

Memorandum

SEPTEMBER 2009

Tax Treatment of Auxiliary Companies in Geneva: A tax-efficient model for multinational corporations and the commercialization of intellectual property rights

Recently, several major international corporations have decided to relocate their European headquarters from the United Kingdom to Switzerland.

Following a trend set by corporations such as Procter & Gamble, Electronic Arts and Yahoo, McDonald's recently announced that the new seat of its European operations would be transferred from London to Geneva. While a central location in Europe, general safety and an efficient public transport system may all be important factors in this decision, the determining criteria is, without doubt, the opportunity to obtain tax benefits for income deriving from the commercialization of intellectual property rights. In this regard, the Swiss tax regime is particularly advantageous.

Switzerland is a federal state and all Cantons (States) enact their own tax laws. Some Cantons provide tax advantages for companies having an administrative, but no commercial, activity in Switzerland or whose commercial activity is primarily carried out abroad. Such companies are called auxiliary, or domiciled, companies. The tax regime to which they are subject is essentially the following: a) dividends income and capital gains on durably held participations are exempted from cantonal and communal income tax b) income deriving from a commercial activity carried out in Switzerland is taxed at the ordinary cantonal rate and, most importantly, c) income resulting from a commercial activity carried out abroad is taxed according to the ordinary cantonal rate, but only on the basis of the importance of the administrative, respectively commercial, activity carried out in Switzerland.

Effectively, this means that only a fraction of the income created abroad is taxed at the ordinary cantonal rate. In Geneva, only 20% of foreign-source commercial income is taxed at the ordinary cantonal rate. Foreign-source interest income from third parties is taxed at 15% of the ordinary cantonal rate and foreign-source interest income from affiliates is taxed at 2,5% of the ordinary cantonal rate.

Such tax advantages are highly beneficial for international corporations focusing on the licensing of international property rights. Indeed, only a fraction of the income deriving from licenses granted by the Swiss entity to other entities abroad will be taxed. Further, expenses will be deductible from the revenues to which they relate.

The beneficial tax treatment described above is purely cantonal. Accordingly, income will be taxed at the ordinary federal rate. Further, a marginal capital tax will be levied at the cantonal level on the Swiss company's share capital and reserves.

International corporations considering the relocation of certain of their activities to Switzerland in order to benefit from this advantageous tax treatment generally apply for a ruling from the cantonal tax authorities, i.e. a binding decision from the tax authorities setting out the parameters of taxation.

Special attention should further be drawn to double taxation treaties. Indeed, some treaties prohibit the taxation of certain types of income at the special rate described above. In such case, a Swiss entity benefiting from such special tax treatment may not be able to obtain the abatement of foreign taxes at the source.