

# Feasibility Study

## Best Practice for a Swiss Input Tax Incentive

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developed by **MME** |||

at the request of, and with  **Nestlé**

## Table of Contents

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I.	Executive Summary	3
II.	R&D&I Tax Credit Regimes in selected Jurisdictions	8
III.	Overview of key elements of a new Swiss ITI	9
IV.	Swiss Best Practice R&D&I model	11
	1. Qualifying taxpayer	11
	2. Mechanism of incentive	12
	a) Concept of the ITI: Tax credit	12
	b) Use of the tax credit	14
	c) Determination of benefit	16
	d) Calculation method	17
	e) No minimal threshold	18
	f) No ceilings	18
	3. Territory Restriction	19
	4. Definition of qualifying R&D&I expenses	20
	a) Qualifying activities	21
	b) Novelty requirement	22
	c) Qualifying expense categories	23
	5. Administration	24
	a) No preapproval or registration	24
	b) Declaration procedure	25
	c) Way of application	25
	d) Assessment procedure	25
	e) Statute of limitations	26
	f) Timing in case of cash refund	26
	6. Other relevant aspect: Framework conditions	27
V.	Best practice references	27
	1. France	27
	2. Ireland	27
	3. United Kingdom	27
	4. Canada	28
	5. Singapore	28
	6. USA	28
	Abbreviations	29

[Annex 1:](#) R&D&I Tax Credit Regimes location overview

[Annex 2:](#) Description of Revenue Audits (Ireland)

[Annex 3:](#) Research and Development Tax Credit Guidelines (Ireland)

[Annex 4:](#) Guidelines on the Meaning of Research and Development for Tax Purposes (UK)

[Annex 5:](#) Scientific, Research and Experimental Development Filing Requirements Policy (Canada)

[Annex 6:](#) Definition of Research and Development in Income Tax Act (Singapore)

[Annex 7:](#) E-Tax Guide on R&D Tax Measures (Singapore)

[Annex 8:](#) User Guide for a company for the e-Filing of income tax return form (Singapore)

[Annex 9:](#) Sample of R&D&I Claim Form (Singapore)

[Annex 10:](#) Claim Form for Credit for Increasing Research Activities – Form 6765 (US)

[Annex 11:](#) Instructions for completing Form for Credit for Increasing Research Activities – Form 6765 (US)

## I. Executive Summary

The Swiss government, due to international pressure, has decided to discontinue the Swiss tax regimes currently available. Many Swiss and foreign multinational groups with strong business presence in Switzerland will be affected. The Swiss Corporate Tax Reform III (CTR III) project, currently under consideration, should offer new internationally accepted tax benefits in order to keep Switzerland competitive and attractive. In that connection, the introduction of a Patent Box - among other measures - is proposed. Such regime is also used in other countries and leads to lower taxation on income from intellectual properties that are the result of Research & Development & Innovation (R&D&I) activities. Current international tax developments - in particular on the level of the OECD -, however, show that the impact of the proposed Swiss Patent Box will be limited massively. Therefore, it is encouraging that the Federal Council proposes an expense-related R&D&I tax incentive in the law proposal of the Corporate Tax Reform III as an additional measure.

**R&D&I Tax Incentive:** A R&D&I tax incentive should focus on promoting immediately the R&D&I activities in Switzerland. Therefore, the so-called "input incentive" supports specifically R&D&I expenses related to these activities. In contrast the tax incentive by means of a Patent Box incentivizes income ("output") from the exploitation of Intellectual Properties (IP). The R&D&I incentive is internationally tested and accepted. Internationally, there are basically three different R&D&I tax incentive systems available: tax credit, super deduction and accelerated depreciation. However, Switzerland should opt for the tax credit system. This corresponds with the EU best practice recommendation of November 2014.<sup>1</sup> The main advantages of the tax credit are the predictability of the benefit, a reduced administrative burden and above all the possibility to book the R&D&I tax credit as an income item (above EBIT) in the financial P&L accounts of the companies, according to international accounting standards. The latter helps not only the group internal tax department but rather the management and the R&D&I departments of companies to see directly the benefit of the incentive and it does not "only" achieve an impact as a reduced tax expense of a company. The R&D&I departments are given the opportunity to reduce their R&D&I expenses incurred in Switzerland, to strengthen their R&D&I budget and thus make them more competitive versus R&D&I activities performed in other countries. This is particularly important when companies take decisions on the localization of new, or expansion, of R&D centers, or when assessing the potential re-location of existing R&D facilities.

An introduction of an R&D&I tax incentive in Switzerland in the form of a tax credit, in combination with the Patent Box, is legally and from an administrative point of view feasible. A potential revenue loss can be managed by introducing such benefit on a low-key

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<sup>1</sup> Cp. Tax Analysts Document Service Doc 2015-576, A study on R&D Tax Incentives of November 2014 prepared by CPB Netherlands Bureau for Economic Policy Analysis in consortium with by CPB, CASE, ETLA and IHS on behalf of the European Commission, available online at: [http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/gen\\_info/economic\\_analysis/tax\\_papers/taxation\\_paper\\_52.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_52.pdf).

level, such as at a low percentage of the qualifying R&D&I expenses, and gradually increase the benefit in the course of gaining experience over time. Important for the effectiveness and success of such an incentive is the direct and practical access without any unnecessary administrative entry hurdles. Therefore, the federation should only set minimal standards and the Cantons, as the competent authorities, should get maximal legislative leeway in order to be in the position to tailor and adjust such incentive to their specific circumstances and needs.

**Economic View:** According to the Global Innovation Index 2014<sup>2</sup>, Switzerland remains the most innovative country in the world for the 4th consecutive year<sup>3</sup>. However, the report indicates that a fall in the growth of public R&D&I support, together with companies hesitating to invest, seem to be leading to slower overall growth of total R&D&I worldwide, especially in high-income countries. In addition, for Switzerland it has to be noted that more than 50% of the R&D expenses of Swiss companies are made abroad<sup>4</sup>. Therefore, various players and strong location competitors of Switzerland have introduced R&D&I tax incentives, often together with a Patent Box or equivalent tax benefits, in order to secure long term sustainable economic growth. Particularly, EU members have undertaken great efforts to support R&D&I activities in their territory as this forms part of the "EU 2020 Strategy"<sup>5</sup>. Consequently, Swiss firms with R&D&I activities in Switzerland, are facing substantial economic disadvantages due to the general high cost level, the strong Swiss franc and the lack of similar tax incentives<sup>6</sup>.

The introduction of a Swiss R&D&I incentive (tax credit) could compensate such disadvantages and would have further positive impact:

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<sup>2</sup> Available online at: [www.globalinnovationindex.org/userfiles/file/reportpdf/GII-2014-v5.pdf](http://www.globalinnovationindex.org/userfiles/file/reportpdf/GII-2014-v5.pdf).

<sup>3</sup> The same applies according to the second overall index of the European Union, the Summary Innovation Index (SII), available online at: [http://ec.europa.eu/enterprise/policies/innovation/files/ius/ius-2014\\_en.pdf](http://ec.europa.eu/enterprise/policies/innovation/files/ius/ius-2014_en.pdf), regarding Switzerland's position in Europe. According to the current report on the development of innovation activities in Swiss commerce published by the Swiss Economic Research Institute KOF of the ETH Zurich (structure report No. 51 and No. 49, available online at: [www.seco.admin.ch/themen/00374/00459/04076/04077/index.html?lang=de](http://www.seco.admin.ch/themen/00374/00459/04076/04077/index.html?lang=de)) Switzerland is also amongst the most innovative countries. However, when looking on the innovation indices based on industry sectors Switzerland comes second after Denmark followed by Finland and Germany. Furthermore, regarding the macroeconomic R&D&I quota Switzerland is left behind Finland, Sweden and Germany. With regard to patent application Switzerland is behind Japan concerning Triad patents and behind Finland and Sweden regarding PCT patents. As a weakness factor the insufficient use of funds in Switzerland for R&D&I is identified.

<sup>4</sup> Compared with 2004, the R&D expenses of Swiss branches abroad increased to 57% and reached a level of CHF 15 billion in 2012. The investments in Switzerland amounted to approximately CHF 13 billion in that year. Cp. Federal Statistical Office, R&D expenses in the private sector, available online at: <http://www.bfs.admin.ch/bfs/portal/de/index/themen/15/09/key/ind2.indicator.20205.202.html>.

<sup>5</sup> Cp. Communication of the European Commission of 3 March 2010 - Europe 2020: A strategy for smart, sustainable and inclusive growth [COM(2010) 2020 final – Not published in the Official Journal], available online at: [http://ec.europa.eu/archives/commission\\_2010-2014/president/news/documents/pdf/20100303\\_1\\_en.pdf](http://ec.europa.eu/archives/commission_2010-2014/president/news/documents/pdf/20100303_1_en.pdf).

<sup>6</sup> It can be observed that Switzerland's performance lead over the EU countries with regard to innovation is declining (cp. above footnote 3, SII, p. 73).

1. **Location Attractiveness:** Strong international competition for innovative companies, the high Swiss cost base and the strong Swiss franc threaten Switzerland as preferred R&D&I location. This will lead to a migration pressure on Switzerland. Furthermore, the current international tax developments at OECD level will likely require a so called "Nexus Approach". These developments indicate that a sustainable IP-structure will require bringing together IP-income and IP-activities in the same location. As a consequence, international groups would have to reconsider in which country (respectively in which countries) they want to reunite the ownership and management of their IP with their substantial R&D&I activities. An attractive Swiss R&D&I tax credit - combined with a Patent Box - could mitigate such pressure and reposition Switzerland as one of the main attractive locations for both IP ownership and R&D&I activities. An attractive R&D&I tax credit system would ensure the location attractiveness of Switzerland.
  
2. **Swiss Export:** The Swiss export industry has a high interest to foster the R&D&I activities in Switzerland, as R&D&I activities are strongly linked to the high-end products that are created and manufactured in Switzerland. The Swiss export industry is challenged to be innovative due to its high cost base and the strong Swiss franc. Only products with a high rate of innovation may generate sustainable demand from foreign markets and the required margins. Therefore, in contrast to low cost countries, Swiss export depends heavily on R&D&I. As a consequence, a transfer of R&D&I activities abroad would most probably lead to a transfer of production out of Switzerland and an additional loss of qualified workplaces in Switzerland. A strong R&D&I tax credit would help maintaining and further developing R&D&I and export industries in Switzerland.
  
3. **Spill-over effects:** Not only companies carrying out R&D&I work would be the only ones benefiting from the Swiss R&DI incentive, but also the whole economy as indirect benefits are earned by other businesses. Furthermore, universities will collaborate more with innovative companies and consequently the quality of innovation will increase and future skilled work force will be ensured. The latter shows that the social factor of innovations may not be underestimated. An attractive R&D&I tax credit system would result in spill-over effects.
  
4. **External Financing:** Primarily younger and smaller companies (YE<sup>7</sup> and SMEs<sup>8</sup>) have serious difficulties to obtain adequate funds for R&D&I. Although national studies show that the SMEs are very innovative, banks and other financial insti-

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<sup>7</sup> The term "Young Enterprise" has to be defined by the Cantons as it will only be relevant with regard to the cash refund mechanism (cp. below 2. b)). For example according to the 2004 Finance Act in France a Young Innovative Company must have less than eight years of age, engage R&D expenditures for at least 15 % of the total revenue charges and fulfill certain legally defined criteria.

<sup>8</sup> The term "Small and Medium-sized Enterprises" has to be defined by the Cantons as it will only be relevant with regard to the cash refund mechanism (cp. below 2. b). For example as defined in EU law cp. EU commission recommendation of 6 May 2003 (2003/361/EC), available online at: <http://www.reach-compliance.eu/english/REACH-ME/engine/sources/regulations/launch-2003-361-EC.html>.

tutes are not willing to grant adequate funding. An attractive Swiss R&D&I tax credit system would lower the hurdle and the level for an external financing.

5. **No Market Distortion:** An R&D&I tax credit incentive would not provoke unfair market competition as all taxpayers could qualify for the benefit based on the same qualifying R&D&I expenses. All companies in Switzerland are able to benefit from the Swiss R&D&I tax credit as long as they decide to invest in R&D&I. Not the government but the companies themselves are the decision makers upon which R&D&I project is worth to be invested and promoted. In contrast to subsidies, which are direct payments, the input incentive is an indirect state support. It is only an advantage, if a company generates taxable income. The unsuccessful R&D&I will not have the opportunity of state support. An exception in the form of a cash refund would have to be considered only for YE and SMEs. For these reasons, this instrument acts more focused and more efficiently as subsidies. An attractive Swiss R&D&I tax credit system would not affect the market competition and only reward the successful entrepreneur.
6. **Counteractive Measures:** With an R&D&I tax credit, the Swiss government could have an instrument to react in distressed economic times; e.g. in case of an immediate strong value increase of the Swiss franc the Swiss government could increase the tax credit rate. An attractive R&D&I tax credit system could create political room for maneuver.
7. **International Acceptance:** R&D&I tax incentives have been commonly used in many OECD countries for decades including almost all EU countries, the USA, Canada, Japan, Australia, China etc. Such tax incentive regimes are internationally accepted and have neither been challenged by the EU nor the OECD. Therefore, these are currently the most stable tax incentives available globally. An attractive R&D&I tax credit system could guarantee longer-term stability.

**Enterprise View:** In order to incentivize enterprises, large multinationals and small businesses, both Swiss and foreign based, to invest in R&D&I, Switzerland needs to meet two key conditions:

1. To maintain and develop an “Ecosystem” where all key players of the R&D&I value chain may work together, i.e. universities, start-up businesses, venture capital firms, industries, suppliers.
2. To create and sustain an overall framework that provides positive conditions to reduce the high costs and risks of R&D&I in Switzerland, including tax incentives on both the R&D&I expenses (input tax credit) and on the revenue from IPs resulting from such R&D&I (output incentive).

Those two conditions, structural and incentive, reinforce each other and create a virtuous circle that some countries that compete directly with Switzerland for R&D&I investments, have managed to establish.

**Conclusion:** Based on the above and as described as follows, we strongly support and recommend introducing an R&D&I tax incentive as part of the CTR III - in combination with a competitive Patent Box - with the following key features:

1. The introduction of a tax credit system (in contrast to the super deduction model as intended in the law dated 5 June 2015), with the option from an international accounting standpoint to treat this tax credit benefit as an "above the line" (i.e. above EBIT) income item, instead of a reduction in corporate tax (i.e. below EBIT).
2. The tax credit rate (as applicable) and as such the amount of the tax credit is at the discretion of the Cantons.
3. In principle, no tax credit for companies in the case of a loss situation; a carry forward should be possible within the framework of the current carry forward legislation.
4. Only for R&D&I activities carried out in Switzerland qualify for the tax incentive; for R&D&I activities incurred across subsidiaries of the same group within different Cantons appropriate measures have to be taken.
5. The tax credit has to be calculated on qualifying R&D&I expenses, i.e. on the volume of R&D&I (volume-based approach), without minimal threshold or maximum amount (no ceiling).
6. An abstract definition of qualifying R&D&I expenses at Federal level (Tax Harmonization Law), with precise and/or self explanatory guidelines that may be adapted easily.

## II. R&D&I Tax Credit Regimes in selected Jurisdictions

This position paper is based on a survey of R&D&I incentive regimes including strong IP-location competitors of Switzerland like Ireland, Singapore and UK and countries with a long R&D&I incentive tradition like Canada, Australia, France, USA and Ireland (cp. R&D&I Tax Credit Regimes location overview, [Annex 1](#)). In addition the EU best practice recommendation released in November 2014 has been taken into account as well. In all the mentioned locations experienced R&D&I incentive experts have been approached.

The assumptions of the survey were:

(a) The effect of an Patent Box regime is limited due to the new international developments (Nexus Approach):

- Many EU/OECD countries combine their preferential Patent Box regime with an R&D&I incentive in order to achieve a best in class position;
- Singapore, China, Brazil<sup>9</sup> and Ireland have just introduced a new or plan to substantially improve their R&D&I incentive;
- UK, Spain, France, Belgium, and the Netherlands already know combinations of an input and an output regime.

(b) Switzerland is currently considering introducing an input incentive as well in order to complement the planned Swiss Patent Box. There are basically three main concerns which makes Swiss tax administration reluctant to propose an R&D&I incentive:

- Lack of experience on tax payer and administration side;
- Complexity of declaration and assessment procedure for tax administration and taxpayer;
- Unpredictability of revenue loss.

The goal of the survey was to receive practical guidance and specific information on how the R&D&I incentive regime is being handled in the mentioned countries in practice. Thus, the focus was more on practical aspects such as administrative procedures, forms and sample calculation and less on generic theoretical aspects.

A further focus was to understand what would be according to the experience of the experts approached a best practice recommendation for Switzerland. For such consideration they have been instructed to take into account that Switzerland is not an EU member state and could follow regulations which are available in other OECD (Non-EU) countries

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<sup>9</sup> Brazil is also included even if not analyzed in detail to represent all relevant continents having ITI schemes.

as well in the case they were more favorable compared to the EU guidance, respecting the fact that Switzerland is primarily interested in long lasting solutions. Furthermore, the incentive regime should be easy to administer for taxpayer and tax administration.

The questionnaire of the survey consists of seven sections:

1. Qualifying taxpayer
2. Mechanism of incentive
3. Territory
4. Definition of qualifying R&D&I expenses
5. Administration
6. Other relevant aspects
7. Special topics

The position paper at hand is a compilation of the inputs received from the different experts and has been compared with the EU best practice recommendation.

### III. Overview of key elements of a new Swiss ITI

The following table is based on the summary of principles of best practice as published by the EU in November 2014<sup>10</sup> and supplemented by the proposed Swiss ITI aspects.

Category	Topics	EU Best Practice Recommendation	Proposed Swiss ITI
Scope	Input related vs. output related R&D&I tax incentive	Input related	Combination of output and input related
	Tax credits vs. enhanced allowances	Tax credits	Tax credits
	Volume vs. incremental based	Volume based	Volume based
	Novelty requirement	New to the country (world)	New to the country
	Expenditure covered	R&D&I wages	Personnel expenses

<sup>10</sup> See footnote 1 above, Table 6.1, p. 74.

<b>Targeting</b>	Region	Common rate for the country	Common rate for each Canton (discretionary clause for Cantons)
	Legal form	Common rate for all legal entities	Common rate for all legal entities in the same Canton
	Company size	No targeting	No targeting
	Ceilings	No ceilings	No ceilings
	Company age	Young Enterprises (YE)	No targeting
	Field of activity/type of technology	No targeting	No targeting (as broad as possible)
	Minimum	No minimum	No minimum
	Cash refund mechanism	Yes, for YE	Yes, but only for YE, SME, contract R&D&I from abroad into CH and distressed companies (discretionary clause for Cantons)
	Carry forward provisions	Yes, for YE	Yes
	Collaboration	With public research institutes	No requirement
<b>Organization</b>	Decision time/refund	Minimum possible	Minimum possible
	Electronic application	Yes	Yes
	One-stop application	Yes	Yes

## IV. Swiss Best Practice R&D&I model

### 1. Qualifying taxpayer

#### Recommendation:

- Swiss legal entities which are subject to Swiss corporate tax;
- Foreign legal entities with place of management in Switzerland and according to Art. 20 paragraph 2 Swiss Tax Harmonization Law (THL) subject to Swiss corporate tax; and
- Swiss permanent establishments of foreign legal entities subject to Swiss corporate tax.

#### Comment:

According to this definition, Swiss partnerships or individuals have no access to the Swiss ITI. As there is no binding EU/OECD obligation, Switzerland may exclude partnerships or individuals from the benefits of the ITI<sup>11</sup>. This question is mainly driven by the expected additional net revenue loss in case the definition of qualifying taxpayer would be extended.

In any case it is crucial for the attractiveness of the Swiss ITI to include foreign entities subject to Swiss corporate tax<sup>12</sup>. Excluding foreign companies or companies with foreign owners would be not only discriminative, but also particularly counterproductive as it discourages R&D&I-related foreign direct investment inflows and knowledge spill-overs from foreign affiliates<sup>13</sup>.

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<sup>11</sup> Cp. answers to Q. 1) c) of the AUS, IRL, UK and US Qn.

<sup>12</sup> SG includes all businesses with active business operation in Singapore cp. [www.iras.gov.sg/irashome/page04.aspx?id=1592](http://www.iras.gov.sg/irashome/page04.aspx?id=1592). FR ITI is also eligible for partnerships, see French Qn. 1) c) i.

<sup>13</sup> According to enclosure 5, 1.45 to the Irish Qn. the fact that the Irish tax credit is available to all corporate tax payers operating in the state, regardless of the size of the company or sector in which they operate is an asset for a small nation with an open economy.

## 2. Mechanism of incentive

There exist different types of R&D&I input tax incentives. In general, three approaches can be distinguished: tax credit, super deduction (= enhanced allowances) and accelerated depreciation. In some countries different regimes exist side by side<sup>14</sup>.

<b>Tax credit</b>	<ul style="list-style-type: none"><li>• Tax credit decreases the corporate income tax liability a company has to pay.</li><li>• Rate can be applied to either corporate income tax, payroll tax paid for R&amp;D&amp;I workers or personal income in case the incentive is targeted to self-employed.</li></ul>
<b>Super deduction</b>	<ul style="list-style-type: none"><li>• A super deduction effectively decreases the amount of taxable profit that is subject to corporate tax, by allowing to "inflate" the R&amp;D&amp;I expenditure base.</li><li>• Example: if the qualifying R&amp;D&amp;I expenditure is CHF 100 and the rate of enhanced allowance 1.5, then the super deduction for tax purposes is increased to CHF 150, and therefore reduce the taxable income.</li></ul>
<b>Accelerated depreciation</b>	<ul style="list-style-type: none"><li>• Accelerated depreciation permits to depreciate the purchased fixed assets at higher rates in the first years of the assets life. This allows, therefore, decreasing the taxable income in the specific periods.</li></ul>

### a) Concept of the ITI: Tax credit

#### Recommendation:

A tax credit system as base concept according to recommended EU best practice, combined with the option to treat this tax credit benefit from an accounting standpoint as an "above the line" income item.

#### Comment:

The tax credit system decreases the corporate income tax a company has to pay whereas the super deduction effectively decreases the base amount that is taxed by allowing to "inflate" for tax purposes the R&D&I expenditure base.

<sup>14</sup> Cp. the UK volume based incentive which offers either a 130% super deduction or a 10% refundable above the line credit for large companies and a 225% super deduction for SME (cp. UK-Qn. Q. 2) c).

Benefits from a tax credit system are more predictable for taxpayers than from a super deduction system and are recommended best practice<sup>15</sup>. From an economic point of view there is little difference between tax credits and super deductions, but from an administrative point of view tax credits are preferred over super deductions because statutory tax rate reductions do not influence ITI benefits<sup>16</sup>. Whenever there is a change in the corporate income tax rate, the effect of super deduction follows the adjustment. This is not the case with tax credits. The benefit of a tax credits system is tax rate independent.

The "above the line" scheme should enable claimant companies to book the R&D&I tax credit as an income item. This would directly reduce their R&D&I expenses. Consequently, it helps managing their R&D&I budget, by potentially investing more in R&D&I activities. It also increases the visibility of the R&D&I department by the generation of this incentive as a result of their activities, and the impact on the department's P&L – since the "above the line" credit increases EBIT. The ability to offer a tax credit "above the line" has been a major boost for Ireland's<sup>17</sup> and UK's<sup>18</sup> offerings. In comparison to a super deduction approach or a below the line tax credit the above the line tax credit would lead to the following advantages:

- Strengthen EBITDA<sup>19</sup>;
- Real cost reduction: expensive highly qualified R&D&I jobs would remain in Switzerland and more new R&D&I jobs from foreign investors would be attracted;
- Increase visibility and buy in;
- Link to budget/reward measures.

There is no clear guidance from the IFRS, which are commonly used by listed companies in Switzerland, regarding the appropriate place in the income statement to recognize a tax incentive. Therefore, in order to obtain the presentation above EBIT mentioned above,

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<sup>15</sup> Cp. Tax Analysts Document Service Doc 2015-576, A study on R&D Tax Incentives of November 2014 prepared by CPB Netherlands Bureau for Economic Policy Analysis in consortium with by CPB, CASE, ETLA and IHS on behalf of the European Commission, 6.1.1., p. 75, available online at: [http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/gen\\_info/economic\\_analysis/tax\\_papers/taxation\\_paper\\_52.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_52.pdf).

<sup>16</sup> In SG the super deduction is applied. However in answer to Q. 2) g) of the SG-Qn. the tax credit system is recommended for Switzerland.

<sup>17</sup> Since the introduction of the regime in Ireland the number of companies benefiting from the credit has increased from less than 75 to nearly 1,500 (cp. enclosure 5 to IRL Qn., 2.5.). The above the line approach allows Irish subsidiaries of multinational companies to pitch for R&D&I projects on the basis of 75% of actual costs per head of conducting R&D&I in Ireland in competition with subsidiaries in other jurisdictions (cp. enclosure 5, 1.24).

<sup>18</sup> The UK Research and Development Tax Credit Statistics released in 2014 (cp. enclosure 12 to UK-Qn., p. 7) shows an increase of claims compared to the previous year in the amount of 26% due to favorable policy changes.

<sup>19</sup> With a positive influence on share price which increases the attractiveness of Switzerland for quoted companies.

it is important to consider the economic substance of the tax incentive and define whether the scheme has the features of a government grant (with presentation above EBIT) or of an income tax credit (presented below EBIT).

Typically, a tax incentive calculated on expenses ("inputs") and not dependent on any results, neither taxable benefits nor income tax amount, can be recognized as an grant above EBIT (with or without offset against tax liabilities).

On the contrary, calculation of the amount of the incentive on accounting results, taxable profits, income tax amount or other ("output") models, will give the scheme the features of an income tax credit to be presented below EBIT.

It is still open what Swiss GAAP FER requires.

## **b) Use of the tax credit**

### Recommendation:

Primarily, the tax credit is to be used to reduce a company's current year corporate taxes.

Carry forward: Where a company does not have sufficient corporate taxes in the current year the excess credit may be carried forward against future years' corporate taxes. Carry forward period should be aligned with the general loss carry forward rules. Cantons may introduce the right to set off unused tax credits against cantonal taxes of other group entities.

Cash refund (optional): It is at the discretion of the Cantons to introduce a cash refund mechanism. A cash refund mechanisms makes sense especially for YE, SME, contract R&D&I from abroad into Switzerland and distressed companies.

Carry back: No carry back mechanism that would allow obtaining tax refunds from previous years for which the company paid corporate taxes.

### Comment:

The option to carry forward excess tax credits to other years is crucial for the effectiveness of a Swiss ITI: it enables companies to take full advantage of the tax incentive and provides companies with more flexibility in their investment decisions. In order to avoid reorganizations due to the introduction of a Swiss ITI, it would make sense for a Canton to grant the right to the taxpayers to set off excess tax credit with the tax liability of other group companies within the same Canton and tax period.

With a cash refund mechanism a company may apply to obtain the tax credit paid out in cash instead of a carry forward, subject to certain conditions. Developments in France,

Canada and the UK regarding cash refunds<sup>20</sup> lead to the conclusion that tax credits available as cash refunds are attractive to companies as valuable source of cash flow.

Cash refund options are especially crucial for distressed companies<sup>21</sup> as well as for SMEs<sup>22</sup> and for YE - as they are often in immediate cash need and have no benefit in carrying forward the credit to future tax periods.

It is also a need for contracted R&D&I from abroad into Switzerland, such as within an international group from the parent company to a Swiss R&D&I center (remunerated generally on a cost plus profit margin). This is for the reason that the latter could generally not benefit from the tax incentive simply because they have only limited tax capacity. In such situations, Cantons should apply a cash refund mechanism. Furthermore, as a side effect a cash refund mechanism would make the Swiss ITI more attractive for foreign investments.

By converting the carry forward amount into a cash refund the Canton allows to convert a future revenue loss (deferred tax asset) into a current revenue loss. In case of cash refunds a discount to a certain percentage could be applied for the conversion of the carry forward amount. It is at the discretion of the Cantons to determine such discount<sup>23</sup>.

As a result in the course of the tax declaration a company may elect whether the tax credit is:

- a) mandatorily, set off against its current cantonal tax liability (or, if permitted, against the current cantonal corporate tax liability of another group entity in the same Canton);
- b) carried forward; or
- c) optional and if any left from a) and b), refunded as cash with an appropriate discount, subject to appropriate conditions.

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<sup>20</sup> Cp. CAN-Qn. Q. 2) b) and g) regarding the lobbying of large companies in order to get a cash refund and UK-Qn. Q. 2) c) describing that after the legal change in April 2013 also large companies can claim a cash credit for R&D expenditure.

<sup>21</sup> The term "distressed company" has to be defined by the Cantons. However, it should include an entity with an adverse balance that is still a going concern, i.e. its latest accounts were prepared on a going concern basis based on the principles of proper bookkeeping and accounting; not economically liquidated or inactive; continuing business activities and not in debt restructuring liquidation or bankruptcy.

<sup>22</sup> Cp. enclosure 5 to IRL Questionnaire, 2.2.

<sup>23</sup> Note: A cash refund mechanism would lead to the fact that, once the carry forward period has elapsed, companies would trigger the cash refund mechanism in the last year of such period.

Carry backs<sup>24</sup> are not recommended for the concept of a Swiss ITI although it would make the tax incentives more attractive but retroactive amendments of revenues of preceding years are not standard in the Swiss income tax landscape.

### **c) Determination of benefit**

#### Recommendation:

It is at the discretion of the Cantons to determine the tax credit rate. It is recommended to introduce one rate for all companies within each Canton, irrespective of size, age, industries, technologies and areas of R&D&I.

#### Comment:

By virtue of the Constitution, only the Cantons are entitled to define the level of benefit of a tax credit system, as it relates to the tax rate. The level of benefit of a super deduction system however could be regulated by the THL as it applies to the taxable base only. But as the Cantons in Switzerland have different tax rates, it is impossible to regulate a Swiss wide even benefit on THL level. In addition, the benefit should be tailored to the specific economic situation of each Canton, depending on various factors. Each Canton needs to find a balance between a potential revenue loss and the attractiveness of such an incentive. An attractive ITI regime would maintain and attract R&D&I activities that would create additional long term economic and tax benefits for the Canton. Therefore, in a cost-benefit equation the Canton should measure its potential future tax losses on a dynamic basis only.

Furthermore, the framework conditions in the Canton have to be taken into account (see below 6. other relevant aspects)<sup>25</sup>. The tax credit rate should be linked to the definition of qualifying expense categories for the purpose of the Swiss ITI. If the definition of qualifying expense categories is rather narrow, then, as a consequence the tax credit rate could be higher.

The EU takes a neutral position on targeting R&D&I companies with respect to their size. However, Switzerland's economy depends on the prosperity of SMEs which manufacture in Switzerland and which in turn are reliant on exports. Swiss SMEs manufacture in Switzerland and these operations are normally strongly linked to their R&D&I. As a consequence they have a substantial currency risk exposure. Currently Swiss SMEs struggle with the strong Swiss franc and Swiss jobs are at risk (production and R&D&I sector). Additionally, smaller SMEs and YE are confronted with difficulties to access external

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<sup>24</sup> According to our survey, IRL (cp. 2.3 in enclosure 3 to the IRL-Qn.), the US (cp. Q. 2) c) of the US-Qn.) and Singapore (cp. Q. 2) c) of the SG-Qn.) offer a 1 year carry back-option. Canada provides a 3 year carry back possibility. All countries offer a carry forward.

<sup>25</sup> Canada can serve as a comparison as there is a tax credit of 20% resp. 35% on federal level and provincial tax credits ranging from 4.5%-37.5% (cp. chart "Provincial Research and Development Tax Incentives" Q. 2) c) of the Canadian Qn.).

funding as they lack collateral and a track record that can provide more certainty to banks and investors. These entry barriers result in overall lower competition and possibly less pressure on incumbents to innovate. However, large companies, especially Swiss Multi-national Corporations (MNCs) and foreign MNCs with substantial activities in Switzerland, should have access to a competitive R&D&I incentive in the same way as all other companies in order to help them maintaining and developing their R&D&I activities in Switzerland over long term, despite the high cost of operations in Switzerland vs. other countries and despite the strong Swiss franc. Consequently, the difference of company size and age and the respective circumstances should not be reflected by applying a different tax credit rate but by means of a cash refund mechanism as there is no use for SMEs and YE of a favorable tax credit rate as long as they do not generate profits<sup>26</sup>.

In general, targeting specific industries, sectors or technologies has the potential drawback that it could discourage innovations that arise from a combination of different technologies<sup>27</sup>. Tying fiscal support to specific fields can restrict recombination, goes against the market forces and competition to allocate resources freely to the most promising areas, and can result in less innovation. Furthermore, such limitation goes against the primary advantage of the input incentive which is a system where the legislator does not influence the decision of R&D&I projects in the private sector (i.e. it does not try to pick the “winners” with the risk that the reaction time is too slow to adapt the incentives to breakthrough innovations).

#### **d) Calculation method**

##### Recommendation:

Volume based approach.

##### Comment:

There are two approaches in calculating the base of R&D&I tax incentives, i.e. volume or incremental based. The volume based approach applies to all qualified R&D&I expenditures while the incremental approach only applies on the incremental part of it, i.e. it is calculated on the excess of an average amount that the company had in either some specified period of time or some specific number of (previous) years.

The incremental approach is not capable of retaining existing R&D&I activities in Switzerland and preventing companies from relocating part or all their existing R&D&I activities abroad. In addition, the administrative burden is significantly higher, since the current R&D&I expenses have to be compared with the expenses of previous years. It also leads to discrimination against companies with high R&D&I spending. Consequently, the incremental approach would lead to unjustified discrimination and potentially be a factor to

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<sup>26</sup> Cp. above section 2.b).

<sup>27</sup> In all of the interviewed countries, the eligibility of the incentives is not limited to particular industries. However, in Canada there exist special federal and provincial tax credits for selected industries.

incentivize delocalization of current R&D&I activities, with potential planning opportunities<sup>28</sup>.

#### **e) No minimal threshold**

##### Recommendation:

No minimum threshold.

##### Comment:

As a principle, a minimum threshold would exclude small companies from the Swiss ITI benefits, which lacks economic justification. It leads to undesired planning behavior on taxpayer side and therefore to more administrative burden and less efficiency on administration side<sup>29</sup>. Any requirement to invest a specific amount in R&D&I before a tax benefit can be received puts smaller companies at a disadvantageous position, while they are potentially important for the innovativeness of an economy in the long run. A high minimum requirement works in favor of large incumbents and can distort competition.

However, it can be said that the application process is a natural limitation in circumstances of very little qualifying expenses.

#### **f) No ceilings**

##### Recommendation:

No ceilings.

##### Comment:

A ceiling makes the incentive less attractive by means of having the disadvantage of distorting the optimal R&D&I investment planning of companies, as it creates an incentive to distribute their R&D&I activities in a way to obtain the maximum tax benefit, spreading R&D&I budgets over time, over subcontractors and over the countries, or even worse, delocalizing part of it, if they reach the ceiling<sup>30</sup>.

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<sup>28</sup> Volume based approach applied in Australia, Canada, France, Singapore and UK. In Ireland the incentive is both incremental and volume based depending on the respective period. For accounting periods commencing 01/01/2015 there will only be the volume based approach (cp. Irish Qn. Q. 2) c) 3., p. 7 for details). The US apply an incremental incentive.

<sup>29</sup> Cp. UK Qn. 2) b), p. 5: UK included a minimum expenditure threshold for SMEs which was removed as it led to companies manipulating claims and consequently to increased compliance burdens. Only Australia still has a minimal threshold (cp. Australian Qn. Q. 2) c) 2.).

<sup>30</sup> In none of the countries under review brackets or ceilings are applied.

### 3. Territory Restriction

#### Recommendation:

Restriction to Swiss based activities only.

Optional: exemption, if qualifying R&D&I activities cannot be conducted in Switzerland<sup>31</sup>.

#### Comment:

1. Use of qualifying expenses is restricted to activities carried out in Switzerland only.
2. The qualifying R&D&I activities can be carried out directly by the company eligible for the tax credit; or
3. The qualifying R&D&I activities can be contracted to another group company or to a 3rd party as long as the respective activities are carried out in Switzerland.
4. The Swiss ITI claim can only be made once in Switzerland for the same qualifying expenses.

Only R&D&I activities performed within the Swiss territory lead to economic benefits in Switzerland<sup>32</sup>. Due to the freedom of establishment, EU member states are not allowed to restrict their input incentive to their national territory only. However, the EU freedom of establishment does not apply to third countries like Switzerland.

In the case of contract R&D&I with a third party, the buyer of such R&D&I (which carries the fund, risk and ownership of the R&D&I) may claim the Swiss ITI in its tax return if it has its tax domicile in Switzerland.

In the case of group internal contract R&D&I and if both buyer and seller are tax domiciled in Switzerland only the buyer can claim the ITI benefits in the Canton of its residence. This would avoid double R&D&I tax incentive on the same R&D&I expenses and would lead for the Canton of the buyer to give a tax benefit without having the immediate

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<sup>31</sup> There should be an exemption for the Swiss territory requirement, if qualifying R&D&I activities cannot be conducted in Switzerland. Foreign qualifying R&D&I expenditure must have significant scientific link to Swiss core activities; this is the case if:

- the Swiss core activities cannot be completed without the foreign activity being conducted; and
- must be unable to be conducted within Switzerland because, for example, it requires access;
  - to a facility, expertise or equipment not available in Switzerland; or
  - to a population (of living things) not available in Switzerland; or
  - to a geographical or geological feature not available in Switzerland.

<sup>32</sup> In France and Ireland qualified research activity must occur in the EU resp. EEA. Regarding the US the qualified activities must occur in the US. In Australia activities can be physically performed outside Australia and remain eligible for benefits only if approved by the government by way of an advanced finding. In Singapore the deductions do not have to relate to research performed in Singapore. Research activities may occur outside of UK, but work must be supervised by a UK company.

economic advantage of the R&D&I activities in its territory. However, on the other hand, this has two advantages: a) the Canton of the buyer does not risk that R&D&I activities are shifted out of the Canton only for tax planning purposes; and b) due to the ownership of the R&D&I results, the Canton of the buyer will benefit from tax revenues generated from higher income when the outcome of such R&D&I, through IP and knowhow, generates new sales and revenues.

Swiss qualifying taxpayer with an R&D&I-PE in another Canton: such case should follow the general principles of contract R&D&I (see above) and needs analyses where IP ownership and R&D&I activities take place. As the Swiss ITI is applied after tax allocation, only the tax credit system would lead to a fair intercantonal allocation as it does not influence the tax base as it would be in the case of super deduction regime.

In the case the buyer has no tax domicile in Switzerland the seller in Switzerland may make the Swiss ITI claim in its tax return.

In an inter-cantonal context, it has to be assured according to international transfer pricing standards that an entity taking the tax incentive is able to demonstrate that the R&D&I was conducted on its own behalf, under its control and management, with its funding, and at its own risk<sup>33</sup>.

#### **4. Definition of qualifying R&D&I expenses**

Countries normally adopt unique definitions as to the type of activities and expenses that qualify. A best in class R&D&I incentive regime offers maximum certainty to qualifying taxpayers on the eligibility of activities. The definition of qualifying activities and expenses and whether or not it is aligned with the Frascati<sup>34</sup> and/or Oslo manual<sup>35</sup> definition will depend on the activities the regime is seeking to incentivize.

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<sup>33</sup> In Australia contract expenses are included as qualified expenses if they are directly related to research activities (cp. Australian approach in AUS-Qn. Q. 3) c), p. 11). In Canada contracted research to third parties, university, colleges and consortiums are qualified (for the special rules cp. enclosure 3 to the Canadian Qn.). In France there is a cap on private subcontracted research (cp. Q. 3) c) of French Qn.). In Ireland contract expenses are included with certain caps (cp. Irish legislation Q. 3) c) of Irish Qn.). In Singapore contract expenses are eligible for various deductions (cp. section 8 and Annex D of the IRAS e-Tax Guide for R&D Tax Measures for Singapore regulation available online at: [https://www.iras.gov.sg/irashome/uploadedfiles/e-Tax\\_Guide/etaxguide\\_IIT\\_RnDTaxMeasures\\_2015-01-22.pdf](https://www.iras.gov.sg/irashome/uploadedfiles/e-Tax_Guide/etaxguide_IIT_RnDTaxMeasures_2015-01-22.pdf)). In the UK SMEs can claim 65% subcontracted expenses. Large companies can only claim subcontracted expenses if paid to university, health authority, charity, scientific research organization, individuals or partnership of individuals (cp. UK Qn. Q. 3) c), p. 8). In the US companies can claim 65% of contract research if the subcontracted activities are within the US (cp. US Qn. Q. 3) c) p. 8f).

<sup>34</sup> Refer to OECD Frascati Manual 2002: Proposed Standard Practice for Surveys on Research and Experimental Development, available online at: <http://www.oecd.org/innovation/inno/frascaticmanualproposedstandardpracticeforsurveysonresearchandexperimentaldevelopment6thedition.htm>.

## a) Qualifying activities

### Recommendation:

On federal level (THL) only a very general abstract definition of qualifying activities is needed. Research and Development (R&D) would be sufficient. The question is whether Switzerland wants to include further elements into such definition beyond traditional R&D, such as:

- a) Innovation that relates to technologies and industrial processes, including activities (market research, consumer research and testing, etc.), that are critical to direct and validate R&D&I activities and results towards products and services that meet market and consumer needs; and
- b) Application of R&D&I and processes into the manufacturing industrialization.

### Comment:

For the attractiveness of an ITI it is crucial that the definition of the qualifying activities is precise and self-explanatory. These could be done by means of guidelines which should

1. be available in Swiss national languages and English;
2. include reconciliation and calculation examples preferably in an online version as for example in the input incentive practice in Singapore, Ireland and the UK<sup>36</sup>;
3. ideally match with accounting standards for R&D&I expenses in order to avoid separate tracking and documentation.

As said above tying fiscal support to specific industries or sectors can result in less R&D&I.

The Frascati manual, issued by the OECD in 2002 and used as a reference, defines R&D as:

"Research and experimental development (R&D) comprises creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society, the use of this stock of knowledge to devise new applications<sup>37</sup>".

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<sup>35</sup> Refer to OECD Oslo Manual 2005: Proposed guideline for collecting and interpreting technological innovation data, available online at: [http://www.oecd-ilibrary.org/science-and-technology/oslo-manual\\_9789264013100-en](http://www.oecd-ilibrary.org/science-and-technology/oslo-manual_9789264013100-en).

<sup>36</sup> Cp. section 3 of enclosure 3 to the Irish Qn. as well as enclosure 9 to the UK Qn.

<sup>37</sup> See Frascati Manual p. 30. The French and the Irish definition are based on the OECD Frascati Manual covering basic research, applied research and development activities.

The UK ITI regime definition of qualifying R&D is significantly narrower than the Frascati manual definition. The UK regime limits R&D to advances in science and technology. Cultural and societal advances are specifically excluded:

"Science is the systematic study of the nature and behavior of the physical and material universe. Work in the arts, humanities and social sciences, including economics, is not science for the purpose of these guidelines. Mathematical techniques are frequently used in science, but mathematical advances in and of themselves are not science unless they are advances in representing the nature and behavior of the physical and material universe<sup>38</sup>".

The UK ITI regime relates to R&D&I in respect of science and technology. The UK ITI regime definition of qualifying R&D&I is also narrower than the definition of innovation of the Oslo manual issued by the OECD in 2005. The UK regime would exclude for example, marketing innovations and business organizational innovations. The Oslo manual gives the following definition of innovation: "an innovation is the implementation of a new or significantly improved product (good or service) or process, a new marketing method, or a new organizational method in business practices workplace organization or external relations<sup>39</sup>". Whilst innovation activities (as defined in the Oslo manual) may also meet the UK regime's definition of R&D&I, i.e. where the innovation is achieved through an advance in science or technology, the Oslo manual definition goes beyond. For example, the Oslo manual definition includes marketing innovations and organizational innovations. The UK R&D&I regime in contrast excludes advances of a non-scientific or technological nature, such as marketing and organizational advances.

## **b) Novelty requirement**

### Recommendation:

Definition of novelty as "New to the country".

### Comment:

The novelty requirement is also the norm formulated in the Frascati Manual: "The basic criterion for distinguishing R&D from related activities is the presence in R&D of an appreciable element of novelty and the resolution of scientific and/or technological uncertainty, i.e. when the solution to a problem is not readily apparent to someone familiar with the basic stock of common knowledge and techniques for the area concerned<sup>40</sup>". There are four types of novelty requirements: (1) new to the world; (2) new to the country; (3)

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<sup>38</sup> Cp. enclosure 9 to UK-Qn. no. 15.

<sup>39</sup> See Oslo Manual pp. 40ff.

<sup>40</sup> See Frascati Manual, p. 34.

new to the product market; (4) and new to the firm. The most widely used novelty requirement "new to the firm" is used in thirteen countries<sup>41</sup>.

The novelty requirement "new to the world" supports R&D&I with potentially largest social returns, yet not especially largest economic return for the country and the firm. In addition, the drawback of strict novelty requirements is that it involves high administrative and compliance costs. In contrast to more stringent requirements, the "new to the firm" definition is easier to administer but reduces the focus of the instrument, such that a larger budget will be needed. The novelty requirement "new to the country" does not support imitation between firms located in the same country and is easier to implement.

### **c) Qualifying expense categories**

#### Recommendation:

A system based on personnel expenses only.

#### Comment:

The Frascati Manual includes the following as qualifying R&D expense categories providing that they are incurred in undertaking the qualifying R&D activities<sup>42</sup>:

- Personnel;
- Overheads including materials and supplies;
- Acquisition of intangible assets such as patents, trademarks, design rights or the depreciation of these assets; and
- Acquisition of machinery, equipment and buildings or the depreciation of these assets.

The Oslo manual extends these expense categories to include the following providing they are incurred in undertaking the qualifying R&D&I activities<sup>43</sup>:

- Computer software and hardware costs;
- Construction and testing of prototypes;

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<sup>41</sup> According to Tax Analysts Document Service Doc 2015-576, A study on R&D Tax Incentives of November 2014 prepared by CPB Netherlands Bureau for Economic Policy Analysis in consortium with by CPB, CASE, ETLA and IHS on behalf of the European Commission, 5.3., p. 59: Belgium, Canada, France, Lithuania, Poland, Portugal, Romania, Slovenia, Spain, Sweden, UK, Croatia and Czech Republic.

<sup>42</sup> See Frascati Manual 2002, pp. 108ff.

<sup>43</sup> See Oslo Manual, pp. 62ff.

- Training staff or changing process etc. in order to be able to commence the R&D&I; and
- Marketing in order to launch a new product.

Personnel expenses often make up the majority of the cost of any R&D&I program or department of a company. Therefore, it is also generally the most important or the key qualifying expense under an R&D&I tax incentive. This indicates that an R&D&I tax incentive based solely on personnel expenses would still offer a valuable benefit to claimant companies and so would be a viable regime. In addition, Cantons could consider to compensate such reduction of the qualifying expense base by an increase of the tax credit rate applicable. Reducing qualifying R&D&I expenses to solely R&D&I personnel expenses may be an effective method of limiting the administrative burden for taxpayers and tax authorities. In particular, it may be more straightforward to distinguish R&D&I and non-R&D&I labor than R&D&I and non-R&D&I investment. Special regulations may need to be applied to contract R&D&I.

## 5. Administration

### a) No preapproval or registration

#### Recommendation:

No mandatory preapproval or registration.

#### Comment:

- In order to make an incentive attractive it is crucial to have no entry hurdle.
- A mandatory preapproval system is not recommended due to higher administrative burden, more costs and less efficiency.
- Any tax payer may seek an advance ruling from the competent Cantonal tax authorities regarding the eligibility of an R&D&I project prior to engaging in the corresponding R&D&I operations. This advance approval (Tax Ruling) is a possibility offered by cantonal authorities to taxpayers, but should be by no means a prerequisite to benefit from the Swiss ITI<sup>44</sup>.

<sup>44</sup> In Australia there is a registration requirement (cp. Q. 2) c) 1., p. 6 of the Australian Qn.). No preapproval or registration required in Canada, France, Ireland and in the USA. Possibility of preapproval in France and UK. In Singapore, in general no preapproval is required. However, Singapore has implemented a respective scheme for certain large and complex projects (reference available online at: [https://www.iras.gov.sg/irashome/uploadedfiles/e-Tax\\_Guide/etaxguide\\_IIT\\_RnDTaxMeasures\\_2015-01-22.pdf](https://www.iras.gov.sg/irashome/uploadedfiles/e-Tax_Guide/etaxguide_IIT_RnDTaxMeasures_2015-01-22.pdf)).

## **b) Declaration procedure**

### Recommendation:

A self-declaration procedure is recommended best practice with a three year period for making claims.

### Comment:

The Swiss tax system is traditionally based on a self-declaration procedure. Many countries do have a self-declaration procedure for their R&D&I incentive. As such, providing the taxpayer with a detailed guideline for filling in respective online forms would lead to an efficient procedure<sup>45</sup>. Qualifying R&D&I expenses in a tax year can be declared till end of the third subsequent tax year. If not claimed by the end of the third year, the right to claim expires automatically. A three-year period is feasible and provides planning security on both sides (taxpayer and tax administration). Once filed, the tax credit resulting from this declaration is applied to the corporate tax liability of the respective tax year (with no retroactive application even if declared expenses relate to preceding accounting years).

## **c) Way of application**

### Recommendation:

Electronic application.

### Comment:

Simple online application improves the take-up rates and the efficiency of the administrative process<sup>46</sup>. In particular start-ups might be discouraged to apply for a tax incentive when they face uncertainty about compliance costs.

## **d) Assessment procedure**

### Recommendation:

It is at the discretion of the Cantons to determine the assessment procedure.

### Comment:

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<sup>45</sup> Cp. Canada's Guide to Form T661 in enclosure 14 to Canadian Qn. (cp. [Annex 5](#)) respectively the Irish Research and Development Tax Credit Guideline (cp. [Annex 3](#)). All countries under review apply a self-declaration procedure.

<sup>46</sup> Canada, Ireland and UK already practice this approach effectively (cp. Tax Analysts Document Service Doc 2015-576, A study on R&D Tax Incentives of November 2014 prepared by CPB Netherlands Bureau for Economic Policy Analysis in consortium with by CPB, CASE, ETLA and IHS on behalf of the European Commission, 6.6., p. 94).

Many countries have introduced an R&D&I incentive without having hired new personnel with special expertise and most administrations have built up sufficient in-house knowledge over time.

The assessment whether an activity/project qualifies for an R&D&I incentive requires more specific knowledge than the assessment of the underlying qualifying expenses. Therefore, in some countries tax authorities seek, in case of an audit, for external support regarding the assessment of the qualifying activities/projects<sup>47</sup>. Such external support can be Universities (EPFL, EPZL, etc.), Independent Scientific Institutes, or Consulting Companies with appropriate R&D&I expertise. The costs of such external support should be agreed and paid by the claimant.

#### **e) Statute of limitations**

##### Recommendation:

A three year statute of limitations.

##### Comment:

The tax credit can be audited by the cantonal tax authority within a three year period after the end of the tax period of the declaration of the respective tax credit. Certainty is crucial for taxpayers and for the attractiveness of an input incentive. Therefore, benefits resulting from an R&D&I incentive should be finally granted after a certain time period.

#### **f) Timing in case of cash refund**

##### Recommendation:

Pay out one month after online declaration in case a cash refund mechanism is applied - subject to later review through ordinary assessment procedure.

##### Comment:

For young, liquidity constrained companies access to external finance is crucial for growth. Especially for these companies, the decision time and the reimbursement of the R&D&I incentive should be as short as possible. If the decision on the refund comes long after the investment has been made, young companies may not respond to the policy. This will distort competition as more mature companies have less binding liquidity constraints<sup>48</sup>.

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<sup>47</sup> See Annex 2.

<sup>48</sup> Up to date only France offers an immediate refund.

## 6. Other relevant aspect: Framework conditions

### Recommendation:

The framework conditions of the respective Canton and of Switzerland have to be observed and to be taken into account.

### Comment:

The framework conditions are also core to the success of a Swiss ITI. If framework conditions in a country are not satisfactory, simply offering a tax incentive is unlikely to have an effect on innovation.

For recruiting foreign talents it is recommended to introduce a simplified admission process. Countries as Australia, the Netherlands, France and UK offer more favorable conditions for highly skilled workforce in the knowledge economy sector<sup>49</sup>.

## V. Best practice references

### 1. France

France is an excellent example of targeting YE. The status of Young Innovative Company, created by the Finance Act 2004 offers a tax exemption on profits to SMEs with less than eight years of existence and which undertake R&D&I expenditures of at least 15% of their costs.

### 2. Ireland

The Irish ITI scheme covers a wide scope of eligible expenditures and offers a common rate of 25% to all types of companies, including foreign entities. The application procedure is very simple (online application, one-stop agency and guides cp. [Annex 3](#)). This simplicity in combination with the flexibility afforded by the payable credit makes the Irish tax credit system among 'the best in class' internationally.

### 3. United Kingdom

The UK R&D&I tax relief schemes stand for feasibility. All relevant information is easy accessible online and several help points are available where companies can get advice (cp. [Annex 4](#)). Regarding the novelty requirement 'new to the world' only those activities are supported that promote the overall knowledge or capability.

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<sup>49</sup> Cp. the Australian Skilled Visa (AUS-Qn. Q. 7) a)), the French "Skills and Talent" visa (cp. French Qn. Q. 7) a)) and the UK "Points Based System (PBS)" (UK-Qn. Q. 7) a)).

#### **4. Canada**

Canada's tax credit was one of the first R&D&I tax credit systems. Actually it is a volume based R&D&I tax credit offering a preferential rate to local small companies. It offers one of the most comprehensive administration practices (cp. [Annex 5](#))

#### **5. Singapore**

The R&D&I claim in Singapore has also a very feasible claiming procedure. Tax ITI benefiting tax payers are required to submit an R&D&I Claim Form together with the company's income tax return (cp. [Annex 6-9](#)).

#### **6. USA**

In the US taxpayers have to report any credit for increasing research credits via a special form (Form 6765, cp. [Annex 10](#)). A detailed guidance is also offered to the benefiting tax payers (cp. [Annex 11](#)).

## **Abbreviations**

<b>AUS</b>	Australia(n)
<b>CAN</b>	Canad(i)a(n)
<b>CH</b>	Switzerland
<b>cp.</b>	compare
<b>CTR III</b>	Corporate Tax Reform III
<b>EBIT</b>	Earning Before Interest and Taxes
<b>EBITDA</b>	Earnings Before Interest, Taxes, Depreciation, and Amortization
<b>EEA</b>	European Economic Area
<b>EU</b>	European Union
<b>FR</b>	France / French
<b>GAAP</b>	Generally Accepted Accounting Principles
<b>GII</b>	Global Innovation Index
<b>IFRS</b>	International Financial Reporting Standards
<b>IP</b>	Intellectual Property
<b>IRL</b>	Ireland
<b>ITI</b>	Innovation Tax Incentive
<b>MNC</b>	Multinational Company
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>p.a.</b>	per annum
<b>PCT</b>	Patent Cooperation Treaty
<b>P&amp;L</b>	Profit and Loss
<b>Q.</b>	Question
<b>Qn.</b>	Questionnaire
<b>no.</b>	Number
<b>R&amp;D</b>	Research and Development

<b>R&amp;D&amp;I</b>	Research and Development and Innovation
<b>resp.</b>	respectively
<b>SG</b>	Singapore
<b>SME</b>	Small Medium-sized Enterprises
<b>THL</b>	Swiss Tax Harmonization Law
<b>UK</b>	United Kingdom
<b>US(A)</b>	United States (of America)
<b>vs.</b>	versus
<b>YE</b>	Young Enterprises