

TAX REFERENCE LIBRARY NO 143



Published in association with:

Meyeralustenberger Lachenal

Switzerland

9th edition





8 Bouverie Street
London EC4Y 8AX UK
Tel: +44 20 7779 8308
Fax: +44 20 7779 8500

MANAGING EDITOR Anjana Haines
anjana.haines@euromoneyplc.com

SENIOR COMMERCIAL EDITOR Prin Shashiharan
prin.shashiharan@euromoneyplc.com

DEPUTY EDITOR Josh White
josh.white@euromoneyplc.com

SENIOR REPORTER Danish Mehboob
danish.mehboob@euromoneyplc.com

REPORTER Alice Jones
alice.jones@euromoneyplc.com

PRODUCTION
Antony Parselle aparselledesign@me.com
João Fernandes jfernandes@euromoneyplc.com

HEAD OF BUSINESS DEVELOPMENT Margaret Varela-Christie
margaret.varela-christie@euromoneyplc.com

HEAD OF BUSINESS DEVELOPMENT – EVENTS Jamil Ahad
jamil.ahad@euromoneyplc.com

BUSINESS DEVELOPMENT MANAGER Raquel Ipo
raquel.ipo@euromoneyplc.com

SUBSCRIPTIONS MANAGER Jack Avent
jack.avent@euromoneyplc.com

MANAGING DIRECTOR Timothy Wakefield
twakefield@euromoneyplc.com

© Euromoney Trading Limited, 2021. The copyright of all editorial matter appearing in this Review is reserved by the publisher. No matter contained herein may be reproduced, duplicated or copied by any means without the prior consent of the holder of the copyright, requests for which should be addressed to the publisher. Although Euromoney Trading Limited has made every effort to ensure the accuracy of this publication, neither it nor any contributor can accept any legal responsibility whatsoever for consequences that may arise from errors or omissions, or any opinions or advice given. This publication is not a substitute for professional advice on specific transactions.

DIRECTORS Leslie Van De Walle (Chairman), Andrew Rashbass (CEO), Wendy Pallot, Jan Babiak, Colin Day, Imogen Joss, Lorna Tilbian, Tim Pennington

ITR is published four times a year by Euromoney Trading Limited. This publication is not included in the CLA license. Copying without permission of the publisher is prohibited. ISSN 0958-7594

CUSTOMER SERVICES +44 20 7779 8610

UK SUBSCRIPTION HOTLINE +44 20 7779 8999

US SUBSCRIPTION HOTLINE +1 800 437 9997

Facing the challenges of reform

Businesses across Switzerland began 2020 anticipating a range of challenges emerging from the widest corporate tax reform in decades. Economic plans were drawn and tax experts were summoned. Little did they know that just months later, the COVID-19 pandemic would bring a second wave of equally strong tax-related challenges.

Partnering with expert practitioners who are closest to the action, ITR brings you an exclusive insight into some of the most significant developments that the Swiss tax world faces in the coming year.

International tax reforms have added a further dimension of complexity to the proceedings. The article by Bär & Karrer explains how the implementation of the Swiss tax reform has been influenced by the impact from the OECD's BEPS Action Plan and the EU's implementation of the Anti-Tax Avoidance Directive (ATAD).

The need to strengthen the country's reputation as a global business centre forms the crux of burckhardt Ltd's article, which also looks at how Swiss modifications to the automatic exchange of information (AEOI) implementation can help optimise legal and planning certainty.

Deloitte Switzerland's article tracks how the pandemic has forced companies to accelerate their digitalisation plans, and



Prin Shashiharan
Senior commercial editor
ITR

discusses how tax departments can accordingly reshape their data, process and people functions.

A further revolution brought about by the pandemic to the traditional workplace is the subject of Tax Partner AG's article. Swiss authorities have sought to address international tax queries that have emerged from the rise of the 'home office'.

Amid the pandemic and waves of reforms, Switzerland continues to harbour a culture of innovation by offering tax incentives on patents and research and development (R&D) programmes. The article from Meyerlustenberger Lachenal considers how companies can benefit from the Swiss innovation toolkit.

Showcasing its strength and resilience, Switzerland has reacted soundly to novel tax challenges. We hope that you enjoy hearing from the tax experts leading the progression in our ninth Switzerland Special Focus.

3 Reform

How international tax reforms have transformed the Swiss tax landscape

Daniel U Lehmann and **Anke Stumm** of **Bär & Karrer** consider how measures put forward by the OECD's BEPS project and the EU Anti-Tax Avoidance Directive have impacted corporate taxation in Switzerland.

8 Reporting

Switzerland steps up CRS implementation

Rolf Wüthrich of **burckhardt Ltd** explains how Switzerland is improving its compliance and reporting functions to strengthen the country's reputation as a global business centre.

14 Transformation

The digital journey of the tax function

Martin Krivinkas and **Patricia Costa** of **Deloitte Switzerland** explore the growing digitalisation of the tax function and take a closer look at its impact on processes, data and people.

19 Strategy

Switzerland settles mutual agreements for remote working

René Matteotti, **Peter Vogt** and **Natalja Ezzaini** of **Tax Partner AG** examine how Swiss authorities have sought to address tax queries concerning cross-border workers, which have emerged from the coronavirus pandemic.

25 Policy

Promoting innovation through tax policy in Switzerland

Thomas Nabholz and **Julian Kläser** of **Meyerlustenberger Lachenal** describe how the research and development super-deduction and the patent box provide innovative Swiss companies with an opportunity for significant tax savings.

Promoting innovation through tax policy in Switzerland

Thomas Nabholz and **Julian Kläser** of **Meyerlustenberger Lachenal** describe how the research and development super-deduction and the patent box provide innovative Swiss companies with an opportunity for significant tax savings.

One year into the post-tax reform era, companies have only started to discover the use of the new incentive schemes for innovation. Initial practical experience reveals large potential benefits for businesses operating in Switzerland.

Swiss tax reform

A year ago, on January 1, 2020, the Swiss federal bill on tax reform and the legislation for implementation at the level of the cantons entered into force. That date marked the finishing line of a 14-year marathon of debate to align Swiss tax law with international rules. The result is the most significant change to the Swiss tax system in over 50 years.

The key element which the EU and OECD demanded with increasing pressure was the abolishment of the special statuses for cantonal tax purposes of holding companies, domiciliary and ‘mixed’ companies. The crux of the reform was to create OECD compliant incentives retaining Switzerland in the top group of the most attractive business locations from a tax perspective. With the introduction of a super-deduction for research and development (R&D) expenses and a tax relief for income from patents – the so-called ‘patent box’ –, two attractive tax incentives for innovation have been designed as part of the tax reform toolkit. Both special regimes are available at the level of cantonal taxes but not for federal income tax.

A federal act on tax reform provided the framework which the cantons had to fill out by amending their own cantonal tax laws. Driven by differences in the composition of their taxpayers, cantonal governments pursued diverging strategies in their tax policy: many chose a significant cut of the general corporate tax rate while others, notably Zurich, Berne, and Aargau, relied on a more targeted relief by exploiting the new special regimes to the maximum. As a result, the tax incentives for

Table 1: Corporate income tax (CIT) rates and effect of tax incentives for innovation

City	Ordinary CIT rate	R&D super deduction	Patent box CIT rate	Relief limitation
Zurich	19.7%	50%	9.2%	70%
Basel	13.0%	not available	8.4%	40%
Geneva	14.0%	50%	13.4%	9%
Zug	11.9%	50%	8.3%	70%

innovation have the greatest effect in those latter cantons. It should be noted that the new regimes come with a relief limitation. This provision ensures that tax is paid on at least 30% (or more, depending on the canton) of the income before special deductions (R&D super-deduction, patent box deduction, notional interest deduction, amortisation of step-up).

After the first year of the post-tax reform era, considerable differences can be observed between industries in making use of the new regimes. While pharma, chemical, and engineering businesses have quickly embraced the opportunity, the response in other sectors such as financial services has been tepid – quite undeservedly.

R&D super-deduction

For cantonal income taxes, it is possible to claim an additional deduction of up to 50% for certain expenses in relation to a taxpayer's own R&D activities and for expenses for outsourced R&D services.

Qualifying R&D activities for the super-deduction

As the first step, a taxpayer needs to identify its qualifying R&D activities. Practical experience shows that companies and, in particular, their scientific staff often set the bar too high when it comes to characterising their activities as 'R&D'. It has therefore proven helpful that tax specialists analyse the situation together with the company's science department.

The definition of R&D for purposes of the super-deduction remains rather vague. The tax laws refer to the definition in the Federal Act on the Promotion of Research and Innovation which, however, provides little guidance. Greater importance is thus attached to the OECD Frascati Manual and Oslo Manual. For each type of innovation, in principle, all five Frascati criteria (cf. Illustration 1) must be met in order for the activity to qualify as R&D.

Significant developments are taking place in the automation of business processes and in exploiting the possibilities of artificial intelligence (AI) for new products. This appears to be true for all industrial sectors whereby innovation is often about new applications covering the

exploitation of research results from various scientific disciplines such as computer science, physics, geography, behavioural science etc.

The Frascati Manual requires that R&D create new findings for the company and, at best, these findings have not yet been used in the particular industry. However, the latter requirement cannot be weighted too high. Furthermore, the Swiss tax administrations attach great importance to the criterion of uncertainty regarding the success of a project. Failed projects are thus a good indicator of innovative activities. Of course, the assessment of innovation projects by mechanically applying the Frascati criteria rarely leads to clear and reliable results. All the circumstances of the innovation case as a whole must be considered.

Generally, if a company is strategically committed to innovation in a particular area and supports this strategy with substantial investments, then the chances to be in a position to apply the R&D super-deduction should be good.

Illustration 1: Definition of R&D according to the OECD Frascati Manual

- R&D comprise creative and systematic work undertaken in order to increase the stock of knowledge – including knowledge of humankind, culture and society – and to devise new applications of available knowledge.
- For an activity to be an R&D activity, it must satisfy five core criteria. The activity must be:
 - Novel, i.e. creating new knowledge;
 - Creative, i.e. based on original, non-obvious concepts and hypotheses
 - Uncertain, i.e. related to the end result;
 - Systematic, i.e. following a plan;
 - Transferable and/or reproducible, i.e. in terms of its results.



Thomas Nabholz

Partner
Meyerlustenberger Lachenal
 T: +41 44 396 91 96
 E: thomas.nabholz@mll-legal.com

Thomas Nabholz is a partner at Meyerlustenberger Lachenal, where he leads the tax practice. He is a certified Swiss tax expert with more than 20 years of experience in Swiss domestic and international tax law.

Thomas advises corporate clients from various industry sectors, as well as private clients and financial investors in national and international tax planning. His focus areas are corporate restructurings and mergers and acquisitions (M&A), corporate finance, private debt/equity, as well as private wealth structuring.

Before joining the firm in October 2019, Thomas co-headed the Swiss financial services international tax and transaction tax services practice of a Big Four firm. His career in corporate taxation includes in-house experience from medium and long-term assignments to the group tax departments of Swiss Re, UBS and Swarovski.



Julian Kläser

Senior associate
Meyerlustenberger Lachenal
 T: +41 44 396 91 44
 E: julian.klaeser@mll-legal.com

Julian Kläser is a senior associate and tax expert at Meyerlustenberger Lachenal.

Julian's practice focuses on Swiss domestic and international tax law for corporates and individuals. His clients include start-ups, technology companies and investors with a focus on blockchain, distributed ledger technology (DLT) and digitalisation. He also has particular experience in tax matters related to high-net worth individuals and the tax aspects of their private and business activities worldwide. Additionally, he advises clients on Swiss VAT and customs.

Julian holds a doctorate in tax law, and regularly publishes articles and lectures in his fields of expertise. He has been appointed as a lecturer in professional development courses concerning federal tax law organised by the Swiss Federal Tax Administration and the University of Berne, as well as Kaleidos University of Applied Sciences, where he gives classes on international individual taxation covering trusts and similar structures.

Super-deductible R&D expenses

For own R&D activities, the super-deduction is calculated on the basis of the corresponding personnel expenses plus a 35% up-lift in consideration of material expenses for R&D. Following a holistic view on R&D activities instead of assessing individual projects, practice has shown that using the personnel expenses of fixed teams instead of project-related personnel costs is an acceptable approach. In addition to the personnel expenses for the actual researchers, the costs of staff with direct management and administrative functions for the R&D teams can be included as well.

Of course, innovation teams are often not exclusively dedicated to R&D activities, but also perform, for example, routine functions. Likewise, the share of R&D management in overall management tasks generally decreases at higher leadership levels. Accordingly, certain cantons tend to

preclude executive board costs from the super-deduction. In practice, all these circumstances can be dealt with pragmatically by flat-rate disallowances of certain personnel expenses.

Contract R&D services

In the case of outsourced (contract) R&D, Swiss tax law in principle assigns the entitlement to the R&D super-deduction to the principal. The recipient can claim the super-deduction for 80% of the invoiced costs.

In cases where a company provides R&D services to a principal who is not domiciled in a canton where the R&D super-deduction is available, it can claim the super-deduction itself. This applies in particular to R&D services performed in Switzerland for the benefit of a foreign recipient.

In principle, R&D services between group companies can be charged at full cost and including an appropriate mark-up.

In general, this leads to a much higher qualifying expense at the level of the principal than if it carried out the R&D itself and could claim the personnel expenses only. When it comes to (tax) planning of R&D functions within a group of companies, this is an aspect to be carefully considered.

Patent box

Many countries provide for tax incentives in the form of lower taxation of income from intellectual property rights that is accounted for in a separate segment – generally referred to as patent, licence, or IP box. The Swiss variant is in line with the minimum standard set by the OECD BEPS Action 5 Report in that it adopts the modified nexus approach and defines the qualifying IP rights slightly narrower than the report.

Within the patent box, the net income from exploiting patents and similar intellectual property (IP) rights is carved out. A company may generate such income by granting licenses and selling patents or by selling goods and services

that are based on patents. The patent box profit, multiplied by the nexus ratio and the relief factor (different depending on the canton), produces the tax-exempt income.

Qualifying IP rights

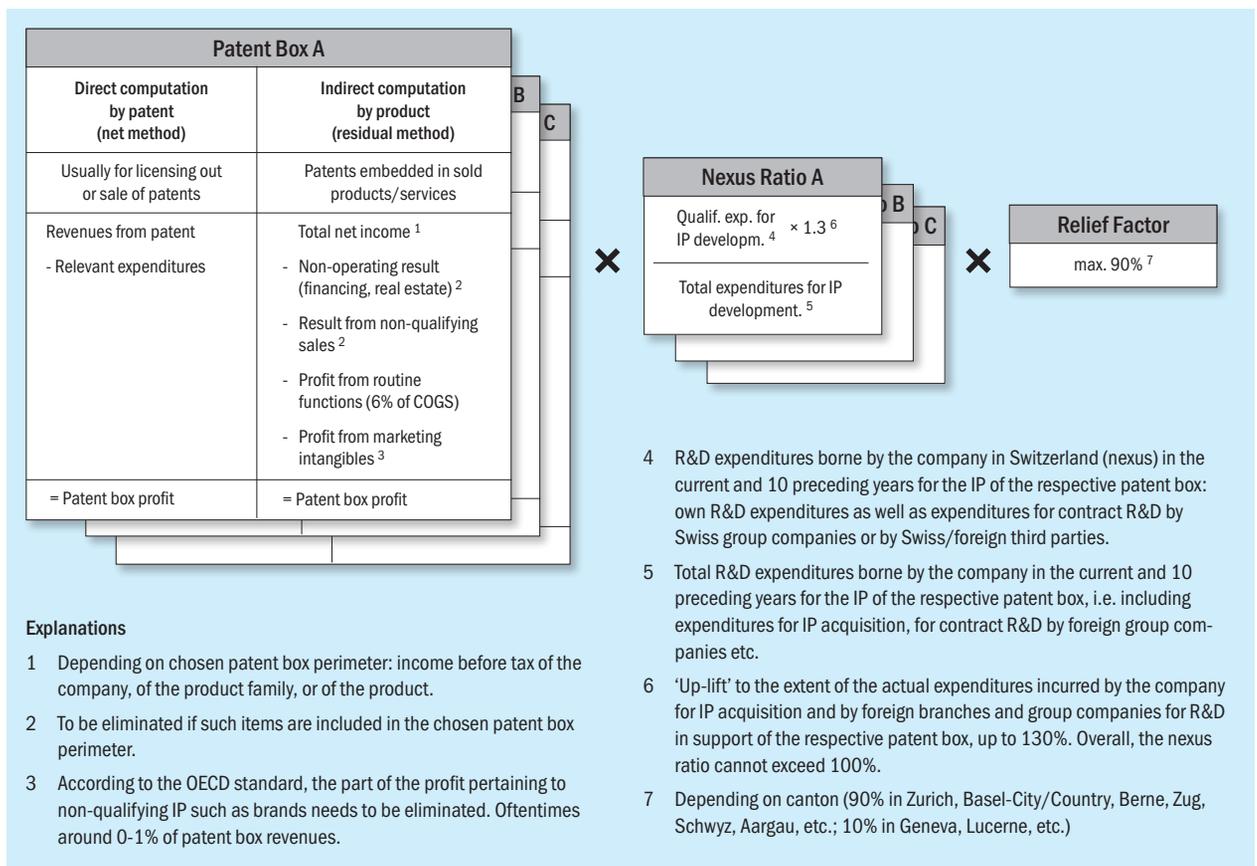
The type of IP rights which qualify for the Swiss patent box are the following:

- Swiss patents;
- European patents with designation of Switzerland;
- Patents for inventions in other jurisdictions, utility models; and
- Comparable IP rights such as supplementary protection certificates and regulatory data protection for pharmaceutical products and pesticides.

Although not explicitly mentioned in the law, revenues generated on the basis of exclusive licenses for the use of patents on Swiss territory also qualify for the box.

By simply relying on the domestic or overseas registration of a patent, the law provides a clear and fairly easy to handle

Illustration 2: Factors to compute the patent box deduction from taxable income



The Swiss Firm to Lead You Worldwide



Client centric

Your needs are at the core of our business philosophy, operations, ideas and solutions. We commit to being efficient, straight-forward and transparent at all times.

Specialized

Our lawyers are experts in their fields. We are particularly recognized for our leadership in advising clients at the intersection of high tech, IP rich and regulated industries.

Innovative

We not only observe but often shape trends in the market and embrace ideas and technology that can move our business forward for your benefit.

criterion to qualify the rights. On the other hand, patent applications, expired/revoked patents, brands, designs, copyrights, and trade secrets do not qualify. An important topic in this context is software. Under Swiss IP law, software can be protected by copyrights but not by patents, unless it is a component of a patented product (computer-implemented invention). As a result, software will only qualify for the box if it is part of a patented invention or patented abroad in its own right.

Computing the patent box deduction from taxable income

When applying the patent box, a company first needs to choose the perimeter of one or more boxes. Among other factors, this choice is driven by the stage of development of the different products and by the capabilities of the enterprise resource planning system in terms of data granularity.

Where the indirect method of computing the patent box profit is used, the idea is to eliminate all revenues from the box profit that are not directly linked to a patent. Experience shows that there is need for discussion with the tax authorities regarding the distinction between qualifying and non-qualifying revenues. For instance, in financial services, certain parts of the investment result may be generated on the basis of a patented solution and should thus not be removed from the box like the financial result in other industries. In some cases, where the indirect method is difficult to apply, it is also possible to determine the qualifying profit by way of a ‘synthetic’ direct computation:

On the basis of a transfer pricing study, the company may establish the amount of license fees which third parties would agree for the use of comparable patents.

Practical challenges

When IP rights are first allocated to the patent box, the expenditures for the development of such IP, for which a tax deduction has been claimed in the preceding 10 years, are recaptured for tax systematic reasons. The Swiss cantons take different approaches, which allow in most cases to mitigate upfront tax costs of the entry into the patent box. However, this makes careful planning of the entry necessary. The recapture as well as the ongoing computation of the nexus ratio require a relatively time-consuming tracking and tracing of R&D expenditures. Automation is key in this space to make the application of the patent box efficient.

Conclusions

For companies that engage in innovation, the R&D superdeduction and the patent box may provide an opportunity for significant tax savings. These tools give a reason to reassess innovation and patent strategies from a tax angle. Companies are well advised to analyse how to best benefit from the Swiss innovation toolkit. They should also make use of the possibility and standard practice in Switzerland to negotiate and get an advance ruling from the competent tax authorities. In terms of implementation, the Swiss tax authorities are generally cooperative and receptive to pragmatic solutions.