12. Switzerland's III Corporate Tax Reform - The Current State of Affairs on the Proposed Fiscal Measures

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Introduction

On June 5, 2015, the dispatch on Switzerland's corporate tax reform (USR/RIE III) was adopted by the Federal Council and was submitted to the Parliament. The reform, which is intended to maintain and strengthen Switzerland's attractiveness as a business location, is in particular intended to serve as a response to the suppression of cantonal privileged tax regimes which are no longer in line with OECD and EU standards. As discussed in an expert opinion prepared for the Federal Council, the fiscal measures proposed by the dispatch of June 5, 2015 are in our opinion compatible with Swiss constitutional law[1]. Since then the reform has, however, been successively discussed by the Council of States and the National Council and some changes to the draft of the Federal Council are being proposed. At the time of the preparation of this article, divergences still exist between the two Chambers and these divergences will first be examined by the Council of States on May 30, 2016.

The present contribution offers an overview of the current state of affairs with respect to the fiscal measures of the reform. In essence, the fiscal measures contemplated by the third corporate tax reform may be broken down into three main categories: (A) so-called tax coherence measures, (B) measures favoring R&D activities, and (C) financing activities. In addition, a rule limiting the effects of these incentives on the global tax liability («Entlastungsbegrenzung») is being considered. Finally, a tonnage tax in favor of the maritime sector is also discussed.

Tax Coherence Measures

The first set of measures is designed to improve the general coherence of the Swiss corporate tax system. Accor-dingly, the reform contemplates the possibility for companies migrating to Switzerland (or transferring assets or functions thereto) to step-up their assets at fair market value (including goodwill) at the beginning of their tax liability in Switzerland[2]. This «step-up» mechanism, which is in paricular applied by several EU jurisidictions, is justified for three main reasons. First of all, it avoids risks of double taxation as hidden reserves and goodwill created abroad are often subject to an exit tax when migrating to Switzerland. Secondly, the measure is coherent as in the reverse case, that is upon emigration out of Switzerland, an exit is levied. Thirdly, the abolition of cantonal tax regimes, respectively the entry into the ordinary tax liability, raises a similar problem as the hidden reserves created in the tax privileged environment then become fully taxable. For this latter situation, the cantons would be able to tax the hidden reserves and goodwill generated during the privileged regime at a separate (reduced) tax rate within five years[3].

Another measure, which may be justified from a systematic point of view, is the possibility for the cantons to reduce capital tax levied on equity pertaining to participations. This measure, which mirrors the participation deduction already applicable to income stemming from qualified shareholdings, is intended to avoid a multiple economic capital taxation of particpations.

Measures Favoring R&D Activities

The second set of measures are those designed to promote R&D activities and innovation in Switzerland[4]. The reform contemplates the introduction of a patent box regime in line with the so-called «modified nexus approach» adopted by the OECD[5]. The need to adopt this measure is indisputed. At the time of writing, some divergences remain between Council of States and the National Council. The draft presented by the Federal Council indeed provides for a maximum 90% reduction on IP income, which the National Council is in favor of suppressing.

With regard to MNEs, the most important effect of the nexus approach relates to the fact that expenses linked to related party outsourcing of R&D functions, for example, on the basis of contract R&D, are, as a matter of principle, not taken into consideration[6]. As a result, certain IP structures will have to be reorganized and an increased centralization of R&D functions is likely to take place. In addition, in line with the nexus approach, costs relating to acquired IP will also be excluded from the definition of qualifying expenses. The agreed consensus, however, refines the nexus approach by allowing an uplift of qualifying expenditures where related party outsourcing and/or acquisition costs are incurred. In other words, the exclusion of expenses linked to outsourcing and acquisition costs is slightly relaxed in the sense that companies would be able to claim a maximum 30% uplift of their qualifying expenditure, subject to a cap based on actual expenditure[7].

From this perspective, Switzerland, which is heading in the direction of having general moderate corporate income tax rates, will be in a better position than certain high tax jurisdictions. Indeed, in Switzerland, any portion of IP income not falling within the scope of the patent box (for example because of outsourcing costs) would still remain subject to a fairly moderate rate to this extent this IP income is allocated to the Swiss entity under transfer pricing rules[8].

In our opinion, the centralization of R&D functions produced by BEPS is also an opportunity for Switzerland. To that end, as we have argued from the very beginning of the reform[9], the patent box should be coupled with a so-called input incentive designed to lower the cost of R&D in Switzerland. The Federal Council also endorses this view. Therefore, the reform would grant the cantons the possibility to allow an enhanced deduction of R&D expenditures[10]. Under the proposal of the Federal Council, accepted at this point by the Council of States in December 2015, the incentive would, however, be limited to R&D activities exercised in Switzerland (territorial restriction). In March 2016, the National Council, on the other hand, voted in favor of an extension of the incentive to foreign R&D activities. This extension is, however, firmly rejected by the Parliamentary Commission of the Council of States as well as by the cantonal Finance Directors.

As we have argued, the unlimited extension by Switzerland of its input incentive to foreign R&D activities would be problematic from a constitutional point of view, in light of the principle of equality of treatment. It is indeed beyond that, from the perspective of the objective pursued and the positive spill over effects, a company conducting its R&D ac-

tivities abroad is not in a comparable position as the company exercising the same activities in Switzerland. A reasonable compromise (and acceptable in our view from a constitutional point of view) would be to allow foreign R&D activities to be taken into account on a limited basis. As for the patent box regime and in line with OECD standards, this could be achieved by allowing an uplift of Swiss R&D expenditures in the case of foreign contract R&D[11]. For the time being, however, the Parliamentary Commission of the Council of States as well as the cantonal Finance Directors support a strict territorial restriction.

Measures Favoring Financing Activities

The draft proposed by the Federal Council did not include a so-called "notional interest deduction" (NID). Yet, the National Council decided to adopt this measure. The Parliamentary Commission of the Council of States, on the other hand, only supports this measure provided that dividends received by individual shareholders from qualifying participations are at least taxed at 60% at the cantonal level.

Another measure designed to support financing activities, which was favored by both the National Council and the Parliamentary Commission of the Council of States, is the introduction of a reduction of capital tax concerning debt claims pertaining to intra-group loans[12].

Tonnage Tax Favoring the Maritime Sector

The draft presented by the Federal Council to Parliament did not include a so-called « tonnage tax » in favor of the maritime sector. It was indeed found that the introduction of a tonnage tax regime in Swiss law would be problematic from a constitutional point of view[13]. Though applied by several States, the tonnage tax is nevertheless a subsidy in favor of a particular sector. Accordingly, within the European Union, the tonnage regime is characterized as a State aid and must be approved by the European Commission pursuant to its guidelines on maritime subsidies[14].

The introduction of a tonnage tax regime in Swiss law would in our view constitute an exception to the principle of equality of taxation to favor a particular sector[15]. The same view is also shared by the German Bundesfinanzhof which considers the tonnage tax as a «grundsätzlich gleichheitswidrige Steuerbegünstigung»[16]. Accordingly, the adoption of a tonnage tax by Switzerland could in our opinion only be founded on art. 103 of the Constitution (structural aid) and provided that the conditions mentioned by this provision are met[17].

In March 2016, the National Council adopted the tonnage tax[18]. Because of these constitutional reservations, the Parliamentary Commission of the Council of States, on the other hand, decided that this measure should form part of a separate package and the possibility to apply the foregoing constitutional basis in casu should be further examined. This position also corresponds to the one dedended by the cantonal Finance Directors.

1) Robert Danon, Avis de droit sur la constitutionnalité des mesures fiscales proposées par la troisième réforme de l'imposition des entreprises (RIE III), 3 juin 2015, available on the website of the Federal Department : https://biblio.parlament.ch/e-docs/383599.pdf (hereafter: Robert Danon, Avis de droit)
2) Art. 61a P-LIFD (Direct Federal Tax Act) and 24b P-LHID (Federal Act on Harmonisation of Direct Taxes)
3) As regards to international acceptance of this measure in the framework of cantonal privileged tax regimes, see Robert Danon, La conformité internationale du mécanisme du step-up, in IFF Forum für Steuerrecht, 1/2015, p. 3
4) As regards to international acceptance of this measure in the framework of cantonal privileged tax regimes, see Robert Danon, La conformité internationale du mécanisme du step-up, in IFF Forum für Steuerrecht, 1/2015, p. 3
5) Art. 24a P-LHID
6) Unlike EU jurisdictions Switzerland may however extend the patent box to domestic related party outsourcing (territorial approach)
7) Robert Danon/Christoph Schelling, Switzerland in a post-BEPS world in Bulletin for international taxation, 2015, p. 203
8) See thereupon BEPS action N 8
9) Robert Danon, La refonte de la fiscalité internationale des entreprises: Analyse des possibles incidences pour la Suisse au regard de questions choisies, in: IFF Forum für Steuerrecht, 4/2014, p. 58; Robert Danon, Avis de droit, pp. 300 et seq
10) Art. 25a P-LHID
11) See Robert Danon, La troisième réforme de l'imposition des entreprises, p. 276
12) See, for the constitutionality of such a measure, Robert Danon, Avis de droit, pp. 68 et seq
13) See Robert Danon, Avis de droit, pp. 131 et seq
14) See Robert Danon, La taxe au tonnage: Conformité internationale et constitutionnalité en droit suisse, in: IFF Forum für Steuerrecht, 1/2016, pp. 283 et seq (hereafter: Robert Danon, La taxe au tonnage)
15) See Robert Danon, La taxe au tonnage, p. 289
16) See Robert Danon, La taxe au tonnage, p. 287 ; Robert Danon, Avis de droit, p. 134
17) See Robert Danon, La taxe au tonnage, p. 300 ; Robert Danon, Avis de droit, pp. 146 et seq
18 Art. 49(4) P-LIFD and 20(3) P-LHID

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