DANON & SALOMÉ

Swiss Corporate Tax Reform ("TP 17")

Steering body presents strategic recommendations to the Swiss Federal Council

1. Background

The Corporate Tax Reform III (CTR III) was meant on the one hand to abolish tax regimes that were not in line with international standards and, on the other hand, to revamp the corporate tax system so as to maintain Switzerland's attractiveness. Yet, the CTR III was rejected in a popular vote on 12 February 2017. Following this rejection, the Swiss Federal Council formed a Steering Body with a view to come up with a revised proposal.

During the last months, the Steering Body did run consultations with political parties, cities, churches and the private sector, so as to reach a broad consensus in order to present a strategy for a new reform which could come into effect as soon as possible.

2. Proposed measures

On 1 June 2017, the Steering Body presented its strategic recommendations to the Swiss Federal Council yesterday. In essence, these recommendations are the following:

- **Abolishment of the cantonal privileged tax regimes** (pure holding regime, domiciliary and mixed company regimes, etc.). The recommendations of the Steering Body initially released on 1 June did not initially mention the introduction of rules with respect to the transition from a privileged regime to the ordinary tax liability. As a result, there was some uncertainty as to whether these transitional rules were actually part of the proposed recommendations. Meanwhile, the document of the Steering Body has been amended to clarify that these transitional rules do actually form part of the proposed recommendations.

- A cantonal mandatory **patent box regime** complying with the OECD **modified nexus approach** laid down in BEPS action item 5.

- **An optional super R&D deduction** allowing R&D expenses to be deducted **up to 150%** (i.e. an additional maximum deduction of 50%). Compared to the initial reform, this additional deduction would be primarily limited to the R&D personnel costs. Irrespective of the introduction of this super deduction, it should be observed that under Swiss law, R&D expenses are currently already fully deductible, provided they are commercially justified.

- **A general limitation** designed to mitigate the combined effects of the patent box regime and R&D deductions. Under the initial project the combined effect of the incentives could not exceed 80% of the taxable income. The steering body further restricts this rule and now proposes that the incentives **may not exceed 70% of the taxable income**.

- **Tightening of partial taxation of dividends received by individuals**: 70% of dividends stemming from qualified (min. 10%) participations held by individuals will be subject to tax at federal level and at least 70% at cantonal and communal level (**mandatory threshold).** On this point, the Steering Body revamps a measure that had already been included in 2015 by the Federal Council in its initial draft but that was eventually not adopted by Parliament. This recommendation, which is designed to mitigate losses of tax revenues would tighten the individual taxation of dividends. Indeed, at present dividends received by individuals are taxed 60% (private shareholding) and 50% (commercial shareholding) for federal income tax purposes while, at the cantonal level, the cantons do not have to comply with a mandatory threshold.

- **The apportionment of direct federal income tax revenues among the Swiss Confederation and Swiss canton**s will be revisited, whereby the latter will be entitled to a higher share (21.2% instead of 17% at present). Cities and communes will be taken into consideration in this context.

- **Family allowances: CHF 30 increase of both the minimum child and education allowances.**

3. Timing

The objective of the Federal Council is to be able to submit a revised package to Parliament as swiftly as possible. Accordingly, the Federal Council shall formally review the recommendations of the Steering Body in June. A consultation draft shall then be prepared. The consultation is expected to end in December 2017 and, at this point, it is contemplated that the dispatch shall be submitted to Parliament **in spring 2018.**

4. Critical remarks

A. Compatibility of proposed package with international and Swiss principles

The proposed measures, in particular the patent box regime based on the OECD nexus approach and the super deduction for R&D expenses which is widely used across the globe, are fully **compatible with international standards.** These measures were already part of the initial corporate tax reform but are now designed in a more restrictive fashion with a clear focus on R&D activities.

From this perspective, the recommended package is also fully **in line with Swiss constitutional principles** which require that incentives do not go beyond what is necessary to achieve the required purpose (e.g. for example the promotion of R&D). A super deduction primarily focusing on costs relating to R&D personnel thus makes sense as it is settled that these expenses are the ones capable of entailing genuine spillover benefits. The same holds true as regards the introduction of rules limiting the combined effects of the patent box and R&D deductions (see on these issues Robert Danon, Expert Opinion to the Swiss Federal Council).

B. Increased importance of cantonal tax rates reductions

This being said, for companies, in particular those that do not carry out R&D activities, the proposed strategy also means that the **reduction by the Swiss cantons of their general corporate profit tax rates will be even more decisive in the future**.

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