BAK Taxation Index press release: the Swiss patent box in a European comparison

Patent box and moderate profit taxes make Switzerland attractive

The patent box planned as part of Switzerland's Corporate Tax Reform III (CTR III) will reduce the tax burden on some companies considerably. In extreme cases, the Swiss patent box looks set to almost halve the effective tax burden of companies. Still, most European countries with similar patent boxes will be able to offer considerably more generous tax cuts. Nevertheless, Switzerland remains tax-attractive: its patent box, combined with moderate profit taxes, makes it a highly favourable location for broad-based companies.

Patent boxes allow tax regimes to favour companies with strong research and development activities and have met with broad acceptance internationally. Numerous European countries have already implemented patent boxes or are considering doing so, with Switzerland planning to introduce its own patent box as part of CTR III. BAK Basel Economics has joined forces with the Centre for European Economic Research in Germany to compare the planned Swiss patent box with its existing European counterparts. The simulation carried out for Switzerland shows what the tax burden for companies in 2015 would look like if the patent box were already being used in relation to profit taxes.

Patent boxes and qualifying income:

On 5 October 2015, the OECD presented the final reports on its project investigating base erosion and profit shifting (BEPS). These reports also regulate the taxation of intangible assets (patent, licence and IP boxes), stipulating that income from patents, similar intangible assets and software can be privileged in tax terms if it meets certain requirements. Other reliefs that relate to non-patented inventions and that would ease the burden for SMEs are also possible. Although the Swiss patent box will be based on the standards drawn up by the OECD, the exact form it will take is still undecided. This text will therefore use the term "qualifying income" where it is assumed that the income in question qualifies for inclusion in the patent box, with the opposite assumption applying for "non-qualifying income".

Switzerland's patent box comparatively modest

In extreme cases, in which all income would qualify, application of the Swiss patent box would halve the effective tax burden. The tax cut in such a scenario would work out much greater in all the countries studied apart from Italy (see Figure 1). In Belgium, Spain, France and Hungary, the tax burden would theoretically be reduced to less than zero.

In reality, only a few companies will be able to report all or most of their income via the patent box. Where the proportion of qualifying income is significantly lower, so too are the tax benefits from using the patent box. A hypothetical industrial company that, for example, has its own production facilities and is able to report 20% of its income via the patent box would engineer much less of a tax cut by using it, regardless of which country it is based in (see Figure 2).

Switzerland still tax-attractive

The updated BAK Taxation Index 2015 shows that Switzerland is tax-attractive for a broad-based company despite the lesser impact of its patent box in relative terms. Of all the countries studied, Switzerland has the lowest effective rate of profit tax for a company with a typical profile (see Figure 2). Merely in the case of a hypothetical company generating exclusively qualifying income it is the case that Switzerland can not compete with the most attractive locations in Europe, due to the generous patent boxes that have been introduced there in the last fifteen years (see Figure 1).

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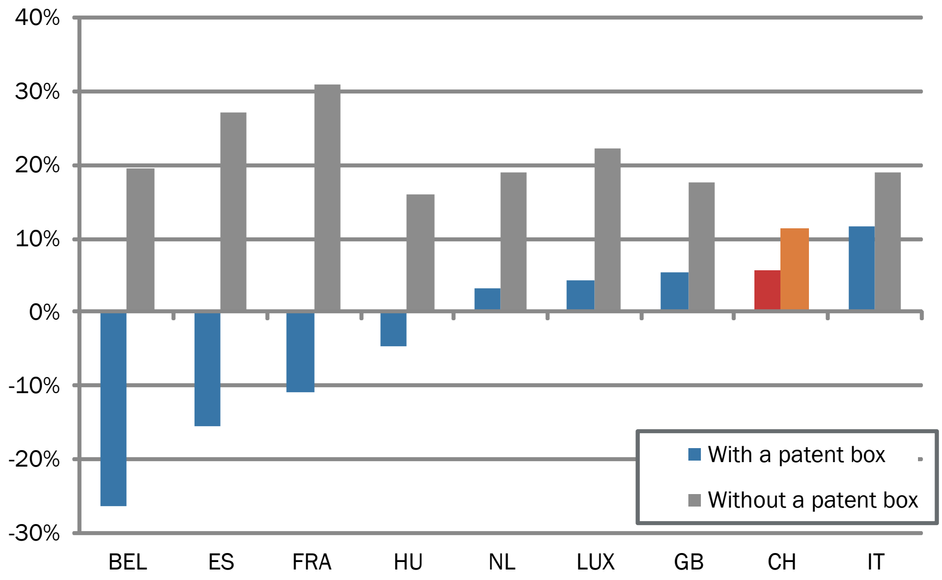
Further information

Full details of the BAK Taxation Index can be found on our website at www.baktaxation.ch.

Fig. 1 Effect of the pantent box on the tax burden for qualified earnings

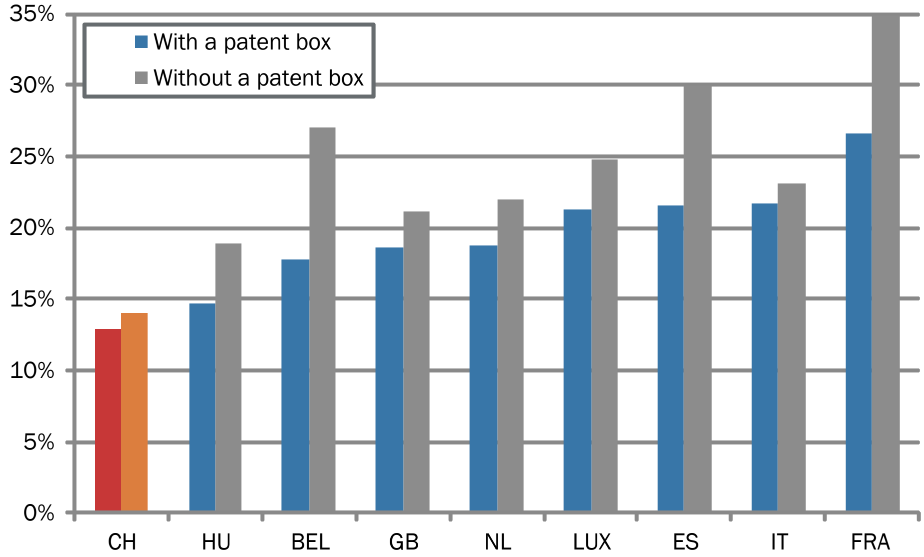


Note: Average tax burden in case of an enterprise which is exclusively generating qualified earnings; patent box: only corporate income tax; cantonal capital.
Source: BAKBASEL/ZEW

Qualified earnings		
Country	**with patent box**	**w/p patent box**
Belgium (BEL)	-26.5%	19.6%
Spain (ES)	-15.4%	27.3%
France (FRA)	-10.9%	30.9%
Hungary (HU)	-4.7%	16.1%
Netherlands (NL)	3.2%	19.0%
Luxembourg (LUX)	4.4%	22.3%
United Kingdom (GB)	5.3%	17.7%
Switzerland* (CH)	5.7%	11.5%
Italy (IT)	11.5%	19.0%

Note: * Switzerland: Unweighted average of the 20 swiss cantons participating in the BAK Taxation Index. Average tax burden in case of an enterprise which is exclusively generating qualified earnings; patent box: only corporate income tax; cantonal capital.
Source: BAKBASEL/ZEW

Fig. 2 **Effect of the pantent box on the tax burden for mixed earnings**



Note: Average tax burden in case of a enterprise which is generating 20% in qualified earnings; patent box: only corporate income tax; cantonal capital.
Source: BAKBASEL/ZEW

Mixed earnings		
Country	**with patent box**	**w/o patent box**
Switzerland* (CH)	12.8%	14.0%
Hungary (HU)	14.7%	18.9%
Belgium (BEL)	17.8%	27.0%
United Kingdom (GB)	18.6%	21.1%
Netherlands (NL)	18.8%	21.9%
Luxembourg (LUX)	21.2%	24.8%
Spain (ES)	21.5%	30.0%
Italy (IT)	21.6%	23.1%
France (FRA)	26.5%	34.9%

Note: * Switzerland: Unweighted average of the 20 swiss cantons participating in the BAK Taxation Index. Average tax burden in case of a enterprise which is generating 20% in qualified earnings; patent box: only corporate income tax; cantonal capital.
Source: BAKBASEL/ZEW

What is the BAK Taxation Index?

The BAK Taxation Index determines quantitatively and objectively comparable indicators for taxation. The BAK Taxation Index analyses and compares the tax levels for companies and highly qualified individuals on a global scale covering over 80 locations in highly industrialized countries. It was published for the first time in 2001 and has since been updated regularly. The last complete update with an international comparison was in 2013 (published in January 2014), and the last update of the tax levels in the Swiss cantons took place in the summer of 2015.

In the **BAK Taxation Index for companies**, the effective company taxation level is measured. For this purpose, all relevant taxes including the respective regulations for calculating the tax base, e.g. depreciation rules, are taken into account. This facilitates an appropriate international tax comparison across individual locations. Simply focusing on statutory tax rates would lead to a distorted representation of the tax level.

The key figure for company taxation is the Effective Average Tax Rate (EATR). The EATR calculates the taxes that would be due on a sample highly profitable investment by a company. It is the most relevant figure for company location decisions from a tax point of view. Furthermore, this study also determines other relevant figures and indicators of taxation.

In the **BAK Taxation Index for highly qualified individuals**, the effective taxation level for highly qualified employees is measured. To this end, various relevant taxes are compiled, including the respective regulations for the assessment of the tax base, e.g. the deduction of employers' contribution to the social security system and to the occupational pension scheme. It also contains social security contributions, if these have the character of a tax, as well as other payroll taxes.

The key figure for the taxation of individuals is the Effective Average Tax Rate (EATR). It is calculated as the implicit tax rate (in %) on the total labor costs, i.e. the employee's gross wage plus all taxes and contributions paid by the employer for the employee. Within the BAK Taxation Index, this figure acts as the effective tax level for a highly qualified employee (single, without children) with a disposable income of 100,000 euro.

The discussion about the **competitiveness of a region** and its attractiveness as a target location for a company or employee should, however, not be restricted to its tax level. Other location factors may play an equally important role (e.g. innovativeness, quality of living, regulations, etc.).

For further information about the BAK Taxation Index, please consult our website: www.baktaxation.ch