Corporate Tax Reform III (CTR III)

On June 17, 2016, the Federal Parliament passed the Corporate Tax Reform III (CTR III). Switzerland has been under international pressure for some years because of its cantonal tax regimes for holding, domiciliary and mixed companies. These tax regimes will be abolished by the CTR III and replaced by a corporate tax system which is consistent with international standards. CTR III will strengthen Switzerland as a tax and business location.

The Socialist Party has already called a referendum and a popular vote will become necessary to get the changes into effect. This referendum will potentially be held in February 2017. The modular approach of the CTR III will allow a number of choices for the cantons to tailor the rules to its particular circumstances. The implementation of the new norms at cantonal level may also be approved by the cantonal electorate. Taking these uncertainties into consideration, it is the aim that most parts of the reform will come into effect at the beginning of 2019.

Companies that have a Siwss subsidiary in their structure should review their structure to make those ready for CTR III.

CTR III includes the following key elements:

- **Abolition of existing cantonal tax regimes for holding, domiciliary and mixed companies including the Principal and Swiss Finance Branch taxation at federal level**

The elimination of the cantonal tax regimes is combined with a five-year transition period after the new law takes effect. The cantons can subject the realization of hidden reserves and goodwill to a separate lower tax rate, provided they have not been taxable under existing law. By the transitional rules it is expected that the overall effective tax rate of many companies concerned might remain at the existing level of approximately between 8% - 11% for the next five years.

- **Reduction of cantonal corporate income tax rates**

The federal tax revenue to be shared with the cantons will be increased. As a result, the cantons will receive about CHF 1.1 billion more in order to support the reduction of the ordinary cantonal corporate income tax rates.

Accordingly, many cantons are planning to reduce their ordinary corporate income tax rates substantially. Canton Vaud has already decided to reduce the overall corporate tax rate of 21.7% (2016) to 13.8% in 2019. Other cantons have announced plans to implement overall tax rates between 12% to 14%.

Furthermore, in the future the Cantons should be able to offer reduced capital taxes on equity relating to participations and intellectual property.

- **Mandatory introduction of a notional interest deduction at federal level and optional introduction at cantonal level**

Under CTR III a notional interest deduction (NID) will be implemented. But only interest calculated on equity exceeding a certain threshold, so called surplus equity, will be tax deductible. The interest rate for NID is based on the long-term Swiss bond rate with no mark-up. For intercompany loans, the applicable interest rate for NID is based on arm's length principle which may be higher than the Swiss bond rate.

- **Introduction at cantonal level of a Patent Box regime which is in line with OECD requirements**

A patent box will be introduced on the cantonal level, resulting in an exemption of up to 90% for income from qualifying IP (patents or similar rights)to privileged taxation of up to a maximum of 90%. The design of the Swiss patent box is in line with the OECD's modified nexus approach.

- **Introduction at cantonal level of a R&D super-deduction**

Under the CTR III an optional deduction of 150% of Research & Development expenditures incurred in Switzerland will be introduced.

- **Overall restriction on tax relief**

The tax benefits of the transitional rules, NID, patent box and R&D deduction are limited to reduce the cantonal corporate income tax by a maximum of 80%.

- **Disclosure of hidden reserves (step up) when entering or leaving Switzerland**

CTR III introduces a comprehensive set of rules dealing with entry and exit out of Swiss tax liability. The difference between the book value and the fair market value can be disclosed at the federal and cantonal level when entering Switzerland. The difference can be disclosed in the tax balance sheet. The disclosed reserves can be depreciated with the standard rates in subsequent years. Goodwill is to be amortized over a period of 10 years. When leaving Switzerland, the difference between the book value and the fair market value is liable to normal taxation.

The abolition of the federal issuance stamp tax and the introduction of a Swiss tonnage tax regime for shipping companies have been postponed and shall be addressed in separate bills.

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