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Tax News: Federal Act on Tax Reform and AHV Financing (TRAF) – Approval in the referendum

In the referendum held on 19 May 2019, the Federal Act on Tax Reform and AHV Financing was adopted by the Swiss people and the cantons. Switzerland has made a large step forward in implementing the abolition of existing corporate tax privileges, which have drawn the criticism by the EU and the OECD over a long period. While the tax reform includes measures designed to safeguard Switzerland's competitiveness in the international tax scene, the social security (AHV) part of the reform provides the national old-age insurance system (AHV/AVS) with dearly needed additional funding to address the growing deficits of the public pensions system.

Background and objectives of the tax reform and its connection with AHV funding

Over the past years Switzerland became exposed to growing international criticism for some of its corporate tax practices, especially at the level of cantonal income taxes. While the European Union put Switzerland on a "grey list" of countries with harmful tax regimes, the OECD (and the EU) called for the abolition of cantonal tax privileges designed to attract companies with "mobile" international activities, such as holding companies, companies with cross-border trading, financing or licensing activities, and of certain special regimes at the federal tax level ("finance branches", "principal companies"). A first legislative attempt to abolish these regimes and to introduce internationally compliant measures (Third Corporate Tax Reform package, "CTR III") had been rejected through a referendum held on 12 February 2017.

The Federal Parliament eventually came up with a new reform package, which includes measures designed to strengthen the funding of the AHV system, to increase the approval of the tax reform. With the now approved tax reform the cantons will receive an increased share in the federal tax revenues, which allows them to refinance certain general corporate tax rate cuts designed to at least partially compensate for the loss of attractiveness due to the abolition of the special corporate tax regimes with its expected negative impact on the local labor markets.

Main elements of the adopted reform package

The Federal Act on Tax Reform and AHV Financing adopted in the vote of 19 May 2019 contains the following measures:

Measure	Mandatory implementation	
	Federal level	Cantons / communes
Abolition of the arrangements for cantonal status companies Currently, status companies pay only a reduced profit tax or none at all at cantonal level. Overtaxation will be avoided through a temporary special rate solution.	No	Yes
Patent box Profits from patents and similar rights will be separated from other profits and taxed at a lower level. The relief may not exceed 90% and is based on current international standards (nexus approach).	No	Yes
Additional deductions for research and development Cantons may allow R&D costs incurred in Switzerland to be deducted for up to 150% of the actual costs incurred. This is based on R&D personnel expenses incurred by the taxpayer plus a 35% markup for other R&D costs, and 80% of the R&D costs charged by third party providers in Switzerland.	No	Voluntary
Deduction for self-financing for cantons with a specific minimum tax rate (notional interest deduction, NID) High-tax cantons whose capital city has an effective cumulative corporate income tax rate of at least 18.03% are allowed to introduce a deduction for self-financing on above-average equity. Currently, only the Canton of Zurich fulfills this condition.	No	Voluntary (if condition is met)
Relief restriction The aggregate tax relief based on the patent box, additional R&D deductions and deductions for self-financing may not exceed 70% of the taxable profit (down from 80% in the CTR III reform). The calculation also includes amortization based on earlier taxation under a cantonal tax privilege.	No	Yes
Step-up of hidden reserves Companies that relocate their headquarters to Switzerland may benefit from additional amortization of stepped-up asset values during the first few years. If such companies migrate from Switzerland to a foreign jurisdiction, an exit tax on hidden reserves will be due, as is already the case at present.	Yes	Yes
Capital tax adjustments The cantons may allow for a reduced capital tax rate relating to equity capital invested in corporate equity interests, patents and similar rights, as well as intra-group loans.	N/a	Voluntary

Extension of the lump-sum foreign tax credit The lump-sum foreign tax credit prevents international double taxation. Swiss permanent establishments of foreign companies will in future be entitled as well.	Yes	Yes
Increased dividend taxation Dividend inclusion for individuals owning corporate equity stakes of at least 10% will rise to 70% at federal level and to at least 50% at cantonal level; cantons may raise the inclusion ratio even further.	Yes	Yes
Capital contribution principle restrictions A repayment restriction will apply on the capital contribution principle: Swiss listed companies may only repay tax-free capital contribution reserves if they concurrently pay taxable dividends of at least the same amount. Intra-group dividends are not affected by the repayment rule. The partial liquidation rule stipulates that capital contribution reserves must be reduced by at least the same amount as retained earnings when a company's own shares are repurchased.	Yes	Yes
Tightening of tax rules in respect of private restructurings The scope of future tax-free capital gains or repayments of contributed reserves in connection with transfers of shares to individually controlled holding companies will be narrowed down.	Yes	Yes
Increase in the cantons' share of federal direct tax revenue The cantons' share of federal direct tax revenue will be raised from 17% to 21.2%.	Yes	N/a
Adjustments to fiscal equalization To prevent upheaval among the cantons, fiscal equalization will be adjusted in line with the new reality in terms of overall tax policy.		
Additional funds for the AHV From 2020, the AHV will get additional funds of around CHF 2 billion per year. This will be partly achieved by higher employer and employee contributions as well as the Federation paying additional funds. This is due to the Federation benefitting from the TRAF.	Yes	No

Next steps

The adopted TRAF provides Swiss companies with clarity about future tax regulations and planning options. The majority of the above measures are expected to come into force on 1 January 2020, with the provisions regarding the interim special tax rate for hidden reserves of previously privileged taxed companies coming into force tomorrow (20 May 2019). According to statements by left wing parties, they could initiate an appeal against the public vote which may impact the entry into force of the TRAF.

In addition to implementation at the level of the direct federal tax, the provisions made by federal law regarding cantonal tax regulations must now also be translated into the cantonal tax laws of each canton. As things stand at present (19 May 2019), the respective implementation drafts in four cantons (Basel-City, Glarus, Neuchâtel and St. Gallen) have been completed, as either no referendum has been held (Neuchâtel and St. Gallen), or the draft has been accepted by the people (Basel-City, Glarus). The cantons of Geneva and Solothurn also voted on the tax proposal today (Geneva: acceptance; Solothurn: narrow rejection). The other cantons are at different stages of the legislative process. However, most cantons plan to decide on the implementation laws (including the reduction of tax rates) within 2019. These developments and potential public votes on cantonal level should be closely monitored by Swiss companies in order to analyse the effects and possibilities offered by the various new regulations and to take steps in good time. This applies in particular on different effects of the abandonment of a privileged tax status and necessary restructuring or preparations to qualify for individual measures.

We would be pleased to support you with such analysis and help you with any further questions you may have.

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