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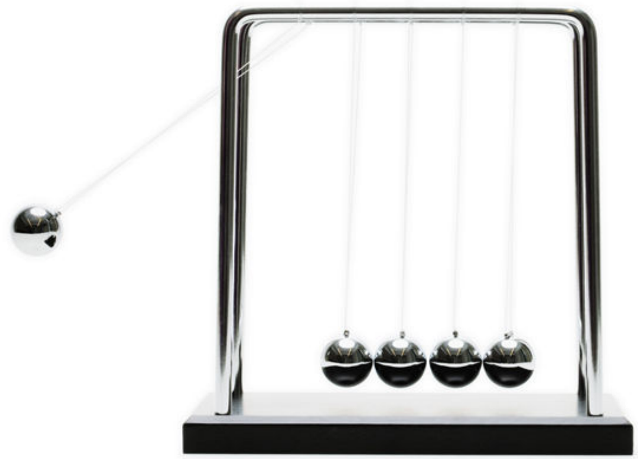
Webcast
Swiss Corporate Tax Reform III



2 October 2014

Audit.Tax.Consulting.Corporate Finance.

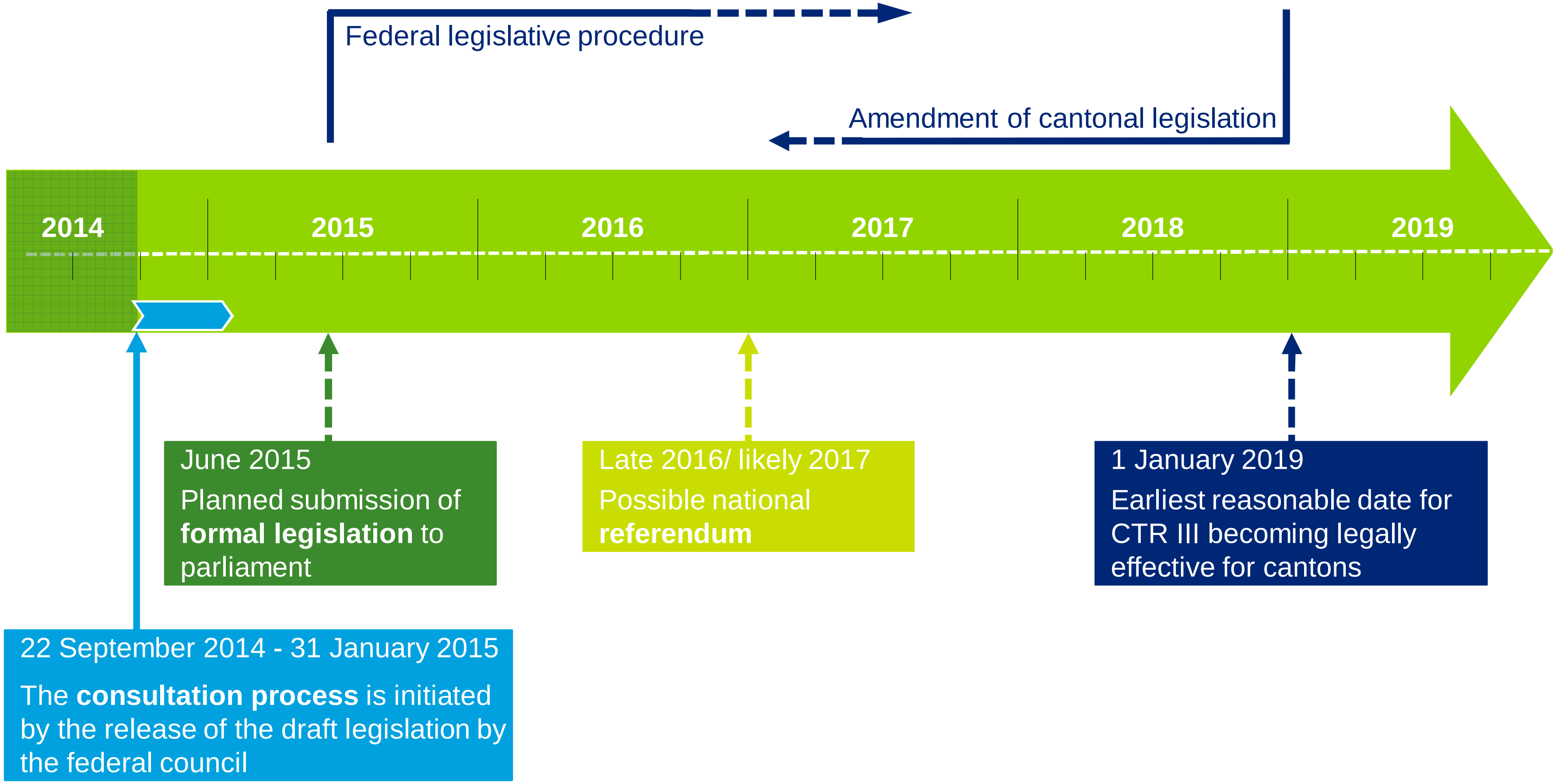
Swiss Corporate Tax Reform III

The following presentation represents our understanding and interpretation of the draft legislation released on **22 September 2014** by the federal council in regard to the contemplated Swiss Corporate Tax Reform III and the explanatory report.

The items discussed herein represent our interpretation only and it is unclear to date if, to what extent, by when and in which form the measures discussed herein will come into law.

Certain is, however, that the tax landscape in Europe is rapidly changing. With the implementation of Corporate Tax Reform III Switzerland would remain an attractive location for doing business.

Expected timeline until implementation of CTR III



Overview

OECD | G20 | EU

are focusing on

Non taxation | Shifting of mobile income | Ring fencing

Abolishment of these regimes and adoption of new measures to compensate

Holding company | Domiciliary company | Mixed company | Principal company | Finance Branch

Swiss corporate tax reform III

Non-tax

Impact on Financial Equalization mechanism
- Abolition of tax privileged regimes and a general reduction of the tax rate will affect cantons differently but will require no significant change in the inter-cantonal Financial Equalization mechanism

Vertical (federation vs. cantonal) compensating measures
- Symmetry of tax income losses between federation and cantons
- Participation of cantons on direct federal tax is increased from 17% to 20.5%

Increased scrutiny
- The federal council has announced to increase the number of tax auditors by 60-70.

Cantonal taxes / Federal taxes

	Cantonal taxes	Federal taxes
Replacement measures	Swiss patent box	
	Notional interest deduction	Notional interest deduction
Other measures	Reduction of CIT rates	Abolition of capital issuance tax
	Capital tax reduction	
	Step up in case of immigration into Switzerland	Step up in case of immigration into Switzerland
	Step up - status change	
	Participation exemption	Participation exemption
	Unlimited loss carry forward	Unlimited loss carry forward
	Group relief for losses	Group relief for losses
Compensation measures	Capital gains tax on securities held by individuals	Capital gains tax on securities held by individuals
	Adjustments to the partial taxation procedure	Adjustments to the partial taxation procedure

Swiss Corporate Tax Reform III

Replacement measures

Other measures

Compensation measures

Replacement measures – Swiss patent box

Status quo

- ETR applicable to foreign license income for mixed companies amounts to 8-10% (Solution in the Swiss canton of Nidwalden: 8.9%).
- License box regimes are being used in various European jurisdictions. While some license box regimes are relatively liberal, others are more restrictive require a higher entry test and more substance.
- All EU IP box solutions are currently under scrutiny by the EU Commission and the OECD under BEPS is also undertaking a comprehensive review to assess what is required so that these regimes do not fall under harmful tax practices.

Draft legislation

- Based on the draft legislation Switzerland plans to introduce a patent box:

1. Qualification of IP rights

- The box shall be limited to income from patents only (incl. income from supplementary protection certificates, income from holding an exclusive licences on such patents and income from first applicant protections according to Art 12 Federal Law on medicinal products and medical devices).
- Trademarks or trade names do not benefit from the Swiss patent box regime.

Replacement measures – Swiss patent box

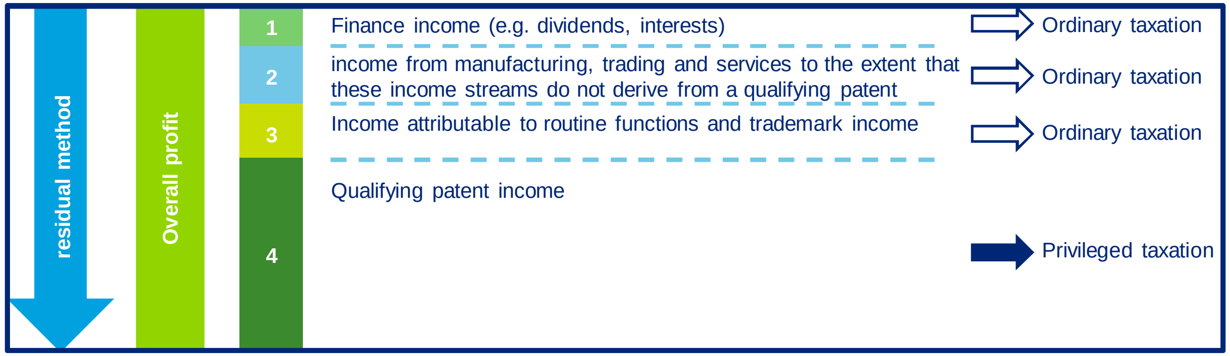
1. Qualification of IP rights
2. Entry Test

- A company is entitled to benefit from the patent box, if:
  - The company is the owner or beneficiary under a usufruct of qualifying patents or is the holder of an exclusive license of such rights; and
  - the company is registered as owner of such patent (during the patent application process, i.e. before the patent is approved, the box cannot be applied. However, already finally assessed tax years can be re-opened once the patent is finally approved); and
  - has significantly contributed to the development of the underlying invention.
- The interpretation of the wording “**significant contribution**” is broadly defined and includes:
  - The creation or further development of the patented invention; or
  - the creation or further development of a product which relies upon such invention;
  - within a group of companies, being in charge over the development is also regarded as a significant contribution.
  - a company that is the beneficiary or has an exclusive license (at least for Switzerland) may benefit from the regime if it belongs to a group of companies that made the significant contribution.

Replacement measures – Swiss patent box

1. Qualification of IP rights | **2. Entry Test** | **3. Calculation method**

- As to the below chart, the qualifying patent income would be calculated based on a residual method, i.e. all income of a company would be considered patent income that is not specifically deducted as nonpatent income (nonpatent income would include (i) financing income, (ii) income from manufacturing, trading and services to the extent that these income streams do not derive from a qualifying patent and (iii) income attributable to routine functions and trademark income).



- It can thus be concluded that the patent income, that is embedded in the sales price of a product, qualifies for a reduced taxation.

Replacement measures – Swiss patent box

1. **Qualification of IP rights** 2. **Entry Test** 3. **Calculation method** 4. **Relief**

- The introduction of a patent box is mandatory for all cantons.
- The extent of tax relief is at the discretion of each canton but limited to 80% of cantonal/communal income. This results in an combined federal/cantonal/communal ETR of approx. 8-10% (no notional interest deduction on patent box income).
- No tax relief is granted for federal income tax purposes.

1. **Qualification of IP rights** 2. **Entry Test** 3. **Calculation method** 4. **Relief** 5. **Transitional Rule**

Change from ordinary taxation to the Swiss patent box regime

- Such change would lead to the taxation of hidden reserves (incl. self-created goodwill) at the ordinary tax rate which can be deferred at the canton's own discretion up to a period of max. 10 years, with a tax effective amortization possible thereafter, but at the reduced patent box rate.

Change from the special tax regime (e.g. mixed company regime) to the Swiss patent box regime

- The change from a special tax regime to the Swiss patent box regime should in general be tax neutral.

Open issues and questions

- It remains to be seen to what extent the individual cantons apply the tax relief (i.e. 80 % or below).
- Recommendation from the OECD in terms of the BEPS initiative (expected in September 2015) may result in the refining of the Swiss patent box .

Replacement measures – Notional interest deduction (NID)

Status quo

- ETR applicable to foreign interest income for holding company 7.8%, mixed company 8-10% and finance branch / company structure 0.5-2%.

Draft legislation

- NID is an internationally accepted and widely practiced concept (e.g. FL, B, I), refers to a deduction of interest on equity exceeding a core equity in addition to actual interest expenses arising from debt financing. This would ensure a somewhat equal treatment of equity financing and debt financing at company level.
- No booking entry in the accounts are required; NID reduces the tax base in the tax return.
- NID is also available to Swiss branches / permanent establishments of foreign companies.
- NID is granted on the average equity exceeding a calculated core (minimum) equity (i.e. average equity minus core equity = surplus equity). The core equity will be assessed asset-by-asset using a defined factor per asset-class, e.g. cash will require 0% core equity, intra-company loans 15% and patent box assets 100% of core equity.
- The notional interest rate would be equal to the 10-year Swiss government bond rate, plus 50 basis points, but would be no less than 2%.
- The minimum safe harbor rate for intra-company loans is 1.5% for 2014.

Replacement measures – Notional interest deduction (NID)

Current taxation of Finance Branch vs. CTR III

FinanceCo (Swiss finance branch)

avg. Assets (in CHFk)		avg. Liabilities (in CHFk)	
100	Cash	-	Debt
900	IC-loans	1'000	Equity
1'000	**Assets**	**1'000**	**Liabilities**

	Corporate Tax Reform III* *Notional Interest Deduction*	
Cash	100.0	0%
IC-loans	900.0	15%
Core equity		135.0
Surplus equity	865.0	

		Status quo *Swiss Finance Branch*	**Corporate Tax Reform III*** *Notional Interest Deduction*
Interest income 2.5%		22.5	22.5
./. NID up to CHF 1bn for SFB (22.5 / 1.21)		-18.6	-
./. NID according to CTR III - NID rate	2%	-	-17.3
Income before taxes		3.9	5.2
combined ETR (for mixed Co. / 10% Quota)	8.3%	-0.3	-
combined ETR	12%		-0.6
Taxable Income		3.6	4.6
Effective tax rate		**1.44%**	**2.77%**

Consequences

- The NID is designed to in particular benefit (inter-company) financing activities, and leads to a general tax rate reduction for most companies.
- NID reduces or eliminates the discrimination of equity financing vs. debt financing from a tax perspective.
- The NID regime should be an attractive solution for finance companies and together with the patent box regime and other measures makes Switzerland more attractive as a finance location.

Swiss Corporate Tax Reform III

Replacement measures

Other measures

Compensation measures

Other measures – reduction of cantonal CIT rates

Status quo

- Combined federal/cantonal/communal effective corporate income tax rates are currently between 12.20 and 24.17%.

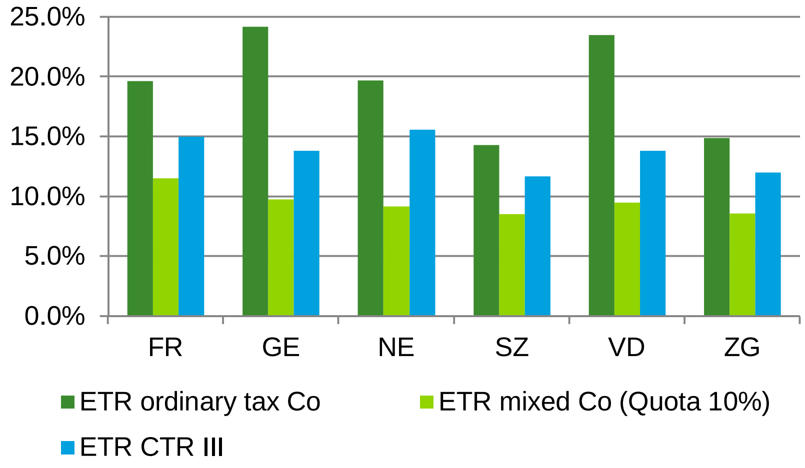
Draft legislation

- Cantons are basically free to reduce their cantonal income tax rates within the boundaries of their budget.
- The federal government announced that it will compensate cantons for lower tax revenue in the amount of CHF 1 billion per year.

Conclusions

- Not all cantons are equally affected by the abolishment of privileged tax regimes. High-tax cantons which would reduce their tax rate would however run a high risk of mobile income being shifted to low-tax cantons.
- Not all cantons have to date announced whether and to what extent they plan to reduce their corporate tax rate.

- The Swiss government anticipates an average reduction of the ETR to approx. 16%, with various cantons reducing their rates to as low as 12 %:



- In addition, the following cantons expect to maintain their low headline tax rates which are:

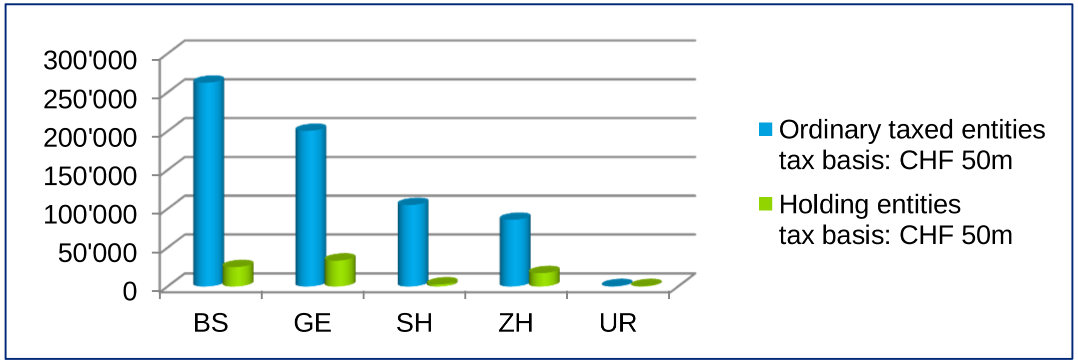
	ETR
• Schwyz*	11.6%
• Appenzell Ausserrhoden	12.7%
• Nidwalden	12.7%
• Lucerne*	11.5%

* Certain regions

Other measures – reduction of annual capital tax

Status quo

- Several cantons allow to credit capital taxes against corporate income taxes which can result in an elimination of annual capital taxes.
- The cantons Appenzell-Ausserrhoden, Argovia, Schaffhausen, St. Gall and Lucerne grant a participation relief on capital tax.
- Below chart for comparison reasons demonstrates the difference of the capital tax burden between an ordinary taxed company and a holding company in selected cantons:



BS = Basel
GE = Geneva
SH = Schaffhausen
ZH = Zurich
UR = certain regions in the Canton Uri

Draft legislation

- Under CTR III cantons are given the opportunity to lower the annual capital tax rate on equity with respect to participations, intellectual property and inter-company loans.

Consequences and open issues

- The change in legislation will increase the tax competition between cantons in Switzerland and is likely to result in a reduction of annual capital taxes for most companies.
- Most cantons have not yet announced whether and to what extent they would reduce capital tax rates.

Other measures – step-up: immigration

Status quo / Facts

- Swiss tax follows Swiss statutory accounts and thus a step-up in basis is often not possible at all or limited due to accounting rules.
- The government acknowledges that there is mismatch in the tax treatment between immigration and emigration as exit taxes are levied in case of an emigration.

Draft legislation

- A step-up of hidden reserves and self-created goodwill in the tax balance sheet would be allowed for direct federal and cantonal/communal tax purposes;
- A step up is available when the company becomes subject to tax in Switzerland, such as in case of a transfer of legal seat and domicile, effective place of management or a transfer of certain assets or functions to Switzerland.
- The step-up amount can be amortized for tax purposes, goodwill on a straight-line basis over a maximum period of 10 years.
- NID will be allowed up to the stepped up fair market value of assets, but not on the stepped up goodwill.

Consequences

- Immigration to and emigration from Switzerland are now tax wise treated equally.
- The step up with subsequent amortization makes a migration to Switzerland very attractive as it could potentially eliminate taxation for up to 10 years.
- In turn, an exit or the transfer of certain functions from Switzerland will result in an exit taxation, while the same standards and valuation methods will be applied as on an immigration to Switzerland.

Other measures – step-up: status change

Status quo / facts

- The step up in case of a transition from a privileged tax regime to an ordinary tax regime is already an established practice and confirmed by the Federal Supreme Court with respect to holding companies.
- There is a consensus that this will also be applied in case of a transition from a mixed company to an ordinary tax regime.

Draft legislation

- The step-up in case of a transition from a tax privileged status (such as the mixed company regime) to an ordinary taxation under CTR III will not be codified in the law because there is already an established practice.
- However, it is stated in the report that moving in or out of a patent box from to an ordinary taxation will be treated as immigration/ emigration. However, the tax levied upon an emigration out of a patent box can be deferred for up to 10 years.

Consequences

- The step-up essentially would grandfather the existing tax rates available under privileged tax regimes so they would continue to apply for a period of up to 10 years after the reform becomes effective.

Open issues and questions

- The tax accounting issue is still not solved, i.e. it is likely that the step-up leads to a deferred tax asset (DTA) (one year effect) but in subsequent years the group ETR is high because of the release of the DTA.
- As there is no draft legislation the cantons are rather free in defining the detailed rules (e.g. with regard to valuation method, depreciation period, taxable quota etc.).

Other measures – participation exemption

Status quo – Participation relief

- The current concept of participation relief provides for an indirect relief mechanism as opposed to a direct exemption.
- The current system could lead to a potential tax leakage in situations (i) where a company is highly leveraged and for that reason does not get full relief on qualifying income or (ii) where there are loss carry forwards, as these will be consumed by participation income before the participation relief applies.

Draft legislation

- Change from an indirect to a direct participation exemption regime on dividends and capital gains that avoids tax leakage.
- No minimum threshold and no minimum holding period is required.
- Under the proposed participation exemption regime participation income does not form part of the taxable income. Instead, participation income, along with capital gains from participations, write-ups on participations and income on subscription rights will be in a separate, non-taxable division, along with capital losses, depreciations, accruals and impairments on participations.
- There is no attribution of administrative or financing expenses to the participation division.
- Equal to the existing rules, if the distribution is deductible at the level of the distributing entity, it will not qualify for the participation exemption.
- The draft legislation does not introduce any CFC rules.

Other measures – participation exemption

- Example comparison for current participation relief and participation exemption under CTR III

Balance Sheet			
Participation	500	Loans	300
		Equity	200
	500		500

Indirect method (old concept)		Direct method (new concept)		
			Qualifying participation income	other income
Participation income	30	Participation income	30	
Financing costs	(15)	Financing costs		(15)
Profit	15	Profit	30	(15)
Income Tax	(1.2)	Income Tax	0	0
Participation relief	100%	Tax losses carried forward		(15)
Effective income tax	0			

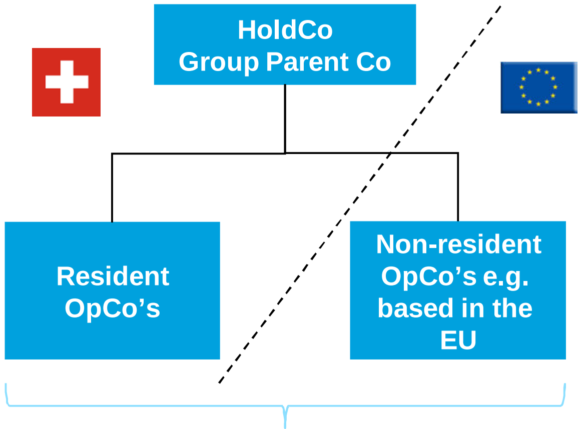
Consequences

- For most companies, the change from a participation relief to the participation exemption will not have a significant impact on the effective tax rate.
- Write-downs on participations are no longer tax deductible.
- All tax leakage will be avoided, which will benefit companies that currently do not have a full participation relief or have loss carry forwards.
- Strengthens Switzerland as holding location.

Open questions

- It is not clear how certain transactions will be treated, i.e. will a loan waiver in favor of a subsidiary be tax deductible?

Other measures – Group relief for losses



Non-exhaustive losses e.g. incurred by the following incidents:

- Ceasing of OpCo’s business by means of liquidation, merger etc.
- Through the expiration of the limited loss carry forward period as regards non-resident subsidiaries (or e.g. as a result of change in ownership etc.)

Facts

- The Swiss draft legislation provides for a group relief respectively utilization of losses incurred by resident and non-resident subsidiaries (incl. lower tier subsidiaries) at the level of the group parent company (GPC) in case of the following situations:
  - where the resident or non-resident subsidiary has exhausted the possibilities available for having the losses taken into account in its state of residence for the accounting period concerned by the claim for relief and also for previous accounting periods; or
  - where there is no possibility for the foreign subsidiary’s losses to be taken into account in its state of residence for future periods either by the subsidiary itself or by another affiliate e.g. in case of a merger or liquidation.
- Only resident entities may classify as GPC. A Swiss PE of a foreign based entity seems not to benefit from such relief.
- GPC must have sufficient financial control over the national and international group members (GM), either by direct shareholding (above 50%) or indirect shareholding e.g. via partnership or joint venture structure (cf. below).

Other measures – Unlimited loss carry forward

Status quo

- Current tax law allows tax losses carried forward to be set-off against current year profits during seven years following the tax year in which the losses incurred. This regime is applicable for both federal and cantonal/communal income tax purposes.

Draft legislation

- Losses can now be carried forward indefinitely.
- Tax losses carried forward will only be offset with 80% of current year profit; 20% of the current year profits will be subject to income tax.
- The new regime is also applicable to losses that are incurred under the current regime that limits loss carry forwards to seven years.

Consequences

- Record keeping has to be adjusted.

Other measures – abolition of capital issuance tax

Status quo

- Currently, a capital issuance tax of 1% is levied on the contribution of equity into a Swiss company (with exemptions on the first CHF 1 million nominal share capital and restructuring transactions).

Draft legislation

- Under CTR III, the capital issuance tax will be abolished.

Consequences

- The contemplated abolishment of the 1% capital issuance tax will not significantly impact the tax burden of most Swiss companies as an exemption applied in most cases, except for cash contributions by the direct shareholder.

Swiss Corporate Tax Reform III

Replacement measures

Other measures

Compensation measures

Compensation measures – Capital gains tax on securities held by individuals

Status quo

- Under the current direct federal and cantonal and communal tax law, capital gains on the sale of privately held assets are fully exempt from income tax (exemption: real estate capital gains tax).

Draft legislation

- Under the proposed regulation, capital gains on the sale of securities held by an individual will be subject to income tax.
- Capital gains derived from participations will be taxable at 70% (capital gains from other securities will be fully taxable). The taxable basis is the difference between the sale price and the acquisition costs.
- Losses on the sale of participations are off-settable against capital gains from such participations with a remaining loss being carried forward for an unlimited period of time.
- Losses on the sale of other securities are fully off-settable against capital gains or income from other securities with a remaining loss being carried forward for an unlimited period of time.
- Capital gains on the sale of other privately held assets such as cars, paintings etc. will remain exempt from income tax (exemption: real estate capital gains tax).
- The capital gains tax will also be levied in case of an exit of the individual from Switzerland.

Consequences

- The taxation of capital gains on the sale of securities significantly deters Switzerland's attractiveness for wealthy individuals.

Compensation measures – adjustments of the partial taxation procedure

Status quo

- Income derived by an individual from qualifying dividends (at least 10% shareholding quota) is taxed preferentially for direct federal and cantonal and communal taxes. The current reduction varies from canton to canton.

Draft legislation

- The taxation of participation income will be adjusted to compensate the corporate income tax rate reduction.
- At the same time the quota for qualifying dividends of currently 10% will be abolished, making the regime broader.

Consequences

- Minority shareholders will benefit, whereby shareholders with an interest of currently above 10% might be negatively affected.

Deloitte Presenters Contacts

Jacqueline Hess

Partner
Deloitte AG
Member of the Management Board
Tel/Direct: +41 58 279 63 12
Mobile: +41 79 823 46 85
jahess@deloitte.ch | www.deloitte.ch
General Guisan-Quai 38, P.O. Box 2232,
CH-8022, Zurich, Switzerland

Flurin Poltera

Partner
Deloitte AG
Direct phone: +41 58 279 7217
Mobile: +41 794 711 669
Direct fax: +41 58 279 6600
fpoltera@deloitte.ch | www.deloitte.ch
General Guisan-Quai 38, P.O. Box 2232,
CH-8022, Zurich, Switzerland

Jacques Kistler

Partner
Deloitte AG
Direct phone: +41 58 279 8164
Mobile: +41 793 737 274
jkistler@deloitte.ch | www.deloitte.ch
Route de Pré-Bois 20, P.O. Box 1808
CH-1215 Geneva 15, Switzerland

Rene Zulauf

Partner
Deloitte AG
Direct phone: +41 58 279 6359
Mobile: +41 79 799 44 97
rzulauf@deloitte.ch | www.deloitte.ch
General Guisan-Quai 38, P.O. Box 2232,
CH-8022, Zurich, Switzerland

Deloitte.