KPMG

Clarity on Swiss Taxes

Switzerland's fiscal flexibility likely shrinking

April 2021

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Photo by Daniel Hager

Switzerland's fiscal flexibility likely shrinking

The coronavirus hasn't just been dominating the headlines for the past year, it's been dominating our lives. After having been an extremely prominent subject matter over the past few years, particularly given the vote on and introduction of the Federal Act on Tax Reform and AHV Financing (TRAF), the topic of taxes, like so much else recently, has faded into the background for most people. At the latest when the final shards left behind by the pandemic have been swept up and the spotlight shifts to the question of how to finance the many relief packages, the topic of taxes – especially global taxes – will be omnipresent again.

Numerous behind-the-scenes discussions are already underway in the various countries about how to finance the increased national debt. After having already significantly changed the tax landscape a few years ago with its Base Erosion and Profit Shifting (BEPS) project, the OECD (mandated by the G20) is now planning to go even further within the scope of BEPS 2.0. These measures are aimed at evening out tax rates on the global stage while also shifting the tax base. One of the main reasons for the latter is that no small number of countries are working to introduce a so-called digital tax that targets the big technology groups, in particular.

While Switzerland has long since been good at holding its own in international tax competition, international efforts to level the playing field are limiting the options that Switzerland and other relatively small countries like Ireland, the Benelux countries and others have for using competitive tax regimes as a way of positioning themselves. Falling prey to the belief that Switzerland, as a sovereign state, can simply ignore each and every international development would be ill-advised. Tax arbitrage will still be possible and Switzerland needs something compensatory to justify its higher wages. Nevertheless, in the long term, lower taxes will not be enough to compete as an international location. Other factors including free market access without trade barriers, access to talent pools both in Switzerland and abroad, extremely good infrastructure and excellent education, will become increasingly important.

Stefan Kuhn
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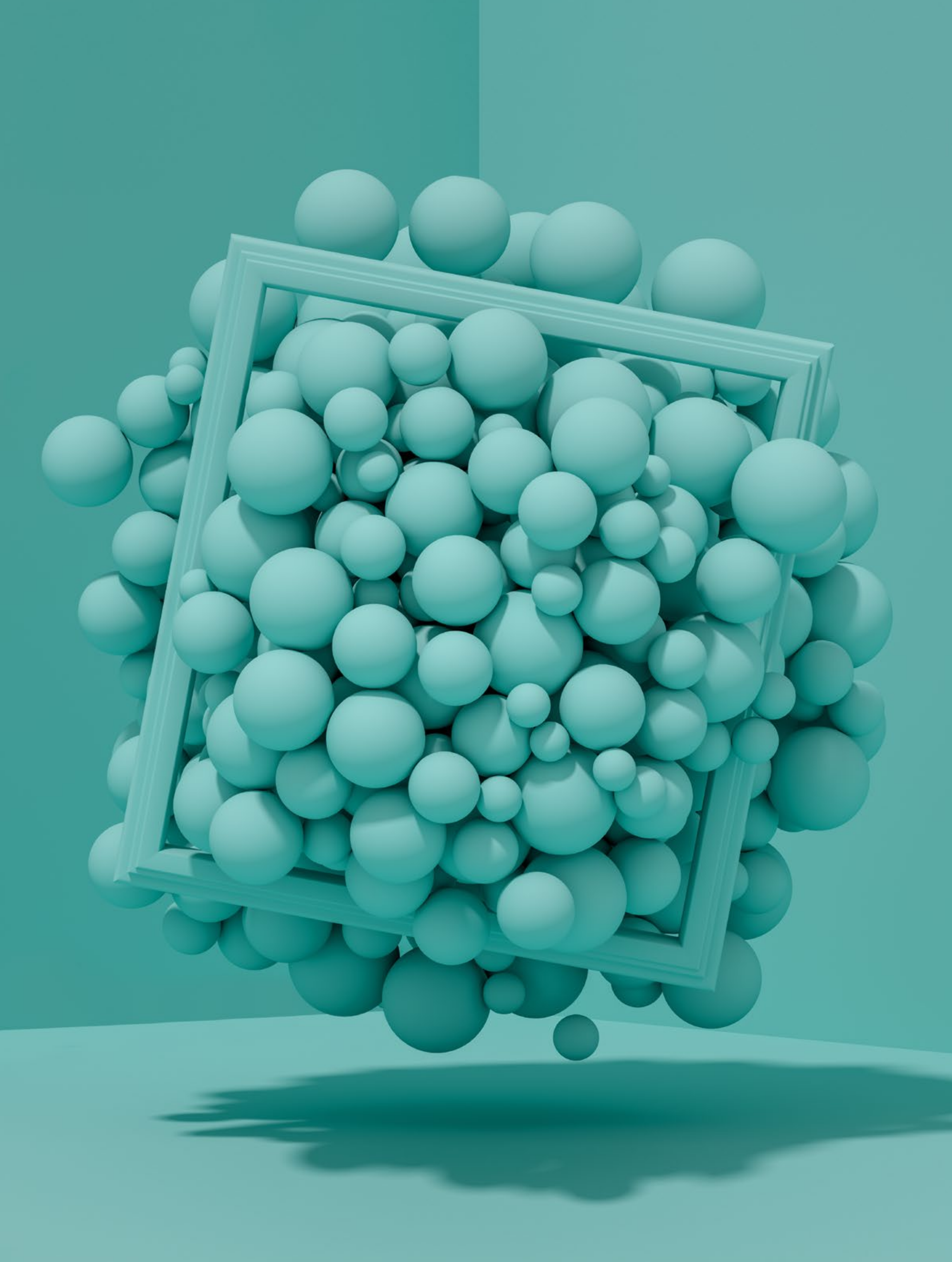
Corporate taxation

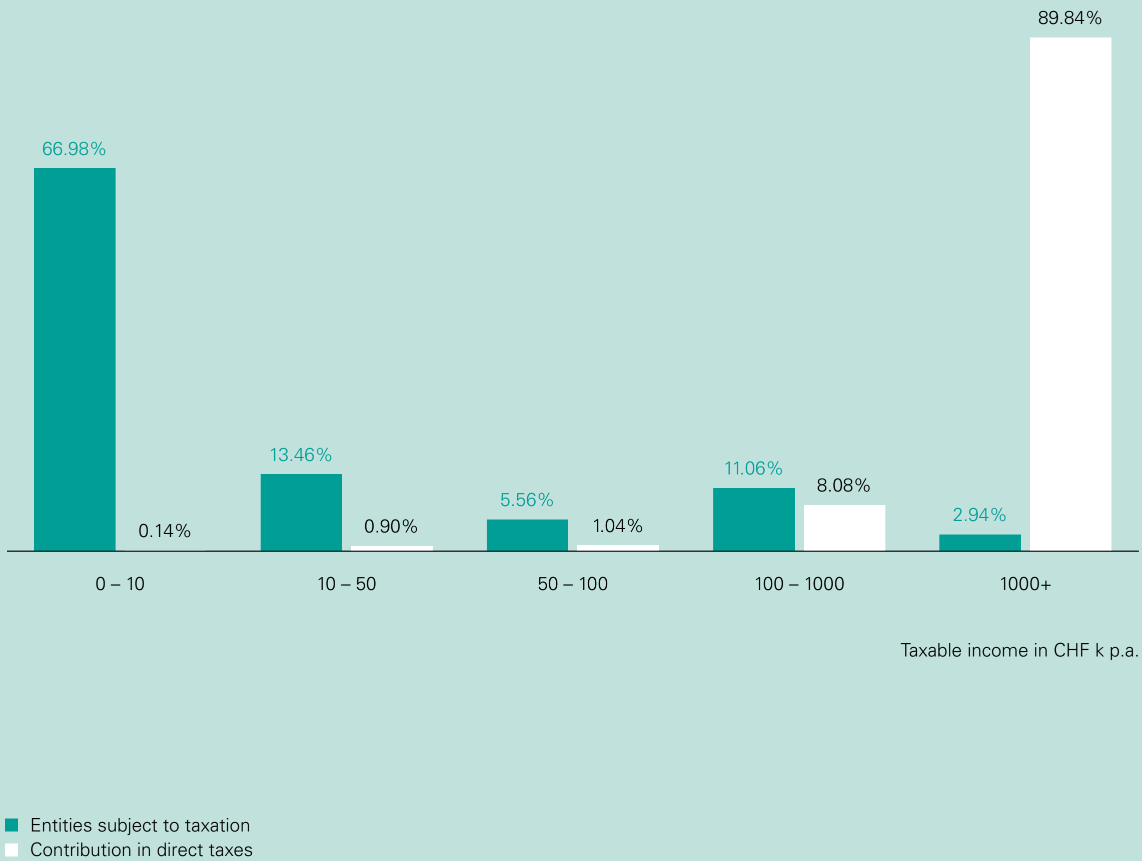
Corporate income tax



Individual cantons lower their net profit tax rates

In the second year after the introduction of the tax reform (TRAF), some cantons have lowered their net profit tax rates. These cantons are specifically the ones that had not yet lowered their tax rates or which had decided to lower the tax rate over several years. The latter is the reason why the drop in tax rates will most likely last until 2025.

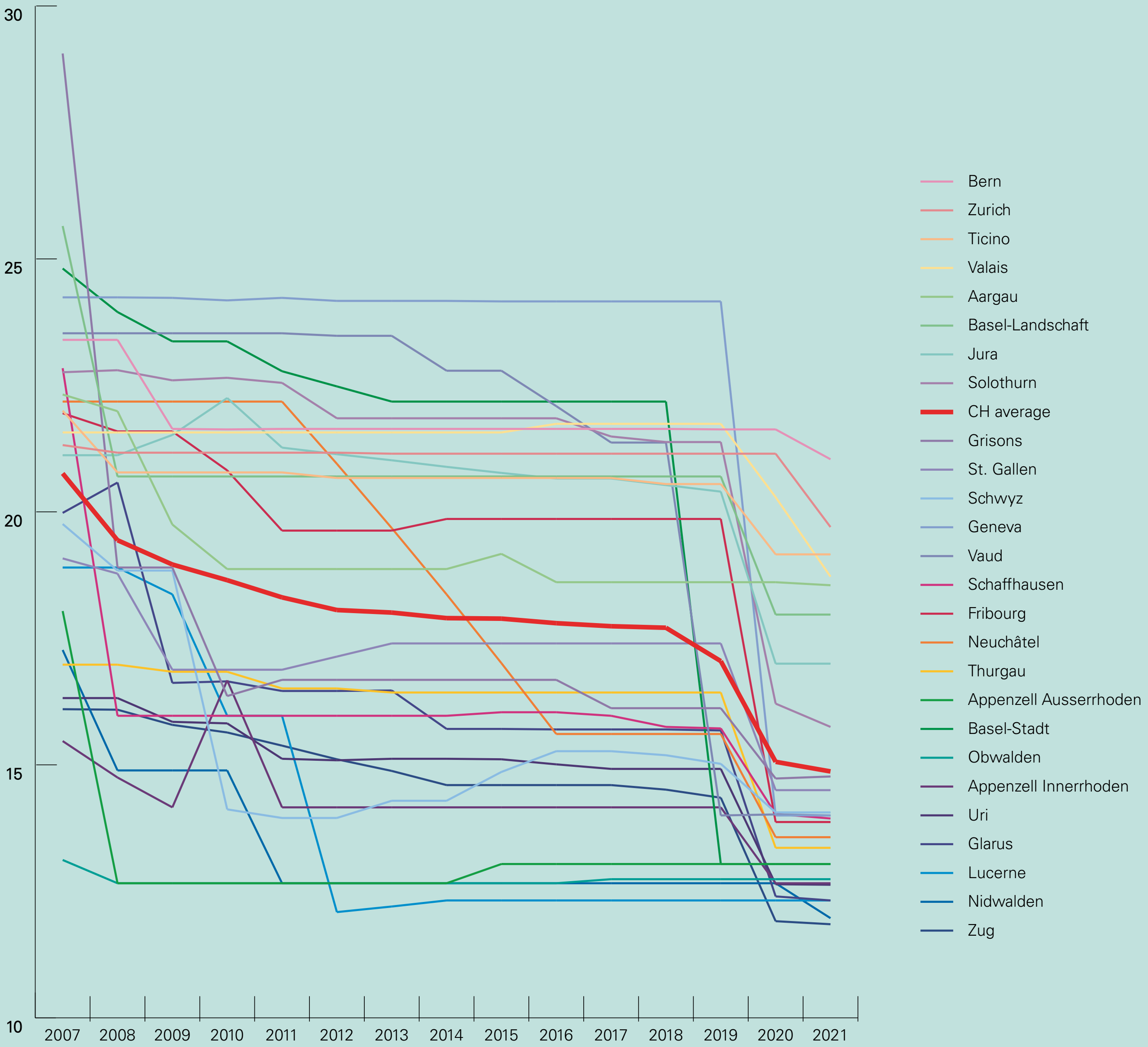
Contribution to tax revenue
While some two thirds of the legal entities pay nearly no direct federal taxes, 2.94% of the country's legal entities bear nearly 90% of the direct federal tax burden. Those figures reveal that the tax burden is shouldered by roughly the same number of companies as in the previous year (2.83% which bore 88.77% of the tax burden).



Source: https://www.estv.admin.ch/estv/de/home/allgemein/steuerstatistiken/fachinformationen/steuerstatistiken/direkte-bundessteuer/dbst-jp-kantone-2016.html

Corporate income tax rates in the cantons – trend from 2007 to 2021

After corporate income tax rates were reduced a few times in the (distant) past, rates stagnated somewhat for a while until Basel-Stadt and Vaud cut their rates in 2019 and most other cantons followed suit in 2020. Individual cantons have (initial or further) reductions scheduled for 2021.



Note: Max. effective pre-tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Corporate tax multipliers for BL, BE (only municipal) FR, GE, JU, SO (only cantonal) and TG for 2020. Source: KPMG Switzerland

Corporate income tax rates in the cantons – 2020 and 2021

After many rates had been reduced in the previous year due to the Corporate Tax Reform (TRAF), the period from 2020 to 2021 only saw tax rates reduced in a few individual cases (mostly due to tax multiplier adjustments). The most major reductions were made in the cantons of Valais and Zurich, where tax rates were reduced in connection with TRAF.

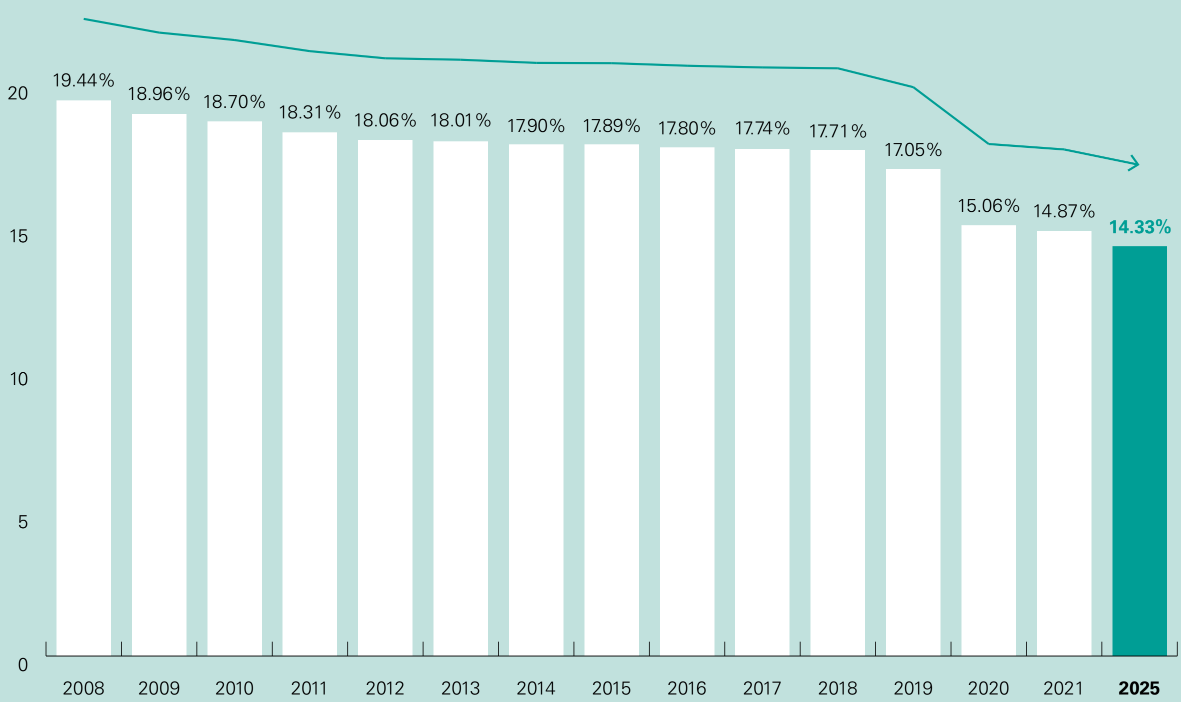
Note: Max. effective pre-tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Corporate tax multipliers for BL, BE (only municipal) FR, GE, JU, SO (only cantonal) and TG for 2020. Source: KPMG Switzerland

Corporate income tax rates in the cantons – 2021 and 2025
Some cantons have not implemented all tax reductions in 2020 (or 2021) that were provided for within the scope of the tax reform. They spread the reductions out gradually over the space of up to five years. The Canton of Zurich had originally planned another reduction from 2023 onward (in addition to the 2021 reduction) as part of a separate bill. This move has since been rejected by the Cantonal Parliament.

Note: Max. effective pre-tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Corporate tax multipliers for BL, BE (only municipal) FR, GE, JU, SO (only cantonal) and TG for 2020. Source: KPMG Switzerland

Corporate income tax rates in the cantons – trend: 2008 to 2025

While the average tax rate had been substantially reduced from 2019 to 2020 (as a result of the Corporate Tax Reform TRAF), only a slight reduction was made from 2020 to 2021. Another slight decline can be expected in the next five years since a few cantons are planning further cuts.



Note: Max. effective pre-tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Corporate tax multipliers for BL, BE (only municipal) FR, GE, JU, SO (only cantonal) and TG for 2020. Source: KPMG Switzerland

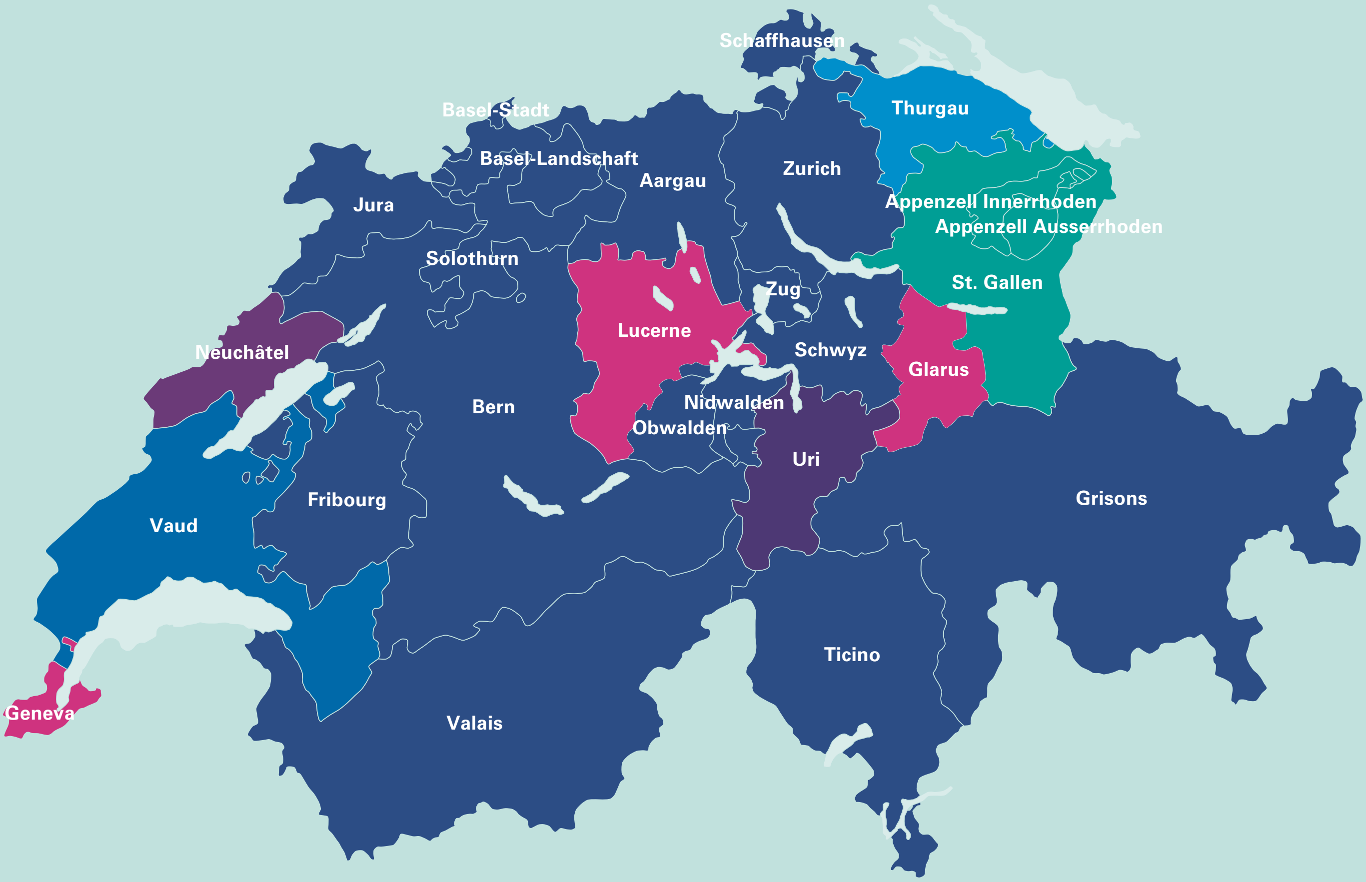
Minimum tax rate

A comparison of the minimum tax rates (maximum relief provided by the new instruments or transitional rule) reveals that the cantons are closing ranks, in part because high-tax cantons, in particular, are using new instruments to provide more extensive relief while the low-tax cantons are frequently more likely to grant limited deductions.

* in case of max. deductions through use of measures under consideration the overall limitation rule

Patent box relief

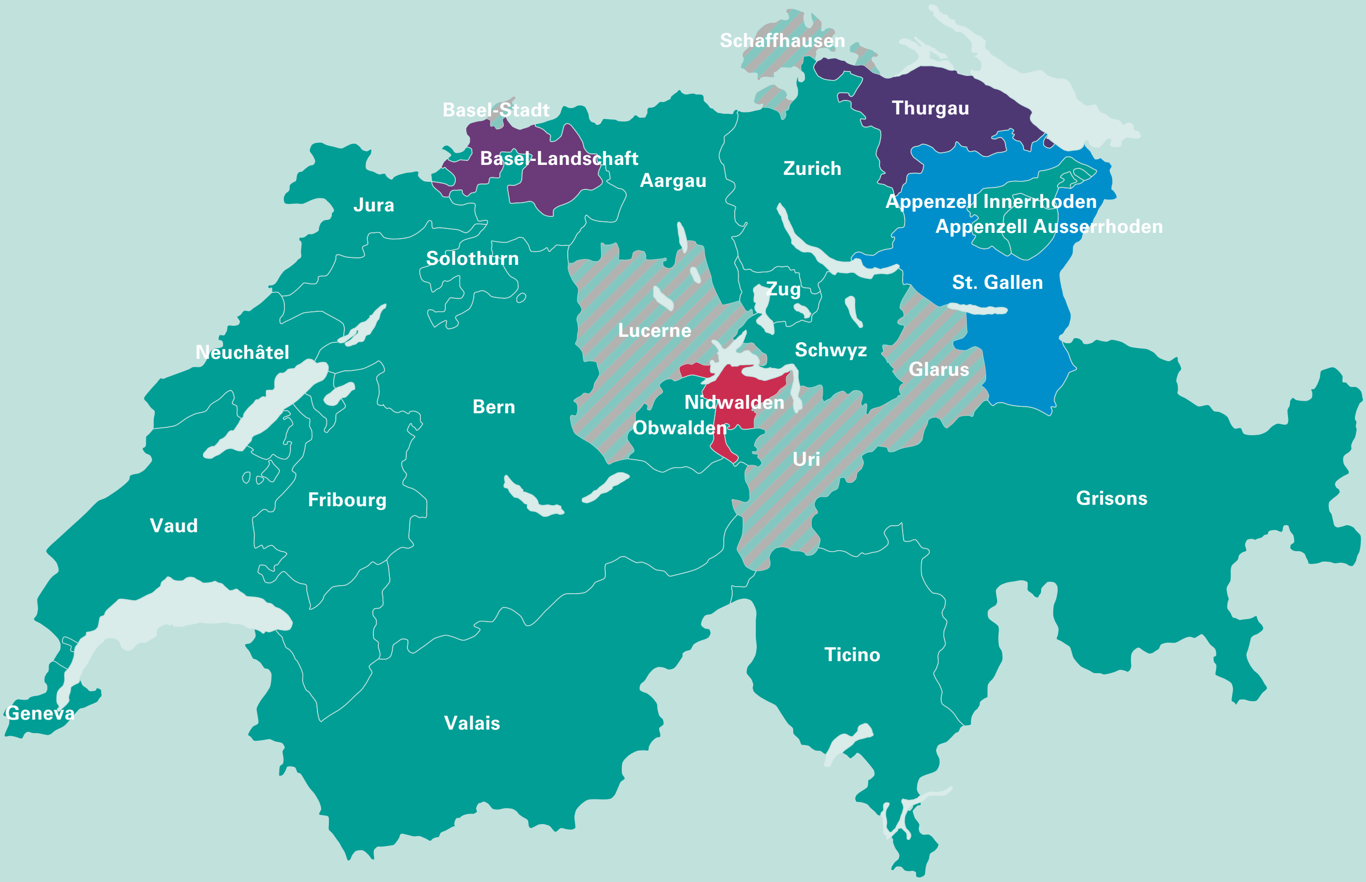
While most of the cantons have set the relief to a maximum of 90%, a few cantons – Geneva, Glarus, Lucerne, Neuchâtel and Uri in particular – are setting this threshold significantly lower.



- 90% Patent box relief
- 60% Patent box relief
- 50% Patent box relief
- 40% Patent box relief
- 30% Patent box relief
- 20% Patent box relief
- 10% Patent box relief

Additional R&D deduction

With the exception of a few cantons in Central Switzerland (Lucerne, Nidwalden, Uri), Glarus, Schaffhausen (only from 2025 onward) and Basel-Stadt, all cantons have introduced the additional deduction for R&D, with most of them capping this deduction at a maximum of 50%.



- 50% Additional R&D deduction
- 40% Additional R&D deduction
- 30% Additional R&D deduction
- 20% Additional R&D deduction
- 10% Additional R&D deduction
- 0% Additional R&D deduction
- n/a

Comparison between cantons and the countries of Europe
A comparison with Europe reveals very few changes made to the lower tax rates. The cantons of Central Switzerland are still positioned positively and they were also joined by Basel-Stadt, Geneva and Vaud in 2020. The Channel Islands and a few countries in (South-)Eastern Europe are the only locations that still offer lower ordinary corporate tax rates. Ireland remains Switzerland's most important competitor in Europe. Very few changes have been made in the European midfield.

Coming in last in terms of the attractiveness of their ordinary corporate tax rates were several countries in Northern, Western and Southern Europe. France and Turkey lowered their rates in 2021. France is planning to reduce its rate to 25% by 2022. Slight improvements were achieved by a few Swiss cantons that tend to be on the upper end (Valais and Zurich).

Note: Max. effective pre-tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Corporate tax multipliers for BL, BE (only municipal) FR, GE, JU, SO (only cantonal) and TG for 2020. Source: KPMG Switzerland

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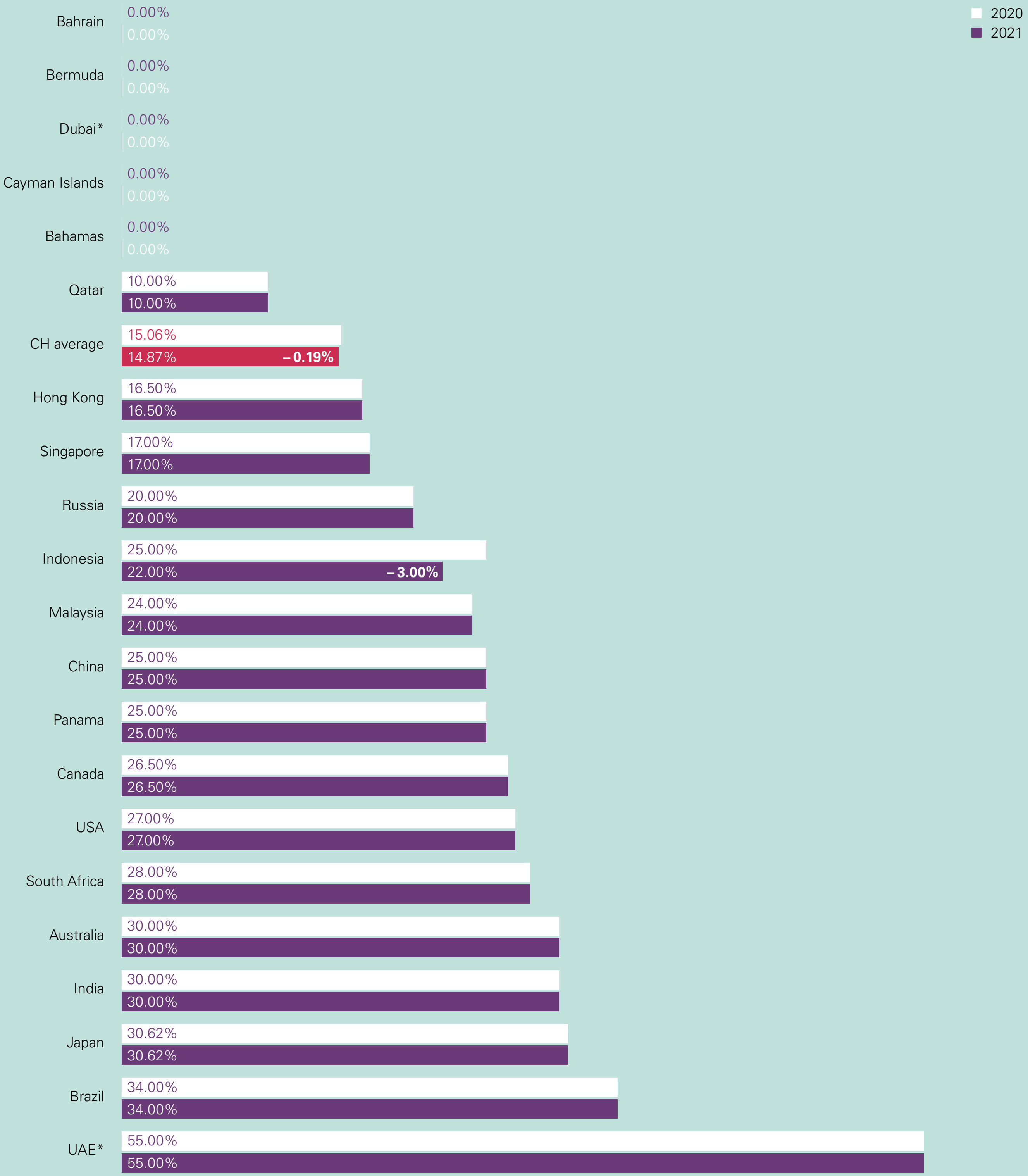
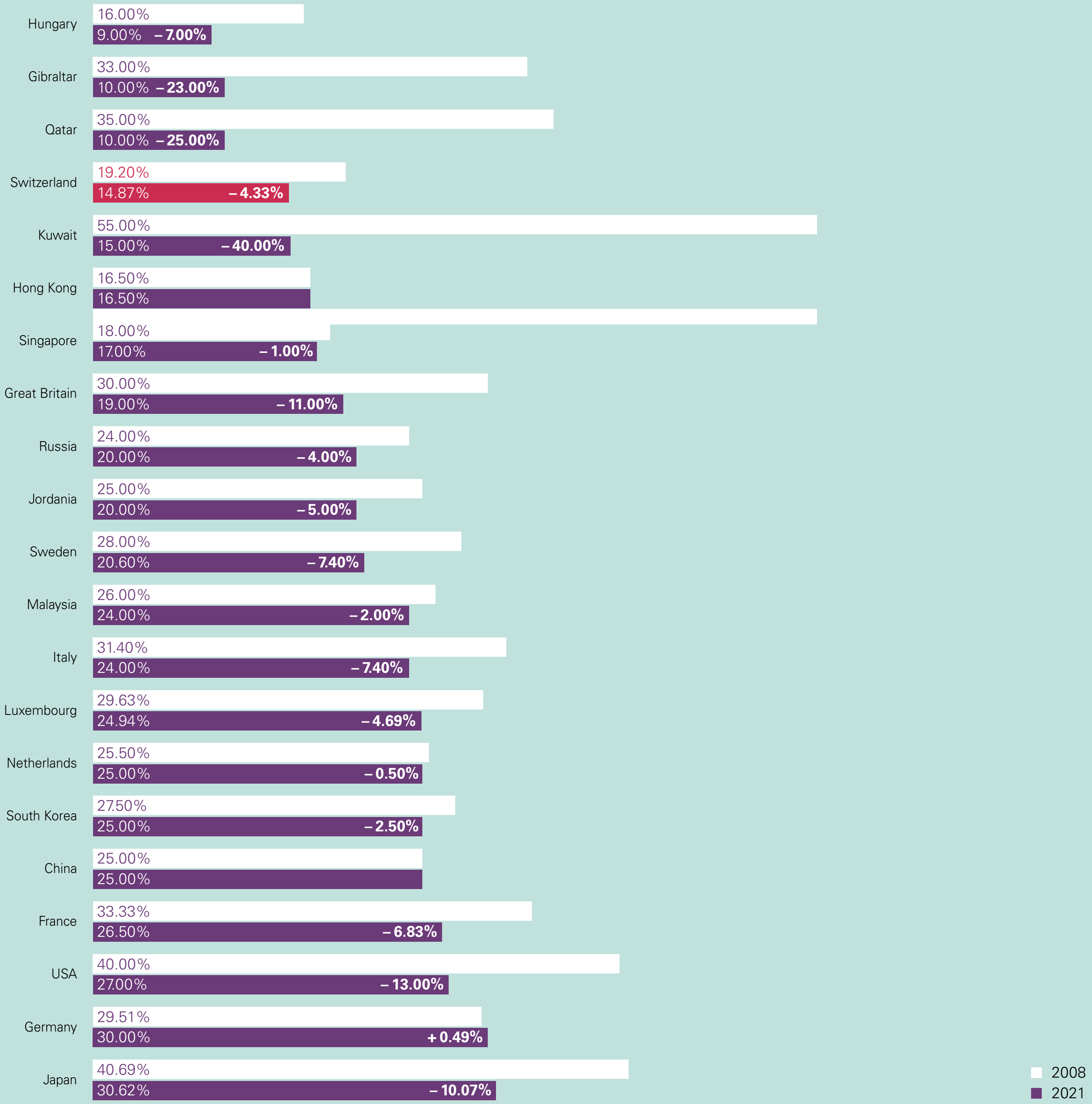
Non-European comparison (selected countries)
The traditional offshore domiciles are still in the lead in terms of their tax attractiveness. A comparison with countries outside Europe reveals that Switzerland is still solidly positioned in the top third (ahead of Hong Kong and Singapore).

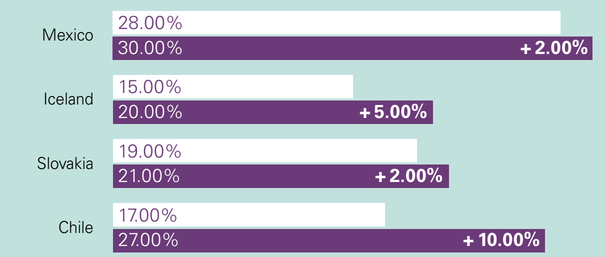


Note: Max. effective pre-tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Corporate tax multipliers for BL, BE (only municipal) FR, GE, JU, SO (only cantonal) and TG for 2020. Source: KPMG Switzerland
* with exceptions (0% – 55%)

Trend: countries 2008 and 2021

Corporate income tax rates have declined sharply in the past few years, with more comprehensive reductions in excess of 10 percentage points seen in the Middle East, the US, the UK and Japan, in particular.





Only a few countries have actually raised their corporate tax rates since 2008.

Note: Max. effective pre-tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Corporate tax multipliers for BL, BE (only municipal) FR, GE, JU, SO (only cantonal) and TG for 2020. Source: KPMG Switzerland

Individual taxation

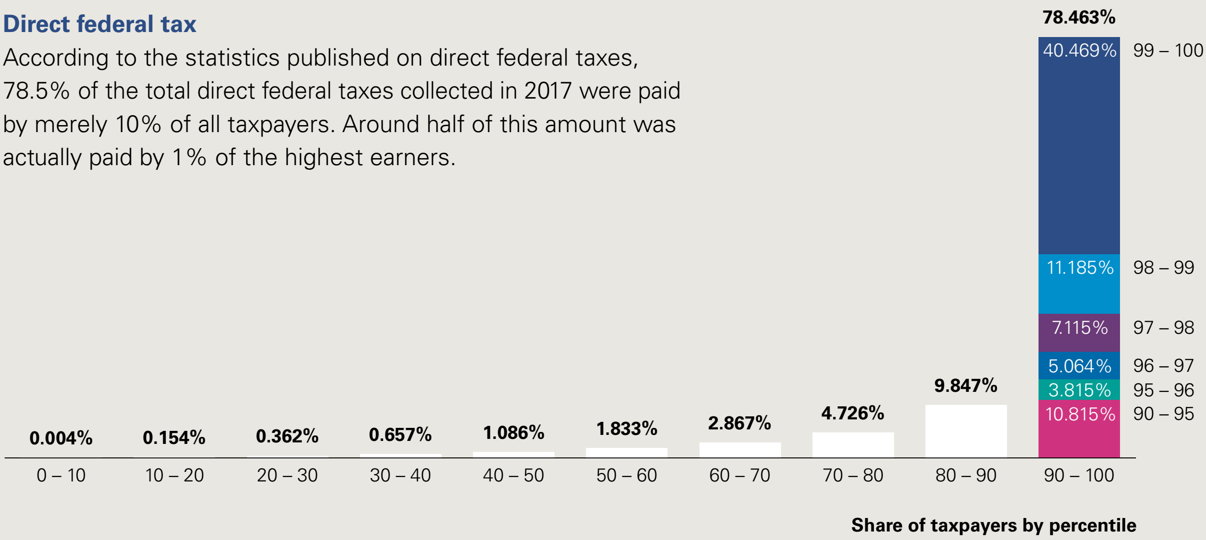
Income tax

Income tax rates in the cantons

Switzerland remains an attractive business location for private individuals. Tax rates for individuals have changed only minimally compared to the previous years and have remained stable with an average maximum tax rate of around 33.75%. Compared with other European and non-European countries, Switzerland is holding on to its midfield status.

Direct federal tax

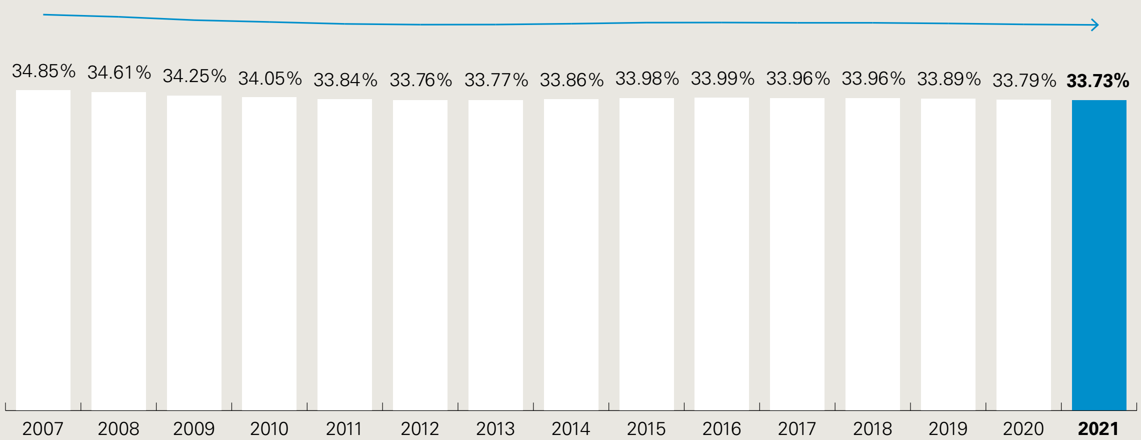
According to the statistics published on direct federal taxes, 78.5% of the total direct federal taxes collected in 2017 were paid by merely 10% of all taxpayers. Around half of this amount was actually paid by 1% of the highest earners.



Source: https://www.estv.admin.ch/estv/de/home/allgemein/steuerstatistiken/fachinformationen/steuerstatistiken/direkte-bundessteuer.html

Income tax rates in the cantons – trend from 2007 to 2021

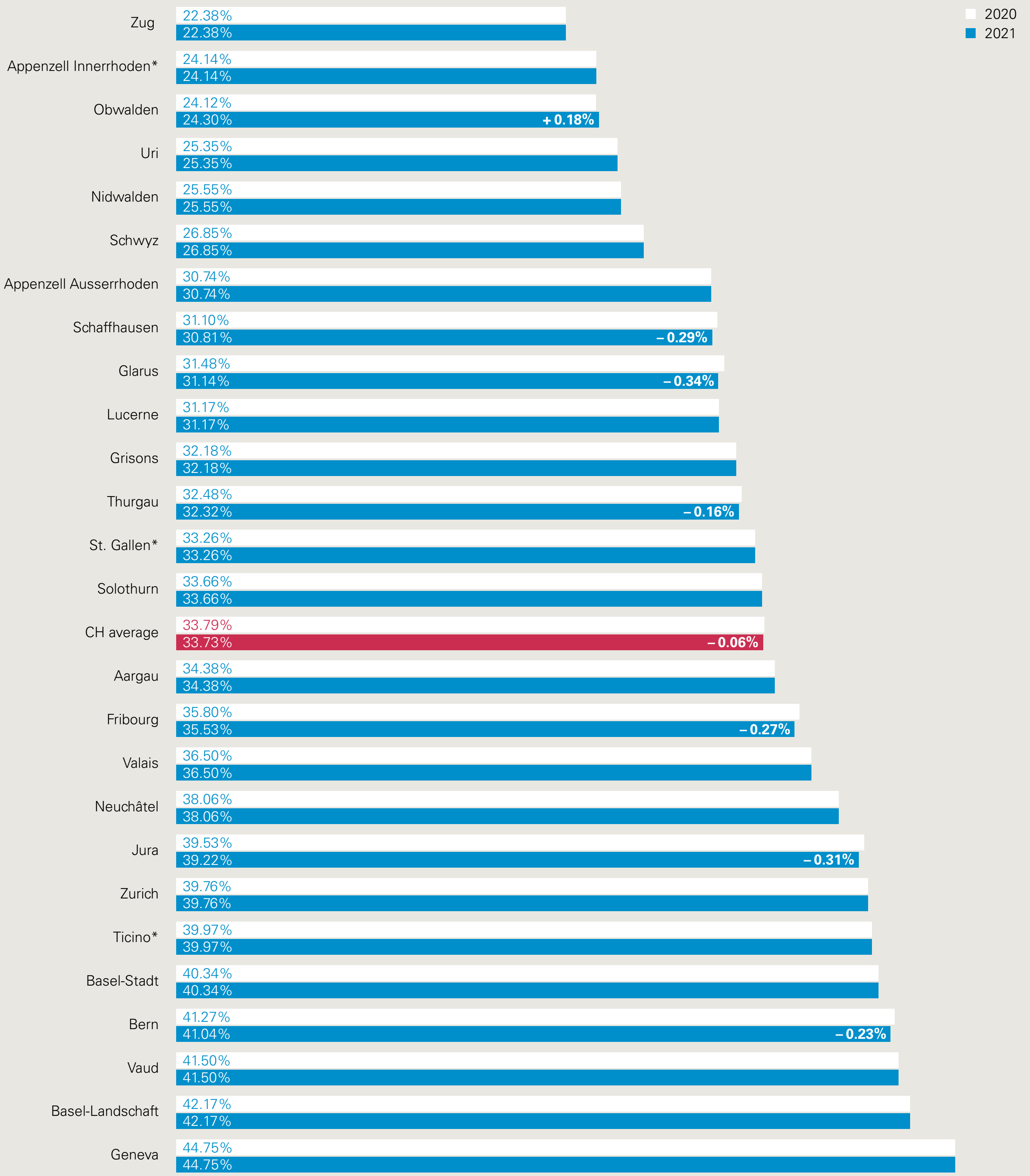
The cantons have tended to reduce the maximum tax rates for individuals in Switzerland by 1% over the past 12 – 15 years. While this trend continues in 2021, most cantons have left their tax rates unchanged in recent years.



Note: Max. effective income tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Income tax rates in the cantons = tax rate in the cantonal capital + 11.5% federal tax. Source: KPMG Switzerland

Income tax rates in the cantons – 2020 and 2021

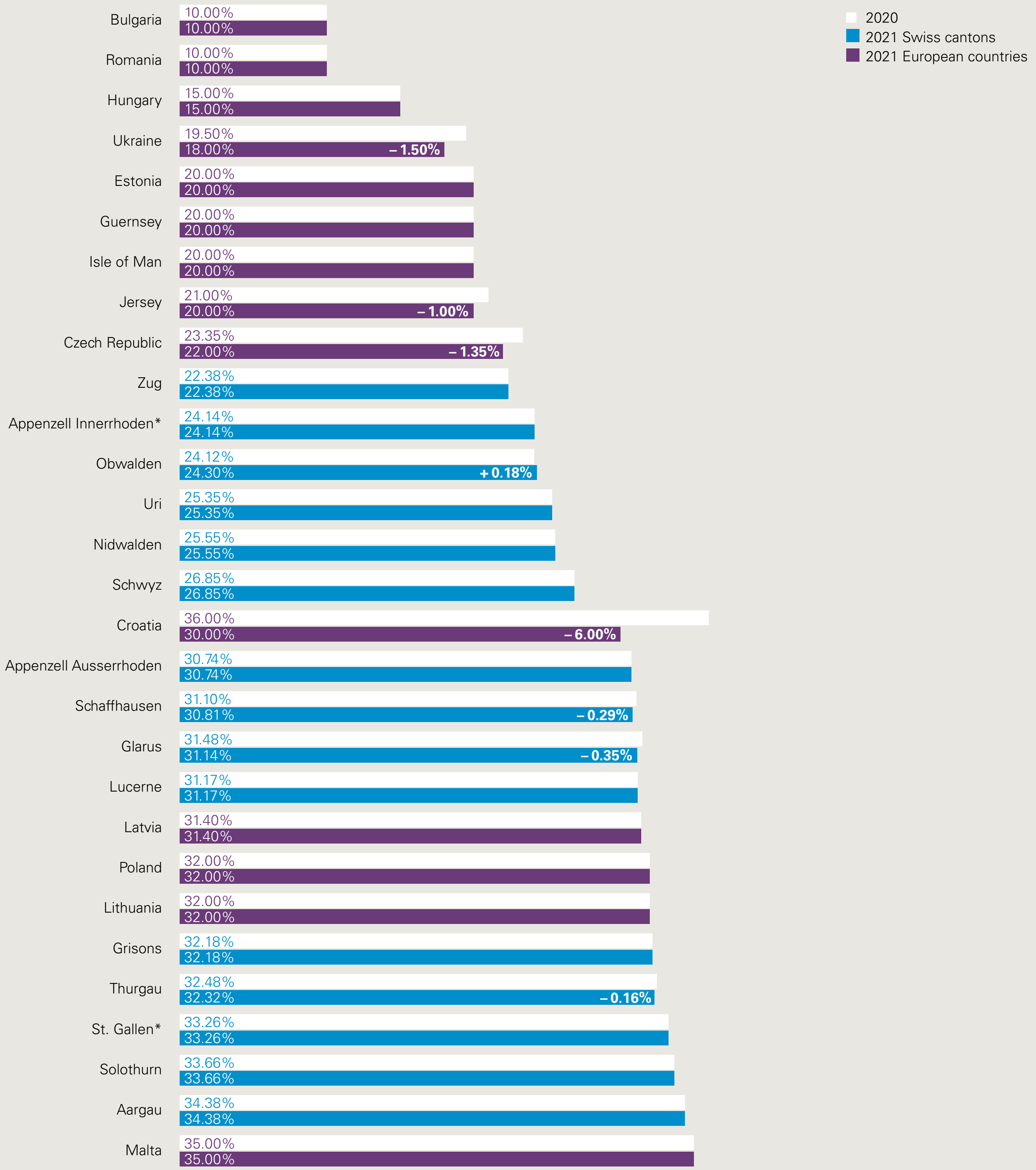
The tax rates in Switzerland have hardly changed for 2021. The cantons of Thurgau, Jura, Glarus and Bern show a minimal reduction in maximum tax rates compared with the tax rates of the previous year; only the Canton of Obwalden raised its rate slightly. The cantons of Western Switzerland continue to have the highest income tax rates - above all Geneva.



Note: Max. effective income tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Income tax rates in the cantons = tax rate in the cantonal capital + 11.5% federal tax. Source: KPMG Switzerland
* based on 2020 tax rates

Comparison between the cantons and the countries of Europe

Compared to Europe, the cantons of Central Switzerland are definitely competitive and can hold their own against low-tax havens like Jersey and the Isle of Man. A tax reform resulted in Croatia drastically cutting its income tax rates in 2021.



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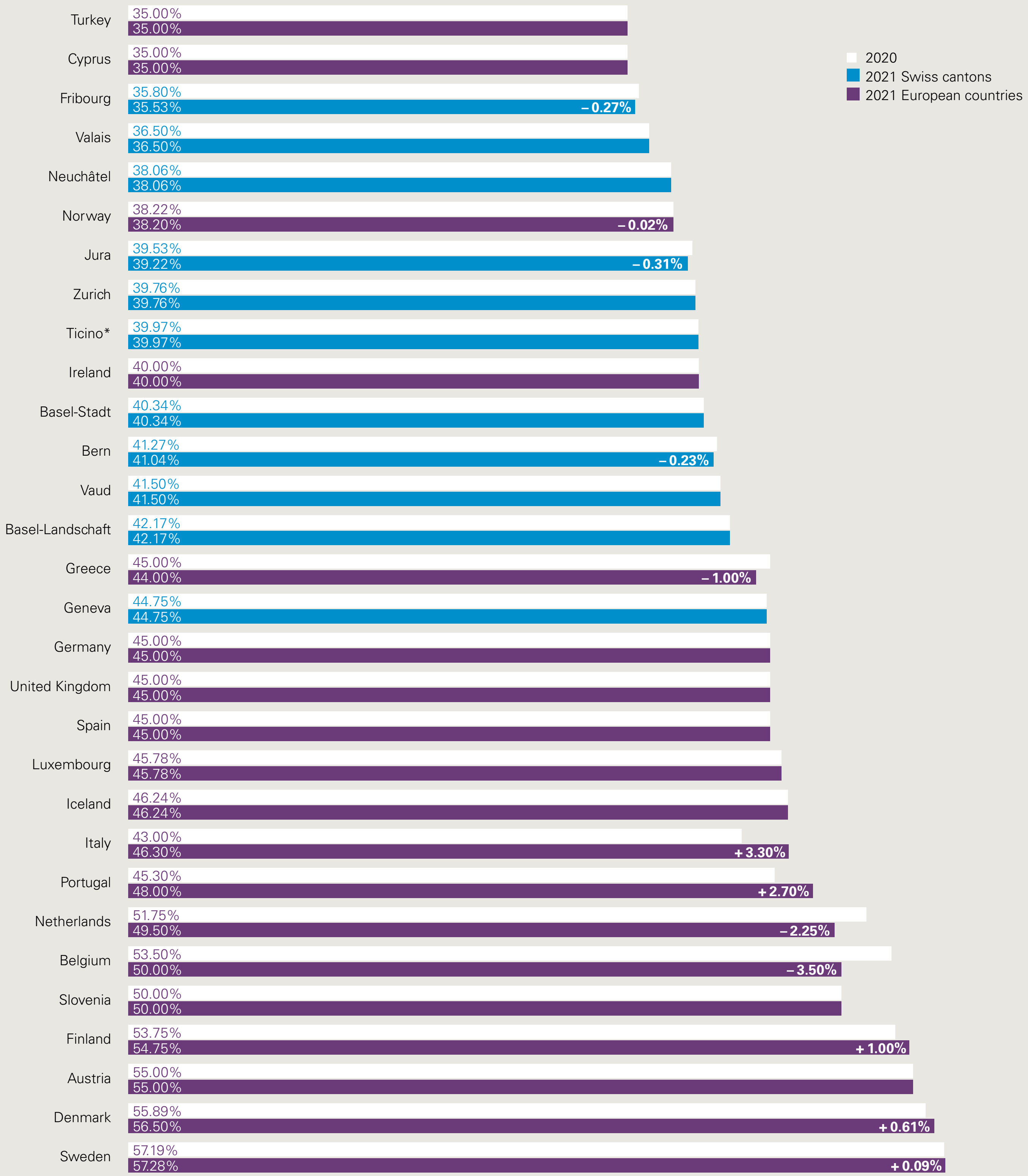

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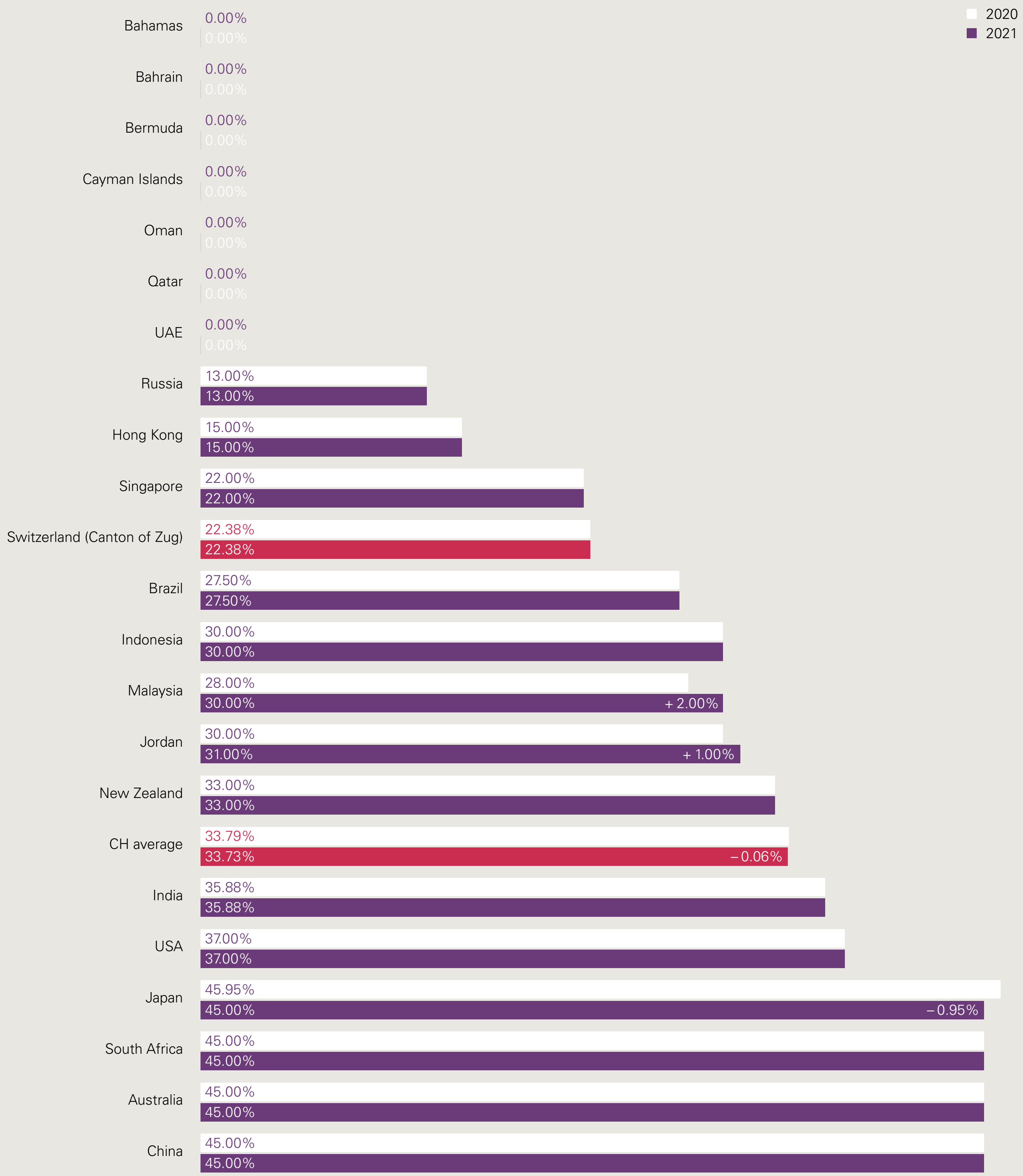
* based on 2020 tax rates

Comparison with non-European countries (selected countries)
The traditional offshore domiciles are still in the lead in terms of the attractiveness of their income tax rates. Compared to non-European countries, Switzerland is still in the midfield. A comparison between the low-tax cantons of Central Switzerland and non-European countries shows that they are comparable with Singapore.



Note: Max. effective income tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Income tax rates in the cantons = tax rate in the cantonal capital + 11.5% federal tax. Source: KPMG Switzerland

Trend: Countries 2007 – 2021

Many countries in Eastern Europe have drastically cut their tax rates over the past decade by introducing flat rate taxes while an upward trend was seen in the tax rates of the Baltic states and a few states in Northern Europe.

Note: Max. effective income tax rate for federal/cantonal/municipal taxes in the relevant cantonal capital. Income tax rates in the cantons = tax rate in the cantonal capital + 11.5% federal tax. Source: KPMG Switzerland

Restructuring the international corporate tax system

Further restrictions are planned with respect to international tax competition and this will have repercussions on Switzerland's tax and location strategy going forward.

The OECD/G20 project entitled "Addressing the Tax Challenges of the Digital Economy" has been in progress for several years now. It actually addresses much more than merely the topic of how to tax the digital economy. In fact, this project aims to restructure the international corporate tax system by making changes to principles on which the current system is based that had previously been considered fundamental. The goal is not only to redistribute a portion of corporate tax income, rather to use the planned minimum tax rule as a way of placing greater restrictions on or even canceling out international tax competition to a certain extent. Being a low-tax location for international enterprises, that could put pressure on Switzerland.

Ongoing OECD/G20 project

The basic approach being taken by the international community in its effort to address the tax challenges of the digital economy is to further develop the former work program for BEPS (Base Erosion and Profit Shifting) in such a way that cancels out base erosion and profit shifting to the greatest possible degree. The proposals are based on two pillars. Pillar One aims to redistribute tax jurisdictions and amend profit allocation regulations both with respect to Automated Digital Services (ADS), in particular, but also in Consumer Facing Businesses (CFB). Pillar Two aims to define a minimum global tax rate to close any gaps still remaining after the original BEPS measures were implemented.

What does Pillar One include?

The BEPS measures presented in 2015 proved insufficiently effective for the digital economy. As a result, several states – including the EU, in particular – endeavored to enact unilateral measures to levy a digital services tax. Not only could this result in greater complexity, but it also harbors the potential for double taxation, as well. To avoid these disadvantages, the G20 and OECD would like to arrive at a consensus solution within the framework of the aforementioned project – as a supplement to or next evolution of the original BEPS project, so to speak.

According to the draft version, Pillar One will impact both automated digital services as well as consumer-facing business. With regard to automated digital services, a list will define which activities fall in this category and which do not. Automated means that the system used to provide the service only needs a limited amount of human input. A service is considered digital if it is provided via the Internet or an electronic network. Consumer-facing business covers the direct or indirect sale of goods and services to end consumers (goods purchased for personal rather than for commercial purposes), including franchising and licensing related to sales of this nature. For a multinational entity to be subject to taxes pursuant to Pillar One, it must generate both a certain level of consolidated revenue (global revenue threshold of EUR 750 million, for example) as well as a certain amount of revenue earned outside its domestic market (foreign revenue threshold of EUR 250 million, for example). That would mean it only impacts larger entities, at least initially.

Within the scope of Pillar One, the jurisdiction in which the revenue is generated (market jurisdiction) is granted a tax right (nexus) once a certain threshold is exceeded. It no longer matters whether a subsidiary or a fixed place of business is registered in this jurisdiction. A share of the global residual profit, meaning after the deduction of routine remuneration, is then allocated to the market jurisdiction. In a departure from the previous arm's length principle, simplified and flat-rate profit allocation principles are to be applied.

How could Pillar One affect Switzerland?

Even if Switzerland is not home to any of the big players in the digital economy, a certain amount of the profit base is likely to be redistributed from Switzerland to foreign market jurisdictions since this will also impact large groups with consumer-facing business. Conversely, as a country with a relatively small number of consumers, Switzerland is likely to receive a smaller amount of the base as a market jurisdiction. On the bottom line, Pillar One is likely to cause Switzerland's tax revenue to decline. However, since no final decisions have been reached on the key parameters yet, the extent of the decline is difficult to estimate. Whether or not a political agreement can be reached on this should become apparent by mid-2021.

If the international community fails to reach any consensus on Pillar One, (additional) digital services taxes already adopted or even enacted (but still suspended) by various countries would be applied. This could impact certain Swiss companies, which would become subject to additional taxes (double taxation) and be faced with administrative challenges. Since the area of application for digital services taxes such as these is rather narrower than that defined in the current version of Pillar One, the impact on Switzerland could even be lower (depending on the specific details and assuming that the larger Swiss groups are more active in the consumer- facing business and less active in the area of automated digital services).

What does Pillar Two include?

While many fundamental questions remain unanswered with respect to the details of Pillar One, agreement within the international community seems more within reach for Pillar Two, which focuses on the definition of an absolute minimum tax rate for taxing corporate profits. Even if the central parameter – the amount of the minimum tax rate – is still undecided, a great deal of progress has already been made on determining the mechanics of how the jurisdictions will be able to implement this kind of minimum tax. Work is currently being done to simplify those mechanics, however.

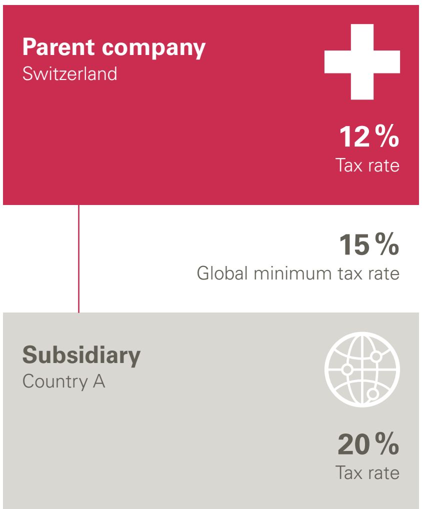
How could Pillar Two affect Switzerland?

The question of what repercussions a minimum tax rate would have on Switzerland depends on the actual tax rate defined. With a minimum tax rate of up to around 12%, the repercussions on Switzerland would be relatively moderate since – if we disregard the effects of relief measures such as the patent box – nearly no canton in Switzerland currently has an ordinary tax rate lower than this (only Nidwalden and Zug are slightly lower). There is some risk, though, particularly if the minimum tax rate is gradually raised over time after its initial introduction.

To illustrate the repercussions of a minimum tax rate on Switzerland, two greatly simplified situations should be considered: the inbound situation and the outbound situation. The following example looks at two possible constellations.

Repercussions on outbound relationships

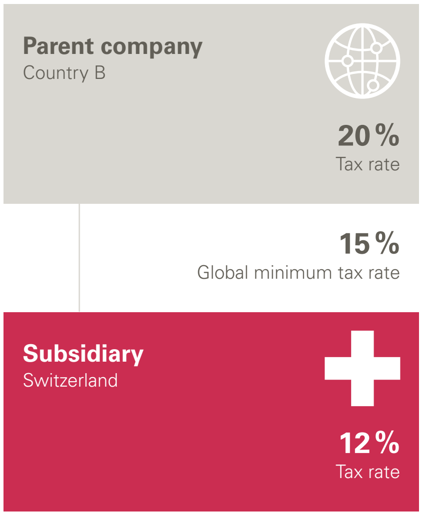
In a traditional outbound situation, we presume that a Swiss parent group uses subsidiaries to operate in a foreign country. In this case, the subsidiaries purchase services from the Swiss parent company (including goods, trademark licenses or other types of licenses, etc.). While the Swiss company is taxed at a rate of 12%, which is lower than the assumed minimum tax rate of 15%, the subsidiary in Country A is taxed at a higher rate. This is illustrated below.



The mechanisms detailed in draft versions for Pillar Two could lead to a situation in which an additional tax is levied on the subsidiary in Country A. This could be done based on the difference between the Swiss tax rate and the minimum tax rate (through the partial non-deductibility of payments made by the subsidiary to the parent company). This would cause the group's total tax burden to rise without generating any additional tax revenue for Switzerland. Switzerland might have to make a fiscal policy decision and consider whether to raise local tax rates (with respect to situations like this) to the level of the minimum tax rate so at least some Swiss tax revenue is generated (if the corporation is going to have an additional tax burden anyway).

Repercussions on inbound relationships

In a traditional inbound situation, we presume that a foreign parent company sets up a subsidiary in Switzerland in order to operate a business through it. This is illustrated below.



In constellations such as these, Switzerland is often considered as a location if the business in question can be operated at attractive tax conditions (for the Swiss subsidiary).

With its most recent corporate tax reform, TRAF, Switzerland and the cantons moved in a direction that resulted in the elimination of special tax regimes but lower general corporate tax rates in most cantons. Lower general tax rates are intended to preserve Switzerland's attractiveness as a business location. However, if tax competition is canceled out below a certain threshold, as provided for under Pillar Two, precisely this strategy will come under pressure. What's more, the special tax rules currently in place (patent box, etc.) could lose their effectiveness if companies are forced to assume that the minimum tax regulations provide no exceptions for measures such as these.

In the example provided, the Swiss company's tax burden of 12% is lower than the assumed minimum tax rate of 15%. The mechanisms detailed in draft versions for Pillar Two could lead to a situation in which an additional tax based on the difference between 15% and 12% is levied on the parent company in Country B for the profit generated by the Swiss company (e.g. via an income inclusion rule/top-up tax). The tax burden of the Swiss company would then shoot up to the minimum tax rate of 15%. The group's overall tax burden would rise accordingly (without generating any additional tax revenue for Switzerland). This would dilute the advantage offered by Switzerland's lower tax rates. It would no longer be able to set itself apart from a rival location with a tax rate of 15%, for example, because the result in both cases would always be a tax burden of 15% when all is said and done. This would cancel out tax competition under the 15% threshold, meaning that the competitive edge offered by a tax rate any lower than this would be limited.

By effectively restricting or even canceling out tax competition, a minimum tax rate is likely to have an impact on Switzerland's attractiveness as a location, in particular. While low tax rates may not be the sole criterion influencing the choice of location, they still carry a great deal of weight. On the other hand, Switzerland's high costs are also factored into the decision. In the past, high costs incurred in Switzerland could be offset by lower taxes. This advantage could disappear and since there is no way to change Switzerland's higher cost level in the short term, the high costs might have an even greater impact on the location's attractiveness.

If tax competition is restricted, Switzerland and the cantons would be forced to develop the location by taking even stronger countermeasures in an effort to limit the extent of the country's loss of attractiveness. Measures to ensure the availability of qualified workers or the creation and expansion of clusters are conceivable. The majority of companies that decided to set up business in Switzerland in 2019, for example, are active in the areas of information and communications technology and life sciences (taken from the annual report for the Greater Zurich Area).

With respect to qualified workers, Switzerland ranks among the leaders in a global comparison. This is a status quo that absolutely has to be maintained so that Switzerland can continue to position itself as an attractive location.

Conclusions

The OECD/G20 project aimed at addressing the tax challenges of the digital economy has been a topic of discussion for quite some time now. The focus has generally been on Pillar One, which redistributes the corporate tax base away from Switzerland and into foreign countries. While Pillar Two has not received as much attention, it is nevertheless expected to have relevant repercussions on Switzerland's attractiveness as a location. Switzerland is (still) able to use its low tax rates to score points in the international location competition. Ongoing developments could, however, cause a fundamental shift in the forces and mechanisms at play in international tax competition, which is a component of location competition. With that in mind, Switzerland is well advised to focus more strongly on other location factors like ensuring the availability of qualified workers or creating and expanding strong clusters.

Areas for action for Switzerland as a tax location

Switzerland has been deftly positioning itself in the international tax environment for decades now, both through the use of attractive tax regimes and by presenting itself as a reliable partner with a proven practice on rulings. While there have always been locations that are more attractive than Switzerland from a tax perspective, the country's blend of good infrastructure, flexible labor law, political and economic stability along with a relatively attractive tax system have given Switzerland an edge.

Several international developments including the OECD project on Base Erosion and Profit Shifting (BEPS), the automatic exchange of information, the spontaneous exchange of certain tax rulings, etc. have ushered in a situation in which the tax system and/or low tax rates are increasingly playing merely a secondary role in the choice of location. In response to international developments, Switzerland eliminated a variety of different tax regimes within the scope of the Federal Act on Tax Reform and AHV Financing (TRAF). In exchange, it now offers tax incentives for research and development and, in particular, has additionally reduced tax rates at the cantonal level. Yet as motions within the scope of BEPS 2.0 discussions have revealed, these compensatory measures have reached their limits. Even if other factors such as the free movement of persons or access to foreign markets have become much more important for Switzerland as a location in the meanwhile, the fact that Switzerland continues to ponder ways of eliminating those elements of our tax system that are detrimental to our standing as a location while still working within the constraints of the internationally accepted framework is important and appropriate.

Group of experts' report on Switzerland as a tax location

The Head of the Federal Department of Finance, Federal Councillor Ueli Maurer, commissioned a group of experts from the Confederation, the cantons, businesses and the scientific community to propose fiscal policies aimed at improving conditions for the private sector and positioning Switzerland as an attractive investment location. The analysis is to focus on the efficiency objective[1] and the location objective[2]. Assessing the proposal's political feasibility or financial viability was not part of the assignment.

After several hearings, the group of experts' report was then published in February 2021.

The report states that the merits of the Swiss tax system (tax law, tax culture, stability, legal certainty) should be preserved and maintained as they are key factors in the success of Switzerland as a business location and contribute to the good financial health of public budgets.

In this context, the group of experts has formulated some guiding principles (targets for the tax system), which should serve as a roadmap for future fiscal policy discussions. It is also entirely possible that these principles could have conflicting priorities. The group of experts acted upon the maxim to "promote growth and the location's attractiveness".

These are the **guiding principles** they formulated:

Tax mix

1. Tax is predominantly levied on income and consumption
2. Tax law contributes to sustainable development and promotes innovation

Tax design

3. Tax law is based on simple rules
4. The tax base is broad and the rates are low
5. The tax system avoids disincentives to work
6. Taxes are neutral vis-à-vis different forms of financing and do not hinder capital accumulation

Process and tax culture

7. The tax culture is client- and citizen-oriented; digitalization responds to these objectives

International aspects

8. Switzerland occupies a leading position in the international competition among business locations

[1] A tax system is deemed efficient if it achieves the specified objectives (in terms of tax revenue and/or distribution) with as few welfare-reducing distortions as possible in the allocation of production factors (especially labor and capital).

[2] The aim of the location objective is to establish a tax system that offers attractive conditions for mobile and value-chain-relevant activities compared to rival locations.

The approach of mainly taxing income and consumption ties in with the levers that best reflect economic performance. The goal is to move away from substance- and transaction-based taxes in order to minimize liquidity problems wherever possible and strengthen risk diversification. The recommendation favoring a broad tax base and low tax rates is expected to incentivize economic activity more strongly and the country's general welfare as a result. Negative incentives need to be reduced in the most targeted, effective way possible.

Besides the advantages mentioned, the Swiss tax system is also confronted with weaknesses and challenges. In that context – starting with the most important discrepancies between the current and target systems (guiding principles) – the group of experts identified which areas for action should be given top priority and recommended that policymakers tackle these areas. The precise details of tax reforms based on those areas for action would still have to be fleshed out in a second step within the framework of specific measures.

Areas for action identified by the group of experts:

Tax mix

1. Reduce capital and wealth taxes
2. Eliminate transaction taxes
3. Create financing neutrality
4. Ensure that uncovered costs for the environment and society are compensated
5. Promote research, development and innovation

Tax design

6. Restrict exemptions and deductions
7. Remove rate differentiation and exemptions in VAT
8. Introduce dual income tax (audit recommendation)
9. Improve incentives to work (audit recommendation)
10. Optimize the participation deduction
11. Expand loss offsetting

Process and tax culture

12. Push ahead with digitalization
13. Retain the practice on rulings
14. Embrace a client-oriented tax culture

International aspects

15. Reform withholding tax
16. Introduce tonnage tax

One of the **areas for action** was defined as **reducing capital and wealth taxes**. That would promote business and investment resilience while reducing the burden on start-ups, which often generate low profits during their early stage of development. It would also improve the self-financing option and strengthen companies' capital base. Since most OECD countries no longer levy taxes on equity or wealth, reducing Swiss capital and wealth taxes will have a positive impact on Switzerland's attractiveness as a tax location for international capital-intensive companies, in particular.

Another recommendation is to **eliminate transaction taxes**. This relates to the issuance stamp duty on equity capital and transfer stamp duty. Eliminating transaction taxes will reduce financing costs and have a less detrimental impact on the choice of financing, which is in line with the guiding principle on financing neutrality. Doing so would strengthen financing based on risk-bearing equity capital. This has a positive effect on both companies' resilience to crises and domestic value creation by establishing an incentive to bring trading business back into Switzerland.

Financing neutrality is to be achieved above all by creating the possibility of deducting the equity yield rate and by partially taxing dividends on non-qualifying participations. At the shareholder level, capital gains are now more tax-efficient than distributions due to the fact that no taxes are levied on private capital gains. This situation distorts the distribution policy in favor of retained earnings. Eliminating the unequal treatment would prompt companies to pare down non-essential working capital and reduce transaction costs. The partial taxation of (any) dividends makes it possible to distribute risk more broadly among participations and have a more widely distributed shareholder base. The possibility of deducting an equity yield rate bolsters the attractiveness of risk-bearing equity capital even further.

To achieve the goal of **promoting research, development and innovation**, the area of application for both the patent box and the additional deduction for R&D should be expanded. That way, copyrights to software as well as intellectual property rights such as designs and utility models or other types of technical know-how would also fall within the scope of the patent box. An easing of the overall limitation restriction is also up for discussion.

Another area for action was identified with respect to **optimizing the participation deduction**. The participation deduction leads to an indirect exemption for investment income. One disadvantage of the indirect exemption is the fact that loss carryforwards are offset against investment income. In a scenario such as this, profit is taxed multiple times, both at the parent company level and at the subsidiary level, thus leading to structures that are tax-optimized to circumvent multiple taxation. There are two conceivable approaches to this problem. One would be switching to a direct exemption and the other involves targeted adjustments to the system currently in place.

Another of the recommendations made by the group of experts relates to **loss offsetting**. The current option of offsetting losses over a seven-year period has the disadvantage that any loss carryforwards remaining after this period will be permanently forfeited. Young R&D companies, in particular, frequently post losses during their first few years of operation. In fact, the loss-generating period commonly lasts for more than seven years, meaning that some losses can no longer be offset. Additionally, companies posting a one-time loss are not treated the same as companies posting multi-year losses. Loss offsetting should be expanded as a result. That would strengthen companies' risk-bearing capacity and achieve greater neutrality with respect to investments.

A **withholding tax reform** is also advisable with an eye to boosting Switzerland's attractiveness as a tax location. The complex refund procedure, comparatively high withholding tax rates and the increasingly broad definition of abuse serve as deterrents to many investors and have prompted finance functions to be shifted to foreign structures. Likewise, the slightly different ways income and corporate tax are assessed compared to the assessment of withholding tax (due to the timing of collection and refunds) are also a disadvantage, especially in international relations. A reform of the withholding tax levied on interest payments would be easier to achieve and this would bring finance functions back to Switzerland, whereas a dividend reform, which could attract settlement projects and prevent outflows, would be more difficult as this would result in a substantial short-term loss of revenue.

Remarks from KPMG

Viewed in terms of the country's international attractiveness as a tax location, certain areas for action are more relevant (such as 1, 2, 3, 5, 10, 11, 15 and 16) whereas others are more internally focused or (possibly) indirectly beneficial to Switzerland's attractiveness as a location (such as 6, 7, 8, 9 and 12). Some areas for action are more operational in nature than they are strategic.

The group of experts does not provide any answers to **international developments**, such as the minimum tax rate or the establishment of new tax nexus rules and instead proposes measures in its report designed to strengthen the country's own tax framework independently of international requirements. The effect of many of the measures proposed for improving Switzerland's attractiveness as a tax location, such as expanding the patent box and the additional deduction for R&D or even introducing a deduction for equity-financing, may not be able to unfold under the influence of the **minimum taxation regulations** expected within the scope of the OECD/G20 project on addressing the tax challenges of the digitalized economy. Particularly if it has to be assumed that the minimum taxation rules do not foresee any exception for measures such as these.

The group of experts proposes **reducing or eliminating** several different taxes (capital and wealth taxes, issuance stamp duty, transfer stamp duty, some aspects of withholding tax) or introducing and/or expanding additional deductions (equity-financing deduction, expansion of loss offsetting, additional deduction for R&D and the patent box). Furthermore, a reduction of (top) tax rates on capital income and second earner income should be examined. Since the **financial needs** are unlikely to decrease in the medium term due to increased national debt resulting from measures enacted to combat the coronavirus, this begs the question of whether the aforementioned reductions and/or elimination of these taxes is realistic in the near future, in part due to the fact that wealth taxes, for example, account for a substantial portion of the tax revenue collected by many cantons and municipalities. No **reciprocal financing measures** are proposed apart from incentive taxes (unless these are designed purely as an incentive tax). The introduction of a tax on private capital gains is addressed indirectly when discussing the topic of financing neutrality by mentioning the fact that the exemption of a tax on private capital gains distorts the situation and talking about a possible reduction in tax planning options related to capital gains. Taxing private capital gains in the future would give rise to questions. Specifically, there is some doubt regarding how capital losses on private assets are to be treated – consistently. Further discussions are needed to clarify the extent to which loss offsetting should be possible.

Eliminating **transaction taxes** is beneficial to a location's attractiveness in the short to medium term, particularly in light of increasingly limited tax competition in the area of corporate taxes. Depending on how the revised international rules on corporate taxation work and how business models evolve going forward, the possibility of switching to transaction taxes in the long term is under consideration. For example, during the hearings held by the group of experts it has been proposed that the possibility of introducing a financial transaction or microtax will be examined.

The **dual income tax** model discussed in the report (merely an audit recommendation), under which earned income is subject to a progressive tax and capital income is taxed proportionally (whereby the proportional tax rate is lower than the maximum rate of the progressive rate levied on earned income), is likely to trigger heated political debates. The so-called 99% Initiative, which will be voted on soon, essentially calls for the opposite: taxing capital income at a higher rate than earned income.

The expert report is correct in stating that the various measures must be **viewed as a whole**, since several of them are interconnected with other measures. The measure that calls for the deductibility of the cost of equity, on the other hand, is somewhat contradictory to the (expansion of the) partial taxation of dividends. The availability of a deduction for the cost of equity is justified by the fact that this helps establish neutrality compared to borrowed capital (for which interest is deductible). Then, however, the tax levied on the investor would have to be neutral or the same, which would not be the case if dividends were partially taxed and interest income were taxed in full.

The withholding tax reform is probably the hottest topic on the political agenda and the Federal Council has published the dispatch on the subject on 15 April 2021. A consultation process on the tonnage tax is currently underway and will end on 31 May 2021.

We should be able to see soon how much progress tax reforms of this nature make in the political arena.

Fiscal policy projects can essentially be broken down into two different categories: those that focus on international location policy (increasingly externally driven; frequently projects undertaken by the international community or international standards) and those with a domestic focus that are expected to provide the necessary incentives, prompt certain behaviors and secure the country’s tax revenue. Projects that fall within the first of those categories must exploit any leeway left in the international requirements in a way that benefits Switzerland to the greatest degree possible. That calls for flexibility and rapid action. In the case of projects that fall within the latter category, care must be taken to ensure that they adhere to relevant and sensible basic principles and that no particular interests are prioritized.

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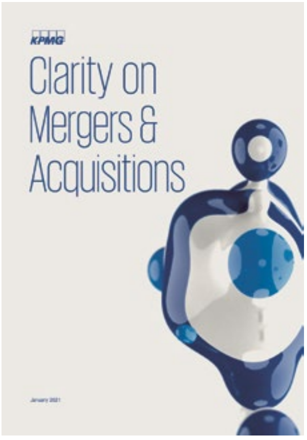

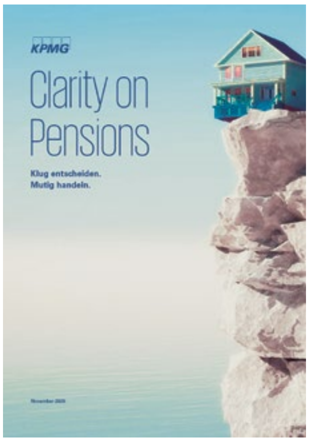

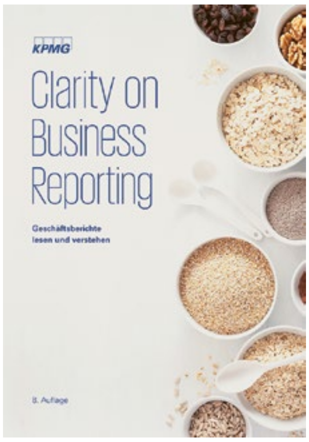

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