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Tax Department

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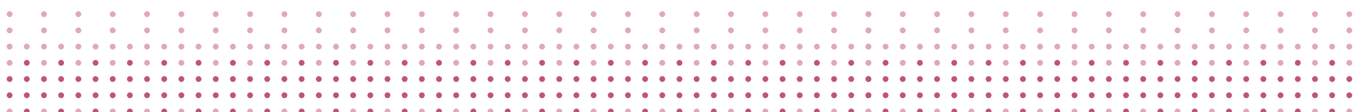
OECD/G20 Project on Taxation of the Digitalized Economy

Current Status	The project for the taxation of the digitalized economy is based on two pillars and aims to adapt international corporate taxation. Pillar 1, indicates that the roughly one hundred or so largest digital and varying 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, in which the largest 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 various policy parameters on the two pillars (IF Statement). These were officially endorsed by the G20 Finance Ministers on October 14. We have reported on the exact parameters in past updates (link past updates). In December 2021, the Pillar 2 Model Rules were published (Link Model Rules). In mid-March 2022, the Commentary to the Model Rules was published (Link Commentary GloBE Rules). As there are still numerous open questions and detailed technical questions needed to be answered by the Implementation Framework at the end of 2022. This deals with the design of the GloBE tax return, safe harbor rules, simplifications and the drafting of administrative instructions. Both the tax administrations of the numerous countries and the many companies affected are currently waiting anxiously for all the promised documents to be issued. In view of the delay, it is assumed that the vast majority of countries will not implement the Pillar 2 rules as early as 2023 (original implementation date), but only at the beginning of 2024. In spring/summer 2022, intensive work was also carried out on Pillar 1 and a public consultation was held on the implementation plans, which have not yet been completed (Progress Report on Amount A). From the company's point of view, some plans appear to be quite difficult to implement. For instance, a great deal of work is still required by the OECD in order to have a completed Pillar 1 implementation package that can be presented to countries in a multilateral convention for ratification by the first half of 2023. According to the current - extremely ambitious - timetable, which highlighted that a critical number of countries have signed and ratified the convention. Whereby, the additional taxation in favor of the sales countries will come into effect by 2024. However, there are considerable doubts about this implementation timetable by the OECD. Various circles even assume that Pillar 1 will not be implemented in the way currently envisaged for the foreseeable future.



Global Tax Reform was given a boost in 2020 by President Biden's US Administration, which is pushing ahead with US reform in parallel. As a result, 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. It was generally perceived that the U.S. and its corporations would be granted special rules under Pillar 2. Therefore, with GILTI, the U.S. would be allowed to apply a deviating minimum tax calculation system with different rules (minimum tax rate, tax base, etc.), which would still be aligned with the OECD GloBE system in the course of the above-mentioned U.S. reform (so-called GILTI equivalence). However, the Biden Administration plans were significantly modified by the US Congress. As a result, the rules adopted by the U.S. Congress, as part of the Inflation Reduction Act, provides for significant differences from the OECD's GloBE rules. For example, the (unchanged) U.S. GILTI minimum taxation rules for U.S. corporations continue to provide for global blending and not country-by-country blending when calculating compliance with the 15 percent minimum taxation. Also, the U.S. tax base differs substantially from the GloBE tax base, which is based on the requirements of international accounting standards such as IFRS. Against the background of these different rules between the USA and the rest of the world, it is currently unclear how a system of equal treatment can be created for US companies and companies from other countries (so-called GILTI equivalence). It also seems unlikely that the US Congress will approve Pillar 1 in the USA.

Not only in the USA, but also in the EU, the project to tax the digitalized economy is struggling with political difficulties. For example, Hungary continues to oppose ratification of the EU directive on minimum taxation, which must be approved by all EU member states. The directive was not even included on the agenda for the Ecofin meeting in early October. However, as early as September 9, five important EU member states (Joint Statement by F, D, I, NL, E) announced their intention to introduce minimum taxation unilaterally, even without an EU directive. Despite problems in the USA and also in the EU, the OECD minimum taxation is likely to be implemented by the vast majority of important jurisdictions at the beginning of 2024.

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.

In June, the Federal Council approved the dispatch on the constitutional amendment in Parliament. In contrast to the consultational draft, 25 percent of the supplementary tax revenue will go to the Federal Government. This is in line with a corresponding decision by the Conference of Cantonal Finance Directors. The cantons are free to decide on the use of any additional revenue.

On September 28, the Council of States dealt with the Federal Council's bill and passed it with only a minimal adjustment. In November, the Committee for Economic Affairs and Taxation (WAK) will deal with the bill, followed by the plenary session of the National Council in the winter session in

	December. The differences are also to be resolved during this winter session, after which the bill can be submitted to the Swiss electorate in June 2023. In parallel to the constitutional vote, the Federal Council is pressing ahead with the enactment of the Federal Council Ordinance on the Implementation of the OECD Minimum Tax. Since important procedural and implementation regulations have yet to be determined by the OECD's Implementation Framework, the consultation on the ordinance will be conducted in stages. In August, the Federal Council presented the first draft of the ordinance, which appears to be limited in two areas. In order to rule out differences in the Swiss implementation of the GloBE rules, the ordinance contains a direct reference to the OECD's Pillar 2 model rules. Furthermore, the draft ordinance regulates the distribution of the supplementary tax revenues between the cantons according to the source. The tax revenues from the Swiss supplementary tax are to be allocated to those cantons whose companies/business units have paid the supplementary tax. Cantons in which the business units already pay more than the minimum tax amount in the form of profit and capital taxes (which is why the business units have not paid any supplementary tax at all) will - in logical application of the polluter pays principle - not receive any share of the supplementary tax revenues. This does not apply to compensation for administrative tasks of a head office canton. When the Federal Council will present the second draft ordinance depends on the completion of the work of the Implementation Framework. In particular, the second draft ordinance will contain important procedural provisions. If the constitutional amendment is approved by the Swiss electorate, the (definitive) Federal Council ordinance should be issued in the second half of 2023 and put into effect on January 1, 2024.
Outlook	With the IF Statement of October 2021, the publication of the model rules, the commentary and the further implementation documents of the Implementation Framework are still expected in 2022. The OECD and G20 have reached all the milestones needed for the introduction of the global minimum tax from 2024. While the statement was supported by a large number of countries, uncertainty prevails as to how things will proceed in the USA with regards to the GILTI adjustment. Despite certain political obstacles, a failure of Pillar 2 can therefore be virtually ruled out. In the case of Pillar 1, on the other hand, further delays should be expected. These may well continue for several more years before a multilateral convention can be submitted for ratification. Important technical issues still need to be settled for Pillar 1. These issues have significant implications for the tax revenues of politically important industrialized countries. In any case, an agreement and ratification of Pillar 1 by a large number of important industrialized countries (especially the USA) currently appears uncertain. Assessment of the consequences for Switzerland and further action: 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 digital taxation on Switzerland is therefore greater than generally assumed. If Switzerland does not adapt to the changed location competition and uses new location measures such as those that have long been used by less attractive countries, the result is likely to be a considerable loss of revenue within a few years. However, for the Swiss economy, which is strongly internationally active, only internationally permissible measures come into question.

Maintaining R&D Attractiveness: An 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 contribute significantly 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 low effective taxation. Therefore, tax incentives for research should be adapted to meet the new international requirements. Permissible according to the OECD 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 intensive activities: Many Swiss companies affected by the OECD minimum tax and large Swiss subsidiaries of foreign companies do not engage in research activities, but in 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 pay substantial taxes on profits to the Swiss tax authorities. Here, too, interesting solutions exist in foreign countries.

With regard to Swiss implementation, SwissHoldings is of the opinion that existing structures that 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 head office canton should play an important role. It should have a certain lead function.

The necessary cooperation between the cantons in the GloBE assessment should be ensured by a new intercantonal body to be created. Since the defense of the assessments against 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 this body. It is also important that the accounting specialists of the Competence Center start their work as early as possible at the beginning of 2023. Close cooperation between the accounting specialists of the administration and the companies is also important. Particularly in the first years of the introduction of the OECD minimum taxation, there will probably be a lack of clear answers to numerous technical questions from the OECD experts. A close exchange between the administration and business should help to significantly reduce legal uncertainty.

In accordance with the existing tax provisions of the Federal Constitution, the additional revenues from the supplementary tax clearly and exclusively belong to the cantons and not to the Confederation (Art. 128 para. 1 let. b BV). This distribution is also factually correct, since the cantons could set the tax rates in such a way that there would be no Swiss supplementary taxes at all: apart from absolutely exceptional years,. Nevertheless, the Conference of Cantonal Finance Directors has decided to allocate a quarter of the supplementary tax revenues to the Confederation. The Federal Council has adopted this distribution and included it in the message on the constitutional amendment. The Council of States also supports this distribution (decision of September 28). However, in view of the discussion in the National Council, voices are currently being raised that would like to allocate a higher share to the Confederation. However, such an allocation would be financially counterproductive for the Confederation. The same applies to the NFA beneficiary cantons. Financially, the Federal Government is the biggest beneficiary of the cantons' efforts to attract the best taxpayers internationally with particularly high employee salaries (income taxes). As a result, profit tax revenues have increased by 550 percent since 1993 to more than CHF 12 billion. Attractive profit tax rates in the cantons are a particularly important reason for this. For example, up to two-thirds of a profit tax franc that accrues in a tax-attractive canton goes directly to the Federal Government. In about 2/3 of the cantons, at least half of the profit tax revenue goes directly to the Federal Government. The OECD minimum taxation will lead to a paradigm shift in the location competition of the states for the most profitable corporate functions. The profit tax factor will lose importance and tax competition will decrease. Numerous cantons will thus partially lose one of their most important locational advantages. The vast majority of cantons will therefore be dependent on supplementary tax revenues to restore their attractiveness to their best taxpayers and employers and to create new locational advantages. If the cantons succeed in this, profit tax revenues will continue to bubble up in the future. In financial terms, the biggest profit driver of successful cantons will continue to be the Federal Government. Therefore, the National Council should absolutely respect the compromise of the cantonal finance directors and under no circumstances allocate more than 25 percent of the supplementary tax revenues to the Federal Government. If the National Council decides on a higher share of supplementary taxes, it will in fact punish the economically successful cantons and reduce their motivation to attract the best taxpayers. Many cantons are unlikely to put up with this

	and will adapt their tax system so that there are no more Swiss supplementary taxes at all and the Federal Government comes away completely empty-handed. Instead of additional revenues, the Federal Government is likely to see billions in revenue shortfalls after just a few years. SwissHoldings is therefore of the opinion that short-term additional revenues from the supplementary tax should not tempt the Federal Government to jeopardize Switzerland's long-term financial success factors. 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