4 October 2016

Global Tax Alert

Swiss canton of Zug releases plan for local implementation of Corporate Tax Reform III

EY Global Tax Alert Library

Access both online and pdf versions of all EY Global Tax Alerts.

Copy into your web browser:

www.ey.com/taxalerts

Executive summary

The Swiss Corporate Tax Reform III (CTR III) foresees the replacement of certain preferential tax regimes with a new set of internationally accepted measures. The legislative changes will implement 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 (post-BEPS) environment by providing planning certainty for the future and ensuring compliance with international taxation standards.

On 17 June 2016, the Swiss Parliament adopted the final CTR III package to strengthen Switzerland's attractiveness as a business location.[1] The new legislation will be subject to a public vote, which will likely take place in February 2017, and is expected to become effective on 1 January 2019.

The cantons are required to adjust their cantonal tax laws in accordance with CTR III. Some measures are mandatory and have to be implemented by the cantons and others are optional. Each canton will, therefore, implement the CTR III individually by tailoring its cantonal tax legislation to its specific needs and circumstances.

Building a better working world

On 19 September 2016, the Government of the canton of Zug presented its strategy for the implementation of CTR III into cantonal tax law. The core component of the plan is the reduction of the corporate income tax rate to approximately 12% (including federal tax). Furthermore, additional tax relief measures will be introduced at the cantonal level such as a patent box, increased deduction of research and development (R&D) costs and a notional interest deduction on surplus equity.

Detailed discussion

In order to maintain its attractiveness as a business location, the Government of the canton of Zug plans the following core measures for the implementation of CTR III at the cantonal level:

Tax rate reduction

The corporate income tax rate is to be reduced from the current maximum rate of 14.6% to approximately 12% (including federal tax). In addition, adjustments are planned with respect to the annual capital tax.

Patent box and R&D super deduction

Another part of the package is the introduction of a patent box regime as well as the concept of an R&D super deduction to promote innovation and R&D activities in Switzerland. The cantonal tax relief for qualifying patent box income will be 90% and qualifying R&D expenses will be eligible for an increased cantonal tax deduction of 150%.

Notional interest deduction

The Government of the canton of Zug furthermore plans to introduce the instrument of a notional interest deduction on surplus equity at the cantonal level in the same way as it will be introduced at the federal level.

The objective is to offer an attractive alternative measure for existing group financing entities as well as to promote group financing and treasury activities in the canton of Zug. While the regulations governing the details of the mechanism for calculating the notional interest expense are still to be issued, it is expected that the base deduction may result in a cash tax rate of between 2.5-4% for a fully equity funded company engaged in group financing activities with its domicile in the canton of Zug.

Limitation of cantonal tax relief

The Government of the canton of Zug furthermore aims – in line with the new federal harmonization law – to limit the maximum cantonal tax relief under the patent box, the R&D super deduction and the notional interest deduction to 80% of the company's net profit in total.

Step-up upon migration to Switzerland

Further, a new rule will be introduced with CTR III, allowing for the tax-neutral disclosure of all built-in gains (including self-generated goodwill) upon relocation of a company, assets or functions from abroad to Switzerland by means of a step-up in tax basis. The stepped-up tax basis can then be amortized tax-effectively in accordance with general amortization rules. Self-generated goodwill must be amortized over a period of 10 years.

Transitional rules for change of cantonal tax status

Existing holding, domicile and mixed companies, which currently benefit from a privileged tax treatment, will be able to disclose their built-in gains either completely or partially upon the change of the cantonal tax status. Zug-based companies will be able to opt between the "two-rate model" (default rule) and the "step-up model" (prior to CTR III). Both rules will apply during a five-year transitional period following the entry into force of CTR III. The built-in gains should be determined based on a generally accepted valuation method.

Under the two-rate model, income derived from the realization of built-in gains created under the former regime will be taxed at a reduced rate during the five-year transitional period (likely until 31 December 2023). While the reduced tax rate is still to be determined, it is generally expected to be fairly low.

Alternatively, companies may apply the step-up model prior to the entry into force of CTR III. The step-up of the built-in gains in the tax balance sheet is tax-free in the amount of the exemption quota. The stepped-up tax basis can then be amortized tax-effectively over time but no longer than five years after the entry into force of CTR III (likely until 31 December 2023). Any stepped-up tax basis remaining after 31 December 2023 must be dissolved tax-neutrally.

It should be noted that the tax relief under the step-up model – in contrast to the two-rate model – is subject to the 80% overall relief limitation (i.e., at least 20% of the net profit before amortization must remain subject to cantonal income taxation). An explanatory leaflet issued by the Zug Cantonal Tax Administration on 22 September 2016 provides further information on the transitional rules governing the change of the cantonal tax status.

Financing

The corporate tax law reform shall be neutral as regards the tax revenues in the canton of Zug. The Government of the canton of Zug emphasizes that the reform will not lead to a shift of corporate tax burdens to private individuals.

Outlook

As the public vote on CTR III at the federal level will likely take place in February 2017, the Government of the canton of Zug will consult again on its strategy thereafter. It is expected that the final proposal will be submitted for consultation in April 2017. Consultation by the cantonal Parliament is planned for 2018. The target date for the entry into force of the new law is 1 January 2019.

Endnote

1. See EY Global Tax Alert, *Swiss Parliament approves Corporate Tax Reform III*, dated 17 June 2016. Further information on Swiss Corporate Tax Reform III is also available under www.ey.com/ch/CTR-III.

For additional information with respect to this Alert, please contact the following:

Ernst & Young AG, Zug

- Kersten A. Honold +41 58 286 3166 kersten.honold@ch.ey.com
- André Bieri +41 58 286 7531 andre.bieri@ch.ey.com

Ernst & Young AG, Zurich

- Daniel Gentsch +41 58 286 3613 daniel.gentsch@ch.ey.com
- Rainer Hausmann +41 58 286 3193 rainer.hausmann@ch.ey.com

Ernst & Young LLP, Swiss Tax Desk, New York

- Thomas Semadeni +1 212 773 8442 thomas.semadeni@ey.com
- Anna Eldring +1 212 773 0607 anna.eldring1@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. 03172-161Gbl

1508-1600216 NY
ED None

ey.com