SwissHoldings

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 transaction stamp duty 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. For the Confederation, the revenue shortfall should be offset within five years. For the cantons and communes, additional revenue should result much sooner (dispatch, p. 3).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. Overall, the Federal Council believes that the reform has an attractive cost-benefit ratio. According to the latest calculations, the Confederation, cantons and municipalities could save up to CHF 200 million per year due to the lower bond interest rates resulting from the reform (new FTA calculations, not taken into account in the dispatch). The dispatch does not include SwissHoldings' request to correct the error in the participation deduction for financing activities. On 17. May, the parliamentary discussion of the bill began with a hearing by the Economic Affairs and Taxation Committees (WAK/EATC) of the National Council. Already from the business associations that were invited to the hearing it was evident that the reform was 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 the transaction stamp duty. 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. On 17 August, the WAK/EATC of the National Council dealt in detail with the withholding tax reform (MM WAK-N). First, the committee decided by a large majority (17 to 4) to approve the reform. In the subsequent discussion, proposals to strengthen tax security were clearly rejected (17 to 8). Smaller

proposals to improve the draft were accepted. Unfortunately, the correction requested by SwissHoldings about the participation deduction for financing activities was apparently not accepted. In the overall vote, the proposal was again accepted by a pleasingly clear margin of 17 votes to 8. The reform can therefore be dealt with by the plenary session of the National Council as early as the autumn session (13 September - 1 October). SwissHoldings is extremely pleased about the strong support of the WAK/EATC for this important reform for many medium-sized and large Swiss companies (SwissHoldings Media Release).

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 (see the new FTA estimate mentioned above). 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: Despite the rejection of corresponding proposals in the WAK/EATC of the National Council, the safeguard function of the withholding tax is likely to remain the bone of contention of the reform. 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 waived additional tax security measures. Should a safeguard be desired politically, various options are available. However, all the solutions (of the many developed and tested by the administration and the economy) 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). An AEOI restricted to the interest area would bring complicated delimitation problems. Need for improvement in the participation deduction: Unfortunately, after the Federal Council the WAK-N refrained from eliminating 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). 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	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. It would be ideal if the reform would pass before the end of 2021 and enter into force as early as the beginning of 2023. If the reform can be adopted by the National Council in the autumn session and by

the Council of States in the winter session, then this would be possible. However, this presupposes that the left renounces a referendum against the reform.

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. 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.

It would be important for us to eliminate the shortfall in the participation deduction. However, it is becoming apparent that this request will not find support due to the shortfall in revenue from the Confederation (CHF 80 million) and the cantons (CHF 50 million). For the too-big-to-fail banks, this shortcoming was eliminated by parliament in 2018. At best, improvements can be achieved for the benefit of the industry in other areas during the political process, such as the transaction stamp duty (e.g. improvement for treasury activities newly exercised from Switzerland or exemption for long-term equity purchases).

The withholding tax reform on interest on borrowed capital represents an opportunity for Switzerland as a business location to increase its international attractiveness in another area and to eliminate one of its most important disadvantages as a headquarters location. Against the backdrop of the loss of attractiveness of Switzerland as a business location due to the OECD digital taxation project, the withholding tax reform is a welcome countermeasure. SwissHoldings will endeavor to convince politicians from left to right of the benefits of the reform. At the same time, however, it should be noted here that the real winner of the reform will be the Swiss treasury (Confederation, cantons and municipalities). Firstly, it will be able to tax the profits from the financing activities of Swiss corporations in Switzerland in future. Because of the OECD minimum taxation, the profits can even be taxed at a higher rate. Many of the WAK-N parliamentarians quickly understood this. We are convinced that the other parliamentary bodies will also recognize this

SwissHoldings

OECD/G20 project on taxation of the digital economy

Current status	The project for the taxation of the digital economy is based on two pillars and aims to adapt international corporate taxation. In 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. This is done through the so-called Amount A. In Pillar 2, large corporations are to be subject to minimum taxation in all their operating states. The work is being led by the OECD Secretariat on behalf of the G7 and G20. The project is decided by the "OECD/G20 Inclusive Framework on BEPS" (IF), which comprises of 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 consultation 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 financially significant for the countries and companies (e.g. 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 technically very complex proposals and presenting an agreement by mid-2021. This was partially successful and in July 2021 the G20 and almost the entire IF agreed on the following: • The world's largest companies (with a turnover of at least EUR 20 billion) must pay tax in their home countries on at least 20% of their profits above a 10% profit margin. • In return all "digital service taxes" and similar unilateral instruments should be abolished. • A minimum tax rate of at least 15% should be ensured for each country. • The work is to be finalized by October 2021, including an implementation plan to take effect from 2023. It should be noted, however, that there are still major differences of opinion among the IF states involved regarding the details, and that the broad agreement on the above points only came about because they were still conceptual and the countries did not want to abandon the project. The new US administration under President Biden plays an important role for the OECD project. Its constructive attitude meant that the negotiations, which had stalled in the winter, could be continued, in particular through its plans for the design of the digital taxation project, which were presented in April 2021 and on which the points decided by the IF are essentially based. In these, it was proposed for Pillar 1 (contrary to the OECD's plans in the Blueprint) that redistribution to market states via the so-called Amount A would no longer be limited to large companies with "Automated Digital Services" or "Consumer Facing Businesses" but would initially focus on the largest and most profitable corporations in the world (around 100 corporations), regardless of whether they are digital corporations or not. This means that the majority of Amount A is likely 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 SAP and the French luxury goods groups. Another part of the US proposal was also the condition that the digital service taxes planned or already introduced by many states be abolished. This also raises the question of how the EU Digital Levy will proceed.

	Finally, the US unsurprisingly stressed the importance of minimum taxes (Pillar 2) to limit what it sees as ruinous international tax competition (race to the bottom). This is also because the US has already been applying its own minimum tax rate of 10.5 percent since the 2017 tax reform, which the Biden administration would like to increase to 21%. The US administration is not altruistic in its support for the OECD project: to finance improvements to the US infrastructure and various new social projects, it wants to significantly increase corporate taxes in the US and eliminate numerous business-friendly special rules, as it announced in the "American Jobs Plan" in March 2021. In order not to maneuver itself economically into the sidelines with these tax increases and thus jeopardize the necessary parliamentary majority in the US Congress, the new international Pillar 1 and Pillar 2 requirements must be aligned with the US plans. Most important in this respect is the introduction of the highest possible international minimum tax rates (Pillar 2). This could encourage US and European or Asian companies to set up more factories and research facilities in the US again as part of the "America first" strategy. In the competition between locations, factors other than attractive corporate taxes must be decisive. 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 waiving of government claims (e.g. social security contributions). In contrast, such instruments are largely frowned upon in Switzerland and are used little, although they are also used to a considerable extent by important European countries such as France and the UK. On Pillar 1: The decision of the IF and G20 has massively simplified the much too complicated rules of the Blueprint. Now only the largest and most profitable global corporations are affected, regardless of whether they are "digital" companies or not. Nevertheless, answers are still pending here on many technical details (e.g. segmentation or dispute resolution) that could also be politically significant. If an agreement is reached on Pillar 1, however, it will be several years before the new taxation rules enter into force globally. Thus, 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 need to be introduced globally at the same time (which makes the envisaged start date of 2023 seem very optimistic). On Pillar 2: The OECD's work on Pillar 2 (minimum taxation) is much further advanced. However, the new US administration is unlikely to be interested in reaching an agreement by October. If the US tax reform succeeds, the US could want to impose even higher minimum taxes than the 15 percent currently under discussion at the global level (which certain other countries would support). As no major technical adjustments have been communicated for Pillar 2 compared to the Blueprint, the following technical explanations continue to be based on the Pillar 2 Blueprint of October 2020. The most important topic currently under discussion for Pillar 2 is whether to switch from the complicated carry forward approach to the deferred tax accounting approach. For more information on Pillar 2, see SwissHoldings May Update 2021.
Outlook	In view of the numerous obstacles and the great importance of the decisions still to be made, the timetable advocated by the IF appears extremely ambitious. Which one of the disputed points, that will be clearer by October 2021, is just as interesting as the question of if the Biden administration will

find a majority in the US Senate for its US tax plans by then. Some 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 countries, a failure of the project cannot be ruled out, especially if there is no majority in the US Congress for an increase in the current minimum tax rate of 10.5% and the other IF countries insist on a rate of at least 15%.

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. If the project fails, there is a risk of the introduction of digital service taxes and/or unilateral minimum taxation rules - possibly with withholding taxes - in many countries.

For this reason, Switzerland's main concern 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.

For Pillar 1, a principles-based and balanced model should be sought. The equal treatment of traditional industrial groups and digital groups envisaged in the US proposal ultimately leads to a continuation of their unequal treatment and the privileged treatment of digital groups. 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 base and many principal companies, Swiss groups and group companies are likely to generate residual profits more frequently, which under Pillar 1 must be shared with large market states. In the interest of Switzerland as a research and management location, the redistribution in favor of the market states must remain moderate.

In the further Pillar 2 work, it is crucial that the minimum tax rate does not rise above 15 percent under any circumstances. Here, there is a danger that the Biden administration, together with selected EU states such as Germany or France, will seek a further increase in the minimum tax rate. Taxes on profits are, from a scientific point of view, harmful to growth and job creation. Especially against the backdrop of the Corona damage in many economies, it would be dangerous to adopt even higher minimum tax rates and eliminate competition. Competition for international companies via moderate minimum taxes must continue to be permitted. Ambiguous other instruments are by no means the better choice.

The emerging requirements of the OECD digital taxation project are not in Switzerland's interest. Nevertheless, Switzerland should adopt the guidelines in large part. If Switzerland were to refuse to implement the minimum taxation requirements, for example, this would do more harm than good to the Swiss economy and the Swiss treasury. The additional tax substrate from minimum taxation would simply flow abroad instead of into Switzerland, and Swiss companies would be exposed to constant conflicts with foreign tax authorities. The Swiss economy and treasury would thus be the big losers from the new international requirements.

The OECD's timetable for implementing the new requirements is extremely ambitious (introduction of the minimum tax requirements as early as 2023). Even if this timetable is fleshed out somewhat more realistically during further OECD work, the timelines are likely to remain ambitious and difficult to reconcile with the slow Swiss legislative process. Therefore Switzerland cannot wait until the final details of the new requirements are known. It must set the legislative process in motion with vigor now, so that when the new

requirements are approved, Switzerland can already begin the consultation process. The first important preliminary work has already begun. This work must be continued in a targeted manner with the involvement of the business community.

Regarding Swiss implementation, SwissHoldings is of the opinion that existing structures that have proven themselves over many years should not be adapted without necessity. For example, SwissHoldings is skeptical that the assessment of the minimum tax should be transferred from the cantons to the federal government. The assessment of the profit tax is the task of the cantons. The cantons should therefore continue to be in the lead about the minimum tax. Nor should the cantons' tax autonomy or competition among the cantons be abolished under the guise of GloBE requirements. The additional revenues from the minimum tax therefore belong to the cantons and not to the Confederation. Those cantons should receive a share of the additional revenue from the minimum tax whose companies have also paid it. Redistributions, for example in favor of the Canton of Berne and at the expense of the Canton of Zug, should be avoided. Redistributions between the cantons must take place via the intercantonal financial equalization system. In general, the following aspects are central to Swiss implementation:

- International acceptance
- Simple legislative and administrative implementation
- Securing the attractiveness of the location
- Compliance with international timelines
- High flexibility
- Recognition of minimum taxation, also from a US tax perspective

With a minimum tax rate of 15 percent, Switzerland will have to find new instruments to be able to retain the particularly profitable activities of international companies in Switzerland that are associated with high tax revenues. 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, France, the UK), also use non-fiscal instruments to promote its location. Such measures could be particularly effective in the research sector. Fiscal improvements (e.g. withholding tax, emissions tax, modified capital tax credit) are also important. In this way, it can be ensured that the companies concerned continue to carry out the activities associated with the highest profit tax revenues in Switzerland in the future.

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