Date: 22.09.2014

CTR III: Glossary

BEPS: Base Erosion and Profit Shifting (BEPS) is an interdisciplinary project of the OECD (Organisation for Economic Co-operation and Development) and the G20 (group of 20 most important industrialised and emerging market nations). It tackles the problem of existing regulations that allow companies to shift their taxable profits from the place of actual business activity to other locations in order to minimise the tax burden or avoid tax altogether. The aim is to draw up shared, balanced and efficient rules at multilateral level so as to prevent such practices. Switzerland is actively participating in the work on this project.

Beta factors: Profits of companies with cantonal tax status (cf. "Tax status") are assigned so-called beta factors with respect to resource potential, which means they are weighted differently. Due to the preferential taxation of these profits, they are only reflected in resource potential with a reduced weighting. The provisions of the Tax Harmonisation Act (THA) form the basis for this procedure. Beta factors are ascertained empirically on the basis of tax data and are set for a four-year period in each case.

Capital gains tax on securities: With the exception of the disposal of bonds with predominantly one-time interest payments and cantonal property gains tax, private capital gains are exempt from income tax under existing legislation. If capital gains on securities were to be taxed as income, a loophole in the current tax system would be closed. At the same time, the current delimitation issues that give rise to legal uncertainties would be resolved.

Corporate tax reforms (I-III): The three series of corporate tax reforms address different issues and involve different areas of focus. The first corporate tax reform was brought into force in 1997. Its measures included improving Switzerland's appeal as a location for holding companies, eliminating the capital tax, and introducing a linear profit tax rate. The second corporate tax reform was accepted by the electorate on 24 February 2008 and was brought into force between 2008 and 2011. Its core elements involved alleviating the burden of double taxation, reducing taxes detrimental to a company's asset base, providing relief for partnerships and applying the capital contribution principle. The third corporate tax reform is designed to strengthen Switzerland's appeal as a tax location by replacing a number of existing regulations that have become the target of criticism.

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Cost compensation: The cost compensation system eases the burden for Alpine and centrally situated cantons, which, for structural reasons, face higher costs for the provision of public goods and services. Contributions for excessive costs take the form of geographical/topographic cost compensation (GCC) on the one hand, and socio-demographic cost compensation (SCC) on the other. Cost compensation is entirely financed by the Confederation.

Counter-financing: The federal finances will be severely affected by CTR III. In order to ensure that the budget remains structurally balanced and that the terms of the debt brake are complied with, these additional burdens have to be counter-financed. As measures on the receipts side are available only to a limited degree, a structural surplus of around CHF 1 billion is to be built up as a key measure in the financial plan.

Depreciation: Depreciation is undertaken so that the current value of assets can be seen in the financial statements at all times. It involves booking the decline in asset value (as a result of the "wear and tear" or ageing of fixed assets) as a cost from an accounting perspective. As an expense item, depreciation has the effect of reducing taxable profit.

Equalization measures, vertical: Payments from the Confederation to the cantons in order to ensure a balanced distribution of the financial burden of CTR III between the Confederation and the cantons. Tax policy measures are implemented largely in the cantons and their communes, where they lead to greater reductions in receipts than is the case for the Confederation. By contrast, the Confederation benefits from the preservation of tax competitiveness, as it can secure direct federal tax receipts.

EU Code of Conduct: The Code of Conduct for Business Taxation was adopted by the Council of EU Economics and Finance Ministers (ECOFIN) on 1 December 1997. The Code of Conduct (CoC) is not a legally binding instrument, but it represents a political commitment on the part of EU member states. Member states have undertaken to rescind any existing tax measures that could be classed as harmful tax competition and to pass no further measures of this kind in the future.

Federal profit tax: The federal profit tax applies to all legal entities headquartered or effectively managed in Switzerland. This affects in particular corporations, i.e. companies limited by shares (Aktiengesellschaften), partnerships limited by shares (Kommanditaktiengesellschaften), limited liability companies (GmbHs), and cooperatives, as well as associations, foundations and other legal entities.

Forum on Harmful Tax Practices: Following the publication of the report "Harmful Tax Competition: An Emerging Global Issue" in 1998, the OECD (Organisation for Co-operation and Development) created a special body known as the "Forum on Harmful Tax Practices". The aim of this body is to highlight and prevent harmful tax practices in OECD member states as well as other countries. The Forum has published three progress reports. Furthermore, it has drawn up a Model Agreement on Exchange of Information on Tax Matters. Switzerland is represented in this body.

Issue tax, abolition: The issue tax is a form of stamp duty. The Confederation levies such a tax on the issuance of participation rights (e.g. on the issuance of shares). The abolition of the issue tax on equity capital would reduce the Confederation's receipts by around CHF 240 million annually. The abolition would have a positive impact on all companies that raise new equity capital. The issue tax on debt capital was abolished on 1 March 2012.

National fiscal equalization: Switzerland's national fiscal equalization system regulates financial relations between the Confederation and the cantons. It comprises the allocation of public expenditure on the one hand, and the redistribution of public money between the Confederation and the cantons (as well as intercantonal redistribution) on the other. National fiscal equalization has two key objectives: to even out the differences in cantonal financial capacity and to increase the efficiency of state task performance.

Notional interest deduction: see "Profit tax, interest-adjusted".

Partial taxation procedure: The partial taxation procedure was introduced as part of the second series of corporate tax reforms in order to alleviate the burden of double taxation. This applies if dividends are first taxed as the profit of a company and then taxed as the income of a shareholder. Certain changes to the current system are due to be undertaken as part of the third series of corporate tax reforms. These include the abolition of a minimum shareholding, the expansion of the procedure to include profit-sharing certificates and a limit to the level of relief granted.

Participation deduction, amendments: The current system of so-called indirect exemption of participation income (reduction of tax amount to reflect net participation income as a proportion of total net profit) can have negative implications. The aim of the amendments is to ensure that the multiple taxation of participation income and capital gains is consistently eliminated and to adjust the participation deduction in line with standard international practice.

Participation deduction: The participation deduction avoids the problem of income on participations (holdings) in a conglomerate being multiply taxed. If a corporation or cooperative (e.g. "Company A") holds a stake in another company (e.g. "Company B") and receives dividends from that company, this income has already been taxed through the profit tax paid by Company B. If this participation income of Company A were then to be liable for tax, this would result in multiple taxation of the participation income, which the participation deduction is designed to avoid.

Principal company: International companies often arrange their regional structures in larger units in order to centralise functions, responsibilities and risks within the group by product area or market. The parent company in such a structure is sometimes referred to as the principal company. For its globalized market, this company will typically assume responsibility for tasks such as purchasing, the planning of research and development, production planning and management, inventory management and logistics planning, the development of marketing strategy, sales planning and management, treasury and finance, and administration.

Profit tax, interest-adjusted: An interest-adjusted profit tax also enables so-called notional interest on equity capital to be deducted from the assessment basis, in addition to the deduction of debt interest. This would ensure the equal treatment of equity capital and debt capital at company level (i.e. without taking into account the tax burden of the shareholder).

Profit tax rate, effective: As the tax amount can be deducted from the assessment basis, the actual tax payable is reduced accordingly. At federal level, this currently amounts to 7.83%.

Profit tax rate, statutory: This is based on the legally prescribed profit tax rates. At federal level, this currently amounts to 8.5%.

Protective interest deduction: The term for deduction of an imputed rate of return on equity capital for the determination of interest-adjusted profit tax.

Reserves, hidden: The difference between the market value of an asset (e.g. a machine) and its lower book value. Hidden reserves can often arise as a result of value increases or write-downs. The realisation of hidden reserves (e.g. following a sale) results in a profit tax liability. The taxable realisation of hidden reserves also occurs if the tax liability comes to an end, e.g. as a result of a move away from Switzerland. Conversely, it is consistent to permit a tax-neutral value increase of hidden reserves generated abroad at the beginning of the tax liability as a result of a move to Switzerland.

Resource equalization: Resource equalization is one of the instruments in the national fiscal equalization system. Cantons with below-average resources can be provided with sufficient disposable financial resources thanks to this process. Resource equalization helps to reduce the differences in financial capacity between the cantons and to preserve tax competitiveness by national and international standards. The procedure is financed by the Confederation and the financially strong cantons. The Confederation finances vertical resource equalization, while the financially strong cantons finance horizontal resource equalization.

Resource index: The resource index forms the basis for resource equalization. It shows the utilizable fiscal capacity of each canton in relation to the Swiss average, whereby the national average resource potential per capita is defined as an index value of 100. Cantons with a per capita resource potential below the national average – i.e. below 100 – are deemed to be financially weak, those with a value of over 100 financially strong.

Resource potential: The resource potential reflects the utilizable fiscal capacity of a canton, and therefore the financial capacity of a canton. This forms the basis for calculating the resource index. It corresponds to the three-year average of the Aggregated Tax Base (ATB), which is essentially based on the assessment basis of direct federal tax.

Ring-fencing: In the tax sphere, the term ring-fencing is understood to mean the different treatment of domestic and foreign companies and/or income, insofar as the income from a foreign source is taxed at a lower level.

Royalty box: In the area of tax, a box is a legislatively prescribed measure that gives preferential tax treatment to certain types of profits. In the case of a royalty box, certain company revenue in the area of intangible assets is given preferential treatment (e.g. royalties from a patent). When designing a royalty box in practice, international developments (in particular the ongoing development of OECD standards and developments in competing locations) need to be taken into account.

Swiss finance branch: The Swiss operating company of a foreign group financing company.

Tax base, aggregated: The Aggregated Tax Base (ATB) forms the basis for calculating the resource index. The ATB aggregates the sum of taxable income and assets of natural persons as well as the total profits of legal entities to produce a single figure. The ATB per capita of a canton relative to the total Swiss ATB per capita then produces the resource index value for the canton in question, thereby reflecting its financial strength.

Tax harmonisation, formal/material: Formal tax harmonisation was accepted as a constitutional mandate by the electorate in 1977. According to Article 129 of the Federal Constitution, the Confederation sets out the principles for harmonising the direct taxes of the Confederation, cantons and communes. Formal tax harmonisation is restricted to tax liability, the object of the tax and the tax period, procedural law and the law relating to tax offences. Material tax harmonisation, which is not provided for in Switzerland, covers tax scales/tax rates and social security deductions.

Tax status, cantonal: Corporations, cooperatives and certain foundations which fulfil a specific function or whose commercial activity is predominantly exercised outside Switzerland can enjoy a special tax status at cantonal level. The Federal Tax Harmonisation Act (THA) distinguishes between different types of companies with special status:

Holding companies (Art. 28 para. 2 THA)

The principal activity of these companies involves holding and managing long-term stakes in other companies.

Management companies

- **Domiciliary companies** (Art. 28 para. 3 THA)
  These companies do not exercise any commercial activity in Switzerland and fulfil only management functions.

- **Mixed companies** (Art. 28 para. 4 THA)
  The commercial activities of these companies in Switzerland is only of subordinated importance.

No special tax statuses exist with respect to direct federal tax.