Tax Department

As of April 2023

OECD/G20 Project on Taxation of the Digitalized Economy

Current Status	The project for taxing the digitalized economy is based on two pillars, intended to improve the acceptance of international corporate taxation. Pillar 1 provides for the largest international corporations, numbering around 100, to pay a higher proportion of their profits in the countries where they sell their products. The focus is on digital corporations, such as Google, Facebook, and Apple, some of which pay hardly any tax on profits in their home countries. However, a large number of traditional industrial companies are also affected, as they already pay high taxes in their home countries, with corporate tax rates of 25 to 30 percent. Project Pillar 2, the OECD minimum tax, requires large companies (with a minimum of EUR 750 million in sales) to pay at least 15 percent tax on their profits in all their countries of operation, using country-by-country blending. The determination of profits is not based on the strongly diverging tax regulations of individual countries, but on international accounting standards (e.g., IFRS, US GAAP, etc.), as the differences in the determination of profits are much smaller in these due to the so-called "true and fair view principle." Additionally, the new international set of rules (called GloBE rules) provides for various corrections, such as for investments or deferred taxes. If a state does not implement the new minimum taxation rules, the state of the parent company or subsidiaries, as the case may be, may tax the difference between the effective tax rate and the minimum tax rate reported by the company for a particular state. The work on the project to tax the digitized economy is being carried out by the OECD Secretariat on behalf of the G7 and G20, with administrative representatives of the involved countries involved in the development of the new rules. The new tax rules will be formally adopted by the "OECD/G20 Inclusive Framework on BEPS" (IF), comprising 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, 2021. We have also 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 GloBE Model Rules was published (Link Commentary GloBE Rules). There are still a large number of open application questions and detailed technical specifications that are to be issued by the so-called Implementation Framework as part of the Administrative Guidance. A first part of these guidelines were published in

December 2022 and February 2023 (link Administrative Guidance). Of particular importance were the requirements for the transitional safe harbors, which should somewhat reduce the enormous administrative burden on the companies concerned in the initial years (2024 - 2026). However, many important specifications are still outstanding and are not expected to be complete until late 2023. Both the tax administrations of numerous countries and the many affected companies are eagerly awaiting the issuance of all the promised documents.

In 2022 and early 2023, intensive work was also carried out on Pillar 1, and a public consultation was held on the implementation plans, which are not yet complete (Progress Report on Amount A). From the company's point of view, some of the plans appear to be difficult to implement, and a lot of work will still have to be done by the OECD so that a finished Pillar 1 implementation package can actually be presented to the countries at the end of May in the form of a multilateral convention for signing (from July 2023) and subsequent ratification. For Pillar 1 to be implemented globally at all, a critical mass of states must ratify the multilateral convention. The deciding factor will be whether the U.S. agrees to ratify the convention. Half of the companies affected by Pillar 1 have their headquarters in the USA. Without US ratification, the planned redistribution from headquarters to market states cannot be implemented. Ratification requires a 2/3 majority in the US Senate. However, there is strong opposition from both Republicans and Democrats. Experts, therefore, believe that Pillar 1 will never find a political majority in the USA.

Minimum Tax Developments in the USA:

The project to tax the digitized economy was given a boost in 2020 by the Administration of U.S. President Biden, which was pushing ahead with U.S. reform in parallel. As part of this, the Biden Administration sought to increase corporate taxes in the U.S. and eliminate some business-friendly special rules (Build Back Better Act [BBB]) in order to finance improvements to the U.S. infrastructure and various new social projects. Since the Biden Administration supported the introduction of global tax reform, it was envisaged that the U.S. and its corporations would be granted special rules under Pillar 2. Thus, with GILTI, the U.S. was to be allowed to apply a deviating minimum tax calculation system with different rules (minimum tax rate, tax base, etc.), which, however, was still to be aligned with the OECD GloBE system in the course of the above-mentioned U.S. reform (so-called GILTI equivalence).

However, the plans of the Biden Administration were subsequently significantly modified by the US Congress. As a result, the rules adopted by the U.S. Congress as part of the Inflation Reduction Act provide 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 in 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 in the USA and the rest of the world, how a system of equal footing can be created for US companies and companies from other countries (so-called GILTI equivalence) currently appears unclear. The OECD has published rules as part of its recently published Administrative Guidance. It is currently unclear whether these will actually be accepted by the USA.

Minimum Tax Developments in the EU:

The project to tax the digitized economy faced political difficulties not only in the USA but also in the EU until late fall 2022. For instance, as of the beginning of December, Hungary opposed the ratification of the EU directive on minimum taxation that required approval from all EU member states. However, the EU Commission succeeded in partially resolving differences of opinion with Hungary as part of an overall solution to various proposals. Thereafter, the directive on minimum taxation could be unanimously adopted by written procedure on December 15, 2022 (link media release). Thus, the 27 EU member states committed themselves to implementing the OECD minimum taxation at the beginning of 2024. This example will likely be followed by many other industrialized countries (e.g., UK, Canada, Japan, Korea) and other states. Despite the aforementioned problems in the USA, it should be assumed that the OECD minimum taxation will be implemented by the vast majority of important jurisdictions at the beginning of 2024.

Implementation in Switzerland:

On January 12, 2022, the Federal Council 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. To enable the implementation of the OECD minimum taxation (pillar 2) quickly in the interests of the treasury and companies, transitional provisions are to be enacted in the constitution. Based on these, the Federal Council will adopt a directly applicable transitional ordinance that will apply throughout Switzerland from January 1, 2024. The ordinance will be replaced later by a Federal law as part of the ordinary legislative procedure.

In June 2022, the Federal Council adopted the dispatch on the constitutional amendment to Parliament. In contrast to the consultation draft, the dispatch provided for 25 percent of the supplementary tax revenue to go to the Confederation. This was in line with a corresponding compromise decision by the Conference of Cantonal Finance Directors. The FTA estimated the amount of the supplementary taxes at between CHF 1 billion and CHF 2.5 billion, but it correctly pointed out on several occasions that the estimate was highly uncertain.

The provisional distribution of the supplementary taxes between the cantons and the Confederation provided for in the transitional provisions was mainly disputed in the Federal Councils. While the Council of States opted for a 75/25 percent distribution, the National Council initially decided on a 50/50 distribution. However, this was corrected during the differences revision, which also took place in the winter session. On December 6, 2022, a majority of the National Council also opted for the 75/25 distribution. The bill was then submitted to Swiss voters on June 18, 2023, after the final vote took place on December 16, 2022. How the cantons use any additional revenue from the supplementary tax will be determined at a later date, depending on the level of expected revenue and the cantonal targets. More clarity on the actual revenues will likely only be available in the course of 2025.

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 2022, the Federal Council presented the first draft ordinance, which is currently limited to two areas. 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. Additionally, the draft ordinance regulates the distribution of supplementary tax revenues between cantons according to the source. The tax revenues from the Swiss supplementary tax are to be allocated to the cantons whose companies or business units have paid the supplementary tax.

The Federal Council is expected to present the second partial draft of the ordinance in May 2023. Due to delays in the Implementation Framework, a third partial draft may also be necessary. The second draft ordinance will contain important procedural provisions in particular. If the constitutional amendment is approved by Swiss voters on June 18, the final and complete Federal Council Ordinance should be issued towards the end of 2023 and enter into effect on January 1, 2024.

Outlook

With the endorsement of the IF Statement by a vast number of countries in October 2021 and the publication of the GloBE Model Rules, Commentary, and other implementation documents of the Implementation Framework expected in 2023, the OECD and G20 have accomplished the most significant milestones for the introduction of the global minimum tax starting from 2024. Despite some political obstacles, the failure of Pillar 2 can be almost ruled out. However, the opposite is true for Pillar 1. Although the technical work is progressing, and the multilateral convention could even be in place by May

2023, ratification by the USA appears to be virtually impossible. Without the USA's ratification, the convention cannot enter into effect.

Assessment of the consequences for Switzerland and further action:

Effects of Pillar 1: The requirements of the OECD digital taxation project are not in Switzerland's interest. For instance, Pillar 1 envisages shifting the taxation of profits from large, profitable groups to the sales states. Those group companies that generate particularly high residual profits are to surrender the earnings. Switzerland is a business location where Swiss and foreign companies carry out activities with particularly high added value and generate high residual profits. Consequently, Switzerland will have to surrender 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. Therefore, Switzerland will not be able to compensate for the aforementioned revenue shortfall with the new tax substrate that it receives as a market state. Overall, Switzerland would 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 Switzerland has to increase its profit taxes to 15% due to the minimum tax, and other countries also succeed in reaching the OECD minimum tax rate of 15% with OECD-compliant tax measures (e.g., patent box), Switzerland will lose the critical location advantage of taxes. If other countries also have lower wages and other costs than Switzerland and grant non-fiscal incentives, Switzerland will have a much harder time competing internationally as a business location in the future. Particularly lucrative and value-added activities (research, management, and other so-called principal functions) are at risk. These activities are particularly profitable not only for corporate profit taxes but also for personal income taxes (taxation of employees) and social security revenues (AHV, etc.).

Nevertheless, it is imperative that Switzerland adopts the requirements of the OECD digital taxation project and implements the minimum taxation at the beginning of 2024. If Switzerland were to refuse to implement the minimum taxation, it would do more harm than good to the Swiss economy and the Swiss Treasury. The additional tax substrate from the minimum taxation would simply flow abroad instead of into Switzerland, and Swiss companies would be exposed to 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, it risks having to record 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.

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. Therefore, the cantons should also be in the lead regarding the minimum tax. The head office canton should play an important role. It should have a certain lead function.

The necessary cooperation between cantons in the GloBE assessment must be ensured by an intercantonal body. The Federal Government and cantons have already taken action in this regard. The Minimum Tax Working Group has begun its work under the umbrella of the Swiss Tax Conference. The Federal and cantonal working group will play a crucial role in ensuring uniform and accurate assessment throughout Switzerland. Companies concerned appreciate the fact that the working group is already active and dealing with specific technical issues. Many implementation issues will arise for the companies and authorities in the coming months until the end of 2024. If the authorities were to deal with technical questions from affected companies only in mid-2026, there would be an acute risk of numerous implementation errors. Close cooperation between the accounting specialists of the administration and those of the companies is also crucial. Especially in the first years of the introduction of the OECD minimum taxation, clear answers to numerous technical questions are likely to be lacking from the OECD experts. A close exchange between the administration and the business community should help significantly reduce legal uncertainty.

SwissHoldings firmly believes that a 75/25 distribution will result in the highest additional revenues for the Confederation and the NFA-beneficiary cantons. If a higher federal share of the supplementary taxes were decided, the motivation of economically successful cantons to attract the best taxpayers would be reduced. The cantons would have to consider or be forced to increase their profit tax rates to retain the necessary 15% minimum tax themselves. This would be worthwhile for the cantons, insofar as they would have sufficient resources to survive in the new competition between locations. However, this would mean that there would be no more Swiss supplementary taxes, and the Federal Government would come away empty-handed. At the same time, such tax increases would hit a large number of companies that are not even within the scope of the OECD minimum taxation or would not have to pay any supplementary tax due to the different tax base. Even if the cantons decide not to adjust their taxes, the Federal Government risks losing revenue after only a few years due to the decreasing attractiveness of the location.

With a 50/50 split, the Confederation would, therefore, risk a financially counterproductive situation. The same applies to the NFA beneficiary cantons. Financially, the Confederation is the biggest beneficiary of the cantons' efforts to attract the best taxpayers internationally, with particularly high employee salaries (income taxes). Of a profit tax franc that accrues in a tax-attractive canton, about 60 percent goes directly to the Federal Government. In 2/3 of the cantons, about half of the profit tax revenue goes directly to the Federal Government. Tax competition pays off: the Federal Government's profit tax revenues have increased by 550 percent since 1993 to more than CHF 12 billion. Attractive profit tax rates of the cantons are a particularly important reason for this.

The OECD minimum taxation will lead to a paradigm shift in the location competition between countries for the most profitable corporate functions. The profit tax factor will lose importance and tax competition will decrease. Numerous cantons will thus partially or largely lose one of their most important locational advantages. In financial terms, the biggest losers - without countermeasures - are likely to be the cantons of Zug and Basel-Stadt. However, more rural cantons are also at risk, as the loss of taxes as a location factor is likely to be particularly drastic for these cantons. The Canton of Zurich is likely to become more attractive, thanks in particular to the Federally funded ETH. Immigration pressure to attractive urban centers such as Zurich or Lausanne is likely to increase without countermeasures by rural cantons. Therefore, the vast majority of cantons will have to rely on supplementary tax revenues to restore their attractiveness to their best taxpayers and employers elsewhere. If the cantons succeed in this, profit tax revenues will continue to bubble up in the future. Financially, the biggest beneficiary of successful cantons will continue to be the Federal Government.

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