SwissHoldings

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, the groups should reduce their foreign financing structures as much as possible and carry out the corresponding activities in Switzerland. According to the Federal Department of Finance, the reform has an "extremely advantageous cost-benefit ratio". Studies commissioned by the federal government promise not only advantages for the business location, but also substantial additional revenues for the Swiss tax authorities. The withholding tax reform is limited to the area of interest on debt capital. The withholding tax on dividends (equity capital), which is responsible for more than 98 percent of the withholding tax revenues (in 2019 without provisions), which now amount to almost 10 billion Swiss francs, remains unaffected by the reform. From April to mid-July, the Federal Council conducted the consultation process on the withholding tax reform. The bill contained widely accepted elements such as the goal of strengthening the Swiss capital market. The change from the debtor principle to the paying agent principle for directly held Swiss bonds and other Swiss interest-bearing securities also received broad support. On the other hand, the proposal on foreign funds and other foreign interest rate products were met with resistance from the financial industry. The main objection was that a tax deduction under the paying agent principle for foreign interest products is administratively very complex and therefore expensive or, that a deduction by the paying agents (i.e. the banks) cannot be made correctly in some cases. The costs incurred by the banks are several times higher than the tax revenues potentially protected from evasion. Given the low interest rates on debtcapital that currently (and in the foreseeable future) exist, such a costly security system is completely exaggerated. Moreover, such interest rate products are in any case not attractive for individuals - for whom security is necessary at all because of fiscal banking secrecy. In September, the Federal Council passed another key decision on the withholding tax reform. Somewhat surprisingly, it decided to completely waive tax protection for interest securities (domestic and foreign) with the exception of domestic bank accounts. The abolition of the debtor principle, which functions poorly in the interest area, will rightfully be maintained. Only if it is abolished can the Swiss capital market strengthen and generate considerable additional income for the Swiss tax authorities. Based on the input from the consultation process, the introduction of the paying agent principle for domestic and foreign interest products should be abandoned. The only exception is Swiss bank accounts, to which the paying agent principle is to be applied in the future. The fact that the Federal Council is foregoing tax protection for all other Swiss interest rate products (funds, structured products, bonds) is probably

	due to the fact that Swiss funds in particular would otherwise have a competitive disadvantage compared to foreign funds. The planned strengthening of the Swiss capital market could be hindered by this disadvantage. In addition, interest income is likely to be even lower in the coming years, which is why a tax hedge does not make any economic sense, (35 percent of zero is still zero). With its parameter decision, the Federal Council also rejected the possibility of providing automatic information exchange in the debt interest area. However, this alternative is not likely to be abandoned and will be raised again in the parliamentary debate. Since the quality of the data exchanged according to the international standard for automatic information exchange is often poor, it is currently impossible to assess if cantons will support such demands. In November, The Federal Council confirmed it will to move forward with the withholding tax reform. It put a temporary shortfall in revenue of CHF 160 million and CHF 25 million for the abolition of the sales tax on Swiss bonds and money market paper, as provided for in the package. The Federal Council also stated that it currently opposes the abolition of the other stamp duties (tax on share transfers and foreign bonds). The Federal Council only sees the abolition of the issuance tax on equity capital as sensible. It helps to overcome the economic consequences of the COVID-19 pandemic by making it easier to recapitalize troubled companies. The question is still open as to if, in the context of the withholding tax reform, the participation deduction for debt financing activities (debt interest transfer) will also be adjusted. In the future, groups will want to carry out their financing activities at the (Swiss) group headquarters or at the headquarters of the Swiss principal. This is also the easiest way for them to comply with the new OECD guidelines on financial transactions adopted in February 2020. Companies with numerous Group functions will be ideal. In many cases, these also have holdings 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 perspective. These deficiencies lead to double taxation (which the participation deduction should avoid). Due to the uncertainty about the financial consequences, the Federal Council has so far refrained from adjusting the participation deduction and eliminating the double taxation that arises in connection with financing activities. If it receives reliable information from the cantons about the financial consequences of the adjustment, the Federal Council could still adjust this decision and propose to the Federal Assembly that the participation deduction be improved. According to the latest information, the dispatch on the withholding tax reform should be adopted by the Federal Council at the beginning of the second quarter of 2021 (i.e. in April) and submitted to the Federal Parliament.
Outlook	The elimination of withholding tax obstacles for debt financing activities remains the most important internal Swiss tax project for member companies in the wake of the AHV tax bill. Due to the new OECD transfer pricing guidelines, the importance and urgency of the reform has increased significantly for Swiss corporations. For SwissHoldings, it is therefore essential that the reform is pushed forward rapidly. In order for the reform to succeed and to avoid protracted disputes, it is important that the business community adopts positions that are as aligned as possible and that are politically acceptable to a majority. SwissHoldings will work to ensure that the business community is as united as possible and that the cantons are behind the proposal. We will also work to ensure that the adjustment of the participation deduction for financing activities will also form part of the Federal Council package. To this end, it is essential that the cantons provide the federal government with estimates of

	the financial imact of an adjustment of the participation deduction. The cantons should not only consider the financial consequences of adjusting the participation deduction. If the Swiss corporations relocate their financing activities to Switzerland, the difference in the interest rate between active and passive loans in Switzerland will also no longer apply. For our companies, this will mean that the calculated income discrepancy from the adjustment of the participation deduction of CHF 15 million from the federal government should be more than compensated for after just one to two years. The withholding tax reform represents an opportunity for Switzerland as a business location to increase its international attractiveness in another area. SwissHoldings will strive to convince politicians from left to right of the advantages of the reform.

OECD/G20 project on taxation of the digital economy

Current status	The project on the taxation of the digital economy aims to reform international corporate taxation. Under Pillar 1, large consumer goods and digital groups are to tax a larger share of their profits in the sales countries. Under Pillar 2, large companies should be subject to a minimum taxation in all their countries of operation. The work is carried out by the OECD Secretariat. Decisions on the project will be taken by the "OECD/G20 Inclusive Framework on BEPS" (IF), which comprises around 140 countries. On October 8 and 9, the IF adopted the OECD report (Blueprint) with technical specifications for each of the two pillars. At the same time, a public hearing was scheduled to last until December 14. Contrary to the original timetable, however, the IF was unable to reach agreement on many technical points. There is also no agreement on the political points that are of real financial importance to the states and companies (e.g. the height of the minimum tax rate, Amount A parameters). The work of the OECD Secretariat will therefore be continued. According to the adjusted timetable, an agreement on the outstanding technical and political points should now be reached in mid-2021. In view of the numerous obstacles (e.g. Covid-19) and the great importance of the decisions still to be taken, the new timetable also appears extremely ambitious. Due to the divergent positions of numerous states, a failure of the project cannot be ruled out. Below is an overview of important interim results from the two blueprints: <u>To Pillar 1:</u> Pillar 1 (redistribution to market states) consists of three components: • A new right of taxation for market states on part of the residual profit to be calculated at the Group level (Amount A) • A fixed profit allocation key for certain basic marketing and sales functions physically carried out in market states (Amount B) • Procedures to improve legal certainty through effective dispute prevention and resolution mechanisms, primarily for Amount A Only large international groups (with sales of at least EUR 750 million) that provide Automated Digital Services (ADS, e.g. Google) or operate a Consumer Facing Business (CFB, e.g. Nestlé) are covered by the new Pillar 1 rules. For these groups, a definable residual profit is redistributed in favor of the market countries. The so-called “Amount A”. Amount A is charged to the Group companies that generate residual profits (e.g. CH Prinzipal). CFB groups will pay taxes on the Amount A in addition to the already incurred

SwissHoldings

taxes on profits in the market countries. ADS groups will pay only Amount A based taxes on profits in the market countries because they usually do not have any distribution companies there.

The starting point for the calculation of Amount A is the profit in the consolidated financial statement of the Group (profit before tax). In a first step, the income statement has to be broken down into the segments ADS, CFB and not Pillar 1 relevant profit. Subsequently, the calculation and allocation of Amount A for the relevant ADS and CFB segments under Amount A is done in three steps:

- Step 1: Determine the Group's residual profit for the relevant segment under Amount A. The residual profit should be the profit that exceeds a certain profit margin, e.g. 10%.
- Step 2: Determine the share of residual profit to be allocated as Amount A to the market countries, e.g. 20%.
- Step 3: Allocation to the individual market states in relation to the achieved turnover

Amount B is independent of the scope of Amount A and corresponds to a standardized compensation for Group companies that perform basic marketing and sales functions in a market. Amount B is strongly based on the arm's length principle currently in force. However, the exact nature and scope of the marketing and sales functions covered by Amount B is not yet final.

The measures to increase legal certainty provide for a dispute resolution mechanism to prevent disputes for the Amount A. This is optional. The tax administration of the state of the Group's headquarter assumes hereby a leading role. Decisions are made in two panels. The solution reached in the dispute resolution process is binding for all tax administrations concerned. The duration of the dispute resolution mechanism can be up to 3 years. During this time, the groups concerned would not yet have legal certainty; however, they would have to pay the taxes resulting from Amount A at the beginning of the process.

Implementation of Pillar 1 requires (i) a multilateral agreement, (ii) globally applicable detailed guidelines (OECD guidelines) and (iii) adjustments to national law. All these steps require several years of preparation and the measures must be introduced globally at the same time (e.g. 1 January 2025). In return for the additional tax payments to market states, unilateral measures such as the current Digital Service Taxes should be abolished.

To Pillar 2:
Pillar 2 (minimum taxation) provides for the introduction of a number of complementary rules for large international groups:

- Income inclusion rule (IIR)
- Undertaxed payments rule (UPR)
- Subject to tax rule (STTR)

Together, these so-called Global Anti-Base Erosion Rules (GloBE) are intended to ensure that all covered groups (at least 750 million euros turnover) pay a minimum level of profit tax in all countries. The states are not obliged to comply with a certain minimum tax rate in their tax laws. If a group company has a lower Effective Tax Rate (ETR) in one state, another state (e.g. the head office state) can tax the difference to the minimum tax rate either by applying the IIR or the UPR. If the ETR in the Headquarters State is too low, the UPR is applied, according to which many other States with subsidiaries and economic relations between subsidiaries and affiliates may tax the difference to the minimum tax rate in the Headquarters State (so-called top-up tax). Although not included in the Blueprint, a minimum tax rate of 12.5% is mentioned in discussions as a minimum rate that is acceptable to the majority. This minimum tax rate would thus be higher than most cantonal minimum profit tax rates and would thus de facto lead to a tax increase for groups and group companies' residing in Switzerland.

Since a minimum taxation concept has already been introduced in the USA in the form of the GILTI rules as part of the US tax reform, US groups are exempted - probably for a limited period of time - from applying the GloBE rules. This special treatment for the USA is controversial but will probably be accepted as a concession to the USA. While GloBE provides for jurisdictional blending, in which the minimum taxation test takes place at country level, US GILTI is a global blending, i.e. a global test.

The starting point for the ETR calculation at national level is the aggregation of all financial statements of the companies in a given country. This is not based on the statutory individual financial statements of a national company, but on the consolidated financial statements of the respective national company in accordance with the accounting standard that the Group uses for its consolidated financial statements. Taxes on capital are also likely to be included in the tax base. The accounting standard accepted for GloBE purposes is in principle any accounting standard recognized as acceptable by the authorities at the Group's headquarters, provided that its application does not lead to a material impediment to competition. IFRS and US GAAP are defined as an appropriate accounting standard. Swiss GAAP FER, on the other hand, will probably not be recognized as adequate without further adjustments. Certain permanent differences between the profit according to (local) tax assessment rules and the profit according to (global) financial accounting standards have to be eliminated (e.g. dividends, gains and losses from the sale of investments). Other adjustments to the accounting rules or the planned simplifications are not elaborated further in this paper.

The minimum tax rate can be undercut by the amount of a carve-out. This carve-out takes into account personnel costs and tangible assets in the country of the national company. This is intended to create incentives for groups with physical substance. However, intangible assets such as self-created product patents are not taken into account. The effectiveness of this carve-out according to current plans is limited and does not even release the profit for routine activities. A carve-out for research and development costs or for the patent box is not foreseen and does not appear to be capable of gaining a majority. This at least calls into question the measures implemented as part of the Swiss tax reform.

The STTR applies to payments based on a DTA and allows the source state to take countermeasures in case the payments are taxed below a certain level in the recipient state. The minimum level is expected to be between 7-9%. With the introduction of tax proposal 17, the STTR should no longer be a major obstacle for Switzerland. The STTR is primarily a concession to developing countries.

	Pillar 2 leads to a restriction of international tax competition. Particularly affected are offshore states, states with tax holidays, patent boxes or particularly advantageous tax regimes that allow effective tax rates below the minimum tax rate. US corporations will probably not be affected by these new rules - at least in the initial phase - because of the acceptance of the GILTI rules as a similar minimum taxation regime. They can continue to benefit from very low tax rates (e.g. 0-5%) in selected countries (as long as the GILTI rules of the US are complied with). Overall, other (less transparent) factors (e.g. subsidies) are gaining in importance in the competition for companies. The central rules of Pillar 2 do not in principle constitute a breach of the applicable provisions in the DTAs, so no multilateral agreement appears necessary for implementation. Moreover, the GlobBE rules are outside the applicable legal security mechanisms and can therefore be introduced unilaterally by states. This means that Pillar 2 could be implemented much more rapidly than Pillar 1.
Outlook	Both the USA and the EU are threatening unilateral measures in the form of trade barriers (e.g. customs duties) or so-called Digital Services Taxes, which provide for the taxation of the sales of digitally operating groups, if the project fails. The Swiss economy and Switzerland have no interest in the failure of the taxation of the digitalized economy project. 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. Swiss corporations are also becoming increasingly digital. If the project fails, the introduction of Digital Service Taxes and/or unilateral minimum taxation rules - possibly with withholding taxes - in a large number of countries is imminent. The Digital Service Taxes, which differ greatly in material terms, will initially affect primarily the US digital groups and the USA. Even under President Biden, the USA will not accept this and will take countermeasures. Currently, It is not yet known how the Biden administration will position itself. The fact that France wants to apply the Digital Service Tax as early as 2020 could soon lead to the first discrepancies. This could have a significant impact on global trade and make it difficult for the Swiss economy to quickly recooperate from the corona recession. The main concern for Switzerland in the coming months is therefore to limit the scope of harmful new rules and their economic consequences as far as possible, and to reduce the administrative burden on companies to a tolerable level. There is also still considerable potential for improvement in the measures to improve legal certainty. In the event of global support for this reform package, Switzerland must adapt quickly to the new rules and take advantage of the opportunities they present. In other words, we must act in a similar way as to the BEPS project, which was completed in 2015. However, we are likely to have less time for decision-making. Thanks to the AHV Tax reform with the new special measures (patent box, input deduction) and the parallel cantonal profit tax cuts, the BEPS project, has brought Switzerland more advantages than disadvantages. With regard to Pillar 1, it is of central importance for Switzerland which companies are considered to be digitally or consumer oriented. Switzerland should press for these new rules to apply primarily to digital companies. The OECD draft specifically addresses the pharmaceutical industry, which is a strong economic sector in Switzerland. Switzerland should therefore try to influence the definition of companies covered by Pillar 1 in its favor.

SwissHoldings

	As an innovation-oriented country with a strong research and development base, Swiss corporations and group companies are likely to generate residual profits more frequently, which according to Pillar 1 must be shared with large sales market countries. In the interest of Switzerland as a research location, a moderate redistribution in favor of the markets should be targeted. For the 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%, from 2026 16.4%), the GloBE minimum tax rate may not exceed 12%. If a higher minimum tax rate is adopted despite jurisdictional blending, an effective carve-out is essential. This is currently not the case. From the point of view of the companies, the administrative effort is also central. Should the IF States take a decision for Pillar 2, Switzerland should adopt the Pillar 2 rules. In addition, voluntary additional taxation at cantonal level for Swiss corporations should be examined in order to prevent the application of the UPR. Otherwise, a further tax reform seems unavoidable if Switzerland wants to keep the tax base in Switzerland. Even if Switzerland's attractiveness as a business location will suffer with the introduction of Pillar 2, there is no alternative to implementing these rules for both Switzerland and Swiss companies. Standing aside would have serious financial and competitive disadvantages. Depending on the level and calculation of the minimum tax rate, it may be necessary to carry out an analysis of how Switzerland should react to the changed conditions of international tax competition. At the very least, the abolition of the emissions levy and certain minor improvements in the participation deduction should be envisaged. With a minimum tax rate of 13% or more, further measures to maintain the attractiveness of the location should be targeted (e.g. abolition of the turnover tax). If Switzerland behaves cleverly, it could benefit financially and economically from the reform. Both pillar 1 and pillar 2 are enormously costly for the companies. The simplifications planned so far are insufficient and must be improved in the coming months. The additional compliance requirements will result in considerable additional costs for corporations, which should be reduced to a minimum. The planned measures for legal certainty are welcome, but if they take up to 3 years, enormous legal uncertainty will remain over this period. Here, Switzerland should insist on pragmatic and simplified regulations that lead to simple processes in implementation and rapid legal certainty. Given the importance of the project for the member companies and Switzerland, SwissHoldings continues to actively support the work on the project. Of course, SwissHoldings will also participate in the ongoing consultation process.