Swiss Tax Reform and its Impact on the Canton of Geneva

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Beginning 1 January 2020, Switzerland will significantly reshape its corporate taxation in an effort to comply with international tax standards while remaining one of the most attractive jurisdictions for foreign investments.

1. Introduction

In this article, I will provide the background that led to that Swiss tax reform ("Reform") also elaborating on the tax regimes that will be phased out. In addition, I will detail the main long-term and transitional measures of the Reform. Finally, I will critically assess whether the Reform will maintain the intended domestic and international competitiveness.

This contribution will be focused on the impact of the Reform in the canton of Geneva. Said canton has been a significant part of the most economically dynamic region of Switzerland over the last decades. It is also home to headquarters and worldwide/regional trading hubs of various major global players in certain industries (e.g. commodities trading).

2. Context

The European Union (EU) started to criticize certain Swiss privileged tax regimes in 2007; however, no significant steps towards reform were taken for several years. Nevertheless, pressure on Switzerland intensified when the OECD published in 2015 its Action 5 report (aimed at "Countering Harmful Tax Practices […]") of the Base Erosion and Profit Shifting (BEPS) initiative. The report specifically listed four Swiss tax regimes that needed to be removed: the cantonal holding regime (which fully exempts from cantonal income tax qualifying holding companies); the cantonal mixed and domiciliary regimes (which provide for low cantonal income taxation of qualifying foreign-source income); and the federal principal regime (which sets a low federal income tax rate for certain qualifying commercial headquarters with significant presence on site).

In response to the BEPS report, Switzerland accelerated its processes for Reform legislation. The federal government prepared a dispatch that pursued the three following goals: (i) maintain Switzerland as an attractive business location; (ii) strengthen the international acceptance of the Swiss tax system; and (iii) preserve the tax revenues of the Swiss confederation, cantons and communes. In 2016, a draft Reform package was adopted by the federal parliament. It aimed at removing the disputed Swiss tax regimes (see above) and another so-called "finance branch regime" beginning 1 January 2019; introducing new preferential tax regimes (see below); and detailing financing measures for the costs of the Reform. It was also anticipated that all cantons would unilaterally decrease their respective cantonal tax rates. A popular referendum was successfully called upon by opponents of said Reform and the Swiss citizens strongly rejected the proposed Reform in 2017. The reasons for the rejection appeared to be the complexity of the proposed measures (e.g. notional interest deduction); as well as uncertainties related to the financing of the Reform (in particular, for middle class and communes/cities).

In order to commit towards a Reform timeline extended by international stakeholders (OECD; EU), the federal government swiftly prepared new Reform legislation that still pursued the three above-mentioned goals while addressing the concerns expressed by the opponents and Swiss population through the 2017 referendum. This revised Reform legislation was adopted by the federal parliament in 2018. A popular referendum was once again successfully called upon. However, this time around, the Reform was accepted by the Swiss population on 19 May 2019.

On the same date as the federal referendum, a cantonal referendum on the Geneva cantonal law complementing and implementing the federal Reform was accepted by the Geneva population.

Finally, the federal principal as well as the federal and cantonal finance branch tax regimes will be phased out by the tax authorities at the same time the above-mentioned Reform will enter into force.

3. Reform in Geneva

Thanks to the accepted Reform, the following tax measures will be implemented in the canton of Geneva beginning 1 January 2020.

The income tax rate will be reduced to 13.99% from approximately 24.17% in 2019 (for companies without preferential tax regimes). For the sake of comparison, all tax rates below are a combination of federal, capital city and respective canton rates (here Geneva city).

For taxpayers which currently benefit from preferential cantonal regimes, a transitional measure (the so-called "two-tax-rate model") will allow them to be taxed at a preferential income tax rate in the range of 13.01%-13.99% until 2024 at the latest. The exact rate per year will be subject to a decision from cantonal tax authorities and will depend on how much foreign-source income the taxpayer had prior to the Reform and how much built-in gains and goodwill exist on top of its tax balance sheet in 2019.

Taxpayers which benefit from principal or finance branch regimes should be allowed to further lower their income tax rate thanks to a transitional measure at federal level but this is yet to be detailed. I anticipate that their tax rates could be reduced at best to 6.06% during 2020-2024 and to 7.21% in 2025-2029. The exact extent of such reduced tax rates would depend on actual implementation of the measures by the federal and Geneva tax authorities and on individual facts and circumstances.

The income tax burden may be further reduced by the following favorable measures. A patent box will provide for an exemption of up to 10% of cantonal taxable income. The patent box regime is compliant with BEPS requirements (in particular, it includes a nexus rule for qualifying costs) but only software which can be considered an inclusive part of a non-software registered patent may qualify for said patent box. Also, an additional deduction of 50% of qualifying R&D costs (mainly personnel costs) will be available. At most, the combination of the patent box and super R&D deduction measures can lower the income tax rate down to 13.47%, which is an overall limitation. As indicated above, taxpayers which benefited from privileged tax regimes pre-reform may continue to benefit from reduced transitional tax rates in 2020-2024. While available in some high-tax cantons such as Zurich, the notional interest deduction will not be possible in the the canton of Geneva.

Furthermore, companies newly migrating to Switzerland will have a clear legal basis to step up (to fair market value) the tax basis of their assets and goodwill tax-free at the time of migration. They may then depreciate their stepped-up basis with a tax effective deduction.

In addition, while the annual capital tax rate will be maintained unchanged at 0.4%, two favorable measures have been introduced. First, a significantly reduced rate of 0.001% will be available in proportion of certain qualifying assets (investments, intangibles, and intercompany loans) over total assets. Second, the capital tax burden will be reduced (down to nil at most) by the amount of cantonal income tax burden. This tax credit will only be progressively introduced taking full effect from 2024.

Other measures of the Reform not discussed in detail are an increase in the individual dividend income taxation and an extension of a tax credit to Swiss permanent establishments for interest and royalties taxed at source in foreign treaty countries.

In addition, a discretionary tax holiday providing for up to 100% exemption of cantonal income tax for up to 10 years will remain available after the Reform for new innovative businesses which in particular do not compete with existing cantonal industry, which create significant new headcounts, and/or which interact with local universities and research institutes.

4. Critical Assessment of the Reform and Conclusion

Post-Reform, it is anticipated that the income tax rates will range between 12.02% and 18.19% in Switzerland. The canton of Geneva will be slightly above the average rate in Switzerland but still be similar and sometimes better compared to cantons with comparable features (major city; proximity to an international airport; international schools and other infrastructures). While it is true that the innovation tools (patent box and additional R&D deduction) will result in tax rates that may not be as attractive as competing cantons and while the transitional tax rate for companies benefiting in 2019 from preferential cantonal tax regimes will also likely be higher than the domestic competition, the quality of infrastructure, the peer networking opportunities and the availability of cantonal tax holiday (which do not exist to the same extent in all competing cantons) should arguably ensure that Geneva will remain a primary location within Switzerland.

On an international scale, I estimate that Geneva alongside Switzerland should be even more prominent as a business place for the following reasons. First, companies will continue consolidating their business presence in key jurisdictions in reaction to BEPS substance requirements. Second, while the recent US tax reform may certainly tempt some US multinationals to repatriate onshore some overseas businesses, the political uncertainties with the next POTUS election and the soon phasing out of the privileged taxation of repatriated income are counterbalancing elements. Amongst EU Member States, the potential wide scope of future digital tax legislation and the far-reaching state aid case law will be factored in for business location decisions. Third, regarding the UK, Brexit and political instability will influence investment decisions.

In summary, I am convinced that the Geneva canton together with Switzerland will remain a primary business location for foreign and domestic investments post-Reform.

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