Swiss Tax Reform (TRAF)

Overview of elements, implementation and impact
Status as of November 2019

Here with you today

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Content

Main reason of the reform:

Tax privileges to be abolished

Current tax privileges and effective tax rates

1	2	3	4
Holding company regime: 7.83%	Mixed / Auxiliary Company regime: 8.3 – 12%	Principal Company practice: 5 – 9%	Finance branch practice: 1 – 2%

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Swiss Tax Reform (TRAF): Elements and timing

Goals of the reform

Public tax revenues

Attractiveness

International acceptance

Overview of measures

Abolishment of tax regimes

- Abolishment of privileged tax regimes (e.g. holdings, mixed companies, etc.)
- Introduction of transitional measures

Patent box

- Reduced cantonal taxation of profits from patents
- At least 10% of those profits are taxable

Additional R&D deductions

- Additional deduction of R&D expenses (up to 50%)
- Promoting R&D in CH

Notional interest deduction

NID

- Notional interest deduction on equity
- Only applicable for cantons with high tax rates (e.g. Zurich)

Overall limitation

- The benefits from certain measures are limited at 70%.
- Ensuring minimal taxation

Reduction of cantonal tax rates

- General reduction of cantonal income tax rates announced
- Ensuring attractiveness of individual locations

Other fiscal measures

- Relief on capital taxes
- Step-up upon relocation to Switzerland
- Lump-sum tax credit for Swiss branches of foreign companies
- Increase of dividend taxation for individuals for qualifying investments (federal level: 70%; cantonal level min. 50%)
- Amendment of capital contribution principle (for companies quoted on a Swiss stock exchange)
- Other measures

Other measures

- Increase of canton's share of direct federal tax – support general reduction of income tax rates in the cantons
- Adjustments in the fiscal equalization
- Social compensation through additional funding of the old age and survivors insurance (AHV)

Social compensation through AHV

- Main difference of TRAF compared to earlier denied corporate tax reform III
- Additional funding of the AHV of CHF 2.1 billion per year
- In particular, additional salary contributions / deductions of 0.15% for employer and employees

Increase of AHV contribution rates as of 1 January 2020

- Adjustment of salary payments (net salaries)
- Adjustment of payroll accounting / salary statements

Timeline

1 January 2019:
Entry into force of the reform ***special tax rate*** in the cantons Basel-Stadt

19 May 2019
Federal public vote

September 2019
Cantonal public vote
e.g. in Zurich and Obwalden

November 2019
Cantonal public vote Basel-Land

1 January 2020:
Entry into force of the reform at federal level

2019

2020

1 January 2019:
Entry into force of the ***reduced corporate tax rate*** in the cantons Basel-Stadt and Vaud

5 May 2019
Cantonal public vote
in Glarus

19 May 2019
Cantonal public votes
in Solothurn and Geneva

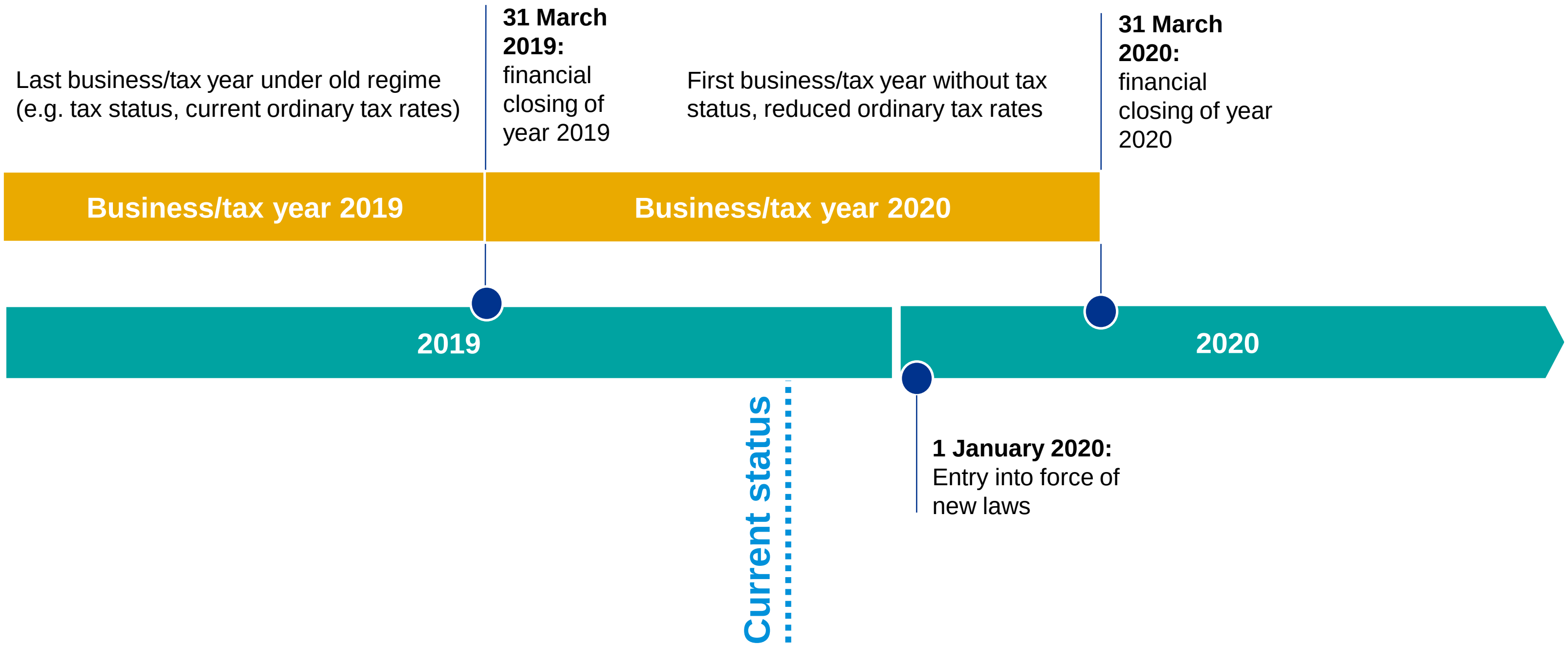
Current status

1 January 2020:
Entry into force of the reform at cantonal level

Timeline (future data according to current estimates)

What if business year ≠ calendar year?

Example financial closing as of 31 March



How could the time of benefitting from the tax regime be extended if the business year ≠ calendar year?

– Potential extension of financial year-end closing to 31 December 2019

– Potential addition of short business year, e.g. 1 April 2019 to 31 December 2019

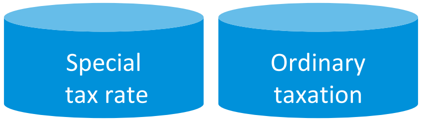
Transitional measures

(change from privileged to ordinary tax status)

Transitional measures for status change

Reason: Taxation of hidden reserves under the tax regime under which they have been created (only relevant on cantonal level)

Transitional measures



Current law Step-up

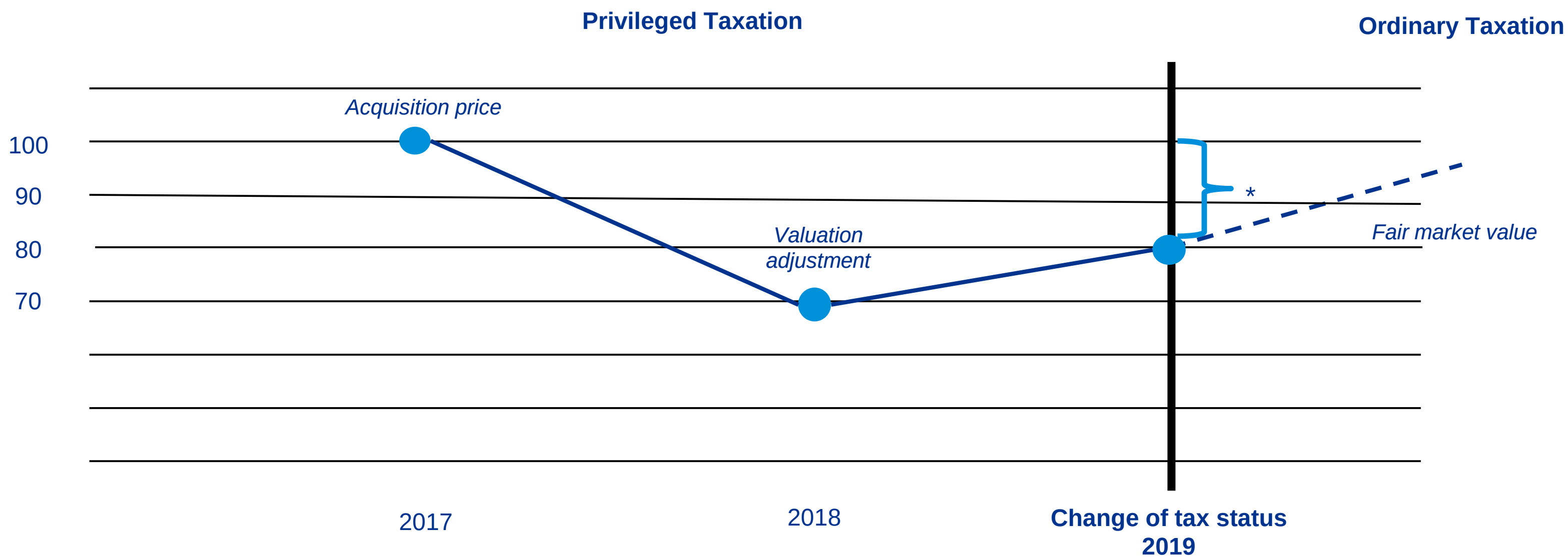
- Revaluation of assets / capitalization of goodwill (in tax balance sheet)
- Amortization over 5-10 years

Special tax rate solution

- Taxation of (a part of) income at a reduced tax rate
- Max. over 5 years

Declaration/request basically in the last tax year before status change (tax return 2019) – potential cantonal differences

Change of status of a holding company



* Difference taxable on federal level but to be exempted at cantonal level

Possible application for reduction of tax acquisition costs for cantonal income tax purposes

Tax accounting impact under IFRS

Tax accounting impact under IFRS

(1/2)

Reduction of cantonal tax rates

Relevant questions:

1. What is the date of the substantive **enactment**?

2. What is the expected **impact** on the **financial statements** (during 2019)?

Possible answers:

1. Substantive enactment of the tax rate reduction is generally at the time of the final decision on the cantonal law (i.e. public vote in most of the cantons or unused expiration of referendum period).

2. The financial statements are expected to be impacted as follows:

   – Revaluation of the deferred tax balances at the period closing following the substantial enactment (e.g. Q2/2019).

   – Potential disclosure as a subsequent event in case of substantive enactment within the sub-sequent event period and if impact to the financial statement would be significant.

Tax accounting impact under IFRS

(2/2)

Abolishment of tax regimes and transitional measures

Relevant questions:

1. What will be the accounting impact of a **current law step-up**?
2. What will be the accounting impact of the transitional measure of **special tax rate solution?**

Possible answers:

1. The step-up for tax purposes creates a tax base and therefore creates a temporary difference. Consequently, a deferred tax asset (or reduction of DTL) needs to be recognized.
2. On purpose, the transitional measure does not indicate a change to the tax balance sheet (no step-up) and therefore no immediate change in temporary differences leading to new deferred tax balances is expected.

   However, there will be an impact on the existing deferred tax balances due to slight change in the applicable tax rate.

Patent box regime

Patent box regime - Overview

Application of the patent box

- Applicable at cantonal level only (mandatory for all cantons), up to 90% relief
- Consideration of modified nexus approach based on R&D expenses incurred → patent box is particularly of interest, if the patent was developed in Switzerland
- Application of patent box is possible from the date of the granting of the patent until the date of its expiration

Qualifying IP

- Patents (Swiss and – if comparable – foreign patents)
- IP similar to patents, i.e.:
  - Supplementary protection certificates
  - Topographies
  - Protected varieties of plants
  - Protected documents according to the Therapeutic Products Act
  - Reports protected by the Ordinance on Plant Protection Products
  - Comparable foreign rights
- Decisive aspect is basically economic / beneficial ownership

Patent box regime - Software

Copyrighted software

- Copyrighted software is not covered by the definition of qualifying IP – hence shall not benefit from the patent box

Cases in which software can qualify for the patent box

- If the software is patented abroad (e.g. US)
- Software which is an integral part of an invention (so called “computerimplemented invention”) which itself – as a whole – is patented

Patent box regime - 4 steps of calculation

Step 1:

Determination of qualifying IP income

Step 2:

Determination of nexus factor

Step 3:

Determination of the scaling factor (depending on canton) and calculation of exempted income

Step 4:

Consideration of overall limitation rule (depending on canton)

Patent box regime - Step 1

Determination of qualifying income

- Direct determination (e.g. external royalty/license income)
- Indirect determination based on residual method (embedded royalties in products), see following example

Residual profit computation from qualifying IP (based on total corporate profit) - simplified example

Total profit

./. Profit from financial activity, real estate, investments

./. Other profit not based on IP / products with IP

ordinary taxation

= Profit from patented products*

./. Embedded trademark fees

./. 6% of product costs (for routine functions)

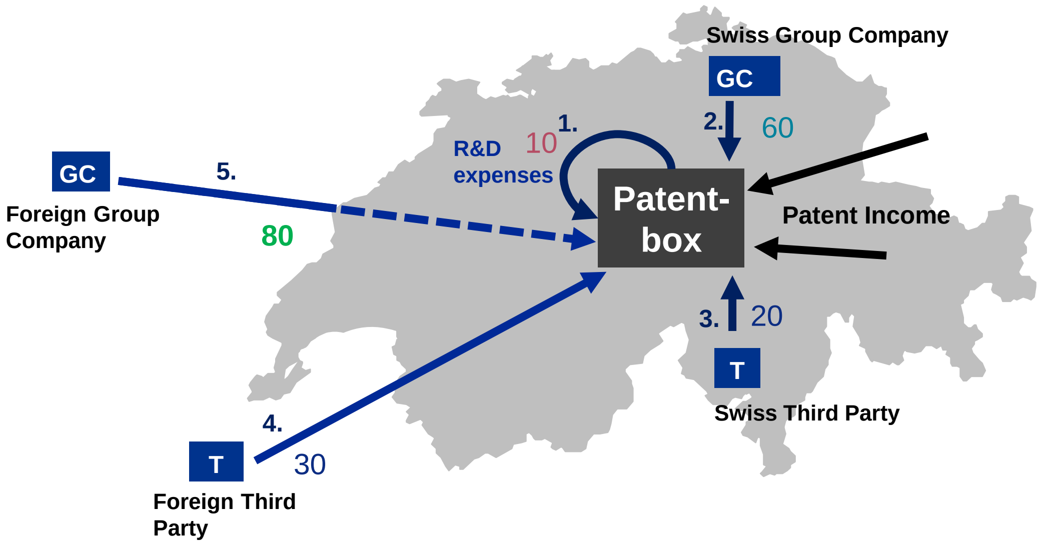
ordinary taxation

= residual qualifying IP income → privileged taxation**

*If net income per product cannot directly be determined. Such profit is to be allocated to the specific products

**Under consideration of the nexus approach, relief up to 90% (depending on canton)

Patent box regime – Step 2 (mod. Nexus app.)



Nexus has to be confirmed by ordinance of the government and is calculated annually based on the R&D expenses of the current and last 10 tax periods

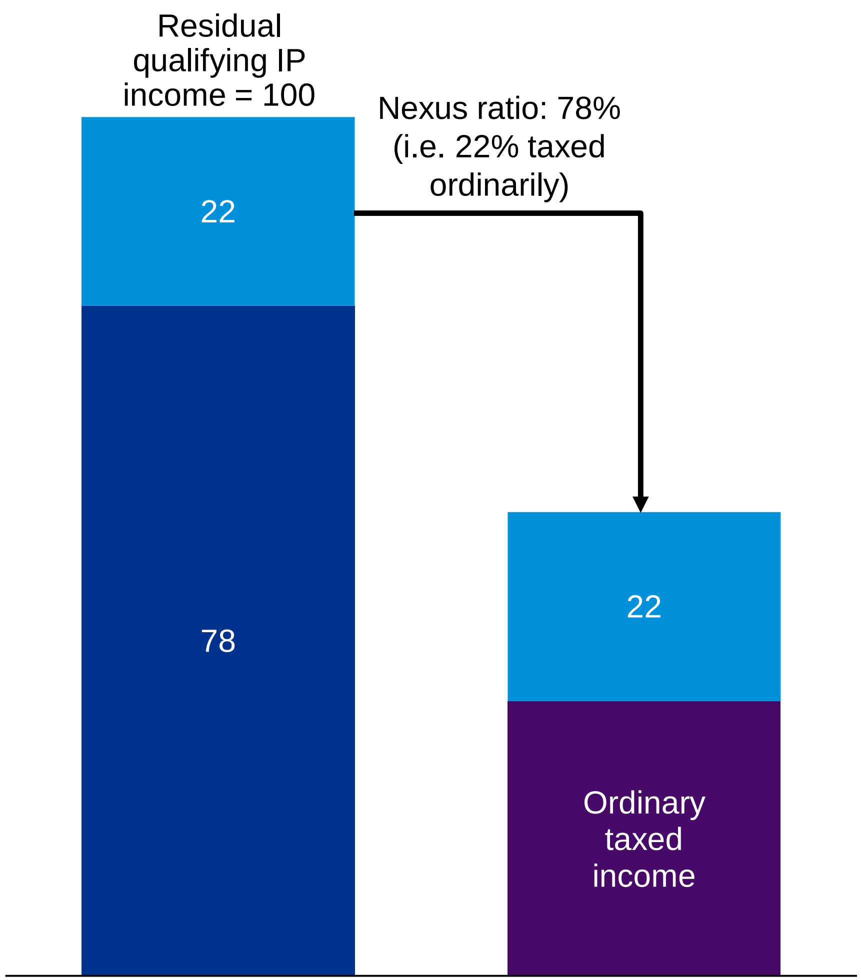
30% «uplift» of qualifying R&D expenses

Qualifying R&D expense / Overall R&D expense

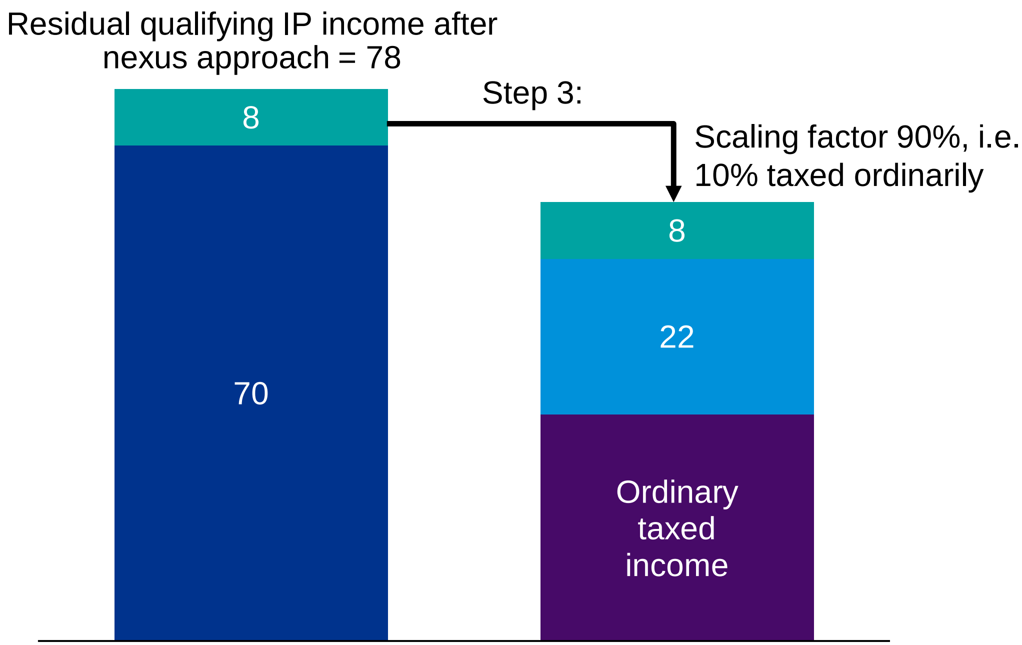
$$\frac{10 + 60 + 20 + 30 + 36}{10 + 60 + 20 + 30 + 80} = \frac{156}{200} = 78\%$$

→ **Only 78% of qualifying residual IP income (box income) is to be tax privileged (i.e. only 78% may be tax exempted by up to 90%)**

Patent box regime – Step 2 (mod. Nexus app.)



Patent box regime - Steps 3 and 4



Step 4:

Consideration of overall limitation (depending on canton)

Additional R&D deduction

Additional R&D Deduction - overview

Broad Definition of R&D:

- Basic research → main goal is to gain knowledge
- Applied research → main goal is to contribute solutions to practical problems
- Science-based Innovation → development of new products, methods, processes and services in industry and society

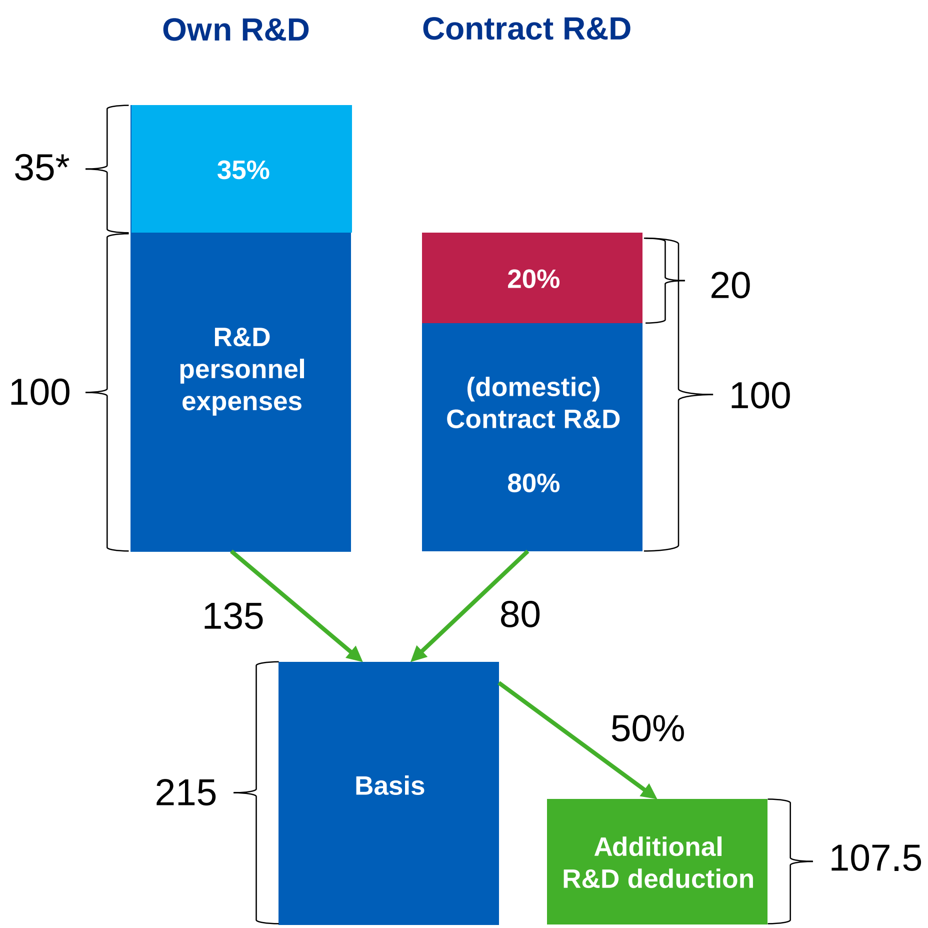
Own domestic R&D
Additional deduction of 50% of R&D expenses (domestic personnel expenses plus markup of 35%)

Domestic contract R&D
Additional deduction of 50% of 80% of invoiced R&D expenses

Documentation requirements still to be determined; potential documentation requirements:

- Project description (including time horizon and overall costs)
- Summary of R&D labor costs with staff list and computation of the 35% markup
- Contract R&D: project contract and invoices

Additional R&D Deduction - calculation example



*Assumption: there are at least other R&D expenses in the amount of 35 (in addition to personnel expenses); hence overall R&D expenses in the example amount to (at least) 235.

Notional Interest deduction (NID)

Notional Interest Deduction - Overview (ZH only)

- The competence to implement the notional interest deduction (NID) in the cantonal legislations is exclusively provided for **cantons with high effective tax rates** under the Swiss tax reform – according to the definition, solely the **Canton of Zurich** is entitled for the implementation
- This measure allows a deduction of a notional interest on **surplus equity**. The interest equals the return on investment of the 10 year Swiss Confederation bond – currently approx. 0%
- For **intragroup loans** a higher (arm's length) interest rate can be applied (measure for group financing activities – margin taxation)
- Expected tax rate of finance companies in Zurich will be approx. 11-12%

Overall limitation of measures

Overall limitation of measures

- Notional interest deduction
- R&D super deduction
- Current law step-up depr.
- Patent box

Maximum deduction of 70% of taxable income before loss carry forwards and excluding participation income

Minimum income of 30% of taxable income before loss carry forwards (approach per entity)

Step-up upon Relocation to Switzerland

Step-up - Relocation to Switzerland

Upon relocation to Switzerland, a foreign company can disclose hidden reserves including goodwill in a tax-free manner. Hence, in the first few (up to 10) years the company may benefit from additional depreciations on such disclosed hidden reserves.

Abroad

Switzerland

Abroad

Exit taxation
(as already today)

Revaluation of assets to FMV in the tax balance sheet (even if not accounted for in the statutory balance sheet)

- Taxed hidden reserves in the tax balance sheet
- Depreciation over maximum 10 years

Relief on capital taxes

Relief on capital taxes

- With the abolishment of the privileged tax regimes, privileged capital tax rates will also be abolished
- Therefore, a relief on capital taxes will be introduced
- The cantons **are entitled** to grant a reduction for equity related to participations, patents and similar rights as well as intercompany loan assets.

Calculation example

Assets	**Liabilities**
100 cash	200 debt
100 receivables	
200 patents	300 equity
100 participations	
500 total	**500 total**

Assets for deduction	**Quota** (of total assets)
200 patents	40%
100 participations	20%
Total reduction of taxable capital or deduction from capital tax amount	**60%**

→ Taxable capital: equity of 300 less 60% = 120

Alternative procedure by the cantons:

- General (capital) tax rate reduction
- Credit of income tax towards capital tax

Snapshot of the proposed cantonal implementation

Cantonal implementations - Overview (1/2)

Status as of November 2019 (undergoing possible changes)

Canton	Patent box (reduction)	Additional R&D Deduction	Overall limitation
Aargau - AG	90%	50%	70%
Appenzell Ausserrhoden - AR	50%	50%	50%
Appenzell Innerrhoden - AI	10%	No	50%
Basel-Landschaft - BL	90%	20%	50%
Basel-Stadt - BS	90%	No	40%
Berne - BE	90%	50%	70%
Fribourg - FR	90%	50%	20%
Geneva - GE	10%	50%	9%
Glarus - GL	10%	No	10%
Grisons - GR	70%	50%	55%
Jura - JU	90%	50%	70%
Lucerne - LU	10%	No	70%*/20%**
Neuchâtel - NE	20%	50%	40%

* Only for current law step-up.
** For all other measures..

Cantonal implementations - Overview (2/2)

Status as of November 2019 (undergoing possible changes)

Canton	Patent box (reduction)	Additional R&D Deduction	Overall limitation
Nidwalden - NW	90%	50%	70%
Obwalden - OW	90%	50%	70%
Schaffhausen - SH	90%	25%*	50%**
Schwyz - SZ	90%	50%	70%
Solothurn - SO	90%	50%	70%
St. Gallen - SG	50%	40%	40%
Ticino - TI	90%	50%	70%
Thurgau - TG	40%	30%	50%
Uri - UR	30%	No	50%
Vaud - VD	No information	50%	No information
Valais - VS	90%	50%	50%
Zug - ZG	90%	50%	70%
Zurich - ZH	90%	50%	70%

* Not applicable until the 6th year of entry into force of the TRAF.
** Not applicable until the 6th year of entry into force of the TRAF; before that, an overall limitation of 70% applies.

Planned cantonal income tax rates (1/2)

Status as of November 2019 (undergoing possible changes)

Canton	Year 2019	Implementation TRAF	Min. tax rate with OL**
Aargau	18.61%	18.61%	11.35%
Appenzell Ausserhoden	13.04%	13.04%	10.51%
Appenzell Innerhoden	14.16%	12.66%	10.31%
Basel-Land	20.70%	13.45%*	10.73%
Basel-Stadt	13.04%	13.04%	11.03%
Berne	21.63%	21.63%	12.46%
Fribourg	19.86%	13.72%	12.60%
Geneva	24.16%	13.99%	13.48%
Glarus	15.68%	12.42%	11.98%
Grisons	16.12%	14.73%	11.72%
Jura	20.40%	15.01%*	10.11%
Lucerne	12.32%	12.32%	9.23%
Neuchâtel	15.61%	13.57%*	11.36%

* Gradual reduction within up to 5 years
** Minimum effective profit tax rate with application of maximum overall limitation of measures
Remark: maximum effective pre-tax rate for federal government / canton / municipality for the respective principal town in percent.

Planned cantonal income tax rates (2/2)

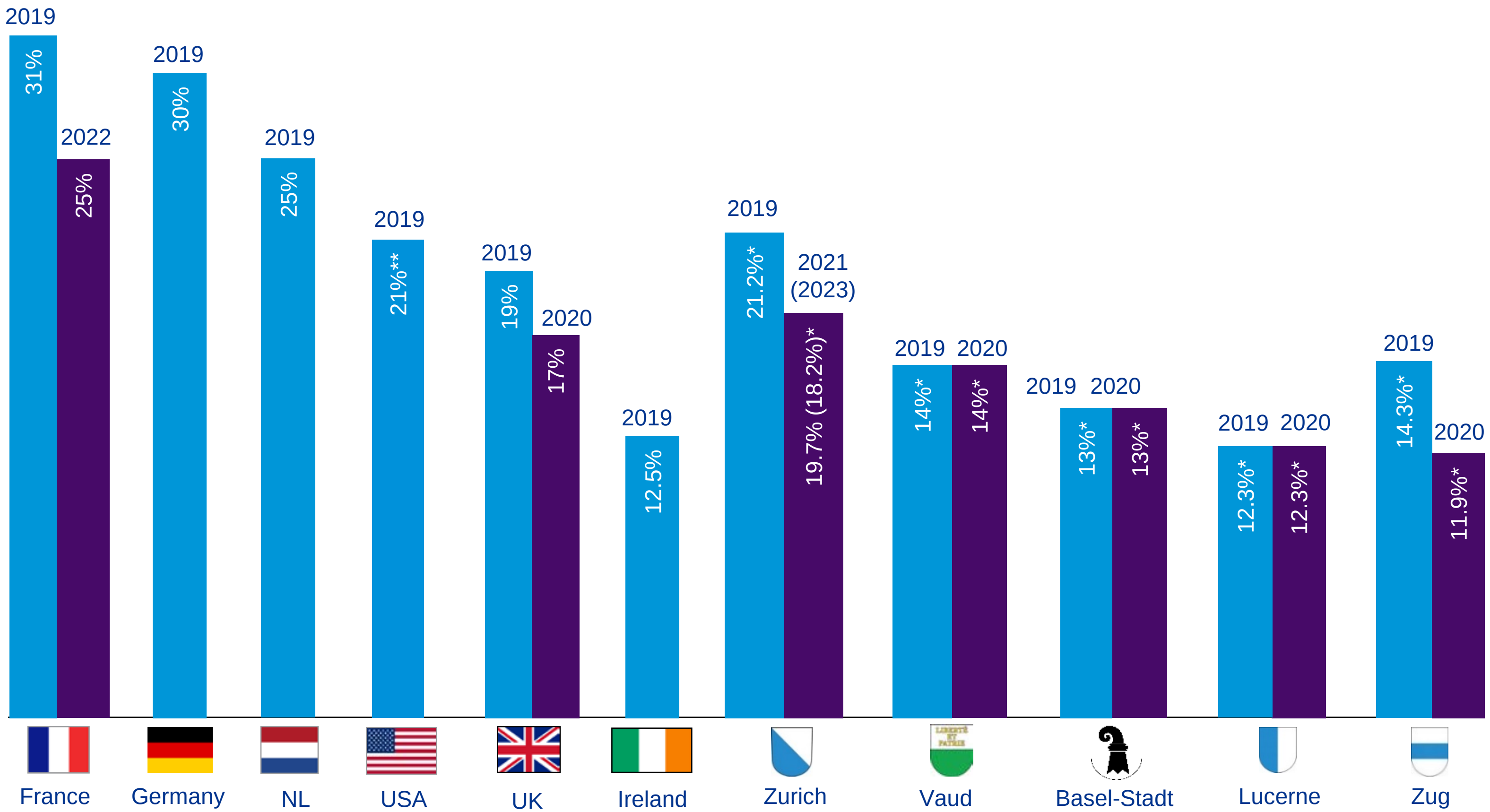
Status as of November 2019 (undergoing possible changes)

Canton	Year 2019	Implementation STAF	Min. tax rate with OL**
Nidwalden	12.66%	11.97%	9.12%
Obwalden	12.74%	12.74%	9.36%
Schaffhausen	15.72%	12.33%*	10.14%
Schwyz	15.02%	14.13%	9.82%
Solothurn	21.38%	15.06%*	10.55%
St. Gallen	17.40%	14.50%	11.95%
Ticino	20.55%	15.89%*	10.41%
Thurgau	16.43%	13.40%	10.70%
Uri	14.92%	12.64%	10.30%
Vaud	13.99%	13.99%	9.77%
Valais	21.74%	16.98%	12.65%
Zug	14.35%	11.91%	9.10%
Zurich	21.15%	18.19%***	11.21%

* Gradual reduction within up to 5 years
** Minimum effective profit tax rate with application of maximum overall limitation of measures
*** First reduction of tax rate as of 2021 (one year after the implementation of TRAF) to ETR 19.7%, second reduction of tax rate (depending on public vote) as of 2023 to ETR of 18.19%.
Remark: maximum effective pre-tax rate for federal government / canton / municipality for the respective principal town in percent.

International competitive tax rates today and tomorrow

Headline tax rates today/tomorrow



* Overall ETR – including federal tax
** Only federal tax

Overall conclusion

Conclusion on Swiss tax reform

IP driven reform as a clear sign of commitment to Switzerland as a location for research and industry

In particular from a **holistic point** of view: new measures as an attractive solution in combination with

- low ordinary tax rates
- consideration of substance approach (i.e. other income)

Effective tax rate as low as **12% without tax planning!**

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What does this tax reform mean for you?

The tax reform enters into force as of 1 January 2020. This leads to the following need for action:

- Adjustment of payroll accounting to consider adjusted AHV contribution rates
- In case of status change: Determination/ declaration of hidden reserves with tax return 2019
- Potential revaluation of existing or accounting for new deferred tax balances
- Potential request of reduced tax acquisition values of investments

What is the impact of the R&D measures or of the notional interest deduction in Zurich? (to be requested as of the tax return 2020)

Link to landing page: www.kpmg.ch/traf


Q&A

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