Update on OECD Pillar 2 – Publication model rules on 20 December 2021 for domestic implementation

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) has agreed on October 8, 2021 to the Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. This Two-Pillar solution is comprised of Pillar One and Pillar Two.

Pillar One aims to ensure a fairer allocation of profits and taxing rights among the states regarding the largest multinational enterprises (MNEs) with a yearly turnover exceeding EUR 20 billion and a profitability of more than 10%.

The focus of this Newsletter lies on Pillar Two, which aims to reduce corporate income tax competition among countries by introducing a global minimum corporate income tax rate of 15%. Pillar Two shall apply to MNEs with an annual turnover exceeding EUR 750 million in at least two of the four fiscal years preceding the relevant fiscal year. The main features of Pillar Two can be summarized as follows:

- **The Global anti-Base Erosion Rules (the so-called GloBE rules)**: these rules, which shall be implemented unilaterally by the single countries, include an (1) Income Inclusion Rule (IIR) and an interdependent (2) Undertaxed Payment Rule (UTPR). The IIR on the one hand imposes a top-up tax on a parent entity in its jurisdiction with regard to income of its group entities in other jurisdictions that are not taxed at an effective tax rate of at least 15%. The UTPR on the other hand is designed as a fall-back solution in case no IIR is implemented in the ownership chain above the constituent entity and shall deny deductions of payments of an entity to group entities in other jurisdictions to the extent that such income is not taxed at an effective tax rate of at least 15% and re-allocate the top-up tax to the UTPR entities making such payments. In order to determine the effective tax rate of a jurisdiction, the GloBE rules operate by using an effective tax rate test according to which recognized taxes paid in a jurisdiction (covered taxes) are put in relation to a specific GloBE tax base of all entities in that jurisdiction (jurisdictional blending). Both covered taxes and the GloBE tax base are based on a recognized international accounting standard (e.g. IFRS, US GAAP and Swiss GAAP FER) after specific GloBE adjustments (e.g. excluding current tax expenses and income from qualified participations as well as certain expenditures such as fines and bribes).

- **The Subject to Tax Rule (STTR)**: this double tax treaty-based rule shall allow source jurisdictions of developing countries to impose a withholding tax of up to 9% on interest, royalty and other specific payments by an entity to a group entity in another jurisdiction if the gross amount of the payment is not taxed at a minimum tax rate of 9% in the jurisdiction of the recipient entity.

It is expected that jurisdictions will start applying the IIR rule as of January 1, 2023 and the UTPR rule as of January 1, 2024. The application of the STTR rule is dependent on the inclusion of such rule in a bilateral double tax treaty. It is intended that a multilateral instrument will be released in the early part of 2022 to facilitate implementation of the STTR in relevant bilateral double tax treaties.

On December 20, 2021, the OECD released the so called model rules which are intended to assist countries to introduce the GloBE rules into their domestic legislation. The model rules provide more specific guidelines on:

- the definition of MNEs within the scope of the minimum tax;
- the mechanism for calculating an MNE's effective tax rate on a jurisdictional basis and the amount of top-up tax payable under the rules;
- the imposition of the top-up tax on an MNE group member in accordance with an agreed rule order;
- the treatment of acquisitions and disposals of group members and particular holding structures and tax neutrality regimes.

In Switzerland, Pillar Two is expected to affect a low three-digit number of Swiss headquartered MNEs and a low four-digit number of Swiss subsidiaries of foreign MNEs. Currently, Switzerland is working on implementing the new GloBE rules in its domestic legislation, while it is expected that the GloBE rules will not be adopted before 2024. It is planned that Switzerland will amend its tax system to ensure that concerned MNEs may not fall in the field of application of foreign top-up taxes. The following three options are currently under discussion for implementation in Switzerland:

- **Supplementary tax model**: according to this approach concerned Swiss entities pay a supplementary tax in addition to the ordinary corporate income tax (plus the other covered taxes) in order to reach an effective tax rate of 15% on the GloBE tax base.

- **Alternative tax model**: in this model concerned Swiss entities conceptually pay an alternative tax of 15% on the GloBE tax base.
- **Combined tax model**: according to this model concerned Swiss entities pay taxes of 15% on the basis of the GloBE rules, but at least the taxes calculated on the basis of the Swiss tax rules. In case the latter are higher, the amount in excess can be carried forward and credited against future alternative taxes.

Need for action: For MNEs with Swiss entities being in scope of the GloBE rules it is now important to take actions, and in particular to:

- better understand the new rules. For example:
  - Do tax measures taken in connection with the Swiss corporate income tax reform (implemented as per January 1, 2020) still prove to be tax efficient? More concretely:
    - What are the consequences of a fiscal step-up implemented in connection with the abolishment of the preferential Swiss tax regimes (holding status, mixed company status etc.)?
    - Can the MNEs still take benefit of the newly introduced tax rules to incentivize Swiss R&D and financing activities?
  - What do the GloBE rules mean in connection with existing losses carried forward or in view of potential future losses?
- assess the impact of the new rules on the own set-up based on calculations and modelling.
- identify and evaluate potential needs for restructuring and amendments of the business model.
- consider group internal implementation procedures and amendments regarding future compliance (e.g. required information, reporting procedures, etc.).

Tax Partner AG
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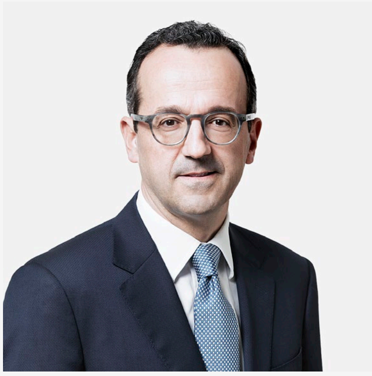

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