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Dual wield against tax competition

The G7 Finance Ministers intend to fully support the efforts of the G20 and the OECD to reallocate taxing rights and to introduce a global minimum tax. Roughly one year after the entry into force of the TRAF, Swiss corporate tax law is once again facing fundamental restructuring. ***Guest commentary by René Matteotti***

For years, international tax policy has been repeating the mantra that a company with global operations must pay tax on its profits once only, no more and no less. Furthermore, taxation should be due in the countries where the added value was created. Profits resulting from intellectual property rights may - in narrowly defined cases - be taxed at a reduced rate through so-called patent boxes, provided that such profits are mainly attributable to research and development activities performed in the country offering the patent box. With the entry into force of the Federal Act on Tax Reform and AHV Financing (TRAF) on January 1, 2020, Switzerland complied with the international requirements and overhauled its corporate tax law, which had proven itself for decades.

With its two-pillar approach, the Inclusive Framework developed by the G20 and the OECD, which currently consists of some 140 countries, is dual wielding to severely curb tax competition. By means of the so-called GloBE Rules, a country-specific

minimum tax of at least 15% based on a largely harmonized tax base is to be levied on multinational enterprises with global gross revenues of at least EUR 750 million.

The GloBE Rules comprise two subtle tax enforcement instruments: the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UPR). If a large multinational enterprise does not achieve a minimum tax rate of 15% on an aggregate basis in a country in which it has economic operations, the country in which the ultimate parent entity has its seat is primarily to be entitled to levy a top-up tax in the amount of the difference between the minimum tax and the effective tax.

The introduction of an IIR is intended to remain voluntary. If profits taxed below the minimum tax rate in one country are not scaled up to the global minimum tax level by means of IIR (e.g., because no IIR has been implemented in the ultimate parent entity's country), the UPR will intervene as a catch-all instrument. If a group company receiving payments from a company domiciled abroad does not achieve the threshold of the minimum tax level, the country in which the paying company has its seat must ensure minimum taxation. It may do so by levying a withholding tax or by fully or partially limiting the deduction for the payment made.

However, it can by no means be concluded from the fact that the G7 is advocating for the introduction of the two-pillar approach that the project will also turn out to be a sure-fire success at the G20 and within the EU. Yet it is in Switzerland's interest to reach an international agreement as otherwise digital taxation regulations and other unilateral defense mechanisms will continue to proliferate, at the expense of legal certainty. Switzerland would do well to set the course already today to preserve its attractiveness for companies with global operations. Switzerland should create the legal basis for a globally accepted minimum tax of 15% for companies of large multinational enterprises falling under the GloBe Rules as soon as possible. For only in this way can foreign countries be prevented from accessing profits generated in Switzerland by imposing top-up taxes. With the maximum profit tax rate for direct federal tax being constitutionally limited to 8,5%, any such minimum taxation mechanism must be regulated in the Tax Harmonization Act. Due to the constitutional autonomy of the Cantons to determine the applicable tax rates, such regulation must in any event remain optional. However, it is essential that the minimum tax will be based on the same tax base as the top-up tax pursuant to the two-pillar approach.

More importantly still, there is the more delicate question as to whether Switzerland should also translate the GloBE Rules into national law. If a significant number of G20 countries opts for doing so, this might trigger a domino effect, so that the introduction of an IIR is likely to become a reasonable option in Switzerland as well. Swiss legislation will in particular face significant challenges if a minimum tax for companies subject to the GloBE Rules was to be made mandatory for cantonal law. The limitation of the applicability of the minimum tax to group companies of multinational enterprises in fact leads to a constitutionally delicate unequal tax

treatment, which in turn must be balanced by targeted fiscal or non-fiscal compensation measures. Of course, the legislator has no carte blanche with a view to such measures, as he must adhere to the requirements set forth by the WTO Agreement on Subsidies and Countervailing Measures as well as to the prohibition on aid stipulated in the Free Trade Agreement between Switzerland and the EU.

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