Taxation in the Canton of Zurich
The Taxation of equity investment, holding, domicile and mixed companies

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Instructions issued by the Department of Finance on taxation of equity investment, holding, domicile and mixed companies

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Instructions issued by the Department of Finance on taxation of equity investment, holding, domicile and mixed companies
(from November 12, 2010; ZStB I No. 26/052)

1 Basic principles

In the Zurich tax law (StG) and the federal law on tax harmonization (StHG), special rules apply for corporations and cooperatives with respect to profit tax and tax on capital:

- § 72 StG, Art. 28 Para. 1 StHG: Participation reduction: principle;
- § 72a StG, Art. 28 Para. 1bis and 1ter StHG: Participation reduction on profits from capital gains and revaluations;
- § 73 StG, Art. 28 Para. 2 and 5 StHG: Profit tax for holding companies;
- § 74 StG, Art. 28 Para. 3 - 5 StHG: Profit tax for domicile and mixed companies;
- § 75 StG: Capital gains and profits from revaluation of participations and intangibles;
- §§ 79 and 82 StG, Art. 29 StHG: Tax on capital.

The stipulations of Art. 28 Para. 1 StHG are to be applied directly, if cantonal law is contradictory.

2 Participation reduction (§§ 72 and 72a StG, Art. 28 Para. 1, 1bis and 1ter StHG)

2.1 Participations

Participations are shares, paid-in capital in limited companies, shares in cooperative societies and participation certificates according to Art. 656a OR, profit certificates and shares in the capital of a SICAF. Not considered as qualified participations are bonds, shares in investment funds and in similar types of investment as well as other assets.

2.2 Income from participations

Under certain conditions, the following may be considered as income from participations, namely the distribution of profits of companies in which participation exists booked as profit and capital gains and profits from revaluations.

1. Distributions of profits

Income from participations consists of all ordinary and extraordinary distributions of profits such as dividends and proceeds of liquidations, provided such are taxed as profits, as well as reclaimable foreign tax at source and refunds of flat-rate tax. Capital repayments are considered to be distributions of profits to the extent such exceed the acquisition costs. Payments that represent justified business expenses on behalf of the corporation or cooperative are not deemed to be income from participations.

This income is only subject to the participation reduction regime if it stems from participations in which the corporation or cooperative holds at least a 10% share or if the participation has a market value of at least CHF 1 million.

2. Capital gains and profits from revaluations

The category of income from participations also includes book profits arising from the disposal of participations and proceeds from the disposal of pre-emptive rights

- if the participation constitutes at least 10% of the registered or nominal capital of the other corporation or if the participation founds the right on at least 10% of the profit and reserves of the other corporation. If the quota of participation falls below 10% due to fractional sales, the participation reduction for
future sales is only applicable, when the participation has a market value of at least CHF 1 million at the end of the tax period preceding the sale;

- as far as the proceeds exceed the acquisition costs;
- if the participation disposed of had been in the possession of the corporation or cooperative for at least one year.

The acquisition costs consist of the purchase price of the participation and the investment in the participation that has taken place since purchase. Disclosed and undisclosed capital contributions taxed as profits and disclosed and undisclosed capital reorganization contributions are included in the foregoing. These are reduced by depreciations made in connection with the distribution of profits and that have led to a reduction of the income subject to the participation reduction regime for dividends.

The participation reduction is granted on book profits within the meaning of Art. 670 CO, bonus stock included as assets as well as for increases in the nominal values of stock under the same conditions as for book profits from the disposal of participations. However, this leads to an increase in the acquisition costs of the revalued participation to the extent that the book profits from the revaluation are subject to the participation reduction regime.

For participations owned by the corporation or cooperative prior to January 1, 1997, the value for profit tax purposes at the commencement of the business year that ended in calendar year 1997 is regarded as purchase price.

### 2.3 Calculation of net income

The net income from participations comprises the difference between the income from participations on the one hand and the financial and administrative costs and depreciations on the other.

1. Financial costs

   The financial costs include interest on debts, commissions and other expenses that in economic terms are deemed to be equivalent to interest on debts. The proportion of the total financial costs attributable to the participations corresponds exactly to the ratio in percentages calculated to three decimal places between the value of the participations for the purposes of profit tax, for which the reduction is being claimed, and the value of all shares for the purposes of profit tax.

2. Administrative costs

   As a rule, the administrative costs consist of 5% of the income from participations for which the reduction is being claimed. Any incidental lower administrative costs have to be claimed by the taxable corporation and evidence must be provided.

3. Depreciations

   Income from participations is to be reduced by the depreciations occurring in relation with the distribution of profits. It is incumbent on the taxable corporation to provide evidence that there is no relation to the distribution of profits.

### 2.4 Calculation of the reduction in capital gains tax

The percentage reduction in profit tax is calculated as follows, rounded to three decimal places:

\[
\text{Net income from participations} \times 100 \\
\text{Total profit subject to tax}
\]

In cases where various authorities may levy taxes, and where either the objective taxation method (e.g. in the case of investment real estate) or the direct quota method is applied, the participation reduction is to...
be calculated according to the relationship expressed as a percentage between that part of the net participation income that falls to the Canton of Zurich and the profit subject to the Zurich tax authority according to the rules for the allocation of taxes.

**2.5 Curtailment of the participation reduction**

Transactions that cause unjustified tax savings in the group lead to correction of the taxable profit or to curtailment of the participation reduction. An unjustified tax saving is said to exist if capital gains and capital losses or depreciations on participations are causally linked.

**2.6 Depreciation on acquisition costs (§ 64 para. 1 subsection 5 StG)**

Depreciation on participations of 10% of the registered or nominal capital or of the profit and reserves of the other corporation may be added to the taxable profits if a sustainable recovery in the value of a participation has occurred and the earlier write-down is no longer justified on the basis of the course of business.

**2.7 Participation reduction and flat tax credits**

The corporation liable for tax may not waive the participation reduction to avoid curtailment of the flat tax credits.

**2.8 Procedure**

The participation reduction has to be claimed when the tax return is filed. The reduction is not granted on the tax authority’s initiative.

Participations of at least 20% of the registered or nominal capital of other corporations should be included on the list of participations maintained for the direct federal tax from business year 1997 on, participations of at least 10% of the registered or nominal capital or of the profit and reserves should be included on the list of participations maintained for the direct federal tax from business year 2011 on and this lists should be enclosed with the tax return. The following details must be given for each participation:

- Date of purchase and purchase price;
- Book value;
- Hidden reserves taxed as profits;
- Further investments.

According to the general rules concerning allocation of the burden of proof, it is incumbent on the taxable corporation to provide evidence of the acquisition costs of participations that have been disposed of.

**3 Holding companies (§ 73 StG, Art. 28 Para. 2 StHG )**

**3.1 Conditions to qualify as holding company**

Within the meaning of § 73 StG and Art. 28 Para. 2 StHG holding companies are corporations and cooperatives whose main statutory purpose is the permanent administration of participations and which do not otherwise carry on any business in Switzerland. The following conditions must be met for taxation as a holding company:

a) The intention of acting as a holding company must be stated in the articles and this purpose must be actively pursued.

b) The main purpose must lie in the permanent administration of participations (shares, paid-in capital in limited companies, shares in cooperative societies, participation certificates). Participation in partnerships does not qualify for the status of being taxed as a holding because triple taxation of profit and
capital has not to be avoided. The same applies to contractual obligations such as loans, advance payments and bond issues.

c) Any secondary purpose that the corporation exercises may only consist of activities that do not constitute a business activity in Switzerland.

d) The pursuit of secondary purposes may only be of subsidiary importance with relation to the permanent administration of participations.

e) The market value of participations or the income from participations must in the long run constitute at least two thirds of total assets or income. Income from participations consists of shares in profits issuing directly from a participation, in other words, payments arising from the company in which the participation is held that represent distributions of profits, not expenses, and capital gains on participations.

3.2 Permissible secondary purposes

1. Management of the holding company

Activities directly relevant to the holding company itself are permissible. These include management of the holding company itself, investment of company funds, company accounting and activities that result from the legal obligations of the holding company, such as exercising the function of a member of the board and participation in annual general meetings.

2. Ancillary activities on behalf of the group

Among other things, the following constitute permitted ancillary activities on behalf of the entire group, namely the setting up of a central management and reporting system for the group, market research in the interests of the group, legal counselling and tax consultation on behalf of the group, staff consulting for managerial staff, group financing through central financing on the capital market and financing of subsidiaries.

The expenses incurred by the holding company for activities conducted on behalf of the entire group may be invoiced to subsidiaries at market rates, as a rule by using the cost-plus method plus an additional 5%. In comparison to the income gained from the participation sector, payments made to subsidiaries must be subordinate in character. Otherwise it will be assumed that non-permissible business activities are taking place.

3. Management of subsidiaries

Management of subsidiaries is only permissible as an ancillary activity if such activity is minimal in comparison to the activity generated by the participations. The results should reflect those of a holding company with subsidiary management tasks and not those of a management company with participations. A further prerequisite is that those persons charged with managing subsidiaries must be employed by the holding company under the civil and social insurance regulations or that the total expenses involved must be charged to the account of the holding company.

4. Management of intangible assets

Management of intangible assets is only permissible as an ancillary activity if the activity is minimal in comparison to the activity generated by the participations.

In general, such management will be regarded as a non-permissible business activity because a condition for the development of inventions on the basis of research and development activity and the exploitation of patents is that the company has sufficient staff resources. The management of trademarks requires active trademark protection, establishment of a strategy for communications, technical assistance and quality assurance on the part of the licensees. As a rule, such business activities constitute activities that are incompatible with taxation as a holding company.
3.3 Profit tax

1. Principle

With a reservation for the conditions stated in sections 2 to 4 below, holding companies do not pay profit tax.

2. Income from real estate in Zurich

Under § 73 para. 2 StG, income from real estate held in Zurich is subject to tax at the regular rate. Appropriate deductions are granted for normal mortgage charges.

The income is deemed to be the total income from letting and leasing including the market rental value of the real estate occupied by the company.

The following may be deducted from income:

- Expenses for maintenance;
- Expenses for management up to a maximum of 5 % of the rental income;
- The interest on debts on the real estate.

The proportion of the total financial costs attributable to the real estate corresponds exactly to the relationship in percentage terms calculated to three decimal places between the value of the real estate for tax on capital purposes and the value of all shares for the purposes of profit tax. An effectively higher mortgage burden may also be taken into account if the necessary evidence is produced by the taxable corporation;

- Proportionate amounts of profit tax and tax on capital.

Net losses from real-estate ownership may be offset against profits from such gained at a later date within the conditions of § 70 StG. Gains or losses may not be offset against the holding company’s other profits.

Multiplicators from real estate ownership in other cantons will be taken into consideration to determine the tax rate. Intercantonal and international tax allocation is regulated in accordance with § 57 para. 3 StG in line with the principles of the federal law prohibiting double taxation among the cantons.

3. Capital gains and profits on revaluations of participations and intangible assets (§ 75 StG)

An annual tax of 6 % is imposed on that part of the capital gains and revaluation profits (as defined in Art. 28 Para. 1 StHG) that corresponds to the difference between the initial costs and the value for the purposes of profit tax of participations, as defined in § 72, which were held prior to the change of status to a holding company and which were either disposed of within ten years of the change of status or upon liquidation of the holding company. No deductions are granted on such profits.

An annual tax of 6 % of the capital gains and profits from revaluations is imposed on capital gains and profits from the revaluation of intangible assets, which were held prior to the change of status to a holding company and which were either disposed of within ten years of the change of status or upon liquidation of the holding company. No deductions are granted on such profits.

Transfer of the domicile abroad or to another canton is considered equivalent to liquidation. However, capital gains profits from revaluations will not be taxed, provided these are allocated to the hidden reserves created after the change of status.

4. Revenues for which relief is claimed for foreign tax at source

Revenues, for which exemption is requested because of foreign tax at source and for which regular taxation in Switzerland is foreseen according to a double taxation convention, will be taxed at the regular rate after deduction of the allowed expenses.

3.4 Tax on Capital

Under § 79 StG, paid-up share capital, paid-up registered or nominal capital, participation certificate capital and those hidden reserves that would have been subject to taxation as profits if profits had been made
are all part of the taxable equity capital. Further, under the provisions of § 80 StG, the taxable equity is increased by that part of the borrowed capital originating from associated companies or individuals that is equivalent to equity capital in economic terms.

Tax on capital amounts to 0.15 ‰ of the taxable equity capital (§ 82 StG).

3.5 Procedure

Holding companies are subject to the regular assessment procedure. These companies must submit the normal tax return accompanied by the business accounts (§ 83 para. 3 StG). The cantonal tax office decides on the taxation in accordance with § 73 StG.

4 Domicile companies (§ 74 para. 1 StG, Art. 28 StHG)

4.1 Conditions to qualify as a domicile company

Within the meaning of § 74 para. 1 StG and Art. 28 Para. 3 StHG, domicile companies are corporations, cooperatives and foundations that exercise administrative activities but do not conduct any commercial business in Switzerland. Foreign corporations may also request that their premises in Switzerland be taxed as domicile companies provided the requirements to do so are met.

Management of the corporation’s own assets is considered above all to be an administrative activity; such assets are those already owned by the corporation and those acquired by the corporation without any actual commercial activity. Ancillary activities such as the management of intangible rights, provision of know-how and invoicing and collection are also considered administrative activities, provided no actual office premises are required and no major activity on the part of staff is required in Switzerland. In contrast, acquisitions, market studies, commercial and agency activities, and the exercise of consulting and advertising functions in Switzerland are regarded as business activities.

It will, however, be concluded that business activity is being conducted abroad and/or an administrative activity is being carried on in Switzerland if what is known as foreign-foreign business (commerce with purchasing and sales abroad) is conducted on instruction from abroad and if the business has no substantial relevance for the Swiss market.

Instructions in the sense of the foregoing are general instructions on how to proceed or specific instructions from management organs or supervisory organs in the case of groups.

4.2 Profit tax

1. Income from participations

No profit tax is charged on income from such domestic and foreign participations and on capital gains and profits from revaluations of participations. Neither is such income included when determining the rate of profit tax. Participations in this sense are rights to a share in the registered or nominal capital of other corporations of at least 10 % or with a market value of CHF 1 million (Art. 28 Para. 1 StHG).

Capital gains and profits from revaluations of foreign participations, which do not fulfil these conditions, are also considered to be profit from Swiss sources similar to revenues from domestic participations.

Administrative and financial expenses and capital losses are deducted from the income derived. The prorata cost of financing is determined based on the value for the purposes of profit tax of the participations compared to the value for the purposes of profit tax of all assets.

An overall loss from participations may not be offset against profits from Swiss or foreign sources.

2. Capital gains and profits on revaluations of participations and intangible assets (§ 75 StG)
An annual tax of 6% is charged on that part of capital gains and profit from revaluations (as defined in Art. 28 Para. 1 StHG) that corresponds to the difference between the initial costs and the value for the purposes of profit tax of participations under § 72 held before the change of status to a domicile company and disposed of within ten years of the change of status or on liquidation of the domicile company. No deductions are granted on such profits.

An annual tax of 6% of the capital gains and profits from revaluations is imposed on capital gains and profits from revaluation of intangible assets held before the change of status to a domicile company and disposed of within ten years of the change of status or on liquidation of the domicile company. No deductions for such profits are allowed.

Transfer of the domicile abroad or to another canton is considered equivalent to liquidation. However, profit from capital gains and from revaluations will not be taxed, provided it is allocated to the hidden reserves created after the change of status.

3. Other revenues arising in Switzerland

Other revenues arising in Switzerland are considered to be income from administrative activities conducted in Switzerland, investment income and capital gains from debtors domiciled in Switzerland, provided they are not allocated to participations as in Art. 28 Para. 1 StHG, and income from real estate held in Switzerland.

Expenses in relation with the foregoing income are deductible from such income. The cost of financing may be distributed in relation to the ratio of such assets to the total assets. Otherwise the net result achieved in Switzerland is established on the basis of a separate account.

The profits achieved in Switzerland will be taxed at the regular rate. Net losses may be offset against the taxable part of profits from activities conducted abroad.

4. Other revenues arising abroad

Other revenues arising abroad are considered to be income from business activity conducted abroad and income from debtors domiciled abroad.

Expenses in relation with the foregoing income are deductible from such income. The cost of financing may be distributed in relation to the ratio of such assets to the total assets. Otherwise the net result achieved abroad is established on the basis of a separate account.

Profits achieved abroad are taxed in relationship to their significance for the administrative activity in Switzerland. However, a minimum quota of 5% will be imposed on corporations with no staff and infrastructure. Net losses may be offset against profits from Swiss sources.

5. Revenues for which exemption is requested because of foreign tax at source

Revenues for which exemption from foreign tax at source are requested and for which regular taxation in Switzerland is foreseen under a double taxation convention will be taxed at the regular rate together with revenues from domestic sources after deduction of the allocated expenses.

6. Rate of taxation

The rate of profit tax is determined solely by the taxable profits subject to profit tax.

4.3 Tax on capital

Under § 79 StG, paid-up share capital, paid-up registered or nominal capital, participation certificate capital and those hidden reserves that would have been subject to taxation as profits if profits had been made are all part of the taxable equity capital. Further, under the provisions of § 80 StG, the taxable equity is increased by that part of the borrowed capital originating from associated companies or individuals that is equivalent to equity capital in economic terms.
Tax on capital amounts to 0.15 per thousand of the taxable equity capital (§ 82 StG).

4.4 Procedure

Domicile companies are subject to the regular assessment procedure. These companies must submit the normal tax return accompanied by the business accounts (§ 83 para. 3 StG) along with supplementary form E for domicile and mixed companies. The cantonal tax office decides on the taxation in accordance with § 74 para. 1 StG.

5 Mixed companies (§ 74 para. 2 StG, Art. 28 Para. 4 StHG)

5.1 Conditions to qualify for taxation as a mixed company

Within the meaning of § 74 para. 2 StG and Art. 28 Para. 4 StHG, mixed companies are corporations and cooperatives whose main business is conducted abroad and whose activity in Switzerland is only subsidiary in nature. Foreign corporations may also request that their premises in Switzerland be taxed as mixed companies, provided the requirements to do so are met.

In contrast to domicile companies, which do not conduct any business activities in Switzerland, mixed companies are permitted to conduct subsidiary business in Switzerland. The main focus of business must relate to activities outside Switzerland. As a matter of principle this is the case if at least 80 % of the gross income originates from sources abroad and 80 % of the expenses is for the company's services abroad or for services provided abroad by third parties. The domicile or residence of the party presenting the invoice is decisive. The conditions for income and expenses have to be fulfilled cumulatively.

All activities that qualify as business and not as administrative activities count as contributing to provision of services.

5.2 Profit tax

1. Income from participations

No profit tax is charged on income from domestic and foreign participations and on capital gains and profits from revaluations of participations. Neither is such income included when determining the rate of profit tax. Participations in this sense are rights to a share in the registered or nominal capital of other corporations of at least 10% or with a market value of CHF 1 million (Art. 28 Abs. 1 StHG).

Capital gains and profits from revaluations arising from foreign participations that do not fulfil these conditions are also considered to be profit from Swiss sources similar to income from domestic participations.

Administrative and financial expenses and capital losses are deducted from the income derived. The pro-rata cost of financing is determined based on the value for the purposes of profit tax of the participations compared to the value for the purposes of profit tax of all assets.

An overall loss from participations may not be offset against profits from Swiss or foreign sources.

2. Capital Gains and profits on revaluations of participations and intangible assets (§ 75 StG)

An annual tax of 6 % is charged on that part of capital gains and profit from revaluations that corresponds to the difference between the initial costs and the value for the purposes of profit tax of participations under Art. 28 Para. 1 StHG held before the change of status to a mixed company and disposed of within ten years of the change of status or on liquidation of the mixed company. No deductions are allowed on such profits.

An annual tax of 6 % of the capital gains and profits from revaluations is imposed on capital gains and profits from revaluation of intangible held before the change of status to a mixed company and disposed of within ten years of the change of status or on liquidation of the mixed company. No deductions for such profits are allowed.
Transfer of the domicile abroad or to another canton is considered equivalent to liquidation. However, profit from capital gains and from revaluations will not be taxed, provided it is allocated to the hidden reserves created after the change of status.

3. Other revenues arising in Switzerland

Other revenues arising in Switzerland are considered to be income from administrative or business activities conducted in Switzerland, investment income and capital gains from debtors domiciled in Switzerland, provided these are not allocated to participations as in Art. 28 Para. 1 StHG, as is income from real estate held in Switzerland.

Expenses in relation with the foregoing income are deductible from such income. The cost of financing may be distributed in relation to the ratio between such assets and the total assets. Otherwise the net result derived in Switzerland is determined on the basis of a separate account.

Profit made in Switzerland is taxed at the regular rate. Net losses may be offset against the taxable part of profits from activities conducted abroad.

4. Other revenues arising abroad

Other revenues arising abroad are considered to be income from business activity conducted abroad and income from debtors domiciled abroad.

Expenses in relation with the foregoing income are deductible from such income. The cost of financing may be distributed in relation to the ratio between such assets and the total assets. Otherwise the net result derived abroad is established on the basis of a separate account.

Profits arising abroad are taxed as a rule at a quota of between 10 and 20 % depending on the scope of business activity in Switzerland. Net losses may be offset against profits from Swiss sources.

5. Revenues for which exemption is requested because of foreign tax at source

Revenues for which exemption is requested because of foreign tax at source and for which regular taxation in Switzerland is foreseen according to a double taxation convention are taxed at the regular rate after deduction of the allocated expenses together with the revenues from domestic sources.

6. Rate of taxation

The rate of profit tax is determined solely by the taxable profits subject to profit tax.

5.3 Tax on capital

Under § 79 StG, paid-up share capital, paid-up registered or nominal capital, participation certificate capital and those hidden reserves that would have been subject to taxation as profits if profits had been are all part of the taxable equity capital. Further, under the provisions of § 80 StG, the taxable equity is increased by that part of the borrowed capital originating from associated companies or individuals that is equivalent to equity capital in economic terms.

Tax on capital amounts to 0.15 % of the taxable equity capital (§ 82 StG).

5.4 Procedure

Mixed companies are subject to the regular assessment procedure. These companies must submit the normal tax return accompanied by the business accounts (§ 83 para. 3 StG) along with supplementary form E for domicile and mixed companies. The cantonal tax office decides on the taxation in accordance with § 74 para. 2 StG.

5.5 Applicability

These guidelines apply to tax periods ending in calendar year 2011 and later and replaces the guidelines from October 17, 2000.