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Switzerland’s new corporate tax reform proposals likely to succeed

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The Swiss Federal Council has released its new corporate tax reform proposals that resolve many of the issues raised in its earlier failed attempt. However, companies and entrepreneurs will be the ones paying for the changes this time.

The new tax proposal 17 (TP17) takes on many of the recommendations made by the steering body responsible for preparing the proposals. TP 17 is the government’s second attempt at overhauling the corporate tax regime. The earlier third series of corporate tax reforms (CTR III) was rejected in a referendum vote in February after businesses and individuals crossed swords on the proposals. Citizens believed their tax burden would rise while corporations would enjoy favourable tax incentives.

The Federal Council said that entrepreneurs and companies will now help counter-finance the new TP17, with entrepreneurs having a higher tax burden on dividends and companies paying higher family allowances. However, the Federal Council reassured businesses by saying that companies will continue to benefit from a competitive tax framework, while the new regime will also allow Switzerland to meet international requirements concerning corporate tax law.

"The proposal goes into the right direction as it aims to strengthen Switzerland's position as an attractive jurisdiction for business from a tax point of view," said Fabian Duss, a partner and certified tax expert at ADB Altorfer Duss & Beilstein in Zurich. "At the same time, the international acceptance of Switzerland's corporate tax system will be improved by implementing the OECD works on harmful tax competition and BEPS."

TP17 contains major adjustments and takes account of the outcome of the CTR III referendum. The proposals include:

- Repealing the special arrangements for cantonal status companies that have benefitted holding companies from paying little or no profit tax. Abolishing the preferential tax regimes will require companies to transition from privileged taxation to ordinary taxation. However, during this transition, companies will be allowed to maintain their tax rate for a transition period of five years.
- Replacing the privileged tax regimes with a reduction of the general cantonal/communal tax rates at the discretion of the individual cantons, with many cantons lowering their tax rate to an effective combined federal/cantonal/communal tax of between 12% and 14%.
- For companies relocating their headquarters, or additional activities and functions to Switzerland, a step-up of asset basis (including for self-created goodwill) will be available for direct federal and cantonal/communal tax.

"The proposal represents a well-balanced solution that should ensure that Switzerland stays an attractive location for multinationals and domestic companies alike, while at the same time having an internationally aligned tax system that is in conformity with international standards," Jackie Hess, tax and legal managing partner, and René Zulauf, international tax partner, at Deloitte Switzerland told *International Tax Review*.

"With the step-up models applied upon the change from privileged to ordinary taxation, the preferential regime rates obtained in the past may be factually 'grandfathered' for several years," Duss said. "Thereafter, the lower ordinary rates will apply. Thus, many businesses will just suffer a slow transition from very low to low corporate income tax rates."

Maarten Koper, global head of tax for Puma Energy in Geneva, told International Tax Review that his company will be "carefully monitor[ing]" what the Swiss federal government and the cantons ultimately decide to adopt and when. Nevertheless, he believes that TP17 will ensure Switzerland is an attractive business hub in the years to come.

Patent boxes across all cantons

One of the key business proposals in TP17 include requiring all cantons to introduce a patent box regime in line with the modified nexus approach recommended in Action 5 of the OECD's BEPS package.

The patent box will be applicable to all patented intellectual property. Tax relief for development costs for the entire research and development (R&D) expenditure per patent will be limited to 90% of the cost, however. Moreover, there will be an option for the cantons to implement additional tax deductions for R&D costs.

"The cantonal-level patent box regimes will be attractive for companies that are already performing R&D activities in Switzerland or are willing to migrate their respective R&D activities to Switzerland to be in line with the OECD nexus approach," Hess and Zulauf said.

However, Duss doesn't not believe the patent box regimes will prove effective. "I do not expect that the patent box regime will be a great success in practice. The implementation and running costs are very high and depending on the canton, the additional tax benefit which may be obtained will be (too) low. If ordinary taxation would e.g. be reduced to 12% it will hardly be worthwhile to do the exercise in order to further reduce the corporate income tax rate to 10% (estimated target rate with patent box)."

Puma's Koper partially agreed with both views, saying the patent box will be attractive but will not be a major factor in business decisions. "It will not be key decision driver to transfer IP (patents) or develop IP in Switzerland – at least not from a tax structuring perspective," he said.

Other measures included in TP17 include:

- Allowing foreign companies operating in Switzerland to be entitled to a flat-rate tax credit to prevent double taxation.
- Increasing the dividend tax rate for entrepreneurs and individuals to 70% at the federal and cantonal level. The measure will apply to dividends, profit shares, liquidation surpluses and non-cash benefits, shares in limited liability companies, cooperative shares and participation certificates (including free shares, free of charge increases, etc.) if the shareholder owns at least 10% of the share capital.
- Increasing the family allowances paid by businesses for their employees.

The proposals will put a burden of around CHF 750 million ($793 million) on the federal budget, but the government claims these changes are necessary now. This is because the current corporate taxation no longer meets international requirements, which is having an increasingly negative impact on Switzerland as a location, hence why the government was quick to revise its corporate tax proposals six months after the referendum on CTR III was held.

Whistle-blower and former former employee of Swiss bank Julius Bär Rudolf Elmer believes some of the proposals are not business-friendly. "The abundance of the interest-adjusted profit tax on the one hand and to the increase of taxation of dividends from 50 % to 70% makes the entire proposal less company-friendly (this tax relief would only be applied to qualifying participations of more than 10% held by individuals as private assets are subject to personal income tax)," said the Swiss whistle-blower who has been hounded by the Swiss government since being accused of breaching his country's bank secrecy laws.

"The entire proposal is definitely more in favour of the man in the street, however, the man in the street would not be satisfied with it," Elmer added. He further noted that the proposals will enhance the global race to the bottom on corporate tax rates at a cantonal level in order to attract new companies and serve the companies which are already domiciled in Switzerland.

Proposals have high prospects of success

According to Duss, TP17 has far better prospects of success than CTR III because it addresses the concerns of citizens which led to CTR III's failure.

"The most important point of criticism was the missing counter financing of the expected losses in tax revenues," Duss explained. "The new proposal includes such a measure by increasing the taxation of dividend payments from shareholdings of 10% or more in the hands of Swiss resident individuals. As such major shareholdings are typically involved with entrepreneur-run businesses, the men in the street are not affected from this increased income taxation. Moreover, employees should receive an increased credit for family education which is borne by the employers. Thus, the counter financing of the proposal is taken from the entrepreneurs, which makes it easier for the men in the street to accept the proposal."

Hess and Zulauf agreed that the renewed proposals have the potential to succeed and contain pro-business measures, while also addressing the concerns of taxpayers and the international tax community. "Among others, the introduction of a notional interest deduction is no longer part of the reform proposal and there is a revenue raising measures in increasing the taxation of qualified individual shareholders," they said.

Effective date remains uncertain

The consultation period, which opened on September 6, runs for three months and ends on December 6. The Federal Department of Finance is planning to submit the dispatch for Parliament to the Federal Council in spring 2018. Consequently, the earliest possible TP17 can enter into force is 2020.

According to Elmer, the government faces a heated debate in parliament over the tax proposals. "The proposed draft bill, which is going to be discussed in Parliament in October 2018, has already caused big waves of views and positions among the major political parties, trade and business associations," he said. "It is already certain that the draft bill will create heated discussions not only in the public but more importantly in the Parliament at this stage. It is still mostly about the 24,000 domiciliary and mixed companies to provide them with incentives to stay tax-wise in Switzerland."

This effective date means Switzerland won't meet its promises to the EU and OECD on implementing the tax reform and abolishing special privileges for corporations by 2019.

However, Hess and Zulauf believe that the legislative process means TP17 will more likely be enacted on January 1 2021, allowing adequate time to implement the law into cantonal legislation.