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Switzerland adopts constitutional basis for implementation of OECD minimum taxation

On June 18, 2023, the Swiss electorate adopted in a popular vote an amendment to the Swiss Federal Constitution. This amendment will form the legal basis for the Swiss Federal Council and the Swiss Parliament to proceed with the implementation of the OECD/G20 Pillar I (market jurisdiction taxation) and Pillar II (global minimum taxation) projects. While the Swiss implementation of Pillar I depends on further international developments, the implementation of Pillar II (minimum taxation) is scheduled for 2024.

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Global Reform of Taxation of MNEs

On June 18, 2023, the Swiss electorate voted in favour of an amendment to the Swiss Federal Constitution. It provides a legal **basis for the implementation of the OECD/G20 Two-Pillar Solution** that shall address the "Tax Challenges arising from the Digitalisation of the Economy", a global tax deal regarding the corporate taxation of large multinational enterprises ("**MNEs**"), joined by the 137 member jurisdictions (including Switzerland) of the OECD/G20 Inclusive Framework on Base Erosion and Profit-Shifting (BEPS) on October 8, 2021.

The amendment to the Swiss Federal Constitution includes a **transitional provision that allows** the Federal Council **to enact** provisions implementing a global **minimum tax of 15% for large MNEs as of January 1, 2024**, by means of governmental ordinance that shall later be replaced by ordinary law provisions. This allows Switzerland to keep pace with international developments in this matter.

As to the first pillar of the OECD/G20 global tax deal ("**Pillar I**"), which is intended to reallocate a portion of the income tax base of large multinationals to market jurisdictions, the Federal Council as well as the Federal Parliament have not yet decided on its implementation in Switzerland, given the lack of progress at an international level.

What are the Key Aspects of Pillar II?

Pillar II aims to put a floor on corporate income tax competition through the global introduction of a 15% minimum corporate tax rate for MNEs[1] with an annual consolidated revenue in excess of EUR 750 million.

The implementation of Pillar II is **not based on an international (multilateral) agreement**, but on model rules – the Global Anti-Base Erosion Model Rules ("**GloBE Rules**") – which each member of the OECD/G20 Inclusive Framework may implement if it chooses to do so.

In order to determine whether the effective tax rate ("**ETR**") reaches the minimum tax rate of 15%, the GloBE Rules provide a **common definition** of **covered taxes** and **taxable income** (GloBE Income) determined by reference to **financial accounting income rules** (such as, e.g., IFRS, US GAAP or Swiss GAAP FER) with agreed adjustments. The ETR is then determined on a **jurisdictional and not an entity basis**, which allows for jurisdictional blending. Further, the GloBE Rules provide for a **substance-based carve-out** (SBIE) that will exclude an amount of income that (after a transition period) is 5% of the carrying value of tangible assets and payroll.

In case the ETR of an MNE should be below 15% a top-up tax is levied to bring the ETR up to 15% ("**Top-Up Tax**").

Which jurisdiction may levy such Top-Up Tax? Very simplified, this is determined by three rules, the so-called qualified domestic minimum top-up tax ("**QDMTT**"), the income inclusion rule ("**IIR**") and the undertaxed profits rule ("**UTPR**").

In **first priority**, the GloBE Rules allow each **jurisdiction to levy itself the Top-Up Tax**. The QDMTT is thus especially relevant for low-tax jurisdictions, given that it reduces the Top-up Tax otherwise levied by another jurisdiction through the IIR or the UTPR. As a result, by implementing a QDMTT a jurisdiction can ensure that any top-up tax is levied by itself (as QDMTT) and not by another jurisdiction (under the regime of the IIR or UTPR).

In **second priority**, the **jurisdiction of the ultimate parent entity** ("**UPE**") of an MNE or, in case the UPE jurisdiction has not introduced the GloBE Rules, the applicable intermediate parent entities ("**IPE**") of an MNE may levy the Top-Up Tax through application of the **IIR**.

In **third priority**, the **UTPR** is applicable where no QDMTT is levied and neither the UPE jurisdiction nor an IPE jurisdiction of the low-taxed constituent entity has applied an IIR. Serving as a "safety net" for such cases, the UTPR generates a tax cash expense at the level of the constituent entities in UTPR jurisdictions ensuring that the 15% ETR is reached.

The **practical consequences of the IIR and UTPR** are that MNEs headquartered in jurisdictions that do not adopt the GloBE Rules (such as for example at least for the time being the United States of America) will nonetheless be subject to the 15% ETR as long as they have a group entity or a permanent establishment (both defined as a constituent entity) in either an IIR or UTPR jurisdiction.

Finally, the GloBE Rules contain **transitional rules** as well as (permanent and transitional) **safe harbour provisions,** which, among other things, provide for *de minimis* exclusions for jurisdictions where certain revenue/profits thresholds are not reached and a simplified ETR calculation.

How will Switzerland implement Pillar II?

1. Implementation as of January 1, 2024 by general reference to OECD GloBE Model Rules

As to the legislative procedure, the Federal Council will **enact a governmental ordinance** based on the amended Swiss Federal Constitution. This is necessary, because the ordinary legislative process would take too long to allow Switzerland to keep up with the GloBE implementation processes in other jurisdictions and may result in Swiss constituent entities of in-scope MNEs to being taxed under the IIR and the UTPR by such foreign jurisdictions (instead of Switzerland). However, the governmental ordinance is of **temporary nature only and must be replaced by a federal law within six years**.

Based on the current draft of the governmental ordinance and an explanatory report, the Federal Council will **introduce the IIR as well as the QDMTT by January 1, 2024**. Regarding the **UTPR, an implementation as of January 1, 2025 is currently under discussion**.[2] In any case, it is expected that the Federal Council will **align and coordinate the implementation dates with other jurisdictions and in particular the EU**.

The Swiss governmental ordinance does not reproduce the GloBE Rules, but rather **refers,** with few exceptions, **to the OECD GloBE Model Rules of December 14, 2021**. The reference is static, meaning that subsequent adjustments of the GloBE Rules are not automatically applied in Switzerland.

The **Top-Up Taxes** levied as a consequence of the enactment of the GloBE Rules in Switzerland are **federal taxes** (as opposed to a cantonal tax); that **will be assessed and levied by the cantons**. Any revenues will be shared among the cantons (75%) and the Confederation (25%).

2. Particularities of the Swiss GloBE Rules

Switzerland **will introduce a QDMTT** that may be characterized as a federal corporate income tax *sui generis* for Swiss constituent entities of an in-scope MNE.

In line with the GloBE Rules, the Swiss QDMTT will be determined in the same way as the Top-Up Tax for IIR and UTPR purposes (including substance-based exclusions and safe harbours). Therefore, taking into account the QDMTT, **Swiss constituent entities will avoid foreign Top-Up Taxes** (IIR/UTPR).

It is important to note that **QDMTT is a mere top-up tax**, meaning that constituent entities of in-scope MNEs will continue to be subject to **the "ordinary" Swiss corporate income and capital taxes**, based on their statutory financial statements prepared according to the rules of the Swiss Code of Obligations ("**CO**"). The GloBE tax base, based on international financial accounting

standards, differs significantly from the corporate income tax base determined in accordance with Swiss statutory accounting law. Therefore, a Swiss constituent entity of an in-scope MNE must **prepare two sets of financial statements for tax purposes**: First, statutory CO accounts to determine its "ordinary" Swiss corporate income and capital tax liability and, second, accounts based on applicable financial accounting standards as a starting point to determine any QDMTT Top-Up Tax liability, if any.

As regards the scope of **covered taxes** for purposes of the GloBE Rules, not only corporate income taxes but **also capital taxes, real estate gains taxes as well as the residual Swiss withholding taxes** (on intragroup dividends) qualify for purposes of the GloBE Rules.

An additional complexity stems from the fact that the **QDMTT** is calculated on a jurisdictional level (jurisdictional blending), whereas the Swiss corporate income tax is generally determined and levied on a single entity basis. Switzerland does not apply any tax grouping rules for corporate income tax purposes. The Swiss federal ordinance implementing the GloBE Rules thus **includes coordination rules** to deal with cases involving **multiple Swiss constituent entities of the same MNE.** To align the jurisdictional blending for QDMTT purposes with the single entity approach for Swiss corporate income tax purposes, the current draft of the governmental ordinance **provides a "one-stop shop" concept.**

Under this one-stop shop concept, **only the Swiss top-tier entity** will be **tax subject for purposes of the QDMTT**, as well as for Top-Up Tax resulting from the application of the IRR and UTPR. Only that entity will have to file the respective Pillar II tax returns and only the canton of its tax residency will make the GloBE assessment and may levy the Top-Up Taxes. In case **no such top-tier entity exists**, the economically most relevant Swiss entity will be considered as tax subject (based on the highest average net income throughout the last three tax periods, or in case of loss situations, highest aver equity during the same period).

In any case, all **Swiss constituent entities** will be **jointly and severally liable** for the Top-Up Taxes.

Finally, the draft Swiss federal ordinance implementing the GloBE Rules includes **criminal provisions** for violation of procedural obligations**. GloBE tax evasion** is fined of up to three times of the evaded amount and **GloBE tax fraud** may trigger prison term of up to three years. No penalties shall be issued for negligent violation of procedural duties or GloBE tax evasion for all financial years that begin by December 31, 2026 and end before June 30, 2028.

It is expected that the Swiss cantons will use their fiscal policy sovereignty to decide on local compensatory measures to ensure Switzerland’s continued attractiveness as a business location.

Most cantons have however not yet announced which measures they intend to put in place in this context. It is however expected for such announcements to occur in the coming months.

What should MNEs with Swiss constituent entities consider?

- The MNE will need to determine whether it is **in-scope of the GloBE Rules**.

- For **business years starting on January 1, 2024 or later**, an in-scope MNE will need to determine whether it is subject to Top-Up Taxes (especially **QDMTT**, but also due to the **IIR**) in Switzerland and if so, it will also have to determine the amount of the respective Top-Up Tax.
- Especially in the transitional phase, it is important for an in-scope MNE to assess whether **safe**

harbour conditions are met as **temporary safe harbours may lapse** for subsequent periods if they are not claimed. From a later point in time, the in-scope MNE may also have to determine whether it is subject to Top-Up Taxes in Switzerland due to the application of the UTPR.
- The in-scope MNE will need to determine its Swiss constituent entity that is considered Swiss tax subject for Top-Up Tax purposes. That Swiss constituent entity will then have to **spontaneously file the GloBE tax return** with the competent cantonal tax administration within 18 months (for the first tax period) or 15 months (for subsequent tax periods) after the relevant business year has ended.

- The Swiss implementation of the GloBE rules **complements rather than substitutes** the generally applicable Swiss corporate income tax law. Therefore, Swiss entities of in-scope MNEs will continue to be required to prepare (stand-alone) statutory financial statements and file ordinary Swiss corporate income and capital tax returns.

- Due to the **joint and several liability** for Swiss Top-Up Taxes between Swiss entities of an in-scope MNE, future transaction agreements will need to include **indemnities for a possible liability for GlobE Taxes** of an MNE.

- Depending on the jurisdictions in which an in-scope MNE has its headquarter and does business, it may have to assess whether Top-Up Taxes paid in Switzerland (especially the QDMTT) qualify as **tax credit** for other minimum taxation rules of other jurisdictions (such as German CFC rules or the US GILTI regime).
- Swiss constituent entities of in-scope MNEs should determine whether they are eligible for cantonal compensatory measures.

[1] Not in scope are government entities, international organizations, non-profit organizations, pension funds as well as investment funds or real-estate investment vehicles that are ultimate parent entities of an MNE group or any holding vehicles used by such entities, organization, or funds.

[2] However, it may also be possible - depending primarily on international developments - that the UTPR may not be introduced for the time being.

Please do not hesitate to contact us in case of any questions.

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