Swiss Supreme Court Decision - Intra-group interest rates

In a recent decision (ATF 9C_690/2022 of 17 July 2024), the Swiss Supreme Court ruled on the scope of the circular letter on tax-allowable interest rates published each year by the Federal Tax Administration (hereinafter: the FTA Circular). As a reminder, this document sets out the rates considered to be in line with market conditions for loans between related parties, and in particular between companies in the same group. Taxpayers who comply with the FTA Circular therefore avoid the risk that the interest rates applied will be considered not to be commercially justified and therefore recaptured as hidden profit distributions, with the corresponding tax consequences (levying of 35% withholding tax and increase of profit tax). If they deviate from this, groups of companies must demonstrate that the rates applied are agreed "at arm's length", i.e. at rates in line with market conditions.

In its recent decision, our High Court confirms that the FTA Circular is a "safe harbour rule" that applies at federal level and is binding on all cantons. However, **the novelty of this recent case law** lies in the fact that the federal judges considered that if the taxpayer had applied an interest rate that deviated from the FTA Circular, he could no longer require the tax authorities to refer to it when determining the level of interest deemed to correspond to market interest rates during the taxation (or recapture) procedure.

In the case in question, a Swiss company had obtained two loans from its parent company at interest rates of 2.5% and 3%. The Zurich tax authorities considered that the interest rates applied were excessive and applied a rate of 1.08% to the company's profits. The taxpayer lodged an appeal with the Zurich Administrative Court, which partially admitted the appeal on the grounds that the computation of a hidden profit distribution should be calculated based on the maximum rate allowed by the FTA Circular, i.e. in this case, a rate of 2% for 2014 and 1.5% for 2015.

In its ruling, the High Court ruled that the rates prescribed by the FTA Circular are only valid in situations where the taxpayer has applied them himself. When the taxpayer deviates from these rates and is unable to prove that the rate applied complies with the arm's length principle, the tax authority is no longer bound by the rates in the FTA Circular and can use another rate that complies with the arm's length principle. The FTA Circular then no longer applies, since the taxpayer himself has deviated from the rates it prescribes.

This decision is of high importance for intra-group financing since, in all cases where the rates applied to financing between affiliated companies deviate from the rates in the FTA Circular, it becomes more essential than ever to demonstrate the "arm's length" nature of the level of interest applied.

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Experience shows that this proof is particularly difficult to provide in the context of a tax audits. We therefore recommend that our clients **have the interest rates applied validated in a prior ruling request**. This approach is even more advisable as it is no longer possible to quantify the risk of a possible recapture - in the event of a dispute over the "arm's length" nature of the rate chosen - based on the difference with the rates prescribed by the FTA Circular.

We will be happy to examine the situation of your various intra-group loans and, if necessary, take steps with the tax authorities.

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