

Switzerland approves tax reform

NEW! EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration [here](#).

Also available is our [EY Global Tax Alert Library](#) on ey.com.

Executive summary

On 19 May 2019, in a popular vote, Switzerland approved the *Federal Act on Tax Reform* and AHV (Old-Age and Survivors Insurance) Financing (TRAF) as adopted by the Federal Parliament last fall. The tax reform's objectives include: (i) securing the long-term tax attractiveness of Switzerland as a business location; (ii) restoring international acceptance of the Swiss tax system; and (iii) securing an appropriate level of tax revenue. The tax reform brings the replacement of certain preferential tax regimes with a new set of internationally accepted measures. The legislative changes align with the broad reduction of the cantonal corporate tax rates.

The table below provides an overview of the corporate tax measures introduced with the reform:

Tax measures	Federal level	Cantonal level	70% relief limit
Patent box	–	✓ mandatory	yes
Research and Development super deduction	–	✓ optional	yes
Notional Interest Deduction on surplus equity	–	✓ optional	yes
Two-rate system	–	✓ mandatory	no
Immigration step-up	✓	✓ mandatory	no
Relief of capital tax	–	✓ optional	no
Corporate Income Tax rate reduction	–	✓ optional	no

Some of the cantonal measures are optional so that the cantons can tailor their legislation to their specific circumstances and needs. The measures are subject to a restriction limiting the overall tax relief to a maximum of 70%. A number of cantons have already held the vote and the remainder is scheduled for the coming months.

Detailed discussion

Background

The last proposed tax reform with the same aim - Corporate Tax Reform III - was rejected by the Swiss voters at the beginning of 2017. Since the need for tax reform was undisputed, the Federal Council immediately drew up a new proposal. Based on the rejection of Corporate Tax Reform III, TRAF was combined with additional AHV financing as a form of socio-political compensation.

Core tax measures

Abolishment of preferential tax regimes

At the cantonal level, tax privileges for holding companies, domicile companies and mixed companies are terminated. At the federal level, the profit allocation rules for principal companies and Swiss finance branches no longer apply.

Patent box with a maximum relief of 90%, mandatory at the cantonal level

A core element of the reform is the introduction of a patent box regime in accordance with the Organisation for Economic Co-operation and Development standard. In the box, net profits from domestic and foreign patents and similar rights are to be taxed separately with a maximum reduction of 90% (rate at cantonal discretion). Before the patent box can be applied for the first time, the corresponding tax deducted research and development (R&D) expenditures must be recaptured and taxed.

R&D super deduction of maximum 50%, optional at cantonal level

The introduction of this super deduction for domestic R&D is Switzerland's commitment to be recognized as an attractive location for R&D. For administrative reasons, the maximum deduction of 50% (rate at cantonal discretion) is limited to personnel expenses for R&D plus a flat-rate surcharge of 35% for other costs and 80% of expenses for domestic R&D carried out by third parties or group companies.

Notional interest deduction (NID), optional at cantonal level

So-called high-tax cantons have the possibility of introducing a NID on excess capital. According to the currently published intentions of the cantonal governments regarding tax rate developments, only the canton of Zurich meets the requirements.

Disclosure of hidden reserves

Hidden reserves including any self-created goodwill at the point in time of transition from privileged to ordinary taxation or migration to Switzerland are confirmed by the tax authorities. In the case of a migration to Switzerland, the so called step-up

system is applied. The tax-free disclosed hidden reserves are to be depreciated annually at the rate applied for tax purposes to the respective assets. In the case of a transition, the so-called two-rate system is applied. Profits relating to the realization of hidden reserves that were generated under a (now abolished) privileged tax regime are subject to a separate tax rate. The cantons are free to determine the amount of this special tax rate. The two-rate system ensures a competitive income tax burden during a five-year transition period. It should be noted that taxpayers may revoke voluntarily their tax privileged status before the reform enters into force (so-called early transition). Depending on the transitional regulations offered by the cantons, this may be a beneficial option.

Overall tax relief of 70%, mandatory at the cantonal level

The patent box, R&D super deduction, and NID as well as possible depreciations from the early transition from privileged to ordinary taxation are subject to the overall tax relief of 70%.

Additional measures

► *Adjustments in taxation of dividend income from qualifying participations*

Dividend income of individuals from qualifying participations is currently partially exempt from taxation to mitigate double taxation at the shareholder level. At the federal level, the taxation rate increases from 50% (business investments) and 60% (private investments) respectively to a standard rate of 70%. At the cantonal level, there is a harmonization of the relief method and an introduction of a minimum taxation rate of 50% (rate at discretion of cantons).

► *Capital tax relief, optional at the cantonal level*

Privileged taxed companies usually benefit from a low capital tax rate. To compensate for the loss of this tax advantage, the cantons are given the possibility to reduce the taxable capital on patents and similar rights, qualifying participations and intra-group loans to also remain competitive from this angle.

► *Adjustments of the capital contribution principle*

Swiss-listed companies may only pay tax-free capital contribution reserves if they pay taxable dividends in the same amount. Intra-group dividends and capital contribution reserves from assets transferred from abroad after 24 February 2008 and in the case of a liquidation

are not affected by this scheme. The above rules shall also apply to the issue of bonus shares and nominal value increases from capital contribution reserves.

► *Extension of the flat-rate tax credits on foreign companies' permanent establishments*

To prevent international double taxation, Swiss permanent establishments of foreign companies should be able to claim withholding taxes on income from third countries with a flat-rate tax credit.

► *Social compensation via the AHV (Old-Age and Survivors Insurance)*

It is assumed that the loss of tax receipts due to the tax reform will amount to CHF2b (in a static view). This shortfall will be compensated through the AHV:

- 0.3% increase in salary contributions (employers and employees one half each)
- Allocation of the federal share of the demographic percentage of value added tax to the AHV
- Increase in the federal contribution to the AHV from currently 19.55% to 20.2%

► *Reduction of cantonal profit tax rates*

The reduction of cantonal profit tax rates is not directly covered by TRAF but is necessary to remain attractive from a tax perspective for former tax privileged companies and thus a key part of the proposed tax reform. The increase of the canton's share of the federal direct tax from 17% to 21.2% enables the cantons to reduce their tax rates. Based on official announcements made by the cantonal governments, it is expected that the majority of the Swiss cantons will provide attractive tax rates on pre-tax income between 12% and 14% (including federal tax).

Implications

The tax reform measures will enter into force as of 1 January 2020. The tax reform achieves its main goal of retaining Switzerland's international attractiveness while having an internationally accepted tax system. The tight time frame requires prompt planning from taxpayers regarding the transition to the new regulations.

The reform represents the greatest change in the Swiss corporate tax system in decades and affects essentially all enterprises in Switzerland. Analysis has to be undertaken within the next few months to properly adjust to the new tax landscape and to avoid a competitive disadvantage.

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

Ernst & Young AG, Zurich

- ▶ Dominik Bürgy dominik.buergy@ch.ey.com

Ernst & Young AG, Geneva

- ▶ Karen Simonin karen.simonin@ch.ey.com

Ernst & Young AG, Aarau

- ▶ Markus Nyffenegger markus.nyffenegger@ch.ey.com

Ernst & Young AG, Basel

- ▶ Andrea Bäscher andrea.baetscher@ch.ey.com

Ernst & Young AG, Bern

- ▶ Matthias Britsch matthias.britsch@ch.ey.com

Ernst & Young AG, Lausanne

- ▶ Christian Aivazian christian.aivazian@ch.ey.com

Ernst & Young AG, Lucerne

- ▶ Martin Zemp martin.zemp@ch.ey.com

Ernst & Young AG, Lugano

- ▶ Sandro Jaeger sandro.jaeger@ch.ey.com

Ernst & Young AG, St. Gallen

- ▶ Roger Krapf roger.krapf@ch.ey.com

Ernst & Young AG, Zug

- ▶ André Bieri andre.bieri@ch.ey.com

Ernst & Young AG, Financial Services, Zurich

- ▶ Thomas Nabholz thomas.nabholz@ch.ey.com

Ernst & Young AG, International Tax Services, Zurich

- ▶ Thomas Semadeni thomas.semadeni@ch.ey.com

Ernst & Young LLP (United States), Swiss Tax Desk, New York

- ▶ Conradin Mosimann conradin.mosimann1@ey.com

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.

© 2019 EYGM Limited.
All Rights Reserved.

EYG no. 002431-19Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com