

NOVARTIS AG SPIN-OFF OF ALCON INC. SHARES ON APRIL 9, 2019 CANADA INCOME TAX GUIDELINES

INTRODUCTION

The following document addresses frequently asked questions (FAQs) concerning the income tax implications to residents of Canada that have an equity interest in Novartis AG on the close of business on April 8, 2019 and received an equity interest in Alcon Inc. on April 9, 2019 as a result of the Novartis AG spin-off of Alcon Inc. (Spin-off).

Novartis AG is a publicly traded company whose shares are listed on the SIX Swiss Exchange and also traded as American Depositary Receipts (ADR) on the New York Stock Exchange (NYSE). The Spin-off was effected on April 9, 2019 by way of a distribution of a dividend in kind of Alcon Inc. shares to Novartis AG Shareholders and ADR Holders. Alcon Inc. became a publicly traded company on the SIX Swiss Exchange and the NYSE on April 9, 2019. Each Novartis AG Shareholder and ADR Holder received one (1) Alcon Inc. share for every five (5) Novartis AG shares/ADRs (the 20% Conversion Ratio) that they held on the close of business on April 8, 2019.

The result of the Spin-off is a foreign dividend for Canadian income tax purposes. The foreign dividend must be included in taxable income by residents of Canada. **An election pursuant to section 86.1 of the Income Tax Act (Canada) (the Act), is available to defer taxation on the foreign dividend, as explained in FAQs 2 to 4 below.**

The information in this document refers to the Federal income tax implications to residents of Canada resulting from the Spin-off. The Canadian provinces rely on the Federal income tax legislation related to foreign spin-offs and have similar income tax implications. Note that residents of Quebec must file a separate election to defer taxation on the foreign dividend with their Quebec income tax returns.

This document is being provided for information purposes only and is not intended to cover all Canadian tax implications resulting from the Spin-off. As such, this document should not be used as tax advice and you should consult with your tax advisor to address your specific tax implications resulting from the Spin-off.

More detailed information related to the Spin-off is available in the Proposed Spin-off of Alcon Shareholder Information Brochure dated February 28, 2019 and the Alcon Inc. Form 20-F Registration Statement dated March 21, 2019; the respective links to the documents are below:

<https://www.novartis.com/sites/www.novartis.com/files/2019-novartis-agm-alcon-en.pdf>

<https://www.novartis.com/sites/www.novartis.com/files/alcon-20f-filing-2019.pdf>

Novartis associates can also refer to the Alcon Spin-off – Equity Restoration for Novartis Associates (North America Participants) slides dated January 31, 2019.

Information on foreign spin-offs is also available on the following Canada Revenue Agency (CRA) website:

<https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/foreign-spin-offs.html>



The following definitions are specific to Novartis associates and external Shareholders and ADR Holders of Novartis AG that are residents of Canada:

DEFINITIONS

American Depository Receipt (ADR): A negotiable certificate issued by a US bank representing a specified number of shares in foreign (non-US) stock traded on a US exchange.

Dividend in kind: Typically, a foreign spin-off results in a foreign dividend in kind, which takes the form of a distribution of common shares of the capital stock of another foreign corporation. It is considered a foreign dividend not eligible for a dividend tax credit, which is taxable as ordinary income to residents of Canada. The amount of the dividend in kind is equivalent to the value of the new shares at the spin-off date. Note that a small cash residual payment often follows where the value of the dividend in kind does not correspond to a whole number of spin-off shares.

Equity: Award granted to a Novartis associate under the Novartis long-term incentive (LTI) plan.

Performance Share Unit (PSU): A PSU is an Equity instrument issued under the Novartis LTI plan. A PSU is technically and legally similar to a RSU (defined below), however the number of Novartis AG ADRs ultimately received based on the conversion of PSUs to ADRs will depend on the achievement of performance targets and other conditions such as continued employment.

Resident of Canada: Every person resident in Canada must pay Canadian income tax on taxable income, including a non-resident person that is deemed a resident of Canada for income tax purposes.

Restricted Stock/Share Unit (RSU): A RSU is an Equity instrument issued under the Novartis LTI plan. A RSU is a promise to receive a Novartis AG ADR at a later point in time, typically at the vesting date at which the RSU is converted to a Novartis AG ADR. Moreover, employment conditions may be linked to an RSU award (i.e., they lapse if employment ends prior to vesting). A RSU does not carry dividend rights and there is no voting entitlement prior to its conversion to an ADR.

Shareholder and ADR Holder: Holders of Novartis AG shares/ADRs that are entitled to receive dividends.

Spin-off: A spin-off occurs when a foreign corporation (i.e., Novartis AG) creates a spin-off company (i.e., Alcon Inc.) by distributing 100% of its ownership interest of a part of its business (i.e., Alcon Inc.) as a dividend in kind to its existing Shareholders and ADR Holders. If you held Novartis AG shares/ADRs at the close of business on April 8, 2019, you received a dividend in kind of Alcon Inc. shares according to the 20% Conversion Ratio.

Taxpayer: Includes a person resident in Canada that is liable to pay Canadian income tax. A person includes an individual, corporation and trust.

Tradable Option: A Novartis AG tradable option is an Equity instrument issued under the Novartis LTI plan that can be sold to a market maker once it is vested.

FAQs

1. What are the Canadian income tax implications on the dividend in kind received by Novartis AG Shareholders and ADR Holders who are residents of Canada?

- Novartis AG Shareholders and ADR Holders received a dividend in kind in the form of Alcon Inc. shares at the rate of one (1) Alcon Inc. share for every five (5) Novartis AG shares/ADRs held at the close of business on April 8, 2019. They also received cash for any fractional shares/ADRs held at that date. The dividend in kind and any residual cash received is taxable to the resident of Canada and must be included in the computation of Federal and provincial taxable income for the 2019 taxation year.
- Canadian income tax legislation allows Taxpayers to defer taxation on the dividend in kind if an election is filed. **The election is explained in FAQs 2 to 4 below.** The election does not cover the residual cash receipt. Please consult with your tax advisor on the tax treatment of the residual cash receipt.
- The dividend in kind and any residual cash received, as a result of the Spin-off, is **not** taxable if the Novartis AG shares/ADRs are held in a registered plan (i.e., Registered Retirement Savings Plan, Tax-Free Savings Account, etc.).

2. Can the income tax on the dividend in kind resulting from the Spin-off be deferred?

- Canadian income tax legislation allows Taxpayers to elect in writing, when filing their Federal tax returns for the taxation year in which the Spin-off occurred, to defer the income tax on the dividend, provided the Spin-off is an "eligible distribution", as defined in subsection 86.1(2) of the Act (Quebec residents can file a similar election with their Quebec income tax returns).
- **Novartis received the enclosed comfort letter, dated February 14, 2020, from the Department of Finance Canada stating that the Spin-off qualifies as an eligible distribution, which will allow Shareholders and ADR Holders to file an election and defer taxation on the foreign dividend income.**
- **The following CRA website will include the Alcon Inc. shares as eligible for the election once an amendment is made to Regulation 5600 of the Act. Note that the amendment to the Act can take some time, therefore, Shareholders and ADR Holders can file the election based on the Department of Finance Canada comfort letter and do not need to wait for the CRA to list the shares on their website.**

<https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/eligible-spin-offs.html>

3. How does a Taxpayer make an election to defer income tax on the dividend in kind received in the form of Alcon Inc. shares?

- The Taxpayer can elect to defer taxation on the dividend in kind by including a letter with the Taxpayer's income tax return for the 2019 taxation year. Please note that individuals cannot file their income tax returns electronically for the taxation year to which the election relates (i.e., 2019). Corporations who file electronically can use the "Notes to Financial Statements" section to submit all the required information. If corporations are unable to fit all the required information in that section, the letter can be sent to the Tax Centre after filing electronically.

- The election letter must contain all of the following information:
 - written notification that the Taxpayer is electing to defer tax relating to the distribution of Alcon Inc. shares from Novartis AG, including a description of both the original Novartis AG shares/ADRs and the Alcon Inc. shares;
 - the number, adjusted cost base (ACB) otherwise determined, and fair market value (FMV) of the Taxpayer's Novartis AG shares/ADRs, both immediately before and after the distribution;
 - the number and FMV of the Alcon Inc. shares immediately after distribution; and
 - attach any tax slips or statements received regarding the foreign dividend income.
- Please consult with your tax advisor for information on filing a late election.

• **Examples of a Federal and Quebec election letter are enclosed with this document.**

4. Who can elect and what are the results of making the election?

- Any Taxpayer that received the dividend in kind in the form of Alcon Inc. shares can make an election. This election allows the Taxpayer to exclude from income the amount of dividend in kind that would otherwise be considered a taxable foreign dividend. However, if this election is made, the ACB of the Alcon Inc. shares will not be the FMV as would otherwise be the case. Instead, the ACB of the Alcon Inc. shares will be based on the cost of the original Novartis AG shares/ADRs that generated the distribution of the Alcon Inc. shares. This ACB will be allocated between the Novartis AG shares/ADRs and the Alcon Inc. shares, as explained in **FAQ 5** below.
- **The election allows a Taxpayer to defer immediate taxation at the ordinary income tax rate to taxation at a capital gain tax rate once the shares/ADRs are sold (i.e., tax applies on 50% of the capital gain instead of 100% of the ordinary income)**
- If the election is not made, the dividend in kind is taxable in 2019 as a foreign dividend income. The ACB of the Novartis AG share/ADR remains the same as before the Spin-off and the ACB of the Alcon Inc. share is \$77.29 in Canadian dollars based on the closing price on April 9, 2019 on the NYSE (Alcon Inc. share closing price of US\$58.04 converted using the exchange rate of 1.3316 on the Spin-off date). **Note that the ACB of Alcon Inc.'s share can be computed differently by using different share prices and exchange rates on April 9, 2019. Please consult with your tax advisor.**

5. How are the ACBs of the Novartis AG share/ADRs and Alcon Inc. shares recalculated when an election is made?

- In the interest of simplicity, the Novartis AG ADRs trading on the NYSE are sometimes referred to as Novartis AG shares in this FAQ. The following example explains how the ACBs of the Novartis AG and Alcon Inc. shares are recalculated. The example uses the closing selling prices on the NYSE on April 9, 2019, the Spin-off date, as the method of determining the FMV of the respective shares. The FMV of the Novartis AG and Alcon Inc. shares were US\$83.41 and US\$58.04, respectively. The FMVs converted to Canadian dollars using the exchange rate of 1.3316 on the Spin-off date were \$111.07 and \$77.29 for the Novartis AG and Alcon Inc. shares, respectively.
- Other approaches to determine FMV are also possible; you should consult with your tax advisor on the approach to use.

- Please note that this information is provided for illustrative purposes only and represents one possible approach to recalculate ACB.

Example

- Novartis AG spun-off the Alcon Inc. business to its Shareholders and ADR Holders by distributing 1 Alcon Inc. share for every 5 Novartis AG shares/ADRs held on the close of business on April 8, 2019 (i.e., 20% Conversion Ratio). For purposes of this example, Shareholders and ADR Holders are considered to be a Taxpayer as previously defined.
- Taxpayer holds 500 shares of Novartis AG with an ACB of \$90 per share. Taxpayer receives 100 shares of Alcon Inc. as a stock dividend from Novartis AG as a result of the Spin-off.
- Assume that the Spin-off meets all of the conditions and is eligible for the election discussed in FAQs 2 to 4.
- Taxpayer files the election to exclude the dividend in kind of \$7,729 (i.e., 100 shares of Alcon Inc. at \$77.29 per share) from taxable income. The new ACB for the Novartis AG and Alcon Inc. shares are recalculated as follows:
- The ACB of the Novartis AG shares will be reduced by an amount determined by the following formula:

$$\mathbf{A \times B \div C}$$

A is the ACB of a Novartis AG share prior to the distribution.

B is the FMV of the fraction of an Alcon Inc. share received for each Novartis AG share held.

C is the sum of the FMV of the Novartis AG share after the distribution and the FMV of the portion for the Alcon Inc. share received for each Novartis AG share.

That is:

$$\mathbf{A = \$90}$$

$$\mathbf{B = 0.2 \times \$77.29 = \$15.46}$$

$$\mathbf{C = \$111.07 + \$15.46 = \$126.53}$$

Therefore, the ACB of Taxpayer's Novartis AG shares are reduced by \$11 per share (\$90 × (\$15.46 ÷ \$126.53)).

- In general, when the election is made, the ACB of the Alcon Inc. shares is deemed to be the amount by which the ACB of the original Novartis AG shares is reduced using the above formula. Since Taxpayer received 0.2 of an Alcon Inc. share for each Novartis AG share held, each 0.2 share of Alcon Inc. will now have an ACB of \$11. Therefore, the ACB of 1 Alcon Inc. share after the election is now \$55 (i.e., \$11 x 5).
- As a result, the new ACB of the shares can be summarized as follows:
Novartis AG shares: \$90 - \$11 = \$79 per share; 500 × \$79 = \$39,500 for all the Novartis AG shares.

Alcon Inc. shares: \$55 per share; 100 × \$55 = \$5,500 for all the Alcon Inc. shares.

- In total, the new ACB of all shares owned by Taxpayer is \$45,000, which is the same as the ACB of the original Novartis AG shares that Taxpayer owned before the Spin-off (i.e., 500 x \$90 = \$45,000).
- A similar ACB calculation is found on the following CRA website:

<https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/information-canadian-shareholders.html#acb>

6. What are the income tax implications of the Spin-off for a Novartis associate that is a resident of Canada and held Novartis AG tradable options at the close of business on April 8, 2019?

- There are **no** immediate income tax implications for holders of Novartis AG tradable options as a result of the Spin-off. Canadian and provincial income taxes will be withheld once the tradable options are sold.

7. What are the income tax implications of the Spin-off for a Novartis associate that is a resident of Canada and held unvested Novartis AG RSUs/PSUs at the close of business on April 8, 2019?

- The holders of unvested Novartis AG RSUs/PSUs are not entitled to the dividend in kind resulting from the Spin-off, and therefore, the election is not required to defer taxation. Given that the Novartis AG share/ADR price decreased as a result of the Spin-off, Novartis AG RSU/PSU holders received additional Novartis AG RSUs/PSUs aimed at preserving the pre-spin value of their equity holding. This transaction is not an economic transaction and involves no dividend nor payment of any kind. As a result, no income tax implications arise at the grant date. Federal and provincial income taxes will be withheld once the Novartis AG RSUs/PSUs vest.

8. What are the income tax implications of the Spin-off for a current or former Novartis associate that is a resident of Canada and held a participation in the Novartis Stock Segregated Fund (Novartis Fund) at the close of business on April 8, 2019?

- The Novartis Fund is a holder of Novartis AG ADRs, therefore, the Novartis Fund received Alcon Inc. shares in the form of a dividend in kind using the same 20% Conversion Ratio. Only current and former associates of Novartis Canada may hold a participation in the Novartis Fund. **The Novartis Fund will have the responsibility to file the election to defer taxation on the dividend in kind.** There are no income tax implications to Novartis Fund holders if the Fund files the election.
- There are **no** income tax implications to Novartis Fund holders if the participation in the Novartis Fund is held in a registered plan.