

Corporate tax reform III

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Background

Following the development of new international standards and pressure from the European Union, Switzerland has initiated a third corporate tax reform. The reform foresees the abolition of the existing privileged cantonal tax statuses (notably holding, administrative and mixed companies), as well as the principal company and Swiss finance branch rules on the federal level that are no longer accepted internationally.

The reform aims to preserve Switzerland's competitiveness as a business location despite the abolition of the statuses by introducing new tax measures with large international acceptance and new fiscal policy measures.

Current status

Privileged tax statuses (cantonal and federal) still exist in federal and cantonal laws. Rulings that were granted in the past will remain valid if the conditions continue to be met. According to some cantonal practice, notably in Geneva, rulings are valid for five years once granted and can be renewed on request.

Accordingly, new rulings or renewals of privileged tax statuses are available. In practice, tax authorities tend to be reluctant to grant new rulings or renewals, but nevertheless do so if the relevant conditions are met. This situation will remain as it is until the entry into force of the corporate tax reform.

Companies benefiting from privileged tax statuses are located mainly in the Lake Geneva region (Geneva and Vaud) and in Lucerne, Zurich and Zug. Ordinary 2015 corporate income tax rates (effective tax rates) combined at federal and cantonal/communal levels, and the equity tax rates in these cantons, were as follows.

2015	Geneva	Vaud	Lucerne	Zug	Zurich
Effective tax rate	24.16%	22.79%	12.31%	14.57%	21.15%
Equity	0.445%	0.071%	0.185%	0.075%	0.174%

*(municipal rates may vary)

Several cantons already allow the crediting of income taxes against capital taxes, which can result in complete elimination of capital tax. This option is limited in Geneva.

Lucerne and Zug are already low-tax cantons for ordinary corporate taxpayers. The main tax privileges at cantonal level are the mixed company regime and holding statuses. Under mixed company status, the taxable basis of income from foreign sources is reduced to 20%, which leads to an effective tax rate ranging between 7% and 12% in these cantons. Holding companies are income tax exempt at cantonal and communal level, and benefit from reduced equity tax rates.

When applying for a new ruling or the renewal of an existing ruling, a company would be well advised to consider the full picture – on the one hand, the Swiss tax savings until the entry into force of the corporate tax reform, and on the other, all current international risks associated with a Swiss ruling. In particular, rulings will probably be exchanged with foreign tax authorities in the near future, in principle from 2018, based on Action 5 of the Organisation for Economic Cooperation and Development (OECD) Action Plan on Base Erosion and Profit Shifting or based on the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters, which Switzerland signed in October 2013 and foresees the spontaneous exchange of information.

Federal legislative project

The maintenance of Switzerland's competitiveness as a business location following the abolition of the privileged tax regimes will be achieved by the introduction of replacement, accompanying or compensatory measures. On April 1 2015 the Federal Council released a first consultation draft that has attracted some criticism. On June 5 2015 the council released an amended draft bill of the corporate tax reform package for further parliamentary debate.

Among other positive amendments compared to the initial draft, the updated corporate tax reform package no longer includes the challenged introduction of a capital gains tax for individuals and confirms the abolition of the issuance tax. However, the notional interest deduction was dropped from the package.

On December 14 2015 the senate approved the legislative draft bill and the following replacement measures, which aim to compensate for the abolishment of the special tax regimes:

- introduction of a patent box;
- introduction of research and development (R&D) super-deductions;
- disclosure of hidden reserves and step-up mechanisms; and
- reduced capital tax.

Under the new patent box regime, which complies with the OECD's nexus approach, cantons may grant a maximum relief of 90% on patent income.

The super-deduction for R&D activities allows cantons to further incentivise domestic R&D. Cantons may, at their discretion, allow tax deductions on qualifying R&D expenses (ie, those incurred by the taxpayer or through contracts by Swiss third parties). The senate approved the super-deductions, but to 150% of the qualifying costs.

A step-up for tax purposes applicable on both federal and cantonal/communal levels has been introduced for companies or additional activities and functions being migrated to Switzerland. Moreover, the project confirms the possibility for companies which, at the time of the entry into force of the new law, will have been benefiting from a privileged tax to release their hidden reserves in a tax privileged manner within five years for tax purposes.

Cantons are further given the opportunity to lower annual capital tax rates on equity to the extent that it relates to patents and participations. Most cantons already allow full compensation of income tax against capital tax.

The senate rejected the foreseen abolition of the 1% issuance tax as a replacement measure. However, it also rejected the introduction of new fiscal revenue-raising measures (ie, the proposed increase in the partial taxation of dividend income for Swiss shareholders (available for shares of at least 10%)).

Next steps

After the senate's approval, the House of Representatives will vote on the legislation draft in its Spring 2016 session. The newly elected House of Representatives has a right-wing majority that is keen to maintain good conditions for Switzerland as a place of business. Therefore, it should not be excluded that the House of Representatives will introduce additional measures to increase Switzerland's competitiveness, particularly the notional interest deduction. By contrast, new tax revenue-raising measures (eg, the increase in the partial taxation) should be dropped from the project.

After the spring session, the two parliamentary chambers must settle their differences. There may be a referendum and a national vote on the legislation. The president of the socialist party has already announced his party's intention to collect signatures for a referendum as a consequence of the Senate's refusal to introduce an increase in the partial taxation.

The final federal legislation is likely to enter into force in 2019, with or without referendum. Initially, the draft federal legislation included a two-year grandfathering rule to allow the cantons to implement the new rules in their laws. The Senate has deleted this from the project. Cantonal laws based on the current project – which remains subject to amendment by the House of Representatives – would have to be amended simultaneously to enforce the federal legislation and introduce the new measures. Therefore, cantons that were awaiting the political outcome of the federal project will need to communicate further regarding their plans.

Cantonal legislative projects

Reduced corporate income taxation

The most eagerly awaited measure on the cantonal level is the reduction of corporate income tax. As it is within the exclusive competence of the cantons to set their cantonal tax rates, there is disparity around that measure. Nevertheless, several cantons have already announced their intent to reduce their corporate income tax rates, generally aiming at a combined effective tax rate (including federal tax) ranging from 12% to 15%.

Some Swiss-German cantons – including Schwyz, Appenzel Ausserrhoden, Nidwalden and Lucerne – simply expect to maintain their current low effective tax rates (of around 12%).

Zug has already announced a 12% target rate, but Zurich has yet to disclose its intention.

In the Lake Geneva region, where ordinary corporate income taxation is the highest (around 24%), Geneva has announced a 13% target rate and Vaud a 13.79% target rate. Unlike other cantons, Vaud is an early runner and has already launched a package for its cantonal tax reform.

Corporate tax reform in Vaud

The Vaud Corporate Tax Reform Draft Bill was submitted to the cantonal parliament and accepted by a large majority on September 29 2015. This is an encouraging sign for neighbouring cantons.

Nevertheless, as the legislative amendments have not been unanimously accepted, a referendum has been called by the opposition. It is expected that the referendum will take place in 2016.

Comment

Despite the complexity of the legislative system, corporate tax reform is on a good path. Switzerland is set to remain an attractive place of business. In particular, the general reduction of corporate income tax rates by the cantons may not come under attack from other countries or international organisations, as it is an absolute sovereign act.

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