This case shows how to structure a Swiss principal company, and how to relocate functions and intangibles from Germany and other European countries to Switzerland by segregating the intangibles and businesses into various usage rights.

Background

Over the years, an American multinational company had acquired several midsize manufacturing groups in Europe, which were well established in their respective markets. All of the acquired companies were active in the same industry, but had a very different geographical profile. Their respective headquarters, R&D centers, manufacturing and sales functions were situated in several European countries, primarily in Germany, France, Switzerland, and Italy. The brands of the group are well known in their market segment.

The profitability of all the companies had been quite volatile in the past and had increased strongly over the last couple of years. However, the different brands had significantly different earnings and margins, partially due to the type of machines, market penetration, and competition. The group was decentralized, with most of the subsidiaries acting independently, to the point where there was fierce competition on several market segments between group companies.

The Restructuring

The shareholder reacted by introducing a principal structure for several group companies, but decided to leave the most profitable subgroups relatively independent initially. The economic effect remained relatively low, as not a lot of synergies were realized and the best practices of the most profitable companies were not made more widely available.

Therefore, the shareholders decided on a principal company for all European businesses. The marketing, manufacturing, R&D, and sales functions would be managed centrally. These measures resulted in high revenue increases and cost savings.

A Big 4 company prepared the structure for the Tax Effective Supply Chain system; one of the most
well-known Anglo-American law firms provided the legal contracts and advice.

**Exit Tax Looms**

When preparing the tax structure, the law firm came to the conclusion that this relocation of businesses and intangibles would lead to exorbitant exit taxation in several European countries.

In particular, taxpayers in Germany are subject to the very aggressive Relocation of Functions legislation. Effectively, when a function is relocated to a group company, then this company must make a buy-out payment amounting to the net present value of all future income associated with the function. Notably, the highest income was earned in Germany.

The Big 4 firm proposed to split the existing fully fledged companies into three pieces: Contract R&D on behalf of the principal, contract manufacturing on behalf of the principal, and a stripped sales agent receiving goods from the principal, with all three pieces working for a Swiss principal company. Therefore, each local company had been divided into a minimum of two companies: one company performing contract R&D, contract manufacturing, and contract assembly (the existing company OldCo), and the other one for sales to existing and future clients (the new company NewCo).

The law firm had advised a split of the old German corporations into two entities, OldCo A and NewCo B. The Swiss principal would then enter into a contract manufacturing and contract R&D agreement with OldCo A. NewCo B was to prepare agreements with the Swiss principal for the distribution activities. The law firm came to the conclusion that the split of the companies required a ruling, as otherwise a high risk would remain. The relocation of functions from Germany to Switzerland and elsewhere would have to be taxed. The high profits and the forecasts amounted to a "hockey stick" of increasing profits in the future. Strict application of the German laws on the Relocation of Functions would have led to a prohibitive tax burden in Germany.

**Finding A Solution**

The client called us to arbitrate between the Big 4 firm and the law firm and find a solution for the huge exit tax.

What to do? How to approach the case?

First we had to check the facts. We came to the conclusion that several elements of the functions and intangibles could be separated by creating usage rights. We have separated the usage of the following elements:

- Relations with suppliers
- Technical manufacturing Know-How
- Patents
- General brand
- Specific customer relations

We have split the brand into several intangible goods, such as customer relations and other marketing intangibles, as it was economically sensible.
It also proved to be efficient from a tax perspective, as it allowed us to apply an advantageous German rule on the calculation of the value for customer relations. This kind of valuation of the customer base reduced the values of the marketing intangibles considerably. The brands in other countries were not segregated between customer base and other marketing intangibles, because such rules do not exist there.

Finally we advised to keep the following usage rights with the German OldCos A and B:
- Relations with suppliers
- Technical manufacturing Know-How
- Existing patents
- National German customer relations

This split was primarily based on the planned activities of the principal company, the OldCo and NewCo respectively: The OldCo would continue to manufacture and therefore keep the supplier relationship and the production know-how.

It would also keep the existing patents that were due to expire in a few years, as the overheads associated with such a transfer would have outweighed the benefit over the remaining life of the patents.

The NewCo would transact with German customers without much oversight by the principal, hence it was decided that it should keep its customer base.

We advised to transfer the following usage rights to the Swiss principal:
- Future patents
- Relations with international customers
- General brand

Future patents would naturally accrue to the principal as it had the principal and actual oversight over R&D activities contracted to the OldCos. It was not anticipated that the future patents would directly be based on the existing patents, hence no direct buy-out was necessary.

As the Swiss principal was to directly interact with international customers, it was natural to transfer customer relations. Existing relations will likely erode over time, hence the value of the existing relations is relatively low. New relations will be built up by the principal over time.

The general brand was to be centralized as the new global marketing was to be established under the principal.

**Implementation**

The economic outcome from such rather complicated structure had to be discussed with the management of the companies. After a series of discussions with the management we came to a compromise as to which usage rights should be transferred and which usage rights should remain in the two German companies OldCo and NewCo respectively, keeping in mind that such usage rights may expire in the future and leading to the right result.

Due to the high risk and difficult operations that would arise from a split of the German OldCos, the
client asked for other solutions than a legal split; in cooperation with a well-known tax lawyer, we proposed a solution where the OldCos created a limited partnership, a NewCo, for the more or less stripped distribution activity in Germany. Capital gains could be avoided by such partnership when transferring assets and functions from OldCo to NewCo.

Finally, the Big 4 firm had to find a solution for the recent changes in the Swiss rules for principal companies. We had to carefully weigh the advantages and inconveniences of the new rules for principals and the alternative rules for mixed companies. Finally the client came to the conclusion that the rules for mixed companies – if used well – might be better than those for principal companies.

**Conclusion**

The client is implementing a reasonable system, leading to increased revenues, reduced costs and significantly reduced effective taxes.

We are confident that this system will be in line with foreseeable future rules on BEPS.