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Tax Newsletter

Mandatory disclosure of cross-border arrangements: How are Swiss-based international groups affected by the 6th Directive on Administrative Cooperation (DAC 6)?

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1. Introduction

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The latest amendment to the EU's Directive on Administrative Cooperation (DAC 6) requires the mandatory reporting of certain cross-border tax arrangements and the subsequent automatic exchange of such information within the EU.

DAC 6 is based on BEPS Action 12 and its purpose is to increase tax transparency by identifying arrangements that involve aggressive tax planning at an early stage.

Even though DAC 6 only concerns EU member states and Switzerland is therefore not obliged to incorporate DAC 6 into national law, international groups based in Switzerland may be affected by the new directive through their subsidiaries or branches in the EU.

The DAC 6 mandatory reporting regime was originally intended to take effect from 1 July 2020, obliging qualifying intermediaries or the respective taxpayer to disclose information on reportable cross-border tax arrangements going back to 25 June 2018 to their tax authorities within 30 days. Due to the COVID-19 pandemic, however, the European Council agreed on an optional six-month deferral of the DAC 6 reporting deadlines on 24 June 2020.

2. Key Features of DAC 6 and its effect on Swiss-based international groups

2.1. What arrangements must be reported?

2.1.1. Cross-border arrangements and hallmarks

A reportable cross-border arrangement means any arrangement that concerns at least one member state and a third country, including Switzerland, and meets at least one of the characteristics or features known as "hallmarks" listed in Annex IV to DAC 6. These hallmarks are categorised into (i) generic hallmarks and specific hallmarks triggering a reporting obligation only if the main benefit of the arrangement was to obtain a tax advantage (i.e. in combination with the "main benefit test", see below) and (ii) other specific hallmarks triggering a reporting obligation per se.

The generic hallmarks linked to the main benefit test include confidentiality clauses, performance-related remuneration or substantially standardised documentation that is available to more than one taxpayer without a need to be substantially customised for implementation.

The specific hallmarks linked to the main benefit test comprise:

i. The acquisition of a loss-making company whilst discontinuing the main activity of such company and using its losses in order to reduce the tax liability;

ii. Arrangements that lead to the conversion of income into revenue that is taxed at a lower level or exempt from tax (e.g. conversion of income into capital);

iii. Arrangements which include circular transactions (resulting in the round-tripping of funds); or

iv. Arrangements involving deductible cross-border payments which benefit from a preferential tax regime in the recipient's residence state or on which the recipient's residence state does not impose any corporate income tax or imposes corporate tax at the rate of zero or almost zero.

The following specific hallmarks trigger the reporting obligation per se (i.e. irrespective of the fulfillment of the main benefit test):

i. Cross-border transactions involving (i) a recipient of a payment who is not resident in any tax jurisdiction or in one that has been assessed as being non-cooperative, (ii) a taxpayer requesting deductions for the same depreciation or (iii) relief from double taxation in more than one jurisdiction, and (iv) the transfer of assets in order to apply (substantially) different valuation methods;

ii. Hallmarks concerning automatic exchange of information and beneficial ownership; or

iii. Hallmarks concerning transfer pricing, such as (i) the use of unilateral safe harbour rules, (ii) the transfer of hard-to-value intangibles or (iii) intragroup cross-border transfer of functions and/or risks and/or assets exceeding 50 percent of the projected EBIT.

2.1.2. Main benefit test

As mentioned above, certain hallmarks will only trigger a reporting obligation if the main benefit test is satisfied. This will be the case if the main benefit or one of the main benefits a person may reasonably expect to derive from an arrangement consists in obtaining a tax advantage.

In the context of the main benefit test, it is irrelevant whether or not the taxpayer has actually obtained a tax advantage, which means the main benefit test is based on an objective point of view.

2.2. Who is obliged to report?

The intermediaries but also, in some specific cases, the taxpayers themselves are subject to the reporting obligations under DAC 6.

An intermediary is anyone who designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement. This definition covers any person who knows or could be reasonably expected to know that he or she directly or indirectly provides aid, assistance or advice with regard to the relevant arrangements. As a result, a wide range of professionals such as consultants, accountants, financial advisors, lawyers, in-house counsels and banks may be subject to reporting obligations under DAC 6. However, the relevant person needs to have a connection to the EU, which is given if such a person (i) is resident or incorporated in a member state, (ii) has a permanent establishment in a member state, or (iii) is registered with a tax, consultancy or legal professional association in a member state.

Therefore, Swiss intermediaries do not fall under the scope of DAC 6 and are not required to meet any related reporting obligations. If only a Swiss intermediary is involved in the arrangement or the involved EU intermediary is subject to a professional privilege and his duty to report is therefore waived, the reporting obligation will pass over to the taxpayer.

For example, in cases where a Swiss holding company grants a loan to a EU subsidiary and the applicable interest rate is determined based on the safe haven interest rates published annually by the Swiss Federal Tax Administration (SFTA), the criterion of a "cross-border arrangement" is met and one of the hallmarks, namely "the use of unilateral safe harbour rules", is also fulfilled, leading to a reporting obligation under DAC 6. In the absence of an EU intermediary, the reporting obligation is conferred upon the relevant EU subsidiary since the Swiss holding company as well as any Swiss intermediaries potentially involved remain outside the scope of the DAC 6 legislation.

2.3. What happens in the event of non-compliance?

To ensure that the reporting obligations are complied with, the local EU member states will henceforth impose penalties of up to several hundred thousand euros.

3. Comment

DAC 6 is an EU directive and, as such, does not need to be incorporated into Swiss law. Neither does it extend to companies having their registered seat in Switzerland. Yet, its impact on groups based in Switzerland may be significant. In certain circumstances, groups based in Switzerland may be affected by DAC 6 for example, on account of intercompany loan relationships whose interest rate is determined on the basis of the safe harbour interest rates published annually by the SFTA, royalties paid to a Swiss group company by a European subsidiary that are preferentially taxed in Switzerland or, linked to the main benefit test, the acquisition of a European loss-carrying company.

Considering the broad scope of DAC 6, it is crucial that Swiss-based groups identify qualifying intercompany transactions at an early stage and make sure that they comply with the applicable subsidiary reporting obligations in cases with no involvement of any EU intermediaries.