SwissHoldings

Tax Department

As of : June 2022

Withholding Tax Reform

Current Status	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% has to be reclaimed via a laborious and lengthy procedure. The current legal situation and the insignificant Swiss capital market have forced the larger Swiss companies to raise outside capital abroad. For this purpose, the Swiss companies have to establish 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. The issuance of foreign bonds via foreign finance companies is becoming less and less accepted internationally (OECD BEPS). Individual countries perceive foreign finance companies with weak substance and view their guarantees with skepticism. It is to be expected that companies would have to strengthen the substance (personnel, functions, capital) within their foreign finance companies in the future. The Federal Council addressed this issue with the publication of the dispatch on the withholding tax reform on debt capital interest in April 2021. This essentially states that in order to strengthen the Swiss debt capital market, then the levying of withholding tax on Swiss bonds is to be waived. In addition, the turnover tax on domestic bonds will also be abolished. The National Council and Council of States clearly approved the bill in the final vote in the 2021 winter session. While the bill was basically uncontroversial among representatives of the conservative parties; it was rejected right to the end by the Greens and the Social Democratic Party. Following the parliamentary process, these parties launched a referendum, which was held on April 27, 2022. The Swiss electorate will vote on the bill on September 25, 2022. The withholding tax reform does not lead to any tax reductions for SwissHoldings member companies. It does, however, enable financing activities to be transferred to Switzerland from abroad; in particular from the Netherlands, Belgium and Luxembourg. The funds raised in Switzerland are then passed on by the Swiss company in the form of loans to the company's operating domestic and foreign subsidiaries. It goes without saying that there are definitely (taxable) profits associated with such activity. <u>The Stumbling Block of the Reform</u>: The first communication on the referendum shows that the safeguard function of the withholding tax will remain the main point of contention regarding the reform, as it was in parliament. During the consultation draft, the Federal Council presented a proposal, in addition to economic growth, would also provide for a marked improvement in tax protection and thus in the fight against tax evasion of capital income. At the same time, the proposal respected financial privacy and fiscal banking secrecy. Upon closer examination, however, it turned out that the proposal had

	significant technical flaws and loopholes. In addition, it would have entailed enormous processing costs.
Outlook	The elimination of withholding tax on debt financing activities is an important tax project for Switzerland as a business location. The reform is an opportunity to gain international attractiveness and to eliminate one of the most important disadvantages as a headquarters location. SwissHoldings emphatically supports the reform and will endeavor to communicate the advantages for the economy, but also for Switzerland as a whole, in the context of the vote. If the bill is approved in the referendum on September 25, 2022, it can hopefully enter into effect as early as January 1, 2023.

OECD/G20- Project on Taxation of Digitalized Economy

Current Status	The project for the taxation of the digitalized economy is based on two pillars and aims to adapt international corporate taxation. In Pillar 1, the hundred or so largest digital and other corporations, will pay tax on a larger share of their profits in the countries where they sell their products. This is done via the so-called Amount A. In Pillar 2, large corporations are to be subject to minimum taxation of 15% 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 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 October 14. In December 2021, the Pillar 2 Model Rules were published (Link Model Rules) and in mid-March 2022, the long-awaited commentary on the Model Rules was published (Link Commentary GloBE Rules). However, as there are still numerous open questions and no agreement has been reached in important areas by the countries involved. These differences of opinion and the numerous detailed technical questions are to be resolved by the so-called Implementation Framework by the end of 2022. Whether this will be achieved by the end of the year is now widely in doubt. Accordingly, it is assumed that the vast majority of countries will not bring the Pillar 2 rules into effect by 2023 but more likely the beginning of 2024. The work on the technical details of Pillar 1 is currently being sent out for consultation by the OECD in the form of building blocks without having an overall picture or being able to comment on one. From the company's point of view, some of the initial technical plans appear to be very difficult or even impossible to implement. Global tax reform was given a boost in 2020 by the new US administration, which is pushing ahead with US reform in parallel. As part of this, the Biden Administration wants to increase corporate taxes in the USA and eliminate some business-friendly special rules (Build Back Better Act [BBB]) in order to finance improvements to the US infrastructure and various new social projects. For the Biden Administration, global reform is likely to advance U.S. reform and steer it in the desired direction. For example, the U.S. has managed to eliminate the focus on digital corporations, which are important taxpayers for the U.S., from Amount A, and the digital service taxes planned

by many countries (e.g., EU Digital Levy) or already introduced must be abolished. However, it seems uncertain whether the necessary majorities will be found in the U.S. Congress for the Biden Administration's plans. While also unlikely that Pillar 1 will be approved, as the USA will probably be granted special rules for Pillar 2. With GILTI, for example, the U.S. is to be allowed to apply a different minimum tax calculation system with different rules (minimum tax rate, tax base, etc.), some aspects of which still have to be adjusted in the course of the above-mentioned U.S. reform. According to the IF statement, it is still open whether (a reformed) GILTI will ultimately be considered equivalent. Currently, there are certain question marks in this regard due to statements by Treasury Secretary Yellen (Yellen business tax credit statement). Until the US midterm elections in the fall, the corresponding work in Congress on the reform of GILTI is likely to remain blocked. Despite various problems in the USA - and certain problems in the EU as well (EU directive on minimum taxation) - minimum taxation is likely to be implemented globally in the end.

Implementation in Switzerland:

On January 12, 2022, the Federal Council had decided how it wants to implement the rules of the OECD digital taxation. The proposal was to amend the Federal Constitution to include a competence standard for both Pillar 1 and Pillar 2 of the OECD project. So that the OECD minimum taxation (Pillar 2) can be implemented as quickly as possible in the interests of the treasury and companies, while transitional provisions are to be enacted in the constitution. Based on these, the Federal Council will adopt a directly applicable transitional ordinance, which will apply throughout Switzerland from January 1, 2024. The ordinance is subsequently to be replaced by a federal law as part of the ordinary legislative procedure.

As the international timeframe (entry into effect 2023/2024) is extremely demanding for the democratically distinct Swiss legislative process, the Federal Council's plans include various additional acceleration measures. Thus, the consultation on the constitutional provision already started in March and lasted until April 20 **(link consultation response SwissHoldings)**. On June 23, the Federal Council will present the dispatch on the constitutional amendment to parliament. On June 27, the Committees for Economic Affairs and Taxation (WAK) of the Council of States started discussing the bill and held a hearing for this purpose. In the fall and winter session of 2022, the business will be dealt with and concluded by the federal councils. Finally, in June 2023, the mandatory referendum on the amendment of the Federal Constitution is to take place. In parallel to the constitutional referendum, the Federal Council is pressing ahead with work on the enactment of the Federal Council Ordinance on the Implementation of the OECD Minimum Tax. The consultation process is to be carried out in stages and will begin in August 2022. It is currently unclear how long this will take. If the constitutional amendment is approved by the Swiss electorate, the (final) Federal Council Ordinance should be issued in the second half of 2023 and come into effect on January 1, 2024.

In terms of content, the Federal Council's plans consider that the majority of the additional revenue from the OECD minimum taxation should go to the cantons (75% to the cantons, 25% to the Confederation). The cantons can decide sovereignly on their use of the funds. However, no comments can be made on the implementation of Pillar 1 at the present time.

Outlook

Within the IF Statement from October 2021, which has now been endorsed by countries such as Ireland. The OECD has taken a huge step forward in this project. Until recently, it seemed clear that the reform had overcome the main obstacles, that were primarily due to the latest developments in the USA. As a result, at the least a partial failure can no longer be ruled out. In any case, an agreement on Pillar 1 currently seems rather unlikely. For Pillar 2, at least a delay must be expected but it currently seems uncertain if a large number of countries will implement the IIR in 2023.

<u>Assessment of the Consequences for Switzerland and Further Action:</u>

Effects of Pillar 1: The requirements of the OECD's digital taxation project are not in Switzerland's interest. For example, Pillar 1 provides for a shift in the taxation of profits from large, profitable groups to the sales states. Those group companies that generate the highest value added, will be required to hand over the earnings. Switzerland is a business location where Swiss and foreign companies carry out activities with particularly high value added. 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 aforementioned revenue shortfall with the new tax substrate that it receives as a market state. Overall, Switzerland is therefore likely to be one of the losers in Pillar 1.

Effects of Pillar 2: 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 in international comparison. If other countries succeed in achieving the OECD's minimum tax rate of 15% with tax measures (e.g. patent box), Switzerland will lose the important location advantage for taxes. If other countries also have lower wages and other costs than Switzerland, in addition to whether 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 particularly lucrative not only for corporate profit taxes but also for personal income taxes (taxation of employees) and social security revenues (AHV, etc.).

Implementation is Required: Nevertheless, it is imperative that Switzerland adopts the requirements of the OECD's digital taxation project. For example, if Switzerland were to refuse to implement the minimum taxation requirements, this would do more harm than good to the Swiss Economy and the Swiss Treasury. The additional tax substrate from minimum taxation would simply move abroad instead of into Switzerland and Swiss companies would be exposed to constant conflicts with foreign tax authorities.

The impact of OECD's digital taxation on Switzerland is therefore greater than generally assumed. If Switzerland does not take countermeasures and invest the additional tax revenues from Pillar 2 (minimum taxation) in location measures, it is likely to become less attractive. For international acceptance, however, it must be ensured that the cantons do not simply refund the additional revenues "tel quel" to the affected companies. This would be required by Swiss Constitutional Law, in order to prevent companies affected by the OECD minimum taxation from being treated less favorably

	than other Swiss companies. Such a refund is inadmissible under International Law and would also not be recognized by the new global minimum tax system. Since only internationally permissible measures can be considered for the globally active Swiss economy, the cantons must find other means. Furthermore, they must ensure that only internationally permissible measures are actually used by the authorities (control function) methods. Furthermore, they must ensure that only internationally permissible instruments are actually used by the authorities (control function). Maintaining R&D Attractiveness: An important area for Switzerland is research. A patent box offers generally low tax rate and cantonal optional R&D deduction are tax measures that contribute substantially to international companies carrying out significant research and development activities in Switzerland. In the current iteration, tax incentives for research will only be possible to a very limited extent in the future due to the OECD's minimum taxation. Even in the Canton of Zurich, a patent box could in many cases lead to low effective taxation. Therefore, tax incentives for research should be adapted to meet the new international requirements. Permissible according to the OECD's guidelines is an R&D promotion that provides for a reduction of the tax amount and is independent of the amount of profit taxes (Art. 4.1.3 resp. definition "Qualified Refundable Tax Credit in Art. 10.1 of the Model Rules). In order to ensure that Switzerland does not lose ground internationally in terms of fiscal research promotion, OECD-compliant research promotion should be strongly expanded. Switzerland can learn a lot from other countries where such research funding is common practice (France, Austria, UK, etc.). Preservation of other Value-Added Activities: Many Swiss companies affected by the OECD's minimum tax and large Swiss subsidiaries of foreign companies do not carry out research activities but typically focus on management, purchasing and other principal activities in Switzerland. Switzerland should also provide tools for them to continue their value-added-intensive activities here, while continuing to pay substantial profit taxes to the Swiss Tax Authority. Regarding this situation, there are many interesting solutions that exist in other foreign countries, which the cantons should not reject per se. Aspects of Content: With regards to Swiss implementation, SwissHoldings is of the opinion that existing structures which have proven themselves over many years should not be adapted without necessity. Like the Federal Council, 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 Confederation exercises a supervisory function in the area of direct federal taxation. The cantons should therefore also be in the lead with regard to the minimum tax. The necessary cooperation between the cantons in the GloBE assessment should be ensured by a competence center. Since the defense of the assessments vis-à-vis other states is carried out by the Confederation (Federal Tax Administration or State Secretariat for International Financial Matters), the Confederation should also play an active role in the competence center. It is also important that the accounting specialists of the competence center start their work as early as possible in the beginning of 2023. In a recommended proposal, the Federal Council will suggest for the reasons of international acceptance, that minimum tax (supplementary tax) should be a Federal Tax; which is correct. However, this should not lead to adjusting the existing constitutional mechanisms and distribution keys. Such

	adjustments could very quickly bring unintended negative consequences and endanger the high profit tax revenues of the Federal Government. According to the existing system, the additional revenues from the supplementary tax clearly and exclusively belongs to the cantons and not to the Confederation. This distribution is also factually correct, since the cantons could set the tax rates in such a way that no supplementary taxes, apart from absolutely exceptional years, could accrue to the benefit of the Confederation. In this context, those cantons should receive the additional revenues from the minimum tax on a pro rata basis, especially whose companies have also paid into it (eg. polluter-pays distribution). Only in this way can the affected cantons introduce new location measures, thereby preserving jobs and tax substrate in Switzerland; while also persevering Switzerland's tax sovereignty. Redistributions between the cantons must take place via the inter-cantonal financial equalization system.The fact that the cantons, via the Conference of Finance Directors, have already declared in their consultation response that they would leave up to 25% of the supplementary tax to the Confederation. Moreover, it is regrettable that the Federal Council is adopting this proposal against this background and, in the medium to long term, dangerous for the Confederation's high profit tax revenues of currently CHF 12 billion. In general, the following aspects are central to Swiss implementation: • International acceptance • Simple legislative and administrative implementation • Securing the attractiveness of the cantons as business locations • Compliance with international timelines • High flexibility • Recognition of minimum taxation, particularly from a U.S. tax perspective