After an extended break, the tax dispute with the European Union (EU) regarding the cantonal tax privileges goes into the next round. The EU expects Switzerland to make satisfactory progress until 30 June 2012, otherwise it will take unilateral action to scrutinize the various cantonal tax regimes. Given this background, alternative tax models compatible with the relevant international and European provisions need to be developed on a unilateral basis.

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The license box as an alternative tax model to the mixed company[1]

Taxation of license income with regard to international and European law

1. Introduction

The focus in the tax dispute with the EU is the preferential tax treatment of holding, domiciliary and mixed companies at cantonal level. The European Commission (Commission) argues that certain aspects of the taxation of the mentioned companies violate the Free Trade Agreement[2] (FTA) between the European Community and Switzerland signed in 1972 and that they represent inadmissible state aid. In particular, the different tax treatment of Swiss sourced and foreign sourced income is being criticized. In this regard, the Commission applies the broad definition of state aid in European law on the FTA provision concerning inadmissible state aid (art. 23 para.1 lit. iii FTA). The Commission's line of argument is not entirely convincing and, in fact, there are legal arguments that Switzerland could raise against both the applicability of the FTA and the allegation of granting inadmissible state aid.[3] However, it is unlikely that those arguments will prevent the Commission from continuously exerting pressure on Switzerland. In addition, an immediate resolution of the tax dispute is important for keeping the attractiveness of Switzerland as business and tax location, not least for multinational corporations. Moreover, the exit of companies that have relocated to Switzerland should be prevented. This applies in particular to principal and trading companies.

The so-called "principal company" is a company, which – for direct federal tax purposes – is taxed in accordance with Circular No. 8 of the Swiss Federal Tax Administration (Circular No. 8).[4] The principal company as defined by the Circular No. 8 is a group company that assumes important functions, responsibilities and risks for certain products and markets. In particular, it assumes "the procurement, the planning of research and development, the production planning and control, the warehousing and logistics, […] the development of the marketing strategy, the sales planning and control […]"[5]. For cantonal and communal tax purposes, the principal company is usually taxed as mixed company in accordance with art. 28 para. 4 of the Tax Harmonization Act (THA).

The term "trading company" used in the context at hand refers to a company which – for cantonal and communal tax purposes – qualifies as mixed company due to its predominantly foreign related business activities. However, for direct federal tax purposes, the trading company is not taxed pursuant to Circular No. 8 since it does not assume central risks and responsibilities for a group.

The so-called license box (i.e. the preferential tax treatment of license income) is being discussed in particular as a potential alternative to the current tax model for principal and trading companies. This article addresses the question of how to set up such a license box at cantonal level in order to particularly be in line with the relevant international and European provisions.

Since the developments in international tax and competition law are highly complex and dynamic, this article does not attempt to provide a comprehensive and final analysis of the compatibility of the license box with the international rules. The following analysis should rather be considered as a constructive contribution to the current discussion on alternative tax solutions in Swiss corporate tax law.

2. The license box

2.1 Introductory remarks

Whether or not a license company with mixed company status can be converted to license box taxation similar to the already existing solution in the Canton of Nidwalden is not discussed in the following; provided a legal basis exists, such conversion should in principle be feasible without any difficulties. The question, instead, is whether principal and trading companies could benefit from a license box. In other words, the question is whether a license box offers advantages even for companies that do not formally derive any license income but rather generate income from the sale of goods. The question is, whether a particular income component from the sales income can be extracted which would then be subject to privileged income taxation (so-called "embedded income").

2.2 Income from IP

First, it is necessary to determine which types of income deriving from IP exploitation qualifies under the definition of IP income that would be subject to privileged taxation.

The Swiss intellectual property law distinguishes *inter alia* between IP protected by specific intellectual property law[6] (e.g. patents, designs, trademarks)[7] and IP protected by individual rights, criminal law or unfair competition law[8] (e.g. manufacturing and commercial secrets as well as, provided certain requirements are met, other types of know-how).[9] The term "manufacturing and commercial secrets" include the technical expertise and experience necessary for the production of goods (e.g. manufacturing process, construction plans, formulas) as well as knowledge relevant for the organization and the business activities of the company which poses potential exploitable value for competitors (e.g. strategy, customer lists, procurement sources).[10] The term "know-how" comprises technical, commercial, administrative and business knowledge and experience necessary for production and service provision.[11] However, it should be pointed out that only secret know-how is legally protected (meaning that it should not be publicly available and all its components should be unknown to others).[12]

The Swiss tax law – with the exception of the provisions in the Canton of Nidwalden[13] – does not contain any definition of IP. For tax purposes, the doctrine views the term "intangible assets" as including both legally protected assets (e.g. patents, trademarks, copyrights) and legally not particularly protected assets (e.g. non-patented innovations, formulas and know-how).[14]

When defining the types of IP income eligible for the IP-Box, particular consideration should be given to the following two aspects: (1) The definition of IP should not be too narrow, since this would dras-

tically restrict the applicable range of the IP-Box, thereby undermining the fundamental purpose of developing a real alternative to the mixed company regime. (2) The IP definition is to be determined in a way that makes it compatible with both the OECD Model Tax Convention on Income and on Capital (OECD-MC) and the EU state aid law. Only this way may international recognition be secured.

Art. 12 para. 2 OECD-MC – which is also the reference for the relevant IP-Box provisions in the Canton of Nidwalden – describes IP indirectly within the definition of "royalties", which are defined as "payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work […], any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience." The last part of art. 12 para. 2 OECD-MC relates to know-how.[15] The term "know-how" here refers to undisclosed information that is not covered by other terms in the definition of royalties and derives from gained experience and knowledge, that has a practical connection to the actual conduct of business. In addition, know-how should have economic value.[16] It follows that, under certain circumstances, even customer lists fall within the IP-definition of the OECD-MC.[17]

The OECD Transfer Pricing Guidelines[18] (OECD-TPG), which particularly focus on multinational corporations, divide commercially exploitable IP into the following two categories: (1) Trade Intangibles (e.g. patents, designs, models), which are used in the manufacturing of goods or for the provision of services;[19] (2) Marketing Intangibles, which represent a particular type of commercial IP (e.g. trade names, customer lists, distribution channels, unique names) which provide for a value-adding support of sales. Know-how and trade secrets may fall within both categories.[20]

The OECD is currently planning a revision of the OECD-TPG.[21] Under discussion is, among others, whether art. 12 para. 2 OECD-MC should also cover goodwill, going concern, profit potential, business opportunities, value drivers, first mover advantage, location savings and market premium.[22] However, a first draft of the provision is expected to be published not before August 2013.[23]

Royalties as defined by art. 12 para. 2 OECD-MC do not cover only payments of any kind made as a consideration for the use of or the right to use IP. They also include the potential gain derived from the disposal of IP as well as revenues from IP exploitation within the group.[24]

2.3 Inclusion of embedded income

Since principal and trading companies generally do not derive license income per se but rather income from the sale of goods, the concept of "embedded income" should be introduced. Any sales price paid by the customer regularly entails remuneration for the IP component inherent in the product (e.g. a patent for the product or the know-how necessary in the manufacturing process).[25] If the IP-Box regime is to become a feasible alternative as a tax model for principal and trading companies, then it is crucial that such embedded income is included in the definition of license income. Thus, it should be allowed to isolate the embedded income in order to enable its preferential tax treatment along with any regular license income. While the Canton of Nidwalden has explicitly excluded the embedded income from privileged taxation, art. 12 para. 2 OECD-MC does not state such restriction. Furthermore, several EU countries have adopted the concept of embedded income (cf. cipher 4.4.1).

The IP component in the sales price could be determined either by explicitly listing all the individual components or by avoiding any further definition of IP. The second method isolates the IP compo-

nent indirectly through profit attribution. Both methods would require a transfer pricing study in order to determine the exact amount of the respective IP components.[26]

2.4 Broad definition of license income

Customer lists, customer relations and distribution networks should qualify as IP in a broad sense both from a national and an international perspective. Based on the current understanding, profit potential and goodwill are not eligible, but it remains to be seen whether the contemplated revision of the OECD-TPG will result in changes in this regard. It can generally be assumed that the IP definition will be expanded in order to cover these areas. As a result, the extracted IP component in a sales price could also internationally be treated in the same way as regular royalty payments. With the inclusion of embedded income, a functional separation of ownership and management of IP from the operational business (sales) and their allocation to different legal entities would ultimately become unnecessary.

3. Mechanisms of a license box

The license box model is based either on the partial exemption of IP income or on the taxation of IP income at a reduced tax rate. The Canton of Nidwalden, for instance, uses the reduced rate method, whereby net license income is subject to taxation only at 20% of the ordinary corporate income tax rate as from 1 January 2011.[27] Under the partial exemption method, instead, license income is partially excluded from the tax basis (in an analogous way to the taxation of foreign sourced income of mixed companies) while the remaining income is subject to ordinary taxation.

With regard to the compatibility of the license box with constitutional and tax harmonization law[28], it should be noted that – based on art. 129 para. 2 of the Constitution of the Swiss Confederation and art. 1 para. 3 THA – the cantons generally have the authority to determine the applicable tax rates (so-called “tariff autonomy”).[29] It follows that, within the constitutional boundaries (i.e. considering constitutional rights and taxation principles), the cantons are allowed to tax certain types of income at a preferred tax rate.[30,31] However, the cantons can unilaterally reduce only the tax rate, whereas the partial exemption of IP income would have to be provided for in the THA (i.e. at federal level)[32], so that the provisions would then apply evenly to all cantons.

For the following two reasons, the partial exemption of IP income in federal legislation is to be preferred: (1) Uniform rules on federal level would help countering up front on potential allegations of regional selectivity in the meaning adopted by the European Court of Justice (ECJ) in its current legal practice regarding European state aid law (cf. cipher 4.2); (2) Legislation at federal level would make it easier to introduce the license box model also in cantons whose electorate may be rather opposed to the privileged taxation of IP income.

4. Compatibility of the license box with European state aid law

4.1 Introductory remarks

The compatibility with EU state aid law is a critical issue when discussing alternative tax models. The FTA, being the legal basis for the tax dispute, is to be interpreted in accordance with the law of the World Trading Organization (WTO). Therefore, WTO-subsidy law should also be taken into account.[33]

4.2 Partial exemption of IP income vs. tax rate reduction

Based on the current laws, the cantons could unilaterally introduce a license box only by offering reduced tax rates (cf. cipher 3). However, not least from a European law perspective, it seems well-advised to adopt a standardized approach in the THA.

In its current legal practice the ECJ has taken the position that also regional selectivity may qualify as inadmissible state aid according to art. 107 of the Treaty on the Functioning of the European Union (TFEU) (cf. cipher 4.3.2. for the general "selectivity" term).[34] Regional selectivity is given, when only some regions within an EU member state offer tax reliefs while not having the necessary autonomy to grant such tax privileges. When addressing the issue of regional selectivity, it is critical to determine the scope of reference. The scope of reference is limited to the geographical area (e.g. territorial entity such as the cantons), if the territorial entity has the necessary autonomy to grant the tax privileges. Should the territorial entity, however, not have the necessary autonomy, the scope of reference becomes the whole state territory, while the tax privileges would still be granted only to companies in the territorial entity (regional selectivity). As far as the Swiss cantons are concerned, the critical question is whether they have sufficient autonomy in the meaning of the European state aid law to grant preferential tax treatment of IP income.

Sufficient autonomy is deemed to exist if the territorial entity is autonomous from the central government on the following dimensions: institutional, procedural and economical/financial.[35] With regard to the tax rate reduction method, the Swiss cantons, in principle, seem to meet these three criteria. However, challenges may arise in connection with the Reform of Fiscal Equalization (*Neugestaltung des Finanzausgleichs*, NFA).[36] The following two scenarios need to be discussed in this regard:

(1) The criteria of economic/financial autonomy is not met if the tax relief granted by the territorial entity is cross-subsidized or subsidized by the central government. The territorial entity should be able to bear on its own the financial consequences of tax reliefs.[37] In case that the tax revenue losses caused by the tax rate reduction on IP income are compensated with NFA contributions (causality), the cantons might lose their economic/financial autonomy. In the literature it is argued that the NFA-contributions are made independently from any reductions of cantonal corporate tax rates.[38] In principle this seems plausible, however, there can be a correlation between tax reliefs and NFA contributions (cf. the tax reliefs in the Canton of Lucerne).[39] If cross-subsidy through the NFA is deemed to exist, then the particular canton would lose the necessary autonomy to grant tax reliefs. As a result, the scope of reference for the assessment of the selectivity criteria would shift from the canton to the whole Swiss territory. Consequently, the companies resident in such a canton would be privileged in terms of taxation compared to those companies resident in other cantons; this could be viewed as a form of regional selectivity.

(2) In the second scenario, the tax rate reduction on IP income leads to a relocation of companies that, even having a high taxable profit deriving from license income, would face – due to the low effective tax rate – a substantially lower tax burden than under ordinary taxation. The NFA contributions to fiscally "weaker" cantons are determined not on the basis of the effective tax revenues based on the cantonal tax rates, but on the basis of potentially existent taxable profits ("resource potential").[40] Consequently, if a company with a high taxable profit but also high license income relocates to a canton granting the tax relief, the canton would have to consider a significant reduction of the NFA contributions without effectively generating higher tax income. If the expected tax revenues

from the relocated company may turn out to be smaller than the missed NFA contributions, the canton may be forced to refuse granting the tax relief; the procedural autonomy could be affected. According to the practice of the ECJ, a territorial entity has procedural autonomy in the context of the regional selectivity criteria, if the central government has no possibility to directly influence the decision of the territorial entity to grant tax reliefs.[41] With regard to the Swiss cantons, the federal government may only have indirect influence on the decision of a canton to offer tax reliefs by means of threatening to reduce the NFA contributions. Accordingly, the autonomous decision-making ability of the cantons would generally not be determined by the NFA from a procedural perspective. Given the constant expansion of the term "state aid", it seems plausible that even indirect influence by the central government on the decision-making of the territorial entity might be deemed as undermining procedural autonomy.[42] With regard to this case, the outlined scenario could result in regional selectivity.

In our view, allegations of regional selectivity can be prevented up front if the partial tax exemption of IP income from the tax basis is introduced on federal level (THA) with a high level of detail which would largely restrict the discretion of the cantons to grant tax reliefs on IP income; the cantons have the competence to determine the tax rates, but not the tax basis. Hence, the tax relief would be uniformly granted in the entire country; the cantons would implement the respective federal legislation with restricted discretion and would further precise the regulations without any further autonomy.[43] In our view, such solution should pass the regional selectivity test.

Unilateral steps by the cantons to reduce tax rates on IP income may trigger regional selectivity if the conversion of a mixed company into a license box model results in tax revenue losses that have to be compensated with NFA contributions (impairment of the economical/financial autonomy) or if the decision of granting a license box is affected by (the indirect threat of) eventual reductions in NFA contributions (eventual impairment of the procedural autonomy), respectively.

4.3 General state aid character of the license box

In addition to the issue of regional selectivity, it is necessary to evaluate the compatibility of alternative tax models with the broadly defined European state aid definition.[44] A license box as described above would qualify as prohibited state aid in the meaning of art. 23 I iii FTA or art. 107 FTEU, respectively, if the partial exemption of IP income (or the tax rate reduction, respectively) represents (1) a tax relief financed with governmental resources, (2) is selective, and (3) leads to competition distortion of the trade between the EU and Switzerland.[45]

4.3.1 Financing the tax relief with governmental resources

Under a license box regime, IP income is partially exempted from ordinary taxation. By granting the tax relief, a canton, in effect, voluntarily gives up on tax revenues. Therefore, the partial exemption of IP income corresponds to a tax relief financed with governmental resources.

4.3.2 Selectivity

The criterion of selectivity is met, if a particular tax provision grants preferential tax treatment to certain companies or groups. In principle, the privileged taxation of IP income can be claimed by any company deriving income from IP regardless of the sector of its business activity. The unpersuasive allegation of the Commission that mixed companies would be selective because only companies with predominantly foreign-related business activities are granted preferential tax treatment[46] could in principle analogously be leveled against the license box model. With regard to principal companies, it

should in principle be possible to justify the fact that predominantly companies engaged in an IP-intensive industry draw more benefits from the privileged license taxation (cf. cipher 4.4.3).

4.3.3 Distortion of competition

Assuming that the license box is selective, it needs to be assessed whether the privileged taxation of IP income leads to a distortion of competition in international trade. In contrast to the taxation of mixed companies, the license box makes no distinction between domestic source and foreign source income. Hence, the criticism of "ring fencing" (i.e. preferential tax treatment of foreign source income) could not be raised against the license box model.[47] Moreover, a purported distortion of competition in the bilateral trade between the EU and Switzerland would be very difficult to be proved[48] and could also be justified (cf. cipher 4.4.3.).

4.3.4 No general state aid character of the license box

Therefore, the license box does not qualify as inadmissible state aid in the meaning of the European state aid law. But if the privileged taxation of IP income yet becomes to be viewed as representing prohibited state aid, the question is whether an eventual selectivity or competition distortion could be justified.

4.4 Justification in the context of the Lisbon Strategy

A potentially prohibited state aid can still be justified if it is aimed at promoting innovation and research and development (R&D). The critical question is whether the broadly defined license income or the license box itself, respectively, corresponds to the meaning used in the EU in connection with R&D promotion.

4.4.1 The Lisbon Strategy

As part of its efforts to revitalize the Lisbon Agenda (also known as the Lisbon Strategy), the Commission made proposals regarding state aid for innovation and released an action plan regarding state aid for R&D.[49] As a consequence, a new community framework for state aid for research and development and innovation has been adopted, which determines among others the extent to which state aid can be used by member states to promote such R&D activities. In its communication the Commission determines how R&D in the EU can be stimulated with tax incentives and which legal requirements would have to be met in particular. The Commission acknowledges tax incentives as an effective means for promoting R&D, describes the legal requirements and notes that several EU member states already grant tax reliefs for R&D.[50] In some countries, for instance, IP income is excluded from the tax basis or is subject to taxation at reduced rates. In addition, many countries allow the deduction of R&D expenses.

Some EU member states have also adopted a broad definition of IP income. Belgium and the Netherlands, for example, include the IP component inherent in the sales price (i.e. the embedded income) in the definition of IP, thereby taxing the embedded income at privileged rates.[51]

To qualify for the Dutch *Innovation Box*, R&D underlying the IP income does not necessarily need to be performed within the Netherlands. R&D is allowed to be carried out abroad by related companies or third parties, provided the R&D activities are performed on risk and on account of the Dutch company holding the IP rights. If the IP is not protected by patent law, at least 50% of R&D is required to take place in the Netherlands. Alternatively, if the Dutch company has significant coordination functions, R&D activity in the Netherlands can be below the 50% threshold.[52] Also under the *Patent In-*

come Deduction in Belgium R&D activities can be carried out abroad by related companies or third parties.[53]

In Great Britain, attempts to reform the taxation of license income are currently under way. Under the *Patent Box* regime, income from qualifying IP will be eligible for preferential tax treatment as from 1 April 2013 after a gradual introduction.[54] It is also envisaged to include the embedded income (i.e. the IP component in the sales price) to the privileged taxation.[55] To qualify for the Patent Box, the domestic company holding the IP will be required to be significantly involved in the R&D as well as in the decision-making process as regards further exploitation of the IP rights. However, other group companies may be commissioned to carry out the R&D itself. Merely passive recipients of income from qualifying IP will be explicitly excluded.[56]

The above-described IP models exemplify that it is insufficient in principle to simply acquire existing IP without having made some sort of contribution to R&D.[57]

4.4.2 Requirements and impact of state aid for R&D

The Commission may allow state aid for R&D, if: (1) It helps to eliminate a real market failure. (2) It is an appropriate instrument to demonstrate an incentive effect for the aid beneficiary. In addition, there should be proportionality between the means (i.e. state aid) and the end (i.e. the problem to be solved); (3) The distortive impact on competition and trade caused by state aid is limited so that, ultimately, the positive effects outweigh the adverse effects.

However, the tax incentives for R&D should be open to as many companies as possible, and they should provide an effective incentive for R&D activities. Instead, tax incentives granted only to R&D carried out domestically would not be compatible with the TFEU.[58]

By an analogous and consistent interpretation of the European state aid definition in the FTA, the Lisbon Strategy should – at least from an EU perspective – also apply to Swiss corporate tax law. Thus, if the license box model in effect leads to the promotion of R&D, certain selective or distortive effects on competition and trade, respectively, could in principle be justified by drawing upon the Lisbon Strategy. The license box would offer potential advantages especially for principal and trading companies. Given the potential feasibility of justification by invoking R&D promotion, it needs to be seen whether and to what extent these companies actually promote R&D activities.

4.4.3 Trading companies with integrated license box

The activities of trading companies generally confine to business abroad carried out without substantial connection to Switzerland. Trading companies do not perform any own R&D activities, and their trading activities do not promote R&D. Their core business consists in purchasing products from foreign related companies or third parties at arm's length conditions and selling them abroad either directly or through third parties. Consequently, in case the license box model is classified as prohibited state aid, it may not be possible to justify the privileged taxation of embedded income by demonstrating promotion of R&D activities. Other measures for preferential tax treatment would then need to be considered, such as tax reliefs on trading income.

4.4.4. Principal companies with integrated license box

If a mixed company is structured as a principal company based on Circular No. 8, the privileged taxation of the embedded income could be justified by demonstrating R&D promotion, since besides IP rights also risks and responsibilities for keeping the value of both the IP component in the sales price

and the related R&D activities are transferred to the principal company. Thereby, R&D activities do not necessarily have to be carried out in Switzerland. By assuming the risks for retaining the value of the embedded income, principal companies, in effect, control and promote the domestic and foreign R&D of the group. This should help justifying an eventual existence of prohibited state aid.[59] Therefore, in order to be in line with the Lisbon Strategy, there should be R&D at least within the group, and the risks for retaining the value of products and the responsibilities for R&D should be assumed by the Swiss principal companies.

4.5 Legitimacy of the license box from the perspective of European law

The license box should be in line with European state aid law. The privileged taxation of license income as described above should neither be selective nor lead to distortion of competition. Based on these assumptions, even pure trading companies may benefit from the license box. Yet it should be emphasized, once again, that it is well-advised to transfer to the Swiss company both the IP rights and the risks and responsibilities for R&D (principal structure). Consequently, eventual selectivity or distortion of competition could then be justified.

5. Conclusion

Especially, but not exclusively, for principal companies holding significant IP, the cross-cantonal introduction of a license box could be an alternative to the current taxation as mixed company. The current low tax burden for mixed companies could be kept more or less at the same level by adopting both a broad definition of IP income and the concept of embedded income. The license box should gain recognition from the EU as tax model, given that it does not qualify as inadmissible state aid and can be justified based on the Lisbon Strategy. Therefore, the license box should be assessed in detail in the current discussion regarding alternatives to the mixed company taxation and may also be addressed in the dialogue with the EU. Legislation at harmonized federal level is to be preferred in order to guarantee the conformity of the license box with international and European law. In this context, the Swiss company should not only hold the existing IP rights (licenses, patents etc.), but also assume both the risks for the embedded income and the responsibilities for the underlying R&D activities.

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2 Free Trade Agreement of 22 July 1972 between the Swiss Confederation and the European Economic Community.

3 Regarding the legal arguments of the tax dispute cf. ROTH PHILIPP, Der Steuerstreit zwischen der Schweiz und der Europäischen Union – Die Vereinbarkeit der kantonalen Steuerprivilegien mit dem FHA im Lichte des Rechts der EU und WTO, ST 10/2010, 721 et seq. and 722 et seq.

4 Circular No. 8 of the Swiss Federal Tax Administration dated 18 December 2001 regarding principal companies.

5 Circular No. 8 (note 4), cipher 1; regarding the taxation of principal companies cf. KUBAILE HEIKO/SUTER ROLAND/JAKOB WALTER, Der Steuer- und Investitionsstandort Schweiz, 2. Auflage, Herne 2009, 157 et seq.

[6] So-called „numerus clausus“ of intellectual property rights (cf. TROLLER ALOIS, Immaterialgüterrechte, Band I, 3. Auflage, Basel/Frankfurt a.M. 1983, 59 et seq. and 75; TROLLER KAMEN, Grundzüge des schweizerischen Immaterialgüterrechts, 2. Auflage, Basel et. al. 2005, 28 and 175 et seq.).

[7] Patents: Federal Act of 25 June 1954 on patents (*Patentgesetz*, PatG, SR 232.14); Design: Federal Act of 5 October 2001 on the protection of design (*Designgesetz*, DesG, SR 232.12); Brands and indications of origin: Federal Act of 28 August 1992 on the protection of brands and indications of origin (*Markenschutzgesetz*, MSchG, SR 232.11). Further, business names are also protected: art. 944-956 of the Federal Act of 30 March 1911 on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations) (*Obligationenrecht*, SR. 220); Copyright work and similar protection rights: Federal Act of 9 October 1992 on copyrights and similar protection rights (*Urheberrechtsgesetz*, URG, SR 231.1); Topographies: Federal Act of 9 October 1992 on the protection of topographies and semiconductor products (*Topographiengesetz*, ToG, SR 231.2) and plant variety rights: Federal Act of 20 March 1975 on the protection of plant breeding (*Sortenschutzgesetz*, SR 232.16).

[8] Federal Act of 19 December 1986 against unfair competition (UWG, SR 241).

[9] TROLLER ALOIS (note 6), 75 and 417 et seq.; TROLLER KAMEN, (note 6), 28 and 175 et seq.; cf. regarding the UWG BAUDENBACHER CARL, Lauterkeitsrecht, Kommentar zum Gesetz gegen den unlauteren Wettbewerb (UWG), Basel et. al. 2001, art. 4 N 67 et seq. and art. 6 N 30 et seq.

[10] BAUDENBACHER CARL (note 9), art. 6 N 32 et seq.; VON BÜREN ROLAND/MARBACH EUGEN/DUCREY PATRIK, Immaterialgüter- und Wettbewerbsrecht, 3. Auflage, Bern 2008, N 1225 et seq.; TROLLER KAMEN (note 6), 176.

[11] BAUDENBACHER CARL (note 9), art. 4 N 69 and art. 6 N 41 et seq.; TROLLER KAMEN (note 6), 176.

[12] BAUDENBACHER CARL (note 9), art. 6 N 42.

[13] Cf. art. 85 para. 3 of the Nidwalden Cantonal Tax Act in combination with § 57a para. 2 of the Nidwalden Cantonal Tax Ordinance. The benefit of the delegation of the definition of the IP term to the executive authority lies in the fact that a definition on ordinance level brings certain flexibility compared to the definition on the level of formally enacted law. The delegation of the competence to define IP to the executive authority can, on the other hand, create a certain tension area with regard to the principle of legality.

[14] KÄNZIG ERNST, Die Eidgenössische Wehrsteuer (Direkte Bundessteuer), 2. Auflage, I. Teil, art. 1-44 WStB, Einleitung, Wehrsteuerpflicht, Wehrsteuer der natürlichen Personen, Basel 1982, art. 21 N 126; LOCHER PETER, Kommentar zum DBG, Bundesgesetz über die direkte Bundessteuer, I. Teil, art. 1-48 DBG, Allgemeine Bestimmungen, Besteuerung der natürlichen Personen, 1. Auflage, Therwil/Basel 2001, art. 20 N 170; REICH MARKUS in: ZWEIFEL MARTIN/ATHANAS PETER (Hrsg.), Kommentar zum Schweizerischen Steuerrecht I/2a, Bundesgesetz über die direkte Bundessteuer (DBG), art. 1-82, 2. Auflage, Basel 2008, art. 20 N 123.

[15] Cf. SZÜCS-HIDVÉGI KATLALIN, article 12: Royalties, in ECKER THOMAS/RESSLER GERNOT/LANG MICHAEL (Hrsg.), History of Tax Treaties, The Relevance of the OECD Documents for the Interpretation of Tax Treaties, Series on International Tax Law, Volume 69, Wien 2011, 497.

[16] Cf. International Bureau of Fiscal Documentation (IBFD), OECD Model Tax Convention on Income and on Capital, Condensed version – 2010 and Key Tax Features of Member countries 2011, Part A, Model Tax Convention on Income and on Capital, condensed version, 22 July 2010, commentary on article 12, cipher 11.

[17] Under the condition that „such a list is [not] developed specifically for a payer out of generally available information (a payment for the confidential list of customers to which the payee has provided a particular product or service would, however, constitute a payment for know-how as it would relate to the commercial experience of the payee in dealing with these customers)“ (cf. IBFD [note 16], commentary on article 12, cipher 11.4).

[18] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD-TPG), July 2010.

[19] OECD-TPG (note 18), Chapter VI, cipher 6.3 et seq.

[20] OECD-TPG (note 18), Chapter VI, cipher 6.5: „Know-how and trade secrets are proprietary information or knowledge that assits or improves a commercial activity, but that is not registered for protection in the manner of a patent or trademark.“ It is further referred to the definition of know-how in the sense of art. 12 para. 2 OECD-MC.

[21] Cf. Transfer Pricing and Intangibles: Scope of the OECD Project, 25 January 2011, <http://www.oecd.org/dataoecd/10/50/46987988.pdf> (downloaded on 18 December 2011).

[22] SILBERZTEIN CAROLINE, Transfer Pricing International Journal, 08/11, Transfer pricing aspects of intangibles: the OECD Project, 4.

[23] Cf. The OECD on the transfer pricing aspects of intangibles, Indicative timeline (as of May 2011), <http://www.oecd.org/dataoecd/7/14/47803614.pdf> (downloaded on 18 December 2011).

[24] Cf. § 57a para. 2, last sentence, of the Nidwalden Cantonal Tax Ordinance.

[25] OECD-TPG (note 18), 197, cipher 6.17; ENGLER GERHARD in: VÖGELE ALEXANDER/BORSTELL THOMAS/ENGLER GERHARD, Verrechnungspreise, 3. Auflage, München 2011, part N, N 289 et seq.

[26] When calculating the IP component, the operating profit of the company would – in application of division accounting – be reduced by allocating a profit share to the IP Box. Thereby, the calculation can be made based on the OECD-TPG, e.g. pursuant to the residual profit split method (cf. Annex II of Chapter II of the OECD-TPG) according to which, in a first step, a minimum compensation is allocated to the operating division for performed functions and risks, in particular R&D, production, sales etc. The remaining (residual) profit is then allocated to the divisions (IP and Operations) based on their individual and value-increasing contributions.

[27] Art. 85 para. 3 of the Nidwalden Cantonal Tax Act. Cf. for a detailed description SCHÄUBLE GÜNTER/GIGER RETO, Lizenzbox in Nidwalden – Ein Steilpass für andere Kantone und den Bund, ST 2010/10, 711 et seq.

[28] Both HINNY and SCHÄUBLE/GIGER plead for the constitutionality or the compatibility of the Nidwalden license box with Swiss tax harmonization law, respectively (HINNY PASCAL, Lizenzbox des Kantons Nidwalden, FStR 2011, S. 138 et seq.; SCHÄUBLE GÜNTER/GIGER RETO [note 27], 716 et seq.).

[29] SCHÄUBLE GÜNTER/GIGER RETO [note 27], 716; Dispatch of 25 May 1983 on the federal acts regarding the harmonization of the direct taxes of the cantons and communes as well as regarding the direct federal tax (Botschaft über die Steuerharmonisierung), 53.

[30] However, based on the tax harmonization law, the cantonal tax rate must not be 0%; i.e. the cantons must tax corporate income while only being free in the determination of the respective tax rates (cf. HINNY PASCAL [note 28], 138 et seq.).

[31] The major focus lies on the principles of general and equal taxation as well as taxation according to the economic capacity (art. 127 para. 2 of the Swiss Federal Constitution).

[32] CAVELTI ULRICH, Schranken des Steuerföderalismus, in Rechtliche Rahmenbedingungen des Wirtschaftsstandortes Schweiz. FS 25 Jahre juristische Abschlüsse an der Universität St. Gallen (HSG), St. Gallen 2007, 367 et seq., 370.

[33] Convention of 15 April 1994 regarding the establishment of the World Trading Organization (SR 0.632.20), Annex 1A.13: agreement on subsidies and countervailing measures (SCMA). Cf. ROTH PHILIPP (note 3), 724 et seq.

[34] Cf. ECJ, ruling of 6 September 2006, case C-88/03 (Azores case); press release of the ECJ of 6 September 2006; COTTIER THOMAS/LIECHTI-MCKEE RACHEL/SCARPELLI SAMUELE, Wirtschaftsrecht der Europäischen Union, Grundlegende Urteile, Bern 2009, S. 663 et seq.; ECJ, ruling of 11 September 2008, case C-428/06 to C-434/06 (Basque region case); press release of the ECJ of 11 September 2008; ECJ, ruling of 18 December 2008, case T-211/04 and T215/04 (Gibraltar case); press release of the ECJ of 18 December 2008. With art. 2.2. SCMA, the laws of the WTO do also contain a provision for the determination of regional selectivity which can be interpreted analogously to the jurisdiction of the ECJ.

[35] Regarding the three criterions of sufficient autonomy of a region cf. SEITZ CLAUDIA, Autonomie der Regionen bei Steuerregelungen - Neuere Entwicklungen im Europäischen Beihilferecht und ihre Bedeutung für die Schweiz, Zeitschrift für die Aktuelle Juristische Praxis 4/2007, 415, 419; for details in this regard, see the opinion of the Advoacate General GEELHOED of 20 October 2005 regarding case C-88/03, the Portuguese Republic vs. the Commission of the EC, no. 54 et seq.

[36] Dispatch on the reform of the fiscal equalization and task allocation between the Confederation and the cantons (Neugestaltung des Finanzausgleichs, NFA), BBl 2002, 2291-2559; regarding the NFA cf. MARKUS REICH, Steuerrecht, Zürich et. al. 2009, § 7 N 11 et seq.

[37] SEITZ CLAUDIA, (note 35), 419; opinion regarding case C-88/03 (note 35), no. 54; ECJ, ruling of 6 September 2006, case C-88/03, Nr. 67 et seq., no. 77 in particular.

[38] SEITZ CLAUDIA, (note 35), 422.

[39] Cf. Tagesanzeiger of 12 May 2010, Wer wem wie viel bezahlt, <www.tagesanzeiger.ch/schweiz/standard/Wer-wem-wie-viel-bezahlt/story/31319616> (downloaded on 18 December 2011); Canton of Lucerne, Planungsbericht und Botschaft des Regierungsrates an den Grossen Rat, B 149, 11, <*www.rawi.lu.ch/planungsbericht_botschaft_b149.pdf*> (downloaded on 18 December 2011).

[40] Regarding the mechanisms of the NFA cf. MARKUS REICH, Steuerrecht, Zürich et. al. 2009, § 7 N 14.

[41] Cf. SEITZ CLAUDIA [note 35], 419; regarding the immediacy of influence ECJ, ruling of 11 September 2008, case C-428/06 to C-434/06, no. 88 et seq. and ECJ, ruling of 18 December 2008, case T-211/04 and T215/04, no. 89 et seq.

[42] The softening of the criterion of immediacy of influence can to a certain extent already be concluded from the opinion of the Advocate General GEELHOED (opinion to case C-88/03 [note 35]); GEELHOED, although describing in no. 54 the procedural autonomy due to the missing capability of the central government to immediately influence the determination of tax rates, he then relativizes the criterion of immediacy in no. 70 by arguing that the mere circumstance that the tax relief was granted based on the principle of national solidarity would be sufficient to contradict the concept of real procedural autonomy.

[43] Based on the existing tax privileges SEITZ justifies the regional autonomy of the cantons by adhering to the tariff autonomy stated in the THA which lead to the exclusion of regional selectivity (SEITZ CLAUDIA [note 35], 422). Although the current taxation of mixed companies in the end results in a reduction of the effective tax rates on cantonal level, this is achieved by a partial exemption of foreign income from the tax base as stated in art. 28 para. 2-4 THA and not by tax rate reductions lying in the cantonal tariff autonomy. Therefore, the exclusion of regional selectivity of the current tax privileges is not established by cantonal tariff autonomy; moreover, due to the uniformly and clearly stipulated federal-wide partial exemption of foreign income (depending on the business activities in Switzerland) on the level of the THA, no tax relief limited to a certain region or tax reliefs individually designed by a region in the sense of regional selectivity can be assumed. The cantons do not have any autonomy as regards the determination of the tax base; moreover, they have to follow the tax harmonization provisions, being standards uniformly stipulated on federal level.

[44] In order to discuss the state aid character of the discussed solutions in the following, it is assumed – against the general opinion of the authors – that the European state aid definition would via art. 23 para. 1 lit. iii FTA also be applicable to Swiss corporate tax law.

[45] ROTH PHILIPP (note 3), 723 et seq.

[46] Cf. ROTH PHILIPP (note 3), 723.

[47] The term ring fencing was significantly influenced by the Harmful Tax Competition of the OECD (cf. Report of the OECD, Harmful Tax Competition – An Emerging Global Issue, 1998, page 26) and was included by the EU in cipher B.1 of the code of conduct for corporate taxation of 1 December 1997 as a criterion for harmful tax practice (Official Journal of the EC, Conclusions of the Council „Economic and financial matters“ of 1 December 1997 regarding tax policy, 98/C 2/01). When examining the state-aid character of a tax provision, it is almost impossible to clearly classify the ring fencing issue under the selectivity and distortion of competition criteria considering that the ring fencing issue generally touches both definition areas. It is our understanding that the selectivity criterion is – analogously to the wording of art. 107 TFEU – to be limited to the different tax treatment of companies and sectors of production. Since the different tax treatment of domestic and foreign income could, however, create a distortion of competition in the trade between (member) states, the ring fencing issue would rather have to be viewed under the criterion of the distortion of the competition. In its critique of the cantonal tax privileges, the Commission also discusses the different tax treatment of domestic and foreign income among others based on the criterion of distortion of competition or trade, respectively (cf. Decision of the Commission of 13 February 2007 regarding the incompatibility of certain Swiss corporate tax provisions with the Agreement between the European Economic Community and Swiss Confederation of 22 July 1972, No. 54 et seq.).

[48] Cf. ROTH PHILIPP (note 3), 723 et seq. (regarding EU state aid law) and 726 et seq. (regarding WTO subsidy law).

[49] Press release of 2 February 2005, IP/05/130; press release of 21 September 2005, IP/05/1169.

[50] Communication of the Commission of 30 December 2006, Abl. EU 2006/C 323/01; press releases of 22 November 2006, IP/06/1600 (state aids) and IP/06/1598 (tax incentives) also regarding the following.

[51] Whereas in the case of Belgium only patent-protected or through so-called extended patent-certificates protected IP is covered (vgl. WARSON ERIC/FORIERS MANUELLA, European Taxation, Official Journal of the Confédération Fiscale Européenne, IBFD, Volume 48, Number 2, February 2008, 72 et seq.).

[52] HOHAGE UWE/KIRCHHOF KERSTIN/BROEREN RAYMOND/HUYBREGTS-JANS ESTHER, Internationales Steuerrecht, iStR, Zeitschrift für europäische und internationale Steuer- und Wirtschaftsberatung, IStR-Länderbericht, 11/2010, 51; WARSON ERIC/FORIERS MANUELLA (note 51), 75.

[53] Cf. WARSON ERIC/FORIERS MANUELLA (note 51), 72 et seq.

[54] HM Treasury, HM Revenue & Customs, The Patent Box: response to consultation, December 2011, cipher 1, <http://www.hm-treasury.gov.uk/d/condoc_responses_patent_box.pdf> (downloaded on 18 December 2011).

[55] Similar to the Belgian solution, the Patent Box shall be limited to patented IP. Cf. HM Treasury, HM Revenue & Customs, The Patent Box: response to consultation, December 2011 (note 54), Ziff. 2.4.

[56] HM Treasury, HM Revenue & Customs, The Patent Box: response to consultation, December 2011 (note 54), cipher 2.3.*;* HM Treasury, HM Revenue & Customs, Consultation on the Patent Box, June 2011, ciphers 2.13 et seq., <http://www.hm-treasury.gov.uk/d/consult_patent_box.pdf> (downloaded on 18 December 2011).

[57] Regarding Belgium cf. WARSON ERIC/FORIERS MANUELLA (note 51), 72 et seq.; regarding the Netherlands cf. HOHAGE UWE/KIRCHHOF KERSTIN/BROEREN RAYMOND/HUYBREGTS-JANS ESTHER (note 52), 51; regarding Great Britain cf. HM Treasury, HM Revenue & Customs, The Patent Box: response to consultation, December 2011 (note 54), cipher 1.4.

[58] Press release of 22 November 2006, IP/06/1598; cf. WARSON ERIC/FORIERS MANUELLA (note 51), 76.

[59] However, the intensity of state aid has to be observed in this case. According to the new community parameter of the Commission, the intensity of the state aid (selective character, distortion of competition etc.) and the intensity of R&D incentive measures need to be put into perspective. Therefore, this is a dynamic possibility of justification which needs to be examined individually from case to case.