

Swiss Tax Reform (TRAF) – Transitional Measures

Corporate Tax

On 19 May 2019, the Federal Act on Tax Reform and AHV Financing (TRAF) was approved in the public vote. The act will come into force on 1 January 2020. The successor of Tax Proposal 17, TRAF includes the abolishment of cantonal tax privileges for holding, domicile and mixed companies. Transitional measures are provided to prevent over-taxation of previously privileged companies upon loss of special status. Companies should prepare now to gain maximum benefit from these transitional measures.

Overview

The abolishment of cantonal tax statuses upon entry into force of the tax reform will lead to an increase the applicable tax rate for companies that previously enjoyed privileged tax status. This is particularly relevant for hidden reserves existing (and not yet taxed) at the time of the change in status. The transitional measures are designed to prevent over-taxation of such hidden reserves.

Transitional measures – two options

For companies changing status, transitional measures provide for two possibilities to prevent over-taxation of hidden reserves. The first, in accordance with current practice in most cantons, it to disclose tax-neutrally and subsequently depreciate existing hidden reserves when the status is abandoned (current law step-up; disclosure solution). The second is application of a special tax rate (special tax rate solution).

Current law step-up (disclosure solution)

Applicability of the current law step-up depends on the canton. It allows companies to effectively disclose hidden reserves formed, or self-generated value created (goodwill), under a privileged tax regime in the tax balance sheet immediately before the privileged status is abandoned. For this purpose, a taxed hidden reserve is disclosed in the tax balance sheet without the need to make a corresponding entry under commercial law. In the following tax periods, the taxed hidden reserve can be depreciated tax-effectively, taking into account the overall limitation of measures. (The depreciation period is defined according to cantonal

regulations or depreciation rates published by the Swiss Federal Tax Administration, respectively).

Special tax rate solution

The special tax rate solution provides for separate taxation over five years of the portion of the profit based on the realization of hidden reserves and goodwill which were previously not taxed under the old regime. The maximum amount is limited to such hidden reserves available at the time of the status change. The amount must be recorded in a decree. In contrast to the practice under the current law step-up, the special tax rate solution does not result in the disclosure of hidden reserves in the tax balance sheet. This eliminates the issue of recognizing deferred tax assets.

Differences between the transitional measures

Which of the two options is more beneficial depends on various factors and requires a case-by-case evaluation.

Current law step-up	Special tax rate
– Disclosure of hidden reserves in the tax balance sheet	– Determination of hidden reserves in a decree
– Inconsistency between commercial and tax balance sheet	– Consistency between commercial and tax balance sheet
– Overall limitation of measures is effective	– Overall limitation of measures is not effective
– Tax-effective depreciation of disclosed hidden reserves over a specified time period	– Separate/special taxation of hidden reserves determined in the decree for a maximum of five years

Valuation of hidden reserves and goodwill

For both options, hidden reserves available at the time of the status change, or self-generated added value (goodwill), must be determined. Hidden reserves arise from a difference between the current value (fair value) and the tax value of an asset or liability. Furthermore, hidden reserves may exist on an asset that is not disclosed. Goodwill exists if the company value determined according to business principles exceeds the net asset value (equity including hidden reserves) and if this value cannot be allocated to certain balance sheet items in the form of hidden reserves.

Hidden reserves must be determined in accordance with a generally accepted or objectively comprehensible valuation method. Both past-oriented valuation methods as well as future-oriented valuation methods are permitted. It must be ensured that the method applied takes appropriate account of the company's business model and that the assumptions are realistic and comprehensible.

Hidden reserves on assets

Relevant hidden reserves may exist particularly on intangible property rights. Hidden reserves on Swiss real estate are not to be taken into account, however, as the income from such real estate is already subject to ordinary taxation under the tax status. In case of participations, the participation exemption is in principle applicable.

Goodwill

Self-generated added value (goodwill) includes assets that cannot be allocated to individual assets. In principle, goodwill consists of the difference between the current company value and the carrying amount of the company. The company value in the sense of a market value is typically determined either based on peer values (multipliers of listed companies or transactions) and/or via the present value of the expected future cash flows of the company (discounted cash flow method).

What does this mean for taxpayers?

Cantonal tax statuses are set to be abolished as of 1 January 2020. In certain cases, it may be beneficial for companies to voluntarily waive their privileged taxation before the tax reform comes into force. Any decision requires a precise examination of all relevant elements and must be made on a case-by-case basis. Addressing this issue now gives companies time to perform the necessary evaluations and prepare to take action.

In a first step, it is important to ask the following questions:

- Does the company currently have a privileged tax status?
- What future tax rate is expected in the company's canton?
- What is the current amount of existing hidden reserves/goodwill?
- Have losses been carried forward?
- Could it be beneficial to change status before the tax reform comes into force?
- Which of the two transitional measures is likely to be more beneficial?

How can KPMG help?

KPMG advises companies on the transition from privileged to ordinary taxation and offers comprehensive support, including:

- Initial analysis of potential transitional measures
- Valuation of existing hidden reserves or goodwill according to a generally accepted valuation methods, taking into account the business model of the company; a step-by-step approach using simplified analyses can be applied. If necessary, a more detailed analysis can be performed subsequently.
- Detailed calculation/simulation to clarify which of the transitional measures is more beneficial for your company.
- Communication with the responsible tax authorities including a possible tax ruling.

Contacts

KPMG AG

Badenerstrasse 172
PO Box
8036 Zurich

kpmg.ch/traf

Stefan Kuhn

Partner
Head of Corporate Tax

+41 58 249 54 14
stefankuhn@kpmg.com

Olivier Eichenberger

Director
Corporate Tax

+41 58 249 41 67
oeichenberger@kpmg.com

Johannes Post

Partner
Head of Valuations

+41 58 249 35 92
jpost@kpmg.com

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