Corporate Tax Reform

A public vote on May 19, 2019 approved a long awaited corporate tax reform. The main objective of the changes is to align Swiss tax law with international standards while preserving and enhancing Switzerland's attractiveness for international mobile companies. The reform will phase out some preferential corporate tax regimes (the mixed domiciliary and principal company regulations) that were in the focus of dispute with the EU and the OECD. A bundle of new measures will strengthen Switzerland's attractiveness as a hub for international business.

For an international investor in a corporate Swiss subsidiary the legislation includes the following main elements:

Patent Box

The introduction of a Patent Box regime on cantonal/communal level is designed to privilege income from patented intellectual property for which the R&D spend occurred in Switzerland. Income from qualifying intellectual property will benefit from a reduction of up to 90% that may result in an effective combined tax rate of approx. 8.5% on all income tax levels. The effective tax rate considering depreciation, interest deduction and further measures may be significantly lower. The new provision reflects the OECD nexus approach.

R&D super-deduction

The cantons may introduce an excess deduction for R&D activities conducted in Switzerland, which allows a corporation to deduct up to 150% of the actual R&D spend for cantonal/communal income tax purposes. R&D super-deductions are accepted under international taxation standards.

Notional Interest Deduction / NID

On cantonal/communal level, a deemed interest may be deducted from an excess equity basis, resulting in an OECD conform tax base erosion. The NID is introduced as a replacement measure for financing activities out of preferential tax regimes such as finance branches and as a general measure to reduce income tax for highly equity financed entities.

Reduction of corporate tax rates

Most cantons have announced to reduce their corporate income tax rates. Selected examples of approx. tax rates (all income tax levels, combined federal and cantonal/communal tax) effective 2020 the latest: canton of Zug 12%, Schaffhausen 12.3 %, Lucerne 12.3%, Basel 13%, Vaud 13.8%, Geneva 14%.

Step-up upon migration

Foreign corporations may benefit from a tax-free step-up in basis to fair market value for direct federal and cantonal/communal tax purposes when migrating their legal seat, effective place of management or upon transfer of functions and assets to Switzerland. The step-up can be amortized tax effectively according to the amortization period pertaining to the individual assets. The reform basically confirms the current tax practice of a tax-free step-up.

Grandfathering rules for preferential cantonal tax regimes

With the changes of the existing cantonal tax regime, such as the mixed company status, companies may release hidden reserves and self generated goodwill created under the preferential tax regime in a tax-exempt manner. The amount of the hidden reserves and goodwill will be determined upon transition and any release within a 5-year transitory period will be taxed at a low combined rate of around 9%. As an alternative, companies have the option to voluntary withdraw from the privileged taxation before the reform becomes effective to benefit from a current practice, as confirmed by Federal Court, that allows a tax-neutral step-up with a tax deductible amortization over the following 5-10 years. The specifics on the grandfathering rules differ depending on involved canton.

Maximum limitation of combined tax reliefs

The combined effect of tax reduction measures is limited to a certain percentage of pre-tax profits to ensure a minimum income tax base, depending on location. Typically, the reduction measure is limited to 70% of taxable income.

Timeline

The reform will come into effect as per 1 January 2020. Grandfathering rules may factually extend the application of the existing tax privileges up to typically 5 years.

Observations and planning

Against this background, companies are advised to familiarize themselves with the new framework based on their specific circumstances. The following actions may be considered:

- Effect examination of a change in taxation status for tax privileged entities;

- Analyzing potential opportunities resulting from the introduction of new measures;

- Impact analysis of reduced tax rates in an international context (e.g. impact on BEPS/ATAD rules);

- Assessment of the existing group structure and potential reorganizations (e.g. onshoring, migration of functions or assets to Switzerland) to encounter BEPS measures while benefitting from advantageous income taxation;

- Cost/benefit analysis (e.g. tracking and tracing of patent income, potential tax costs entering into Patent Box, transparency aspects, reorganization costs vs. tax savings).

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