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Corporate Tax Reform – Results of the Consultation Process

The aims of the Swiss Corporate Tax Reform III (CTR III) are to guarantee a competitive corporate tax rate, to restore international acceptance of Switzerland as an attractive location from a tax point of view and to ensure sufficient tax revenue. After completion of the consultation process, the Federal Council announced in April 2015 that various changes which had originally been envisaged would no longer be pursued. In particular, the taxation of capital gains on privately owned securities, and the notional interest deduction for companies, should not be pursued. The Swiss tax laws would be fundamentally changed by the introduction of the CTR III reforms.

International taxation of companies is currently based on the interaction between the national tax laws and bilateral agreements. The double taxation treaties ("DTTs"), however, have primarily the object of avoiding an international double taxation. Lately it has increasingly been brought to the attention of the general public that these DTTs, as well as the national tax laws, are used to reduce taxation through international construction – mainly by multinational enterprises – in which profits are separated from the place where there are economic activities of substance and transferred to low-tax jurisdictions. Sometimes it is possible for a double non-taxation to be achieved by such constructions. Switzerland has hitherto benefited from such practices, due to its general tax conditions. As a result of the international pressure which has been building up for years, Switzerland finds itself forced to change its corporate tax laws. CTR III is intended to restore international acceptance of Swiss corporate taxation.

Abolition of the Tax Privileges for Holding and Administrative Companies

The greatest change is probably the abolition of the special cantonal tax regimes. Today, holding

companies and administrative companies benefit at cantonal level from advantageous corporate income taxation and net asset taxation. From the point of view of the EU and the OECD, the privileged taxation of the profits generated outside Switzerland represents a distortion of trading conditions which needs to be eliminated. If these privileged companies left Switzerland, there would be a loss of tax revenue, particularly at the level of federal taxes. It should be borne in mind that these companies pay approximately one-half of the corporate income taxes received at federal level.

For holding companies which have purely holding functions, it is unlikely that the changes will have a significantly negative impact, at least for purposes of corporate income tax. At the level of cantonal taxes they will be able to benefit from the participation exemption on dividend income from qualifying participations, as they already do at the level of federal tax.

For administrative companies (the five companies with the highest turnover in Switzerland have this tax status), there is so far no sign of any effective compensatory measures. At present only a general reduction of the tax rate would save them from a

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considerable increase in their tax liability. Relocation would not only result in a reduction of tax revenue, but also lead to a loss of skilled jobs.

Changes in Capital Tax

The abolition of the special cantonal tax status also means that the privileged taxation of the capital (net assets) will no longer apply. The cantons may therefore consider amendments to their capital tax provisions, in order to prevent holding companies with a high equity from leaving Switzerland. Participations, intercompany loans and intangible property should benefit from a reduced capital tax rate (or even be exempted from it altogether).

License Box

A license box is to be introduced at cantonal level. The aim is to tax income from patents and Supplementary Protection Certificates at a reduced rate. The areas of research, development and innovation should thus be encouraged. Income and costs which are not based on licenses or on a sale of products with qualifying intangible rights are to be subject to ordinary taxation.

Switzerland favors a broad definition of the license box. At international level, however, it appears that the Modified Nexus Approach is becoming established. The Modified Nexus Approach envisages that income from licenses and patents may only be taxed at a lower rate when these are based on research and development work undertaken at the tax domicile of the company holding them. This approach is not advantageous for smaller countries such as Switzerland, as the companies which are resident here have significant research and development activities performed outside Switzerland. There might be however a possibility for up to 30% of the research services which were actually performed abroad to be added on to the income of the Swiss license box.

The advantages of a license box are greatly reduced by the Modified Nexus Approach. To supplement it, a disproportionately high deduction for research and development expenses (up to 150%) is being discussed. It is assumed that such a measure would be accepted at international level, as numerous countries already have such "super deductions".

Disclosure of Hidden Reserves (Step-Up in Value)

Where a company transfers its registered office abroad, it has to declare and pay tax on its hidden reserves, as the Swiss tax authorities will no longer have access to them after its departure. It is suggested that the reverse process should now



be possible: a company should have the possibility to make a tax-neutral revaluation (step-up) of its hidden reserves in the tax balance sheet when it moves to Switzerland or changes its tax status from privileged taxation to ordinary taxation, and subsequently to make deductions for amortization on these which are recognized in the P&L.

Abolition of Issue Stamp Duty | Tonnage Tax

The Swiss Federal Council continues to support the abolition of issue stamp duty on equity capital.

In the course of the consultation process, the introduction of tonnage tax was suggested from various quarters. This tax can be found in the area of international shipping and is calculated on the basis of the volume of cargo. Consideration is being given to the possibility of including such a tax in the draft legislation, as this could represent an alternative measure to the existing privileges for certain trading companies.

Future developments

The Federal Council is currently working on a revised version of the draft legislation as well as a corresponding dispatch. This work is expected to be finished in June 2015. The political discussions regarding CTR III can then begin. It can be assumed that in the end there will be a referendum about the introduction of CTR III. It is unlikely that the changes will enter into force before 2018; moreover, transitional periods may well apply. Sufficient time thus remains for following further events, and for planning and if necessary implementing any steps needed. It is important to keep an eye on the developments in connection with CTR III.



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