Executive summary

On 17 June 2016, the Swiss Parliament approved the final bill on Corporate Tax Reform III after the two parliamentary chambers (National Council and Council of States) had resolved their remaining differences and reached a final agreement a few days earlier.

The reform foresees the replacement of certain preferential tax regimes with a new set of internationally accepted measures. The legislative changes will go along with a broad reduction of the headline corporate tax rates and will ensure that Switzerland remains attractive for multinational corporations in a post-base erosion and profit shifting (BEPS) environment by providing planning certainty for the future and ensuring compliance with Organisation for Economic Co-operation and Development (OECD) standards.

The table below provides an overview of the corporate tax measures that will be introduced with the reform. Some of the cantonal measures are optional so that the cantons can tailor their legislation to their specific circumstances and needs. The overview also shows which cantonal measures will be subject to a restriction limiting the overall tax relief to a maximum of 80% (see details further below).
<table>
<thead>
<tr>
<th>Measures</th>
<th>Federal level</th>
<th>Cantonal level</th>
<th>80% relief limit*</th>
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<tbody>
<tr>
<td>Patent box</td>
<td>-</td>
<td>✓</td>
<td>yes</td>
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<tr>
<td>R&amp;D super deduction</td>
<td>-</td>
<td>✓</td>
<td>yes</td>
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<tr>
<td>NID on surplus equity</td>
<td>✓</td>
<td>✓</td>
<td>yes</td>
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<td>Two-basket approach</td>
<td>-</td>
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<td>no</td>
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<td>Immigration step-up</td>
<td>✓</td>
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<tr>
<td>Relief of capital tax</td>
<td>-</td>
<td>✓</td>
<td>no</td>
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<tr>
<td>CIT rate reduction</td>
<td>-</td>
<td>✓</td>
<td>no</td>
</tr>
</tbody>
</table>

(o) optional            * at cantonal level only

Detailed discussion

Background

A reform of Switzerland's corporate tax system became necessary due to the changing international tax environment and the former controversy on business taxation with the European Union (EU), which was finally resolved by a joint statement between Switzerland and the EU in October 2014. The legislative process for the Corporate Tax Reform III was initiated with the primary goal to strengthen the attractiveness of Switzerland as a business location by aligning the Swiss corporate tax system with the latest international standards.

The bill on the Corporate Tax Reform III that has now been approved by the Swiss Parliament differs in various aspects from the initial version proposed by the Swiss Federal Council on 5 June 2015. In particular, the Swiss Parliament included in the reform package the interest-adjusted corporate income tax on surplus (above-average) equity, more commonly referred to as the notional interest deduction (NID), and restricted the overall tax relief of newly introduced measures at the cantonal level to a maximum threshold of 80%. The abolition of the one-time capital duty has been postponed and will be addressed in a separate bill at a later stage; the same applies to the introduction of a tonnage tax which had been proposed by the National Council in the course of the parliamentary debate.

Core measures

Abolition of preferential tax regimes

Certain preferential tax regimes or practices will end upon the entry into force of the Corporate Tax Reform III, while simultaneously an attractive set of replacement measures will be introduced. At the federal level, the taxation practices for principal companies and finance branches will be affected, whereas at the cantonal level, the holding, domiciliary and mixed company regimes will go away. It should be noted that these preferential tax regimes or practices will continue to be available as long as the amendments to the relevant tax laws have not been enacted with legal effect. The earliest possible date for the implementation of the legislative amendments and the abolition of the aforementioned regimes is 1 January 2019.

Introduction of OECD-compliant patent box

The final bill provides for the mandatory introduction of a patent box that is fully compliant with the modified nexus approach of the OECD. The patent box will only be available at the cantonal level and the maximum level of permissible tax relief for income related to the patent box has been set at 90%.

Introduction of R&D super deduction

As one of the optional cantonal measures, the final bill allows for the introduction of an increased tax deduction for research and development (R&D) expenses. The R&D super deduction is restricted to a maximum percentage of 150% of qualifying expenses incurred in Switzerland. Expenses related to R&D activities performed abroad are excluded from the increased tax deduction.
**Introduction of NID on surplus equity**

The NID on surplus equity constitutes a highly relevant and novel feature, as compared to the initial draft bill. The introduction is mandatory at the federal level and optional at the cantonal level. The optional introduction at the cantonal level is linked to a minimum taxation of dividends received by individual shareholders. The link foresees that a canton may only introduce the NID if at least 60% of dividend income derived from qualifying participations held by individuals as private assets is subject to personal income tax.

Under the NID provisions, companies with surplus equity are entitled to claim a deduction of a notional interest expense thereon. The amount of the surplus equity will be determined based on the company’s assets along the lines of the principles of the hidden equity calculation. The applicable notional interest rate conforms to the yield on 10-year Swiss federal state bonds. To the extent of receivables from related parties (intra-group financing) an arm’s length interest rate can be applied instead.

**Step-up upon change of tax status/transitional system**

Comprehensive rules governing the transition from preferential taxation to ordinary taxation are highly relevant in connection with the phasing out of existing preferential tax regimes.

The final bill provides for a two-basket approach with two different tax rates to be applied during a five-year transition period following the abolition of the cantonal tax regime:

(i) The ordinary tax rate applies to profits derived from value created under the ordinary taxation scheme (first basket)

(ii) A reduced tax rate applies to profits related to the realization of built-in gains that were generated under the former cantonal tax regime (second basket)

Taxpayers may also voluntarily waive their cantonal tax privilege prior to the entry into force of the Corporate Tax Reform III. Such “premature” exit would typically allow, based on the current practices in most cantons, for a tax-neutral step-up of the built-in gains created under the preferential tax regime followed by a tax-effective amortization over a maximum period of 10 years. Unlike the two-basket approach under the Corporate Tax Reform III, the tax relief resulting from the step-up under the current practices will be subject to the aforementioned 80% overall tax relief limitation once the reform of the cantonal tax laws comes into force.

**Step-up upon migration to Switzerland**

The final bill introduces consistent rules at the federal and cantonal levels that allow for a tax-neutral disclosure of built-in gains (including self-generated goodwill) upon relocation of a company, activities or functions from abroad to Switzerland with a corresponding step-up in tax basis. The subsequent amortization of the disclosed built-in gains will be tax-effective in accordance with the general amortization rules. Self-generated goodwill will have to be amortized over a maximum period of 10 years.

**Restriction of overall cantonal tax relief**

The Corporate Tax Reform III grants discretion to the cantons with regard to the optional introduction of various core measures. In order to avoid zero-taxation or tax accounting losses, a maximum threshold has been defined in order to limit the effect of the cantonal tax relief. The overall cantonal tax relief provided by the patent box, R&D super-deduction, NID as well as the step-up under the current cantonal practices will, therefore, be restricted to a maximum of 80%. No such restriction applies at federal level.

**Additional measures**

**Relief measures for cantonal capital tax**

The cantons will have the option to introduce targeted capital tax reductions on the company’s net equity related to participations, intangible assets and intercompany loans, aside from further relief measures such as general capital tax rate reductions or the possibility to credit income taxes against capital taxes.

**Partial taxation of qualifying dividend income**

The rules governing the cantonal taxation of individuals are subject to cantonal tax laws. This includes the definition of the method and the extent to which a partial relief on dividend income taxation for private individual shareholdings is granted by the cantons. As mentioned above, the NID can only be introduced by cantons that levy personal income tax on at least 60% of the dividend income earned by individuals.

**Increased share in direct federal tax revenue**

In order to compensate for the losses in cantonal tax revenues that are expected to result from the newly implemented measures as well as the anticipated broad reduction in corporate tax rates (summarized below), the share of the cantons in the direct federal tax revenue will be increased from 17% to 21.2%.
Related measures not directly included in the reform

General tax rate reductions
As a measure to further boost the attractiveness of Switzerland as a business location and to compensate the abolition of the cantonal tax regimes, most cantons will lower their ordinary corporate tax rates. Cantonal tax rate reductions are at the full discretion of the cantons. Based on official announcements already made by numerous cantonal governments, it is expected that the majority of the Swiss cantons will provide attractive low headline tax rates on pre-tax income between 11.5% and 14% (including federal tax) once the reform package enters into force.

Abolition of one-time capital duty
The Swiss Federal Council proposed the abolishment of the one-time capital duty in its initial draft bill. However, in order to not endanger public acceptance of the Corporate Tax Reform III, the National Council and the Council of States decided to postpone this measure and to include it in a separate bill at a later stage.

Introduction of tonnage tax
The introduction of a tonnage tax (applicable to the shipping industry at the federal and cantonal levels which would allow shipping companies to calculate their taxable profit based on shipping space rather than the result according to their profit & loss statement) was subject to some back-and-forth in the parliamentary debate. It was ultimately decided to address the introduction of such new regime also in a separate bill at a later stage.

Timing
The final bill is subject to an optional referendum. If, within 100 days of the final bill’s publication in the Official Gazette, 50,000 voters sign a petition requesting a public referendum, the proposed Corporate Tax Reform III measures will be subject to a popular vote which may be expected to take place in the course of 2017. The target date for the entry into force of the reform package is currently 1 January 2019.

Endnotes
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