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YES to Tax Reform and OASI Financing (TROF)

On May 19, 2019, Swiss voters accepted the Federal Act on Tax Reform and OASI Financing (TROF Act). This means that the urgently needed tax reform can finally be implemented. The YES vote is a crucial step towards preserving jobs and safeguarding the attractiveness of Switzerland as a business location.

For years, Switzerland had been under international pressure to abolish the tax privileges for legal entities. It can now honor its pledge to do so in the nick of time and avoids becoming a prominent name on the EU/OECD black list. The tax reform eliminates significant legal uncertainties for (foreign) corporations in Switzerland and will stem, or at least minimize, the dreaded exodus of (mainly) mobile companies with a large tax base.

TROF enables the implementation of the following elements:

- **Abolition of tax privileges.** The privileged taxation status of holding, mixed, domiciliary, and principal companies as well as Swiss finance branches will 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 (step-up) or are granted a special tax rate for a limited transition period that will cushion the effects of the abolition.

- **Financing of the old-age pension system (OASI).** Salary contributions to OASI will be increased by 0.3% (0.15% each from employer and employee), from the current 8.4% to 8.7% in the future.
- **Patent box system.** Introduction at cantonal level of a mandatory patent box in line with the OECD standard. 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 inventions by SMEs that are not protected by a patent as well as proprietary (copyrighted) software.
- **Deductions for research and development.** The cantons can introduce an additional deduction for R&D costs. The total deductions may not exceed 150% of the actual costs incurred and are limited to staff costs plus a flat-rate allowance. The measure applies only to domestic research and development activities.
- **Deduction for equity financing (notional interest deduction).** High-tax cantons 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%. At present, only the Canton of Zurich qualifies as high-tax canton and plans to make use of the notional interest deduction option.
- **Maximum tax relief.** Tax relief on profit derived from the three aforementioned privileges (patent box, R&D deductions, notional interest deduction) is capped at 70%. The calculation includes write-downs based on the earlier taxation as privileged-status company (step-up under old law).
- **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).
- **Limitation of the capital contribution principle.** The tax-free repayments of capital contribution reserves (KER) by corporations and cooperatives listed in Switzerland will be limited. These entities can only make tax-free KER payments if they also distribute at least a matching amount of (taxable) dividends from commercially distributable other reserves (if available). An exception applies to KER repaid within a corporation, and to KER accruing after February 24, 2008 in the context of a relocation to Switzerland or a transfer of assets from abroad.
- **Vertical offset.** The cantonal share of the direct federal tax collected increases from 17% to 21.2% as a financial contribution to potential corporate tax cuts or as compensation for the loss of tax income because of the relocation of previously tax-privileged corporations. The overall trend suggests a cut in corporate tax rates from an average 19.6% today to about 14.5%. Within the cantons, municipalities and communes must be adequately compensated for the effects of the tax reform ("communes article").
- **Adjustments to the capital tax.** The cantons may lower the taxable portion of equity capital attributable to participations and patents when calculating the capital tax.
- **Disclosure of hidden reserves.** Companies relocating their domicile to Switzerland may write down their disclosed hidden reserves for a period of 10 years. This helps reduce the profit tax burden. If they transfer their domicile abroad, the currently prevailing exit tax continues to apply.

- **Adjustments to tax-free capital gains (transposition).** The threshold of 5% above which the sale of a participation to an own-controlled capital company represents a taxable transposition will be abolished. This means that any "sale to oneself" will always be taxable.
- **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.
- **Fiscal equalization.** The tax reform also adjusts inter-cantonal fiscal equalization. Under the new rule, the profits of legal entities are given a lower weighting than other revenues. In addition, financially weak cantons will receive federal compensation totaling CHF 180 million for a period of seven years.

Implementation of TROF

The main part of the reform will enter into force on January 1, 2020. It is now up to the cantons to implement the tax reform. The compulsory elements of the reform will become effective in cantonal law from January 1, 2020, regardless of the status of implementation. The optional elements mentioned above require a change of law at cantonal level, which means that cantonal voters will also have a say on the respective cantonal adjustments and any corporate tax cuts.

We will keep you posted on the further developments in connection with TROF, in particular as regards the cantons.

Tax Partner AG, May 2019

Tax Partner AG, Taxand Schweiz

Tax Partner AG, Taxand Switzerland, is focused on Swiss and international tax law and is recognised as an important independent tax boutique. With currently more than 10 partners and counsels and approximately 40 professionals, the firm has been advising multi-national and national corporate clients as well as individuals since it was established in 1997.

Tax Partner offers the full range of tax advice thereby offering a unique in-depth service quality to its clients.

As a part of its growth and continuously expanding international relationships, Tax Partner co-founded Taxand in 2005. Taxand is the world's largest independent tax organisation delivering high quality integrated tax advice worldwide.

Tax Partner has repeatedly been nominated as a leading tax firm in Switzerland in several international rankings.

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