Executive summary

On 1 June 2017, the steering body composed of federal and cantonal representatives and led by Federal Councillor Ueli Maurer set out the suggested cornerstones on the Swiss tax reform, now referred to as “Tax Proposal 17” (TP 17), on which the Swiss Federal Council will decide later this month.

The objective of the proposed tax reform remains to ensure that Switzerland continues to offer a sustainable, internationally accepted and competitive corporate tax system. The TP 17 package is - compared to the rejected bill on Corporate Tax Reform III (CTR III) - a leaner package with reduced benefits but it takes into account the interests of the cities and the communes. The aim of the new proposal is to reduce tax revenue shortfalls, to generate higher overall revenues and to introduce a social component in order to achieve a more balanced, transparent and a generally politically accepted corporate tax reform.

Detailed discussion

Background

On 12 February 2017, Swiss voters, in a popular vote, rejected the federal bill on CTR III as adopted by the Federal Parliament last summer.¹
CTR III was supposed to align the Swiss corporate tax system with international standards by replacing existing tax regimes with a new set of internationally accepted measures effective 1 January 2019. However, disagreements on the scope of the new measures and the handling of the anticipated tax losses caused the rejection. Opponents argued that the tax revenue shortfall eventually would have to be borne by the Swiss population.

Nevertheless, the need for tax reform due to the changing international tax environment is undisputed in Switzerland. Therefore, the Swiss Federal Council decided to prepare a revised and more balanced bill in close cooperation with the cantons and the communes as quickly as possible.

The cornerstones on TP 17 differ in various aspects from the rejected CTR III measures. In particular, the steering body included in the proposed TP 17 package social components such as the increase of the child and education allowances in favor of individuals, restricted the overall tax relief of the patent box and the research and development (R&D) super deduction at the cantonal level to a maximum threshold of 70% instead of 80% and increased the partial taxation of dividends from qualifying participations held by Swiss individuals to 70% at the federal and at least 70% at the cantonal level. On the other hand, the criticized notional interest deduction (NID) on surplus equity has been excluded from the proposed package.

The following overview summarizes the differences between the proposed measures under CTR III and TP 17.

<table>
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<th>Cornerstones on TP 17 (based on press release of 1 June 2017)</th>
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<td>Abolition of preferential tax regimes</td>
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<td>At the federal level, the taxation practices for principal companies and finance branches will be abolished, whereas at the cantonal level, the holding, domiciliary and mixed company regimes will go away as it was already proposed under CTR III. It should be noted that these preferential tax regimes or practices will continue to be available as long as the amendments to</td>
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the relevant tax laws have not been enacted with legal effect. Even though the cornerstones on TP 17 do not explicitly address the rules governing the transition from preferential taxation to ordinary taxation (the so-called “two-rate system”) and the rules governing the step-up upon migration to Switzerland as outlined in CTR III, it should be noted that these rules were undisputed under CTR III and are therefore expected to be equally adopted by TP 17.

Introduction of OECD-compliant patent box
The TP 17 package includes the mandatory introduction of a patent box that is fully compliant with the modified nexus approach of the Organisation for Economic Co-operation and Development (OECD). The patent box will only be available at the cantonal level and will - compared to CTR III - not include patented software. The maximum level of permissible tax relief for income related to the patent box has remained at 90%.

Introduction of R&D super deduction
As one of the optional cantonal measures, the revised reform also allows for the introduction of an increased (up to 150%) tax deduction for qualifying R&D expenses incurred in Switzerland. The deductions should focus primarily on personnel expenses.

Restriction of overall cantonal tax relief
Similar to CTR III, the effect of the cantonal tax relief is limited in order to avoid zero-taxation or tax loss carry forwards. The overall cantonal tax relief provided by the patent box and the R&D super-deduction shall be restricted to a maximum of 70% of the entity’s net profit (80% under CTR III). It is assumed that the amortization on disclosed built-in gains relating to the step-up under the current system will be included in this threshold as well.

Partial taxation of qualifying dividend income
The minimum taxation of qualifying dividend income earned by Swiss resident individuals should be 70% at the federal level and at least 70% at the cantonal level under TP 17 (i.e., individuals shall only benefit from a maximum exemption of 30%).

Increased share in direct federal tax revenue
In order to compensate for the losses in cantonal tax revenues expected to result from the suggested measures as well as the planned 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% as already proposed by CTR III. In addition to this, a new clause will be included in the new proposal to take into account the cities and communes in connection with the increase of the cantons’ share in the federal tax revenue.

Family allowances
The minimum amount for family allowances is to be increased by CHF30. This means that child allowances will rise to at least CHF230 and education allowances will rise to at least CHF280. In this regard around 18 cantons will need to raise respective payments.

Relief measures for cantonal capital tax
Even though the cornerstones on TP 17 do not explicitly address the cantonal options to introduce targeted capital tax reductions on the company’s net equity (related to participations, intangible assets and intercompany loans) as well as further relief measures such as general capital tax rate reductions or the possibility to credit income taxes against capital taxes, it should be noted that these rules were undisputed under CTR III and are therefore expected to be equally adopted by TP 17.

Related measure not directly included in TP 17
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 in connection with TP 17. 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 15% (including federal tax) once the new reform package enters into force.

Next steps
The Swiss Federal Council will now discuss the cornerstones on TP 17 and will decide on the parameters in June 2017. Afterwards, the consultation process will be initiated, which should be completed by December 2017. Thereafter, the Federal Council will finalize and adopt the federal bill. It is expected that the dispatch for the attention of the Federal Parliament will be adopted in spring 2018.

In order to ensure fast implementation of TP 17, the cantons will have to push forward their cantonal implementation plans in parallel to the federal legislative procedure.
Endnote


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