NEWSLETTER – OCTOBER 2018

TAX LAW

Tax Reform and AHV Financing (TRAF)

On March 21, 2018, the Swiss Federal Council issued its dispatch on the Tax Proposal 17 (TP 17). This reform project was following the rejection of the Corporate Tax Reform III (CTR III) by the Swiss population on February 12, 2017. On September 28, 2018, the Swiss Parliament adopted the Federal Act on Tax Reform and AHV Financing (TRAF). TRAF replaces TP 17 and is intended as a "balanced compromise" to ensure a wider political support. It pursues the objective of complying with today's international corporate tax standards which can no longer tolerate any favorable treatment to certain revenues depending on their origin. TRAF also aims at maintaining the fiscal attractiveness of Switzerland as a competitive business location within a global and European context.

I. CONTEXT

On February 12, 2017, the Swiss population rejected CTR III. The Federal Council was under the pressure to react quickly and put forward an alternative and more consensual proposal likely to be accepted by a large majority of the political stakeholders and the electors in the event of a referendum. In March 2018, TP 17 was adopted in this context.

TP 17 aimed at maintaining a competitive corporate taxation system for Swiss companies while ensuring international acceptance of the Swiss corporate tax regime. TP 17 maintained certain core and unchallenged items of CTR III: in particular, the abolition of preferential tax regimes. Some other measures had been abandoned or adjusted as, for example, the notional interest deduction or the redefined patent box regime.

During the fall session, the Parliament finally deliberated over TP 17 and adopted TRAF on September 28, 2018. The content of TRAF is essentially the same as TP 17. The new Federal Act also includes further adjustments to TP 17 as, for example, the reintroduction of a potential deduction of notional interest (with a narrow scope) or the AHV financing. In a thorny political context, this social compensation measure is intended to ensure a large public acceptance of the reform and to avoid a new rejection by the population in the event of a referendum.

II. SUMMARY OF TRAF MEASURES

TRAF includes, among the key measures, the following:

- Abolition of cantonal tax regimes as well as certain tax practices at a federal level (finance branch, principal structures);
- At a cantonal level, in order to mitigate transition to ordinary taxation system, hidden reserves (including goodwill) which were set up in accordance with former cantonal tax regimes, will be subject to a specific tax, if properly reported, during a five-year period following the abolition of said regimes;
- Mandatory introduction of a patent box regime at a cantonal level for patents and similar rights allowing an exemption up to 90% on income taxes (a federal regulation will provide further detailed guidance);
- Optional introduction of an additional deduction for R&D costs at a cantonal level;
- Foreign companies relocating to Switzerland can disclose their hidden reserves (including goodwill) without any income tax (step-up). Subsequent depreciation on these hidden reserves will be deductible;

- At a cantonal level, the overall tax relief from the patent box, the R&D additional deduction, the hidden reserves' reporting as well as the notional interest deduction shall not exceed 70% of the taxable profit;
- Cantons may reduce capital taxation on equity in relation to patents and similar rights, participation rights, as well as intra-group loans;
- In order to prevent international double taxation, Swiss branches of foreign companies will benefit from the lump-sum tax credit;
- Abolition of the 5% threshold applying to a transposition (i.e. self-disposal) with the consequence that all participation transfers to a controlled entity may be taxable;
- Amendment of the capital contribution principle for companies listed on a Swiss stock exchange.

Further measures were introduced to balance the reform proposal:

- Taxation of dividends from qualified participations held as private assets will be increased: 70% at a federal level and at least 50% at a cantonal level (a current 60% threshold applies at a federal level and none at a cantonal level);
- The cantonal share in the direct Federal tax income will be increased from 17% to 21.2% (cities and municipalities will be properly taken into account);
- The financial equalization will be adjusted in order to limit the gap between cantons;
- The expected tax loss generated by the tax reform (around CHF 2 billion per year) will be compensated by an additional AHV financing.

III. Next steps

Given the urgency of the matter, the delay following the rejection of CTR III and the recent international developments, TRAF provides an ambitious timetable.

The 100-day referendum period ends on January 17, 2019. If no referendum is called, the first measures could already enter into force in January 2019. The majority of the new provisions will however become applicable in 2020. If a referendum is called, a public vote is likely to take place on May 19, 2019.

Starting from mid-June 2019, cantons will need to implement the tax reform to ensure that the new provisions will enter into force at the beginning of 2020.

IV. Cantonal situation : Vaud and Geneva

Given that the privileged tax status must be abolished and the international fiscal competition has increased significantly, cantons shall take immediate action to remain attractive business locations at an international level.

This lies especially true for the cantons of Vaud and Geneva, where a large number of multinational companies benefitting from such cantonal tax status have been set up in recent decades.

Accordingly, and even before TRAF was adopted at a federal level, Vaud had already adopted a unique lowered corporate income tax rate (the overall rate will amount to 13.79% as from January 1st, 2019). By adopting an early reform, Vaud has sent a clear and reassuring message to multinational corporations. The cantonal reform was approved by 87% of the Vaud electors in a referendum held in 2016.

In Geneva, after the adoption of TRAF by the federal Parliament, members of the Geneva Council had to update their own project, especially regarding its social dimension. Following a wide-ranging consultation of the stakeholders, the revised project was presented on October 17, 2018. It provides among others a unique corporate income tax rate reduced to 13.79% (instead of a current rate of 24.16%) and partial affectation of 50% of corporate income tax to capital tax during 5 years, then a 100% affectation. Geneva Council had to remove certain social compensation measures resulting in a double social levy and therefore, an excessive increase of the labor cost. The reform proposal will be now discussed at the Geneva Parliament and a cantonal referendum is likely to be held in May 2019.

The content of this newsletter is general and does not constitute in any way legal or tax advice. Should you seek advice with respect to specific circumstances, please contact any of the following persons:

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