SwissHoldings

Tax Department

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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 reported on the exact parameters in past updates (link past updates). Pillar 2 (OECD minimum tax) 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). As there are still a large number of open application questions, detailed technical specifications are to be issued by the so-called Implementation Framework as part of the

Administrative Guidance. A first part of these guidelines was 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 into 2023. Both the tax administrations of the 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 countries must ratify the multilateral convention. The deciding factor will be whether the U.S. decides 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:

After the publication of the additional guidance on the OECD model rules in February 2023 and the US House of Representatives changing to a Republican majority after the midterm elections in fall 2022, the negative rhetoric against Pillar 2 has increased in the US. In particular, concerns over the UTPR have become a key point of criticism, with Republican House and Senate members issuing several letters and op-eds calling for a significant overhaul of the UTPR mechanism and threatening retaliation if those changes do not happen. In May, every Republican on the House tax-writing committee released legislation that would impose additional tax on individuals and companies residing in countries that implement the UTPR. House Republicans have also proposed to completely eliminate OECD funding due to their involvement in crafting the problematic Pillar Two rules as part of their Fiscal Year 2023-2024 government spending legislation. It remains unlikely that this retaliatory legislation or a complete elimination of OECD funding will pass this Congress, but it forbodes what could happen if a Republicans were to win a majority in both chambers of Congress and the Presidency in the 2024 US elections. Currently, there are clear tensions with the Democrat administration which negotiates in the OECD discussions.

Adding to those tensions over the UTPR, the Congressional Joint Committee on Taxation calculated the impact of Pillar Two under various scenarios and showed that if all remaining Inclusive Framework countries enacted the Pillar Two rules in 2024 while the US enacted in 2025 (the most likely timeframe for US action), there would be revenue losses of nearly $60 billion over a 10-year period for the US. The Joint Committee also made clear that those revenue losses could be more than double that amount if the US did not enact every element of Pillar Two or if the US tried to replace existing elements of their tax code such as the Corporate Alternative

Minimum Tax (CAMT) or the Base Erosion and Anti-Abuse Tax (BEAT) with the overlapping policies from Pillar Two. Congressional Republicans, and potentially even some Congressional Democrats, took this official revenue estimate from the Joint Committee as another sign that the U.S. Treasury negotiated poorly at the OECD over Pillar Two, managing to give away a sizable portion of the U.S. tax base as a result of these policies. This revenue loss may embolden Congress in seeking further changes or delays to the Pillar Two rules.

Minimum Tax Developments in the EU

Not only in the USA, but also in the EU, the project to tax the digitized economy struggled with political difficulties until late fall 2022. For example, as recently as the beginning of December, Hungary opposed the ratification of the EU directive on minimum taxation, which must be approved by 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 have committed themselves to implement the OECD minimum taxation at the beginning of 2024. This example will probably be followed by a large number of other industrialized countries (e.g. UK, Canada, Japan, Korea) and other states. Despite the aforementioned problems in the USA, it should therefore 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. The publication of the GloBE Model Rules, Commentary, and other implementation documents of the Implementation Framework expected in 2023; as well as the implementation laws at the decision-making stage in many countries, it is clear that the OECD minimum tax will be introduced by a large number of countries from 2024. The situation is currently exactly the opposite for Pillar 1. While the technical work will soon be completed and the IF is expected to present and adopt the multilateral convention in July '23, ratification by the U.S. seems politically unlikely in the foreseeable future. The EU, Switzerland and even the USA are likely to sign the multilateral convention. Without ratification by the USA, however, the convention cannot enter into force and redistribution can begin. <u>Assessment of the Consequences for Switzerland and Further Action:</u> 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.).

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). To ensure that Switzerland does not lose ground internationally in terms of tax incentives for research, it is advisable to examine OECD-compliant research incentives in detail. Switzerland can learn a lot from other countries where such research promotion is common practice, such as (France, Austria, UK, etc.). At the same time, the cantons should use their funds in a more focused and budgetary manner. The goal of research promotion is to attract attractive business activities that are associated with high profits and tax revenues. In doing so, the cantons should not require companies to carry out all R&D&I activities in Switzerland, which is expensive in terms of wages. It is much more important that the central management activities are carried out here and that the intangible assets are located in Switzerland. In addition to R&D&I, the cantons will have to examine whether they want to specifically promote other activities with high added value. As long as they find internationally admissible instruments for this, which needs to be targeted, the cantons are economical with their funds and additional revenues result; such instruments should be seriously examined.

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. 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