GLOBAL LEGAL INSIGHTS

Corporate Tax

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In comparison to 2019, which reported a transaction value amounting to USD 127bn, 2020 was quite an unusual year due to the global pandemic accompanied by the uncertainty of the economic impact caused by COVID-19. As such, the uncertainty and the waves of the pandemic emerging globally resulted in a significant drop of total deal value by around 50% to approx. USD 56bn. Almost three-quarters of that amount was attributable to the 10 largest mergers and acquisitions (M&A). These were driven primarily by the two largest transactions in terms of deal value, the public takeover of Sunrise Communications AG, the second-largest telecommunications provider in Switzerland after Swisscom, and the acquisition of CPA Global Limited, a leader in the development of intellectual property and legal support services. Notably, Swiss companies acquired significantly more foreign companies than *vice versa*: outbound transactions amounted to 42% (154 transactions), whereas there were only 23% inbound transactions (84 transactions). The impacts of COVID-19 were low, or at least lower than expected in the M&A market. The associated physical absence broke or accelerated new grounds such as a shift from physical signings and closings. The recent developments required adjustments and facilitated the deal-making process.

Tax litigation

In addition to traditional tax litigation matters, international requests for exchange of information remain a highly prolific ground for tax litigations in Switzerland. Switzerland continues to receive a large number of requests for assistance under the double tax treaties (DTTs) and agreements on the exchange of information, and the Multilateral Convention on Mutual Administrative Assistance. 2020 was Switzerland's record year with 46 requests to foreign tax authorities.[1] Most of the 2,112 requests from foreign authorities received by Switzerland were from Israel, France, South Korea, Germany and Austria.

Most court cases usually deal with procedural aspects of the administrative assistance requests, such as the possibility to use information in respect of third persons, provision of information in respect of third persons (which is a common concern when, for example, the data in respect of bank account transactions is provided), and the obligation of the Swiss Federal Tax Administration (SFTA) to inform third persons *ex officio* and provide them with a possibility to object to the disclosure of information by way of administrative assistance.

The fact that the decisions of the Swiss Federal Supreme Court often reverse the decisions of the Swiss Federal Administrative Court shows that there are still many aspects of the administrative assistance practice that remain uncertain. In 2020, the Federal Supreme Court made several leading decisions in administrative assistance cases, of which two are particularly noteworthy. In July 2020, the Federal Supreme Court ruled in a case that third parties whose identification characteristics are (exceptionally) not redacted do not need not be informed about the contemplated data transfer.[2] A reservation applies to so-called "evidently entitled appellants". However, the vague wording indicates that there is room for interpretation. As a result, data transfer of third parties might be processed without the third party having a possibility to appeal against it. According to another decision dated the same day,[3] the recipient state shall not be allowed to use information obtained through administrative assistance procedures against third parties. This restriction is referred to as the principle of personal specialty. In the context of the previous practice, the latter decision deserves special mention since the Federal Supreme Court overruled the Organisation for Economic Co-operation and Development's (OECD's) view on the use of obtained information through administrative assistance. Although this seems to provide better protection of affected parties, potential violations of the principle of speciality by the recipient state following the OECD's view and corresponding prosecutions, however, cannot be prevented. Therefore, there is a reasonable expectation that the trend of increasing disputes in the context of administrative assistance proceedings will continue.

Financing transactions and liquidity enhancement measures

With the Swiss economy feeling the impact of the COVID-19 pandemic, 2020 highlighted an increase in financing and re-financing transactions, as well as other measures aimed at liquidity management of the balance sheet situation. The accompanied types of work range from the issuance of straight bonds and conclusion of credit facility agreements to equity issuances and issuance of convertible bonds, or a combination of all of the above. In addition, new forms of debt financing emerged. For example, in September 2020, Novartis issued a EUR 1.85bn sustainability-linked bond, which is the first of its kind in the healthcare industry and the first sustainability-linked bond incorporating social targets.

For liquidity reasons or because of the requirements for emergency loans from the federal government, companies may have to waive the distribution of already declared dividends or change the purpose of the share buybacks; for example, by placing the treasury shares on the market or distributing them as dividend in-kind. All such measures require a careful tax analysis to avoid adverse tax consequences.

IPOs

During 2020, only two companies (Ina Invest Holding AG and V-Zug AG) were listed on the Swiss stock exchange. These were not classic IPOs but spin-offs. The small number of IPOs was a consequence of the uncertainty caused not only by the COVID-19 pandemic, but also the US presidential elections. There is expectation or at least hope that the vaccinations and cures will bring the current environment one step closer to (a little or more) economic stability.

On 29 April 2021, Switzerland's first IPO was launched: PolyPeptide Group AG, a company from the life sciences sector and a global leader in peptide development and manufacturing, listed its shares on the Swiss stock exchange with a market capitalisation of CHF 2.4bn. The second IPO is Montana Aerospace AG, a leading manufacturer and supplier of system components and complex assemblies for the aerospace, e-mobility and energy sectors with worldwide engineering and manufacturing operations. Its shares were listed on the Swiss stock exchange with a market capitalisation of CHF 1.4bn.

Significant deals and themes

M&A

The following deals stood out in 2020 and early 2021, all requiring tailored corporate tax advice for the transaction itself, the integration or the debt financing:

- **Farmers Group, Inc. and Farmers Exchanges agree to acquire MetLife's property and casualty business**: In December 2020, Zurich Insurance Group's wholly owned subsidiary, Farmers Group, Inc., together with Farmers Exchanges, agreed to acquire MetLife's property and casualty business in the US for USD 3.94bn. The transaction was completed in April 2021.
- **Partners Group acquires significant equity stake in Telepass S.p.A.**: In December 2020, Partners Group, the Swiss-based global private markets investment manager, acquired a significant equity stake in Telepass S.p.A., a leading electronic toll collection services provider in Europe. The transaction values Telepass S.p.A. at an enterprise value of over EUR 2bn.
- **H2 Energy Holding AG and Trafigura Holding GmbH enter into an investment agreement**: On 17 December 2020, H2 Energy Holding, a Swiss pioneer in the fields of renewable energies and hydrogen technology, entered into an investment agreement with Trafigura Holding regarding a minority investment in H2 Energy Holding. In addition, H2 Energy Holding and Trafigura Holding agreed to form a joint venture to develop the design and implementation of fuel cell and green hydrogen-based ecosystems for hydrogen-fuelled trucks on a Europe-wide scale.
- **Liberty Global completes the acquisition of Sunrise Communications AG**: After its pre-announcement for its public tender offer to acquire all publicly held shares of Sunrise Communications and following receipt of the regulatory approvals, Liberty Global successfully completed the acquisition of Sunrise Communications in November 2020. Total transaction value amounted to approx. USD 7.15bn and was the largest transaction in Switzerland in 2020.
- **Warburg Pincus LLC sells Avaloq to NEC Corporation**: In October 2020, Warburg Pincus, a leading global private equity firm, and other shareholders, sold their shares in Avalog, a Swiss-headquartered, internationally leading fintech company, to NEC Corporation. The transaction value amounted to USD 2.2bn.
- **Vifor Pharma Group sells OM Pharma**: In September 2020, Vifor Pharma, a global leader in iron deficiency, nephrology and cardio-renal therapies, sold its OM Pharma business, which primarily focuses on therapies for respiratory and urinary tract infections and is active in the treatment of vascular diseases, to Optimus Holding Ltd., a company founded by Etienne Jornod together with long-standing Swiss entrepreneurs and the Turkish pharmaceutical company Abdi Ibrahim.
- **Lupa Systems LLC becomes new anchor shareholder in MCH Group AG**: On 10 July 2020, MCH Group announced a comprehensive set of measures, including a new anchor investor, Lupa Systems, an independent private investment company owned by James Murdoch. In order to strengthen its capital structure and shareholder base and to accelerate its ongoing transformation, MCH Group's board of directors proposed to its shareholders a capital increase of CHF 104.5m, Lupa Systems as a new anchor shareholder, and a restructuring of the group's debt capital. Lupa Systems and the public sector shareholders, who were expected to each hold around one-third of MCH Group's shares, have signed a long-term relationship agreement to, among other things, secure Art Basel in Basel. The comprehensive set of measures proposed by MCH Group were dependent on the approval of the MCH Group's shareholders, which finally took place on 27 November 2020.

- **BP Plc sells its chemicals business to INEOS Group Holdings SA**: In June 2020, BP sold its petrochemicals business for USD 5bn to Sir Jim Ratcliffe's INEOS Group. The deal resulted in INEOS taking on BP's aromatics division, which produces chemicals for polyester used in clothing, film and packaging, as well as BP's acetyls business, whose products are used in food flavourings, paints and glues.
- **Firmenich acquires DRT from Ardian**: On 28 May 2020, Firmenich announced that it had successfully completed its acquisition of Les Dérivés Résiniques et Terpéniques (DRT), a world leader in plant-based chemistry, mainly from pine trees, and one of the leading suppliers globally of high-quality, renewable ingredients. The transaction value amounted to USD 1.917bn.
- **Canada Pension Plan Investment Board sells Veeam Software AG**: In March 2020, Canada Pension Plan Investment Board sold Veeam Software, a global leader in cloud data management software, to Insight Partners for a transaction value of USD 5bn. This was one of the largest transactions in Switzerland in the first half of 2020.
- **Parjointco N.V. and Pargesa Holding SA announce reorganisation of holding structure**: On 11 March 2020, Parjointco, a company jointly controlled by Power Corporation of Canada and the Frère family, and Pargesa Holding announced an agreement for a proposed transaction that would simplify the group structure pursuant to which Pargesa shareholders receive shares of Groupe Bruxelles Lambert.
- **Equistone Partners Europe acquires Franke Water Systems AG**: On 3 March 2021, Equistone acquired Franke Water Systems (KWC and WSC Groups), an international manufacturer of intelligent water solutions for residential bathrooms, residential kitchens and commercial washrooms, from Franke Group. The transaction closed on 30 April 2021.

Financing

- **Novartis issues a EUR 1.85bn sustainability-linked bond**: In September 2020, Novartis Finance S.A., a subsidiary of Novartis AG, issued a EUR 1.85bn sustainability-linked bond due 2028 with an interest rate of 0.000%. The bond is **the first of its kind in the healthcare industry and the first sustainability-linked bond incorporating social targets**, with bondholders entitled to receive a higher amount of interest if Novartis fails to meet its targets for expanding access to its innovative medicines. The bond is guaranteed by Novartis AG.
- **Chubb INA Holdings Inc. issues USD 1bn Senior Notes**: On 15 September 2020, Chubb issued USD 1bn Senior Notes due 2030 with an interest rate of 1.375%. The Senior Notes are unconditionally guaranteed by Chubb Limited, Zürich, Switzerland, and are registered on NYSE.
- **Swiss International Air Lines AG and Edelweiss Air AG enter into a CHF 1.5bn credit facility agreement secured by the Swiss Confederation combined with location policy measures**: Swiss International Air Lines and Edelweiss Air have entered into a CHF 1.5bn revolving credit facility agreement with Credit Suisse (Schweiz) AG and UBS Switzerland AG as mandated lead arrangers, coordinators and lenders and additional banks as part of a syndicate. The Swiss Confederation, represented by the Swiss Federal Department of Environment, Transport, Energy and Communications, acted as surety provider covering 85% of the credit. The financing is linked to certain Swiss location policy measures. Deutsche Lufthansa AG and the German government have agreed to this financing as well.
- **Goldman Sachs and UBS place new convertible bonds and the public repurchase offer for existing convertible bonds by Basilea Pharmaceutica Ltd**: On 28 July

2020, Basilea completed the offering of approx. CHF 97m 3.25% convertible bonds due 2027 to finance the repurchase of a part of Basilea's existing convertible bonds due 2022. With the repurchase of part of its existing bonds financed by newly issued bonds, Basilea was able to extend its debt maturity profile and to optimise its debt structure.
- **The Swiss Re Group updates its USD 10bn Debt Issuance Programme, issues EUR 800m Guaranteed Subordinated Notes and SGD 350m Guaranteed Subordinated Notes**: The Swiss Re Group has updated its USD 10bn Debt Issuance Programme, and thereunder has issued (i) EUR 800m Guaranteed Subordinated Fixed Rate Reset Step-Up Callable Notes with a scheduled maturity in 2052, and (ii) SGD 350m Guaranteed Subordinated Fixed Rate Reset Callable Notes with a scheduled maturity in 2035.
- **Idorsia Ltd completes a capital increase**: On 23 October 2020, Idorsia completed a capital increase by way of an at-market rights offering. The offer price was set at CHF 22.50 per share and the capital increase resulted in gross proceeds of approx. CHF 535.5m. Idorsia intends to use the net proceeds of approx. CHF 520m to support the regulatory filing and, if approved, commercial launch of daridorexant and to fund the further development of its diversified pipeline.

Real estate transactions

Conzzeta sells residential properties to PLAZZA AG: The pension funds of Conzzeta completed the process of selling their residential properties in the "Tiergarten" quarter and at other locations in and around Zürich. In the context of the sale, PLAZZA decided to exercise its pre-emptive right as landowner and to acquire the two residential properties in the "Tiergarten" quarter at a price of CHF 61.1m.

Syngenta Crop Protection AG acquires a production facility from Novartis: In September 2020, Syngenta, a global leading chemical crop protection company, acquired a production facility located on the GETEC PARK.SWISS area from Novartis Pharma Schweizerhalle AG.

Implenia AG and Ina Invest Holding AG: On 12 June 2020, Implenia completed the spin-off of Ina Invest Holding and the shares of Ina Invest Holding were, after a concurrent capital increase, listed on the SIX Swiss Exchange. Ina Invest Holding is a Swiss real estate company whose entire portfolio shall be developed and realised according to the highest sustainability criteria. In parallel, Ina Invest Holding completed a rights offering and raised CHF 116m.

Key developments affecting corporate tax law and practice

<u>Domestic legislation</u>

Federal Act on Tax Reform and AHV (social security) Financing

On 1 January 2020, the Federal Act on Tax Reform and AHV (social security) Financing (TRAF) entered into force. The TRAF repealed the privileged tax regimes, i.e. holding, mixed and domicile companies at the cantonal level, and finance branch and principal companies at the federal level. As compensation, the new legislation, *inter alia*, introduced a mandatory OECD-compliant patent box regime and an optional super deduction for research and development (R&D) expenditures. Both instruments are implemented at cantonal level only.

Since the TRAF only sets out general parameters of both regimes, the modalities of implementation – such as the qualifying R&D activities, tax charge upon entry into patent box, re-calculation rules for the qualifying income quota in case of the patent box – may differ from one canton to another. Further, the maximum deductions permitted also differ between the cantons. For example, in Zürich, 90% of the qualifying patent income is exempted from the tax base and the total combined tax deduction from different incentives must not exceed 70% of the taxable profit (before deductions). The same limits apply in Aargau, Bern, Jura, Nidwalden, Obwalden, Schwyz, Solothurn, Ticino and Zug. Other cantons have implemented more restricted deductions, e.g. St. Gallen limited the patent box deduction to 50% of the qualifying patent income and the overall deduction to 40% of the taxable income, while Basel did not even implement the R&D super deduction.

In addition, in order to counteract the impact of the abolition of the privileged tax regimes, most of the cantons significantly decreased the cantonal corporate tax rates. For example, the effective corporate tax rate (including federal tax rate) in Basel decreased from 20.18% to 13% as of 2019, in Geneva from 24.16% to 13.99% as of 2020, in Zürich from 21.15% to 19.7% as of 2021 (discussions are ongoing regarding a further decrease in 2023), and in Zug from 14.62% to 11.91% as of 2020. The cantonal tax rate reductions resulted in a national decline of nearly two percentage points in the average Swiss rate to 15.1% and enabled Switzerland to get to the top third of the global rankings for corporate tax rates. Furthermore, most of the cantons also decreased capital tax either by decreasing the capital tax rate or deducting a percentage of taxable equity attributable to qualifying participations, intercompany loans and patents from the taxable base, or a combination of both measures.

As an important change, the new provisions include a restriction on the capital contribution principle. Dividend distributions out of capital contribution reserves are neither subject to withholding tax nor to Swiss income tax for individuals. The TRAF introduced a 50:50 rule stating that distributions out of capital contribution reserves of companies listed in Switzerland will only benefit from the tax-free regime if the company makes a distribution out of taxable reserves of at least the same amount. A comparable rule applies in case of a share buyback on the second trading line where, at a minimum, the same amount of capital contribution reserves and other reserves must be used. These restrictions for distributions do not apply to distributions from the so-called foreign capital contributions reserves, e.g. capital contribution reserves created through the contribution of participations in foreign companies (share-to-share exchange).

With respect to the decrease in effective corporate tax rates introduced as part of the TRAF measures, however, the OECD's efforts for a minimum tax, Pillar 2, must be monitored (see below for further information).

Withholding tax reform

The current tax framework levies a withholding tax of 35% on interest payments on a domestic bond. Thus, it is less attractive to issue bonds in Switzerland compared with other jurisdictions. Consequently, Swiss groups in practice avoid this withholding tax disadvantage by issuing their bonds through a foreign group company. Intra-group financing activities are also frequently not carried out in Switzerland because of the withholding tax. The Swiss legislator identified this issue and set goals to strengthen the debt capital market in Switzerland and to increase its attractiveness for group financing activities. Accordingly, in April 2020, the Swiss Federal Council proposed a conceptual reform of the withholding tax on debt instruments, the central element of which is the move from a debt-based system to a paying agent system.

The move to a paying agent withholding tax regime has been discussed already for some time by the Swiss legislators. The basic principle of the new regime is as follows: a Swiss-based paying agent will be responsible only for withholding and transferring the withholding tax on interest payments made to individuals based in Switzerland.

After having reviewed the results of the consultations indicating that the implementation of a paying agent system is not only technically complex but also expensive, the Federal Council decided in September 2020 to submit a new proposal. The new proposal abolishes withholding taxes on all interest income, with the exception of interest on customer credit balances from individuals resident in Switzerland. In addition, the securities transfer tax on domestic bonds shall also be abolished. On 15 April 2021, the Federal Council published its adopted dispatch for approval to the Federal Assembly.[4]

Besides the mentioned proposals (abolition of withholding tax on interest income and securities transfer tax on domestic bonds), the withholding tax notification procedure shall be expanded. The current framework rules that a withholding tax of 35% is levied on dividend distributions. Between Swiss group companies, the notification procedure can be applied, thereby avoiding a cash-out of 35% and reclaim by the Swiss parent company in case of minimum 20% shareholdings. The reform aims to reduce the threshold for participation to 10% (instead of 20%) and to extend the validity of confirmations regarding the international notification procedure to five instead of three years. The consultation procedure is currently running for the proposed simplification of the withholding tax notification procedure.

The entry into force of the Swiss federal withholding tax reform, if adopted, is not expected before 2023 due to accompanying required adjustments at the ordinance level. The exact measures of the proposed reform may change as a result of the parliamentary debates.

Reform of corporate law

On 19 June 2020, the Swiss Parliament adopted the revision of the stock corporate law.[5] Among other things, the bill contains new provisions for more flexible formation and capital regulations. Specifically, a new legal instrument has been introduced: the capital band. The board of directors will be authorised to increase or decrease the capital as required within a predefined range between plus 50% and minus 50% of the registered share capital – the capital band – for a maximum period of five years. The introduction of the capital band will replace the previous instrument of authorised capital, which only permits capital increases. The reform provides that capital contribution reserves that may be repaid tax-free at a later stage may only be created at the end of the capital band, i.e. after five years at the latest. This may have negative tax consequences under certain constellations. Furthermore, as part of the revision of the Stock Corporation Act, the Federal Council was instructed to prepare the catalogue of permissible foreign currencies for the denomination of a stock corporation's capital. The reform also explicitly allows the possibility of interim dividends distributed from profits of the current financial year. The reform addresses many more topics such as gender quota on the board of directors and the executive board of major listed companies. Some of the technical adjustments regarding the foundation process and changes in capital will also require adjustments in the Commercial Register Ordinance, not likely to enter into force before 2023.

Tax treatment of fines and bribes

On 11 November 2020, the Federal Council decided on the entry into force of the Federal Act on the Tax Treatment of Financial Sanctions with effect from 1 January 2022.[6]

According to this Act, domestic punitive financial sanctions, i.e. fines, monetary penalties and punitive administrative sanctions, will still not be tax-deductible. In contrast, foreign sanctions with punitive character shall be tax-deductible for corporations in exceptional cases provided that the sanctions violate Swiss public policy (*ordre public*) or if a company credibly demonstrates that it has taken all reasonable steps to comply with the law. Furthermore, bribes paid to private individuals will no longer be tax-deductible, which also includes expenses that make an offence possible or are paid in return for one being committed. The implementation of this Act harmonises Swiss tax with Swiss criminal law.

Circular Letter No. 37 regarding the taxation of employee stocks

Share-based incentive plans are very popular in Switzerland among employers of all sizes as the employee (typically manager or director) receiving the right to participate in the equity of the employer strengthens the employee's relationship with, and his/her commitment to, the employer. From a financial incentive perspective, incentive share plans provide for the possibility of a tax-free private capital gain for Swiss taxable employees. The tax treatment of an employee's stock in its employer may substantially deviate from canton to canton due to a broad deviation in the determination of the fair market value of non-listed shares and similar instruments. In order to strengthen the harmonisation of the tax treatment of employee stock, the SFTA published on 30 October 2020 the amended Circular Letter No. 37 "Taxation of Employee Participations" (Circular 37).[7] The alignment of the tax consequences from participation plans is expected to increase Switzerland's attractiveness for start-ups and established companies alike.

The amendments according to Circular 37 primarily address the valuation and tax treatment of non-listed employee shareholdings. In contrast to the stock of listed companies, for non-listed companies – to which category start-ups generally belong – a fair market value is only at times available, i.e. in case of a recognised substantial third-party transaction involving such stock. When a fair market value is missing, the company's equity needs to be determined based on a suitable and recognised valuation method, which is referred to as the "formula value".

Circular 37 newly refers to the so-called practitioners' method, a widely used valuation method for the purpose of Swiss wealth tax, as an appropriate formula value for unlisted stock. According to the practitioners' method, the fair market value of a company is based on a weighted average of the accounting equity (single weighting) and the capitalised historic earnings (double weighting), with the accounting equity being considered the floor. However, other valuation methods (e.g. turnover or EBITDA multiples) may be applied as well, provided that they are accepted by the tax authorities.

As a general rule and key taxation principle in Switzerland, private capital gains from movable assets realised by Swiss resident individuals are tax-free. This principle of tax-free capital gains applies according to Circular 37 without restrictions for founder shares and shares that were either purchased at fair market value, or for which the employee was taxed at grant (in case of a discounted acquisition) on the basis of a fair market value. In case of employee stock without a fair market value, for which a formula value was calculated at grant, the capital gain may not be entirely tax-free. The portion of the capital gain exceeding the formula value based on the same valuation method as applied at grant, the "excess gain", is considered salary and subject to income tax and social security deductions. In this respect, probably the most noteworthy amendment in Circular 37 is the extension of the practice already performed by certain cantons to treat an excess profit as tax-free after a period of five years from the grant of the shares, provided that no change to a different formula or fair market value occurred in such period.

<u>International tax developments</u>

Mandatory disclosure rules: Impact of the EU Mutual Assistance Directive (DAC 6)

Directive 2018/822 (DAC 6) of 25 May 2018 is based on Base Erosion and Profit Shifting (BEPS) Action 12. The goals are to increase tax transparency by identifying arrangements with aggressive tax planning components at an early stage. For this purpose, the EU introduced with its DAC 6 mandatory disclosure requirements for certain tax planning models with cross-border elements in the EU area. In principle, intermediaries (encompassing advisors) in third countries such as Switzerland are not subject to these disclosure requirements. Therefore, in case a Swiss intermediary is involved in a harmful arrangement or an EU intermediary can claim a professional privilege, their duty to report aggressive tax planning arrangements falling under DAC 6 will be waived and in return passed to the taxpayer. As an exception, however, if an advisory activity has an EU nexus, potentially aggressive tax planning models of the clients must be disclosed by the respective Swiss advisor. An EU nexus advice is present, for example, if advisory activity is provided through a permanent establishment in an EU Member State, or if an advisor is registered under the law of an EU Member State or is a member of an organisation for legal, tax or advisory services.

Global Forum's recommendations

On 6 April 2020, the Global Forum's second round peer review report in respect of Switzerland was published.[8] As in the first round, Switzerland was found to be largely compliant. The main recommendations concern the availability of ownership and identity information and the confidentially provisions, in particular the obligation of the jurisdiction's information exchange mechanism to make sure that it has adequate provisions to ensure the confidentiality of the received administrative assistance requests. The first set of recommendations appears to be related to the fact that the Federal Act on the implementation of the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes was only adopted recently and its effectiveness has not yet been tested.

Due to the COVID-19 pandemic, the test of effectiveness has been postponed to 2022. In contrast, the recommendations in respect of confidentially may prove problematic. In particular, it is recommended to ensure that the request letter is kept confidential during administrative proceedings, that a rather narrow exception to the right to see the file is expanded, and that the information on the received requests (including the bulk requests) is not published in the Federal Gazette. As these requirements impinge on the fundamental rights of the parties in administrative proceedings, it remains to be seen whether and how they might be implemented in Switzerland.

OECD Programme GloBE, Pillar 1 and Pillar 2

In May 2019, the OECD published a programme of work on the tax challenges arising from the digitalisation of the economy, whereas the OECD decided, in October 2020, to continue the work in this regard. The OECD's programme of work proposals is founded on two pillars and will be the next challenge Switzerland needs to address. As per the proposed solution in Pillar 1, a higher share of consolidated profits should be allocated to market jurisdictions for taxation. Pillar 2 is about a minimum taxation rule. It envisages a worldwide minimum tax rate for a group of companies. Should a company's income tax rate be below this minimum tax rate, other states where a group of companies is seated shall be entitled to levy additional taxes. Under certain conditions, a similar taxation nexus has already been applied by several high-tax jurisdictions (*inter alia*, the EU under the Anti-Tax Avoidance Directive II) for controlled foreign companies (CFCs) by fictitiously adding back profits from these lower-taxed controlled foreign group companies to the parent company.

Switzerland's position to these developments is that taxation should continue to apply at the place of performance-related value creation and that the share of profit to be allocated to market jurisdictions remains in proportion with their share of added value, and hence moderate.[9] A tax competition shall be available within a fair framework. New taxation rules shall not hinder growth and innovation. Should the new rules as proposed within Pillars 1 and 2 be implemented, Switzerland as a smaller, innovative and export-based economy will likely see its tax revenue decreasing.

In order to keep Switzerland attractive as a location and to protect the Swiss tax base, some cantons have already responded to foreign CFC rules by introducing adjustable income tax rates (*flexible Gewinnsteuersätze*). The introduced rates mean that the cantons can be divided into two categories: Option 1; and Option 2. Option 1 provides for an increase of the income tax rates on request. Under certain circumstances, a tax authority can decide, or a taxpayer can request, as the case may be, an increase of the cantonal income tax rate in order to reach the minimum tax rate accepted by the foreign tax jurisdiction and thereby avoid a taxation of Swiss profits abroad or non-deductible expenses for payments to Switzerland. Option 2 provides for an automatic increase of an income tax rate in case another jurisdiction should request a minimum taxation. There is no harmonised law in force yet, which is why the wording differs between the cantons that have already introduced respective provisions to avoid CFC rule taxation. A positive consequence of the introduction of these rules is the increase of fiscal income, whereas the affected companies profit from a lower tax burden in Switzerland compared to the foreign jurisdiction applying the CFC rules. However, the constitutional conformity of these rules might be challenged and subject to court proceedings. It is expected that a harmonised legal foundation will be discussed soon by the legislator, in particular, should the work regarding Pillar 2 proceed and Switzerland's attractiveness be threatened.

Automatic Exchange of Information (AEOI)

The legal foundations for the AEOI have been in force since 1 January 2017. The Swiss Parliament has approved the introduction of the AEOI with 108 partner states. Aside from Switzerland, more than 100 states committed to implement the standard. Switzerland's network of AEOI partner states includes all EU and European Free Trade Association Member States, almost all G20 states, and all OECD states. Financial account information was successfully exchanged with a total of 86 partner states.[10]

On 11 November 2020, the Federal Council approved the amended Ordinance on the AEOI (AEOIO), together with the amendment to the Federal Act on the International Automatic Exchange of Information in Tax Matters (AEOIA),[11] thereby responding to the recommendations presented by the Global Forum to Switzerland. Among other things, the amendments are an adjustment of the applicable due diligence requirements and an introduction of a document retention obligation for reporting Swiss financial institutions. The amendments to the AEOIA and AEOIO entered into force on 1 January 2021.

International DTTs

Switzerland remains active in negotiating new or revising existing DTTs. As of 1 January 2021, Switzerland has signed more than 100 DTTs, most of which contain a provision on the exchange of information according to international standards. In addition, Switzerland has signed 10 tax information exchange agreements, all of which are in force.

Revised DTTs that entered into force, or whose dispatch was submitted to the Swiss Parliament for approval, between March 2020 and March 2021 include treaties with the Principality of Liechtenstein, Malta, Cyprus, Bahrain and Kuwait. The revision of these DTTs implements the BEPS minimum standards and some of them include an arbitration clause. Furthermore, Switzerland has concluded DTTs with Brazil and Saudi Arabia, which will apply as of 1 January 2022.

As an example, Switzerland and the Principality of Liechtenstein signed a protocol on 14 July 2020 (not yet in force) amending their agreement for the avoidance of double taxation with respect to taxes on income and capital. The protocol implements the minimum standards for double taxation agreements resulting from the BEPS project. It contains an anti-abuse clause that refers to the main purpose of an arrangement or transaction and ensures that the DTT is not abused. It also supplements the provision on the mutual agreement procedure in accordance with the minimum standard.

Tax policy in response to the COVID-19 pandemic

With respect to the COVID-19 pandemic, in its report "Tax and Fiscal Policy in Response to the COVID-19 Pandemic: Strengthening Confidence and Resilience", the OECD pointed out that recovery after containment and mitigation may require fiscal stimulus and tax support. However, the support must be carefully timed and well targeted. According to the OECD, tax support should be directed to limiting adverse impacts and aggregate demand, especially for the most vulnerable households and businesses.

Switzerland has implemented several fiscal support measures in order to safeguard employment and wages and support self-employed individuals and companies. For instance, the eligibility for unemployment benefits has been extended, short-time working has been extended, and speedy COVID-19 bridging loans with low interest rates, backed by the Swiss Confederation, have been made available for all types of businesses (limited to five years). Around 137,000 COVID-19 loans have been provided to date. Also, a number of tax measures have been implemented: companies have been given the possibility to temporarily defer payment of social security contributions; and tax payment periods can be extended without interest on arrears. For this reason, the interest rate for value-added tax (VAT) was reduced to 0.0% (from 21 March to 31 December 2020). The same regulation applied to direct federal (personal and corporate income) tax (from 1 March to 31 December 2020). All of these measures were temporary.

Digitalisation efforts

The Federal Department of Finance currently accompanies various digitisation projects. The goal is to provide a platform for digitised and secure processes with the federal administration and make the services more easily accessible to citizens and companies, and centralise the ePortal online services provided by the Swiss Federal Customs Department and the SFTA.[12] Online services will be offered completely across this platform in the future. Further information can be found at https://www.eportal.admin.ch.

In 2020, the SFTA digitalised its services for the processing of VAT and withholding tax as well as the charges for radio and TV.

<u>Domestic – cases</u>

Decision of the Swiss Federal Supreme Court 2C_1116/2018 dated 5 August 2020 – Principles of International Profit Allocation and Tax Rulings

In this case, the Swiss Federal Supreme Court dealt with the application of domestic profit allocation methods for cross-border enterprises and the binding force of confirmed tax rulings.

Two companies located in Switzerland, in the canton of Glarus, supported foreign military troops and civilian emergency services abroad with daily consumption products (food, fuel, etc.). The products were acquired in countries abroad and transported to the respective conflict areas worldwide. Both companies maintained permanent establishments on-site for the processing of the products. Subject to the decision were the companies' business activities in Afghanistan from 2009 to 2011, respectively, and the tax periods from 2009 to 2011.

Switzerland and Afghanistan did not enter into a DTT. Swiss tax law provides for an exemption of foreign permanent establishments' profits, regardless of whether there is a DTT or not.

The profit allocation between the Swiss headquarters and their foreign permanent establishments for federal income tax purposes was subject to a cantonal tax ruling. The tax authority of Glarus confirmed with letters dated 2008 and 2010 that for the purpose of direct federal tax, the domestic taxable profit was based on costs incurred in Switzerland (without personal costs) plus a profit margin of 50% (for tax periods as of 2007 and 2009, respectively). For taxes at the cantonal level, another profit allocation method was admitted. In 2012, the SFTA, after reviewing the case, objected against the unlawful profit allocation for the periods from 2009. The cantonal tax authority of Glarus subsequently shared the SFTA's view. The cantonal tax authority assessed the taxable profits for tax periods 2009 to 2011 on a worldwide basis, less the profits from the permanent establishments on a cost plus 10% basis with a maximum 1% of net revenue. Both companies appealed against the tax assessments of 2009 to 2011.

In Switzerland, there is a long-standing tradition to submit a ruling request for contemplated transactions or business activities with the tax authorities and to get a confirmation for the tax consequences of respective transactions or activities. The question at hand was whether a confirmed ruling by the tax authority of Glarus that contradicts the law still has binding effect, i.e. to what extent the protection of confidence (*Vertrauensschutz*) in a (false) confirmation by a competent authority may exist.

The Federal Supreme Court first considered that the tax rulings contradicted tax law in Switzerland. According to the tax rulings, Swiss costs were the starting point based on which a taxable profit was calculated without considering any foreign income. When correctly applying Swiss tax law, however, the worldwide income of the companies would serve as the starting point and then, based on a profit allocation, a foreign profit would be exempted. Thus, the ruling confirmation contradicted tax law but would still be binding. Further, the Federal Supreme Court stated that an incorrect ruling, e.g. a ruling contradicting the law, would not be protected if such incorrectness is easily recognisable for the parties. Due to limited considerations by the lower court whether incorrectness of the rulings was easily recognisable in the case at hand and whether the taxpayer made disposition in reliance on the ruling, the Swiss Federal Supreme Court admitted the appeal and referred the case back to the lower court for further assessment of the recognisability of the incorrectness of the rulings.

One of the requirements for a good faith protection in the received ruling confirmation is that the confirmation is not obviously incorrect, i.e. easily recognisable. It is expected that the outcome of the pending court case will provide more insight on the interpretation of the recognisability of any ruling.

Decision of the Swiss Federal Supreme Court 2C_880/2018 dated 19 May 2020 – Clarification regarding Beneficial Ownership and Treaty Entitlement

The Swiss Federal Supreme Court clarified the meaning of beneficial ownership according to DTTs and specified treaty abuse by passing through constellations of profits/dividends.

A. Plc is a bank headquartered in the United Kingdom and which belongs to investment banking group A with headquarters in New York, USA. In May 2008, A. Plc received a gross dividend of approx. CHF 100m for its participation in B. AG (B shares). The withholding tax of 35% of the gross dividend was deducted. On 30 September 2008, A. Plc submitted a request to the SFTA for a reimbursement of the withholding tax in the amount of 20% of the gross dividend. In the following, A. Plc had correspondence during several years with the SFTA regarding its request for reimbursement. Finally, on 28 February 2017, the SFTA rejected the reimbursement request. After A. Plc's appeal to the Federal Administrative Court was dismissed as well, the matter was brought to the Swiss Federal Supreme Court.

The dispute revolves around the reimbursement request of 20% withholding tax on a dividend pursuant to the DTT between Switzerland and the United Kingdom. A claim under the DTT for reimbursement of the withholding tax requires the recipient to be the beneficial owner of the dividend. The definition of beneficial ownership is controversial and led to numerous court proceedings in Switzerland and foreign jurisdictions. In Switzerland, the Federal Supreme Court's leading case on the meaning of the term "beneficial owner" dated 5 May 2015 (DFT 141 II 447). According to this decision, the beneficiary is anyone who can fully make use of the dividend and enjoys it to the full extent. If the recipient is limited in his use by a contractual or legal obligation because he has to forward the dividend to another person by contract or law, he is not entitled to the use of the dividend and is therefore not seen as the beneficial owner.

The Federal Supreme Court, considering a dynamic interpretation of the meaning "beneficial owner" and founding its assessment on the principle of substance over form, held that a person is not entitled to use the dividend income, i.e. is not the beneficial owner, if he has a contractual or legal obligation to forward the dividend to another person. Whereas the former leading decision also found an actual obligation to forward dividends to be sufficient for a person to lose their beneficial ownership status, this decision makes clear that treaty entitlement will only be excluded in case of a legal obligation.

In the case at hand, A. Plc concluded derivative agreements for the purchase of shares under the condition to forward 15% of the gross dividend and other similar agreements with obligations to forward reimbursed dividends. The Federal Supreme Court concluded that, for these arrangements, there is no explanation other than that which the counterparties tried to get in the position of claiming the advantages arising out of the DTTs between Switzerland and the United Kingdom. One must conclude that the main reason for the arrangements was to profit from treaty benefits. Thus, the arrangements concluded between A. Plc and its counterparties fulfils the characteristics of a profit forward arrangement, which is why A. Plc's treaty entitlement was revoked and its appeal dismissed.

Tax climate in Switzerland

<u>Increasing tax disputes</u>

Increasing tax transparency, which especially results from the implementation of the AEOI, has led to a flood of non-punishable voluntary disclosures during the last few years. The implementation of the mandatory disclosure requirements introduced in Directive 2011/16/EU on mandatory AEOI in the field of taxation in relation to reportable cross-border arrangements (DAC 6), although not directly applicable to Switzerland, undoubtedly adds to tax transparency.

As a result of increased transparency, we expect that the amount of tax litigation, in particular intercantonal disputes, i.e. disputes among high- and low-tax cantons and also tax arbitration in the field of transfer pricing, is going to increase in the next few years.

Tax reforms

Various measures at the cantonal and federal levels have ensured a relatively smooth implementation of the TRAF and the abolishment of privileged tax regimes. The local tax authorities are generally cooperative and searched for business-friendly compromises to settle the most pressing issues, such as, for example, the taxation of hidden reserves accumulated in the period when a company was subject to a privileged tax regime. Although there are still some uncertainties as to how the patent box regime and the R&D super deduction will be definitively assessed, both instruments should also raise, or at least maintain, the attractiveness of Switzerland.

Further reforms such as the withholding tax reform are currently being prepared and should contribute to Switzerland's competitiveness as a location for multinational corporations. Should Pillar 2 be further pursued by the OECD and a minimum group tax rate be introduced, already existing means such as adjustable corporate income tax rates could allow for the protection of Switzerland's attractiveness for tax purposes and secure the Swiss tax base. Lastly, intercantonal questions in view of less harmonised rules in the various cantons will hopefully be solved in the upcoming years.

Developments affecting attractiveness of Switzerland for holding companies

Following the entry into force of the TRAF, holding companies are no longer exempt from cantonal and communal profit tax. Still, the attractive participation deduction provisions for dividends and capital gains will remain unchanged. The availability of the participation deduction in combination with the decrease of cantonal taxes in almost all of the cantons should ensure that Switzerland remains an attractive location for holding companies. Further, Switzerland currently has no intention of introducing CFC rules and generally remains, with its extensive DTT network, a beneficial location for holding companies.

Industry sector focus

Technology industry/fintech

As part of the Swiss federal government's policy for an internationally competitive financial centre, finance.swiss was launched, which is a key pillar of the Federal Council's strategy on Switzerland's communication abroad. The finance.swiss portal has sponsors from both the Swiss Confederation and the financial sectors and brings together the latest information regarding the Swiss financial centre in one place.

For example, Switzerland aims to become a global hub for green digital finance and this was communicated through finance.swiss. Therefore, an action plan has been published by the Green Fintech Network facilitating access to sustainable data. This could help Switzerland turn into a global leader in the area of green fintech.

Debt markets

In order to ensure financial stability, the Federal Council decided on 29 October 2020 to extend the exception of interest on too-big-to-fail (TBTF) instruments, which are an important tool used by banks to meet regulatory capital requirements from withholding tax until the end of 2026. Similarly, the proposed comprehensive reform of withholding tax is going to strengthen the debt market in a medium-term priority. Since the dispatch was recently published and will be subject to parliamentary debate, this reform will not enter into force before 2023, which is why the banks are dependent on some certainty for the tax treatment of the interest on TBTF instruments.

The reform of the Withholding Tax Act in respect of interest income has potential to boost the Swiss debt market. It is hoped that the reform will lead to an increased competitiveness of the Swiss debt capital market. The recent proposal by the Federal Council to abolish withholding tax on interest paid to Swiss corporate and all foreign investors should make it more attractive for Swiss companies to issue bonds and notes and carry out group financing activities (e.g. treasury and cash pooling functions) outside of Switzerland. Considering the total volume of bonds by Swiss corporations of 500bn whereof around three-quarters were issued abroad, there is huge potential for future activities for domestic bonds in Switzerland.

The year ahead

As mentioned, 2020 will be remembered as the year when COVID-19 caused shutdowns worldwide with far-reaching consequences. Economic activities were limited (voluntary and non-voluntary) in various aspects. Positive news was released on 9 November 2020, when Pfizer-Biontech had a breakthrough regarding a vaccine for COVID-19. Further announcements of vaccines followed, and this is expected to provide economic stability and consequently accelerate M&A activity.

Switzerland offers an attractive tax regime. With the TRAF coming into force as from 1 January 2020, effective tax rates were substantially reduced for corporations in Switzerland. First potential discussions or disputes with tax authorities will evolve in 2021, when tax declarations for 2020 will be submitted and the use of additional tax benefits according to the TRAF might be challenged. So far, the tax authorities have been open for collaborative discussions. Further, as Switzerland has a broad treaty network, attractive income tax rates, TRAF instruments (patent box, R&D super deduction, etc.) reducing the tax burden, no CFC rules, and tax certainty due to the availability of advance ruling confirmation, it still has a favourable environment for companies. The current reforms regarding corporate law and withholding tax will contribute to Switzerland's competitiveness as a business location.

Should the new rules as proposed by the OECD within Pillars 1 and 2 be implemented, Swiss multinationals would be affected by measures such as adjustable corporate income tax rates that need to be implemented to retain Switzerland's international taxation competitiveness. A full absorption, however, is not expected or likely.

Switzerland intends to remain a world-leading financial centre. The withholding tax reform, in particular, could promote Switzerland to continue to be attractive as an international business location and produce added value. The SIX's trading venue for green bonds and first issuances of sustainability bonds (by Raiffeisen Schweiz in 2019) and sustainability-linked bonds (by Novartis in 2020) might be the beginning of a promising development.

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Endnotes

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