Taxation Department

Withholding Tax Reform

Current status	On 15 April, the Federal Council passed the bill on the withholding tax reform on interest on debt capital. The bill essentially provides that, in order to strengthen the Swiss debt capital market, the levying of withholding tax on Swiss bonds is to be waived. Only interest on Swiss bank accounts held by natural persons domiciled in Switzerland should continue to be subject to withholding tax. The static revenue shortfall of the reform amounts to CHF 170 million (federal government and cantons). In addition, in order to strengthen the Swiss capital market, the levying of sales tax on Swiss bonds will be waived, which will result in a static revenue shortfall of CHF 25 million, which will accrue exclusively to the Confederation. There is a temporary effect of CHF 1 billion that has no impact on the budget, but for which provisions had to be made long ago. In other words, the Confederation and the cantons could not simply save a billion francs by abandoning the reform. The Dispatch does not include SwissHoldings' request to adjust the participation deduction for financing activities. Overall, the Federal Council believes that the reform has an attractive cost-benefit ratio. For the Confederation, the loss of revenue should be offset within five years. For the cantons and municipalities, additional revenue should result much sooner (Dispatch p. 3). On 17. May, the parliamentary discussion of the bill will begin with a hearing by the Economic Affairs and Taxation Committees (WAK/EATC) of the National Council. It is already evident from the business associations invited to the hearing that the reform is mainly seen as a "bank bill", which, however, is wrong. The withholding tax reform is a reform for medium-sized and large Swiss industrial companies. Insurance companies and other service providers also directly benefit from the reform. Swiss banks, on the other hand, only benefit indirectly from the bill, which is why they prefer other reforms such as the abolition of sales tax. Unlike most other tax reforms supported by the business community, the withholding tax reform is not a tax-cut bill. SwissHoldings member companies will not pay less profit, capital or other taxes in Switzerland due to the reform. On the contrary: our companies, which are already the most important taxpayers in Switzerland, will pay more domestic taxes in Switzerland due to the reform. They will relocate their activities from abroad, especially from the Netherlands, Belgium, and Luxembourg, to Switzerland and pay the associated taxes in Switzerland in the future. If, on the other hand, the reform fails, companies will likely have to strengthen the substance (personnel, functions, capital) of their foreign finance companies based on the OECD BEPS requirements. In many cases, this will be at the expense of their Swiss assets. These circumstances make the withholding tax reform currently the most important internal tax proposal for SwissHoldings' industrial and service companies. Why companies need the reform: Bonds issued directly by Swiss companies in Switzerland or abroad have the withholding tax deduction of 35% on the interest. International investors hardly ever buy bonds where only 65% of the interest is transferred immediately and the remaining 35% must be reclaimed via a laborious and lengthy procedure. The current legal situation and the resulting insignificant Swiss capital market are forcing the larger Swiss companies to raise foreign capital abroad. For this reason, Swiss companies must set up subsidiaries abroad (usually finance companies) and issue bonds through them. In return, the Swiss parent company provides a guarantee to the foreign finance company. The funds raised are then passed on by the foreign finance company to the other operating subsidiaries. Swiss

companies and thus Swiss jobs may only be marginally financed with funds from such foreign bonds. In principle, foreign bonds may only finance jobs and activities abroad, but not those in Switzerland.

The issuance of foreign bonds through foreign finance companies is becoming less and less accepted internationally (OECD BEPS). Insubstantial foreign finance companies with guarantees are met with skepticism by individual countries. If the withholding tax reform succeeds, Swiss companies will quickly relocate their financing activities to their Swiss headquarters and in the future, issue their bonds primarily from Switzerland. The funds raised will then be passed on by the Swiss company in the form of loans to the company's domestic and foreign operating subsidiaries. It goes without saying that there are certainly (taxable) profits associated with such activity.

The strengthening of the Swiss capital market is helping various sections of the economy: Thanks to the reform, Swiss companies can offer international investors bonds without the 35% deduction on the interest. In the future, medium-sized Swiss companies will also be able to issue bonds without the tax deduction, making their bonds more attractive to international investors and lower interest rates. Propitious bonds will become more attractive for medium-sized companies compared to more expensive bank loans (US model). When issuing bonds, Swiss industrial companies are supported by Swiss banks, which is why they also benefit. The federal government, cantons, and municipalities can also offer their bonds to international investors without the tax deduction and benefit from lower interest rates. The Swiss capital market will therefore be massively strengthened, and the Swiss economy will grow (approx. 0.5 %). The withholding tax reform therefore stands for economic growth, additional revenues, as well as reduced expenditures for the federal government, cantons, and municipalities. Compared to other tax reforms, the reform has an excellent cost-benefit ratio.

No risk to high withholding tax revenues: Withholding tax is an important source of revenue for the federal government (approx. 10 bn in 2019; only 5.2 bn in 2020 due to Corona special effects). 98% of the revenue comes from withholding tax on dividends (mainly from foreign shareholders of large Swiss corporations). The reform exclusively deals with withholding tax on interest on debt, which is why the high revenues remain unaffected by the reform. The fact that withholding tax on interest hardly generates any revenue for the Confederation is due to the fact that Swiss bonds are mainly purchased by taxpayers who declare the interest in their tax return and take on the costly refund procedure. Other taxpayers buy foreign bonds without tax deductions. In other words, the current tax security in the interest rate domain is useless.

The hurdle of the reform: The security function of the withholding tax in the area of interest is likely to be the bone of contention. In the consultation draft, the Federal Council presented a proposal that, in addition to economic growth, also provided for a marked improvement in tax security and thus in combating tax evasion of investment income. At the same time, the proposal respected financial privacy and fiscal banking secrecy. On closer examination, however, it emerged that the proposal not only had significant technical shortcomings, but also accrued major costs. The costs of the proposed tax security would have been many times higher for the banks, who would have had to carry out safeguard measures, than the safeguarded tax revenues of the treasury.

Apart from normal bank accounts, the Dispatch does not provide tax security. Should a safeguard be desired politically, various options are available. However, all solutions have considerable problems. Comprehensive deduction systems, such as that of the consultation draft, are associated with enormously high costs in relation to the potential loss of revenue for the Confederation of CHF 10 million (Dispatch p. 39) and should only be economically justified if the interest on borrowed capital is significantly higher. With the introduction of a comprehensive automatic exchange of bank

	information on domestic banking data, the withholding tax on dividends would lose its raison- d'être. After all, Switzerland does not need two backup security systems, namely a reporting procedure (AEOI) and a withholding procedure. Particularly, the withholding tax on foreign dividends would have to be reduced in this case from 35% to the ordinary DTA residual rate of 15%. However, this would result in a reduction in revenue for the Confederation (90%) and the cantons (10%) totaling CHF 1.6 billion. This revenue comes almost exclusively from foreign shareholders of major Swiss companies such as Nestlé, Novartis, Roche, and others (Dispatch p. 14). Need for improvement in the participation deduction: Unfortunately, the Federal Council has refrained from proposing to also eliminate the deficiency in the participation deduction. Eliminating the deficiency is a condition for the expected positive effects of the reform to fully materialize. It enables the Swiss parent companies themselves to issue bonds to the capital market and to pass on the funds raised without tax disadvantages to domestic and foreign subsidiaries (no need for an intermediary Swiss finance company with little substance). Without adjustment of the participation deduction, the parent companies suffer double taxation because of issuing the bond and passing on the funds raised in the form of loans. The costs of correcting the deficiencies amount to CHF 80 million for the Confederation and CHF 50 million for the cantons. We estimate that the shortfall in revenue should be offset within 2-3 years due to the relocation of activities to Switzerland.
Outlook	As mentioned, the elimination of withholding tax obstacles for debt financing activities is currently the most important Swiss tax project for our member companies. Due to the transfer pricing guidelines for financing activities presented by the OECD in 2020, the importance and urgency of the reform has even increased for Swiss groups. For SwissHoldings, it is therefore crucial that the reform is to be swiftly driven forward. For the reform to succeed and to avoid protracted disputes, it is important for the business community to adopt positions that are as similar as possible and that enjoy political majority support. Our efforts should focus on the numerous advantages of this reform for Switzerland as a business location, but also for the federal government, cantons, and municipalities. The hurdle of the reform is likely to be tax security. Parliament, as the Federal Council before it, is likely to want to thoroughly examine all security options such as a deduction on domestic and foreign bonds or a reporting procedure. The business community should support these efforts. The discussion about fiscal banking secrecy and financial privacy protection, will also pick up speed again. Whether Parliament decides in favor of a reporting procedure or a deduction system should not be of concern to SwissHoldings. As legal entities, our member companies must upon request, hand over all the supporting documents and information necessary for correct assessment, including bank records., to the Swiss tax authorities. In AEOI countries, our companies' bank details are already reported to the tax authorities, which does not pose a problem for the companies. We need to focus our concern on removing the withholding tax obstacles for debt financing activities (including the adjustment of the participation deduction). If Parliament decides in favor of a more far-reaching deduction procedure, our member companies will not have to take on any tasks or bear any costs. However, if Parliament decides in favor of a comprehensive reporting procedure (AEOI), we will point out that in this case the withholding tax on dividends, which is detrimental to our companies, will have to be reduced from 35% to 15%. If Parliament wishes to introduce a comprehensive withholding system, we will have to point out the associated costs for the banks concerned. For us, the most important adjustment to the Federal Council's proposal must be the elimination of the deficiency in the participation deduction. This improvement is crucial for us. For the TBTF banks, this deficiency was remedied by parliament in 2018. In view of the limited shortfall in revenue and

	the enormously high tax payments of our affected companies, they must not be discriminated against. The withholding tax reform on interest on borrowed capital represents an opportunity for Switzerland as a business location to gain more international attractiveness in other areas and to eliminate one of its most important disadvantages as a headquarters location. SwissHoldings will endeavor to convince politicians from left to right of the advantages of the reform.

OECD/G20 project on taxation of the digital economy

Current status	The project on the taxation of the digital economy aims to adapt international corporate taxation. Under Pillar 1, large digital and other corporations are to pay tax on a larger share of their profits in the countries where they sell their products. Under Pillar 2, large companies are to be subject to minimum taxation in all the countries in which they operate. The work is being carried out by the OECD Secretariat. The project is decided by the "OECD/G20 Inclusive Framework on BEPS" (IF), which includes around 140 countries. At the beginning of October 2020, the IF adopted a report (Blueprint) written by the OECD with technical specifications for each of the two pillars. At the same time, a public hearing was held until mid-December 2020. Contrary to the original schedule, however, the IF was unable to reach agreement on many technical points. Nor was it possible to present an agreement on the policy points that are of financial significance for the countries and companies (e.g. the level of the minimum tax rate, parameter amount A). The OECD Secretariat's project work therefore continued from February 2021 with the aim of simplifying the proposals, which were technically far too complex, and presenting an agreement by mid-2021. However, the OECD Secretariat was unable to demonstrate how the major differences of opinion among the states involved were to be bridged. The OECD project, on the other hand, is receiving strong support from the new US administration under President Biden. To finance improvements to the US infrastructure and various new social projects, he wants to significantly increase corporate taxes in the US and eliminate numerous business-friendly special rules. To ensure that the tax increases do not end in an economic and financial fiasco for the US, the new international Pillar 1 and Pillar 2 rules must be aligned with the US plans (and not vice versa). Most important for this is the introduction of the highest possible international minimum tax rates (Pillar 2). If US companies are not to be disadvantaged in international competition, the location factor "low corporate taxes" and thus tax competition must be massively restricted from the US perspective. If, in the context of "America first", US but also European or Asian companies are encouraged to set up factories and research facilities in the USA again, factors other than attractive corporate taxes must be the decisive factor in the competition for locations. The factors used by the US in this regard include, in particular, a wide variety of aid/subsidies for the creation and maintenance of research and production jobs or the waiver of government claims (e.g. social security contributions). In contrast, such instruments are largely frowned upon in Switzerland and are rarely used. At the beginning of April, the Biden administration presented its plans for the digital taxation project to the countries of the Inclusive Framework. Not surprisingly, the US stressed the importance of minimum taxes (Pillar 2) to limit what it sees as ruinous international tax competition (race to the bottom). The US would prefer a minimum tax rate at the level of its own planned minimum tax rate of 21 percent. Currently, this rate is still just above 10 percent. At the same time, however, the US has stated that it does not want to use the rules of Pillar 2 itself. Under Pillar 1, the US presented a new proposal. As was to be expected, this proposal is strongly tailored to US interests. Contrary to the plans of the OECD in the Blueprint, the

redistribution to the market states via the so-called Amount A is no longer to be limited to large companies with "Automated Digital Services" or "Consumer Facing Businesses". Only the very largest and most profitable corporations in the world should now have to pay the Amount A, which should then be distributed to the market states of the company. According to reports, the focus is currently on companies with sales of at least 20 billion euros and an EBIT margin of at least 20 percent. A total of 100 billion euros in profit tax substrate is to be redistributed from these companies to their market states. According to reports, the digital groups are to contribute a share of (only) around 35 percent. The lion's share is to come from traditional industrial groups, which already make substantial tax payments via their sales companies in the market states. These include, of course, Swiss corporations such as Nestlé, Novartis and Roche, but also numerous other European corporations such as Volkswagen, SAP and the French luxury goods groups. Part of the US proposal is, of course, also the condition that the Digital Service Taxes planned or already introduced by many states be abolished again. This raises the question of how the EU Digital Levy will proceed. Currently, the US proposal is being intensively discussed by the OECD.

To Pillar 1:

Since the US proposal entails various significant adjustments to the Pillar 1 Blueprint from October 2020, we will refrain from explaining the most important technical parameters. In any case, the OECD is in the process of massively simplifying the far too complicated rules of the Blueprint in parallel with the treatment of the new US proposal.

If an agreement is reached on Pillar 1, it will be several years before the new taxation rules come into effect globally. The implementation of Pillar 1 requires (i.) a multilateral agreement, (ii.) globally applicable detailed guidance (OECD Guidance) and (iii.) adjustments to domestic law. All these steps need several years of preparation and the measures must be introduced globally at the same time (e.g. 1 January 2026).

To Pillar 2:

The OECD's work on Pillar 2 (minimum taxation) is significantly advanced. An agreement by mid-2021 seems possible here. However, the new US administration in particular is unlikely to be interested in an agreement by October. If the US tax reform succeeds, the US is likely to want to impose even higher minimum taxes than the 15 percent currently under discussion at the global level.

As no major technical adjustments are expected in Pillar 2 compared to the Blueprint, the following technical explanations are still based on the Pillar 2 Blueprint of October 2020. The most important issue currently under discussion in Pillar 2 is whether to switch from the complicated carry-forward approach to the deferred tax accounting approach.

Pillar 2 provides for the introduction of a set of complementary rules for large international groups:

- Income inclusion rule (IIR)
- Undertaxed payments rule (UPR)
- Subject to tax rule (STTR)

Together, these so-called Global Anti-Base Erosion rules (GloBE) are intended to ensure that all affected corporations (with a minimum turnover of 750 million euros) pay a minimum amount of profit tax in all states. The states are not obliged to comply with a certain minimum tax rate in their tax laws. If a group company has a lower effective tax rate (ETR) in one state, another state (e.g. the country of headquarters) can tax the difference to the minimum tax rate using either the IIR or the UTPR. If the head office state has an ETR that is too low, the UTPR applies, according to which many

other states with group subsidiaries and economic relationships between subsidiaries and group companies in the head office state may tax the difference at the minimum tax rate (so-called top-up tax). Currently, a minimum tax rate of 15 percent is often mentioned in discussions. This minimum tax rate would be significantly higher than most of the cantonal minimum profit tax rates and would thus in fact lead to a substantial tax increase for groups and group companies based in Switzerland.

Since a minimum taxation concept had already been introduced in the US as a part of the US tax reform in the form of GILTI rules, the previous Trump administration demanded that US corporations be exempted from the application of the GloBE rules. This special treatment for the US was controversial, but has so far been accepted as a necessary concession to the US. The Biden administration also wants to hold on to this exemption. At the same time, the Biden administration wants to make substantial adjustments to US-GILTI. As with GloBE, where the minimum tax test is applied at the country level, such "jurisdictional blending" is also to be applied to US-GILTI in future. The US minimum tax rate is to be set at 21 percent. However, the tax base of GloBE and that of the planned new GILTI regime differ. According to experts, the GloBE rate must therefore be lower than the GILTI rate to ensure a level playing field.

The starting point for the ETR calculation at country level is the aggregation of all income statements of the companies included in the consolidated financial statements in a particular country. This is not based on the individual statutory financial statements of a national company, but on the financial statements for the consolidated financial statements of the national company concerned in accordance with the accounting standard used by the Group for its consolidated financial statements. Capital taxes are presumably also included in the tax base. The accounting standard recognized for GloBE purposes is generally any accounting standard recognized as acceptable by the authority of the Group's domicile, provided that its application does not result in a material impediment to competition. IFRS and US GAAP are defined as an adequate accounting standard. Swiss GAAP FER, on the other hand, will probably not be recognized as adequate without further adjustment calculations. Certain permanent differences between the profit according to (local) tax rules and the profit according to (global) financial accounting rules have to be eliminated (e.g. dividends, gains and losses on sales of investments). Further explanations of other adjustments to the accounting rules as well as the planned simplifications are not provided here. These are also currently being discussed again in the OECD (possible switch to deferred tax accounting).

The minimum tax rate can be undercut by the amount of a carve-out. This carve-out considers personnel costs and tangible assets in the state of the national company. This is intended to create incentives for corporations with physical assets. However, intangible assets such as internally generated product patents are not considered. However, the effectiveness of this carve-out under current plans is limited and does not even free up profits for routine activities. A carve-out for research and development costs or for the patent box is not planned and does not appear to have majority support. This at least calls into question the measures implemented as part of the Swiss tax reform.

The STTR applies to payments based on a DTA and allows the source state to take countermeasures if the payments are taxed below a certain level in the recipient state. The minimum level is likely to be between 7-9%. With the introduction of Tax Proposal 17, the STTR should no longer be a major obstacle for Switzerland. The STTR is primarily a concession to developing countries.

Pillar 2 leads to a restriction of international tax competition. Offshore states, states with tax holidays, patent boxes, or particularly advantageous tax regimes that allow effective tax rates that are below the minimum tax rate

	are particularly affected. Overall, other (less transparent) factors (e.g. aid/subsidies) are gaining in importance in the competition for companies. The central rules of Pillar 2 do not, in principle, constitute a breach of the applicable provisions in the DTAs, which is why no multilateral agreement appears necessary for implementation. An agreement under Pillar 2 would rather be regarded as a new global minimum standard. Moreover, the GlobBE rules are outside the existing legal certainty mechanisms and can thus be introduced unilaterally by states. This means that Pillar 2 could be implemented much more quickly than Pillar 1. For example, the EU Commission would like to implement the GLOBE rules as quickly as possible (e.g. as early as 2024) or impose them on all other states.
Outlook	According to the current timetable, some sort of high-level agreement should be reached by mid-2021. In view of the numerous obstacles and the great importance of the decisions still to be made, this timetable seems extremely ambitious. It is more realistic that a high-level agreement can only be reached in October 2021, when there is also more clarity as to whether the Biden administration will find a majority in the US Senate for its US tax plans. Such an agreement would also need to include the key policy parameters. The technical details of Pillar 1 and Pillar 2 are therefore more likely to be available in spring 2022. Due to the divergent positions of numerous states, failure of the project is still not ruled out. However, the commitment of the Biden administration has significantly reduced this risk. Although the emerging requirements are not tailored to Switzerland's interests, an international agreement is preferable to a failure of the project. Thus, globally uniform standards instead of a jungle of different standards in a multitude of states are also in Switzerland's interest. We depend on our companies being able to supply their products and services to many countries without restrictions. Swiss companies are also becoming more and more digital. If the project fails, there is a threat of the introduction of digital service taxes and/or unilateral minimum taxation rules - possibly with withholding taxes - in many countries. The Digital Service Taxes, which are materially very different, will primarily affect US digital corporations and the US in a first step. As digitalization progresses, a growing number of Swiss companies are also likely to be affected by such taxes. For this reason, Switzerland's main focus in the OECD work over the coming months will be to limit the scope of application of harmful new rules and their economic consequences as far as possible, as well as to reduce the administrative burden on companies to a tolerable level. There is also still considerable potential for improvement in the measures to improve legal certainty. Regarding Pillar 1, it is of central importance for Switzerland that the focus is once again placed more strongly on digital companies. Our traditional industrial companies already pay more than substantial amounts of tax in the market states. At the same time, they are extremely important taxpayers in Switzerland. Switzerland must insist that the new rules apply primarily to digital corporations. A principles-based and balanced model is key. The equal treatment of traditional industrial and digital corporations envisaged in the US proposal ultimately leads to a continuation of their unequal treatment or the privileged treatment of digital corporations. In order to avoid discrimination against traditional industrial corporations with substantial local substance in the market states and their headquarters states (e.g. Switzerland), the new OECD taxation model should provide for a new tax nexus to be created for digital business models. The balance between the innovation efforts in the headquarters state and the distribution activities in the market states is essential for the success of such a new taxation model. As an innovation-oriented country with a strong research and development pillar, Swiss corporations and group companies are likely to generate residual profits more frequently, which according to Pillar 1 must be shared

with large market states. In the interest of Switzerland as a research location, a moderate redistribution in favor of the market states must be targeted.

In the case of Pillar 2, it is crucial that the minimum tax rate be moderate. There is a risk here that the Biden administration, together with selected EU states such as Germany or France, will seek a substantial increase in the minimum tax rate. Scientifically speaking, profit taxes are detrimental to growth and job creation. Especially against the backdrop of the Corona recession, it would be dangerous to adopt such high minimum tax rates and eliminate competition. Moreover, it is currently very uncertain whether the Biden administration's proposals will be able to gain majority support in the US. Switzerland must therefore join like-minded countries in opposing the US administration's plans. Competition for international companies via moderate minimum taxes (max. 12.5%) must continue to be permitted. Non-transparent other instruments are by no means the better choice. For innovation-focused locations, it is of key importance that research activities can continue to receive direct tax support, which is not provided for in the current proposals (no carve-out).

The emerging requirements of the OECD digital taxation project are not in Switzerland's interest. In order to minimize the damage, Switzerland should nevertheless adopt and implement the requirements. If Switzerland were to refuse to implement the minimum taxation requirements, tax substrate would flow abroad, and Swiss companies would be exposed to constant conflicts with foreign tax authorities. The Swiss economy and treasury would thus be disadvantaged due to the new international requirements.

At the same time, Switzerland must quickly adapt to the new rules, the work on implementing Pillar 2 is likely to be urgent. In fact, this work should already be tackled with vigor today. Switzerland must be prepared if the minimum tax rate under Pillar 2 is to be set at over 12.5 percent. The higher the minimum tax rate, the more new instruments Switzerland will have to find in order to be able to retain the particularly profitable and high-tax income activities of international companies in Switzerland. In other words, Switzerland should adapt to the changed competitive conditions, maintain its attractiveness as a business location and, following the example of other countries (e.g. the USA), use non-fiscal instruments in particular to promote the location. Improvements in other tax areas should also be sought (withholding tax, issue tax, sales tax in the case of corporate restructuring). This ensures that the companies concerned will continue to carry out the activities associated with the highest profit tax revenues in Switzerland.

Switzerland should therefore act in a similar way to the BEPS project concluded in 2015. However, we should be given much less time for decision-making this time. Thanks to the AHV tax reform with the new special measures (patent box, research deduction) and the parallel cantonal profit tax reductions, the BEPS project which was concluded in 2015 brought Switzerland significantly more advantages than disadvantages. While the requirements of the BEPS project were tailored to Switzerland's strengths, this will not be the case with the requirements of the digital taxation project. The aim of the digital taxation project is precisely to take tax substrate away from successful countries such as Switzerland (Pillar 1) and to hold them back in the competition between locations (Pillar 2).

In view of the importance of the project for member companies and Switzerland, SwissHoldings continues to actively support the work on the project.