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NEWSLETTER

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# Small business friendly and useful for all Swiss companies

Dear Sir or Madam,

Over the last few years Switzerland has been undertaking major reforms of its business corporate tax laws. With the Corporate Tax Reform I in 1998 special tariffs for holding, domiciliary and mixed companies were harmonised, and a participation exemption was introduced on federal level. At the forefront of the Corporate Tax Reform II 2008 stood the attractiveness of location for major companies and the reduction of the economic double burden regarding taxation for legal entities and corporations. This year, Swiss voters will be deciding about the Corporate Tax Reform III.

**Switzerland – EU**
The trigger for this was the conflict between Switzerland and the European Union (EU) about the privileged taxation of companies (holding companies, domiciliary companies and mixed companies). At the centre of international criticism was also the so-called principal company status with specific regulations for international tax allocation which as a result actually led to low taxation in Switzerland as well. And finally, Corporate Tax Reform I will be revoked by Corporate Tax Reform III.

With its clean money strategy the Federal Government has radically transformed the tax environment and the banking environment. While Switzerland had handled an estimated two-thirds of all dirty money assets all over the globe until the turn of the millennium now the banks have been freed of it and have become leading examples. Opening an account has become tortuous, and it is nearly impossible to deposit large sums of cash. While the USA made Switzerland bleed heavily for accepting dirty money from US clients, they have no problem doing the same kind of business with Latin American clients. What had been worded as an impressive demand turned out to be nothing more than a war about market segments.

In 2014 Switzerland was able to settle the tax dispute with the EU by agreeing to abolish those previously mentioned privileged taxation models while the EU was simultaneously willing to abandon counter measures. As a consequence the aim of the Corporate Tax Reform III now is to consolidate the international acceptance of Switzerland as a company location and to secure the statutory framework for companies. Particularly those tax statuses for holding, domiciliary and mixed companies will be abolished which, having been enshrined in the Tax Harmonisation Act and in the cantonal tax laws, are not in compliance with international standards.

What had been a necessary consequence of the clean money strategy for individuals now needs of course to be adjusted for legal entities. The privileged taxation of companies that are predominantly foreign owned leads to Switzerland becoming an attractive location for many companies. As a consequence, numerous companies decided to move to Switzerland, and in combination with legal and attractive tax rulings they managed to stimulate Switzerland, by way of job creation and with increased tax revenues. The tax income via these status companies (i.e. tax privileged companies) are in several cantons higher than the tax revenue coming from ordinarily taxed companies. Subsequently abolition of these tax privileges, as has been demanded by the EU, will become a rather delicate issue. Thus far, tax privileged companies could decide to move out of Switzerland if they are not offered new attractive regulations.

Switzerland is not alone in this respect; internationally, around 40 tax models have been abolished, 5 of which in Switzerland. As a result of these changes, not only Switzerland will be required to offer attractive solutions, but all countries need to adapt. Should Switzerland miss its target to be an attractive tax location, then tax revenues will go down.

The current solution primarily stipulates a reduction in tax rates at federal and cantonal level and for every company, whereas status companies will be losing their privileged taxation. The winners will be long-established Swiss companies. The losers, to some extent, will be status companies; however, based on the reform, they should still be able to profit from an attractive solution. A comparison with the situation abroad can be quickly performed. There are signs that many companies can live with the new status. Thus the main winners will be long-established small and medium-sized enterprises!

**The significant elements of the reform**

Without going into too much tax-technical detail, the most significant elements of the tax reform are as follows:

- Capital tax will be reduced by lowering the capital tax rate
- Capital tax will be reduced by lowering the assessment basis (capital tax participation exemption)
- Profit tax rate will be lowered (BS from 22% to 13%)
- Introduction of an equity capital interest deduction
- Revenues from patents will be taxed at lower rates
- Tax reduction on innovations (input promotion)

All companies in Switzerland previously taxed “normally” will profit from this reform.

**No future without reform**

There is no alternative to Corporate Tax Reform III. Should the Swiss voters reject it, the legislators will be obliged to abolish the separate taxation of status companies. These will then be subject to normal taxation. As a consequence, many of them will then leave Switzerland in favour of countries with more favourable tax models. Other countries also have introduced the patent box and many other measures. As a consequence, Switzerland will then lose quite a substantial amount of tax revenue. It does not look very likely that this can be compensated for by the currently existing taxation.

One of the possible consequences could be a general tax increase without any additional state service provision. Forecasts about tax volume should Corporate Tax Reform III be accepted are difficult. There will be a decline in tax revenue from "normal" companies, with an increase in tax revenue from status companies on the other hand. The calculation models by various cantons are showing a vastly differing picture, with an overall tendency towards bearable tax deficits. Compared to that, the calculation models show a rather bleak picture with the exodus of the status companies.

Kind regards
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