

# Intra-group loans, interests, cash pooling from a Swiss tax perspective



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## Transfer pricing considerations in general

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Switzerland does not have specific transfer pricing regulations but follows the Organization for Economic Co-operation and Development (OECD) Guidelines as close as possible.

Swiss transfer pricing practice bases on Article 58 of the Federal Direct Tax Act as well as on Article 24 of the Harmonization of the Cantonal Tax Laws Act, which both define the calculation of a taxpayer's taxable net profit.

The FTA yearly issues instructions on the safe harbor maximum and minimum interest rates as set by reference to the prevailing interest rates in the Swiss market. If taxpayers deviate from the safe harbor rates, it is strongly advised that they maintain documentation to support the arm's length nature of the rates applied.

Swiss tax authorities are increasingly analysing transfer pricing aspects during tax audits.

Advance pricing agreements are possible.

# Leaf lets published by the FTA

## Loans in CHF

### “Safe harbor rules”

- Loans made **from** related parties (in CHF) - **maximum** interest rates (2018):

Real estate loans	Home construction, agriculture	Industry and business
a loan up to the amount possible for mortgage (i.e., 2/3rds of the market value of the real estate)	1%	1 ½%
rest	1 ¾%	2 ¼%
Operational loans	Trading and manufacturing companies	Holding and asset management companies
made to trading and production companies	3% up to CHF 1m loans, on exceeding loans 1%	2 ½% up to CHF 1m loans, on exceeding loans ¾%

- Loans **to** related parties should bear a **minimum margin** of ¼% to ½%, depending on whether equity or debt financed.

**Market test reserved, documentation of at arm’s length conditions**

## Leaf lets published by the FTA Loans in foreign currencies

The FTA published safe **harbour rules for interest rates on loans in foreign currencies for FY 2018**. Thin cap rules as well as minimum and maximum interest rates are relevant in order to avoid negative tax consequences. The below mentioned interest rates are safe harbour. In case of documented higher or lower fair market rates for certain financings, might such rates will be accepted by the Swiss tax authorities in a case-by-case analysis.

Loans granted to related parties	Currency	Safe harbour rate (but at least the rate evaluated based on the CHF rates mentioned in the previous slide)
In case the company who grants the loans is back-financed with third party loans, at least a <b>minimum margin of ½% (up to CHF 10 million; above ¼%)</b> needs to be added to the third party loan rates. If such calculated interest rate is lower than the interest rate for CHF loan, at least the CHF loan interest rate applies.		
Loans granted from related parties		Same safe harbour rates as mentioned in the previous slide
Basically the rates for CHF loans apply (see previous slide)		

## Swiss thin capitalization rules

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The thin capitalization rules require that each asset class has to be underpinned by a certain equity portion. The calculation is based on fair market values, but often the lower book values suffice to demonstrate compliance with the rules. **Allowable debt financing applicable to each asset**

• cash and like assets	100%
• debtors for deliveries of services provided	85%
• other debtors	85%
• inventory	85%
• other current assets	85%
• domestic and foreign bonds denominated in CHF	90%
• foreign bonds not denominated in CHF	80%
• quoted domestic and foreign shares	60%
• other shares	50%
• participations (share interest of market value of CHF 2 million or 20% of a company)	70%
• loans	85%
• business fixtures	50%
• factories, houses, land	70%
• other real property	80%
• formation, capital increase, organization costs	0%
• other immaterial assets	70%

## Interest rate determination

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Some criteria for the determination of an appropriate interest rate:

Criteria	Remarks
Currency	Economically substantiated?
Guarantees	Condition to get a loan? Group company to grant the guarantee?
Contract clauses	At arm's length?
Contract period	Adapted to business needs? Long term vs. short term?
Earlier contract termination possibility	Influence on pricing?
Credit rating of debtor	Analysis of financial situation and business plan? Third party offer?
Repayment clauses	At arm's length?

# Developments

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Notional interest deduction: Not included in Swiss tax proposal 17 (tax reform planned)

ATAD I (Anti Tax Avoidance Directive 2016/1164 EU)

- Article 4: Interest limitation rule
- Member States should apply these measures as from 1 January 2019

ATAD II (Directive 2017/952 EU)

- Hybrid mismatch arrangements,
- ATAD II will be an amendment to the ATAD and shall include third countries

International exchange of information



# Swiss Withholding Tax Act (WHTA)

## Tax collection

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### Introduction

The Swiss Withholding Tax Act (WHTA) is divided into two sections: The first section is about the tax collection and the second section about the tax refund for Swiss beneficiaries. The tax refund of the non-Swiss beneficiaries is based on the respective Double Tax Agreement.

### Tax collection

**Article 4 WHTA:** Following income is among others **subject to tax**:

- <sup>1</sup> The **interest, rents, profit shares and other income on capital assets** such as:
  - a. **bonds**, mortgages and annuity letters issued in series, and holdings recorded in the debt register issued by a **person domiciled in Switzerland**;
  - b. **shares**, interest in limited liability companies, cooperative companies, participation certificates and profit sharing certificates, issued by a **person domiciled in Switzerland**;
  - c. units of a collective investment scheme within the meaning of the Collective Investment Schemes Act of 23 June 2006 (CISA) issued by a person domiciled in Switzerland or by a person domiciled abroad together with a **person domiciled in Switzerland**;
  - d. client assets with Swiss banks and savings banks are subject to withholding tax on income from capital assets.

# Swiss Withholding Tax Act (WHTA)

## Tax collection

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### Tax collection

#### **Article 9 WHTA:** Definition of a **person domiciled in Switzerland**

<sup>1</sup> A **Swiss resident** is anyone who is domiciled in Switzerland, who is permanently resident in Switzerland, or who is incorporated or registered as a company in the Swiss commercial register; legal entities and commercial companies without legal personality whose registered office is located abroad but who are actually managed and active in Switzerland are also considered as being domiciled in Switzerland.

**Article 12 WHTA:** The **tax claim** regarding income on capital assets arises when the taxable payment is due.

**Article 13 WHTA:** The **tax rate** for income on capital assets is 35%.

#### **Article 14 WHTA: Mandatory deduction**

<sup>1</sup> At the payment, transfer, crediting or billing the taxable income, the taxpayer must deduct the amount of withholding tax, without regard to the creditor.

<sup>2</sup> The taxpayer must give the recipient of the taxable payment the necessary information in order to assert the claim to a refund and, upon request, issue a corresponding certificate.

# Swiss Withholding Tax Act (WHTA)

## Tax refund for Swiss domiciled beneficiaries

The refund to Swiss domiciled beneficiaries is based on Swiss Withholding Tax Act. However the refund to Non-Swiss domiciled beneficiaries is based on the respective Double Tax Agreement.

### Refund for Swiss domiciled beneficiaries

#### Article 21 WHTA: Refund request

<sup>1</sup> The right-holder may, pursuant to arts. 22 to 28, request a refund of the withholding tax withheld by the debtor on capital income, if he had the **right to use the assets** that produced the taxable income when such income accrued

<sup>2</sup> The refund is prohibited in all cases in which it would lead to **tax avoidance**.

#### Article 24 WHTA: Entitlement

<sup>2</sup> Legal entities and commercial companies without legal personality are entitled to a refund of withholding tax if they had their **domicile in Switzerland** at the time when the taxable payment became due.

#### Article 25 WHTA: Forfeiture

<sup>1</sup> Legal entities, commercial companies without legal personality, and foreign companies with a place of business in Switzerland (art. 24 paras. 2, 3 and 4) that **do not regularly book income** as subject to withholding tax forfeit their right to a refund of the withholding tax deducted from that income.

# OECD Model Tax Convention

## Tax refund for Non-Swiss domiciled beneficiaries

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### Refund for Non-Swiss domiciled beneficiaries

#### Article 1 Model Tax Convention: Person covered

This convention shall apply to persons who are resident of one or both of the Contracting States.

#### Article 4 Model Tax Convention: Definition of residency

<sup>1</sup> For the purposes of this Convention, the term “**resident of a Contracting State**” means any person who, under the laws of that State, is liable to tax therein **by reason of his domicile, residence, place of management or any other criterion of a similar nature**, and also includes that State and any political subdivision or local authority thereof.

This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

# OECD Model Tax Convention

## Tax refund for Non-Swiss domiciled beneficiaries

### Refund for Non-Swiss domiciled beneficiaries

#### Article 10 Model Tax Convention: Dividend income

<sup>1</sup> Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

<sup>2</sup> However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

- a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;
- b) 15 per cent of the gross amount of the dividends in all other cases.

#### Article 11 Model Tax Convention: Interest income

<sup>1</sup> Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

<sup>2</sup> However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

# Swiss Withholding Tax Act (WHTA)

## Intra-group balances

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Interest payments on bonds and client credit balances are generally subject to Swiss withholding tax at a rate of 35%. This may have consequences on both the external and internal financing of Swiss-based groups.

- With respect to **external financing**, the withholding tax levied on interest payments makes the issuance of bonds in Switzerland rather unattractive. For this reason, groups established in Switzerland often carry out financing activities abroad.
- With respect to **intragroup financing**, the important point is whether a particular intragroup obligation (note payable) qualifies as a bond/client credit balance or not.
  - Generally, **obligations** qualify as **bonds** if they are issued by a Swiss borrower to more than **10** (if the terms are identical) or **20** (if the terms are similar) non-bank creditors and the total credit amount is at least **CHF 500,000**.
  - Moreover, if a Swiss company has more than **100 non-bank creditors** and a loan volume of at least CHF 5 million, such obligations are deemed to be a **client credit balance** with the corresponding withholding tax consequences for interest payments.

These limitations are generally known as the **10/20/100 non-bank lender** rules.

# Swiss Withholding Tax Act (WHTA)

## Intra-group balances

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### Refund for Non-Swiss domiciled beneficiaries

#### Article 14 paragraph 1a of WHT regulation: Exemption for group-balances

- <sup>1</sup> **Credit balances among group companies** are based on WHTA **not qualified as bonds** under article 4, paragraph 1, lit. a nor as client credit under article 4, paragraph 1, lit. d; this applies regardless of their duration, their currency and their interest rate.
- <sup>2</sup> **Group companies** are companies whose financial statements are **fully or partially consolidated** in accordance with recognized accounting standards in the consolidated financial statements.
- <sup>3</sup> Paragraph 1 is not applicable if:
- a. domestic Group company **guarantees** a bond of a foreign Group company; **and**
  - b. the **funds forwarded** by the foreign Group company to the domestic Group company exceed the equity of the foreign Group company as at the balance sheet date

As a result, the intragroup financing activities of Swiss groups with foreign-issued bonds outstanding and a Swiss downstream guarantee in place need to take account of the 10/20/100 non-bank rules. However, the exemption for intragroup financing activities according to article 14 of WHT regulation needs to be considered.

# Swiss Withholding Tax Act (WHTA)

## Intra-group balances

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In order to facilitate group financing in Switzerland, the federal council has decided to amend the paragraph 3 of article 14 of the Swiss withholding tax regulations with effect 1 April 2017.

- Under this amendment, a **downstream guarantee issued by a Swiss group company** no longer automatically leads to a situation where the exemption for intragroup obligations is not applicable.
- The amended withholding tax ordinance states that the intercompany shall also be applicable for groups with a foreign bond guaranteed through a downstream guarantee of a Swiss guarantor,
  - **provided that the funds that are forwarded by the foreign bond issuer to Swiss group companies do not exceed the equity of the foreign bond issuer.**



# Cash Pooling

## Introduction

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- As a general rule, cash pooling agreements, such as notional or physical cash pooling arrangements, are permitted under Swiss law for multinational companies that are either headquartered in Switzerland or have a local subsidiary in Switzerland.
- Under Swiss law, there are no specific statutory rules governing cash pooling agreements.
- However, there are a number of general rules that have to be considered in connection with cash pooling agreements.
  - Generally, purely notional cash pooling does not create legal issues as it does not create material legal obligations.
  - However, issues may arise in the case of physical cash pooling, which involves loans between group companies and the holder of the master account,
  - or if securities are granted in connection with either physical or notional cash pooling.

# Cash Pooling

## Legal perspective

Most constraints regarding cash pooling agreements under Swiss law are related to provisions of company law. Some of the constraints are:

<p>Duty of the Management Board</p>	<p>Management Board is responsible among others for the financial strategy. As a consequence, the board shall carefully evaluate whether a cash pooling agreement is in the company's best interests and (in relation to up- or cross-stream counterparties) at arm's length.</p> <p>After entering into the cash pooling agreement, the Management Board shall monitor the cash pooling agreement, in particular, the creditworthiness of the holder of the master account and the other group companies and, if necessary, to take appropriate measures to reduce their company's exposure.</p>
<p>The company's protected equity</p>	<p>A company's share capital plus the statutory reserves (together, the <b>protected equity</b>) may not be distributed to the shareholders as a dividend or as a hidden dividend distribution.</p> <p>Therefore, when dealing with a parent or a sister company, to the extent that the <b>cash pooling agreement could affect the company's protected equity</b>, a cash pooling agreement may only be entered into on <b>arm's length conditions</b>.</p> <p>If a <b>cash pooling agreement is not at arm's length loans</b> may only be granted to a parent or a sister company <b>up to the company's freely disposable equity</b>. When defining the company's freely disposable equity for future dividend distributions, all such loans must be deducted.</p>

# Cash Pooling

## Tax perspective

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Following aspects should be considered with cash pooling arrangements:

At arm's length	The terms and conditions agreed between the holder of the master account and the group companies have to be at arm's length otherwise withholding tax (too high interest rates) or stamp tax (too low interest rates paid by the Swiss entity to a parent company) may be triggered.
Applicable interest rates	<p>The <b>interest rates</b> must be higher if the <b>cash pooling arrangement qualifies as a loan</b>. The Swiss Federal Tax Administration issues a circular letter every year setting out accepted maximum and minimum interest rates as safe haven rules for loans as mentioned in previous slide.</p> <p>According to the practice of the Swiss Federal Tax Administration (SFTA) a <b>loan</b> is given in a cash pooling arrangement if the funds are provided on a <b>short-term basis for a period of more than one year</b>.</p> <p>The Swiss Federal Tax Administration confirmed in a recent case that provided a balance is <b>negative or zero for at least five days during the calendar year then no loan is given</b>.</p>

## Cash Pooling Federal Court Decision

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In his decision (BGE 140 III 533 of 16 October 2014) the Swiss Federal Court stated:

- An upstream or cross-stream loan which is not at arm's length terms (a “loan with distribution characteristics”) constitutes a hidden distribution of profit
- If the amount of a loan with distribution characteristics **exceeds the amount of the lending company's distributable equity** (ie the amount available for dividend distributions), such loan constitutes a violation of the statutory capital protection provisions
- and if the amount of a loan with distribution characteristics **does not exceed the lending company's distributable equity**, such loan does not violate the statutory capital protection provisions, but blocks the lending company's distributable equity in an amount equal to the amounts outstanding under the loan.

# Cash Pooling

## Federal Court Decision

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Against the background of the Judgment, a technical committee of EXPERTsuisse (formerly the Swiss Chamber of Auditors and Certified Tax Experts) released a **Q&A document** which contains recommendations to auditors on how to treat intra-group receivables in the course of an audit. The Q&A document contains a list of criteria that should be taken for intra-group accounts:

- formalities (are the loan and the arm's length analysis documented?);
- content of the contract (have matters such as the applicable rate of interest, the term of the loan, termination modalities, repayment and security been specified?);
- counterparty (what is the borrower's creditworthiness, ability and willingness to repay, and is interest paid or merely capitalised?); and
- risk (eg what is the ratio of the lender's aggregate amount of intra-group receivables and its total assets)

# Swiss Withholding Tax Act (WHTA)

## Cash Pooling

A cash pooling company pays for the received intra-group loan an interest of 1% according to the leaflet of the Federal Tax Administration. All loans are below CHF 10 million.

Hidden dividend distribution?

balance sheet					
0.00%	bank	200	999	group loan	1.00%
1.50%	group loan	800	0	bank	
			1	equity	0%
		1000	1000		

P&L statement					
1.00%	interest expense	10	12	interest income	1.50%
	other expense	1.5			
	profit	0.5			
		12	12		

# Swiss Withholding Tax Act (WHTA)

## Cash Pooling

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The applied interest rate of 1.5% is too low. As a consequence a hidden dividend distribution with income and withholding tax consequences results.

The Federal Tax Administration would do the following calculations:

<b>Calculated interest expense for received loans:</b>			
	<b>loan</b>	<b>rate</b>	<b>interest</b>
Interest income on loans	800	1.50%	12
Calculated interest margin	800	-0.50%	-4
Calculated interest expense	800	1.00%	8
Interest expense on loans	1000	1.00%	10
Hidden dividend distribution			2

## Disclaimer

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