

Tax News

Tax Proposal 2017

Thirteen months after Swiss voters rejected the third corporate tax reform (CTR III), the Federal Council dispatched a new draft reform bill, Tax Proposal 2017 (TP17), on March 23, 2018. TP17 aims to abolish internationally criticized corporate tax privileges while trying to preserve Switzerland's attraction as a business location without sacrificing too much of the tax base.

Assessment

In sum, it can be said that TP17 essentially contains the same elements as CTR III. The key differences are:

- Focus on staff costs when claiming R&D deductions
- Tighter cap on tax relief (max. 70%)
- No notional interest deduction concept
- Increase of the taxed threshold for qualified dividend income (min. 70%)
- Higher cantonal share of the direct federal tax collected
- Increase in child and education allowances
- Tightening of the current transposition rules

It will take a lot of political effort and compromise to get the proposal past the two chambers of Parliament. The bill is far from having majority backing.

Measures outlined in the TP17 dispatch

- **Tax privileges.** The cantonal tax regimes for holding, mixed, and domiciliary companies will be abolished. At the federal level, the privileged treatment of principal companies and finance branches will also be abolished. Companies that lose their privileged status are given the option, if cantonal practice allows it, to disclose their existing hidden reserves tax-neutrally.

- **Patent box system.** A mandatory patent box will be introduced at cantonal level. Under this system, net profits derived from patents and comparable rights will be taxed at a discount of no more than 90%. The term “comparable rights” encompasses supplementary protection certificates, topographies, plant varieties, data protection in accordance with the Therapeutic Products Act, and the corresponding foreign rights. Not included in the patent box are innovations that are not protected by a patent, and proprietary (copyrighted) software. This measure does not apply to the direct federal tax.
- **Deductions for research and development.** Deductions for domestic R&D expenditure will be capped at 150% of real costs and are now limited to (directly attributable) staff costs plus a flat-rate allowance of 35%. It is up to the cantons to decide whether they want to implement this measure. It does not apply to the direct federal tax.
- **Cap on tax relief.** Tax relief on profits derived from the two aforementioned privileges is capped at 70% (i.e., at least 30% of the taxable profit is liable for taxation). The cap also includes the tax depreciation on stepped-up assets obtained by relinquishing the special tax status. This measure is mandatory for the cantons but does not apply to the direct federal tax.
- **Adjustments to the capital tax.** The cantons may grant capital tax relief by lowering their capital tax base relating to participations and patents (proportionate equity).
- **Disclosure of hidden reserves when moving to Switzerland.** Companies that transfer their domicile to Switzerland can disclose hidden reserves tax-neutrally and initially benefit from additional write-downs on stepped-up values. This measure applies to the direct federal tax as well as to the cantons.
- **Expansion of lump-sum tax credit.** As a new measure, permanent Swiss establishments of foreign companies will also be eligible for a lump-sum tax credit. This measure applies to the direct federal tax as well as to the cantons.
- **Partial taxation of dividends.** The threshold for the partial taxation of dividends from qualified participations (10% or more of the capital) is increased to a minimum of 70% at federal and cantonal level. The cantons can opt for a higher rate. This measure applies to the direct federal tax as well as to the cantons.
- **Adjustments to certain tax-free capital gains (transposition).** Under the existing regime, individuals were able to sell participations of max. 5% to own-controlled corporations at market value without any tax implication. This threshold will be abolished, which means that even portfolio securities will now be affected by the transposition restrictions. This measure applies to the direct federal tax as well as to the cantons.
- **Vertical offset:** The cantonal share in the direct federal tax collected increases from 17% to 21.2%. In distributing the surplus, the cantons must take due consideration of the financial needs of the municipalities and communes.
- **Child and education allowances:** The minimum amount of the child and education allowances will be raised by CHF 30. The child allowance will amount to at least CHF 230, and the education allowance to at least CHF 280. This element is plainly outside the scope of corporate taxation and was added for purely socio-political reasons (a concession to the political left wing).

It's worth noting that TP17 does not provide for a notional interest deduction system – something the Canton of Zurich, in particular, had demanded.

The cantons are called on to drive their cantonal implementation plans in parallel to the federal proposal and to make them public by the time the decision on TP17 is due (which has already happened in parts). This is aimed at reinforcing the proposal's transparency. Overall, there appears to be a trend **to cut the combined corporate tax rates (federal, cantonal, communal, pre-tax) from an average 19.6% today to about 14.5%.**

Next steps

Parliament will now deliberate on the bill. If all goes to plan, TP17 could clear the parliamentary hurdle in the fall 2018 session. Once again, a referendum against the bill in its current form cannot be ruled out. If no referendum is called, the first measures could be implemented as soon as January 1, 2019; the bulk of the reform could enter into force as of January 1, 2020.

We will keep you posted on the further developments in connection with TP17.

Tax Partner AG

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Tax Partner AG, Taxand Schweiz

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