EU Anti Tax Avoidance Directive (ATAD)

Considerations from a Swiss perspective

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Agenda

- Relation of Switzerland to BEPS and ATAD
- Comparison between ATAD rules and Tax Avoidance Rules stipulated by Swiss tax law
- Impact of ATAD on Swiss/EU cross-border structures
- Proposal for appropriate legal measures taken in Switzerland following the implementation of ATAD

Relation of Switzerland to BEPS and ATAD

- Switzerland signed the BEPS Agreement in June 2017 and committed itself to implement its minimum standards:
  - *Action 5: Harmful tax practices*
    - Abolishment of preferential tax regimes for holding, domiciliary and mixed companies (expected in 2020 as part of the Corporate Tax reform III (Tax proposal 17) subject to a national referendum held in May 2019)
    - Spontaneous exchange of information on tax rulings
  - *Action 6: Prevention of Treaty Abuse*
  - *Action 13: Country-by-country reporting for multinational companies*
  - *Action 14: Dispute resolution mechanism*
- EU introduced ATAD I/II to address "aggressive tax planning" and incorporate the implementation of BEPS standards into the national laws of its member states.
- Switzerland is not an EU member state and will not adopt the ATAD I/II rules

Comparison between ATAD rules and Tax Avoidance Rules stipulated by Swiss law tax

- **Interest Limitation**
  - *ATAD:*
    - Fixed Ratio Approach: Deductibility of (exceeding) borrowing costs is, as a general rule, limited to the higher of 30% of taxable EBITDA or EUR 3 million.
  - *Switzerland:*
    - Debt provided by affiliated parties
      - No requalification of debt into equity if the Swiss entity adheres to certain debt/equity ratios
      - Safe haven interest rates published annually by the Swiss Tax Authorities
      - Proof that the interest payment is “at arm’s length” / withstands comparison with third parties may be furnished
    - Debt provided by independent third parties
      - No requalification if debt has been provided by independent third parties
- **Exit-Taxation**
  - *ATAD:*
    - Mandatory taxation of hidden reserves upon relocation of entities/assets
  - *Switzerland:*
    - Mandatory taxation of hidden reserves upon relocation of entities/assets

Comparison between ATAD rules and Tax Avoidance Rules stipulated by Swiss law tax

- **Avoidance of Treaty Abuse**
  - *ATAD:*
    - GAAR according to which arrangements that have been put into place for the main purposes or one of the main purposes of obtaining DTA benefits should be ignored and not accepted for tax purposes
  - *Switzerland:*
    - Strict rules backed by the Swiss Federal Supreme Court
      - Unwritten GAAR rule similar to the rule stipulated by ATAD
      - Strict rules regarding beneficial ownership (no legal or economic forwarding allowed)
- **CFC rules**
  - *ATAD:*
    - ATAD requires the introduction of CFC rules
  - *Switzerland:*
    - No CFC rules

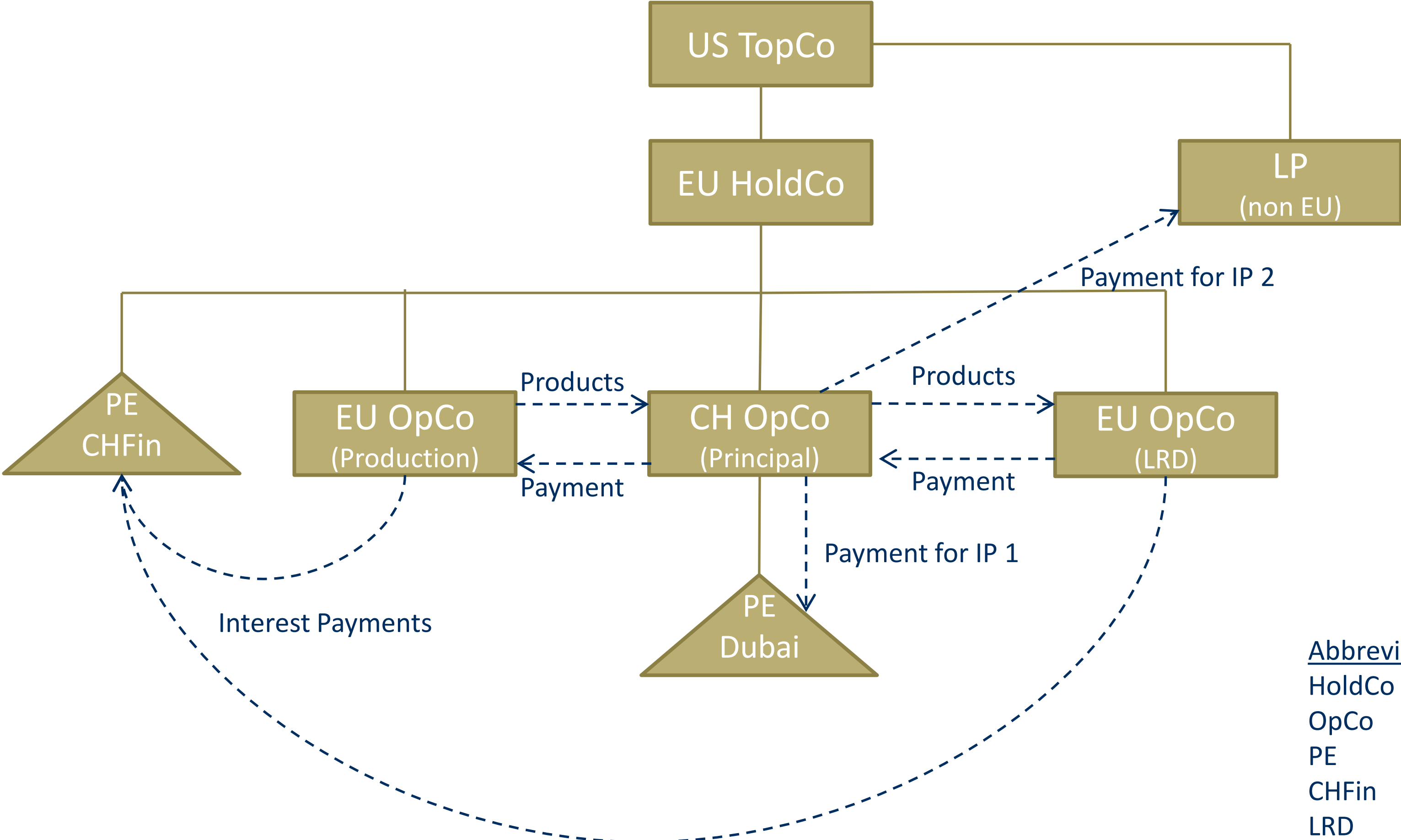
Comparison between ATAD rules and Tax Avoidance Rules stipulated by Swiss law tax

- **Hybrid Mismatches**
  - *ATAD:*
    - ATAD requires the introduction of Anti-hybrid rules
  - *Switzerland:*
    - No Anti-hybrid rules

Impact of ATAD on Swiss/EU cross-border structures

- All Swiss / EU cross-border structures must be analysed regarding the impact of ATAD on these structures on a case-by-case basis
- In particular, ATAD II, along with its extension of the hybrid mismatch rules to hybrid mismatch structures in non-EU countries, will have a significant impact
- Specific Swiss / EU cross-border structures that will certainly be affected by ATAD include the following structures:
  - Structure involving a Swiss Finance Branch (due to the notional interest deduction for the benefit of the head office abroad)
  - Structure involving a Swiss Principal entity (due to the notional PE allocation to affiliated distributors abroad)

Impact of ATAD on Swiss/EU cross-border structures



<u>Abbreviations:</u>

HoldCo = Holding Company
OpCo = Operational Company
PE = Permanent Establishment
CHFin = Swiss Finance Branch
LRD = Low Risk Distributor

ISSUE 1: Deduction without Inclusion

- For Swiss tax purposes, the Swiss Finance Branch may benefit from to a notional interest deduction granted on account of its head office, EU HoldCo.
- However, depending on the local implementation, ATAD may give rise to the following tax adjustments:
  - According to the new mismatch rules, the notional interest deduction on the level of the Swiss Finance Branch could be added to the corporate income of EU HoldCo.
  - According to the new mismatch rules, the EU OpCos, being the borrowers, could deny the deduction of interest payments to the Swiss Finance Branch due to the notional interest deduction.

  → Only one of the aforementioned tax adjustments should be applied.

ISSUE 2: Disregarded PE income

- Principal companies in Switzerland may benefit from a notional PE allocation. It is notionally assumed that the affiliated foreign LRDs constitute a PE for the Swiss principal abroad.
- According to the mismatch rules, the notional PE allocation could result in a tax adjustment in the states the LRDs are resident in. The notionally allocated profit may either be subject to taxation as PE income or be added to the corporate income of the foreign LRDs.

ISSUE 3: Imported Mismatch

- In the case at hand, the CH OpCo (principal company) makes royalty payments to the Dubai Branch and to the LP (outside of the EU), being the owners of the IP. The IP is linked to the products sold by CH OpCo (principal company) to the EU OpCos (LRDs).
  - Impact of ATAD with regard to the royalty payments to the Dubai Branch:
    - Since the Dubai Branch does not qualify as a hybrid entity, there is no imported hybrid mismatch.
    - As a result, the payments of the EU OpCos (LRDs) to the CH OpCo should be acceptable from an ATAD perspective, even if the payments are partially forwarded to the Dubai Branch.
  - Impact of ATAD with regard to the royalty payments to the LP (outside of the EU):
    - If the LP qualifies as intransparent for US tax purposes and transparent for tax purposes in its residency state , the LP will be regarded as a hybrid entity from an ATAD II perspective .
    - If the LP (outside of the EU) qualifies as a hybrid entity, the payments of the EU OpCos to the CH OpCo may not qualify for a tax deduction on the level of the EU OpCos due to constituting an imported mismatch case.

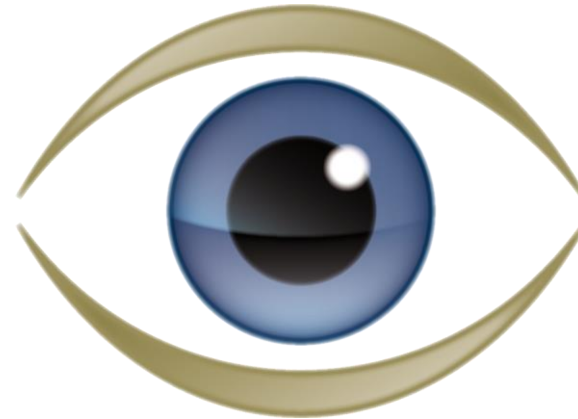
ISSUE 4: CFC

- CH OpCo (principal company) may be regarded as a CFC from the perspective of the residence state of EU HoldCo, which triggers CFC taxation on the level of EU HoldCo.
- Requirements:
  - EU HoldCo holds a participation of more than 50% in CH OpCo
  - Effective corporate income tax rate applicable to CH OpCo in Switzerland is lower than 50% of the effective corporate income tax rate that CH OpCo would have paid if CH OpCo were resident in the residence state of EU HoldCo.
  - No applicability of an exception
    - Possible exceptions depend on the specifications of the CFC rules applied in the residence state of EU HoldCo:
      - Activity Restriction / Real Business Activity
      - Principal Purpose Test / No inappropriate tax structure

Proposal for appropriate legal measures taken in Switzerland following the implementation of ATAD

- In order to protect or even increase its attractiveness as a business location, Switzerland should take unilateral measures to avoid double taxation issues that could result from the implementation of the new ATAD rules.
- Possible measures:
  - Tax exemption / tax credit / requalification into tax-free dividend payments in case of interest payments from an EU entity to a Swiss entity, in which the interest payment is not accepted for tax purposes in the EU state based on the ATAD interest limitation rules.
  - Possibility of flexible tax rate increases for group companies of multinationals in Switzerland in order to avoid the application of CFC taxation in the EU state the parent company is resident in.

Thank you for your attention



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