



## The Future of Tax Incentives

How are tax incentives treated under Swiss statutory GAAP and IFRS?

# THE FUTURE OF TAX INCENTIVES

Tax incentives and government grants have long been used by countries to stimulate economic activity, encourage investment and promote particular industries or behaviours. Despite their widespread use, tax incentives and government grants are not without their critics. Common concerns include inefficiency, complexity, and distortions. Pillar Two, the OECD's project to establish a minimum tax rate of 15% for multinational companies with consolidated annual revenues of EUR 750 million or more, will have a significant impact on tax incentives and government grants in Switzerland and other countries around the globe in the future. We are likely to see a shift from profit-based tax incentives to subsidy-based support, reshaping the way governments encourage investment and economic growth, while maintaining compliance with international tax standards.

In this six-part publication series "The Future of Tax Incentives", Deloitte Switzerland analyses how Pillar Two will reshuffle the cards and what impact these new tax incentives and government grants may have in related areas, with a focus on Switzerland. This fifth publication discusses how these new tax incentives need to be treated under Swiss statutory GAAP and IFRS.

## Background

As traditional tax incentives often no longer work due to Pillar Two, various jurisdictions are introducing new incentives that increasingly have the character of subsidies. Technically, these new incentives are typically designed either as Qualified Refundable Tax Credits ("QRTC") or as actual government grants.

QRTC can either be offset against income taxes due or will be paid out after four years at the latest. Compared to traditional tax incentives, they have the character of subsidies because they will always result in a financial benefit, either in the current tax year or after four years at the latest. Traditional tax incentives, such as an R&D super deduction, only result in a financial benefit if the company has a taxable profit in that tax year. Government grants, on the other hand, are classic subsidies since companies are entitled to receive an immediate payment.

So far, little discussion has taken place on the question of how these new incentives should be treated for Swiss statutory GAAP and IFRS. They could be presented either as tax expenses (reduced tax expenses, "below the line") or in the operating result (increased income or reduced expenses, "above the line"). Presentation under Swiss statutory GAAP is relevant because in Switzerland, the taxable profit is based

on this accounting standard due to the "tax follows accounting" principle. The presentation under IFRS is mainly of interest to investors.

## Statutory GAAP

The provisions of Swiss statutory GAAP are set out in the Swiss Code of Obligations ("CO"), although the presentation of tax incentives and government grants is not explicitly addressed. Art. 959b CO only requires that tax expenses (direct taxes such as income and capital taxes) be presented separately in the income statement. The EXPERTsuisse "Handbook of Auditing" comments on asset-related subsidies, i.e., government grants for investments. These can either be deducted from the cost of the asset (net method) or recognised as deferred income and presented in the income statement over the useful life (gross method)<sup>1</sup>:

There is no established practice in Switzerland yet. In Deloitte Switzerland's view, the following practice could be considered based on these limited rules:

- Government grants: These may not be presented as a reduction in tax expense, as they clearly do not have the character of a tax incentive. If they are granted in connection with an investment, they should be reported using the

gross or net method described above. Consequently, the effect of the government grant is not recognised in a single year, but over several years. All other grants must generally be presented as income. Due to the prohibition of netting, it is unlikely that they will be presented as negative expenses.

- QRTC: Since they are integrated into the tax system, the main approach, in the view of Deloitte Switzerland, is to recognise them as a reduction in tax expense, which is how traditional tax incentives have been recognised to date. If, however, it is unlikely that the QRTC will be offset against taxes, i.e., a payment is expected after four years, an accounting treatment similar to that of government grants can also be considered. If the benefit will only be paid out in the next period(s), the QRTC may be recognized as deferred income (negative tax expense) in the current period.

In Deloitte Switzerland's view, the incentive received, whether as a QRTC or as a government grant, is subject to income taxation. There is no legal basis for an exemption from taxation. If a government grant is recognised in the profit or loss statement over several years (investment-related subsidy), the tax consequences also occur over several years.

<sup>1</sup> EXPERTsuisse, HWP 2023, Part III N 348

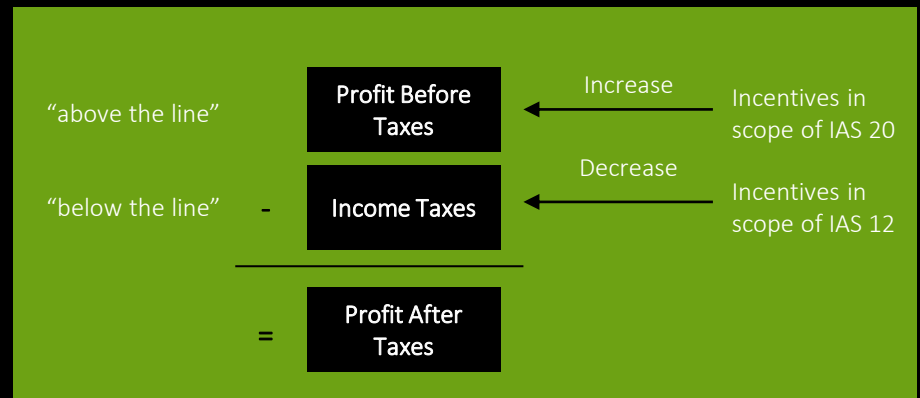
## IFRS

There are two relevant standards that need to be considered when assessing the treatment of tax incentives and government grants under IFRS: IAS 12 (Income Taxes) and IAS 20 (Accounting for Government Grants and Disclosure of Government Assistance).

The initial clarification is whether QRTC and government grants fall under IAS 12 or IAS 20 (or are even out of scope of both standards).

- IAS 20: applies to all government grants and other forms of government assistance (IAS 20.1). However, it does not cover government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or loss or that are determined or limited based on income tax liability (such as income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates).<sup>2</sup>
- IAS 12: applies to income taxes but does not deal with methods of accounting for government grants or investment tax credits (IAS 12.4). IAS 12 does not provide a definition for investment tax credits, which is a term used in many tax jurisdictions to describe a wide range of tax arrangements. Investment tax credits are generally understood as tax benefits received for investments in specific qualifying assets or activities. Furthermore, a tax credit provides a reduction to taxes payable and can be distinguished from a tax deduction which is factored into the determination of taxable income.<sup>3</sup>

When a tax credit is determined to be an investment tax credit (and, consequently, outside the scope of IAS 12 and IAS 20), it is a matter of judgement under IAS 8 to determine the most appropriate accounting treatment. It may be appropriate to



analogue to IAS 12 or IAS 20 depending on the specific facts and circumstances. No specific factor is conclusive on its own.<sup>4</sup>

Based on these partly contradictory provisions, the following conclusions are possible in Deloitte Switzerland's view:

- Government grants: fall under IAS 20.
- QRTC: the most appropriate accounting treatment for such refundable tax credits will be a matter of judgement to be determined under IAS 8. It will be necessary to look carefully at the substance of the particular credit, including the requirements that must be met to generate the credit and how the credit will be realised in practice. IAS 12 and IAS 20 are likely to provide the most appropriate references for the purpose of determining an appropriate accounting policy. For example, if the credit can be used to generate a cash payment and realisation is not dependent on any past or future income tax liability, then it may be reasonable to conclude that the credit is in the nature of a government grant and is not within the scope of IAS 12.<sup>5</sup>

If an incentive falls under IAS 12, it is generally to be presented as a reduction of the income tax expense and thus leads to a lower effective tax rate (ETR). The operating result is not affected.

If an incentive falls under IAS 20, the following principles need to be followed:

- The grant is recognised as income over the period necessary to match it with the related costs, for which it is intended to compensate, on a systematic basis (IAS 20.12). A grant receivable as compensation for costs already incurred or for immediate financial support, with no future related costs, should be recognised as income in the period in which it is receivable (IAS 20.20).
- A grant relating to assets may be presented either as deferred income, or by deducting the grant from the asset's carrying amount (IAS 20.24).
- A grant relating to income may be reported separately as other income or deducted from the related expense (IAS 20.29).

## Summary

In both statutory GAAP and IFRS, government grants may not be presented as a reduction in tax expense, but "above the line". This leads to an increase in the operating result and a reduction in the effective tax rate. When presenting a QRTC, an assessment must be made on a case-by-case basis.

**Next week's publication:** What is the state of play for new tax incentives in Switzerland?

<sup>2</sup> Deloitte Accounting Research Tool, A36.2

<sup>3</sup> Deloitte Accounting Research Tool, A13.2.6-1

<sup>4</sup> Deloitte Accounting Research Tool, A13.2.6-1

<sup>5</sup> Deloitte Accounting Research Tool, A13.2.7-1

# CONTACTS

## Our Support

Deloitte's network of 1,000 Government Grants, Credits and Incentives specialist can assist in the development and execution of an effective end-to-end government incentives strategy. This includes working with you to develop internal processes and structures to analyse appropriate opportunities to assist qualifying taxpayers to apply for and claim government grants, credits and incentives.

If you would like to discuss this topic, please reach out to our key contacts below.



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