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Taxation Department

Withholding Tax Reform

Current status	With the withholding tax reform, the Federal Council wants to strengthen the Swiss debt capital market and encourage Swiss groups (as well as foreign groups with important activities in Switzerland) to issue their bonds here if possible. In addition, these groups should greatly reduce their foreign financing structures and carry out their corresponding activities in Switzerland. According to the Federal Department of Finance, the reform has an "extremely advantageous cost-benefit ratio". As a precaution, the Federal Department of Finance estimates the cost of the reform at CHF 200 million. After the Federal Council approved the parameters of the withholding tax reform in June and September 2019, the consultation process was launched at the beginning of April 2020. The draft contains widely accepted elements, such as the change to the paying agent principle for directly held Swiss bonds and other Swiss interest-bearing products. Resistance comes from the financial sector regarding the proposal on foreign funds and foreign structured products Also for these products the Federal Council suggests implementing a tax deduction on interest income. The banks responded that they would not be able to make a day-to-day deduction for these products without timely information and/or a payment. In other words, they would not be able to implement the requirements of the Federal Council on many of those foreign products. Nor could the Swiss legislator require foreign funds to provide the necessary information in good time. The banks prefer a low-cost solution where as many paying agent functions as possible can be transferred to the custodian of securities and funds (e.g. SIX Group). Where this is not possible, the legislator should either accept a loophole in tax security or accept a reporting procedure limited to these foreign products. Without adjustments to foreign interest-bearing products, there is a considerable risk the withholding tax reform could fail. From an industrial perspective, reform failure must be prevented. On February 11th, the OECD adopted new transfer pricing guidelines for financial transactions. The new guidelines deal with intra-group financing (guidelines for intra-group loans, cash pools, etc.). If Swiss groups are to be able to comply with the new guidelines, they must be able to carry out all their financing and issue their bonds from Switzerland (to the benefit of the Swiss tax authorities). The outdated withholding tax, which is detrimental to industry, banks and the tax authorities in the field of debt capital, must now be adjusted immediately. Without reform, companies will be forced to significantly strengthen their financing structures abroad with staff and functions. If the reform is successful, the Swiss tax authorities will be able to collect additional revenues from our companies. The new OECD guidelines also helps ensure the Federal Council achieve its aforementioned goals. If the withholding tax reform fails, however, reduced revenues for the Swiss tax authorities and job

	relocations abroad are inevitable. In the future, enterprises will want to carry out their financing at the (Swiss) company headquarters or at the headquarters of the Swiss principal, where they can most easily comply with the new OECD guidelines. Companies with numerous corporate functions are ideal. In many cases, these have investments in subsidiaries and are dependent on a well-functioning participation deduction. It is precisely here that the Swiss participation deduction has shortcomings in an international comparison. These deficiencies lead to double taxation (which the participation deduction should be avoided). Due to the uncertainty about the financial consequences for SMEs, the Federal Council, in its benchmark decision of September 2019, rejected our request to slightly adjust the participation deduction and to eliminate the double taxation that arises in connection with financing activities. Amid the new OECD guidelines, this decision is regrettable.
Outlook	The elimination of withholding tax obstacles for debt financing activities remains the most important purely domestic tax project for member companies in the midst of the AHV tax bill. Due to the new OECD transfer pricing guidelines, the importance and urgency of the reform has significantly increased for Swiss groups. For SwissHoldings, it is therefore crucial that failure of the withholding tax reform is avoided and that the reform is rapidly pushed forward. In order for the reform to succeed and to avoid protracted disputes, it is important that the business community adopts similar positions that are politically acceptable to a majority. If the various business sectors have different views (loophhole or reporting procedure for foreign interest-bearing securities), the Federal Council should, nevertheless, move forward with the reform and submit sensitive topics to the Federal Assembly for decisions. SwissHoldings will work within the consultation process framework in order to ensure that business is as united as possible. To secure a political majority, a reporting procedure must be limited to those areas where a tax deduction by the paying agent (bank) would entail high costs (foreign funds, structured products, and possibly also foreign bonds). A complete tax protection system is likely to have better chances politically than a system with loopholes. Nevertheless, the business community must also acknowledge this possibility. Since the automatic exchange of banking information (AEI) with foreign countries often provides data that is difficult to use, a Swiss reporting procedure must function better than the AEI (promotion of e-securities project of banks, FTA and cantons). SH will proceed to ensure the Federal Council may submit a politically widely supported dispatch to parliament in winter 2020/21. However, the corona measures could delay the timetable.

OECD/G20 project on taxation of the digital economy

Current status	The project on the taxation of the digitalized economy of the "OECD/G20 Inclusive Framework on BEPS" (IF), which comprises around 140 states, is currently in a critical phase: both at the political and technical level. The IF states are still far from an anticipated consensus solution. In order to find a political compromise, various European states proposed to the USA due to the corona pandemic that the scope of Pillar 1 should initially be limited to "automated digital services". The "consumer facing businesses" were only to be included

later in the process of redistributing profit tax to the market states. After all, the digital companies had even benefited economically from the lockdown. Not surprisingly, the USA, where digital companies are important taxpayers, did not agree with this proposal. In a letter dated 12 June, the USA declared that it wanted to take a temporary break in the Pillar 1 project work (see appendix) in order to be able to focus on the serious economic consequences of the corona epidemic. At the same time, they warned other countries against introducing Digital Services Taxes, as such taxes would lead to countermeasures by the USA.

With regard to Pillar 2 (minimum taxation), the USA in its letter was optimistic that a global agreement could be reached by the end of the year. However, the US is demanding that its GILTI regulations be considered as equivalent. The emerging countries in particular, which were particularly committed to Pillar 1, are likely to find it difficult that the USA can continue to apply GILTI while the rest of the world has to apply the stricter GLOBE rules. GILTI is based on the more business-friendly global blending (i.e. the global average of tax rates), while GLOBE will be subject to the stricter jurisdictional blending (average tax rate per country). Not surprisingly, China as another major power, has expressed considerable difficulty with the proposed Pillar 2 requirements. Work on this pillar is being driven in particular by Germany and France. However, Europe (and Switzerland in particular) should be careful not to create competitive tax disadvantages for its companies.

In response to the US letter, the OECD stated that project work on both Pillars would continue in accordance with the IF mandate. The results of this work will be reviewed by the IF in October 2020. Given that the US temporarily withdrew from the work on Pillar 1, making a decision on this in October 2020 seems unrealistic. It is generally assumed that the OECD will focus on the work on Pillar 2. The aim is for the IF to make a decision on this in October 2020.

If and when work on Pillar 1 will continue, cannot be assessed at this time. SwissHoldings assumes that this technically enormously demanding work will only be properly resumed after the US presidential elections. What both pillars have in common is that their enactment is likely to take at least another four to five years until the necessary adaptation of numerous DTTs has gone through the legal process.

The negotiations are also challenging at the technical level:
With regard to the Unified Approach on Pillar 1 (the redistribution of income tax revenues from the resident state to the market states), the IF adopted an overview of the architecture at the end of January.

Amount A: According to the overview, under the Unified Approach, certain large companies (turnover >750 million euros) should transfer an additional part of their profits to the market states for taxation: (i) companies that provide automated digitized services (ii) companies that (directly or indirectly) sell consumer-facing goods and services. The share of profits for the market states, called "Amount A", is determined according to a fixed formula. If, according to accounting principles, the consolidated profit exceeds the level of routine profits (e.g. 10% return on sales), the market state is entitled to a fixed share (e.g. 20%) of the residual profit in excess of this amount. Amount A is therefore only owed if the group achieves particularly high margins. It is planned to explicitly exclude various economic sectors from Amount A (e.g.

extracting industry, financial sector).

Amount B: In addition to Amount A, Pillar 1 is intended to achieve compensation standardization of market states for basic sales activities (LRD). Market states are more and more aggressive in this area, which ties up additional resources (personnel, capital, time spent on APAs and MAPs, etc.) for many companies. For Amount B, simple formulas should be developed (possibly differentiated by region or industrial sector) that would replace the current company-specific compensation.

Amount C: If the functions performed in the market state (although it is still unclear whether this applies only to additional sales activities or also to non-sales functions) exceed the level for Amount B, the market state can demand compensation for the additional functions as "Amount C".

The OECD faces major challenges in determining the proportion of corporate profits that forms the basis for Amount A and in designing a mechanism to prevent double taxation through the three amounts A, B, and C. A kind of "ruling process" is being developed where, in addition to the resident country, a limited number of market countries must give their approval of the basis for calculating the amounts in a timely manner. If they agree to the distribution of the consolidated profit between the resident state and the market states (and thus also which state receives tax revenues and which loses tax revenues), this result should apply to all states concerned. Whether e.g. India with its all-powerful courts can agree to such a procedure remains to be seen. At the end of January, the IF adopted an update report on the activities of Pillar 2 concerning the introduction of global minimum taxation rules (Global Anti-Base Erosion Proposal GloBE). Since then, the OECD has continued to intensively work on the design of the GloBE - despite the corona crisis - although major technical challenges remain to be solved in this area and numerous countries oppose the introduction of minimum taxation rules. For Switzerland (and other countries in a similar position), a global minimum tax rate must be moderate. The USA does not appear to have any fundamental objections to the introduction of global minimum taxation rules. However, the USA is demanding that they be allowed to continue to apply their GILTI rules. This means that two standards should apply in pillar 2 - GILTI for US groups and GloBE for all other groups. In other words, non-US groups in all countries must prove that they comply with the global minimum tax rate of - often quoted - 11-13%. For US groups, it is sufficient that they comply with the GILTI minimum tax rate (13.1% and 16.4% from 2026) overall. Even though the OECD claims the opposite, it is like comparing apples to oranges.

The minimum taxation rules should only affect companies with an annual turnover of EUR 750 million or more (CbCR requirements). The minimum tax rate will continue to be calculated using trustworthy accounting standards such as IFRS or US-GAAP and not on the basis of widely differing and country-specific tax assessment rules. Lower standards such as Swiss GAAP FER will not be recognized and will have to pass equivalence tests on a regular basis. In which cases deviations from the results of the accounting standards are necessary and how to proceed technically (e.g. how to break down the global consolidated financial statements to countries) is still a controversial issue. Taxation on capital should be taken into account when calculating the minimum tax rate, but this is disputed. The question of carve-outs (circumstances that entitle the company to fall below the minimum tax rate) is also highly

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	controversial. While the chances for R&D carve-outs (IP box) are apparently poor, other exceptions could find a majority.
Outlook	The Swiss economy and Switzerland have no interest in the failure of the project to tax the digital economy. We are dependent on our companies being able to supply their products and services to a large number of countries with as few restrictions as possible. If the project fails, the introduction of Digital Service Taxes and/or unilateral minimum taxation rules - possibly by withholding taxes - is threatened in a large number of countries. The Digital Service Taxes, which differ greatly in material terms, will initially affect primarily the US digital companies and the USA. The USA - whoever wins the US presidential election - will not tolerate this and will take countermeasures. These could have a considerable impact on global trade and make it impossible for the Swiss economy to overcome the corona recession quickly. Therefore, for Switzerland, it is important to limit the scope of debilitating new rules as much as possible and to quickly adapt to the new rules and look for new opportunities. In other words, we must act similar to the BEPS project, which was completed in 2015. However, we should be given less time to make decisions. Thanks to the AHV tax reform with the special new measures (patent box, input deduction) and the parallel cantonal profit tax cuts, the BEPS project has brought Switzerland more advantages than disadvantages. For Pillar 2 work, it is crucial that the minimum tax rate is moderate. If US companies are allowed to apply GILTI (tax rate 13.125%), the GloBE minimum tax rate may not exceed 10%. Therefore, global blending must also be applied under the GloBE approach. If a higher minimum tax rate than 10% is adopted despite jurisdictional blending, carve-outs are important. From the companies perspective, the administrative effort is also central. For companies, jurisdictional blending is much more costly than global blending. "White lists" are helpful in this context. If a state can prove that it is not possible for its companies to comply with the minimum tax rate, then all its companies should belong on the white list. Instead of numerous exceptions, average tax rates (e.g. from the last 5 years) should be used more often. This also reduces the administrative burden for the companies. Should the IF States adopt a decision on Pillar 2, Switzerland should consider a voluntary supplementary taxation for Swiss groups. This is to prevent possible withholding taxes or non-deductibility for tax purposes of payments from permanent establishments to Switzerland. Depending on how the minimum tax rate is calculated, it may be necessary to analyze which taxes in Switzerland are included in the calculation and which are not, in order to make adjustments where necessary. Given the importance of the project for the member companies and Switzerland, SwissHoldings continues to actively support the project work. Should the OECD organize hearings, SwissHoldings will actively participate.