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Tax News

Update on Tax Proposal 2017

We summarized and assessed the dispatch of the Swiss Federal Council on its Tax Proposal 2017 (TP17) in our newsletter of March 2018.

The Council of States, as the first of the two chambers of Parliament, debated TP17 on June 7, 2018, and endorsed the proposals of its Economic Affairs and Taxation Committee (EATC). This resulted in the following key changes to the dispatch of the Federal Council:

- Listed companies shall have limited scope for the tax-free distribution of paid-in capital surplus (capital contribution reserves).
- High-tax cantons shall have the option of introducing a deduction for equity financing (the so-called notional interest deduction).
- Partial dividend taxation at cantonal level shall be adjusted.
- The cantons may reduce their capital tax rate also with regard to loans.
- TP17 will be tied to the reform of the national old-age pension system (OASI).
- The increase in the child allowance rate shall be cancelled.

Limitation of the capital contribution principle

The capital contribution principle was introduced on January 1, 2011 in the second round of corporate tax reforms (CTR II), whereby repayments of capital contribution reserves (KER) are, in principle, exempt from withholding and income tax. The Council of States now wants to limit the capital contribution principle by making repayments conditional, i.e., corporations and co-operatives 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). This rule shall apply to all existing and future KER, with the exception of KER to be distributed within the corporation, and KER accruing after 31 December 2010 in the context of a relocation to Switzerland or a transfer of assets from abroad.

If an entity decides to repay KER without simultaneously distributing taxable dividends to at least the same extent, such a repayment becomes taxable (having withholding and possibly income tax implications), although taxation is limited to the amount of commercially distributable other reserves. If an entity does not have any distributable reserves, unrestricted tax-free KER repayments are possible.

Example: A listed company has on its balance sheet only KER of CHF 10 million, equity capital of CHF 100,000, and legal reserves of CHF 50,000. If it repays CHF 5 million worth of KER, the CHF 5 million will not be proportionally re-qualified as (taxable) dividends. If the same company has retained earnings totaling CHF 3 million and repays CHF 5 million worth of KER, CHF 2.5 million of the KER repayment will be valued as taxable dividends. If the company's retained earnings amount to only CHF 2 million, only CHF 2 million of the KER repayment will be valued as taxable dividends.

If companies listed in Switzerland buy back their own shares, they must reduce KER to the same extent as their retained earnings.

These rules shall apply correspondingly to the emission of bonus shares and par-value increases funded by KER.

Deduction for equity financing

High-tax cantons shall have the option of introducing a deduction for equity financing, i.e., the notional interest deduction. 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.

Partial taxation of dividends

The Council of States has made an adjustment to the cantons' partial dividend taxation, whereby the partial taxation of dividends from qualifying participations shall amount to at least 50% at cantonal level (Federal Council: 70%). It has left the partial taxation at federal level at 70%.

Funding of the old-age and survivor's insurance (OASI)

The Council of States wants to tie TP17 to the issue of funding for the OASI under a new federal law on tax reform and OASI financing. According to the EATC concept, the loss in tax revenue as a result of TP17 shall be compensated via additional funding for the OASI, based on the principle of "each tax franc is being financed through an OASI franc." 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. This tie-in represents a political compromise and amounts to a constitutional balancing act.

Further measures under TP17

For other measures proposed under TP17, please see our newsletter of March 2018.

Next steps

The aforementioned changes made by the Council of States are not final. In a next step, the National Council, as the second chamber of Parliament, will deliberate TP17 in the upcoming fall session. If all goes to plan, TP17 could clear the parliamentary hurdle in the fall 2018 session. 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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