Swiss Corporate Tax Reform III: Latest developments

The consultation procedure for Swiss Corporate Tax Reform III (CTR III), the most sweeping Swiss corporate tax reform in more than 50 years, ended January 31 2015. **Deloitte**'s Rene Zulauf and Diego Weder provide an update what is still to come as part of the reform package, and analyse what changes should be made in light of stakeholder feedback.

Further legislative processes for CTR III

As a next step the Swiss Federal Department of Finance (FDF) will analyse the feedback received in the course of the consultation procedure and will issue a report to the Swiss Government, that is, the Swiss Federal Council, summarising the results from the consultation process by March 25 2015 at the earliest. The input from the cantons will be given special consideration in the report and the FDF will also take into account international tax developments that have occurred in the meantime.

The Federal Council will decide on the report provided by the FDF and on the drafting of the message to the legislation of CTR III on or after March 25 2015.

The message to the legislation in regard to CTR III will be submitted to the Swiss national parliament on or after June 5 2015. The first opportunity for the Swiss national parliament to discuss the draft legislation in regard to CTR III is during the summer session of the parliament, which lasts from June 1 until June 19 2015.

Since CTR III is a complex and delicate topic and given that the political parties on all sides – left and right – may have to make concessions that may not be palatable to their voters, there could be some reluctance to discuss the draft legislation to CTR III before the general elections of the Swiss parliament in October and the Swiss Federal Council in December 2015. Accordingly, there is some likelihood that the Swiss parliament will only discuss the legislation in regard to CTR III in the winter session of 2015, which lasts from November 30 to December 18 2015, or, even more likely, during the following spring session (February 29 to March 18 2016).

Once the CTR III legislation has been approved by both chambers of the Swiss parliament, anyone can demand a public vote, that is, a referendum on the CTR III legislation, as long as they can gather 50,000 signatures from Swiss voters within 100 days. Since 50,000 signatures is not a big hurdle, given that this is a controversial topic and that the CTR III legislation will likely be a compromise on certain issues that may leave some parties dissatisfied, a referendum seems most likely at this time.

A national vote (referendum) on CTR III would then likely take place in late 2016 or early 2017. Since the cantons need about two years to implement the CTR III legislation, which is only a framework law, into their cantonal laws, the most probable date to expect CTR III to become legally effective is January 1 2019. If it takes longer, then the law might not become effective before January 1 2020 and, should there be no referendum, the law could theoretically already come into effect in 2018.

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General acceptance of CTR III, but some disagreement on replacement measures

All interested parties are in agreement that the current tax privileged regimes, such as the mixed, holding or principal company regime, need to be replaced. The majority of stakeholders also agree that there have to be adequate replacement measures to maintain, and possibly improve, the tax competitiveness of Switzerland as a preferred location for multinationals. There is further agreement that all replacement regimes have to be fully in line with international standards and to be BEPS-proof, that is, to be aligned with the proposed measures under the base erosion and profit shifting (BEPS) initiative of the OECD.

However, the majority of interested parties are of the view that the draft legislation should be trimmed down and be limited to the main replacement measures as below:

- Patent box;
- Notional interest deduction;
- Step-up;
- Reduction of cantonal income taxes;
- Abolition of the capital issuance tax; and
- Reduction/adjustment of capital taxes.

Accordingly, most interested parties believe that other less central replacement measures should not be implemented at this time as part of CTR III. These measures are, in particular: the change in the participation exemption regime to a direct participation exemption and unlimited loss carry-forwards. Some parties are also against the abolition of the 1% capital issuance tax on equity contributions.

A majority of cantons do not support the introduction of a notional interest deduction for fear of losing too much tax revenue.

Finally, the sole proposed revenue-raising measure – the introduction of a capital gains tax for individuals combined with a draconian exit tax for individuals – faces broad-based opposition. The vast majority realise that such a tax would constitute Switzerland shooting itself in the foot, because it would discourage the very same international executives and their multinationals that Swiss policy attempts to lure into the country by offering expensive corporate tax concessions. In addition, it is very doubtful that a capital gains tax, in the way it is proposed, would be an effective revenue-raising measure at all.

Patent box

The introduction of a patent box regime (Swiss Licence Box) has broad-based support and is generally not disputed. The Swiss business community and the centre-right political parties support a patent box that is as liberal and as broad as internationally accepted.

In addition, the Swiss business community requests the introduction of R&D incentives, which allow for a multiple deduction of research, development and innovation expenses for income tax purposes, and which are common in many European countries.

On the other hand, most of the cantons as well as all the centre-left political parties support the definition of a narrower patent box as it is currently included in the draft legislation.

It is, however, clear that the Swiss Licence Box will be within the boundaries of whatever the OECD decides on the topic as it is the consensus that a Swiss patent box has to be fully in alignment with BEPS and the Swiss Licence Box legislation would be amended, if necessary, to be 'BEPS–proof'.

Notional interest deduction (NID)

While the NID finds the support of a majority of interested parties, particularly from the Swiss business community, its proposed introduction is rejected by a majority of cantons and the left-wing parties for fear of a loss in tax revenues.

All parties agree that the NID has to be structured reasonably and in such a way that it will not open the door for tax abuse – for example, no NID should be granted on participations or non-business assets.

Further, the Swiss business community considers a NID rate tied to the 10-year Swiss government bond as too rigid and only useful as a safe haven rate, instead suggesting that application of arm's-length NID rates, supported by a transfer pricing benchmark study, should be allowed.

Step up

A step up for tax purposes would allow companies to push up assets and liabilities to fair market values and to capitalise future profits (self-created goodwill) which then can be amortised tax effectively over 10 years. Such a step up would be granted: i) upon migration of a foreign company to Switzerland on both a federal and cantonal level with the intent to attract further multinationals to Switzerland; and ii) on the transition of a tax privileged company, such as a mixed company, into ordinary taxation on a cantonal level (as the tax privilege was granted on a cantonal level only) to allow such a company to essentially maintain its tax privileged rate for another 10 years.

A step up is supported by the vast majority of interested parties. However, certain cantons oppose a step up for fear of loss in tax revenues and prefer a model under which the introduction of a step up is optional for cantons.

Items that need to be clarified are the valuation method to be applied for the step up, as well as the exact mechanics of the step up so that it would not only result in a cash tax benefit but also in a corresponding tax accounting benefit under IFRS and US GAAP accounting standards. A working group comprised of representatives of the Swiss business community, the Swiss Federal Tax Administration and Big 4 accounting firms as well as major law firms is now working on these issues.

Reduction of cantonal income taxes and capital taxes

The majority of interested parties view the broad-based reduction of corporate tax rates as one of the key replacement measures. The consensus is that the general ETR level (combined effective federal/cantonal/communal tax rate) on average will go down to approximately 15% to 16%. However, various cantons are already (or plan to be) significantly below these rates.

So far the following cantons have announced a reduction of the ETR (combined effective federal/cantonal/communal rates) or can be expected to keep their current low ETR:

Appenzell AR:	Keep low ETR of 12.7%
Fribourg:	13.72%
Geneva:	13.00%
Lucerne:	Keep low ETR of approx. 12% (lowest taxed community 11.5%)
Nidwalden:	Keep low ETR of 12.7%
Neuchatel:	15.60%
Schwyz:	Keep low ETR of approx. 12% (Freienbach/Wollerau)
Vaud:	13.80%
Zug:	12.00%

The extent to which the other cantons may reduce their income tax rates depends in particular on the specific financial situation each canton is in, the amount of the contribution by the Swiss Federation as well as on where other cantons set their tax rate, that is, on the extent of inter-cantonal competition.

The reduction of the capital taxes is supported by a vast majority of interested parties.

Legislative outlook

The consultation procedure has shown that CTR III, which entails the replacement of existing tax privileged regimes by other measures, enjoys the broad support of interested parties in Switzerland.

The main replacement measures – step up, patent box regime, NID and a general reduction of corporate tax rates – find the support of a majority. In turn, the introduction of a capital gains tax for individuals is rejected by the vast majority.

Peripheral measures, such as change of the participation exemption regime or unlimited loss carry-forwards, seem not to have sufficient support.

Accordingly, the legislation on CTR III that will be brought before the Swiss parliament and likely will be voted into law by the parliament can be expected to be broadly in line with the proposed draft legislation, whereby changes necessary to align with the OECD BEPS initiative, in particular in regard to the Licence Box, will be incorporated.

While a subsequent public vote is likely, we deem it also likely that the CTR III legislation will pass a referendum, so that CTR III will come into law in 2019 or 2020.

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