GREATER ZURICH AREA

Swiss corporate tax reform – what's next?

GZA Webinar – May 21, 2019 12pm EDT / 9am PDT / 6pm CEST

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Reachable in one day

Inhabitants
> 8 million / about 25% foreigners

4 national languages
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English is the business language

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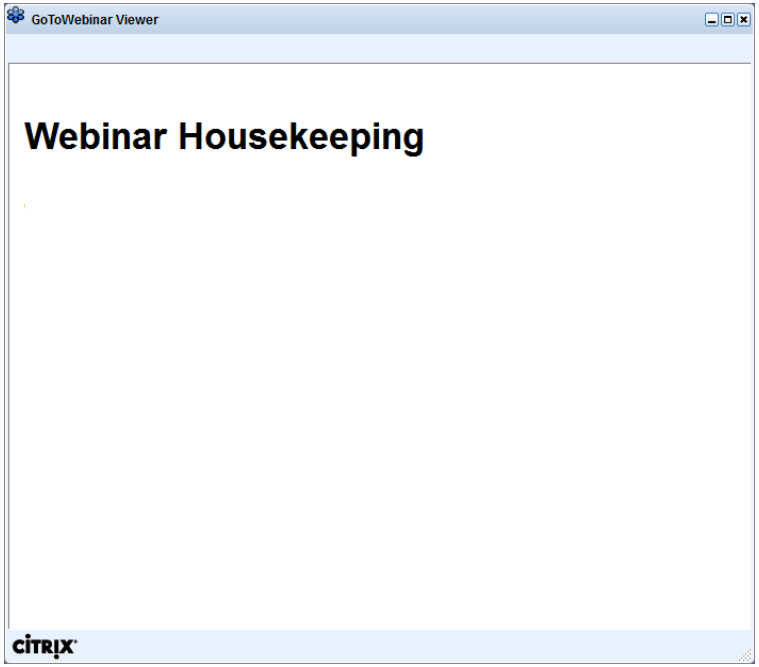
Agenda

1. Context
2. Impact on Swiss corporate tax payers
3. TRAF Bill
4. Transitional rules
5. Cantonal implementation
6. Key takeaways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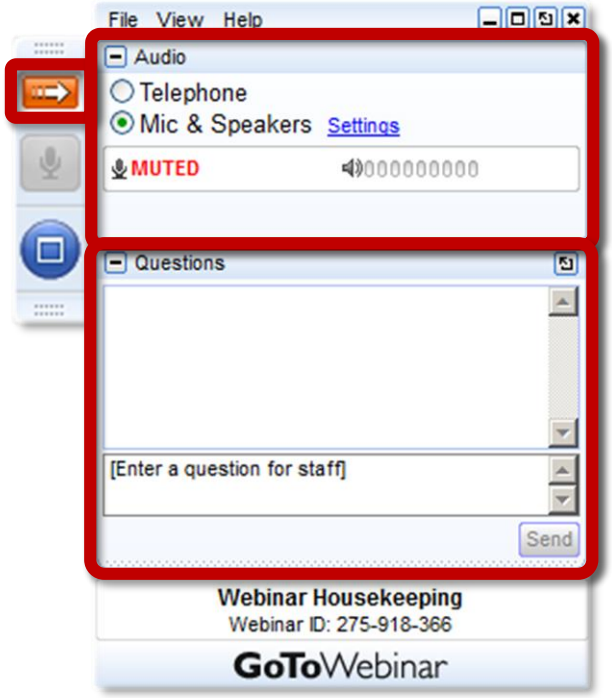
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Context: Tax Reform and AHV Bill (“TRAF”)

- Switzerland has been under pressure from the EU as well as the OECD to reform the corporate tax system.

- The first attempt at overhauling the system was known as corporate tax reform III (CTR III) which was rejected by the Swiss voters on February 12, 2017.

- The Federal Council and Parliament immediately drafted a new proposal called Tax Proposal 17 and renamed it as the Federal Act on Tax Reform and AHV Financing (TRAF). Bill covers not only corporate taxation but also funding of the Swiss old age pension (“AHV”) system. AHV will not be discussed today.

- What does it mean for Swiss based corporate tax payers ?

Impact TRAF on Swiss corporate tax payers

- Overall: business as usual, Switzerland is attempting to prevent disruption of company taxation and remains an attractive location for business.

- The provisions of TRAF will become effective 1.1.2020 at both cantonal and federal level.

- For ordinary taxed Swiss companies: no material changes, other than, depending which canton, a reduction in cantonal tax. Swiss federal tax rate remains unchanged (8,5%)

- For privileged taxed companies (holding, domiciliary, mixed company status) : a choice needs to be made: 1. continue ordinarily taxed or 2. opt for one of the two transition options.

Impact TRAF on Swiss corporate tax payers

- Transition option 1: for Swiss tax purposes apply a revaluation of the business, resulting in a goodwill asset (with a corresponding increase in fiscal retained earnings), which can be depreciated in 5-10 years; or

- Transition option 2: for Swiss tax purposes apply a revaluation of the business, also resulting in a fiscal goodwill asset, which is released within 5 years, albeit taxable at a lower rate. Other, “new” income will be taxed at ordinary rate.

TRAF Bill

Measures	TRAF – final bill and cantonal implementation
Patent Box	•90% reduction (modified nexus approach) on patents •Expected to include outsourcing to Swiss related parties or third parties (anywhere)
R&D Super-deduction	•50% super-deduction on R&D (salary) expenses •Includes outsourced activities
Step-up in basis in general	•Tax neutral step-up on immigration or transfer of business operations/functions to Switzerland
Step-up in basis for regimes	•Depreciation model on built-in gains/goodwill if tax regime ends •Separate rate model applies once TRAF enters into force •Cantons to publish separate rate
Notional interest deduction	•Deduction on excess equity financing up to an arm's length interest rate •Canton of Zurich only

TRAF Bill

Measures	TRAF – final bill and cantonal implementation
Capital tax relief	•Capital tax relief on qualifying investments (10%), patents and intra-group loans
Base-erosion limitation	•Deductions under new tax measures combined (except general step-up regime) cannot exceed 70% of total income
Abolishing of tax regimes	•Preferential tax regimes at both federal (e.g. principal companies, Swiss finance branches) as well as cantonal level (holding-, domiciliary - & mixed status) abolished
Foreign WHT credit	•Swiss branches of non-resident entities may benefit from a foreign withholding tax credit (subject to conditions)
Cantonal tax rate reductions	•Cantons to significantly reduce tax rates (12 to 14%) E.g. Zug 12%

TRAF timeline

- 19 May 2019: Swiss federal referendum
- During 2019: cantonal votes (e.g. Zug 24th of November 2019)
- 20 May 2019: some TRAF provisions potentially enter into force
- 31 December 2019: Swiss preferential tax status (holding, domiciliary, mixed company status, principal status, Swiss finance branch regimes) will terminate
- Swiss companies currently applying a preferential tax regime may benefit from a tax-neutral step-up mechanism, provided they elect to do so prior to 1 January 2020
- 1 January 2020: TRAF entry into force
- Practical point: the Swiss cantonal tax offices will during 2019 likely be overwhelmed with TRAF related tax payer requests.

Transitional rules

Transitional rules
Overview of transitional rules

Immigration step-up (principal taxation)

- Goodwill / 10-year amortization period (nArt. 24c (4) FHTL)
- Abolishment upon December 31, 2019 (pro-rata temporis for non-calendar year taxpayers)

Old law step-up (cantonal tax regimes)

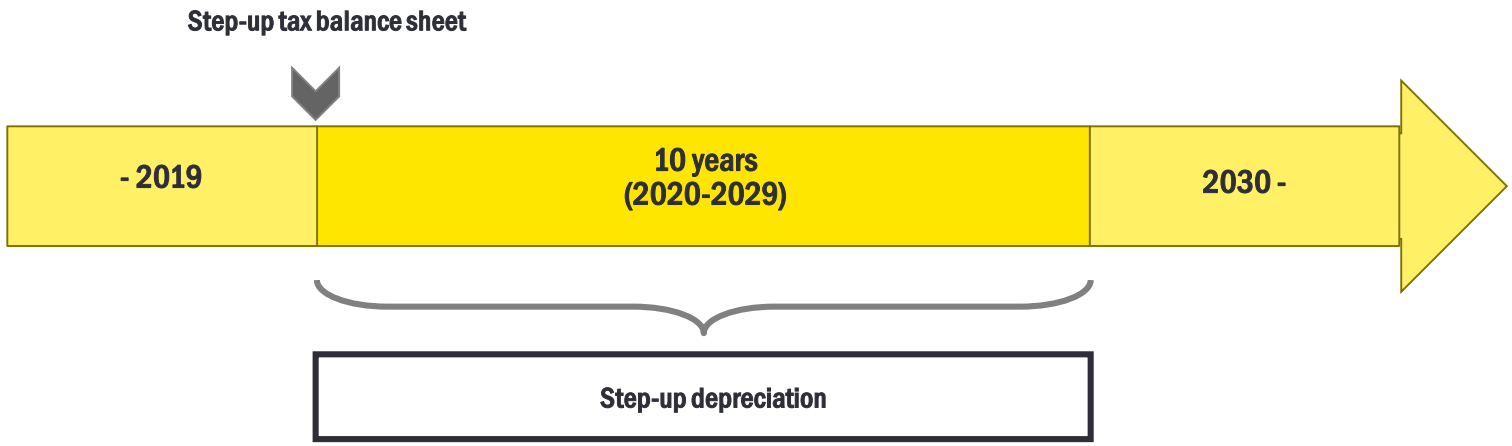
- 5-10 year amortization period (depending on canton)
- DTA recognition
- Not available in all cantons

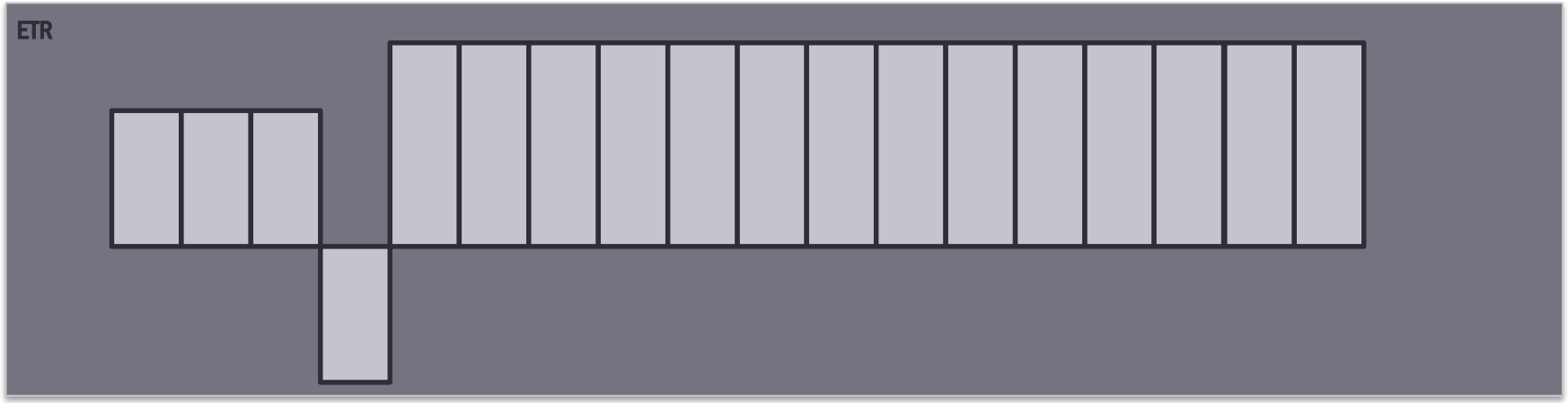
Two-rate model (cantonal tax regimes)

- Limited to 5 years (by tax law)
- No DTA recognition
- Mandatory for all cantons

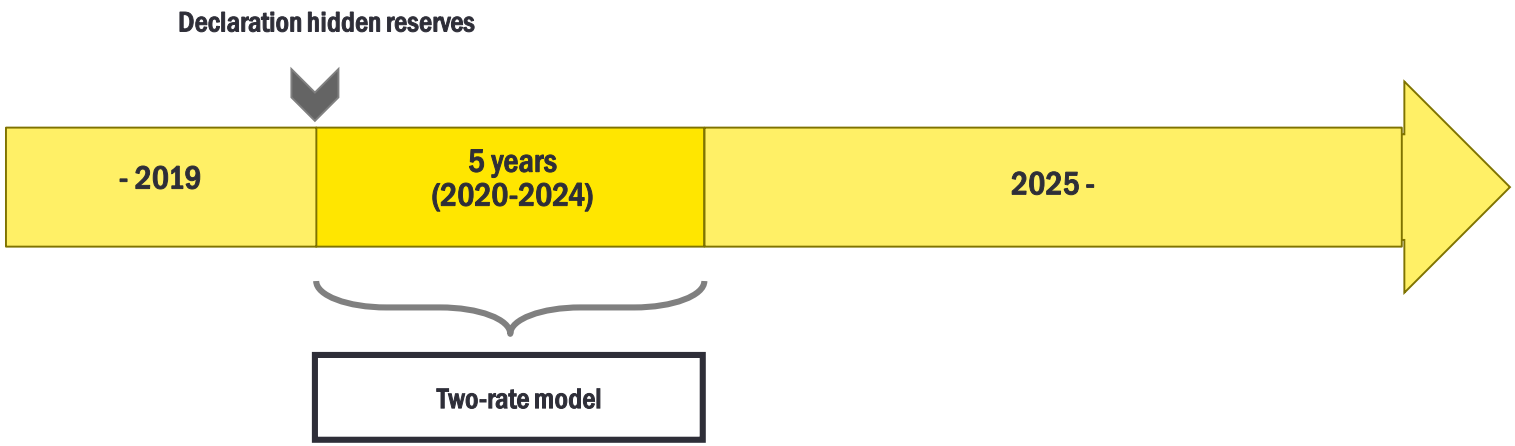
Combination of two-rate model and step-up?

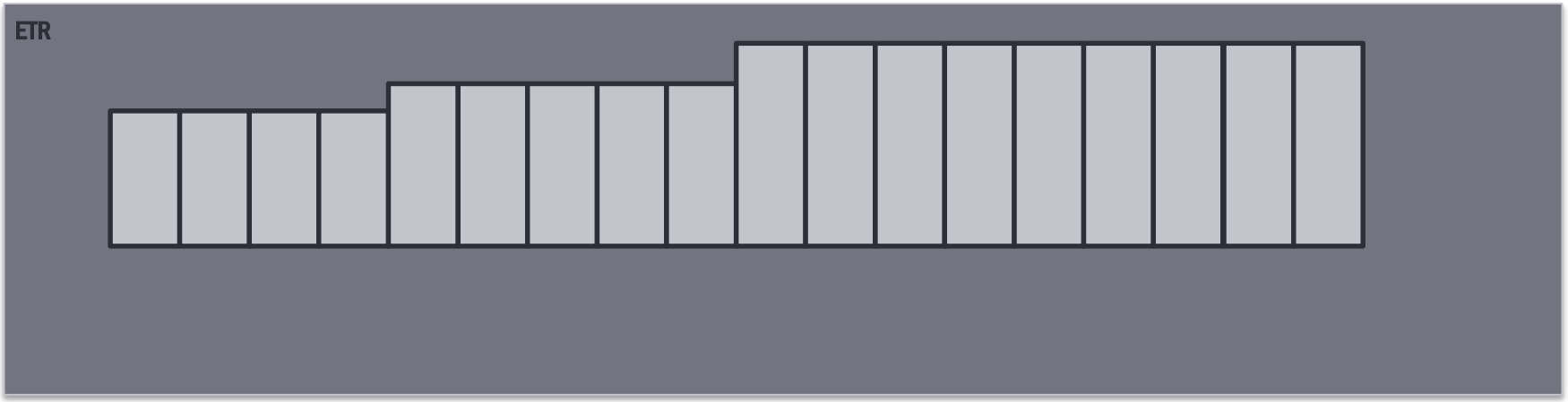
Transitional rules
Old law step-up



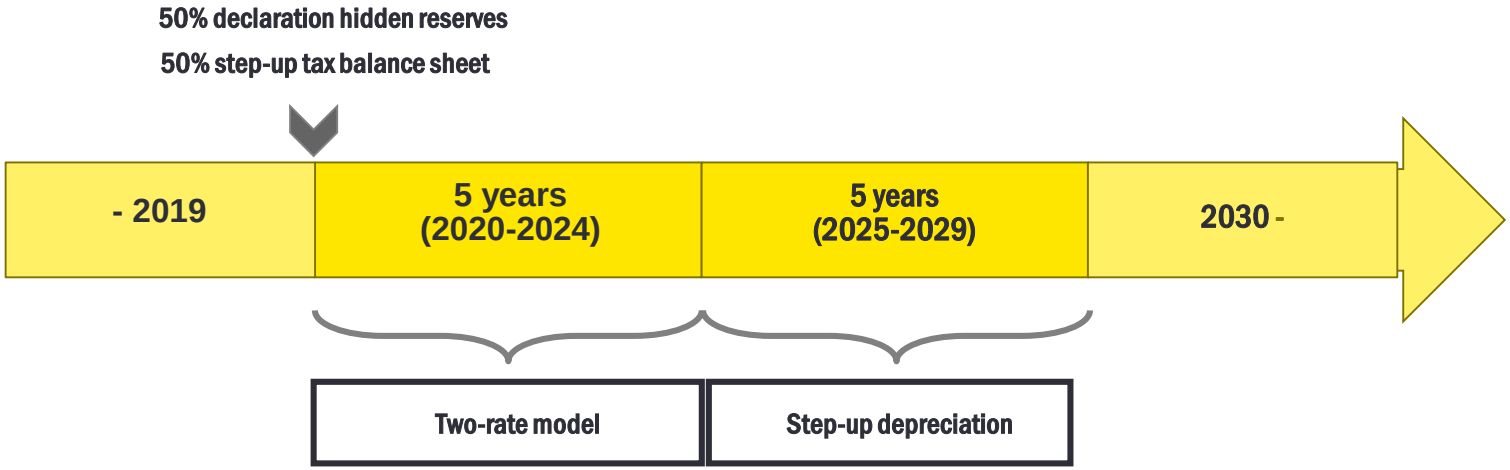


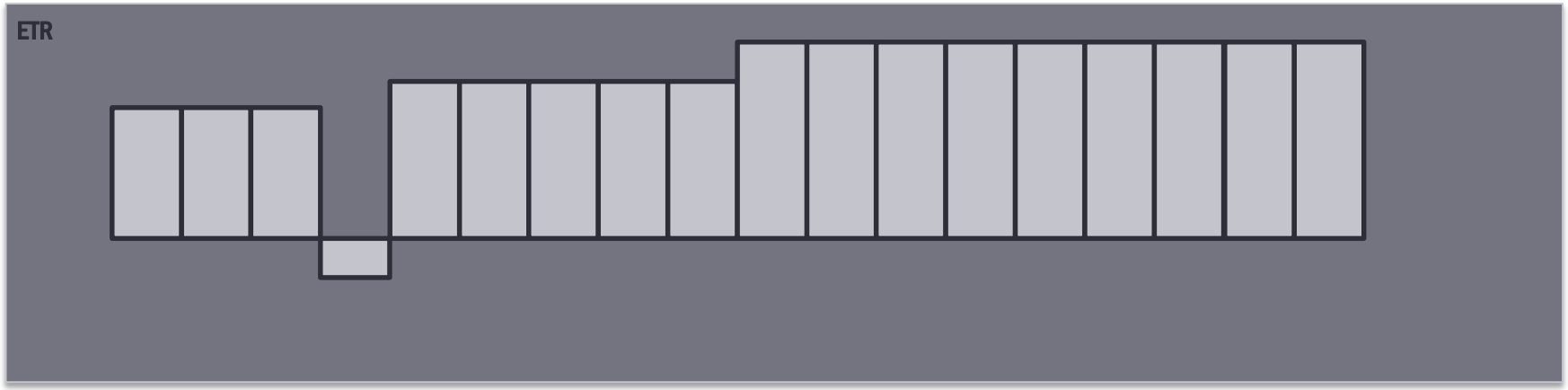
Transitional rules
Two-rate model





Transitional rules
Combination of two-rate model and step-up





Transitional rules
Combination of two-rate model and step-up

	DTA (group tax accounting)	Application period	Subject to cantonal relief limitation	Anticipated level of taxation
Step-up	Yes	5-10 years	Yes	Lower
Two-rate model	No	5 years	No	Higher
Combination	Reduced (by ~50%)	10 years	Yes (as of 2025)	Slightly higher (first 5 years)

- Step-up would often be the preferred transition method if there were no DTA issue
- Two-rate model was introduced as alternative transition rule without DTA issue, but is limited to 5 years by law and often entails slightly higher taxation
- A combination of both models would allow to benefit from extended application period, if available, while also mitigating the DTA issue during first few years

Transitional rules
GZA implementation

Step-up-approach		Canton	Two-rate-model
Amortization period	**Increase of taxable equity**		**Reduced tax rate** *(in the capital of the Canton)*
5 years	Yes	Glarus	1.5%
not yet communicated	not yet communicated	Graubünden	0.98%
tbd	No	Schaffhausen	0.8%
10 years	Yes	Solothurn	1.0%
5 years	Yes	Schwyz	0.4%
10 years	Yes	Ticino	1.0%
5 years	Yes	Uri	1.0%
5 years	Yes	Zug	0.8% - 1.2%
10 years	No	Zurich	0.5%

Cantonal implementation

Cantonal implementation
Reduction of cantonal income tax rate

Canton	Current tax rate[1]	Envisaged tax rate[1]	Reduction
Glarus	15.70%	12.42%	-3.28%
Graubünden	16.12%	14.02%	-2.10%
Schaffhausen	15.75%	14.26%/12.33%[2]	-1.49%/-3.42%
Solothurn	21.38%	13.12%	-8.26%
Schwyz	15.19%	14.3%	-0.89%
Ticino	20.67%	16.0%/17.0%	-4.67%/-3.67%
Uri	14.92%	12.51%	-2.41%
Zug	14.62%	12.02%	-2.60%
Zurich	21.15%	19.70%/18.19%[3]	-2.96%/-1.45%

1) Max. rate on pre/tax income

2) 14.26% (2020-24) / 12.33% (from 2025)

3) 19.70% (2020-24) / 18.19% (from 2023)

Cantonal implementation
Patent box/R&D super deduction

Patent box		Canton	R&D super deduction
Exemption quota	Entry cost		Deduction quota
10%	Acc. federal law[1]	Glarus	Not available
70%	Not yet communicated	Graubünden	Not available
90%	Yes[2]	Schaffhausen	25%[3]
90%	Not yet communicated	Solothurn	50%
90%	Acc. to federal law[1]	Schwyz	50%
90%	Not yet communicated	Ticino	50%
30%	Acc. to federal law[1]	Uri	Not available
90%	Yes[2]	Zug	50%
90%	Yes[2]	Zurich	50%

1) R&D expenses deducted in the current and the previous ten years are subject to entry cost

2) Historic development costs are offset against eligible income during first five years

3) Upon transition period of 5 years (from 2025)

Cantonal implementation
Notional interest deduction (NID)

Application and effect

- Limited to high-tax cantons (headline tax rate of at least 18% across the entire tax scale) The NID may reduce the tax rate by up to 7%

Mechanism

- NID is calculated on surplus equity only, core equity is not eligible
- Excluded assets are (1) participations, (2) non-operating assets, (3) patents or equivalent rights, (4) stepped-up assets, and (5) assets relating to transactions that give rise to unjustified tax savings (anti-abuse provision)
- Interest rate on surplus equity is based on 10-year government bond yield (~0.1%) or arm's length interest rate in case of receivables from related parties

Only expected to be available in the canton of Zurich

Cantonal implementation
Capital tax reductions

Current net equity tax situation

- Typically one rate for ordinarily tax companies and a reduced rate for companies benefitting from a privileged tax regime (e.g. holding or mixed companies)
- Rates vary significantly between the cantons
- Tax credit system in some cantons

Tax Reform outlook

- One tax rate depending on canton
- Cantons can grant the following reliefs based on the harmonization act:
  - Tax credit system
  - Partial exemption from net equity tax for:
    - Participations
    - Patents and equivalent rights
    - Intercompany loans

Despite capital tax reductions, often above the previous privileged rate

Cantonal implementation
Capital tax reductions

Canton	Current tax rate		Envisaged tax rate	Relief net equity tax
	Ordinay	Holding		IP = Patents / P = Participations / IC = Intercompany loans
Glarus	0.252%	0.005%	0.252%	100% (IP/P/IC)
Graubünden	0.488%	0.005%	0.488%	n/a
Schaffhausen	0.204%	0.005%	0.005%	n/a
Solothurn	0.176%	0.024%	0.022%	80% (IP/P/IC)
Schwyz	0.167%	0.010%	0.007%	n/a
Ticino	0.290%	0.029%	0.290%	Not yet communicated
Uri	0.001%	0.001%	0.001%	n/a
Zug	0.074%	0.003%	0.075%	98% (IP/P/IC)
Zurich	0.172%	0.034%	0.172%	90% (IP/P/IC)

Cantonal implementation
Impact of the reform on tax rates

Current income taxation

- Ordinary tax rate (12%-24%)
- Mixed company (8%-13%)
- Principal company (4%-10%)
- Holding company (7.8%)
- Finance branch (0.8-2%)
- Tax Holiday

Maintained until 2019

Effects of the tax reform

- CIT reduction (12-14% in most cantons)
- Further reduction of income taxes through introduction of various measures (9-12% in most cantons)
- Transitional rules (5-10 years)
- Tax Holiday

Beginning 2020

Cantonal implementation
Outlook

Votes on cantonal implementation GZA	
Glarus	Adopted on 5 March 2019
Graubünden	In Cantonal Council of Graubünden in August 2019
Schaffhausen	End of consultation 2nd half of 2019
Solothurn	19 May 2019 X
Schwyz	24 November 2019
Ticino	TBD
Uri	24 November 2019
Zug	24 November 2019
Zurich	24 November 2019

Key takeaways

Key takeaways

- With the implementation of TRAF, Switzerland and the GZA cantons will continue to offer a very attractive corporate tax framework
- GZA cantons continue to offer generous tax incentives for the establishment of activities in Switzerland
- The tax reform will bring fundamental changes to the Swiss corporate tax system
- The tax reform achieves its main goal of retaining Switzerland's international attractiveness while having an internationally accepted tax system
- Tax payers should analyze their options and perform reviews regarding the transition to the new regulations

There are many opportunities.
The biggest risk is to not explore them now!


Q&A

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Thank you