Executive summary

On 16/17 March 2016, the National Council decided on the draft bill on the Corporate Tax Reform III (draft bill) as already amended by the Council of States within the parliamentary winter session 2015. The draft bill differs in several aspects from the initial version published by the Swiss Federal Council in June 2015 as well as the version amended by the Council of States in December 2015.¹ The current draft bill as amended by the National Council includes elements that particularly enhance the attractiveness of Switzerland's tax environment for companies.

Among the good news is that the National Council supports the introduction of an interest-adjusted corporate income tax on above-average equity, generally known as notional interest deduction (NID). The introduction of a tonnage tax into the draft bill and the abolition of the one-time capital duty on equity within a separate draft bill, are also part of the National Council's decision of 16/17 March 2016. The National Council further decided to grant the cantons with a high level of discretion to extend the optional input promotion (i.e., increased tax deductions for research and development (R&D) expenditures) to expenditures for R&D activities performed abroad. However, in this regard the draft bill entails a novel limiting factor. The combined cantonal tax relief of patent box, input promotion, NID and step-up should not exceed the threshold of 80%.
Detailed discussion

Core measures in detail

Patent box (cantonal level)
In line with the initial proposal, the draft bill includes the mandatory introduction of a patent box at the cantonal level, which conforms to the modified nexus approach of the Organisation for Economic Co-operation and Development (OECD). Previously, the maximum level of permissible tax relief for patent box income was set at 90%. This limitation was left out in the draft bill of the National Council. However, companies would still be subject to the aforementioned limitation of the overall combined tax relief of 80%.

R&D super deduction (cantonal level)
Also in line with the initial proposal, the draft bill includes the optional introduction of a cantonal input promotion, i.e., an increased tax deduction for R&D costs at the cantonal level. However, in contrast to the previous version, this so-called super deduction should not be limited to a maximum of 150%. Cantons shall be free to decide which level they consider as appropriate, subject to the overall combined limit of 80% as mentioned above. A significant novel feature of the draft bill as amended by the National Council is that the cantons should have the additional opportunity to grant an increased tax deduction also for R&D costs of a Swiss company in connection with its activities performed abroad.

NID (federal and cantonal level)
In contrast to the previous versions of the draft bill, the draft bill as amended by the National Council suggests the introduction of an interest-adjusted corporate income tax on above-average equity (NID). It is proposed that this measure becomes mandatory at the federal level and optional at the cantonal level. Tax relief under the NID shall be subject to the overall combined tax relief limit of 80% as mentioned above.

Disclosure of built-in gains (including goodwill) upon migration to Switzerland or upon change of tax status (federal and cantonal level)
In line with the previous proposals and accordingly representing final agreement between the National Council and the Council of State, the draft bill provides comprehensive rules for the tax-neutral disclosure of built-in gains (including goodwill) upon migration to Switzerland or upon change of tax status from a preferential taxation regime to ordinary taxation. The disclosure of built-in gains is especially highly relevant in connection with the abolition of the cantonal tax regimes. It ensures a competitive current income tax burden during a five-year transitional period. The revised bill considers two different models:

- The original step-up (as outlined in the consultation draft of September 2014) applies with regard to the relocation to Switzerland.
- A two-basket approach with two different corporate income tax rates applies during the transition period from the privileged taxation regime to ordinary taxation. Under the two-basket approach, the ordinary tax rate applies for profits relating to value created under the ordinary taxation (first basket) and a lower tax rate applies for profits relating to the realization of built-in gains that were generated under a privileged tax regime (second basket).

The proposed models for the disclosure of built-in gains are mandatory for all cantons and the two-basket approach is applicable for a transition period of up to five years. Additionally, the rules for the disclosure of built-in gains are also subject to the overall combined tax relief limit of 80%.

Restriction of tax relief (cantonal level)
In contrast to the previous version of the draft bill, and as mentioned above, the wording of the National Council’s draft bill grants a high level of discretion to the cantons on the above mentioned measures. The only limiting factor set by the National Council is the restriction that the overall combined tax relief of the above mentioned measures (i.e., patent box, R&D super deduction, NID and step-up) shall be restricted to a maximum percentage of 80%.

Abolition of one-time capital duty (federal level)
Contrary to the previous version of the draft bill, the National Council proposes the abolishment of the one-time capital duty as initially proposed by the Swiss Federal Council. However, the National Council wants to include this measure into a separate bill, distinct from the already existing bill, in order not to endanger the acceptance of the Corporate Tax Reform III. Accordingly the segregated bill was sent back to the Economic Committee of the National Council (WAK-N) for further discussion and refinement detached from the Corporate Tax Reform III bill.

Tonnage tax (federal and cantonal level)
Contrary to the previous proposals, the draft bill as amended by the National Council introduces a tonnage tax applicable to the shipping industry at the federal and cantonal level. This measure would allow shipping companies to calculate
their taxable profit based on the shipping space rather than on their profits recorded in their financial accounts. The tonnage tax could lead to a lower tax burden for companies engaged in the shipping industry.

Partial taxation of qualifying dividend income (federal and cantonal level)

As already agreed by the Council of States, the National Council also rejected the proposal of the Swiss Federal Council regarding the harmonization of the partial taxation of qualifying dividend income for individuals at the federal and cantonal level (i.e., limitation of the tax relief to 30%). Accordingly, this measure is finally rejected and the existing and more flexible legal situation shall be maintained (i.e., at the federal level a 40% exemption applies for dividend income from qualifying participations held as part of private assets and a 50% exemption applies for dividend income from qualifying participations held as part of business assets; at the cantonal level the extent of the partial taxation and the applicable exemption method depends on cantonal law).

Measures not officially included in Corporate Tax Reform III

Corporate income tax rate reduction

In order to further boost Switzerland's attractiveness as a business location, cantons envisage lowering their ordinary corporate tax rates to compensate for the abolition of the cantonal tax regimes. It is in the sphere of autonomy of the cantons to determine their applicable corporate income tax rates. Therefore, albeit de facto being one of the corner stones of the Corporate Tax Reform III, the reduction of the cantonal corporate income tax rates is not formally within the scope of the bill. However, what is formally part of the draft bill is firstly, that cantons have the possibility to introduce targeted capital tax reductions on net equity related to participations, intangible assets as well as intercompany loans and secondly, a measure to counter-finance the revenue losses of the cantons resulting from the reduction of the cantonal corporate income tax rates. An increase of the cantonal stake on the direct federal tax revenue is envisaged. In this regard the National Council follows the proposal of the Swiss Federal Council, which suggested an increase from currently 17% to 20.5%.

Timing

As a next step the draft bill will again be discussed by the Council of States and its technical commission (WAK-S). It is planned that the remaining differences between the two Councils (National Council and Council of States) should be eliminated in the next parliamentary summer session with the possibility that the final vote on the Corporate Tax Reform III will be held at the earliest during the same session. Hence, in case no referendum is called, the new federal and cantonal tax laws could take effect, at the earliest, at the beginning of 2019.

Endnote

1. Further information on the Swiss Corporate Tax Reform III is also available under www.ey.com/ch/CTR-III.
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