Switzerland
Bär & Karrer

Tax bill rejected

On February 12 2017, the Corporate Tax Reform III draft (CTR III Draft) was rejected in a national referendum. As a result of that rejection, a new bill will have to be elaborated and agreed on within a short time frame by the Federal Council and Parliament. It is still expected that a new bill will introduce certain accompanying fiscal measures aimed at maintaining the international competitiveness of Switzerland, but the bill also needs to be in a form that attracts majority support and counters reservations of expected losses in tax revenues.

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Corporate Tax Reform III

In recent years, Switzerland has been under increasing pressure from both the EU and the OECD to abolish its preferential tax regimes, that is, the existing cantonal tax privileges for holding, domiciliary and auxiliary/mixed companies as well as certain federal tax practices pertaining to finance branches and principal companies. Switzerland committed to abolishing these tax privileges in a joint statement with the EU in October 2014 and even the critics of the CTR III Draft clearly support this intention.

Opponents of the rejected CTR III Draft were primarily concerned with the potential resulting cantonal tax deficits, and their criticism was broadly aimed at limiting the suggested accompanying measures.

The main aspects of the rejected CTR III Draft and measures for a potential new draft

The CTR III Draft prepared by the Federal Council and Parliament included the following elements. Some of these will likely be found in a new proposal:

- Abolition of preferential cantonal tax regimes and certain federal tax practices (to be retained in a new proposal).
- Higher allocation of share in federal income tax revenues to cantons to create basis for reduction of cantonal corporate income tax rates: a compensation of the cantons (and municipalities) via the federal income revenues will continue to be necessary upon the abolition of the tax privileges in order to enable the cantons to reduce their corporate income tax rates.
- ***Introduction of a patent box at cantonal level:*** such a measure will be in line with OECD guidelines, if maintained in the new proposal.
- ***Introduction of a super-deduction for R&D expenses at cantonal level (optional):*** it is unclear whether the super-deduction will continue to be part of the new bill.
- Introduction of a notional interest deduction (NID) at federal and cantonal level (optional): this measure was highly criticised and will likely not be part of a new proposal.
- Dividend taxation (maximum 40% reduction) at the level of individual shareholders as requirement for cantonal NID: it remains to be seen whether the new legislative proposal will stipulate a higher taxable quota.
- Taxation of built-in gains arising under a cantonal tax privilege: this is closely linked with the abolition and will likely be kept.
- ***Limitation of total benefit at cantonal level:*** patent box, super-deduction of R&D expenses and NID together were not allowed to reduce the taxable profit by more than 80% at cantonal level to provide planning certainty for the cantons.
- ***Introduction of possible reduction of cantonal net equity tax:*** this again is linked to the abolition of tax privileges and was largely undisputed.
- ***Improvement for withholding tax refund of Swiss branches:*** this proposal is a general improvement and should be kept in a new bill.

Next steps

The opponents of the CTR III Draft strive for a more balanced bill which may still be implemented, in their view, by the beginning of 2019. The Federal Council takes the view that a new draft may take longer as the reform remains a complex undertaking. Anyhow, it can be expected that the Federal Council and the legislator will react quickly to end the uncertainty and avoid unilateral tax repercussions from the EU or individual countries.

The new proposal likely will be less far-reaching. In particular, the provided measures like the super-deduction for R&D expenses as well as the Notional Interest Deduction might not be part of the new proposal. In addition, potential counter measures like increasing the partial taxation quota for dividends at the level of individuals require further discussion.

Meanwhile the affected companies with cantonal/federal tax privileges have the option of voluntarily renouncing their privileges and benefiting from a tax neutral ’step-up‘ on built-in capital gains. In this way, depending on the individual facts and circumstances, it may be possible to ensure that the existing corporate tax burden will remain similar on the cantonal level for a few more years.

Affected companies should closely monitor further developments in Swiss fiscal legislation. Even in view of the prevailing ordinary income tax rates ranging between 11.5% and around 24% (without consideration of the intended future cantonal tax rate reductions) Switzerland remains an attractive place for business activities, with its highly qualified workforce and stable political environment.

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