CORPORATE TAX - SWITZERLAND

Taxation of digital economy: Swiss response to recent OECD statement

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Introduction

Digitalisation is changing the way businesses operate and new business models have become a growing challenge for existing international tax systems.

Under the Base Erosion and Profit Shifting (BEPS) project, the Organisation for Economic Cooperation and Development (OECD) is tackling the complex question of how to adapt international taxation systems to make them fit for the digital age. In this context, on 31 January 2020, the OECD released a statement update on building a new international framework for allocating part of the profits of multinational enterprises (MNEs) with a substantial digital business footprint in countries in which they have a large user base, but no physical presence (market jurisdictions). The statement update includes insights on business lines potentially in scope as well as more details on nexus and profit allocation rules. Many questions are still open and the international community, including Switzerland, will continue to work towards reaching an agreement on the key policy features by the end of 2020. This article provides an overview of the statement update and outlines Switzerland's position in this regard.

Background

As per the current international income tax rules, business profits generated by an enterprise are taxable exclusively by the state of residence unless the enterprise conducts business in the source state through a permanent establishment (PE) situated therein. In other words, a country can tax a foreign enterprise only if there is a nexus through a certain level of physical presence in the respective country.

However, novel business models continue to erode the need for physical presence in target markets. As a consequence, many MNEs in the digital space (eg, Google, Amazon, Instagram and Facebook) are able to avoid taxation in market jurisdictions, lacking physical presence therein, while having a large user or consumer base in countries contributing to their annual revenues.

Against this backdrop, the OECD has been working on a two-pillar approach to adapt the existing international income tax rules to the changing modern global economy. While the first pillar addresses the broader challenges of the digitalised economy and focuses on the allocation of taxing rights, the second pillar refers to certain other BEPS issues.

Pillar One

Pillar One focuses on modifying the existing nexus and profit allocation rules to provide market jurisdictions with additional taxing rights. Accordingly, the new nexus rules would depart from the traditional PE concept and a portion of profits would be allocated among the different eligible market jurisdictions in which an MNE has no physical market presence.

Pillar Two

Under Pillar Two, the focus is on introducing a minimum level of taxation and certain other measures yet to be defined to prevent the shifting of profits to low-tax jurisdictions.

Statement update

The statement update released on 31 January 2020 provides further insight into Pillar One, focusing

on the allocation of taxing rights, outlining its architecture and aim to include both automated digital and consumer-facing businesses in its scope. By contrast, for Pillar Two, only a high-level progress report on the OECD's work was released.

In summary, the statement update includes the following noteworthy new or clarified elements:

- Safe harbour regime: the US proposal to make Pillar One an optional safe harbour regime, meaning companies should be able to opt into or out of changes to the allocation of taxation rights between countries, must be considered in further detail.
- Scope: Pillar One is intended to apply to:
    - automated digital services (ie, businesses which create revenue by providing automated and standardised digital services to a large and global customer or user base, such as online search engines, social media platforms, online marketplaces, digital content streaming, online gaming, cloud computing services and online advertising services); and
    - consumer-facing business (ie, businesses which generate revenue from the sale of goods and services of a type commonly sold to consumers (ie, individuals that purchase items for personal use rather than commercial or professional purposes) such as businesses selling personal computing products (eg, software and mobile phones), clothing, branded foods and refreshments, franchise models or automobiles, but not entities merely selling consumer tangible goods into a market jurisdiction without a significant and sustained presence in the relevant jurisdiction).

  The definition of both categories has not yet been elaborated. By contrast, business selling intermediate products and components that are incorporated into a finished product sold to consumers, extractive industries, sellers of raw materials and commodities, most financial services (including insurance) as well as airline and shipping businesses are likely to fall outside the scope of Pillar One.

- Thresholds: the new rules should be limited to MNE groups that meet certain thresholds, namely:
    - a gross revenue threshold (which could be the same €750 million threshold used for country-by-country reporting);
    - a carve-out for situations wherein the total aggregated in-scope revenue falls under a certain threshold;
    - a carve-out for situations wherein the total profit to be allocated under the new taxing right would not meet a certain *de minimis* amount; and
    - additional thresholds concerning the effective computation of the residual profit allocated to market jurisdictions and application of the new nexus rule.
- One-stop-shop approach: there should be simplified reporting mechanisms and exclusive filing in the ultimate parent jurisdiction (rather than all market jurisdictions).
- Measurement: the consolidated group financial accounts should form the calculation basis for the portion of residual profit allocable to market jurisdictions and rules for the treatment of losses must be set up.
- Dispute resolution: a mandatory and binding new approach on a multilateral basis should be developed to prevent disputes and to timely resolve any disputes that arise.
- Multilateral instrument: the new rules should be implemented by a multilateral convention superseding the relevant provision of existing tax treaties and applying between jurisdictions that have not yet concluded bilateral treaties.

Many important details and policy issues under the two pillars remain unresolved and various countries have introduced or proposed unilateral measures to impose new taxes on digital service providers. This has increased pressure on the OECD to reach a consensus-based solution to tax the digital economy by the end of 2020 to avoid such unilateral actions in future.

Swiss position

In connection with the statement update, Switzerland assured that it would maintain its support for the development of a multilateral solution for taxing the digital economy to avoid unilateral actions that jeopardise growth and innovation. Further, Switzerland takes the stance that:

- international companies should be taxed where added value is generated. Accordingly, the share of profit to be allocated to the market jurisdictions should remain in proportion to the share of value added and, thus, be moderate; and
- a binding minimum tax level generally hampers innovation and growth and tax competition must continue to be allowed within a fair framework. Thus, any minimum tax recommendations on an international level must be moderate.

Switzerland further expects that smaller, innovative and export-based economies such as

Switzerland will lose out on income tax receipts once the existing international income tax rules will have been adapted.

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