



Date: 22.09.2014

---

## **CTR III – Questions and Answers**

### **1. International aspects**

- a. What is the connection between the third corporate tax reform, the OECD's BEPS project, and the business taxation dialogue with the EU?*

In order to maintain Switzerland's competitiveness as a business location, internationally acceptable concepts are required also in the area of corporate taxation. On the one hand, this means making certain adjustments to existing Swiss regulations which the EU believes distort competition and which are being reviewed by the OECD. On the other, the third corporate tax reform will involve the introduction of new regulations that preserve the competitiveness of Switzerland as a business location.

The question of international acceptance therefore arises not just in respect of the EU, but also with regard to the OECD, whose BEPS (Base Erosion and Profit Shifting) project is likely to lead to an adjustment to international tax regulations.

- b. Why is Switzerland not adopting the EU's Code of Conduct?*

This is an internal code of conduct which applies only to EU member states. However, Switzerland is prepared to discuss individual business taxation aspects with the EU.

- c. What does Switzerland want from the EU in this dialogue?*

Switzerland's objective is to reach a balanced understanding with the EU which also encompasses the countermeasures taken on the EU side. Specifically, if Switzerland adjusts its corporate taxation to international standards and abolishes the controversial regimes, the countermeasures taken in the EU should likewise no longer apply. The EU's negotiation delegation was also persuaded that there can be no question of Switzerland adopting the EU's Code of Conduct. The understanding with the EU initialled on 1 July 2014 takes account of these points.

- d. Where will this tax dialogue with the EU go from here?*

On 1 July, the heads of delegation from Switzerland and the EU initialled a mutual understanding in the business taxation dialogue. The aim is to sign the understanding as soon as possible. We are currently looking for a suitable signing date.

*e. What did Switzerland get out of this dialogue with the EU?*

An understanding with the EU gives companies in Switzerland a certain degree of legal and planning certainty. An issue that has caused friction between the two sides for many years can finally be resolved. An understanding with the EU will also have a positive impact on discussions in the OECD.

*f. What developments are you expecting in the OECD over the next few months that could have repercussions for corporate taxation in Switzerland?*

One aim of the BEPS project is to conclude a review of the tax regimes in OECD member states. Given that it was not possible to conclude this review by this summer as planned, the work will continue. The new aim is to conclude the review of all tax regimes by mid-2015. Swiss tax regimes have also been under review since November 2012. Consequently, it is all the more important to press ahead with the reform.

The OECD is also reviewing royalty boxes and similar regimes that currently exist in a number of member states. At present, however, it is questionable whether the review of these regimes can be completed prior to the adoption of the dispatch on the CTR III.

*g. How is Switzerland positioning itself on the issue of corporate taxation in the OECD discussion and at the meetings of G20 Finance Ministers?*

Switzerland supports tax competition between countries, and welcomes initiatives that shape this principle fairly. Switzerland is therefore actively contributing to the work of the relevant working groups of the OECD's BEPS (Base Erosion and Profit Shifting) project. Two aspects are important to Switzerland:

- Fair competition between business locations must continue to be possible, including in relation to tax.
- International standards must apply universally, and in particular also to all financial centres and competing locations in Switzerland.

*h. What type of IP box do you think is "BEPS compatible"?*

It is not possible to answer this question yet, as work at the OECD (and EU) level is still under way. For the time being, Switzerland has taken note of the IP boxes that are currently permitted. We are now waiting to see which IP box will be deemed admissible internationally.

*i. Yes, but what is Switzerland's position?*

If other countries have a particular IP box system, then we believe it is possible at the present time for Switzerland to also choose that system. First of all, however, we must wait on the results of the BEPS project on IP boxes.



## 2. Tax policy aspects

### *a. Are royalty boxes a sustainable instrument?*

Royalty boxes are a reality today in a number of competing locations and are therefore a goal-oriented tool for implementing a country's strategy in this area. Existing boxes are currently being scrutinised more closely by the OECD and the EU with regard to their compatibility with international standards. The results of these investigations are not yet known. International developments in this area will have to be factored in accordingly.

### *b. What effects will the proposed royalty box have for individual cantons and companies?*

Royalty boxes can be used by all companies that generate specific revenue from intangible assets. The effects at cantonal level will depend greatly on a canton's economic structure.

### *c. How high can the profit tax rate on mobile tax bases be set in order to prevent companies from moving elsewhere?*

It is not possible to make a general statement in this regard. This would depend on the nature of the activity and on the competitive situation in other locations. With the royalty boxes that currently exist in a number of EU countries, revenue from intangible assets is currently taxed at between 5% and 10%.

### *d. What are the aims of the tax policy measures?*

The measures are designed to strengthen Switzerland as a tax location. At the same time, international acceptance is to be increased. Finally, companies active in Switzerland should continue to make an important contribution to the financing of public tasks. Moreover, a package of measures is being put together with a view to improving the mechanics of corporate tax law and its balance.

### *e. Will the issue tax on equity capital now be abolished altogether?*

This issue is not only part of the current corporate tax reform, it is also being addressed by parliament (09.503). The Federal Council argued some time ago that the abolition of the issue tax should be incorporated into the third corporate tax reform.

### *f. Why should the interest-adjusted profit tax be restricted to above-average levels of equity capital?*

The interest-adjusted profit tax offers attractive location parameters for the corporate function of group-internal financing. In this respect, both the basic model (with its protective interest deduction on the entire equity capital amount) and the alternative model (which restricts the protective interest deduction to above-average amounts of equity capital) are equally effective. However, in the event of an unchanged statutory tax rate – and therefore one that is equal for both models – the latter model should result in only 30% to 50% of the lower receipts entailed by the basic model, depending on how it is structured.

- g. How will the measures under the third point of the strategy improve the mechanics of corporate tax law and its balance?*

The capital gains tax and the adjustments to the partial taxation procedure ensure a balanced tax burden in the area of capital income. This also enables account to be taken of the principle of legal form neutrality. The adjustments to the partial taxation procedure will also abolish the minimum shareholding deemed unconstitutional by the Federal Supreme Court and thus completely eliminate the burden of double taxation. In addition, the misplaced incentives in the area of "dividends instead of salary" will be discontinued. The introduction of rules on the disclosure of hidden reserves aims to standardise existing rules in the cantons and at the federal level. Furthermore, all similar cases are to be handled in the same way. The abolition of the issue tax on equity capital serves to enhance neutrality in financing, as equity capital will no longer be taxed additionally. The temporally unlimited offsetting of losses takes account of taxation on the basis of ability to pay, as companies can now always claim their losses in full. With the adjustments to participation deductions, multiple taxation in a conglomerate can now be completely abolished.

- h. What advantages do the adjustments to participation deductions have for companies?*

In the previous system, it could occur that income on participations that was effectively exempt from tax had to be offset against operating losses or that the upward revaluation of depreciation and value adjustments that were no longer justified led to a taxable profit, even though the depreciation or value adjustments on which this was based had not had a profit-reducing effect. The new system gets rid of these adverse effects and multiple taxation in a conglomerate can be completely eradicated. Dispensing with the apportionment of financing and administrative costs has an equally positive impact on companies. Furthermore, the new system is easier to apply administratively.

- i. Why is the introduction of a capital gains tax on securities being proposed?*

The fact that private capital gains are exempt from tax constitutes an exception in the applicable legislation which should be restricted. This exception gives rise to a range of difficult delimitation issues, all of which are rendered invalid by the capital gains tax on securities. This simplifies tax assessment for both the authorities and taxpayers and increases legal certainty. In recent years, the profit tax burden has tended to decline. For the sake of an overall tax burden that is balanced, it would seem justified to apply the capital gains tax to earnings from shareholders' participation rights. Furthermore, the capital gains tax gives rise to additional receipts and thereby benefits counter-financing and the Federal Council's objective of putting forward a balanced overall package with the third series of corporate tax reforms.



### 3. Fiscal policy aspects

*a. How high are the federal and cantonal receipts generated from companies that have special tax status?*

Viewed as an average between 2008 and 2010, the corresponding profit tax receipts of the cantons and their communes amounted to just under CHF 2 billion (20% of all profit tax receipts). Over the same period, the corresponding receipts of the Confederation amounted to around CHF 3.6 billion (48% of all profit tax receipts).

*b. How significant are the individual statuses in question?*

Measured in terms of profit tax receipts, so-called mixed companies are the most significant group, followed by domiciliary and holding companies. The Confederation benefits more from status companies than the cantons do (cf. 3a). The reason for the considerably higher proportion of profit tax receipts from such companies is explained by the fact that the Confederation taxes companies with cantonal tax status at the standard profit tax rate of 8.5%.

*c. How much is the corporate tax reform costing the Confederation and how is it being financed?*

The proposed tax measures give rise to a decline in receipts of 0.5 billion. In addition, there are costs totalling 1.2 billion for equalization measures and a temporary supplementary contribution for the cantons. The total cost will be financed through additional receipts (increased number of tax inspectors, 0.3 bn) and expenditure-related measures (total of 1.5 bn). The most important component here is generating structural surpluses, with a target of 1 billion.

As the reform will be implemented over a prolonged period of time, it is not possible to make reliable forecasts about the Confederation's financial situation. The creation of structural surpluses will prevent federal expenditure from being increased initially only to be reduced again when the reforms come into force, which would result in quite an unpredictable financial policy. A moderately lower expenditure growth rate combined with receipts-related measures is a more reliable strategy for the players involved.

*d. How does the amount of 1 billion for the vertical equalization measures materialise?*

The starting point for the equalization measures is the difference between the receipt losses of the cantons and the Confederation that result from the reform. The sum (extrapolated based on the year of commencement, i.e. 2017) amounts to half of this difference. Thus, the costs of the reform will be split equally between the cantons and the Confederation. The calculations were done using a model (based on plausible assumptions) of the manner in which the average tax burden of companies in Switzerland changes. The cantons are more affected by these changes, hence the Confederation's participation.

*e. What instruments will be used to implement the vertical equalization?*

The tax competition between the cantons should be distorted as little as possible. Given this premise, the equalization should take the form of an increase in the cantons' share of direct federal tax.

*f. What would be the extent of tax receipts lost to the Confederation and the cantons as a result of the interest-adjusted profit tax?*

The magnitude of the lost receipts will depend on the interest adjustment model and the level of the protective interest rate. Basic model: direct federal tax just under CHF 1 billion (incl. cantons' share of direct federal tax), cantons' and communes' profit tax just over CHF 1.1 billion. Model with protective interest deduction restricted to above-average equity capital amounts as described in the consultation draft: direct federal tax CHF 320 million (incl. cantons' share), cantons' and communes' profit tax CHF 290 million. When it comes to evaluating the financial implications, it should also be remembered that foregoing the interest adjustment would also entail lost receipts as a result of companies moving elsewhere.

*g. Does a canton automatically benefit more from the Confederation's vertical equalization measures if it cuts its profit tax rate to a greater degree?*

The vertical equalization measures are designed in such a way that they cannot be directly influenced by cantonal tax policy. They are designed to increase cantonal freedom of manoeuvre in the area of fiscal policy generally and in the long term, and cannot be influenced by the specific tax policy of a canton.

*h. Won't cantons be put under pressure (e.g. to cut profit tax) if the Confederation sets out the vertical equalization on an ex ante basis?*

Despite the tax policy measures, profit tax cuts may prove to be unavoidable, depending on the specific situation of a canton. The equalization measures are to be stipulated in advance in order to give the cantons planning certainty. It is not yet clear whether (and to what extent) the cantons will reduce profit taxes, and how companies will respond to this development. As a result of these uncertainties, the vertical equalization measures will have to be laid down on the basis of assumptions. In the wake of implementation of the reform, the degree to which the vertical equalization measures achieve their objective will be reviewed, and if necessary an application will be made to parliament for their adjustment.

*i. Why are Swiss cities not represented in the project organisation?*

According to the principles set out in Articles 44 and 45 of the Federal Constitution, it is the cantons that act as the Confederation's counterparts. However, the Federal Council is aware that Swiss cities will be directly affected by the repercussions of any reform, given where many of the affected companies are based. On the other hand, the same point applies generally to all communes. The Federal Council has therefore set itself the target of "ensuring that the receipts of the Confederation, cantons and communes are sufficient to finance state activities", among other objectives. The repercussions for the communes are therefore contained in the reflections on the cantons in the steering committee's report.

*j. Why is an adjustment to the fiscal equalization system necessary?*

With an abolition of cantonal tax statuses, domestic and foreign revenue would be factored into the calculation of resource potential with a full weighting (due to the discontinuation of beta factors). Without adjustment measures, this would result in massive dislocations (in particular a much higher resource potential for any canton with many status companies), without anything changing fundamentally in terms of the economic power of the cantons.

*k. Which cantons will be the winners and which will be the losers as a result of the resource equalization adjustment?*

It is too early to make a firm statement in this respect. The resource equalization adjustment will occur with a time delay of four years, i.e. probably not until 2023. The simulations in appendix 3 of the explanatory report show the differing degrees of cantonal susceptibility if the profit tax base in the cantons remains unchanged. However, conclusions regarding potential winners and losers can only be drawn to a limited extent.

*l. Why is Switzerland now taking a smaller share of company profits in tax?*

The combination of the new special regulations and cuts to cantonal profit tax rates will have two effects. On the one hand, companies currently taxed in the ordinary way would benefit from a generally lower tax rate if cantons cut their profit tax rate. On the other, a number of mobile companies could move elsewhere, as the introduction of a standard rate would not allow for competitive taxation. Both of these developments would lead to lower tax receipts.

*m. Is there any incentive for cantons to maintain mobile corporate tax bases now if this entails a significant increase in their resource potential?*

The solution will need to involve factoring corporate profits into resource potential in such a way that does not deviate fundamentally from the current situation. This should mean that there is still an incentive to maintain or attract these companies, not least due to their economic significance.

*n. Aggregated Tax Base (ATB): Why is the tax rate levied on company profits lower than that for personal income?*

Corporate profits have a greater degree of mobility, which means this segment of the tax base cannot be exploited to the same extent.

*o. Why are the beta factors not simply continued for the new boxes?*

The discontinuation of tax statuses also means that beta factors can no longer be included in calculations. When it comes to weighting box revenue, new factors that are based on a different system will have to be calculated. Moreover, depending on the way the boxes are designed, it is likely that only a certain proportion of current status profits will be taken into account in a box. The remaining profits of status companies would be included in cantonal resource potential at 100%, which would lead to distortions.