



TRAF - Implementation and First Experiences

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Key Take-aways

- 1.** The considerable room for manoeuvre of the cantons in the selection and design of TRAF measures promotes intercantonal tax competition.
- 2.** Some transitional solutions adopted by the cantons raise legal questions. The companies concerned should actively discuss these with the tax authorities.
- 3.** Companies can benefit from the TRAF, in particular former status companies. The choice of location, structure and value chains must be critically reviewed.

1 Introduction

The Federal Act on Tax Reform and Financing of Social Insurance ("**TRAF**") entered into force on 1 January 2020. The cantons were obliged to adapt their cantonal legislation as of this date. Around three-quarters of all cantons timely implemented the TRAF measures into cantonal law on 1 January 2020. However, some cantons have not yet done so and have in some cases adopted transitional solutions. Companies domiciled in these cantons must review the consequences this might have for them.

This newsletter deals with the implementation of the TRAF measures at cantonal level, which are particularly relevant for corporations.

2 Implementation of TRAF at Cantonal Level

At cantonal level, the legal provisions of the TRAF are specified in the Direct Taxation Harmonisation Act ("**DTHA**"). The DTHA allows the cantons discretion when implementing the measures. The following summarizes the extent to which this discretion has been used at cantonal level in the implementation of mandatory and optional TRAF measures. In addition, with the legislative reform virtually all cantons have introduced voluntary measures outside the TRAF.

2.1 Mandatory Measures

(including discretion of the cantons)

- Abolition of **cantonal tax privileges for Swiss status companies** (i.e. companies that were taxed preferentially as holding, domicile or mixed company).
- Introduction of cantonal **patent boxes**. With a patent box, the profit from qualifying patents and comparable rights ("**patent box profit**") is separated from other profit and taxed at a reduced rate. The extent of the reduction of the patent box profit can be freely determined by the cantons up to a maximum reduction of 90%. Almost two-thirds of the cantons have opted for the maximum reduction, while a few only provide for a reduction of 10% (GE, GL and LU). The remaining cantons range between 20–50% reduction (AI, AR, NE, SG, TG and UR).
- Introduction of a **tax relief limitation**. According to this limitation, the tax-reducing TRAF measures may lead to a maximum reduction of taxable profit of no more than 70% before loss offsetting. The cantons may provide for a lower relief limitation. Only a minority of the cantons has opted for the maximum relief limitation; the majority provides for a lower reduction, with GE and GL at the foot of the list with 9% and 10% relief limitation respectively.
- **Disclosure of hidden reserves** in the event of a change of status. If a cantonal tax status ceases to apply, the DTHA stipulates that hidden reserves (including goodwill) will be taxed separately when realized within the next five years. However, the cantons are free to set the special tax rate. The base special tax rates mainly range between 0.5% (e.g. ZH and SG) and 4% (FR). Some cantons also provide for staggered special rates (AR, NW, OW and ZG).

- Increase of the **partial taxation of dividends** from qualifying participations held in the private and business assets of individuals to at least 50%. About two thirds of the cantons (e.g. ZH, ZG and BE) tax such income at a rate of 50% to 60%, the remaining at a rate of 70% (FR, GE, GL, JU, SG, SO, TI and VD; BS even 80%).
- Introduction of a **repayment and partial liquidation rule under the capital contribution principle** for companies listed on Swiss stock exchanges.

The adoption of optional TRAF measures is not within the competence of the cantonal government.

2.2 Optional Measures

- Introduction of an **additional deduction for qualifying research and development expenses ("R&D")** of up to 50%. More than half of the cantons provide for a maximum additional deduction (e.g. ZH, ZG, SZ and BE). In contrast, some cantons (BS, GL, LU and UR) waive an additional R&D deduction altogether.
- Introduction of a **tax deduction for self-financing**. Based on this, there is the possibility of a notional interest deduction on excessive equity ("**core equity**") of a company. As a prerequisite for the introduction, a total effective income tax burden of a minimum of 18.03% must exist in the canton. Thus, the tax deduction for self-financing could only be implemented in the canton of ZH. According to the circular note of the Swiss Federal Tax Administration, the notional interest rate for 2020 was set at 0%. However, insofar as the core equity is attributable to receivables from related parties, an imputed interest rate can be applied that is comparable to a third-party rate.
- Introduction of a **reduction of the capital tax base** by reducing the equity attributable to participation rights, patents and intercompany loans. This measure was implemented by the majority of the cantons, but to a very different extent. Some cantons provide for a reduction of up to 100% (AG, GL and SG).

2.3 Measures Outside of TRAF

- **Reduction of cantonal income tax**. Almost all cantons have made adjustments within the framework of their tariff autonomy. In particular, the French-speaking cantons of Switzerland have reduced their corporate income tax rates, in some cases substantially (especially GE). At least three cantons (AG, LU, AI) have either not lowered their corporate income tax rates at all or the planned reduction was rejected by the public (BE).
- **Reduction of cantonal capital tax**. The reduction in capital tax was introduced by only just under half of the cantons.

The reductions in capital tax rates differ substantially. Some cantons have implemented a general reduction of the capital tax rate, down to the rate that was applicable for status companies (e.g. AI, GE, GL and SH).

3 Transitional Periods and Solutions

According to the TRAF provisions, cantons must adapt their legislation to the date of entry into force of the TRAF, i.e. 1 January 2020. The cantons are **not granted a transitional period**, which is unusual. Seven cantons were not able to implement their legislative reforms on 1 January 2020. These are the cantons SO, TG, TI, NW, VS, BE and AI. In most of these cantons votes should take place this year. In the cantons of BE and AI, however, it is questionable whether the reforms can be implemented in 2020.

From 1 January 2020, the mandatory provisions of the **DTHA** will be **directly applicable** by virtue of the derogatory force of federal law, insofar as they are contradicted by cantonal tax law. In principle, this should lead to the maximum application of all TRAF measures at cantonal level. In order to prevent this or to avoid gaps and contradictions in the transition to cantonal tax reform, the cantonal executive bodies were obliged to issue the necessary **provisional regulations** until the legislation in the respective canton has been adapted to the new provisions. Such transitional solutions can be implemented in different ways.

Some of the affected cantons (BE, SO and TG) have adopted the provisions by putting the planned cantonal bills (resp. the mandatory TRAF measures) into force retroactively from 1 January 2020. The **retroactive effect** will therefore apply as soon as the cantonal implementation bill has been formally adopted. According to the cantons, there is no need for a transitional ordinance in this case. In the canton of BE, for example, the bill will be discussed by the Grand Council in spring 2020. If no referendum is held, the new tax law is to enter into force on 1 January 2021. It is envisaged that some of the mandatory provisions of the TRAF will already enter into force retroactively as of 1 January 2020. In principle, the retroactive entry into force of mandatory measures is to be viewed from the **perspective of legal certainty** and is permissible if it does not have a burdensome effect and proves to be moderate in terms of time.

Other cantons (NW and AI) have adopted provisional provisions by an **executive decree** of the Cantonal Council or the Government Council. In order to avoid gaps and contradictions in the year 2020, the Government Council of the canton of AI, for example, has issued provisional provisions within the framework of a resolution which is identical in content to the bill planned for the People's Assembly 2020. The decision of the Government Council on the provisional implementation of the Federal Act entered into force on 1 January 2020 in accordance with the deadline. However, the new Tax Act is then only to enter into force on 1 January 2021.

In the cantons of TI and VS, the transitional solution is unclear. Presumably they will also put the mandatory TRAF measures into effect retroactively.

In view of the principle of legality, both **transitional solutions** appear somewhat **questionable in terms of the rule of law**. In principle, it can be assumed that the cantonal

governments may, due to the urgency of the situation, adopt the mandatory measures **outside of an ordinary legislative process**. However, the cantonal governments have **no legislative competence regarding voluntary TRAF measures**, since in these cases the applicable cantonal law does not contradict the DTHA. Nevertheless, the canton of AI, for example, has done just that by providing for an additional R&D deduction of 50% in its decision of the Government Council.

Further, it is presumably within the competence of the cantonal governments to deviate from the measures in the DTHA (e.g. 90% reduction in the patent box) to the disadvantage of taxpayers with regard to the mandatory measures, as the DTHA allows the cantons a corresponding degree of **leeway** in its design. But even this is not undisputed in the academic world.

It follows that companies domiciled in cantons with such transitional solutions are recommended to contact the cantonal tax authorities directly and to obtain **legal certainty**, for example within the framework of a **tax ruling**.

4 First Experiences

Although concrete effects of the TRAF have yet to be seen, it is already apparent that the cantons are making extensive use of their competencies in implementing the TRAF within the scope of their possibilities. This **inconsistent implementation** is reflected, for example, in the design of the patent box. Whether the patent box proves to be an effective measure depends mainly on the respective cantonal design. Especially in those cantons which only provide for a minimum reduction of 10%, the administrative expenses for the track and tracing as well as the calculation of the patent box profit could exceed the possible tax savings. Furthermore, the Confederation has not issued any further provisions regarding the definition of qualifying R&D expenses for the additional deduction for R&D. In this regard, the DTHA refers to the Federal Act on the Promotion of Research and Innovation. In principle, the definition of qualifying R&D expenditures is broader than under the patent box. For example, the canton of AG has already planned to issue a comprehensive circular letter in this regard.

Calculations show that former status companies in some cantons will be better off in the future due to the TRAF, or its cantonal implementation. This applies in particular to pure holding companies, among other things thanks to the **continuing participation exemption** and **lower taxes on profits and capital**. In the case of holding companies that generate significant other income, however, it will be necessary to examine whether the holding structure continues to make sense economically.

5 Conclusion and Outlook

The cantons have exercised the discretion granted to them in the design of the TRAF measures. While there can be no question of harmonization, **intercantonal tax competition** has been further stimulated as a result. Companies may have to rethink their choice of domicile and the structuring of functions and value chains. Uncertainties arise in connection

with the **transitional solutions** adopted by cantons that are in delay. Particularly in the case of retroactive entry into force of the cantonal bill with a long delay and the transitional provisions enacted outside the ordinary legislative procedure by government decree, there is **legal uncertainty** as to whether these decrees have been adopted correctly, especially if they introduce non-compulsory DTHA measures. Affected companies should actively contact the tax authorities in order to obtain **legal certainty**.



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