

Tax News

Update on Tax Proposal 2017 (TP17) or Tax Reform and OASI Financing (TROF)

In our last newsletter of June 2018, we summarized and assessed the decision of the Council of States regarding the Tax Proposal 2017 (TP17). The main point was the tie-in of TP17 with the reform of the national old-age pension system (OASI) under a new federal law on tax reform and OASI financing (TROF).

Tax reform and OASI financing

The second chamber of Parliament, the National Council, debated TROF on September 12, 2018. Here the issue of linking tax reform and OASI financing led to substantial debate. But eventually the National Council clearly endorsed the proposal of the Council of States.

Two minimal differences remained between the two chambers of Parliament. For one, the National Council slightly tightened the so-called "Communes article" – the cantons must adequately compensate the communes for the loss in tax revenue as a result of the tax reform instead of merely giving "due consideration" to their needs. In addition, the National Council imposed greater restrictions on capital contribution reserves (see below). The Council of States endorsed both adjustments at its session of September 17, 2018 and thus removed the remaining differences.

The proposal is now ready for the final vote in Parliament at the end of September 2018. Anything but a clear yes vote would be a big surprise.

The measures of TROF

The key changes can be summarized as follows:

- **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. With this patent box, the net profit attributable to patents and comparable rights will be taxed at the ratio of the qualifying research and development expenditure to the overall research and development expenditure per patent or comparable right (nexus quotient) with a maximum reduction of 90%. This measure does not apply to the direct federal tax.
- **Deductions for research and development.** The deduction for research and development costs incurred domestically may not exceed 150% of the actual costs. It is up to the cantons to decide whether they want to implement this measure. It does not apply to the direct federal tax.
- **Deduction for equity financing (notional interest deduction).** High-tax cantons shall have the option of introducing a deduction for equity financing. A canton is deemed a high-tax canton if the (cantonal and communal) tax rate is at least 13.50%. Which means that probably only the Canton of Zurich will be able to benefit from this rule.
- **Cap on tax relief.** Tax relief on profit derived from the three aforementioned privileges is capped at 70% (i.e., at least 30% of the taxable profit is liable for taxation). This cap also includes write-downs on the disclosed hidden reserves as well as internally generated added value (goodwill) thanks to earlier taxation as a privileged status company (step-up under old law). 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. Such relief relates to the equity capital of a company that is attributable to participations, patents, and loans to group companies.
- **Disclosure of hidden reserves when moving the domicile to Switzerland.** Companies that transfer their domicile to Switzerland can disclose hidden reserves as well as internally generated added value tax-neutrally, and subsequently benefit from additional write-downs. This measure applies to the direct federal tax as well as to the cantons.
- **Limitation of the capital contribution principle.** The tax reform limits the tax-free repayments of capital contribution reserves (KER), a principle that was introduced in the second round of corporate tax reforms. The new rule makes repayments conditional, in that corporations and cooperatives listed in Switzerland can only make tax-free KER repayments if they also distribute at least a matching amount of (taxable) dividends from commercially distributable other reserves (applies both federally and at cantonal level). An exception applies to foreign KER, i.e., KER accruing after February 24, 2008 in the context of a relocation to Switzerland or a transfer of assets from abroad. This restriction also applies analogously to the issue of bonus shares or increases in nominal value.
- **Partial taxation of dividends.** The partial taxation of dividends from qualifying participations (10% or more of the capital) is set at 70% at federal level (before: 60%) and shall amount to at least 50% at cantonal and communal level (before: no lower limit). The cantons are free to opt for a higher limit.
- **Adjustments to tax-free capital gains (transposition).** Under the existing regime, individuals were able to sell participations of max. 5% to own-controlled capital companies at market value without any tax implication. This threshold is to be abolished, which means that even portfolio securities will now be affected by the transposition restrictions.

- **Vertical offset.** The cantonal share of the direct federal tax collected increases from 17% to 21.2%. In distributing the surplus, the cantons must adequately compensate the municipalities and communes.
- **Financing of OASI.** The expected loss in tax revenue as a result of the tax reform shall be compensated via additional funding for OASI. As a consequence, salary contributions shall be increased by 0.3% (0.15% each from employer and employee), from the current 8.4% to 8.7% in the future.

Next steps

As stated, the Council of States resolved the last differences and endorsed the version of the National Council. The proposal is now ready for the final vote in Parliament at the end of September 2018.

A referendum against the new federal law was already announced by various parties and must be seen as likely. Which means that the Swiss voters will have the last word (in spring 2019). If no referendum is called, the first measures could be implemented as soon as January 18, 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 TROF.

Tax Partner's TROF information event on November 21, 2018

We like to draw your attention to our early-evening information event on TROF on November 21, 2018 (from 17:30 at the Park Hyatt hotel in Zurich). A separate invitation will follow in mid-October.

Tax Partner AG

Zurich, September 2018

Tax Partner AG, Taxand Schweiz

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