

# "TAX PROPOSAL 17": CONSULTATION PROCEDURE: WHICH TAX INCENTIVES ARE STILL AVAILABLE?

Dimitri Rotter

The draft of the "Tax Proposal 17" has been released and incorporates most of the elements of the rejected corporate tax reform III, but as announced the notional interest deduction has been abandoned. The following article summarises the main incentives of the Tax Proposal 17 and related measures. Especially with regard to the step-up options, the time has come to begin with tax planning.

## I. Legislative development

The Swiss government has started the consultation procedure on the "Tax Proposal 17".

After rejection of the corporate tax reform III (which aimed at replacing the criticised privileged tax regimes by alternative measures) by popular poll in February 2017, the Federal Government promised to quickly present alternatives, which was called "Tax Proposal 17". This was necessary because the pressure of the EU and the OECD to abolish the privileged tax regimes is still being exerted.

On the 9th of June the Swiss Government presented the outline of the new proposals and on the 6th of September it dispatched a draft and started the consultation procedure. After the end of the consultation procedure, which will last till 6th of December 2017, the Federal Department of Finance plans to submit its proposal to the Swiss parliament in spring 2018. According to the Department, in the best case the "Tax Proposal 17" will – despite its name - enter into force in 2020.

Although this draft is not the wording of the final act, it shows what tax measures may be introduced. During the legislative process some tax incentives may be amended or even removed, but it is not very likely that additional measures will be introduced at a later stage.

## II. The key elements of the new proposal

### 1. Abolition of the privileged regimes (holding, mixed company, domicile company, finance branch and principal rulings):

These special regimes, which are only applicable at cantonal level, will be abolished.

### 2. Patent box

Profits from patents and similar rights will be segregated from other profits and taxed at a lower rate at the cantonal level. The cantons can determine the amount of such relief, the maximum relief being 90%. The implementation of the patent box will be in compliance with the patent box as defined by the OECD. Profits stemming from patents and similar rights can be included in the

patent box. Software as such cannot be patented according to Swiss laws and accordingly cannot benefit from the relief of the patent box. Computer-implemented inventions including software can however be patented in Switzerland and benefit from the relief. Additionally, software patented in foreign jurisdictions where this is possible may benefit from the relief.

### **3. Super-deduction for R&D**

The cantons can introduce a deduction increased by 50% on the effective costs for research and development.

### **4. Limitation of relief**

The relief resulting from measures 2., 3. and 7. may not exceed 70% of the taxable profit, as determined without these measures.

### **5. Significant decrease of cantonal profit taxes**

Although this is not part of the draft, it is clear that with a view to maintain the attractiveness of the Swiss tax environment, the cantons will reduce the ordinary cantonal profit tax rate. This will also benefit all the Swiss companies which did not qualify for the privileged regimes. According to the announcements of several cantons, the effective tax rates (including the federal tax) will be as low as 12% in tax friendly cantons. It is however not expected that the tax rates will be lowered below 10%.

### **6. Step up for new tax payers in Switzerland**

A company may become a new taxpayer in Switzerland for several reasons, being the redomiciliation of the company (i.e. without dissolution abroad and new set-up in Switzerland), the move of the effective management or the transfer of substantial parts of the company or functions to a Swiss company or permanent establishment.

Such companies shall be allowed to disclose their hidden reserves accumulated abroad in the tax balance sheet at the moment of their entry into the Swiss tax system and subsequently depreciate them in a tax-effective way, which lowers the taxable profit. The same is possible for original goodwill, which has to be written off over a period of ten years.

This measure may be especially interesting for companies having been domiciled in low tax jurisdictions.

### **7. Cantonal step-up possibility before the change of law**

A similar incentive already exists under the current cantonal regulations, whereby the company voluntarily abandons the special regime. The disclosure of hidden reserves and goodwill will not be taxable or only to a very limited extent, based on the rules of the privileged regime. After abolishment of the special regimes and increase of the tax rate (i.e. from 2020 or 2021 onwards), a yearly depreciation of these hidden reserves and the goodwill over a period of probably 5 years (or till 5 years after the enactment of the new law) will be deductible tax-wise against profits. It may be that the privileged tax rate on equity will be applicable till the enactment of the new regime despite the voluntarily opting out of the privileged taxation. Technically speaking this is not part of the Tax proposal 17 but already possible now and offers interesting planning opportunities.

### **8. Step-up with special tax rate**

The Tax proposal 17 itself provides for a different step-up procedure. Companies actually taxed according to a privileged regime may in the proportion of their tax exemption under the privileged regime (e.g. 90% for a mixed company) ask for an assessment of their hidden reserves and

original goodwill created during this status. During five years following the enactment of the new law, the company can have its profit taxed at a special, lower tax rate till the assessed amount is used up. The cantons will have to define this special tax rate.

For both step-up options under (i.e. 7. and 8. above) the goodwill is determined by taking into account previous profits. This may lead to quite substantial goodwill and corresponding tax savings.

#### **9. Reduction of tax on equity**

The tax on equity can be lowered by setting off the profit tax against it. In other words, if the profit tax is high enough, no tax on equity will be due. This measure could already be introduced according to the current law, however not all cantons made use of it. With the abolishment of the privileged regimes, the lower tax rate on equity provided by these regimes will also disappear and thus additional cantons may introduce this relief.

The new law gives the cantons an additional possibility to reduce equity tax. The relief consists of reducing the equity tax base in proportion to participations or to patents and similar rights (as defined for the patent box) from the sum of the assets. For example, a holding whose assets consist of 95% of participation in subsidiaries would see its equity tax reduced by 95%.

#### **10. Limitation of dividend relief**

Dividends stemming from a participation of at least 10% in a corporation (Swiss or foreign corporations) are taxed at a lower rate at federal and cantonal levels, whereby the relief varied from one canton to the other. The new measure foresees that dividends must be taken into the tax base for 70% of their effective amount. The cantons are free to increase this percentage even further.

#### **11. Tightening of the so-called "Transposition"**

Private capital gains are basically exempted in Switzerland. Under the current regulations, as an exception, the sale of 5% or more of the shares of a company to another company belonging (minimum 50%) to the same person (i.e. the seller) does qualify as taxable income. This exception is called "Transposition".

The draft of the new law does abolish the 5% threshold, with the result that every sale of shares to one's own company (minimum holding of 50%) is taxable income instead of tax exempted capital gain. This is clearly a compromise to make the above listed tax incentives for companies politically more acceptable.

#### **12. Increase of the share of the cantons of the direct federal tax**

The cantons are entitled to a share of the tax income resulting from the direct federal tax levied on their territory. In order to mitigate the lowered tax income of the cantons, their share of the direct federal tax shall be increased. Originally in June, an increase from 17% to 21.2% was planned. The proposed increase is lower and will only amount to 20.5%. The cantons are held to take into consideration the costs of their cities and communes in the use of this additional income.

#### **13. Increase of the minimal family allowances**

The family allowances vary from one canton to the other but the federal law requires a minimum. This minimum will be increased by CHF 30. Several cantons are however already above this increased minimum which means that there will be no changes in these cantons.

### III. Conclusion

In comparison to the corporate tax reform III, the main element that has been dropped is the notional interest deduction. Besides this, the application of certain incentives has been narrowed, some tax increasing measures inserted and the repartition of the tax proceeds between the Confederation and the cantons has been amended.

Companies taxed under a special regime are well advised to start with their tax planning without delay, especially with regard to the step-up options.

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#### ZURICH

Bellerivestrasse 201  
CH-8034 Zurich  
Tel. +41 44 386 60 00  
Fax +41 44 383 60 50  
zurich@froriep.ch

#### GENEVA

4 Rue Charles-Bonnet  
CH-1211 Geneva 12  
Tel. +41 22 839 63 00  
Fax +41 22 347 71 59  
geneva@froriep.ch

#### ZUG

Grafenaustrasse 5  
CH-6302 Zug  
Tel. +41 41 710 60 00  
Fax +41 41 710 60 01  
zug@froriep.ch

#### LONDON

17 Godliman Street  
GB-London EC4V 5BD  
Tel. +44 20 7236 6000  
Fax +44 20 7248 0209  
london@froriep.ch

#### MADRID

Antonio Maura 10  
ES-28014 Madrid  
Tel. +34 91 523 77 90  
Fax +34 91 531 36 62  
madrid@froriep.ch

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