

## Change of status for companies with tax privileges

Due to TRAF, the tax privileges of holding companies, domiciliary companies and mixed companies will be abolished as per 1/1/2020. The question is whether these companies will have to face an increased tax burden from next January or whether there are tax planning options.

### A. Applicable law

As per the current law, a company with tax privileges has two advantages at the cantonal and municipal level: It does not pay any profit tax (holding companies) or pays a reduced profit tax (domiciliary and mixed companies) and it benefits from a reduced capital tax rate. At the federal level, on the other hand, the company is ordinarily taxed.

### B. Situation from 1/1/2020

The abolishment of the tax privileges from 1/1/2020 is based on federal law and is thus applicable all across Switzerland. As a consequence thereof, it is irrelevant whether or not the cantons adapt this point in their taxation laws until then. As far as the federal tax is concerned, nothing will change.

#### a) Profit tax

The profit tax is going to be what is referred to as a “**fiscal shock**” for companies that currently have tax privileges. For instance, if a holding company with its headquarters in Zurich is currently liable to pay approx. 8 percent tax (federal tax) on its interest income, it will become liable to pay a profit tax of more than 18 percent (federal, cantonal and municipal tax).

Various **countermeasures** have been implemented in order to absorb this fiscal shock. These have been described in detail below.

- The cantons are lowering their tax rate for profit tax. It should however be noted that companies that currently have tax privileges will still have to pay more profit tax as compared to before, no matter how much the reduction in the cantonal profit tax rates is.
- Hidden reserves present at the time of the change of status can be realised with a reduction in the tax during a transitional phase. Exceptions to this are, however, hidden reserves in investments of qualified participations; this especially concerns holding companies. Only if a holding company has hidden reserves as a result of ancillary activities can these reserves be used to reduce the tax. One may think of hidden reserves in trademark rights or in free float of shares.
- There are two methods for reducing the tax by means of hidden reserves, mentioned in the previous section:

- In the *disclosure method* ("step-up"), the hidden reserves are disclosed in the tax balance and depreciated over a specified period of time. The depreciation reduces the taxable profit and thus the cantonal profit tax. In order to ensure a specific minimal tax for the transitional phase, the annual depreciation is limited by means of a tax relief limitation. The extent of this tax relief limitation, the period of depreciation and the depreciation method are very different in different cantons.
- In the *special tax rate method*, the hidden reserves, if realised within five years, are subject to a special tax rate that is considerably lower than the ordinary tax rate. The special tax rate could be between 1-3 percent, depending on the canton.

Which of these two methods is more advantageous for a particular case is something that needs to be checked. Some cantons also allow a combination of the two methods. The special tax rate method will be applicable from the year 2020. In case of abolishment of the privileged tax status for a tax period before that, the disclosure method can be used. The exact time until which the respective methods can be used is different in different cantons. In order to be able to determine the optimum time and method, a simulated calculation on the basis of forecast figures is recommended.

#### b) Capital tax

With respect to capital tax, the situation in different cantons is again very different. Most of the cantons will abolish the privileged capital tax rate for status companies (exception: Grisons). However, this does not necessarily mean that the capital tax will increase, as the cantons are also implementing **countermeasures** in this regard.

- Most of the cantons are reducing the ordinary capital tax rate. However, this is often not enough to obviate a deterioration of the tax burden..
- Furthermore, the cantons can exempt equity parts allotted to investments in qualified participations, patents or corporate loans from the capital tax. This can result in a major tax reduction for a classic holding company with a considerable part of the assets in investments in qualified participations and corporate loans.

Against this background, the capital tax burden for holding companies with considerable ancillary activities (e.g. trademark rights, asset management), as well as for domiciliary and mixed companies, will tend to increase. Whether this will mean more tax and to what extent will be case-specific and will depend on the cantonal implementation of TRAF.

#### C. Planning options

It is already possible today for companies concerned to **voluntarily** relinquish their special status of privileged taxation and thus cause the change of status from privileged to ordinary taxation on their own behalf. This is possible for all tax periods that have not yet been finally

assessed. With regard to tax planning, it is interesting to note that, in certain cases, an early, voluntary change of status can be advantageous.

It is not possible to disclose hidden reserves in **investments in qualified participations**. The reason for this is that in case of a realisation in future, these hidden reserves are subject to a participation exemption and are thus not taxed. This, however, is not applicable in all cases. Especially if investments have been impaired in the past, there is a risk of tax implications in case of a reversal of the value in future. This can be avoided if the correct precautions are taken at the time of change of status.

Tax **losses** from a period before the change of status cannot be offset at the cantonal and municipal level or can be offset only partially. This is the reason why relinquishing the special status of privileged taxation early and voluntarily might be advantageous in a loss situation.

In view of the abolishment of the privileged taxation, the question of principle especially for a holding company may be asked, whether the company should continue to exist. After all, the company will not only need to pay taxes every year, but will also cause running costs for the administration. An optimisation by means of a **merger** or liquidation may thus be appropriate in certain cases. On the other hand, there are cases where founding an intermediate holding company in another canton might become necessary to reduce the capital tax burden. This is especially the case when a change of the legal domicile is not possible.

Several companies that currently have tax privileges do not have a lot of personnel and infrastructure. A **change** to another location is much easier to manage in such cases than in the case of operating companies. It must however be noted that the new location must have the necessary substance to be accepted from a tax perspective. A change of domicile should therefore be well-planned and should not be a rash decision.

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