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Patent box

August 2019/February 2020

Key points of the tax reform regarding the patent box

Patent box (cantons, not confederation)

- Introduction of a mandatory patent box according to the OECD standard
- Income from intellectual property rights and similar rights (protection certificates, extensions, topographies) is taxed separately from other income and at a reduced rate → goes into the «box».
- Legal entities, self-employed persons, single companies and private companies can make use of the patent box
- The box may only include income that is attributable to domestic research and development activities → Nexus Approach.
- The amount of the reduction is up to the cantons. However, the reduction may not exceed 90%.

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How does the patent box work?

Implementation and management of the patent box

Step 1

Recording of revenue/patents qualifying for the patent box.

Step 2

Clarification of the cantonal regulations for admission. Calculation of the entry costs.

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Implementation and management of the patent box

Step 3

Management of the patent box / calculation of the residual profit / determination of the nexus factor.

Step 4

Determination/costs of exit from the patent box.

Step 1: Which intellectual property rights are concerned?

Art. 24a Tax Harmonisation Act (StHG):

[1] The following are considered **patents**:

a. Patents under the European Patent Convention of 5 October 1973 in its revised version of 29 November 2000 with designation Switzerland;

b. Patents under the Patent Act of 25 June 1954;

c. Foreign patents corresponding to the patents under letters a or b.

[2] The following are considered **similar rights**:

a. Supplementary protection certificates under the Patent Act of 25 June 1954 and their renewal;

b. Topographies protected under the Topographies Act of 9 October 1992;

c. Plant varieties protected under the Varieties Protection Act of March 20, 1975;

d. Documents protected under the Therapeutic Products Act of December 15, 2000;

e. Reports protected under the implementing provisions of the Agriculture Law of 29 April 1998;

a) Foreign rights corresponding to the rights referred to in letters a-e.

Step 1: Which intellectual property rights are concerned?

- Art. 24a Tax Harmonisation Act (StHG): → **The list is exhaustive.**
- Patent protected **inventions of SMEs** and copyrighted **software** do therefore not qualify for the patent box!
- Exceptions to the regulations:
  - Software for which a patent has been granted abroad.
  - Software which is part of an invention(so-called computer-implemented invention), especially if the software serves a technical application.
- **Inventions by SMEs must be patented in order to be covered by the patent box.**
- This is not very expensive in Switzerland, but the disadvantage here is the disclosure of business secrets.

Step 2: Entry into the patent box

Recording of the revenue/patents qualifying for the patent box.

- **Solution StHG**
  - **Upon entry into the patent box** - consideration of R+D costs of the last 10 years which relate to the patent and as far as they were deducted tax-effective.
  - Creation of a taxed hidden reserve.
  - The cantons have a certain degree of flexibility in the taxation of the relevant values upon entry.
    - One-time settlement procedure at a special rate.
    - IP loss recapture mechanism – means: Settlement of defined costs before entry with the box profit - until the amount is "used up"; max. 5 years.

Step 3: Calculation of «box profit»

a) Determine residual profit

Residual profit means ***«remaining»****-profit. The starting point for the calculation of residual profit is the total profit of the company, from which all parts of the profit that are not related to patents and similar rights are removed from the patent box. This method is called the "top down approach" or the residual method.*

- Revenue from licenses of patents or similar rights.
- Profit from the sale of patents or similar rights.

Step 3: Calculation of «box profit»

b) Correct residual profit according to the modified Nexus approach

- This means that the residual profit is multiplied by the Nexus factor.

- Nexus Factor $= \dfrac{qualifying\ R\ \&\ D\ expenditures + Uplift\ (max.\,30\%)}{total\ R\ \&\ D\ expenditures}$

Step 3: Calculation of «box profit»

What is the Nexus Approach?

- Nexus means **«context», «connection».**
- The nexus approach is based on the basic idea that profits from intellectual property rights are taxable in the **same country** where the related research and development expenses are generated.
- Therefore, R & D expenditure needs a **connection to Switzerland** in order to increase the box profit.
- One speaks of the **«modified»** nexus approach, because an up-lift of max. 30 % is permissible in order to take into account R & D expenditure of affiliated *foreign* companies that does not actually possess this domestic connection.

Step 3: Calculation of «box profit»

b) Correct residual profit according to the modified Nexus approach

- Qualifying R & D expenditures are:
  - Costs of research and development carried out by the taxpayer himself.
  - Costs for research and development by an independent third party.
  - Costs for contract research by a Swiss group company.
- Not qualifying R & D expenditures are:
  - Costs for outsourcing research and development to a foreign group company.
  - Costs for the acquisition of intangible assets.
- However, non-qualifying expenditures can be taken into account in the Nexus factor as part of a so-called "up-lift", up to a maximum of 30% of the qualifying costs.

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Step 3: Calculation of «box profit»

- The patent box leads to a **reduction of the assessment basis.**

- This reduction may not exceed 90% of the box profit.
  (Art. 24b Abs. 1 StHG).

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Calculation example patent box

Assumptions:

• Total net revenue	5’000
• Net revenue from products without patents	1’600
• Total product costs	3’500
• Product costs without patents	1’100
• Total prodution costs	640
• Production costs without patents	200
• License profits	80
• Profit before tax	1’000
• Income from financing activities	60
• Brand fees	98

Calculation example patent box

Assumptions:

- Routine functions 10% of production costs
- Profit mark-up 5%
- Own expenditure development IP 400
- Overall expenditure development IP 780
- Up-lift of 30%
- 90% reduction with patent box

Net revenue	**5000**					
Net revenue without patents	1600	1600				
Net revenue with patents	3400					
Product costs without patents	-1100	-1100				
Product costs with patents	-2400					
Gross profit I	**1500**	**500**				
Personnel/operating expenses Production costs without patents	-200	-200				
Personnel/operating expenses Production costs with patents	-440					
Gross profit II	**860**	300				
License profits	80					
Income from financing activities	60		60			**Box profit**
Profit before tax	**1000**	-300	-60	-2	-98	**540**

Calculation example patent box

$$\underbrace{540}_{\text{Box profit}} \times \underbrace{\frac{400 + \text{Up-lift max. 30\%}}{780}}_{\text{Nexus factor = 66,66\%}} = \underbrace{360}_{\text{Box profit}} - 10\% = \underbrace{324}_{\text{Profit patent box, which is deducted from the assessment basis}}$$

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Calculation example patent box

Profit before tax	1’000
- Profit patent box	324
Taxable profit	**676**

Decision-making aids for patent box

- **3 important requirements** to benefit from the patent box:
  - Qualifying intellectual property (patents).
  - Profitability of qualifying intellectual property.
  - Qualifying R & D activity (high nexus ratio).
- Entry into the patent box makes sense for highly profitable IP with a long patent term (selective patent box entry).
- Entry cost for IP.
- R & D/patent box strategy (relocation of R & D activities to Switzerland; register as many patents as possible).
- Administration costs for companies.
  - Tax savings versus processing effort (tracking and tracing).