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# Tax Reform: Switzerland Remains an Attractive Location for Foreign Businesses

Swiss voters adopted tax reform measures on May 19, 2019. The Federal Council formally enacted the Federal Act on Tax Reform and AHV Funding (hereinafter STAF) on June 14, 2019. Most of the measures will come into effect on January 1, 2020, both at the federal and cantonal levels. As part of this reform, the Federal Council has also abolished various regulatory practices

(however, without changing the law) concerning principal companies and Swiss Finance Branches.

## Background

In the past, various types of companies in Switzerland, in particular mixed holding companies, domiciliary companies and management companies, benefited from extensive tax privileges at the cantonal level. The cantonal privileges in question were regarded as harmful tax regimes by the European Union (EU). Switzerland declared to the EU and the Organisation for Economic Co-operation and Development in 2014 that it was prepared to abolish these cantonal tax regimes. Previous reforms adopted by the Swiss parliament were, however, blocked by referendums. Switzerland was placed on the grey list on December 5, 2017, by the EU and given until the end of 2019 to abolish said tax regimes.

In order for Switzerland to remain attractive and competitive as a business location beyond the abolition of the tax regimes, all reform proposals included relief measures through tax rate reductions, including non-detrimental rate reductions for licensing revenues, as well as tax incentives for research and development (R&D) spending. Domestic policy demanded higher dividend taxation rates and a limitation of tax-free repayment of capital contributions. It was not until this tax reform was linked to additional Swiss Social Security funding, that the proposed measures finally found a majority among Swiss voters.

## Timing

The changes will be implemented at both the federal and cantonal levels as of January 1, 2020. There is no transitional period for the respective cantonal laws due to the political urgency at hand. In cases where cantons do not manage to amend their laws in time, the relevant federal law will in principle prevail. Nevertheless, the cantons retain autonomy in the implementation of tax relief measures and rates. Great attention must, therefore, be given to the implementations on the cantonal level.

Hidden reserves on balance sheet items that would not have been taxable under a given tax regime can be taxed separately upon transition to ordinary taxation. This measure came into effect immediately on May 20, 2019. This means that affected companies can opt out of their current tax regime before the end of 2019 and benefit from a special rate solution.

## Essential Elements

### 1. Abolition of Tax Regimes

The key point and trigger of the reform is the complete abolition of all harmful cantonal tax regimes as of January 1, 2020. Also abolished will be the holding privilege, which at the cantonal level grants tax exemptions on net income (except for Swiss real estate income), provided that company investments or investment income account for at least two-thirds of total assets or income.



David Kunz



Urs Suter

**David Kunz**, of counsel with Suter Howald Rechtsanwälte, is a certified tax expert. His main areas of practice are corporate tax law and international tax law.

**Urs Suter** is a senior partner at Suter Howald Rechtsanwälte. His main areas of practice are corporate and commercial law, banking and finance, succession planning and corporate tax law.

Both authors have extensive experience in complex matters and cross-border transactions.

Suter Howald Rechtsanwälte  
Stampfenbachstrasse 52  
Postfach  
Zürich, Switzerland CH-8021

+41 44 630 48 11 Phone

david.kunz@suterhowald.ch  
urs.suter@suterhowald.ch  
suterhowald.ch

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## 2. Partial Taxation of Dividend Income

At the federal level, the taxation rate of dividends from qualifying holdings (at least 10 percent of the share capital of a corporation or cooperative) will be increased to 70 percent as of January 1, 2020. Federal law also stipulates that cantonal taxation rates must amount to at least 50 percent as of January 1, 2020.

## 3. Relief Measures

In order to maintain or increase Switzerland's economic competitiveness while abolishing the tax regimes at issue, various relief measures have been introduced.

### A. Special Rate or Step-Up

When transferring from a special tax status to ordinary taxation, a company can disclose hidden reserves in a tax-neutral manner. However, this applies only to hidden reserves formed with tax effect under the special tax status. Hidden reserves in qualified holdings and in real estate properties are not affected. The former will continue to benefit from the holding's deduction. The latter has been subject to taxation until now.

Hidden reserves on securities that do not qualify as holdings (free float), trademark rights, goodwill, provisions, etc. can benefit from a special rate if disclosed. There are two models: the disclosure solution and the special rate solution. With the disclosure solution, hidden reserves can be capitalized on the tax balance sheet and then depreciated for tax purposes in accordance with depreciation tables. The special rate solution provides for hidden reserves to be taxed separately within the next five years if they are realized.

### B. Reduction of Cantonal Tax Rates

Most cantons are planning substantial tax rate reductions on profits, from the currently effective 12 to 24 percent (consisting of federal, cantonal and municipal taxes) to the 12 to

14 percent range. The cantons of Basel-Stadt, Geneva, Glarus and St. Gallen have already decided to, and in some cases massively, lower tax rates on profits. Other cantons will follow suit with tax rate reductions. One exception is the Canton of Zürich, which will maintain comparatively high effective tax rate profits.

### C. Possibility to Reduce Capital Tax Base

As of January 1, 2020, cantons will be able to levy a reduced tax on equity attributable to holdings, patents and similar rights, as well as on intra-group loans.

### D. Patent Box

From January 1, 2020, cantons will have to tax profits from patents and comparable rights at a reduced rate (so-called patent box). However, the reduced rate is not applicable to federal taxes.

Patents, registered in Switzerland or abroad, are particularly affected. Software only qualifies if it is part of an invention or has been granted a patent abroad. Non-qualifying rights are software without patent protection, trademarks, trade names, designs or trade secrets.

When entering the patent box, R&D expenses of the last 10-year period must be accounted for.

### E. Special Deduction for Research & Development

From January 1, 2020, cantons may allow R&D expenditures to be deducted along with an additional deduction of no more than 50 percent of actual expenditures.

### F. Interest on Equity (Interest-Adjusted Profits Tax)

From January 1, 2020, cantons can grant a deduction for self-financing (so-called interest-adjusted profits tax). Imputed interest on qualified holdings, non-operating assets, patents and comparable rights is excluded. The calculation method

introduces an incentive for intra-group financing or the financing of related companies.

Only cantons with an effective total tax rate of 18.03 percent can apply this measure. Currently, only the Canton of Zürich meets the requirements to offer this deduction.

## 4. Relief Limitation

The cumulative tax relief offered through the measures above combined may not exceed 70 percent of taxable profits before offsetting of losses from previous years.

## 5. Further Reform Elements

### A. Restriction on the Distribution of Capital Reserves for Listed Holding Companies

Distributions from reserves from capital contribution and share premium are tax exempt for non-listed companies. However, listed companies must now distribute taxable retained earnings to at least the same extent as they repay tax-free capital investment reserves.

### B. Adjustment of the Flat-Rate Tax Credit

In the case of a foreign tax retention, there no longer is a "flat-rate tax credit," but rather an effective tax credit.

## Conclusion

With the adoption of this reform, Switzerland will continue to have a stable and reliable tax system. The country remains an extremely attractive and internationally competitive business and tax location. It is recommended that international companies review their corporate group structures and current tax situation. New international tax planning opportunities may arise from setting up a new Swiss company location or from upgrading an existing business presence in Switzerland. 