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Never too Late not to Implement Pillar 2

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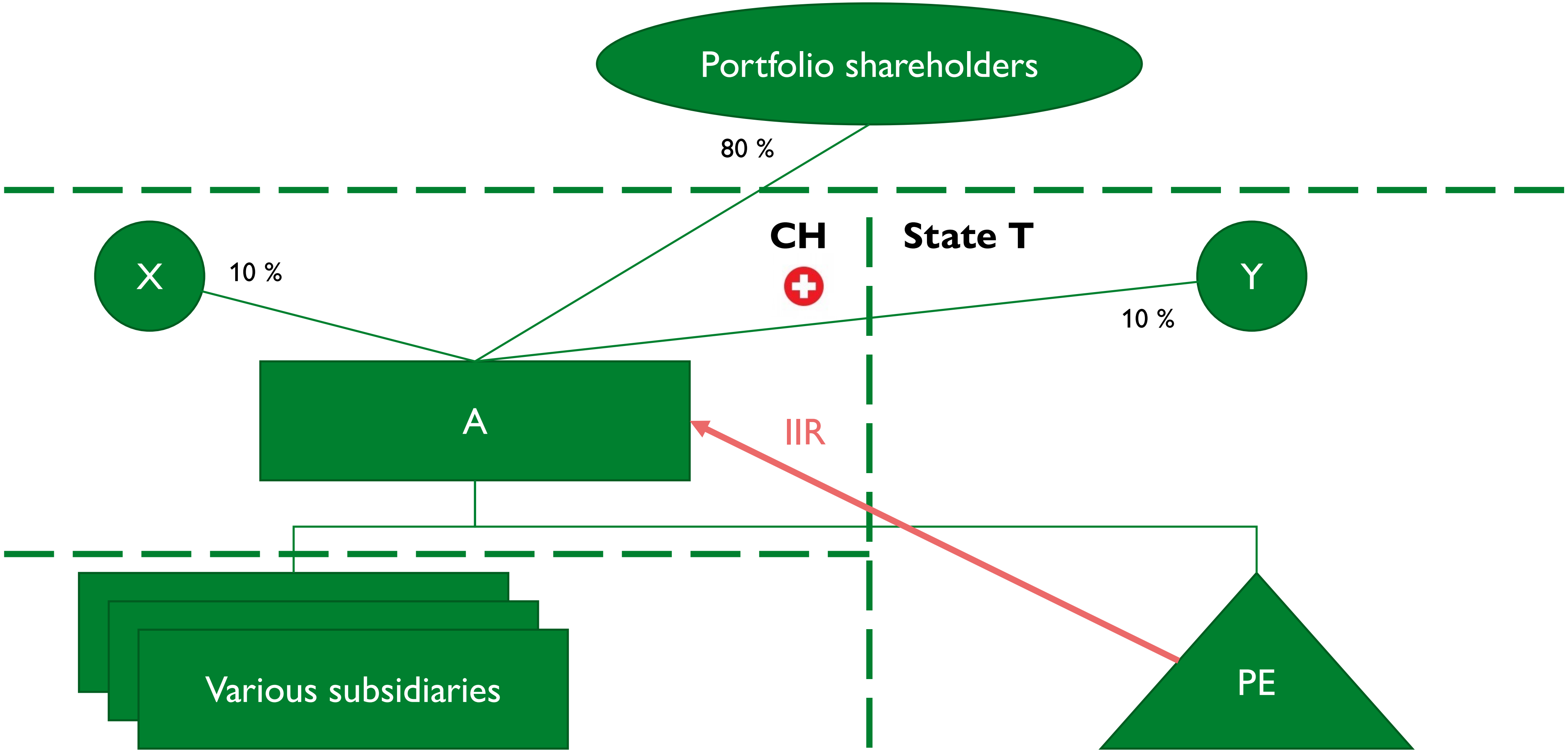
From insight to impact.

Overview


Portfolio shareholders
80 %
CH
State T
X
10 %
Y
10 %
A
IIR
Various subsidiaries
PE

Three options:

Switzerland has three options:

- Option 1: Implementation of IIR and QDMTT → legal limitations
- Option 2: Implementation of QDMTT → practical limitations
- Option 3: Postponement of the whole project

Option 1

Overview

Possible conflicts of an income inclusion rule (IIR) with treaty law:

- BUSINESS PROFITS (Art 7 OECD-MC)
- ASSOCIATED ENTERPRISES (Art 9 OECD-MC)
- PROHIBITION OF EXTRATERRITORIAL TAXATION OF DIVIDENDS (Art 10 para 5 OECD-MC)

BUT: SAVINGS CLAUSE (Art 1 para 3 OECD-MC)

Focus on potential conflicts of a Swiss IIR with Art 7, Art 9 and Art 1 para 3 OECD-MC

Business Profits

- **Wording of Art 7 para 1 and 2 OECD-MC:**

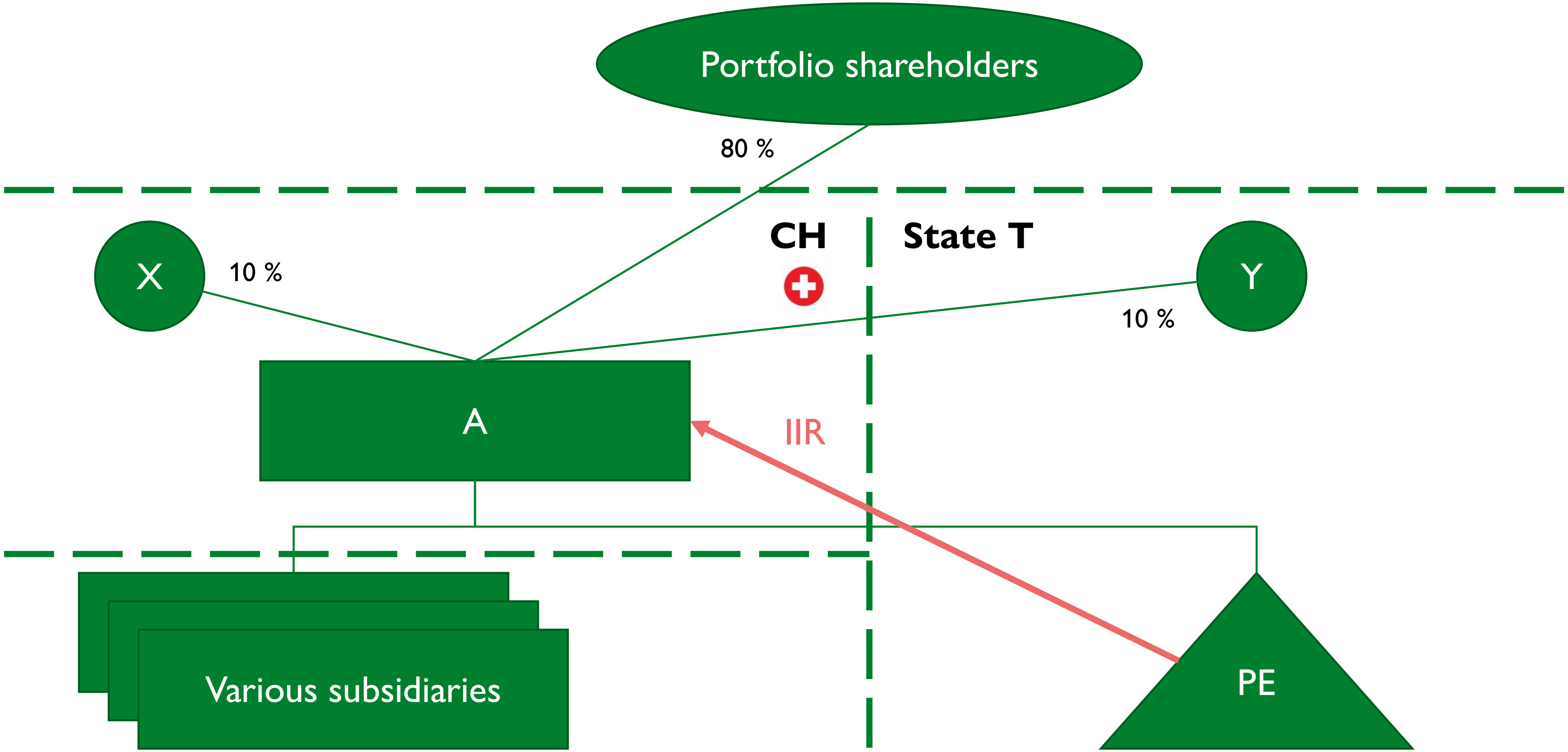
  "1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

  2. For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise."

- **Observation of the Swiss delegate in the Commentary on Art 1 OECD-MC:**

  "With respect to paragraph 81, Switzerland considers that controlled foreign corporation legislation may, depending on the relevant concept, be contrary to the spirit of Article 7."

Business Profits



Associated Enterprises

- **Wording of Art 9 para 1 OECD-MC:**

  "1. Where

  a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

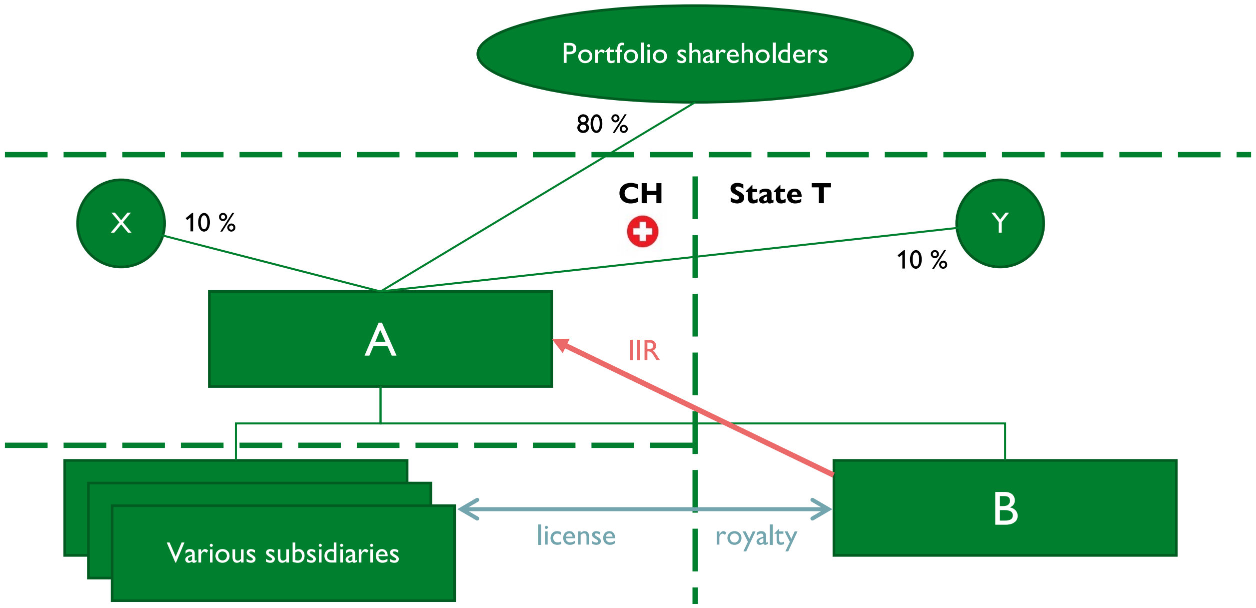
  b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

  and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

Associated Enterprises

- Correctly read, Art 9 OECD-MC deals with quantifying arm's-length-taxable-profits of associated enterprises and the allocation of those profits among states.
- By applying an IIR, CH would increase the tax base of Company A by including in its income the profits which have not been derived from Company A but by its subsidiary B in State T.

An IIR reallocates the profits of the controlled company to the shareholder. (= Taxing the taxable base which was allocated to another country on an arm's length basis.)



Associated Enterprises

One possible conclusion:

- As far as IIR go beyond the boundaries of article 9 OECD-MC they must be restricted by it.
- The ALP forms the basis of bilateral tax treaties, treating members of MNEs as operating as separate entities.

Therefore, IIR disregards the allocation within a concept of acknowledging separate entities as agreed in tax treaties.

+ The argument, that IIR would serve as an extension of anti avoidance mechanisms, is weak.

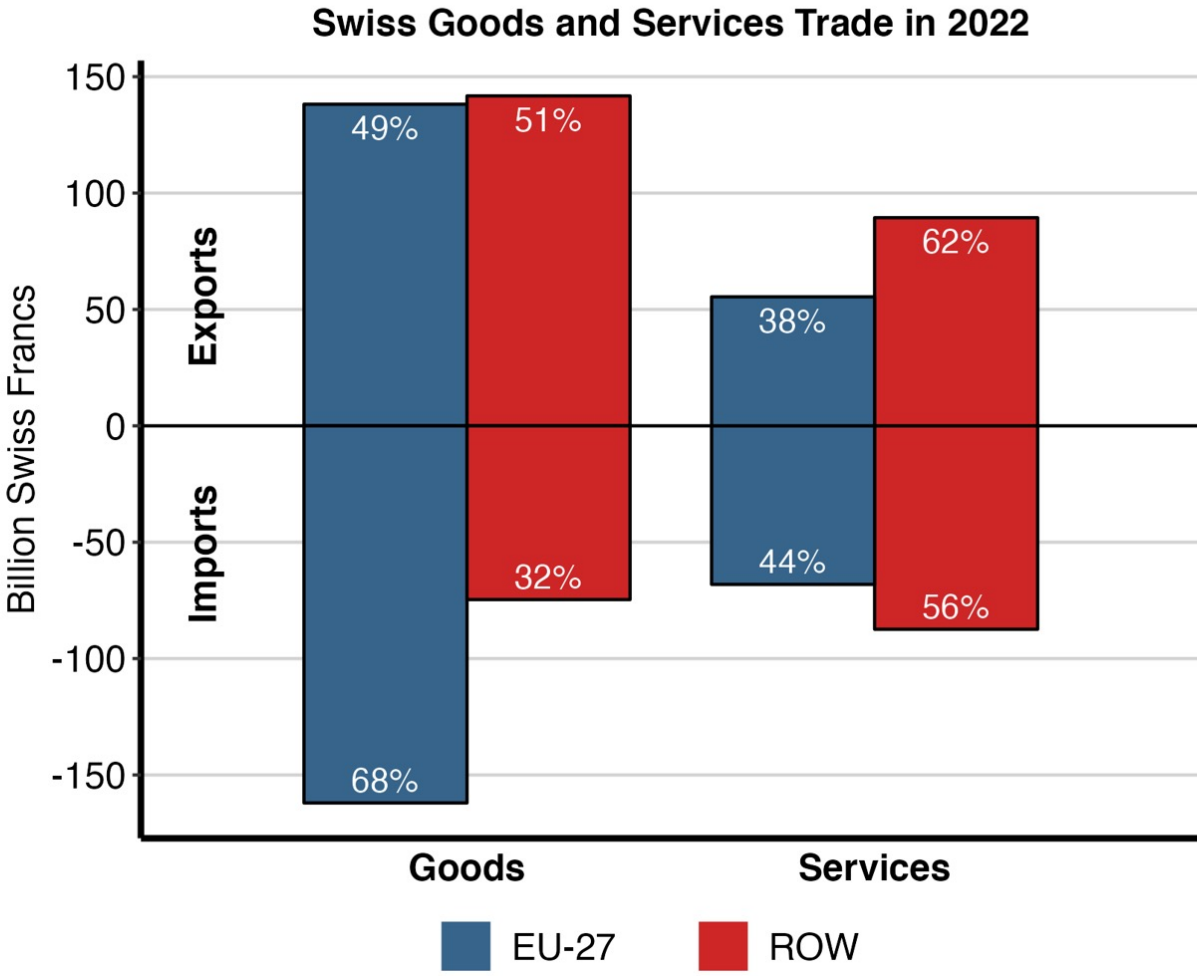
Savings Clause

- **Wording of Art 1 para 3 OECD-MC:**

  "This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, 23 [A] [B], 24, 25 and 28."

Option 2 + 3

Trade data (ILE-HSG Trade Monitor – Legge et al.)



Source: FOCBS (Goods), SNB (Services)

More data

- The Netherlands and Luxembourg are by far the most important intra-group recipients of dividends (own calculation – not published). But:
  - 83.48 % of UPEs under the MLC (Amount A) are not in the EU.
- So it is unclear how much under-taxed profits will be subject to an IIR. Maybe 40%? 50%?
- It could even be significantly below 40% (if we consider safeguards and SBIE and potential intra-group reorganizations).
- Is it really worth to legislate?
- Own opinion: We have not reached the critical mass.

Table 2. Annex I – Points Attributed to Jurisdictions for Purposes of Certain Provisions

Jurisdiction	Points
Belgium	9
Canada	6
China (People's Republic of)	94
Denmark	4
France	56
Germany	45
Hong Kong (China)	88
India	15
Ireland	21
Japan	47
Korea	11
Mexico	2
Netherlands	15
Saudi Arabia	2
Spain	15
Switzerland	34
United Kingdom	49
United States	486
Other Jurisdictions	0

Conclusion

- Strong legal and practical reasons for **Option 3: Postponement of the whole project.**
- Partial implementation of Pillar 2 will increase pressure on those states implementing the model rules.
- Significant competitive disadvantage for EU MNEs – but also for intermediate holding companies/ investment hubs.
- This might have two consequences:

  1. Mild application of the rules in the EU (e.g., deemed consolidation, excluded entities, etc.).
     This will undermine the effectiveness of the rules and it will mitigate the pressure on other states.
  2. Political pressure will increase within the EU to abolish Pillar 2.

- Are we any further by the end of 2024?
- **Is Pillar 2 a dead concept?**