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Corporate Tax Reform III (CTR III)

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Corporate Tax Reform III (CTR III)

- Replacement measures of current privileged cantonal tax regimes
  - Swiss licence box
  - Interest adjusted corporate income tax on surplus capital (NID)
  - Adaption of annual capital tax
  - Systematic realisation of hidden reserves (Step-up)
- Improved systematic measures
  - Abolition of issuance stamp tax on equity capital
  - Adaption of rules relating to utilization of tax loss carry forward
  - Switch from indirect to direct participation relief
- Compensatory measures
  - Amendment of partial taxation of participation income
  - Introduction of a capital gains tax on privately held securities by individuals

Replacement measures (1)
Swiss licence box

- Article 24b LHID
- Only applicable at cantonal level
- Mandatory
- Definition of qualifying IPs :
  - Patents
  - Protections certificates
  - Exclusive licence of qualifying IP
  - "Protection du 1er requérant"
    → Not for brands
    → Not for patentable processes

Replacement measures (1)
Swiss licence box

- Eligibility test
  - Substancial contribution to development
  - Control over development of qualifying IP
  - Being part of the Corporate Group in case of exclusive licence
- Mechanism
  - Separate taxation of income from intellectual property
  - Residual approach
  - Step-wise approach to define income subject to preferential treatment (financial activities, revenues from non-qualifying IPs, Routine functions and marketing IP, licence net income)
- Tax benefit
  - Base reduction (max 80%)

Replacement measures (1)
Swiss licence box

- Suitable measure for Switzerland
- Support R&D&I activities
- Maintain competitivity (international level)

- Limited impact on multinational companies HQ
- No impact on trading activities
- International developments (BEPS) are to be considered in the process going forward (broad vs narrow box)

Replacement measures (2)
NID

- Art. 59 al. 1 let. e, 1bis et 1ter LIFD
- Art. 25 al. 1 let. e, al. 1ter et 1^{quater} LHID
- Applicable at federal and cantonal level
- Mandatory
- Notional interest deduction only on qualifying surplus capital
- Interest rate :
  - 10-year federal bond rate + margin of 50bps ;
  - Minimum rate of 2%

Replacement measures (2)
NID

- Tax attractive solution for financing activities
- Retention of highly mobile financing functions and relocation of new financing activities

- International acceptance ?
- Attract activities with limited tax income and few new employments
- No impact on trading activities
- Limited / variable effect for multinational companies
- Substantial tax income loss for Confederation / Cantons
- Side effects :
  - benefit to companies presently under ordinary tax regime
  - Less financial compensatory measures from Confederation

Replacement measures (3)
Adaption of annual capital tax

- Art. 29 al. 2 let. b et al. 3 LHID
- Only applicable at cantonal level
- Option for cantons to adapt annual capital tax on :
  - participations
  - intangibles
  - Group loans
- Maintain competitivety
- Mandatory measure induced by abolition of privileged cantonal tax regimes

Replacement measures (4)
Systematic realisation of hidden reserves (Step-up)

- Art. 61 et 61a LIFD
- Art. 24, 24c et 78g LHID
- Mandatory
- Depending on system change, applicable at cantonal level or at federal and cantonal level

Replacement measures (4)
Systematic realisation of hidden reserves (Step-up)

- Consistent tax treatment of system changes, e.g. :
  - Leaving privileged cantonal tax regimes
  - Entering/leaving licence box
  - Relocation to/from abroad
  - Entering/leaving tax exemption (23 al. 1 LHID, 56 LIFD)
- Beneficial tax realisation of hidden reserves created under tax privilege over a period of 10 years after loss of relevant tax privilege and avoidance of windfall effects on changing from previously ordinarily taxed companies to licence box
- Mechanism (leaving privileged cantonal tax regimes) :
  - Revaluation (step-up) of the added value created under the tax privilege (capitalisation of hidden reserves/internally generated Goodwill)
  - Creation of tax amortization base (Goodwill amortization max 10 years)
  - Revaluation results in tax due over 10 years

Replacement measures (4)
Systematic realisation of hidden reserves (Step-up)

➢ Leaving privileged cantonal tax regimes

Example (X SA) :

- Goodwill : CHF 3'736'043'137
- Cantonal and communal tax on Goodwill : CHF 155'413'883 (ICC 4.13%)
- Ordinary tax rate : 20%
- P&L after abolition of privileged canton tax regimes :

	ICC	IFD
Profit	376'304'314	376'304'314
Goodwill depreciation (1/10)	(376'304'314)	0
Taxable profit	0	376'304'314
Profit tax	0	31'985'867
Goodwill tax	15'541'368	

Effective tax rate 11.64%

Replacement measures (4)
Systematic realisation of hidden reserves (Step-up)

➢ Leaving privileged cantonal tax regimes

- Substancial profit increase (X SA) :

	ICC	IFD	Total
Profit	1'881'521'569	1'881'521'569	
Goodwill depreciation (1/10)	(376'304'314)	0	
Taxable profit	1'505'317'255	1'881'521'569	
Profit tax	248'360'847	159'929'333	
Goodwill tax (1/10)	15'541'368		
Total	263'902'215	159'929'333	**421'487'173**

Effective tax rate
18.66%

Replacement measures (4)
Systematic realisation of hidden reserves (Step-up)

- Leaving privileged cantonal tax regimes
  - Substancial profit decrease (X SA) :

	ICC	IFD
Profit	100'000'000	100'000'000
Goodwill depreciation (1/10)	(376'304'314)	0
Taxable profit	(376'304'314)	100'000'000
Profit tax	0	8'500'000
Goodwill tax (1/10)	15'541'368	
Total	15'541'368	8'500'000

Effective tax rate
22.37%

Replacement measures (4)
Systematic realisation of hidden reserves (Step-up)

- Limited time measure (10 years)
- Allow privileged tax regime companies to keep their old rate
- In theory :
  - no need to reduce the cantonal corporate income tax rate (or reduction spread over the years)
- In fact :
  - mandatory reduction in canton Geneva to maintain his attractiveness
  - Substancial tax income loss (compensatory effect loss)
- No long term solution
- Practical issues (e.g. valuation, impact on taxable capital, treatment IFRS / US GAAP)
- International acceptance ?

Improved systematic measures

- Abolition of issuance stamp tax on equity capital
  - Art. 1 al. 1 let. a et art. 5 à 12 de LT
  - Currently, 1% on capital increases / contributions
  - Cost CHF 200'000'000 millions (federal level)

- Adaption of rules relating to utilization of tax loss carry forward
  - Art. 31, 67, 205c et 207d LIFD
  - Art. 10 al. 2, 3 et 3, art. 25 al. 2, 3 et 4, art. 78f LHID
  - Applicable at federal and cantonal level
  - Mandatory
  - No limitation in time anymore (currently 7 years)
  - Minimum taxation of 20%; tax losses may only be set off against 80% of the income

Improved systematic measures

- Switch from indirect to direct participation relief
  - Art. 58a et 67a LIFD
  - Art. 24a et 25a LHID
  - Applicable at federal and cantonal level
  - Mandatory
  - Full exemption (income / expenses not part of taxable base anymore)
  - No reduction by administrative and financing costs
  - Participation in corporation or co-operative required but with no minimum holding requirements
  - No deduction of depreciation on participations (except for final losses of subsidiaries)
  - Exception : participations held by banks recorded in current assets (capital gains)

Improved systematic measures

- Overload the reform
- Not necessary to achieve reform objectives

Compensatory measures (1)
Amendment of partial taxation of participation income

- Art. 18b al. 1, 20 al. al. 2 LIFD
- Art. 7 al. 1bis, 8 al. 2^{quinquies} LHID
- Applicable at federal and cantonal level
- Mandatory
- For qualified investments for individuals
- No minimum holding requirements anymore (today typically 10% minimum holding required)
- Maximum relief of 30% (today typically higher reliefs granted : 40% (private assets) / 50% (business assets)) → no flexibility for cantons anymore
- Financial impact difficult to assess (application field extension vs decrease amount of relief)

Compensatory measures (2)
Introduction of a capital gains tax on privately held securities by individuals

- Art. 16 al. 3, art. 20 al. 1 let. h, art. 20a et art. 24 let. k LIFD
- Art. 7 al. 1, art. 28 LHID
- Applicable at federal and cantonal level
- Mandatory

Compensatory measures (2)
Introduction of a capital gains tax on privately held securities by individuals

- 70% of capital gains from a sale of shares (as well as participation or jouissance rights) shall be subject to income tax at ordinary rates
- 100% of capital gains from a sale of other securities (bonds, options, derivatives) shall be subject to income tax at ordinary rates
- A transfer of residence abroad leads to immediate taxation of potential capital gains (exit tax)
- Losses can be offset with gains and carried forward (to be offset with future gains from shares/other securities)
- Acquisition costs at effective date of new law: Valuation of pre-existing securities for net wealth purposes
- Deferral of capital gains taxation until effective sale only in case of participations transferred to heirs
- Abolishment of existing anti-abuse measures against excessive use of tax free capital gains (indirect partial liquidation, transposition etc.)

Compensatory measures (2)
Introduction of a capital gains tax on privately held securities by individuals

- Could jeopardize global success of the reform
- Conflicting with wealth tax
- Random financial compensatory effect
- Quid about employee equity plan ?

Geneva corporate income tax rate

- Reduction of cantonal corporate income tax rate : target rate of 13%

What is next : Political agenda

- 31st january 2015 : End of Consultation procedure
- 1st semester 2015 : Approval of Final Proposal by Federal Council
- 2016 : Final Decision Parliament (Start of Referendum Period)
- 1st january 2017 : Law enters into force (expected)
- 1st january 2019 : Implementation into cantonal law (expected)

Thank you for your attention