Executive summary

On 28 September 2018, the Swiss Parliament approved the final draft of the Federal Act on Tax Reform and AHV (Old-Age and Survivors Insurance) Financing (TRAF), formerly referred to as Tax Proposal 17, 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 tax reform’s objective is to secure the long-term tax attractiveness of Switzerland as a business location and to restore international acceptance of the Swiss tax system and at the same time securing an appropriate level of tax revenue. The tax reform foresees the replacement of certain preferential tax regimes with a new set of internationally accepted measures. The legislative changes will go along with the intention of a broad reduction of the cantonal corporate tax rates.

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. Some measures are subject to a restriction limiting the overall tax relief to a maximum of 70%.

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 experience of the rejection of the Corporate Tax Reform III, the tax losses of TRAF will be compensated by 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 to be terminated. At the federal level, the profit allocation rules of principal companies and Swiss finance branches are to be repealed.

Patent box with a maximum relief of 90%, mandatory at cantonal level
A core element is the introduction of a patent box regime in accordance with the OECD 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 would meet the requirements.

Disclosure of hidden reserves
Hidden reserves including any self-created goodwill at the moment of the 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 cantonal level
The patent box, R&D super deduction, 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 in order 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 cantonal level
Privileged taxed companies usually benefit from a low capital
tax rate. In order 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 in order 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. Not affected by this scheme are intra-group
dividends and capital contribution reserves from assets
transferred from abroad after 24 February 2008 and in the
case of a liquidation. 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 an 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 the current 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 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 18%
(including federal tax).

Outlook
If no referendum is held, the first measures of the tax
reform could enter into force in 2019 and the main part of
the measures from 2020. If 50,000 voters sign a petition
requesting a public referendum within 100 days of the final
bill’s publication in the Official Gazette, the proposed TRAF
measures will be subject to a popular vote. Certain parties
have already announced their intention to hold a public
referendum. TRAF would thus most likely be put to the
people's vote on 19 May 2019. The entry into force of TRAF
would be delayed accordingly, but would still occur swiftly.

The European Union (EU) has given Switzerland until the end
of 2018 to abolish the internationally no longer accepted tax
privileges. The EU finance ministers will meet in March 2019
for a general update on the tax policy.

Implications
The proposed tax reform achieves its main goal of retaining
Switzerland’s international attractiveness while having
an internationally accepted tax system. Even though a
referendum is rather likely, the tight time frame requires
swift planning from the taxpayers regarding the transition
to the new regulations.

For more information on Swiss Tax Reform, you may register
for: Webcast about Swiss Tax Reform on Tuesday, 2 October
2018 at 1.30 -2.30 pm CEST.
Endnotes


2. Organisation for Economic Co-operation and Development.

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