Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
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Swiss Confederation

Federal Department of Finance FDF

27.03.2015

Third series of corporate tax reforms

Glossary

BEPS: Base Erosion and Profit Shifting (BEPS) is a 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 deals with companies' current practice of shifting their taxable profits from the place of actual business activity to other locations in order to minimise the tax burden or avoid tax altogether – as the applicable law allows. The aim is to draw up shared, balanced and efficient rules at international level so as to prevent such practices. Switzerland is actively involved in this project.

Beta factors: Profits of companies with cantonal tax status (cf. "Tax status") are assigned beta factors and therefore have a lighter weighting with respect to resource potential (cf. "Resource potential"). Due to this preferential taxation, profits flow in reduced amounts into the resource potential. The basis for this is the Tax Harmonisation Act. Beta factors are ascertained empirically on the basis of tax data and are set for a four-year period.

Corporate tax reforms (I-III): The three series of corporate tax reforms address different issues and involve different areas of focus.

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 balanced and that the terms of the debt brake are complied with, these losses have to be counter-financed. As receipts can only be increased to a limited degree, expenditure growth is to be restricted 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.

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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 (CoC) was adopted by the Council of EU Economics and Finance Ministers (ECOFIN) on 1 December 1997. The Code of Conduct is not a legally binding instrument. It obliges EU member states at a political levelto 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 (FHTP): The FHTP aims 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.

Holding companies (Art. 28 para. 2 THA) The principal activity of these companies involves holding and managing long-term stakes in other companies.

Input promotion: Input promotion is when research and development expenses are promoted through tax measures. Unlike in the case of the royalty box (cf. "Royalty box"), the emphasis is on expenses, i.e. input, with this instrument. In principle, a distinction can be made between granting tax credits and an additional deduction for research and development expenses in the tax balance sheet.

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 210 million annually. The abolition would have a positive impact on all companies that raise new equity capital. The issue tax on debt capital was already abolished on 1 March 2012.

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.

Direct federal tax does not recognise any tax status.

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 pursues two primary aims: to reduce cantonal differences in

financial capacity and to increase the government's efficiency in the performance of its tasks.

Nexus approach, modified: This approach was drawn up by the OECD in connection with royalty boxes. The Nexus approach is meant to ensure that only the revenue associated with domestic research and development costs benefits from tax privileges within the scope of the royalty box. In keeping with the model developed by the OECD, however, additional relief is possible to a limited degree (uplift).

Notional interest deduction: cf. "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 prevent double taxation. This applies if dividends are first taxed as the profit of a company and then taxed as the income of a shareholder. The procedure for the Confederation and the cantons is to be harmonised within the scope of the third series of corporate tax reforms, whereby relief is to be introduced overall at the level of the assessment basis. Moreover, relief is to be limited.

Participation deduction: The participation deduction avoids income on participations in a conglomerate being multiply taxed. If Company A holds a stake in Company B and receives dividends from that company, this income has already been taxed through the profit tax paid by Company B. If this were again taxed as a profit in Company A, the income would be subject to multiple taxation.

Participation profit tax: With the exception of the disposal of one-time interest-bearing bonds and cantonal property gains tax, private capital gains are exempt from income tax under existing legislation. If profits on holdings of at least 10% were to be taxed, a loophole in the current tax system would be closed. At the same time, some of the current delimitation issues that give rise to legal uncertainties would be resolved. Moreover, given that the incentive is already there today, the measure on neutrality with regard to legal form would provide for entrepreneurial activity in terms of selecting the type of legal entity. This incentive is likely to be reinforced with the implementation of CTR III.

Principal company: International companies centralise functions, responsibilities and risks within the group by product area or market. The parent company in a centralised structure is referred to as the principal company. It typically assumes global 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 rate, effective: As the tax amount can be deducted from the assessment basis, the actual tax payable is reduced. At federal level, this 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%.

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 ensures the equal treatment of equity capital and debt capital at company level (i.e. without taking into account the tax burden of the shareholder).

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 and 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 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: The term ring-fencing is understood to mean the lower taxation applied to the foreign income of domestic and foreign companies in a given country.

Royalty box: In the area of tax, a box is a measure prescribed by tax law that gives preferential tax treatment to certain types of profits. In the case of a royalty box, certain forms of company revenue in the area of intangible assets are 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 produces the resource index value for the canton in question and reflects 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:

The first corporate tax reform came into force in 1997. It included improving Switzerland's appeal as a location for holding companies, eliminating the capital tax, and introducing a linear profit tax rate.

The OECD created the Forum on Harmful Tax Practices after publishing the report entitled "Harmful Tax Competition: An Emerging Global Issue" in 1998.

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.

Tonnage tax: Tonnage tax is a special type of profit determination in connection with oceangoing vessels. Profit is determined on the basis of ships' net tonnage.