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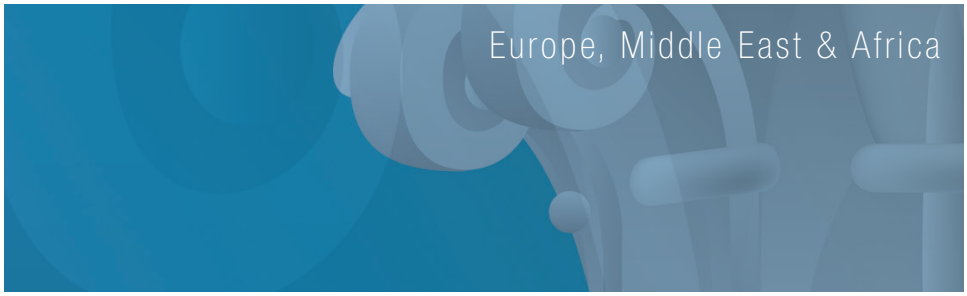

The Advantages of Switzerland as an IP Management Location

In 2011, the Canton of Nidwalden in Switzerland introduced its License Box, an attractive tax regime for IP (Intellectual Property) companies with a reduced tax rate for license income. After two years of positive experience, it may be considered the most liberal and advantageous among comparable systems within the European countries.

Switzerland as Location for Innovation Companies

Switzerland is not only one of the world's leading financial centers, but also provides an outstanding environment for innovation. Switzerland ranks first in World Intellectual Property Organization's Global Innovation Index 2012 and is according to the Innovation Union Scoreboard 2013 the overall innovation leader in Europe, outperforming all Member States.

Factors which enable Switzerland to hold this position are certainly a stable political situation, a very stable currency with minimum transfer restrictions, highly sophisticated and secure financial institutions and the fact that Switzerland is home of some of the world's most recognized research institutions. Furthermore, its geographic location in the heart of Europe, its rich nature and the high quality of life, make Switzerland attractive for highly educated personnel.

Another key factor lies in Switzerland's tax system: Traditionally, Switzerland is known for competitive tax rates. This, on the one hand, is due to the fact that Switzerland has a direct democracy in which taxpayers have the right to vote on tax issues and governmental expenses. On the other hand, the states (cantons) are competing with each other to offer benefiting tax regimes which attract companies and individuals. With the introduction of the License Box system in 2011, the Canton of Nidwalden further reduced the taxing obligations for IP companies on net license income: The fixed income tax on net license income derived from the use of intellectual property is only one fifth of the regular income tax, i.e 8.8%.

Other European jurisdictions know very similar tax regimes for income generated through IP rights. This article will provide an insight on the differences of the different regimes and particular advantages.

Concept of the License Box

The IP tax regime allows a legal entity with a statutory domicile in the Canton of Nidwalden to operate a separate division, the License Box, as part of its regular commercial operations. All IP and research and development (R&D) related activities, in particular related license incomes, are attributed to the License Box within the company. Incomes generated by the License Box are subject to the reduced tax rate.

Consequently, the License Box system allows a company to conduct any kind of operational business activities

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(i.e. employ personnel, conduct trade, R&D manage or actively use IP rights) and in the meantime profit from a reduced tax rate with regard to license income. Thus, there are no selective criteria an entity must fulfil in order to get access to favorable tax conditions regarding its licensing income.

The License Box reduces the tax rate for license incomes by 80%, i.e. to a cantonal income tax of 1.2%. Together with the federal tax (6.6%), the effective statutory tax rate for license income amounts to 8.8%.

Broad Range of Privileged IP Rights

The definition of license income is based on Art. 12 para. 2 of the OECD Model Convention. Accordingly, license income "constitutes payments of any kind received as a consideration for the use of, or the right to use":

- copyrights of literary, artistic or scientific work including cinematograph films,
- patents,
- trademarks,
- designs or models,
- plans, secret formulas or processes, or for information concerning industrial, commercial or scientific experience (know-how).

It thereby remains irrelevant whether a patent or another IP right is registered in Switzerland: Profits from IP rights granted by third countries (e.g. U.S. patents) are also eligible for the relief.

Thus, the Canton of Nidwalden has chosen to adopt the widest definition of license income available within Europe. Most other European jurisdictions limit the application of a reduced IP tax rate to innovative profits derived from patents and possibly know-how. Only very few apply it to royalties derived from trademarks and none to all kind of copyrights.

The Swiss system does not – other than most of the comparable European models – differentiate between "old" and "new" IP rights. The reduced tax rate applies to any income derived from the IP rights defined under para. 1 above, i.e., independent of whether the IP rights have been developed before or after the introduction of the new tax regime.

Furthermore, it is irrelevant whether the Swiss IP company has been involved in the development of the the relevant IP right or if it has purchased the IP right in question from a third party. It is sufficient that the Swiss company receives license fees on licensed IP rights. Accordingly, passive IP holding companies also qualify for the regime. The Swiss system shares this advantage with Luxembourg. However, contrary to Luxembourg, even IP rights that have been purchased from an associated company fall under the License Box regime.

Broad Range of Privileged IP Profits and Additional Tax Deductions

Both license incomes that have been generated through licensors situated in Switzerland, as well as abroad, fall under the scope of the tax reduction regime.

The reduced tax rate applies to net license income derived from qualified IPR. Thus, expenses in connection to the collection of the license fees may be deducted from the license income. The same applies to other financial and administrative expenses (including attributable tax costs) as well as depreciation and license payments to other companies.

Furthermore, the tax regime of the Canton of Nidwalden promotes R&D activities by allowing their full deduction as expenses, thus reducing the taxable income. In addition, tax provisions may be made for future R&D investments.

Who Should Consider a License Box in Switzerland?

Taking into account the positive tax effect, nearly all companies having income from any form of IP rights should consider a License Box in Switzerland. Usually, and if there is no prior Swiss presence of a company, a turnover from IP of around USD 1'000'000 p.a. is recommended to make the establishment of a Swiss License Box profitable.

The setup and recurring costs are limited and can be agreed upfront with an appropriate service provider. These services normally include establishing and registration of the company, accounting, group reporting and tax fillings as well as providing a board member or director. Depending on the specific group requirements and the size of the company (i.e. total assets, turnover) the IP Company may even abstain from being audited.

The music and pharmaceutical industry were among the first to establish License Boxes in the Canton of Nidwalden. In the meantime, other industries followed and will follow. Keeping in mind that no local context is required, License Boxes are an alternative for many U.S.- based or other international companies having taxable income from IP rights, even if it is generated within a group.

Conclusion

Even though the License Box of the Canton of Nidwalden has with currently 8.8% not the lowest effective tax rate on license income among the comparable systems of other European jurisdiction, it is, taking into consideration all relevant factors, likely to be the most advantageous:

- Other than with mentioned regimes, the reduced tax rates applies to a much broader catalog of IP rights, and in particular, includes profits generated from know-how and trade secrets.
- Consequently, there is no need to register additional IP in order to profit from the relief.

Moreover, the License Box tax relief also applies to license incomes gained from IP rights prior to their registration. This is of particular importance for companies operating in fast-moving markets where a technology may become outdated even before a patent registration has been granted.

Finally, the applicability of the regime is neither limited with regard to the source of the license payment nor to the developer of the IP right. P