



The implementation of the patent box

Covid-19 and the related tax issues have been omnipresent in the Swiss tax landscape in recent months. The entry into force of the corporate tax reform (so-called TRAF) and the measures associated with it have inevitably been overshadowed by the Covid-19 pandemic. Nevertheless, companies have been able to profit from various TRAF measures as of 1 January this year. The patent box is one of those measures. Mid way through the first year of application, it seems like a good time to take a closer look at this measure in more detail.

1. In general

The patent box is a mandatory measure of the TRAF and is implemented in all cantons, which is why most of them are currently pressing ahead with the establishment of a practice. For many companies (not only large groups), the question arises whether and to what extent they can benefit from the privileged taxation of their patent earnings. The establishment of a practice by the tax authorities is still in its infancy. Future developments are being monitored with great interest.

2. Design of the patent box

The patent box provides for tax relief of max. 90% on a company's profit arising from patents. The determination of the profit arising from patents that falls within the scope of the tax relief is determined as follows:

a. *Determination of total (gross) profit arising from patents;*

- b. *Calculation of the nexus quotient* (this roughly corresponds to the ratio between the local research and development expenditure for patents ("R&D expenditure") and worldwide R&D expenditure);
- c. *Determination of net profit arising from patents* by multiplying the gross profit arising from patents by the nexus quotient (broadly speaking).

A profit so determined benefits from the cantonal tax relief of up to 90%. The maximum limitation of the reduction allows the cantons to design independently the patent box according to their own needs within their tariff autonomy.

However, the devil is in the detail when it comes to the actual establishment and design of an attractive patent box. In the Ordinance of 13 November 2019 on the Reduced Taxation of Profits from Patents and Comparable Rights ("Patent Box Ordinance"), the Swiss Federal Council defined guidelines, in particular with regard to the beginning and end of tax liability, the principle of computation and derivation of the net profit that benefits from the tax relief, the design of the patent box and the determination of the nexus quotient. We shall look at these requirements in some more detail.

3. Regulations of the Patent Box Ordinance

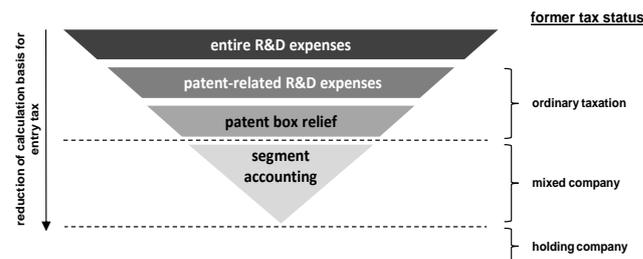
- a. *Entry into the patent box:* The privileged taxation can only be claimed at the time of the granting of a patent (not already at the time of its application).

- b. *Method for determining net profit arising from patents:* A taxpayer can choose between two options and can either determine the net profit arising from patents by means of a direct profit allocation to specific patents, or based on the so-called residual method if the patents are contained in a product (and are not specifically allocable).
- c. *One patent box or multiple patent boxes:* A taxpayer is given the option of implementing one patent box for each individual patent, for each product and related patents or for a product family with related patents. However, it is a general rule that fewer patent boxes mean less administrative work and costs for a taxpayer. Nonetheless, to establish several patent boxes might be advantageous, if the profit arising from patents can be directly allocated to specific patents and if the application of the residual method is therefore not necessary.
- d. *Determining of the nexus quotient:* The idea behind the nexus quotient is that a taxpayer who wants to benefit from the patent box has to demonstrate sufficient substance in Switzerland. Substance is measured on the basis of patent-related R&D activities in Switzerland in relation to the R&D activity abroad. In technical terms, this is referred to as the so-called *modified nexus quotient*.

4. The entry tax

Upon the establishment of a patent box, a taxpayer simultaneously receives the "entrance ticket": profit tax is levied on the entire patent-related R&D expenditure of the previous ten years. Colloquially, this is referred to as the *entry tax*. Due to the fact that the patent box offers a maximum relief of 90%, max. 90% of the patent-related R&D expenditure can be subject to the entry tax. If the company previously benefited from the holding company or mixed company status, no entry tax or a reduced entry tax may be levied. This is because the R&D expenses had no tax-reducing effect (for holding companies) or only a partial tax-reducing effect

(for mixed companies). Simplified, the calculation basis for the entry tax is determined as follows:



5. Intercantonal approach to the patent box

With the entry into force of the TRAF, the patent box will apply in all cantons. However, due to the fact that the cantons can design the patent box freely and according to their own needs, a taxpayer may find himself in the unfavourable situation that the design of the patent box at his canton of domicile is not ideally suited for these requirements. This might be due to a low overall tax relief restriction for all applicable TRAF measures, unattractive conditions of the patent box, or the taxpayer would already be operating close to the overall tax relief restriction in case of the establishment of a patent box. If the taxpayer nevertheless wishes to benefit as much as possible from the patent box (and any other TRAF measures, if applicable), the question arises as to whether this can be achieved by way of corporate restructuring (i.e. transfer of patent-related assets and liabilities and/or R&D activities qualifying for the patent box).

In February 2020, the Swiss Conference of Cantonal Chancellors CCC published its circular letter No. 34 concerning "*intercantonal tax exemption for companies claiming deductions provided for in TRAF*". However, the CCC circular letter No. 34 is mute on many intercantonal questions in relation to the patent box. Our article published in the ASA – Archiv für Schweizerisches Abgaberecht, ASA 88 | 10 | 2019-2020, S. 783 ff. provides possible solutions to a number of these questions as well as detailed explanations relating to the patent box as a whole (<https://asa.weblaw.ch/asaissues/88/10/die-inner--und-inter-997658ea60.html> ONCE&login=false).



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