Tax reform and AVS financing (TRAF)

12 April 2019

Aliasghar Kanani
Tax Partner
Admitted to the Geneva Bar
LL.M. in International Taxation

Timeline

1 July 2014, Agreement to abolish criticized cantonal regimes signed between the EU and Switzerland

April 2015, 3rd Corporate Tax Reform (CTR III)

12 February 2017, The negative Swiss popular vote on the CTR III

6 September until 6 December 2017, Tax Proposal 17 open for consultation

28 September 2018, the Swiss Parliament approves the tax reform joint with AVS Financing (TRAF)

19 May 2019, the Swiss popular vote is scheduled

the TRAF may enter into force as of **2020**

Abolition of current Swiss corporate tax privileges (1)

- **Why?** EU claimed that Swiss cantonal tax privileges (such as the holding status and the auxiliary tax status) constitute forbidden fiscal state aid.

- **Result?** Switzerland agreed in 2014 to abolish the controversial cantonal corporate tax privileges. Additional changes due to BEPS.

- **Aim?** Introduce new measures to remain competitive and attractive on the international scene.

Abolition of current Swiss corporate tax privileges (2)

1. The Swiss cantonal tax privileges to be abolished :
   - Holding status (art. 28 al. 2 LHID)
   - Auxiliary tax status (Art. 28 al. 4 LHID)
   - Domiciliary company status (art. 28 al. 3 LHID)

2. End of the tax practices:
   - Swiss Finance branch
   - Principal company

CTR III / TRAF

Practical measures	CTR III	TRAF
Abolition of current Swiss corporate tax privileges	✓	✓
Patent box	✓	✓
R&D super-deductions	✓	✓
Notional interest deductions	✓	«✓»
Step up	✓	✓
Modification of the Capital tax	✓	✓
Increase of individual income tax on dividends from substantial shareholdings	✓	✓
Cantons and communes must benefit from such increase as well	X	✓
Social measures	X	✓

New Swiss cantonal patent box

- **Compulsory** measure at cantonal and communal level

- **Qualifying income** from patents would benefit from a **reduction of up to maximum 90%**

- Corporate taxpayer needs to (i) (economically) **own the patent and** (ii) **have made a crucial contribution to the development of the underlying invention** (creation and continuous development)

New Swiss cantonal patent box (2)

Eligible rights:

- Patents and comparable rights
- Supplementary Protection Certificates (SPC)
- Foreign comparable rights

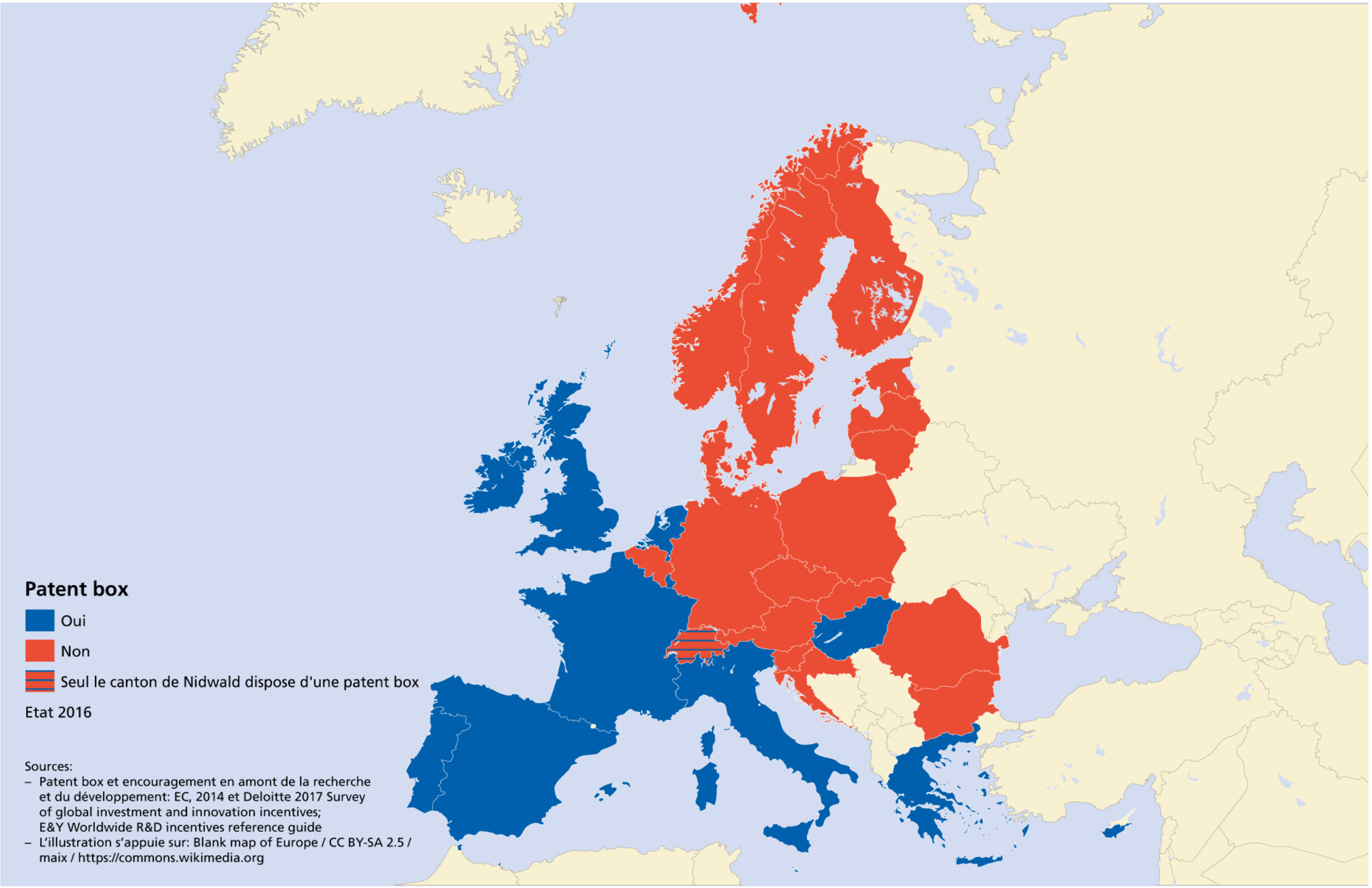
New Swiss cantonal patent box (3)

Calculation of the taxable patent box profit

- Licensing income (**royalties**) and gains on sales of patents and the like
- **Embedded royalties**, i.e. compensation for patents embedded in the sales price of a product or a service
- In the latter case, **the residual method** will apply in Switzerland (based on the profit on a product or service or the profit of an enterprise, from which all non-patent related profit is deducted)

New Swiss cantonal patent box (4)

International comparison:



New Swiss cantonal patent box (5)

Exemple simplifié de patent box au sens des dispositions des articles 24 a et 24 b LHID et 12A et 12B LIPM

Données du cas

Nous sommes en présence d'une filiale suisse d'une multinationale. La société suisse vend des produits brevetés (CHF 120'000) et non brevetés (CHF 150'000). Elle reçoit également des dividendes et des intérêts. En outre, elle a supporté des coûts de développement du brevet émanant de son propre département de R&D pour CHF 25'000 et à hauteur de CHF 20'000 de sa filiale à l'étranger.

Détermination du résultat de la patent box (méthode résiduelle)

Le point de départ et le compte de résultat statutaire (bénéfice net comptable)
Etape 1 : déduction du résultat financier (net)
Etape 2 : déduction des revenus et charges qui ne reposent pas sur des droits éligibles (vente d'un produit ou d'un service)
Etape 3 : déduction des revenus produits par les fonctions de routine et les rémunérations des marques

Compte de résultat (CHF)	Statutaire	Etape 1	Etape 2	Etape 3
Vente produits brevetés	120'000	120'000	120'000	120'000
Rémunération de la marque et des fonctions de routine	80'000	80'000	80'000	
Vente produits non brevetés	150'000	150'000		
Dividendes et intérêts	30'000			
Total des produits	380'000	350'000	200'000	120'000
Dépenses de recherche et de développement (R&D)	25'000	25'000	25'000	25'000
Frais de marketing (marque)	15'000	15'000		
Intérêts dus	10'000			
Total des charges	50'000	40'000	25'000	25'000
Bénéfice net comptable	330'000	310'000	175'000	95'000
Bénéfice qualifiant pour la *patent box*				**95'000**
Bénéfice ordinaire (hors *patent box*)				**235'000**

Source: Rapport de la commission fiscale de Grand Conseil GE du 8 janvier 2019, p. 23 (PL 12006-A)

New Swiss cantonal patent box (6)

Détermination du coefficient nexus

Coûts assumés autorisés pour le développement du bien immatériel
- Coûts autorisés assumés par le contribuable
- Coûts autorisés car transfert à proches en Suisse
- Coûts autorisés car transfert à tiers en Suisse ou à l'étranger

\+

Uplift frais assumés pour transfert et acquisition (jusqu'à 30% des coûts assumés autorisés)

―――――――――――――――――――――

Coûts totaux assumés pour le développement du bien immatériel
- Coûts assumés autorisés pour le développement du bien immatériel
- Coûts assumés non autorisés pour le développement du bien immatériel (y compris les frais de transfert et d'acquisition

Coefficient nexus : (CHF 25'000 + (CHF 25'000 * 30%)) / (CHF 25'000 + CHF 20'000) = 72%

Le coefficient nexus réducteur de 72% s'explique par le fait qu'une partie des frais de R&D en relation avec le brevet de la société suisse ont été développés auprès d'une filiale à l'étranger.

Détermination du résultat imposable

Compte de résultat fiscal	CHF	
	Patent box	Hors patent box
Bénéfice net comptable avant dégrèvement		330'000
Bénéfice net de la patent box	95'000	
Coefficient nexus	72%	
Abattement selon l'article 24b al. 1 LHID et 12B al. 1 LIPM	10%	
Part exonérée du résultat net provenant de brevets et de droits comparables	6'840	(6'840)
Bénéfice net imposable		323'160

Source: Rapport de la commission fiscale de Grand Conseil GE du 8 janvier 2019, p. 24 (PL 12006-A)

New Geneva patent box (7)

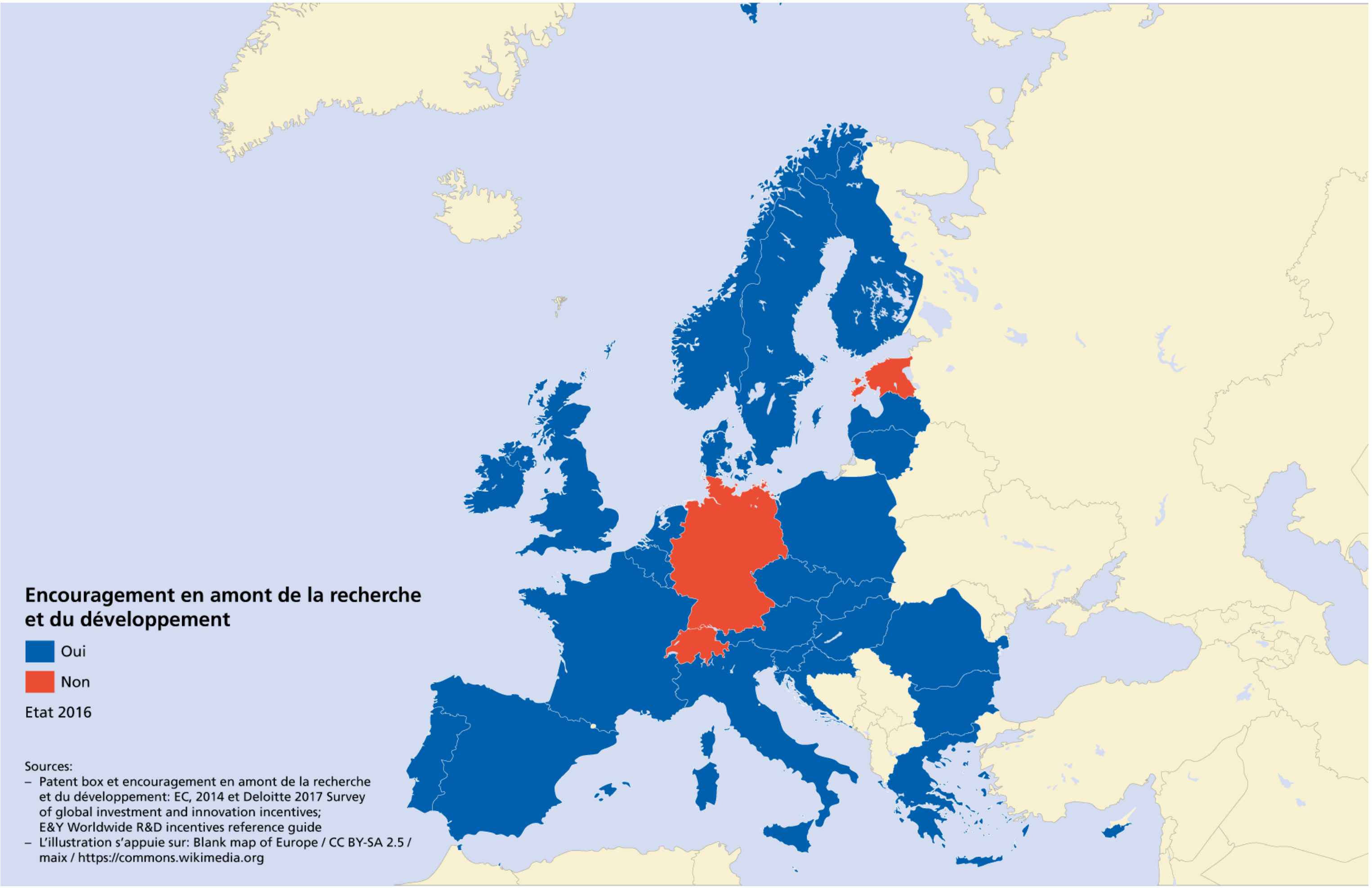
The Geneva Reform provides that **qualifying income** from patents would benefit from a **reduction of up to maximum 10%.**

R&D super-deduction

- **Voluntary measure** at cantonal and communal levels**.**
- This measure aims to promote **Swiss based research & development** activities.
- It consists of a special super-deduction for **Swiss research and development expenses**
- The **Geneva Reform** provides for a super-deduction of 150% for Swiss R&D expenses.

R&D super-deduction

International comparison:



Step-up provisions (1)

1. Compulsory measure at cantonal and communal levels, but only applied on specific request by the taxpayer

2. Two types:

   A. at the end of a tax privilege

   B. in case of immigration to or emigration from Switzerland

Step-up provisions (2)

A. at the end of a tax privilege

1. Step-up for unrealized and hidden reserves existing at the moment the cantonal special tax status are abolished.

2. Amortized and taxed separately at a special rate during a **five year transition period**.

3. Amounts determined by a **special, separate tax assessment.** The Geneva Reform provides for a special rate of **13%**.

4. Will likely not be used by auxiliary companies…not favorable and can be further debated at international level

Step-up provisions (3)

B. in case of immigration to and emigration from Switzerland

1. General **step-up provisions** to be introduced for unrealized and hidden reserves existing at the start of the Swiss tax liability (e.g. in case of **immigration** of a company, an enterprise, or essential parts or assets thereof).

2. Release of such immigration reserves through amortization will **NOT be subject to Swiss income tax.**

3. Amounts determined by a **special, separate tax assessment** (upon immigration). Not in commercial books.

Taxation of substantial dividends

- Taxation of substantial dividends will have to be based on at least **70%** of such dividends at **federal tax level (art. 18b LIFD)** and **minimum 50% at cantonal tax level (art. 7 LHID).**
- Currently resp. 60% or 50% at federal level and no minimum at cantonal level (some cantons apply a rate as low as 10% …)
- The **Geneva Reform** provides for **70%** (private assets) and **60%** (business assets).

Reduction of the corporate tax rates

1. The reduction of the corporate income tax rate

- **voluntary measure** introduced on a cantonal tax level.
- The effective rate including cantonal, communal and federal income taxes:
  - In **Vaud**: reduced from 21.37% to **13.79%** (entered into force 1.1.19)
  - In **Zurich**: aim to reduce from 21.15% to **18.2%**
  - In **Zug**: should be reduced from 14.62% to **12.09%**
  - In **Geneva**: aim to reduce from 24.16% to **13.99%**

2. The reduction of the cantonal corporate capital tax :

- **voluntary measure** introduced on a cantonal level.
- This measure would apply to **qualifying participations, patents** and to **loans between group companies**.
- In Geneva: aim to keep 0.4% and to reduce from 0.07% to 0.0012% for qualifying assets – full credit as of 2024
- In Vaud: reduced to 0.13% - full credit

Reduction of the corporate tax rates

3. Overall tax benefits limitation

- **Federal law:** tax reduction shall not exceed 70% of the taxable income before compensation of losses carried forward

- **Geneva law:** tax reduction shall not exceed 9% of the taxable income before compensation of losses carried forward, i.e. an effective rate of 13,29%

Reduction of the corporate tax rates

4. International comparison

- Ireland: 12,5% (25% on non-trading passive income)
- UK: 19%, 17% starting from 2020
- Malta: 35% reduced to 5% in certain cases
- NL: 24% (above EUR 200'000 of profits), reduced to 21%
- Belgium: 29%, reduced to 25% starting from 2020

CONCLUSION

FOR GENEVA:

- Trading companies in Geneva will pay 13,99% instead of 11,6% or even less…

- Holding companies will pay 13,99% on passive income other than qualifying dividend income instead of 7,83%. Capital tax reduced drastically on specific assets, i.e. typically "holding assets"

- Ordinarily taxed companies will pay 13,99% instead of 24,16%! – improve investment opportunities and remain competitive

- Innovative companies based in Switzerland will benefit from tax advantages that already exists in the EU…

- What are you going to vote on May 19?...

Aliasghar KANANI

Tax Partner
Avocat, LL.M. in International Taxation
MAS in Business Law

kanani@ilf.ch
@AKananiSwiss

Lausanne | Shanghai | Dubai | Paris | Luxembourg | Hong Kong