11. Reforming Corporate Tax in Switzerland - Tax Proposal 17

Yvan Mollier, General Mills, Nyon
Dr. Markus Frank Huber, EY Switzerland, Geneva

Introduction

Besides the United States' ("US") presidential elections, one topic kept the Swiss corporate landscape particularly busy in 2016: The proposed Corporate Tax Reform III ("CTR III")[1).

The reform was designed to address international criticism levied by the Organization for Economic Cooperation and Development ("OECD") and the European Union ("EU") whilst maintaining and strengthening Switzerland as an attractive business location.

However, in a referendum on February 12, 2017, Swiss voters decided against the legislative proposal. An analysis of the vote indicates that the majority of the voters were uncertain about the consequences entailed by CTR III and voted in favor of the status quo.

The Federal Department of Finance is expected to inform about the cornerstones of an adjusted proposal – the so-called "tax proposal 17" – in June 2017. These cornerstones are currently discussed and developed by different stakeholders. As expressed by the Federal Council, it is imperative that a solution will be found to overcome the current reform gridlock.

This contribution first provides a short summary of the events leading to the CTR III proposal and then addresses the consequences of the referendum and the implications for proposal 17 – taking into account the legislative developments in the US and the EU.

Events Leading to the CTR III Proposal

Switzerland provides special corporate tax regimes for companies operating mainly abroad. Although the OECD criticized these privileges already in the 90s, international pressure increased after 2013 under the influence of the G20[2).

In addition, in 2005 the mentioned regime came under attack by the EU. In the view of the European Commission, these tax regimes constituted an infringement of the Swiss-EU Free Trade Agreement of 1972 ("FTA").

The European Commission concluded that the tax treatment of these companies amounted to state aid, which would be incompatible with Art. 23 (1) (iii) FTA. However, it was the position of Switzerland that tax matters were not covered by the FTA[3). After a decade of disagreement between Switzerland and the EU on the topic, a memorandum of understanding was signed in 2014 expressing the joint statement of Switzerland and the EU to overcome their differences in relation to corporate taxation[4).

Addressing the international critique, the major objective of CTR III was to replace the criticized tax regimes with solutions strengthening the attractiveness of the Swiss market place in particular for internationally mobile activities. With the rejection of CTR III and the commitment to abolish the mentioned regime, the Swiss law maker is more or less back to square one.

Consequences of the Referendum and Proposal 17

The legal uncertainty provoked by the critique raised by the OECD and the EU and the rejection of CTR III could have certain negative impacts on the Swiss market place in the mid-term. It may be considered likely that new investment into Switzerland may be delayed as a reaction to this legal uncertainty.

One may not expect any immediate exodus of companies out of Switzerland. After all, with the rejection of CTR III the mentioned regimes are still in force and the legal landscape has not changed yet – albeit that change is inescapable in light of the international criticism outlined above.

It is expected that proposal 17 may comprise a patent box solution as well as a form of Research & Development ("R&D") super deduction at the cantonal level. At the same time, the proposal may potentially abstain from notional interest deduction at the federal level, which was politically controversial during the discussions around CTR III. However, it should be noted that according to latest information available it seems that the tough fronts have softened up and it remains to be seen as to whether the proposal 17 may still comprise the notional interest deduction.

In addition, it should be noted that under current law if special regimes are phased out, taxpayers may step-up the assets to fair-market value and amortize those assets over a certain period of time. Alternatively, under CTR III the taxpayer had the choice of invoking the two-tax rate system[5). It should be noted that the step-up model has been confirmed by numerous court decisions under the current system[6). Therefore, it should be expected that the models should be available under proposal 17.

In the course of the discussion regarding CTR III, most Swiss cantons indicated that they may reduce the overall effective tax rates down to 18% to 12%.

International Developments

The OECD Base Erosion and Profit Shifting ("BEPS") project accelerated the worldwide convergence process of the tax assessment basis. R&D super deductions or the patent box so far are instruments generally accepted by the international community.

Regarding reform projects in other states, it is interesting to see how the US and the EU, both major political powers within the OECD, currently intend to adapt their respective tax laws for the future.

US

At this moment it is hard to say anything with certainty about future US tax legislation reforms. Nevertheless, the Republican blueprint, which has been released in June 2016, and the proposal outlined by President Trump on April 26, 2017 already may provide direction as to what the US corporate tax reform may look like[7).

The centerpiece of the House's blueprint and of the announcements made by President Trump is a *corporate tax rate reduction* from currently *35%* to about *20%* to *15%* respectively. Both advocate the adoption of a territorial tax system, which would typically exclude most or all of the income that businesses earn outside of the US[8].

As the US is currently one of the countries with the highest corporate tax rate, the proposed reduction and change to a territorial tax system could effectively strengthen the market place. As a result, US based groups might review their strategy as regards investment with respect to low tax countries (amongst them Switzerland).

The blueprint supports the idea of a border-adjustable tax. A *border-adjustable tax* would exempt exports and tax imports within the context of a new destination-based cash flow business tax system. Both further propose a one-time *repatriation tax* on overseas corporate profits.

In short, the US tax reform as currently discussed may incentivize US multinational companies to relocate some business to the US.

EU

In October 2016, the European Commission proposed a relaunch of the common consolidated corporate tax base. In addition, the European Commission proposes to directly incentivize R&D activities of multinational companies by way of a super deduction on such expenditure.

Companies would be entitled to a yearly super-deduction of 150% on their R&D expenditure. To the extent that R&D expenditure reaches beyond MEUR 20, companies would even be entitled to an additional super-deduction of 25% of the exceeding amount[9].

A centerpiece of the European Commission's proposal is an allowance for growth and investment that provides for a tax deduction for ten years based on a percentage of the increase in a company's equity. An equity decrease would be taxable on the same basis[10]. The concept resembles the notional interest deduction, which has been provided for by CTR III.

Policy Implications

Again, as with CTR III, the selection of tax instruments within the tax proposal 17 should reflect the respective developments in the OECD and the EU. Thereby one may safeguard that a globally accepted and competitive solution is chosen that may provide a level of certainty over the next few years.

In this context it should be assessed whether a new law that only lays down the bare essentials of a reform could be the best option since the range of acceptable instruments is constantly changing. This would allow the stakeholders (e.g. the Swiss Federal Department of Finance, the industry, etc.) to more flexibly adjust the legal framework to future international developments. Thereby, Switzerland could avoid that kind of harmful legal uncertainty it is observing at the moment.

The substantial reduction of overall effective tax rates in most cantons described above coupled with additional globally accepted measures is in light of global developments the direction to go. It sends the right signals to foreign investors and companies currently subject to Swiss special tax regimes. However, all stakeholders need to be prepared to clearly communicate to the Swiss voters what impact tax proposal 17 may have on the budget of the different levels of governmental bodies.

In any case, the most important task at this moment is to come up with a new law as soon as possible to create tax stability for the future and at the same time foster Switzerland's position as an attractive business location for multinational companies.

The legal uncertainty of today creates a competitive disadvantage for Switzerland as a market place and may provide Switzerland's competitors with arguments as to why preference should be given to their location. Therefore, it is imperative that the international community is getting the signal that Tax Proposal 17 is quickly moving into the right direction.

1) Cf. in the previous edition of this yearbook: Robert J. Danon, Switzerland's Corporate Tax Reform – The Current State of Affairs and the Proposed Fiscal Measures, in: Swiss-American Chamber of Commerce, Yearbook 2016/2017, pp. 61-62.
2) OECD, Harmful Tax Competition – An Emerging Global Issue, Paris: OECD Publications 1998, §§ 57 et seq.; Markus Frank Huber/Svetlana Isaenko, The Swiss Answer to BEPS (Part I), in: Swiss-American Chamber of Commerce, Yearbook 2016/2017, pp. 61-62, p. 61.
3) Christa Tobler, State Aid Under Swiss-EU Bilateral Law: The Example of Company Taxation, in: Bulterman, Hancher, McDonnell and Sevenster (eds), Views of European Law from the Mountain, Liber Amicorum Piet Jan Slot, Austin/Boston/Chicago/New York/The Netherlands: Wolters Kluwer, Law & Business 2009, pp. 195-205, p. 196.
4) Swiss Federal Council/EU Commission, Joint statement of 14 October 2014, available at: https://www.newsd.admin.ch/newsd/message/attachments/36882.pdf.
5) Laurenz Schneider, Armin Marti, Remo Küttel, Aufdeckung stiller Reserven infolge Wegfalls von Art. 28 Abs. 2-4 StHG, in: Expert Focus 11/15, pp. 936-942, p. 939; Laurenz Schneider, Armin Marti, Remo Küttel, Aufdeckung stiller Reserven infolge Wegfalls von Art. 28 Abs. 2-4 StHG (2. Teil), in: Expert Focus 12/15, pp. 1049-1057, p. 1049 et seq.
6) Cf. decisions of the Swiss Federal Supreme Court of February 18, 2014 (2C_842/2013).and 12 March 2012 (2C_645/2011).
7) With regard to the blueprint please see: Ways and Means Committee, US House of Representatives, A Better Way: Our Vision for a Confident America—Tax (24 June 2016), Washington: 2016, available at: http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.
8) The House's blueprint intends to lower the corporate tax rate to a flat rate of 20%. The White House' 2017 Tax Reform for Economic Growth and American Jobs issued on 26 April 2017 advocates a reduction down to 15%. See The White House' 2017 Tax Reform for Economic Growth and American Jobs issued on 26 April 2017 and the House's blueprint on p. 28.
9) See Art. 9 (3) of the proposal for a Council directive on a common corporate tax base {SWD (2016) 341}.
10) See Art. 11 (4) of the proposal.

About the authors:

Yvan Mollier is Chief of Tax at General Mills in Nyon. He is a member with the Tax Chapter Board of the Swiss-American Chamber of Commerce.

Dr. Markus Frank Huber is Partner, International Tax Services at EY in Geneva. He is a member with the Tax Chapter Board of the Swiss-American Chamber of Commerce.

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