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, 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, 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, were not considered in the dispatch). The dispatch does not include SwissHoldings' request to correct the error in the participation deduction for financing activities. The matter will be further addressed in a motion (18.3718). On 28 September, the National Council was the first to deal with the reform. Referrals for review to strengthen tax safeguards were clearly rejected (122 to 66). The smaller amendments proposed by the Commission to improve the bill were all adopted during the detailed consideration. In the overall vote, the bill was again clearly adopted by 122 votes to 68 (Media release National Council). On 28 October, the Committee for Economic Affairs and Taxation of the Council of States will deal with the reform. This means that the reform could be discussed by the plenum of the Council of States already in the winter session of 2021 followed by the final vote of the two chambers. The withholding tax reform is a reform for medium-sized and large Swiss industrial companies. Insurance companies and other service providers also benefit directly from the reform. Swiss banks benefit only indirectly from the bill, which is why they prefer other reforms such as the abolition of the turnover 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 as a result of the reform. On the contrary, our companies, which are already the most important taxpayers in Switzerland, will pay more taxes domestically as a result of the reform. They will move 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 in all likelihood have to strengthen the substance (personnel, functions, capital) at their foreign finance companies due to 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 the industrial and service

companies of SwissHoldings.

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.
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. The Council of States may also want to again closely look at all the safeguard 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, could also pick up speed again. Whether the Council of States 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 to the Swiss tax authorities (including bank records). 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. It would have been 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.

	Elimination of problems discovered in the meantime, which arise for treasury activities newly carried out in Switzerland). Since the abolition of the turnover tax as part of the stamp duties will have a very difficult stand politically and is unlikely to be abolished during the next fifteen years, the obstacles of this Swiss financial transaction tax that are really important for the industry can be addressed (exception for long-term, business-related share purchases; switch to digital procedure without the antiquated blue card). 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 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.

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 around 140 countries. On October 7-8, 2021, 136 out of 140 IF countries adopted a statement with policy parameters on the two pillars (IF Statement). These were officially endorsed by the G20 Finance Ministers on 14 October. The following parameters were adopted: • The world's largest companies (at least EUR 20 billion in sales) must pay tax in the countries of sale on 25% of the group profit that exceeds a 10% profit margin (Amount A of Pillar 1). The tax is paid by the group companies that have profit margins above 10%. • In return all "digital service taxes" and similar unilateral instruments should be abolished. • International companies that are required to prepare a country-by-country report, i.e., have a turnover of at least EUR 750 million, must comply with a minimum tax rate of 15% in each country (Pillar 2). The calculation of the minimum tax is based on a tax base determined according to accounting principles (e.g. IFRS) that is largely standardized internationally. • The redistribution by means of Pillar 1 Amount A will take place from 2023 and is based on a multilateral agreement to be submitted next year and subsequently ratified. After seven years (2030), the turnover limit will be reduced from EUR 20 billion to EUR 10 billion, which will significantly increase the number of companies affected. Pillar 2 (minimum taxation) represents a so-called "common

approach", is "voluntary" and will apply from 2023 (Income Inclusion rule) or 2024 (Undertaxed Payments rule).

It should be noted, however, that there are still differences of opinion between the IF states involved regarding the details. The Pillar 2 Model Rules and the corresponding technical explanations are due to be published at the end of November 2021. Until then, at least for Pillar 2, important differences of opinion on the technical details still need to be resolved. The publication of the technical details on Amount A is expected to take place even later. For the Swiss legislative process, the extremely ambitious implementation timetable represents a major challenge.

The global tax reform is taking place in parallel with a US reform. As part of this, the Biden administration wants to significantly increase corporate taxes in the US and eliminate numerous business-friendly special rules (Bipartisan Infrastructure Framework [BIF] and Build Back Better Act [BBB]) to finance improvements to US infrastructure and various new social projects. For the Biden Administration, global reform is likely to serve to advance U.S. reform and move it in the desired direction. For example, the U.S. has managed to ensure that Amount A eliminates the focus on digital corporations, which are important taxpayers for the U.S., and requires the elimination of Digital Service Taxes that many states have planned (e.g., EU Digital Levy) or already implemented. This means that the majority of Amount A is likely to come from traditional industrial groups, which already make substantial tax payments via their distribution companies in the market states. These naturally include Swiss corporations such as Nestlé, Novartis, or Roche, but also numerous other European corporations such as SAP or the French luxury goods groups. Whether the US will participate in Pillar 1 at all will probably not be known until spring 2022. The US is also likely to be granted special rules for Pillar 2. With GILTI, for example, the US will apply a different minimum tax calculation system with different rules (minimum tax rate, tax base, etc.). According to the IF statement, it remains to be seen whether this system, the content of which has not yet been determined, will ultimately be regarded as equivalent.

In order to not maneuver oneself economically into the sidelines with the tax increases and thus endanger the necessary parliamentary majority in the US Congress, the international requirements of Pillar 1 and Pillar 2 must be aligned with the US plans. Most important for this is the introduction of the highest possible international minimum tax rate. 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.

<u>Technical explanations for Pillar 2:</u>

Pillar 2 provides for the introduction of a set of complementary rules for affected companies:

- Income Inclusion Rule (IIR)
- Undertaxed Payments Rule (UTPR)
- Subject To Tax Rule (STTR)

Together, these so-called Global Anti-Base Erosion rules (GloBE) are intended to ensure that all affected companies (with a minimum turnover of

	750 million euros) pay at least 15% in profit and capital taxes in all states. The states are not obliged to comply with the minimum tax rate. The introduction of Pillar 2 is voluntary (common approach). If a group company has an Effective Tax Rate (ETR) lower than 15% in one state, another state (e.g., the head office state) can tax the difference to the minimum tax rate by applying the IIR. If the head office state has an ETR that is too low, the UTPR applies, according to which many other states with 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). 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 each country. This is not based on the individual statutory financial statements of a country company, but on the financial statements for the consolidated financial statements of the country 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 accepted 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 could recently also be recognized as adequate. Certain permanent differences between the profit according to (local) tax assessment rules and the profit according to (global) financial accounting rules must be eliminated (e.g., dividends, gains and losses from sales of participations). The minimum tax rate can be undercut by the amount of a carve-out. This carve-out considers personnel costs and depreciation on tangible assets in the state of the national company. According to the IF-Statement, the carve-out amounts to 5% (i.e., the deductible personnel expenses do not amount to 100% but to 105%). A higher carve-out is possible during a transitional period of 10 years. This instrument is intended to create incentives for companies with physical substance. The effectiveness of the carve-out according to the IF statement is limited. Intangible assets such as self-created product patents are not considered. This calls into question, for example, the measures implemented as part of the Swiss tax reform, to say the least. The STTR applies to payments based on a DTA (interest, royalties, and similar payments). It enables the source state to take countermeasures should the payments be taxed at below 9% in the recipient state. With the introduction of Tax Bill 17, the STTR should no longer represent a major obstacle for Switzerland.
Outlook	With the IF Statement of October 2021, which has now also been endorsed by countries such as Ireland, the OECD has taken a huge step forward in this project. It is not impossible that the reform will still fail, but it is now highly unlikely. At most, the US Congress can still seriously jeopardize the reform of the taxation of the digital economy, especially if no qualified majority can be found in Congress for the state treaty on Pillar 1. <u>Switzerland's international efforts in the coming months:</u> At the international level, Switzerland will need to ensure that its legitimate interests are considered in the coming months. Numerous important questions (ETR calculation, marketing, and distribution profits safe harbor, etc.) are still open, particularly regarding the technical details. These are decisive in determining how much Switzerland, as a typical domiciliary state

of large international companies, must surrender to market states. A market state may receive a significantly lower share of profits for taxation compared to the home state with its central R&D, management and other core functions that are indispensable for the success of the company. Especially in the case of traditional industrial groups that produce and sell high-quality goods, market states often already receive considerable compensation (e.g., pharmaceuticals). Significant additional compensation at the expense of the home state could lead to a situation where high expenditure in the education sector is no longer worthwhile. A reduction in education expenditure, particularly in the university sector, because it is not sufficiently rewarded in tax terms, would be disadvantageous in terms of solving global challenges (e.g., global warming, hunger, pandemics). It is also important to limit the administrative burden. Business expenditure to meet administrative tax requirements is and remains unproductive and should therefore be kept as low as possible. There is also considerable potential for improvement in measures to improve legal certainty.

Assessment of the consequences for Switzerland and further action:

The requirements of the OECD digital taxation project are not in Switzerland's interest. Pillar 1, for example, envisages a shift in the taxation of the profits of large, profitable groups to the sales states. The group companies that generate the highest value added are to relinquish the income. Switzerland is a business location where Swiss and foreign companies carry out activities with particularly high added value. As a result, Switzerland will have to relinquish significantly more tax substrate from domestic and foreign companies than other industrialized countries. At the same time, Switzerland is an insignificant sales market in global terms. It will therefore hardly be able to compensate for the shortfall in revenue described above with new tax substrate that it receives as a market state. Overall, Switzerland is therefore likely to be one of the losers in Pillar 1. This is likely to become even more pronounced from 2030, when the thresholds for redistribution will be significantly lowered.

The situation is similar for Pillar 2 (minimum taxation). Low taxes on profits are an important reason why international companies carry out activities with high value added and high profits in Switzerland. The low taxes partially compensate for the very high Swiss wages by international standards. If other countries succeed in achieving the OECD minimum tax rate of 15% through tax measures (e.g., patent box), Switzerland will lose the important locational advantage of taxes. It should be borne in mind that the OECD tax base will in all probability be broader than the current Swiss profit and capital tax base, i.e., the OECD tax rate of 15% corresponds to a Swiss tax rate of over 15%. If other countries also have lower wage and other costs than Switzerland, and if they grant additional non-fiscal incentives, Switzerland will probably have a much tougher time competing internationally as a business location. At risk are the particularly lucrative value-added activities (research, management, and other so-called principal functions). These activities are not only particularly lucrative for corporate profit taxes, but also for personal income taxes (taxation of employees).

Nevertheless, it is imperative that Switzerland adopts the requirements of the OECD digital taxation project. 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. If Switzerland did not implement the Pillar 1 requirements, Swiss companies would have to consider whether they could maintain their Swiss headquarters. In other words, Switzerland must now do everything in its power to implement the international requirements in good time (Pillar 1 by 2023 and Pillar 2 by 2024).

The effects of the OECD digital taxation in Switzerland are therefore greater than generally assumed. If Switzerland does not take countermeasures and invest the additional tax revenues from Pillar 2 (minimum taxation), it is likely to become massively less attractive.

The simplest countermeasure would, of course, be for those cantons that receive additional tax revenue from affected companies because of the OECD minimum taxation to simply refund the additional revenue "tel quel" to the companies concerned. This approach would even be required under Swiss constitutional law, as it would prevent companies affected by the OECD minimum taxation from being treated less favorably than other Swiss companies. However, such a refund is inadmissible under international law. Since only internationally permissible measures can be considered for the Swiss economy, which is very active internationally, the federal government and the cantons must find other instruments. Furthermore, they must ensure that only internationally permissible instruments are used by the authorities (control function).

One important area for Switzerland is research. The patent box, the generally low tax rates and the cantonal optional R&D deduction are tax measures that make a significant contribution to international companies carrying out significant research and development activities in Switzerland. Tax incentives for research in their current form will only be possible to a very limited extent in the future due to the OECD minimum taxation. Even in the Canton of Zurich, a patent box could in many cases lead to effective taxation that is too low. Therefore, the still permissible tax incentives for research must be adjusted so that they comply with the new international requirements. Permissible according to the OECD guidelines is an R&D subsidy that provides for a reduction in the amount of tax and is independent of the level of profit taxes (paras. 230ff. Blueprint II). To ensure that Switzerland does not lose ground internationally in terms of fiscal research promotion, OECD-compliant research promotion must be greatly expanded.

Numerous Swiss companies affected by the OECD minimum tax and large Swiss subsidiaries of foreign companies do not carry out research activities, but rather management, purchasing and other principal activities in Switzerland. Switzerland should also provide instruments for them so that they can continue their value-added activities here and continue to hand over substantial profits to the Swiss tax authorities.

The OECD's timetable for implementing the new requirements is extremely ambitious. Switzerland cannot therefore wait until the final details of the new requirements are known. It must start the legislative process 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 economy. For example, the EU will have prepared a detailed draft of an implementation directive on Pillar 2 by December 2021 and will submit it to the member states for approval.

Regarding the 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 regarding

	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 in favor of the Canton of Berne, for example, 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, particularly from a US tax perspective