BOITELLE TAX

OECD Pillars I and II
Implementation in Switzerland
A three-step approach

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Agenda

1. Introduction
2. Pillars I & II : reminders
3. Implementation in Switzerland – A three-step approach
   a. Change of Constitution – Referendum in June 2023
   b. Ordinance of the Federal Council
   c. Federal Law
4. Conclusion

1. Introduction

1. Work related to the OECD BEPS Program – 2015 and 2018 final report (G20)

2. Related work of the EU :
- 21.09.2017 : EU communication for digital economy
- 21.03.2018 : 2 draft guidelines
  - Taxation of companies with important digital presence;
  - Common system of tax on digital services

3. Unilateral measures of some States

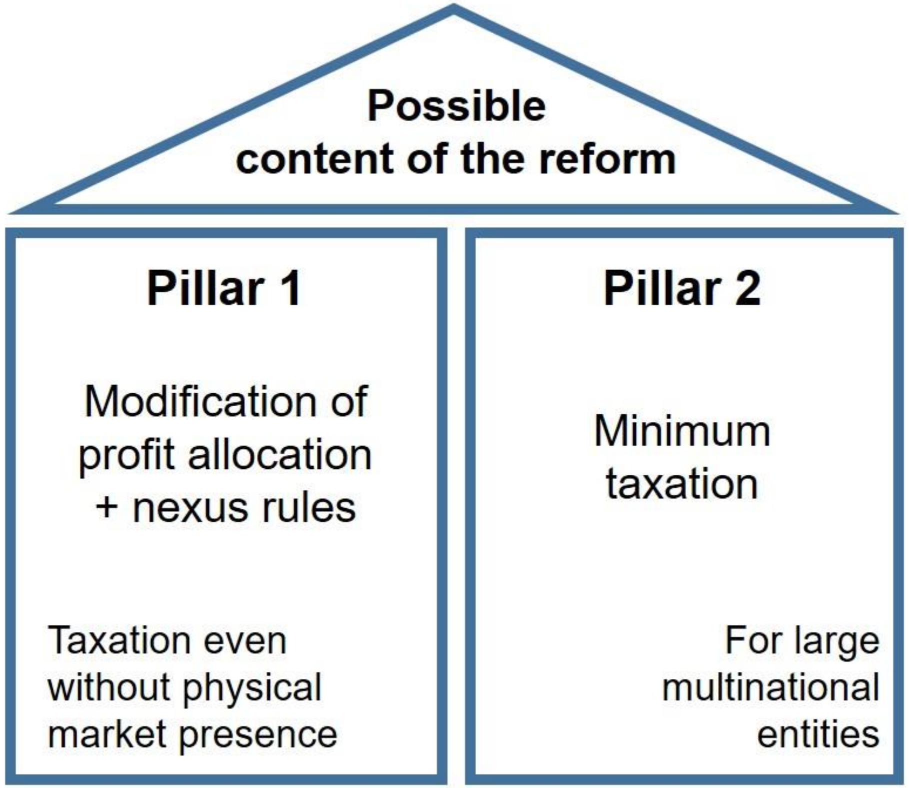
4. 20.04.2021 – UN introduces section 12B of its DTA.

5. 01.07.2021 – OECD Pillars reform and minimal tax rate of 15% accepted by 130 States

1. Introduction

- The OECD Pillars I and II reform aims to adapt taxation to new digital developments.
- Large international companies and the whole digitalised international economy are to be affected.
- The objective is to avoid a proliferation of national unitaleral measures, thus ensuring legal certainty.
- The OECD proposes a 2 pillar-system and a global minimum tax rate of 15%.
- Historical milestone : global minimum tax rate never accepted before.

2. Pillars I & II : reminders



Source :
https://www.sif.admin.ch/sif/en/home/finanzmarktpolitik/digit_finanzsektor/best_digit_wirtschaft.html

2. Pillars I & II : reminders

Pillar I :

- Pillar I provides a shift of taxing rights to market jurisdictions, without regard to physical presence.
- Scope : MNEs with global revenu > EUR 20 billion turnover and profit margin > 10%.
  - Less than 100 companies worldwide are targeted. Such companies will have to pay taxes on some of their profits in market jurisdictions.
- *Nexus* rule :
  - Applies if a company has significant and sustained participation in the economy of a market jurisdiction. Its purpose is to determine if the jurisdiction qualifies for the Amount A allocation.
  - Amount A allocated to places where the company reaches EUR 1 million of revenue (EUR 250K if GDP inferior to 40 billion).

2. Pillars I & II : reminders

Pillar I :

- New reallocation rule : 3 different amounts
  - Amount A = new taxing right for market jurisdictions with a share of MNEs residual profit (20 – 30% of residual profit).
  - Amount B = a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction.
  - Amount C = dispute resolution mechanism.

2. Pillars I & II : reminders

Pillar II :

- Pillar II provides for a minimum tax rate level of at least 15% for companies operating internationally whose annual turnover exceeds EUR 750 million.
- GloBE (Global anti-Base-Erosion) rules introduce an additional tax of the difference between the local effective rate and the minimum rate of 15%.
- 4 components part of the GloBE proposal:
  1. Income inclusion rule – **IIR**
  2. Undertaxed payments rule – **UTPR**
  3. Switch-over rule – **SOR**
  4. Subject to tax rule - **STTR**

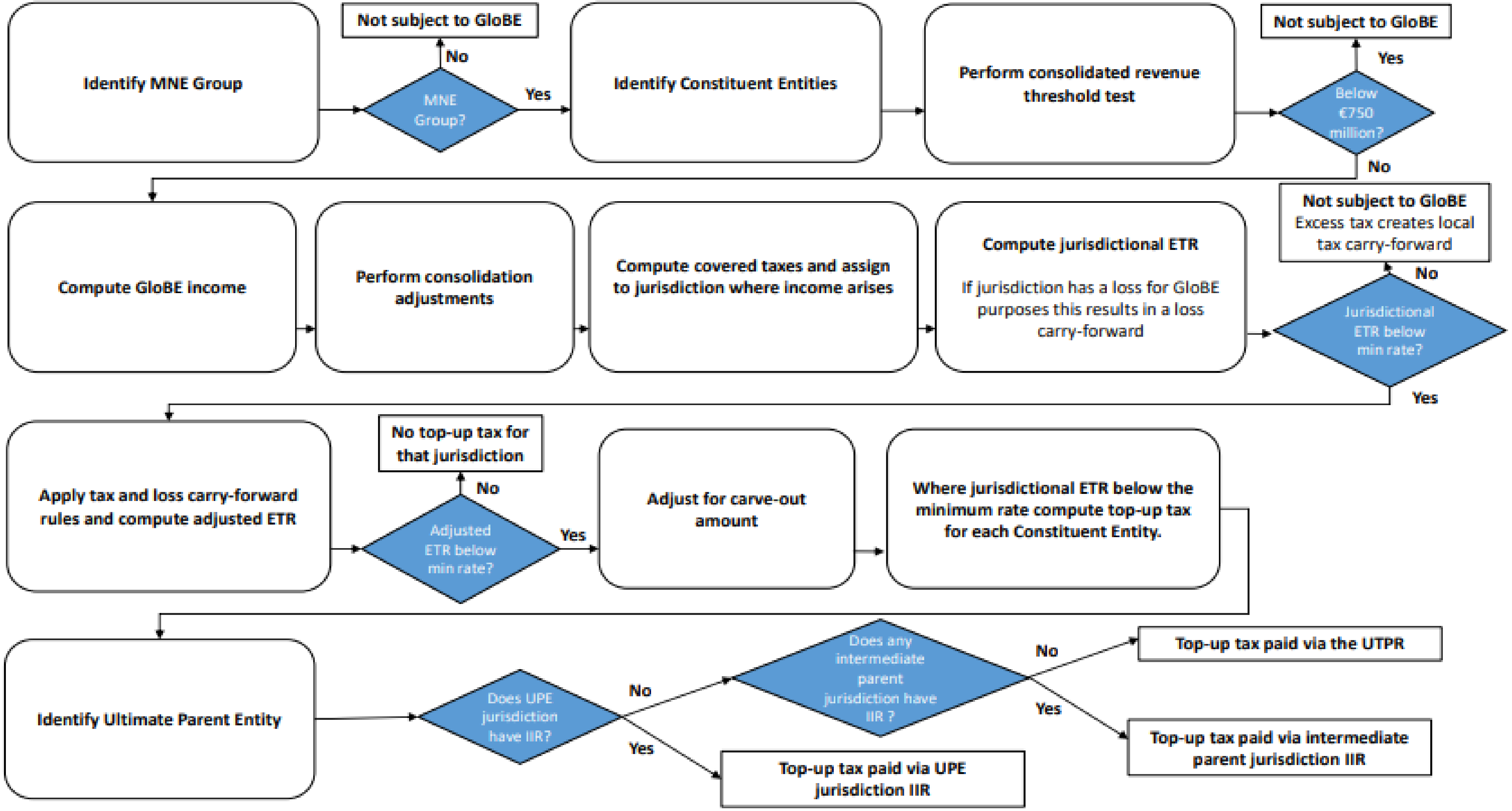
2. Pillars I & II : reminders

Pillar II :

- Pillar II consists of :
  - 2 interlocking domestic rules which together composer the GloBE rules:
    - **IIR :** imposes a top-up tax on a parent entity
    - **UTPR :** ensures low-tax income of MNE group members is taxed at minimum ETR (minimum 15%).
  - Treaty rule : **STTR** allows source taxation on related party payments taxed in recipient country at below minimum rate.

Flow Diagram

40. The flow diagram below is intended to provide a high-level overview of the process steps for applying the GloBE rules to wholly-owned Constituent Entities of an MNE Group.



3. Implementation in Switzerland

- Switzerland has been very active in the negotiations of the BEPS project and the OECD Pillars.
- Switzerland signed the July 2021 Agreement with major reservations, in particular that "*the interests of small, innovative countries are to be taken into account in the final rules*" and national legislative procedures to be respected.
- Swiss companies concerned :
  - Pillar I : only a few large companies, e.g. Roche, Novartis and Holcim.
  - Pillar II : about 200 Swiss companies and several hundred Swiss subsidiaries of foreign groups.

3. Implementation in Switzerland

- **Pillar I :** As for now, the modalities of the concrete implementation of Pillar I at the national level cannot yet be defined. Adaptations of international law are necessary beforehand. The Federal Council will decide on its implementation in due course.
- **Pillar II :** Although Switzerland is not obliged to introduce minimum taxation, it cannot prevent minimum taxation for corporate groups operating in Switzerland.
  - Thus, if Switzerland doesn’t act, these large groups will be taxed abroad. The Confederation therefore has every interest in adapting its tax system in order to preserve its economic and fiscal interests.
  - The Federal Council has outlined a step-by-step plan.

3. Implementation in Switzerland

- **Federal council plan – a three-step approach :**
  - **Step 1 :** Adoption of a constitutional provision
  - **Step 2 :** Federal Ordinance
  - **Step 3 :** Federal Law

- This project is driven by the following guidelines :
  - Ensuring minimum taxation
  - Implementing it in a targeted manner
  - Preserving federalism

3. Implementation in Switzerland

a. Adoption of a constitutional provision :

- By decision of 11 March 2022, the Swiss Government decided to implement the OECD reform by means of a new constitutional provision and transitional provisions.
  - By definition, the adoption of such provision requires the acceptance of the people and of the cantons by a double majority, which implies a popular vote (referendum).
  - A constitutional basis is necessary to give competence to the Confederation (art. 3 Cst. *a contrario*). This new provision will allow the Federal Council to subject companies to different tax rates.
  - Popular vote on the proposed amendment likely in June 2023.

3. Implementation in Switzerland

a. Adoption of a constitutional provision – art. 129a nCst. :

Art. 129a Special taxation of large corporate groups

1. The Confederation may enact provisions on taxation in the market state and on minimum taxation for large enterprise groups.
2. It shall take account of international standards and model rules.
3. In order to safeguard the interests of the Swiss economy, it may derogate from :
   a. The principles of universality, equal treatment and economic capacity in accordance with art. 127 par. 2 ;
   b. The maximum tax rates provided for in art. 128 par. 1 ;
   c. The provisions on enforcement set out in section 128(4), first sentence ;
   d. The exceptions to tax harmonization set out in art. 129(2).

3. Implementation in Switzerland

b. Federal ordinance based on transitional provision :

- In order for the project to come into force in **January 2024**, the Federal Council must be enabled by a transitional constitutional provision to temporarily regulate the minimum taxation by means of a Federal ordinance.
  - This process allows the necessary legal basis (= federal law) to be elaborated without the time constraints of an ordinary legislative procedure which can be very long in Switzerland.

3. Implementation in Switzerland

b. Federal ordinance – Guidelines

- Ensuring minimum taxation :
  - Minimum taxation will be ensured by a supplementary tax levied on companies for which the scope of Pillar II is met.
  - Such supplementary tax will be determined on the basis of a standardized calculation basis, different from the rules in Swiss income tax law.
  - 2 types of corporate groups active in Switzerland :
    - Groups that do not reach the minimum taxation in Switzerland ;
    - Groups that do not reach the minimum taxation abroad.
  - Implementation in 4 steps :
    1. Determine the tax burden by canton
    2. Calculate the minimum tax according to the OECD (15%)
    3. Calculate the Swiss supplementary tax (15% - aggregate Swiss tax rate)
    4. Allocate the Swiss top-up tax proportionnaly to the group entities that contributed to the under-taxation

3. Implementation in Switzerland

b. Federal ordinance – Guidelines

- Implementing minimum taxation in a targeted manner :
  - Only companies that meet the scope of application are affected. The federal and cantonal income tax remains unchanged.

- Preserving federalism :
  - In order to preserve the sovereignty of the cantons (art. 3 Cst.), the taxation and collection of the supplementary tax will be carried out by the cantons. 75% of the revenues from the supplementary tax will also be allocated to the cantons. The other 25% will be allocated to the Confederation.

3. Implementation in Switzerland

c. Federal law:

- Once the application of the international rules is sufficiently clear, the Parliament will pass a federal law replacing the Ordinance.
  - Compliance with the ordinary legislative process : (1) Federal law, (2) optional referendum, (3) possible popular vote and (4) entry into force.
  - The Federal Council will likely submit a bill based on its Ordinance, while adapting it to the experience it will have had since January 2024.

3. Implementation in Switzerland

Economic and financial consequences :

- As conceived, the project allows Switzerland to collect additional tax revenues that would otherwise go abroad. Such increase in tax revenue gives Switzerland the leeway to increase its attractiveness to corporate groups.
  - 25% of additional tax revenues will be allocated to the Confederation, which will have to use it to cover the additional expenses related to the national financial equalization and to strengthen the attractiveness of the Swiss business sector. The cantons will keep 75% of the revenues.
  - Cantonal competitiveness is preserved by distributing revenues in accordance with the principle of causality which means the following :
    - If a corporate group has several entities in Switzerland, the supplementary tax is allocated proportionnally to their respective responsability for the failure to reach the minimum taxation.
    - Corporate entities that reach the minimum taxation amount do not have to pay a supplementary tax. Thus, the cantons in which they are domiciled do not participate in the revenues of the supplementary tax.
- Financial consequences are uncertain. In the short term, additional tax revenues from supplementary tax are estimated at 1 – 2.5 billion CHF.

4. Conclusion

- Implementation of Pillar I is not yet very advanced, compared to Pillar II.
- Pillar II is on schedule to be implemented by January 2024.
- Higher tax revenues are expected and will be invested in the attractiveness of Switzerland for corporate groups.
- The consultation procedure on the draft ordinance runs until 17 November 2022 and the Parliament is expected to decide on the constitutional provision by December 2022.

Questions ?

Thank you for your attention!

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