NEW PROPOSAL FOR SWISS CORPORATE TAX REFORM

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Tags
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Notional Interest Deduction
Patent Box
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INTRODUCTION

Following up on our recent article on Swiss corporate tax reform,[1] the Steering Committee representing the cantons and Swiss Federation issued its recommendation regarding the implementation of a modified corporate tax reform to the Swiss Federal Council on June 1, 2017. The corporate tax reform has been renamed the Tax Proposal ("T.P. 17") and is, in general, based on the Corporate Tax Reform III ("C.T.R. III"), which was rejected on February 12, 2017, by Swiss voters.

The Steering Committee met representatives of cities, municipalities, political parties, business associations, and labor unions in order to achieve a more balanced, transparent, and politically accepted corporate tax reform. Compared to the C.T.R. III, the package has been adjusted and now also includes a social component. As expected, the preferred tax regimes provided by Swiss law will be abolished and the main goals of the reform remain the same (*i.e.*, to maintain Switzerland as an attractive and competitive business and tax location, to be in line with international best practices, and to generate sustainable tax revenues). This article summarizes the most important differences between the C.T.R. III and T.P. 17.

PROPOSED ADJUSTMENTS

Notional Interest Deduction

While the C.T.R. III included a deemed interest deduction on excessive shareholder's equity – known as a notional interest deduction ("N.I.D.") – this measure is not included in the new proposal. Since this measure was one of the most debated items in the C.T.R. III, the exclusion was expected. Swiss finance branches (*i.e.*, branches of a foreign company providing finance services to group members) will face higher corporate income tax rates, since they will be subject to ordinary taxation on a cantonal/municipal level and no additional deduction for extra equity will be granted.

Patent Box

The introduction of a cantonal/municipal level intellectual property ("I.P.") or "Patent Box" regime, based on the O.E.C.D. nexus approach, is also included in the new proposal. Compared to the C.T.R. III the Patent Box will, however, not include patented software. Therefore, software companies will not be able to benefit fully from tax relief granted by the Patent Box regime.

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1 See Peter von Burg and Natalie Peter, "Swiss Corporate Tax Reform Postponed," *Insights* 2 (2017).

Deduction for Research and Development

In addition to the Patent Box regime, the C.T.R. III provided for an optional deduction of 50% for research and development ("R&D") costs incurred in Switzerland. This optional deduction is included in the T.P. 17 as well. However, the Steering Committee emphasized that the deduction should be limited to personnel expenses. Fees to contract research organizations may not generate the enhanced tax benefit.

Introduction of an Overall Limitation of Tax Reduction at the Cantonal Level

The measures provided for by the C.T.R. III would have allowed for up to an 80% reduction of taxable profits at the cantonal/municipal level. However, the T.P. 17 has restricted the reduction. Provided a company will be able to benefit from multiple measures of the new proposal, the total reduction will be limited to 70%. Hence, such companies will face slightly higher corporate income tax rates.

Income Tax Rates

As under the C.T.R. III, it will still be at the discretion of the cantons to decrease cantonal/municipal corporate income tax rates. However, the minimum taxation of qualifying dividend income earned by individuals must be at least 70% under the T.P. 17, whereas under the C.T.R. III the minimum taxation was 60%. This increased taxation of dividend income earned by individuals will mainly impact owners of small- and medium-sized entities ("S.M.E.'s") and will lead to a slightly higher total income taxation.

Family Allowance

The minimum amount for the family allowance will be increased to CHF 230 for child allowance and CHF 280 for education allowance. Most of the cantons will need to raise payments to comply with the new minimum standards. This measure introduces a social component into the reform that was not part of C.T.R. III.

OUTLOOK

In general, the need for tax reform is undisputed, and it is expected that, following discussion by the Federal Council and the Swiss parliament, the above-mentioned proposals will be included in the final bill. As mentioned above, the removal of the N.I.D. should not generate further discussion, and the N.I.D. most likely will not be included in the final reform. The other proposals discussed above include only small changes to the reform proposals of C.T.R. III and some adjustments may be made after discussion by the Federal Council and the Swiss parliament. Finally, the proposal to increase the family allowance may be questioned by center or right-wing parties, since it is not connected to corporate taxation.

The step-up mechanism – imposing a tax on the realization of undisclosed hidden reserves and self-generated goodwill at a special low tax rate during a transitional period – is not explicitly addressed by the T.P. 17. However, it is anticipated that this mechanism will still be applied for a transitional period.

The T.P. 17 is only in its initial stage. The expected timeline provides that the Federal Council will confirm or adjust the T.P. 17 in June. It is further expected that the Swiss Federal Department of Finance will prepare the draft bill, which will undergo consultation by the end of this year. If all goes well, the Swiss parliament will adopt the bill in the spring of 2018. Subject to the consensus among all parties, no additional voting on the reform is likely, provided that sufficient signatures to a request for referendum are not gathered. Because the cantons must join the Federal government through the adoption of the proposals under cantonal law, it is expected that the reform will come into force on the 1st of January 2020 or 2021.

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