'step-up potential' and an estimate of the possible tax benefit from claiming the step-up rules. The free of charge PwC step-up app will become available by mid-September 2017. Companies with relatively straightforward fact patterns also may request a PwC Switzerland valuation report directly via the PwC step-up app for a fee. This report contains a validated fair market value and an estimation of the step-up benefit potential, which can be used as the basis for discussions with the tax authorities.