Swiss tax reform (TRAF)

Fresh perspectives

May 2019

kpmg.ch/traf

What is it about?

Transitional measures to consider hidden reserves including goodwill

Additional deduction for research and development (R&D)

Patent box for reduced taxation of income from patents and similar rights

Notional interest deduction (NID)

Overall limitation of measures on cantonal level

Relief on capital taxes

Amendment of capital contribution principle

Implications of the Swiss tax reform (TRAF)

The public voted on 19 May 2019 to accept the Federal Act on Tax Reform and AHV Financing (TRAF), confirming the reform of corporate taxation in Switzerland. With TRAF, Swiss tax practices and laws are to be harmonized with internationally required taxation standards. The measures also strengthen Switzerland as a business location with a focus on innovation, value creation and job preservation. Companies can also expect greater legal and planning certainty.

The new Swiss tax reform (which now incorporates supplementary AHV financing through an additional 0.3% in social security contributions, among other things) abolishes the cantonal tax statuses for holding, domicile and mixed companies as well as the abolition of regimes for principal companies and finance branches. New measures are intended to (partially) compensate for this abolition. However, the cantons must implement essential elements through their cantonal tax laws.

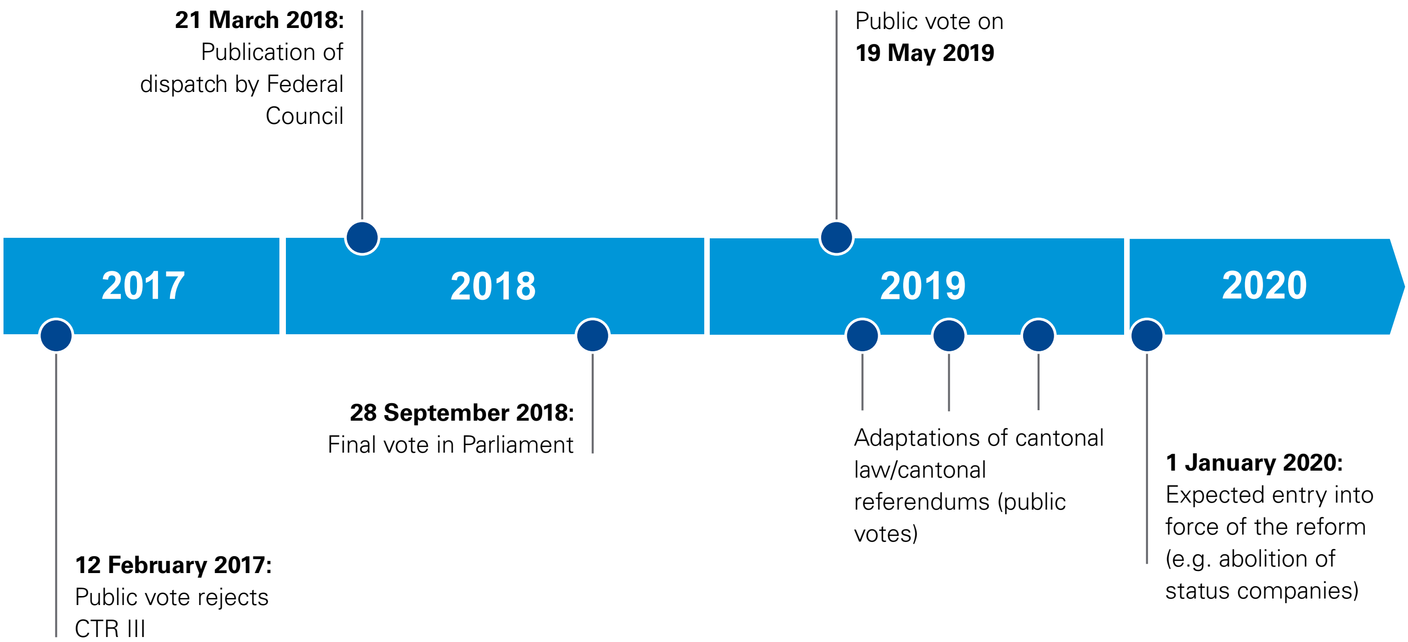
Cantonal tax law changes need to be taken into account for the tax rates to be applied in the annual financial statements. When calculating deferred taxes, it is important to consider which cantons have already "adopted" reductions in their income tax rates. If company-specific effects of the reform have not yet been analyzed, business leaders should do so now in order to take advantage of any planning opportunities.

Do I have privileged tax status?

Which measures will benefit my company?

Would restructuring be helpful to increase the benefits of measures?

Timeline for TRAF (previously Tax Proposal 17)*



* Future data according to current expectations

Transitional measures

The transitional measures are intended to ensure the taxation of hidden reserves under the tax regime in which they were created. For companies that switch from a privileged status to ordinary taxation, this means that existing hidden reserves should be taxed at a correspondingly lower rate when they change status. This is relevant for cantonal and communal taxes. The transitional measures can be subdivided into a step-up on the occasion of a status change (also referred to as current law step-up) and a new legal regulation as a transitional measure (special tax rate solution, sometimes also referred to as a new law step-up).

Current law step-up (disclosure in tax balance)
The current law step-up serves the effective (essentially tax-free) disclosure of the hidden reserves and/or goodwill formed under privileged taxation in the tax balance sheet. Subsequently, the assets revalued in this way or the taxed hidden reserves can be depreciated and the taxable profit reduced accordingly in the subsequent tax periods. The cantonal rules or the depreciation rates published by the Swiss Federal Tax Administration apply, respectively. The introduction of the current law step-up is not mandatory for the cantons.

Special tax rate
With the special tax rate, the portion of the profit that is based on the realization of hidden reserves existing when the tax reform came into force, including goodwill created by the company itself, is taxed separately in the following five years to the extent that these reserves were not previously subject to taxation. Companies can therefore still benefit from a lower tax rate for a maximum of five years. The special tax rate solution is mandatory for the cantons, which are responsible for determining the rate to be applied.

Relief on capital taxes

With the abolition of privileged tax statuses, the currently valid reduced capital tax rates will also be abolished. For this reason, the cantons can introduce relief on capital taxes. Such relief may be applied to equity that is attributable to participations, patents and similar rights as well as intercompany loans.

Notional interest deduction (NID)

The notional interest deduction (NID) is a measure intended only for "high-tax" cantons and will probably only apply in the canton of Zurich. The measure will be limited to cantonal and communal taxes.

A notional interest deduction is granted on safety equity, i.e. the equity which in the long term exceeds the average equity required for business operations. Companies with an above-average equity ratio may thus benefit from the NID. The safety equity is calculated by deducting the core capital from the effectively available equity (NID only applies if there is a surplus). The core capital is calculated by multiplying the assets by a capital adequacy rate. These capital adequacy rates are defined in an ordinance. The NID cannot be applied to participations, non-operating assets, goodwill from the disclosure of hidden reserves or assets created for the purpose of benefitting from unjustified tax benefits.

The applicable interest rate will be based on the yield on ten-year Swiss federal bonds. To the extent that safety equity is proportionately attributable to receivables of all kinds from related parties, a higher arm's length interest rate may be applied (so-called margin taxation).

Additional R&D deduction

To promote R&D, cantons may grant additional deductions for R&D expenses (in addition to expenses incurred, which may be deducted as business expenses). The exact amount of the deductions is at the discretion of the cantons, but is limited to 50%. R&D expenses are taken into account if they were incurred directly by the taxpayer or indirectly by third parties in Switzerland. In the case of own expenditure, the personnel expenditure plus a surcharge of 35% is decisive. In the case of indirect R&D expenditure, 80% of the invoiced costs.

The additional R&D deduction is only intended for cantonal and communal taxes and depends on the voluntary transposition into cantonal law.

Overall limitation of measures

Although the (new) measures may be applied in combination, the tax reform provides for minimum taxation of 30%. The patent box, the additional R&D deduction, the NID and depreciation in connection with a step-up (current law step-up) may reduce the profit (before deduction of these measures, before loss carryforwards and excluding net participation income) by a maximum of 70%. The cantons have the option of providing for a higher minimum taxation when transposing these measures into cantonal law. Surpluses resulting from this restriction cannot be carried forward. Certain details of this relief limit are currently still unclear and need to be defined by the authorities within the framework of implementing provisions. The relief limit could, for example, be calculated as follows:

Profit according to income statement	CHF	50,000
Thereof net participation income	CHF	8,000
Relevant basis*	CHF	42,000*
Additional R&D deduction	CHF	10,000
Notional interest deduction	CHF	3,000
Patent box deduction	CHF	15,000
Step-up depreciation	CHF	10,000
Total deductions	CHF	38,000
Profit after deductions*	CHF	4,000*
Maximum permitted deductions (70% of relevant basis)*	CHF	29,400
Deduction surplus (to be added back)	CHF	8,600
Minimum profit (30% of relevant basis)*	CHF	12,600*
Net participation income	CHF	8,000
Taxable profit before loss carryforwards	CHF	20,600
Loss carryforwards from previous years	CHF	10,000
Taxable profit (before participation exemption)	CHF	10,600

* Excluding net participation income

Amendment of the capital contribution principle

The capital contribution principle is to be restricted for companies listed on Swiss stock exchanges. A repayment rule and a partial liquidation rule should be applied, taking into account the principle of proportionality. According to the repayment rule, a company may only distribute tax-free capital contribution reserves if taxable dividends of the same amount are distributed. Otherwise, the repayment is taxable to the corresponding extent, but at most to the extent of the other distributable reserves under commercial law.
The same applies mutatis mutandis to the issue of bonus shares and bonus increases in the par value of shares from capital contribution reserves. According to the partial liquidation rule, at least half of the liquidation surplus should be charged to the capital contribution reserves in the case of share buybacks. Exempted from the repayment rule are reserves from capital contributions created after 24 February 2008 (public vote on the capital contribution principle) in the context of a relocation (or transfer of assets) to Switzerland or a cross-border contribution to a Swiss company (including cross-border mergers and restructurings), as well as capital contribution reserves in the event of the liquidation or – for withholding tax purposes – transfer of the domicile abroad of corporations and cooperatives.

Patent box

Income from patents and similar rights, provided they have a relevant connection to Switzerland, is included to a reduced extent in the tax base. A maximum reduction of 90% is provided for, with the cantons being able to decide on a smaller reduction. The patent box covers patents, protection certificates under the Patent Act, topographies under the Topographies Act, plant varieties under the Plant Variety Protection Act, documents protected under the Therapeutic Products Act, reports protected under the Plant Protection Products Ordinance and the corresponding foreign rights. Software is also covered if it is part of a patented invention (computer-implemented invention) or if it is patented abroad.
For the corresponding connection, the focus is on whether the patents and comparable rights are related to qualifying R&D expenses (compared to total R&D expenses; modified nexus approach), i.e. only the income that is related to corresponding qualifying R&D expenses is considered eligible box income. The patent box will only be applied at the level of cantonal and communal taxes; its introduction is mandatory for the cantons.

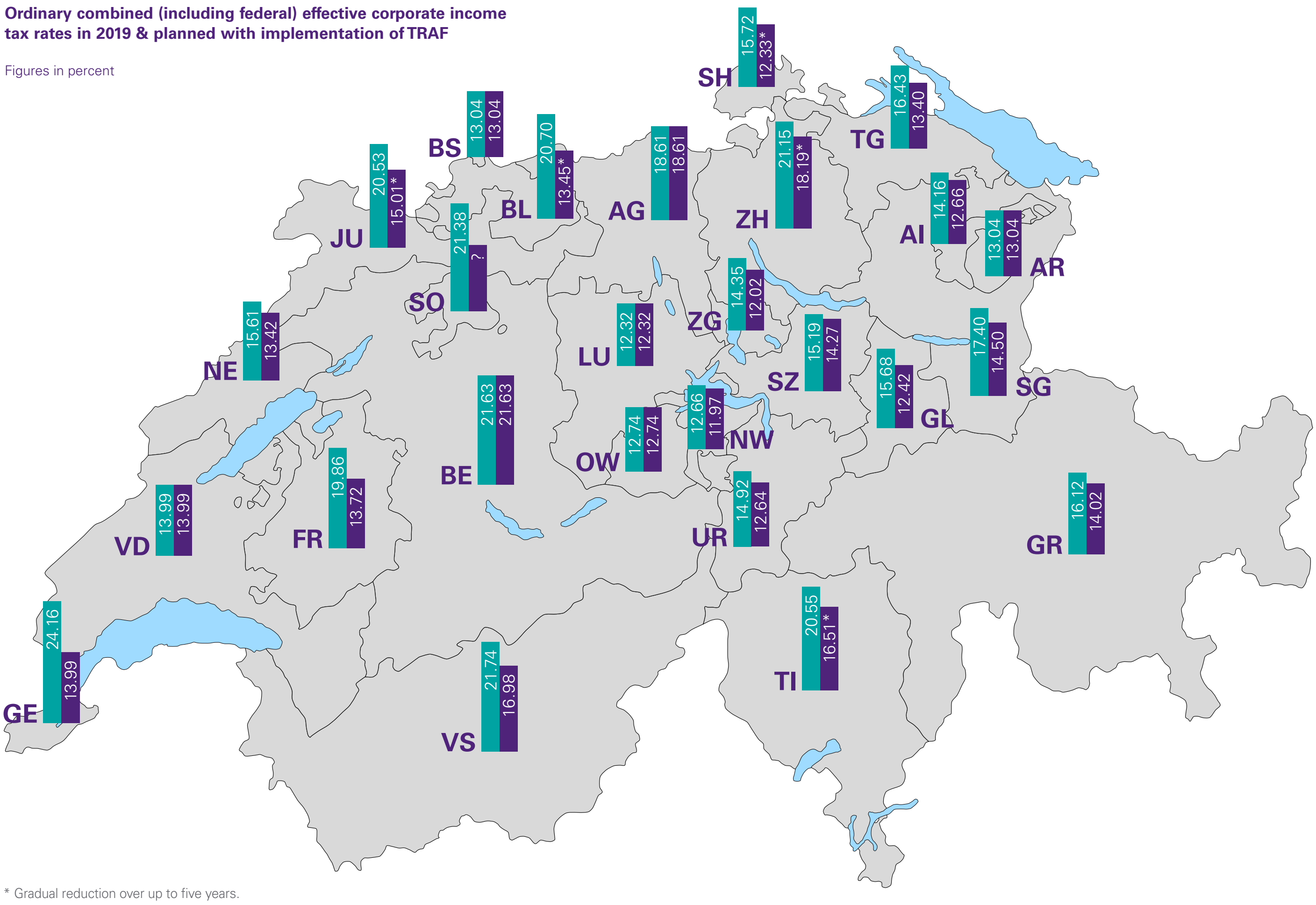
What future tax rate can I expect in my canton?

Corporate tax rate reductions at cantonal level

In addition to the measures provided in the tax reform, the cantons can reduce their ordinary corporate tax rates. Some cantons have already approved the ordinary corporate tax rate they are planning on implementation of the tax reform.

Ordinary combined (including federal) effective corporate income tax rates in 2019 & planned with implementation of TRAF

Figures in percent



* Gradual reduction over up to five years.
Note: Maximum effective pre-tax rate for federal government/canton/municipality for the respective cantonal capital. Tax rates as end of April 2019.
Source: KPMG.

Our offering - TRAF tax reform

	Service	Deliverable	Price
Focus workshop	– Workshop at your business premises (max. 3 hours) with two of our Tax specialists for a reduced fixed fee – Perform analysis based on essential facts established in advance: tax status, identification of privileged income streams, notional quantification of anticipated additional tax burden – Outline planning options and next steps	Brief memorandum (max. 2 sides) with selected focus areas	Fixed fee
Presentation for the board of directors	– Present relevant changes to the board of directors – Provide level of detail as required (before or after further analysis; see below)	Presentation on site	Standard rates
Transitional measures (step-up)	– Perform initial impact analysis with respect to transitional measures – Value existing hidden reserves/goodwill applying a generally accepted valuation method – Perform a detailed calculation/simulation to weigh up the two options provided under transitional measures – Communicate with the relevant tax authorities, including obtaining rulings	Detailed report, depending on scope	Standard rates
Patent box	– Identify qualifying rights – Calculate/simulate expected effect (cost-benefit analysis) – Support the process of defining boxes and adjust financial reporting to simplify application – Assist with calculation and implementation, including documentation duties	Detailed report, depending on scope	Standard rates
Additional R&D deduction	– Identify qualifying R&D expenses – Calculate/simulate expected impact – Assist with processing and presenting relevant information and costs	Detailed report, depending on scope	Standard rates
Notional interest deduction (NID)	– Assess applicability of the measure – Calculate/simulate expected impact	Detailed report, depending on scope	Standard rates
Overall limitation of measures	– Assess applicability of the measure – Calculate/simulate expected impact – Identify and evaluate any optimization measures	Detailed report, depending on scope	Standard rates
Relief on capital taxes	– Identify assets that qualify for the rule – Calculate/simulate expected impact – Identify and evaluate any optimization measures	Detailed report, depending on scope	Standard rates
Amendment of the capital contribution principle	– Assist with identification and disclosure of exempt reserves – Support with planning capital repayments and cross-border restructuring	Detailed report, depending on scope	Standard rates

Contacts

KPMG AG
Badenerstrasse 172
PO Box
CH-8036 Zurich

kpmg.ch/traf

Zurich and Ticino Region
Stefan Kuhn
Badenerstrasse 172
CH-8036 Zurich
T: +41 58 249 54 14

Basel Region
Reiner Denner
Viaduktstrasse 42
CH-4002 Basel
T: +41 58 249 42 40

Bern-Mittelland Region
Frank Roth
Hofgut
CH-3073 Gümligen-Bern
T: +41 58 249 58 92

Central Switzerland Region
Markus Vogel
Landis + Gyr-Strasse 1
CH-6301 Zug
T: +41 58 249 49 64

Eastern Switzerland Region
Peter Michael
Bogenstrasse 7
CH-9001 St. Gallen
T: +41 58 249 25 54

Western Switzerland Region
Janick Pochon
Avenue du Théâtre 1
CH-1002 Lausanne
T: +41 58 249 46 45

kpmg.ch/socialmedia