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Swiss Corporate Tax Reform

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On May 19, 2019, the Swiss Corporate Tax Reform was approved in a popular vote. Most of the new measures are expected to become effective as of January 1, 2020.

Key takeaways:

- **Many cantons will further reduce their corporate tax rates**
- **Tax neutral step-up in basis for new activities in Switzerland**
- **The existing priviledged tax status will be replaced by new preferential tax rules, which are fully in line with OECD standards. The new rules inter alia include:**
  - Patentbox
  - R&D super-deduction
  - Notional Interest Deduction

Measures

Measure	Impact
Reduction of corporate tax rates in many cantons	Lower income tax burden for a wide array of businesses without the need to meet special requirements (in addition to participation relief, which continues to exist and exempts dividends and capital gains derived from qualifying participations). Lower capital tax burden on participations of at least 10%, on intragroup loans, and on patents and similarly protected rights.
Tax neutral step-up of tax basis upon relocation to Switzerland	Enterprises moving assets, functions, business operations, permanent establishments, or their registered office or place of effective management to Switzerland may revaluate all assets (other than participations of at least 10%) newly becoming subject to taxation in Switzerland at fair value. This step results in an income tax neutral step-up of the tax basis. In the years following this income tax neutral asset step-up, the assets can be amortized tax effectively and thereby reduce the taxable income.

Abolishment of the existing privileged tax status for holding companies, administrative companies, mixed companies, principal companies, and finance branches	Full compliance with international tax standards. Companies with existing privileged tax status have the following options: • Tax status change and tax neutral step-up in basis before the new rules become effective followed by amortizing the disclosed hidden reserves tax effectively in the following years (in most cantons), or; • Request a binding decision on the hidden reserves upon the introduction of the new rules and claim a reduced tax rate on hidden reserves realized within 5 years (in all cantons). Participation relief continues to exist, i.e., dividends and capital gains derived from qualifying participations remain exempt from corporate income tax.
Patent Box	At the cantonal level, the residual income derived from patents and similarly protected rights developed in Switzerland will generally be taxed at a reduced level (maximum tax discount of 90% at cantonal level). This new tax incentive for R&D activities is fully compliant with OECD standards.

R&D super-deduction	The cantons may provide that up to 150% of the expenses for research and development activities in Switzerland can be deducted for cantonal and municipal income tax purposes. Such R&D super-deduction can be claimed on: • 135% of the costs for staff taken on due to R&D activities in Switzerland; and • 80% of the costs for contract research performed in Switzerland. This new tax incentive for R&D activities is fully compliant with OECD standards.
Notional Interest Deduction	The Canton of Zurich plans to introduce a notional interest deduction. All cantons with a total pre-tax corporate income tax rate exceeding 18.03% may allow such a notional interest deduction; this is a tax deduction of an arm's length interest rate on equity exceeding the equity required for the long term business activity.
Cap for tax reliefs	A company's maximum cantonal income tax reduction resulting from the patent box, R&D super-deduction, amortizations on disclosed hidden reserves upon a status change under current law, and the notional interest deduction may not exceed 70% in total (i.e., minimum tax burden at cantonal level of 30% of the ordinary tax burden). The cantons may introduce a more restrictive threshold.

Other measures	• Extension of lump sum tax credit for foreign withholding taxes to Swiss permanent establishments of foreign companies; • Extension of taxation of individuals contributing privately held shares into a controlled company; • Tax discount of 30% for federal and of up to 50% for cantonal income tax purposes for dividend income from privately held qualifying shareholdings; • Limitation of tax free distribution of share premium/paid in surplus for listed companies unless distributing retained earnings in the same amount; • Adjustment of the tax equalization scheme between the cantons; Increase of the cantons' share in the federal income tax; • Additional contributions to the public old age and survivors' insurance.

Need for Action

The Corporate Tax Reform will impact the corporate tax burden for all Swiss companies and branches in most cantons. This impact should be analyzed, and potential options for relocations should be considered.

For companies engaged in R&D activities in Switzerland and/or in the exploitation of patents and similarly protected rights developed in Switzerland, the R&D super-deduction and/or the patent box may provide an opportunity for significant tax savings.

For a company currently benefitting from a special tax status, one should consider opting for ordinary taxation even before the Corporate Tax Reform becomes effective. This maneuver may prove beneficial, especially in the following situations:

- Consider a company with substantial hidden reserves: In many cantons, a company may disclose its hidden reserves tax neutrally upon the end of a special tax status even as early as of today. Such an early disclosure results in an income tax neutral step-up of the tax basis, allowing the company to make higher future amortizations, which would bring a lower income tax burden.

- Consider a company that is a subsidiary of a non-Swiss parent facing certain disadvantages: Foreign controlled corporation rules, a tax credit system for dividend income, and/or other obstacles, if the tax rate, at the Swiss subsidiary level, is below a certain minimum threshold. Depending on the canton and municipality, different ordinary tax rates ranging from 11.5% and 24% are available.
- This tax rate spread allows choosing a Swiss location where the corporate tax rate meets the minimum tax rate required by foreign law.

Such status change to ordinary taxation and a tax neutral step up in basis is, however, not always the most tax efficient option (e.g., consider a situation where there is a tax loss carryforward, where other new tax benefits already reach the maximum overall relief, or where a tax neutral asset step-up would result in an unwelcome deferred tax asset in the group's consolidated financials). In such case, the company should request a binding assessment on the amount of its hidden reserves when the current privileged tax status is to be abolished. If realized within five years, these hidden reserves will be subject to a reduced favorable income tax rate.

Finally, for a foreign business considering setting up or upgrading a Swiss presence, both the new option for a tax neutral step-up in basis as well as the reduction of the corporate tax rates may result in new international tax planning opportunities.

Jonas Sigrist

Partner
Attorney at law, Swiss Certified Tax Expert
Head of Tax Practice Group

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 93 26
jonas.sigrist@pestalozzilaw.com

Silvia Zimmermann

Senior Counsel
Attorney at law, Dr. iur., LL.M.

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 48
silvia.zimmermann@pestalozzilaw.com

Remo Keller

Partner
Swiss Certified Tax Expert

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 78
remo.keller@pestalozzilaw.com