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Swiss Tax Reform Package Approved: Update and Outlook

The Swiss National Council approves the proposed tax reform package! On 12 September 2018 the larger chamber of parliament adopted the proposal of the Economic Affairs and Taxation Committee of the Council of States on the Federal Act on Tax Reform and AHV Financing (formerly Tax Proposal 17), which is largely in line with the legislative bill adopted by the Council of States, the smaller chamber of parliament. Although slight differences regarding the capital contribution principle remain to be settled, the majority of member of the National Council sees the adopted text of the bill as a viable compromise.

After the rejection of the IIIrd Corporate Tax Reform package (CTR III) in a popular referendum held in February 2017, the Federal Council released a revised legislative bill for a tax reform on 21 March 2018, after a wide public consultation process was held. On 7 June 2018, the Council of States included, inter alia, a new subsidy of CHF 2 billion per annum for the Federal Social Security Scheme (AHV) as a form of socio-political compensation in its reform proposal to sweeten the proposal to a wider group of members of parliament (and their voters). Consequently, the former "Tax Proposal 17" is now known as the Federal Act on Tax Reform and AHV Financing (TRAF). The National Council has debated the TRAF on 12 September 2018 and backs the current proposal. Proposed differences to the bill proposed by the Council of States mainly concern the restrictions around using capital contributions in cases of dividend distributions and capital repayments.

Overall, the TRAF includes measures that are largely similar to the previously rejected version of the CTR III package but with some modifications designed to achieve support from the majority of Swiss voters. Like the previous package, the TRAF sets out to repeal the current privileged corporate tax regimes (holding, mixed and domiciliary, or auxiliary companies, the finance branch regime and the principal company regime). It introduces some new measures designed to maintain Switzerland's competitiveness in the international tax arena (in particular, an OECD-conforming patent box regime and a super-deduction for R&D expenses). Although the highly controversial notional interest deduction (NID) was no longer included in Tax Proposal 17 as opposed to the rejected CTR III package, the National Council backs the proposal of the Council of States to implement a NID de facto only for the canton of Zurich.

The following table contains a summary of the key measures of the TRAF, as agreed between both chambers of the Federal Parliament:

Measure	Mandatory implementation	
	Federal level	Cantons / communes
Abolition of the arrangements for cantonal status companies Currently, status companies pay only a reduced profit tax or none at all at cantonal level. This preferential treatment will be abolished with TRAF. Overtaxation will be avoided through a temporary special rate solution.	No	Yes
Patent box Profits from patents and similar rights will be separated from other profits and taxed at a lower level. The relief may not exceed 90% and is based on current international standards (nexus approach).	No	Yes
Additional deductions for research and development Deductions for R&D costs incurred in Switzerland may be granted for up to 150% of the actual cost incurred. This is based on R&D personnel expenses incurred by the taxpayer, plus a 35% markup for other R&D costs, and 80% of the R&D costs charged by third party providers in Switzerland.	No	Voluntary
Deduction for self-financing for cantons with a specific minimum tax rate (NID) High-tax cantons whose capital city has an effective cumulative corporate income tax rate of at least 13.5% are allowed to introduce a deduction for self-financing on above-average equity. Currently, only the Canton of Zurich would fulfil this condition.	No	Voluntary (if condition is met)
Relief restriction The aggregate tax relief based on the patent box, additional R&D deductions and deductions for self-financing may not exceed 70% of the taxable profit (down from 80% in the CTR III package). The calculation also includes amortization based on earlier taxation under a cantonal tax privilege.	No	Yes
Increased dividend taxation Dividend inclusion for individuals owning corporate equity stakes of at least 10% will rise to 70% at federal level and to at least 50% at cantonal level; cantons may raise the inclusion ratio even further.	Yes	Yes

Measure	Mandatory implementation	
	Federal level	Cantons / communes
Introduction of a repayment and partial liquidation rule in the case of the capital contribution principle for companies listed on Swiss stock exchanges A repayment restriction will apply on the capital contribution principle: Swiss listed companies may only repay tax-free capital contribution reserves if they concurrently pay taxable dividends of at least the same amount. Intra-group dividends are not affected by the repayment rule.The partial liquidation rule stipulates that capital contribution reserves must be reduced by at least the same amount as retained earnings when a company’s own shares are repurchased.	Yes	Yes
Increase in the cantons' share of federal direct tax revenue The cantons' share of federal direct tax revenue will be raised from 17% to 21.2%.	Yes	N/a
Consideration of the cities and municipalities The cantons have to give consideration to the needs of cities and communes in connection with the increase in the cantons' share (the National Council wants cities and municipalities to be fully compensated for the effects of the TRAF, thus strengthening the cities' and municipalities' rights).	N/a	Yes
Capital tax adjustments The cantons may allow for a reduced capital tax rate relating to equity capital invested in corporate equity interests, patents and similar rights, as well as intra-group loans.	N/a	Voluntary
Step-up of hidden reserves Companies relocating their head offices from abroad to Switzerland may benefit from additional amortization of stepped-up asset values during the first few years. If such companies migrate from Switzerland to a foreign jurisdiction, an exit tax on hidden reserves will be due, as is already the case at present.	Yes	Yes
Tightening of tax rules in respect of private restructurings The scope of future tax-free capital gains or repayments of contributed reserves in connection with transfers of shares to individually controlled holding companies will be narrowed down.	Yes	Yes

Measure	Mandatory implementation	
	Federal level	Cantons / communes
Extension of the lump-sum foreign tax credit The lump-sum foreign tax credit prevents international double taxation. Swiss permanent establishments of foreign companies will in future be entitled to it as well.	Yes	Yes
Fiscal equalization adjustments To prevent upheaval among the cantons, fiscal equalization will be adjusted in line with the new reality in terms of overall tax policy.		
CHF 2 billion in "social compensation" via the Social Security Scheme (AHV) The Confederation has to pay a higher share of the AHV, as it benefits from the TRAF. The proposal is expected to raise over CHF 2 billion per annum for the AHV.	Yes	No

The National Council is in line with the Council of States that listed companies may only pay out tax-free capital contribution reserves if they distribute taxable dividends in the same amount. The Council of States provides for certain exceptions for companies that have moved to Switzerland from abroad. There remain small differences between the two chambers of parliament in relation to the use of capital contribution reserves, which still need to be settled within the current autumn session of the parliament before the two chambers can cast their final votes on the TRAF.

Small leftist parties have already announced that they would call for a popular referendum against the TRAF. In the event that no referendum is called for, the first measures of the reform are scheduled to enter into force by 1 January 2019, while the main part of the reform would be implemented by the cantons and become effective as of 1 January 2020. A popular referendum would delay the introduction by at least a year.

Authors

Susanne Schreiber
Partner
T: +41 58 261 52 12
susanne.schreiber@baerkarrer.ch

Christoph Suter
Partner
T: +41 58 261 57 25
christoph.suter@baerkarrer.ch

Peter Reinarz
Partner
T: +41 58 261 53 30
peter.reinarz@baerkarrer.ch

Bär & Karrer Ltd.
Brandschenkestrasse 90
CH-8027 Zurich

Telephone: +41 58 261 50 00
Fax: +41 58 261 50 01
zurich@baerkarrer.ch

baerkarrer.ch
Zurich, Geneva, Lugano, Zug