cutting through complexity

KPMG INTERNATIONAL

Taxation of Cross-Border Mergers and Acquisitions

Switzerland

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Switzerland

Introduction

As part of the ongoing trend of globalization, Swiss enterprises are expanding significantly into foreign markets by setting up foreign entities or by mergers and acquisitions (M&A). Foreign strategic and financial investors are increasing their M&A activities in Switzerland, focusing particularly on smaller quoted entities and larger non-quoted entities.

The Swiss tax system and Switzerland's extensive network of tax treaties offer attractive structures for M&A activities. This chapter addresses the relevant deal structure (share deal or asset deal) issues, the choice of acquisition vehicle and tax-efficient financing arrangements.

Recent developments

Individual shareholders holding their shares as private assets generally benefit from tax-exempt capital gains when selling their shares, but dividend income is subject to tax. The Swiss courts have issued a number of wide-ranging anti-abuse judgments that re-classify capital gains as taxable dividend income. In response to this case law, a new regulation covering the so-called indirect partial liquidation (IPL) practice was introduced in 2007.

An IPL is assumed where the following conditions are met:

- a Swiss-resident individual sells privately held shares to a company or an individual holding the acquired shares as business assets
- at least 20 percent of the share capital (single shareholder or collectively) is transferred
- non-business-related assets are available in the target group
- distributable reserves, from a commercial law point of view, are available in the target
- dividends are distributed within a five-year period
- there is cooperation between the seller and the acquirer.

Where these conditions are met, the tax-exempt capital gain for the seller is reclassified as a taxable dividend in the amount of the lower of the capital gain or distributed reserves. Therefore, sellers usually request the insertion of an appropriate clause in the share-purchase agreement to restrict the acquirer from distributions that might trigger such a reclassification.

A circular letter from the federal tax administration dated 6 November 2007 helped to clarify the application of the IPL. It stated that loans or guarantees granted by the target company in connection with the acquisition do not qualify as direct or indirect distributions, provided the financial assistance complies with the arm's length principle and does not result in a reduction of retained earnings (i.e. write-down of receivables).

Post-acquisition reorganizations, such as a merger between the target and acquisition vehicle, generally qualify as direct or indirect distributions and trigger an IPL. The distribution of existing reserves is also deemed to be an IPL.

The corporate tax reform II enacted in 2008 contains beneficial changes, including:

- privileged taxation of qualifying dividend income for personal shareholders
- tax reliefs for the liquidation or sale of entrepreneurial businesses
- the introduction of the capital repayment system, which, as of 2011, exempts repayments of capital contributions (share surplus, contributions, etc.) made after 31 December 1996 from withholding tax (WHT) and from taxation at the level of the Swiss-resident individual shareholder.

Asset purchase or share purchase

Whether an acquisition is executed in the form of an asset or a share deal leads to different tax implications for both the seller and acquirer. Acquirers usually prefer asset deals to limit their risks from the acquired business and achieve a step-up in value. Sellers often prefer share deals, which usually produce tax-exempt capital gains.

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Purchase of assets

Purchase price

The purchase price for the acquired business must be allocated to the different assets. Based on accounting regulations, the acquired assets are stepped-up to their fair market value and an excess amount is booked as goodwill. Where the acquired business includes shares, the allocation of the purchase price to shares and other assets has important tax implications for the seller and purchaser. Thus, the allocation should be agreed on in the purchase agreement.

Goodwill

Where the purchase price exceeds the net value of the assets acquired in the purchase of a business, part of the purchase price may be allocated to goodwill. Goodwill normally must be depreciated in the Swiss statutory accounts of the acquirer. The depreciation allowed for tax purposes is usually either 40 percent per year for 5 years on a declining-balance basis (the remaining balance being considered in the last year) or 20 percent per year on a straight-line basis. This corresponds with the treatment of intangible property generally. Therefore, there is no disadvantage in allocating a part of the purchase price to goodwill. Given the high rate of depreciation, it may even be advantageous. Where economically justified, it may be possible to accelerate the rate of depreciation.

Depreciation

Depreciation for tax purposes generally follows the accounting rules, and safe haven depreciation rates have been published by the tax authorities. Tangible assets may be depreciated either on a straight-line or declining-balance basis. Once a method has been chosen, the business must use that method consistently, unless it is economically justifiable to change from one method to another. It is possible to use different methods for different assets and to apply extraordinary depreciations in certain situations (e.g. for participations). The depreciation of shares is generally tax-deductible, but the shareholder is required to revalue qualifying shares (shareholding with a share quote of at least 10 percent) where the value has increased.

Tax attributes

The tax effect of an asset purchase is that depreciations of the purchased asset reduce the income tax basis at the level of the purchaser and the seller realizes a taxable gain or loss. Special cantonal/communal rules may apply for the transfer of real estate (real estate gains tax). The purchaser cannot use the tax loss carry forward of the acquired business (except for reorganizations under the Merger Act, such as spin-offs and transfers of shares).

Value added tax

Where assets are transferred individually, items that are within the scope of valued added tax (VAT) are subject to the normal VAT rules for goods or services at the standard rate of 8 percent or reduced rate of 2.5 percent. However, the notification procedure must be applied where assets are transferred between two VAT-registered parties and:

- the VAT would exceed 10,000 Swiss francs (CHF)
- the assets are transferred as part of an intercompany asset transfer
- the assets are transferred in a reorganization under the Merger Act or tax-neutral reorganization.

In this case, no VAT needs to be paid, only declared, and the acquirer assumes the VAT position of the seller. Where assets are transferred abroad (exported), VAT is levied at 0 percent.

Transfer taxes

Securities transfer tax is payable on the transfer of any taxable securities (e.g. bonds, shares), where a registered securities dealer acts on its own account or as an intermediary in the transfer. Swiss securities dealers within the meaning of the Swiss stamp duty legislation also include companies not performing a banking-type function (i.e. Swiss companies whose assets include taxable securities with a book value higher than CHF10 million). The rate of securities transfer tax is 0.15 percent on Swiss securities and 0.30 percent on foreign securities.

Real estate transfer tax and notary fees may apply on the transfer of Swiss-located real estate and may differ among the 26 cantons.

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Purchase of shares

The purchase price is fully attributed to the shares acquired. The shares are not depreciable in a Swiss acquisition vehicle, unless the investment's fair market value falls. A reduction in value is tax-deductible for the Swiss acquirer, whereas a subsequent increase in the value of participations with a share quote of at least 10 percent triggers a taxable revaluation (clawback). Goodwill cannot be separately recognized in the balance sheet.

Sellers usually prefer a share deal because a Swiss corporate seller can usually benefit from a tax-exempt capital gain (provided that shares of at least 10 percent held for at least one year are sold). Swiss individual sellers holding shares as private assets usually achieve a tax-exempt capital gain, provided the restrictions under the IPL rules (see previous section) are complied with. Individual sellers holding the shares as business assets and selling qualifying shareholdings (at least 10 percent) may benefit from a privileged taxation.

Tax indemnities and warranties

All historical tax liabilities remain with the Swiss target entity. Thus, a tax due diligence is highly recommended to assess potential risks. The acquirer usually negotiates contractual tax indemnities and warranties from the seller to shift the target's tax exposures for pre-closing periods to the seller. Such indemnities are essential for non-quantifiable tax risks arising from subsequent tax audits.

Tax losses

Tax losses can be carried forward for a period of 7 years but are usually not approved by the tax authorities until the date of use. With the exception of special cases, such as the transfer of shares in a non-active company, Swiss law does not restrict the use of tax loss carry forwards in a target company following a change of ownership.

Crystallization of tax charges

As stated earlier, tax liabilities remain with the Swiss target entity and crystallize at this company's level.

With respect to Swiss WHT on dividends, the acquirer needs to consider the so-called old reserves theory established by the Swiss tax authorities. This applies to retained earnings subject to a non-refundable WHT on dividends of more than 0 percent. Where, due to a change in ownership, the refundable WHT is increased to a higher rate than before the transaction, the Swiss tax authorities may argue that distributable reserves are still earmarked at the previous lower refundable WHT rate. The amount subject to the previous WHT rate is usually the lower of distributable reserves and the non-business relevant assets at the time of the change in ownership.

Pre-sale dividend

A Swiss seller usually does not wish to pay out pre-sale dividends. However, a purchaser can request such dividends to mitigate its WHT exposure under the old reserves theory or where the seller imposes post-closing restrictions under the IPL regime on the acquirer (see earlier sections).

A dividend can only be distributed on the basis of (audited) annual accounts not more than 6 months old. Thus, a later dividend distribution of retained earnings may require an (audited) interim balance sheet, not more than 6 months old at the time of the distribution. Interim dividends (i.e. dividends from current-year earnings) cannot be paid out under current Swiss corporate law.

Transfer taxes

Where the seller or purchaser qualifies as a securities dealer (e.g. a bank or Swiss company with more than CHF10 million in shares or securities on the asset side of the balance sheet), a securities transfer tax of 1.5 percent on domestic shares and 3 percent on foreign shares applies. Exceptions apply where the shares are sold as part of a restructuring (e.g. merger, spin-off or intercompany transfer of qualifying shares).

Tax clearances

Tax rulings are possible and common in Switzerland. They can usually be obtained quickly within four to six weeks and without much difficulty. Rulings concerning income and capital taxes must be submitted to the cantonal tax authorities. Rulings concerning VAT, stamp duties, securities transfer taxes and WHT must be submitted to the federal tax authorities. Rulings that the acquirer wishes to submit pre-closing for the Swiss target entity usually require authorization by the target and seller.

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Choice of acquisition vehicle

The acquisition of a Swiss business or Swiss target company should be carefully structured because the choice of acquisition vehicle influences the subsequent tax rate.

Local holding company

Due to the absence of a group taxation in Switzerland (except for VAT), a Swiss target does not necessarily need to be acquired by a Swiss acquisition vehicle. However, a Swiss acquirer may benefit from a preferential tax regime or enable a tax-neutral merger with the target (e.g. if required by the financing banks).

Under Swiss tax law, a holding company is defined as a company that conducts no business activity in Switzerland but simply holds investments. Provided at least two-thirds of the company's assets are represented by investments and/or earnings from investments, the holding company may benefit from a privileged taxation of generally 7.8 percent corporate income tax, achieved by a tax exemption at the cantonal and communal level, and ordinary taxation at the federal level.

For companies not qualifying for a privileged taxation at the cantonal level, dividend income from qualifying participations (shareholdings of at least 10 percent or with a fair market value of at least CHF1 million) benefits from a participation deduction at the federal level. The participation deduction reduces the income tax in the proportion of the net revenue from qualifying participations to the company's net profit. The net revenue from qualifying participations is defined as the gross revenue less proportionate finance expenses and a lump-sum deduction of 5 percent for administration expenses, leaving the participation income virtually tax-exempt.

Depreciation of shares due to a lower fair market value is tax-deductible, but the shareholder is required to revalue qualifying participations where the value has increased again, resulting in taxable income.

Interest expenses for financing the acquisition can be offset against taxable income. Where there is insufficient taxable income, the expenses increase the holding company's tax losses carried forward. Pushing debt down by merging the acquisition vehicle with the target entity is unlikely to be accepted by the Swiss tax authorities for anti-abuse reasons. According to current practice, a debt pushdown can usually only be achieved for strategic buyers or by careful structuring.

Foreign parent company

An acquisition by a foreign parent company should take into account existing tax treaties or the application of the Swiss-European Taxation of Savings Treaty in order to benefit from a reduced or zero WHT on dividends.

On 1 January 2005, Switzerland introduced the reduction-at-source concept on qualifying dividend payments to treaty-protected foreign parent companies. The reduction is obtained by filing an advance application with the federal tax authority, which is valid for 3 years. The federal tax authority usually reviews the treaty entitlement of the foreign shareholder, focusing on substance and equity, so a ruling stating the facts for the shareholder's entitlement is generally recommended. On approval of the application, only the net applicable treaty tax rate is payable, instead of paying 35 percent Swiss WHT and then applying for a refund. In any case, all relevant WHT declaration forms need to be filed to the tax authorities within 30 days after the due date of the dividend distribution. In case of late filing, the right to apply a reduction at source is forfeited.

In addition to tax treaties, similar rules to those stated in the EU Parent-Subsidiary and Interest and Royalties Directives became applicable to Swiss companies on 1 July 2005 (Swiss-European Taxation of Savings Treaty). Consequently, dividend payments to EU-domiciled parent companies on direct shareholdings of at least 25 percent held for at least 2 years benefit from a full reduction of withholding at source (i.e. WHT rate of 0 percent). The same applies to intragroup interest payments and royalties paid to Swiss companies. Royalties paid by Swiss companies are not subject to Swiss WHT under domestic law. Irrespective of any treaty, a foreign shareholder selling its Swiss subsidiary is not subject to Swiss income tax based on domestic law (exceptions for real estate companies may apply).

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Non-resident intermediate holding company

The comments earlier in this chapter for a foreign parent company also apply for non-resident intermediate holding companies, which may be chosen to take advantage of a more beneficial tax treaty with Switzerland. However, the holding company needs to meet the substance requirements of the federal tax authorities to benefit from such a treaty or from the Swiss-European Taxation of Savings Treaty (see earlier in this chapter).

Local branch

A foreign corporation acting as the head office of a Swiss branch is subject to Swiss income and capital tax with respect to its income and capital. The allocation of the acquired target to the Swiss branch should be carefully structured because participations are usually allocated to the head office for tax purposes.

Swiss branches are taxed in the same way as companies, so they can qualify for the holding company privilege (see earlier section). The tax treaty between Switzerland and the country of the head office usually applies to dividends from the Swiss target, but this should be reviewed on a case-by-case basis. A WHT refund on dividend income from a Swiss subsidiary claimed by the Swiss branch is usually difficult to obtain in practice.

Joint venture

The taxation of joint ventures depends on their legal form, whether they are corporations (see earlier comments on holding companies) or partnerships, which usually qualify as tax-transparent. In the latter case, the tax residency and legal form of the partners determine the tax implications. Usually, a joint venture in the form of a separate corporate entity is preferable since the liability of the partners can be limited and the allocation of profits and the application of tax treaties is clearer.

Choice of acquisition funding

The funding of the acquisition with debt, equity or hybrid instruments must be considered from a Swiss tax perspective to achieve a tax-efficient funding structure.

Debt

Stamp duty is levied on the issue and transfer of bonds (including cash bonds and money market instruments). Bonds include all written acknowledgments of debt issued for collective fundraising purposes. Depending on the bonds, the following rates are applicable:

- issue of domestic bonds and notes: 0.12 percent per year of the bonds' term
- issue of domestic bank paper, medium-term notes and certificates of deposit: 0.06 percent per year of the notes' term
- issue of domestic money market paper: 0.06 percent per day/360.

WHT of 35 percent is levied on interest paid on bonds (refund under a tax treaty may be possible). Interest on ordinary loans is not subject to WHT.

For Swiss WHT and stamp duty purposes:

- A loan qualifies as a bond where the aggregate number of non-bank lenders (including sub-participations) to a Swiss entity under a facility agreement exceeds 10 (under equal conditions) or 20 (under variable conditions), and the total amount of such debt exceeds CHF500,000.
- Debt without fixed maturity date (e.g. cash pooling) is usually not relevant for a Swiss company as debtor (i.e. the company does not qualify as bank for Swiss tax purposes), where the aggregate number of its non-bank lenders does not exceed 100 and the total amount of such debt does not exceed CHF5 million.

As interest on private and intercompany loans is generally exempt from WHT, taxpayers should ensure not to exceed the above thresholds.

Deductibility of interest

Interest expenses are generally tax-deductible. However, deduction of interest to affiliates may be subject to limitations. The federal tax administration publishes annual guidelines on the interest rates considered appropriate on CHF and foreign currency borrowings (safe haven minimum and maximum interest rates).

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The tax authorities also have issued thin capitalization guidelines (safe-haven rules), which define the level of generally accepted underlying debt for different asset categories.

Based on these guidelines, Swiss companies can debt-finance their assets up to the percentages listed as follows:

Asset (valued at fair market value)	Percent
Cash	100
Receivables	85
Inventory	85
Other current assets	85
Swiss or foreign-issued bonds in CHF	90
Foreign-issued bonds in foreign currency	80
Listed Swiss or foreign shares	60
Other shares	50
Participations	70
Loans	85
Fixed assets	50
Real estate for manufacturing purposes	70
Intangible assets	70

Source: KPMG in Switzerland, 2014

For finance companies, the liabilities allowed are usually 6/7 of total assets (finance branch: 10/11). As mentioned earlier, these guidelines are only safe haven rules. The company can diverge from them, provided it can prove that the financing structure within its business complies with arm's length terms.

Non-compliance with the thin capitalization rules that cannot be justified results in a reclassification of part of the related-party debt into equity (subject to capital tax) and of the interest paid thereon as a non-tax-deductible deemed dividend distribution subject to Swiss WHT. Debt from third parties is outside the scope of the thin capitalization rules, but third-party debt secured by related parties qualifies as related-party debt for thin capitalization purposes.

Withholding tax on debt and methods to reduce or eliminate it

Federal WHT of 35 percent is levied at source on the following income from movable capital:

- deposits with banks
- profit distributions by resident companies or investment trusts (including hidden profit distributions)
- bonds and other similar negotiable debt instruments issued by a Swiss-resident borrower.

The WHT rate may be reduced under a tax treaty or the Swiss-European Taxation of Savings Treaty. The reduced rates vary considerably from treaty to treaty.

Checklist for debt funding

- Does the debt qualify as third-party debt (no related-party guarantees)?
- Are the safe haven interest rates for intercompany financing met?
- Are the thin capitalization rules complied with, or is a third-party test available?
- Does the debt qualify as a bond or the borrower as a bank for Swiss tax purposes, triggering stamp duty and WHT?

Equity

Some equity financing may be required to meet debt-to-equity requirements of financing banks or to strengthen the equity position of the target group.

Stamp duty at the rate of 1 percent is payable on the issue of shares, except for the first CHF1 million, which is tax-free. Other contributions as well as a capital surplus are also subject to stamp duty. Exemptions may apply to restructurings. The abolition of stamp duty is currently being discussed by the Swiss legislature.

Dividends are generally subject to 35 percent WHT. Reductions or exemptions may be available under a tax treaty or the Swiss-European Taxation of Savings Treaty. Dividends from a shareholding of at least 20 percent from a Swiss company to a Swiss corporate shareholder can be distributed without payment of WHT.

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Reorganizations

Transactions and reorganizations are generally tax-neutral where the tax liability in Switzerland continues, the tax book values are continued and the business is a going concern or business unit.

Under the capital contribution principle (effective as of 1 January 2011), not only the repayment of share capital but also reserves derived from qualifying contributions made by direct shareholders (e.g. capital surplus, contributions) may be repaid without being subject to WHT and without being subject to income tax for Swiss shareholders holding the shares as private assets.

Statutory merger

The Merger Act provides for two kinds of statutory mergers:

- *Merger by absorption:* Assets and liabilities are transferred to the surviving corporation in exchange for newly issued shares. The shares in the absorbed company are then cancelled, and the company is dissolved.
- *Merger by combination:* A third company is formed specifically to continue the absorption of two or more corporations. The shareholders of the combined corporations receive shares in the new company in exchange for their shares in the now combined corporations.

Mergers are generally income tax-neutral; that is, any hidden reserves should be transferable free of tax where the following conditions are met:

- Assets and liabilities are transferred at tax book value (thus, a step-up in basis without income tax consequences is not possible).
- Liability to Swiss taxes continues. This requirement is met even where the merged entity carries on its business only through a Swiss permanent establishment.

The surviving corporation usually takes over the tax attributes of the merged corporation. Any tax loss carry forward of the merged company can be used by the surviving corporation, provided that no tax avoidance is involved.

The merger should not trigger any WHT consequences where reserves and retained earnings of the merged entity are transferred to – and remain with – the surviving company.

A share capital increase in the context of a qualifying reorganization (merger) is usually not subject to stamp duty. Stamp duty also does not apply on security transfers.

Where the surviving entity of a merger uses treasury shares that it previously repurchased from shareholders to compensate the shareholders of the absorbed company, any positive difference between the current fair market value and the repurchase price is considered taxable income of the surviving entity. For private Swiss shareholders receiving such shares, the difference between nominal value (and potentially proportionate capital contributions as of 2011) and fair market value is subject to income tax. Hence, a private shareholder could suffer tax consequences without being aware of the exposure beforehand and without receiving any additional cash. Foreign corporate and private shareholders receiving new shares may be subject to non-refundable Swiss WHT. Contractual hold-harmless clauses are recommended.

Cash considerations to private shareholders are subject to WHT and to income tax at the shareholders' level.

Cross-border mergers

The Swiss Code on Private International Law (CPIL) includes provisions governing registered office transfers to and from a foreign country, as well as provisions to cover cross-border mergers, demergers and transfers of assets. In contrast to purely domestic mergers and immigration through cross-border mergers, the requirements for emigration mergers include pre-transaction safeguards to protect creditors (Art. 163b par. 3 CPIL). The provisions apply correspondingly to demergers and transfers of assets involving Swiss and foreign companies.

Other provisions relate to the place for debt collection and jurisdiction in connection with cross-border transactions and to the recognition of registered office transfers, mergers, demergers and transfers of assets carried out in foreign jurisdictions.

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Immigration merger

Basically, the same rules apply as for a domestic merger. Therefore, the main question is whether the foreign legislation permits an immigration merger.

Emigration merger

Where a Swiss business is transferred outside Switzerland, the tax consequences may be significant. As the emigration is regarded as a deemed liquidation, the same tax consequences are triggered as in a statutory liquidation process (i.e. hidden reserves are subject to income taxes and any deemed liquidation proceeds subject to WHT). Where the business activity is continued in Switzerland through a permanent establishment of the merged company, the transaction is tax-free for corporate income tax purposes. However, WHT is due on the deemed liquidation proceeds. Whether, and to what extent, a refund of the WHT (35 percent) is available depends on the domicile of the shareholders of the former Swiss entity and, in an international context, the applicable tax treaty or EU-Swiss Taxation of Savings Treaty.

Share-for-share transactions involving Swiss targets and/or Swiss investors (quasi-merger)

In exchange for their shares, the shareholders of the contributed company are given shares in the receiving company. The acquired operating company continues to exist as a subsidiary of the acquiring company. Share-for-share transactions are in principle tax-neutral and are often a more flexible alternative than statutory mergers because, for example, risks and liabilities of the target are kept isolated and the administrative and operational burden may be lower (international mergers).

Privately held targets may prefer a share-for-share deal. Cash consideration of up to 50 percent of the transaction value is permissible and, in principle, is tax-free for the private Swiss shareholder, whereas cash consideration in a statutory merger qualifies as taxable income and is subject to WHT.

The less favorable tax consequences of a statutory merger cannot be avoided by structuring the transaction as a share-for-share deal with subsequent absorption of the target. Based on the substance-over-form rule, such a transaction would qualify as a statutory merger where the absorption occurs within a five-year period. Swiss private shareholders who might be facing taxable income on a subsequent merger are likely to insist on hold-harmless clauses in transaction agreements.

Demerger

The Merger Act stipulates that corporations and associations can either split-up or spin-off parts of their business.

- In a split-up, the transferring entity is dissolved after the transfer and shareholders receive shares of the entities that takeover the assets.
- In a spin-off, the transferring entity continues operations after the transfer and shareholders receive shares of the entities that takeover the assets.

Demergers are generally income tax-neutral. Any hidden reserves should be transferable tax-free where the following conditions are met:

- Assets and liabilities are transferred at tax book value (thus, a step-up in basis without income tax consequences is not possible).
- Liability to Swiss taxes continues. This requirement for an income tax-neutral reorganization is met even where the acquiring entity carries on the acquired business only as a Swiss permanent establishment.
- Business units are transferred and remain, and their operations are continued for a certain period after the reorganization.

Neither the assets transferred nor the shares in the transferee entity are subject to a blocking period. Thus, investors can immediately dispose of business units of the target that are not in line with their strategic plans or need to be transferred for anti-trust reasons. Additionally, target groups can be more easily tailored to meet the market’s expectations.

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However, the requirement of continuing businesses in both entities is generally subject to close scrutiny by the tax authorities. For pure holding companies, the term 'business' implies that the participations held are qualifying participations in active entities and that the holding companies perform true group management functions with their own personnel. Pure management of a corporation's own assets or pure holding of participations does not qualify as business. Finance or intellectual property companies qualify as businesses where they provide services to third parties or affiliated entities and have at least one full-time employee. For non-operating entities, a demerger might prove difficult due to the stringent requirements on the business quality. Other means of transfer may be preferable, such as the transfer of assets (discussed later). Where a group with mixed business entities is to be divided into two or more separate parallel groups, the demerger of the common holding and intellectual property entities requires special attention.

The demerger should not trigger any WHT consequences where reserves and retained earnings of the transferring entity are transferred to – and remain with – the acquiring company.

Where reserves and retained earnings are converted into share capital, WHT is due and private Swiss-resident shareholders realize taxable income. Whether, and to what extent, a refund of the WHT (35 percent) is available must be analyzed on a case-by-case basis.

A share capital increase in the context of a qualifying reorganization (demerger) may not be subject to stamp duty. Stamp duty does not apply on securities transfers.

Intragroup transfer of assets

The rules regarding the transfer of assets (and liabilities) between Swiss-domiciled group companies or their subsidiaries are a first step toward a kind of group taxation system. In principle, the intragroup transfer of qualifying participations (20 percent shareholdings), businesses or parts of businesses and fixed assets at tax book value is tax-neutral. The tax-neutrality of the transfer of assets is subject to a five-year blocking period applying to the assets transferred and the common control of the Swiss legal entities involved (e.g. where the Swiss transferor and transferee have a common parent company). Evidence of common control has to be provided annually, or the blocking period is considered to be breached. In complex group structures, the ownership of the participation needs to be closely monitored to satisfy these requirements. If a blocking period is breached, any Swiss entity under common management at that time is jointly and severally liable for taxes due.

In practice, the blocking period is mainly relevant for transfers of individual assets, such as real estate or intellectual property. The transfer of businesses should qualify under the demerger rules and not be subject to a blocking period.

Where the transferee breaches the blocking period, hidden reserves are realized and taxed in the transferor entity and a dividend is deemed to be paid to the shareholder of the transferor entity. The deemed dividend is subject to Swiss WHT, which may not be fully recoverable for foreign shareholders. The foreign shareholder is advised to provide for appropriate contractual protection in the transaction agreements.

Asset drop-down

The contribution or sale at tax book value of businesses, business units, fixed assets or qualifying participations (20 percent shareholdings) into a subsidiary that is subject to Swiss taxation is tax-neutral. Except for qualifying participations, the drop-down of assets is subject to a five-year blocking period. The blocking period applies to both the transferred assets and the participation in the transferee entity.

Hybrids

Debt is usually only reclassified as equity where thin capitalization is an issue. In other circumstances, instruments having the form of debt are accepted as such and follow the Swiss accounting principles.

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As a rule, hybrid financial instruments can be characterized as follows:

Redeemable preference shares	Share capital
Convertible loan notes	Debt
Perpetual debt	Debt
Index-linked debt	Debt
Profit participation loan	Debt

Source: KPMG in Switzerland, 2014

Regarding income derived from hybrid financial instruments, the Swiss participation deduction and privileged taxation of dividend do not apply to (dividend) payments treated as tax-deductible at the level of the payer.

Discounted securities

An acquisition of securities at a discount generally results in a taxable gain where the full value of the security is realized. The tax treatment generally follows accounting rules, but this should be reviewed on a case-by-case basis.

Deferred settlement

A deferred settlement of interest generally does not affect the deduction of the interest for tax purposes at the time the interest is booked.

Deferred settlements of the purchase price can be structured through a vendor loan or earn-out rules. For vendor loans, the comments on debt financing apply. Earn-out elements generally should be treated as part of the capital gain for the seller and subsequent acquisition costs for the purchaser. Depending on the circumstances, it may be advisable to gain certainty on the tax treatment with an advance ruling.

Other considerations

Concerns of the seller

As mentioned, a Swiss-resident seller (corporation or individual holding shares as private assets) usually prefers a share deal to benefit from a tax-exempt capital gain. However, a seller with tax losses close to forfeiture may be willing to agree to an asset deal. Sellers also tend to prefer a share deal because the historical tax risks remain with the entity to be sold.

Company law and accounting

The Swiss Code of Obligations (CO) covers a number of business entities in Switzerland. In structuring a transaction, the parties involved must decide which type of entity best suits their needs. Tax issues may play an important part in these decisions.

Corporation – *Aktiengesellschaft* (AG)

The corporation corresponds to the American corporation and is the most widespread form of association in Switzerland. It is also considered best-suited to meet the requirements of foreign business interests. It is preferred for its ease of incorporation and the limited liability. Its main features are:

- formation according to the CO
- liability limited to share capital
- formed by issue of bearer or registered shares
- minimum share capital of CHF100,000
- restrictions on the acquisition of own shares.

Limited liability company – *Gesellschaft mit beschränkter Haftung* (GmbH)

The limited liability company (LLC) is a hybrid of a corporation and a partnership that is becoming more widespread in Switzerland. For Swiss tax purposes, the LLC qualifies as a corporation. Its main features are:

- formation procedure similar to a corporation, according to CO
- owners have limited legal liability
- owners may participate in the management of the company
- minimum share capital of CHF20,000.

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Other, non-corporate forms of business entity admitted by the CO are as follows:

Partnership – *Kollektivgesellschaft*

- partners must be individuals
- no legal personality
- partners have unlimited liability
- transparent for tax purposes.

Limited partnership – *Kommanditgesellschaft*

- partners with unlimited liability must be individuals
- partners with limited liability can be individuals or corporations, among others
- transparent for tax purposes.

Simple association – *Einfache Gesellschaft*

- registration in the commercial register is not possible
- contractual arrangement in the nature of a joint venture
- corporations and individuals can be members
- transparent for tax purposes.

Corporate reorganizations, such as spin-offs, mergers, business transfers, and, in principle, cross-border mergers, are possible under the Merger Act of 2004. Most of these restructurings can be implemented tax-neutrally.

Swiss entities must follow the Swiss accounting rules, which are also relevant for taxation purposes.

Group relief/consolidation

Apart from VAT, the concept of a consolidated or group tax return is unknown in Swiss tax law. Accordingly, each corporation is treated as a separate taxpayer and files tax returns separately.

Under Swiss company law, consolidated financial statements are required for companies under common control, by majority vote or by another method.

The company is exempt from the duty to prepare consolidated statements where, together with its subsidiaries, it does not exceed two of the following thresholds in any 2 successive fiscal years:

- a balance sheet total of CHF20 million
- revenues of CHF40 million
- an average annual number of employees of 250.

However, consolidated statements must be prepared for the purpose of assessing as reliably as possible the company's financial position where:

- The company has outstanding bond issues.
- The company's shares are listed on a stock exchange.
- Shareholders representing at least 10 percent of the share capital request a consolidated statement.

Consolidated financial statements of non-listed companies are not made public.

Transfer pricing

Switzerland has not implemented formal transfer pricing rules or documentation requirements for intercompany transactions with foreign related parties or permanent establishments. Requirements in other countries can serve as general guidelines for Swiss tax purposes. Such requirements include written agreements concluded in advance, compliance with these agreements, and arm's length conditions determined on the basis of functions and risk. Detailed transfer pricing studies are recommended for significant transactions as preparation for a possible tax audit or for an advance tax ruling to support the applied principles and terms.

Dual residency

Swiss corporations are subject to Swiss income tax if their statutory seat or actual management is in Switzerland. Thus, corporations whose statutory seat is outside of Switzerland but whose day-to-day business is managed in Switzerland qualify as Swiss-resident, as do those with their statutory seat in Switzerland but actual management abroad. Special rules apply to residency for Swiss stamp duty and WHT purposes. Transaction planning needs to reflect these taxes and, in particular, the provisions of an applicable tax treaty.

Foreign investments of a local target company

Switzerland has no formal controlled foreign company (CFC) rules and applies the participation deduction on dividends irrespective of any minimum taxation requirements. The participation deduction regime (see this chapter's section on local holding companies) also applies to capital gains on the sale of qualifying participations held for a minimum of one year. Income associated with foreign permanent establishments is tax-exempt under domestic law. Tax losses from foreign permanent establishments are provisionally allocated to the Swiss headquarters and recaptured to the extent the permanent establishment makes profits in a seven-year period.

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Comparison of asset and share purchases

Advantages of asset purchases

- The purchase price (or a proportion) can be depreciated or amortized for tax purposes.
- A step-up in the cost-base for capital gains tax purposes is obtained.
- Generally, no inheritance of historical tax liabilities (except for VAT, social security, employee WHT or in case of reorganizations).
- No deferred tax liabilities on retained earnings.
- Possible to acquire only part of a business.
- Interest expenses for the acquisition generally can be set-off against taxable income of the acquired business.
- Profitable operations can be acquired by loss-making companies in the acquirer's group, thereby gaining the ability to use the losses.

Disadvantages of asset purchases

- Possible need to renegotiate supply, employment and technology agreements, and change stationery.
- From a legal point of view, the transaction involves more work and set-up of individual acquisition entities for a cross-border transaction.
- May be unattractive to the seller due to a taxable gain, which may increase the price.
- Higher transfer duties (e.g. on real estate and securities)
- Benefit of any losses incurred by the target company remains with the vendor.

Advantages of share purchases

- Likely to be more attractive to the seller, so the price is likely to be lower (where the vendor is a private individual or corporation).
- May benefit from tax losses of the target company (set-off against subsequent profits of target for a limited period).
- May benefit from existing supply or technology contracts and tax rulings for the target company.
- No real estate transfer tax (except for acquisitions of real estate companies).

Disadvantages of share purchases

- Deferred tax liability on difference between market and tax book value of assets.
- Risks and previous liabilities remain with the acquired entity.
- No deduction for the purchase price (no tax-effective depreciation of goodwill).
- Acquisition of tax liabilities on retained earnings that are ultimately distributed to shareholders.
- Debt for acquisition cannot generally be pushed down to the operating company.

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Switzerland – Withholding tax rates

This table sets out reduced WHT rates that may be available for various types of payments to non-residents under Switzerland's tax treaties. This table is based on information available up to 1 December 2013.

Source: International Bureau of Fiscal Documentation, 2014

	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Domestic rates				
Companies:	35	0	0/3/35	0
Individuals:	0/35	N/A	0/3/35	0
Treaty rates				
Treaty with:				
Albania	15	5	5	5
Algeria	15	5[3]	0/10[4]	10
Anguilla[5]	–[6]	–	–	–
Antigua and Barbuda	–	–	–	
Argentina[7]	15	10	12[8,9]	0/3/5/10/15[10]
Armenia	15	5[11]	0/10	5
Australia	15	15	10	10
Austria	15	0	0	0
Azerbaijan	15	5[12]	5/10	5/10[13]
Bangladesh	15	10	0/10[14]	10
Barbados	–	–	–	–
Belarus	15	5	5/8	3/5/10[15]
Belgium	15	10	0/10	0
Belize	–	–	–	–
British Virgin Islands	–	–	–	–
Bulgaria	15	5	0/10	0/5[16]
New Treaty[17]	10	0[18]	0/5[19]	5
Canada	15	5[20]	10	0/10[21]
Chile	15	15	5/15[22]	5/10[23]
China (People's Rep.)	10	10	10	10
Colombia	15	0	0/10	10
Croatia	15	5	5/10	0
Czech Republic	15	5	0	5

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	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
New Protocol	15	0	0	5
Denmark	15	0[24]	0	0
Dominica	–	–	–	–
Ecuador	15	15	10	10
Egypt	15	5	0/15	12.5
Estonia	15	5	0/10	5/10
Faroe Islands[25]	15	0	0	0
Finland	10	0	0	0
France	15	0	0	5[26]
Gambia	–	–	–	–
Georgia	10	0	0	0
Germany	15	0[27]	0	0
Ghana	15	5	10/0	8
Greece	15	5	7	5
Grenada	–	–	–	–
Hong Kong	10	0[28]	0	3
Hungary	10	0	0	0
Iceland	15[29]	5	0	0
India	10	10	–/10[30]	5/10[31]
Indonesia	15	10	10	10
Iran	15	5[32]	0/10	5
Ireland	15	0	0	0
New Protocol	15	0[33]	0	0
Israel	15	5	5/10	5
Italy	15	15	12.5	5
Ivory Coast	15	15	15	10
Jamaica	15	10	0/5/10[34]	10[35]
Japan	10	0/5[36]	0/10[37]	0
Kazakhstan	15	0/5[38]	10	10
Korea (Rep.)	15	5	5/10	5
Kuwait	15	15	10	0/10[39]
Kyrgyzstan	15	5	5	5
Latvia	15	5	10	0/10

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	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Liechtenstein	–	–	0/–[40]	–
Lithuania	15	5	10	5/10
Luxembourg	15	0/5[41]	0/10[42]	0
Macedonia (FYR)	15	5	0/10	0
Malawi	–	–	0	0/–
Malaysia	15	5	10	10
Malta	15	0	10	0
Mexico	15	0	5/10[43]	10
Moldova	15	5	0/10	0
Mongolia	15	5	0/10	0/5
Montenegro[44]	15	5	10	5
Montserrat	–	–	–	–
Morocco	15	7	10	10
Netherlands	15	0[45]	0	0
New Zealand	15	15	10	10
Norway	15	0	0	0
Pakistan	20	10	10	10
Philippines	15	10	10	15
Poland	15	0[46]	0/5[47]	0/5
Portugal	15	10	10	5
New Protocol	15	0/5[48]	0/10[49]	0/5
Qatar	10/15[50]	5	0	0
Romania	15	0[51]	5	0/10
Russia	15	0/5[52]	0	0
St. Kitts and Nevis	–	–	–	–
St. Lucia	–	–	–	–
St. Vincent and the Grenadines	–	–	–	–
Serbia	15	5	10	0/10
Singapore	15	5	0/5	5
Slovak Republic	15	0	5	0/5[53]
Slovenia	15	5	5	5
New Protocol	15	0[54]	0/5[55]	0/5[56]
South Africa	15	5	5	0
Spain	15	0[57]	0	5

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	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Sri Lanka	15	10	5/10	10
Sweden	15	0	0	0
Taiwan	15	10	10	10
Tajikistan	15	5	10	5
Thailand	15	10	10/15	5/10[58]
Trinidad and Tobago	20	10	10	10
Tunisia	10	10	10	10
Turkey	15	5	5/10	10
Ukraine	15	5	0/10	0/10[59]
United Arab Emirates	15	5	0	0
United Kingdom	15	0	0	0
United States	15	5	0	0
Uruguay	15	5	10	0
Uzbekistan	15	5	0/5	5
Venezuela	10	0	5	5
Vietnam	15	7/10[60]	10	10
Zambia	–	–	0	–

Notes:

1. Many treaties provide for an exemption for certain types of interest, e.g. interest paid to the state, local authorities, the central bank, export credit institutions or in relation to sales on credit. Such exemptions are not considered in this column.
2. Unless otherwise indicated, the reduced rates in this column apply if the recipient company owns at least 25 percent of the capital or the voting power in the Swiss company.
3. This rate applies if the recipient company owns at least 20 percent of the capital in the Swiss company.
4. The lower rate applies to interest paid by a public body and to interest paid to a bank.
5. Extension of the 1954 tax treaty with the United Kingdom.
6. The domestic rate applies; there is no reduction under the treaty.
7. The treaty with Argentina is provisionally implemented from 1 January 2001.
8. The lower rate applies to interest paid by public bodies.
9. The lower rate applies to interest paid to a bank. Conditions may apply.
10. The zero rate applies as long as Switzerland does not, according to its domestic law, levy a withholding tax on royalties paid to non-residents. The 3 percent rate applies to news-related royalties. The 5 percent rate applies to copyright royalties, excluding films, etc. The 10 percent rate applies to patents, trademarks and know-how.
11. The lower rate applies if the Armenian company holds directly at least 25 percent of the capital of the Swiss company and the capital invested exceeds CHF200,000.
12. This rate applies if the Azerbaijani company directly owns at least 20 percent of the capital in the Swiss company and has made investments equal to at least 200,000 US dollars (USD) in Switzerland.
13. The lower rate applies to royalties for any patent, design or model, plan, secret formula or process and for know-how.
14. The zero rate applies if the interest is paid by virtue of a contract of financing or of delay in payment relating to the sale of industrial, commercial or scientific equipment or to the construction of industrial, commercial or scientific installations as well as of public works.

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15. The lower rate applies to royalties for any patent, design or model, plan, secret formula or process and for know-how.
16. The lower rate applies as long as Switzerland does not, according to its domestic law, levy a withholding tax on royalties paid to non-residents.
17. Effective from 1 January 2014.
18. This rate applies if the beneficial owner is (i) a company (other than a partnership) that holds at least 10 percent of the capital in the company paying the dividends for at least 1 year prior to the payment of the dividends; (ii) a pension scheme; or (iii) the Central Bank.
19. The zero rate applies, inter alia, to interest paid to, inter alia, (i) a pension scheme; on a loan granted by a financial institution; and (iii) a related company that holds at least 10 percent of the capital in the company paying the interest for at least 1 year prior to the payment of the interest.
20. This rate applies if the recipient company owns at least 10 percent of the capital or voting power, as the case may be, in the Swiss company.
21. The lower rate applies to computer software, patents and know-how.
22. The lower rate applies to e.g. interest paid on a loan granted by a bank and an insurance company, and interest on bonds or securities that are regularly and substantially traded on a recognized securities market.
23. The lower rate applies to equipment leasing.
24. The zero rate applies if the recipient company holds directly or indirectly at least 10 percent of the capital in the Swiss company. The rate also applies to dividends paid to a recognized pension fund or pension scheme.
25. Extension of the 1973 tax treaty with Denmark.
26. Different rates apply if the French recipient is controlled by a non-French resident.
27. The zero rate applies if a 10 percent capital holding has been held for at least 12 months.
28. The zero rate applies if the beneficial owner is (i) a company that holds at least 10 percent of the capital of the Swiss company; (ii) a pension fund or scheme; or (iii) the Hong Kong Special Administrative Region or the Hong Kong Monetary Authority.
29. For dividends paid to individuals, the rate is 20 percent; if paid to companies, the rate is 18 percent.
30. The domestic rate applies to interest received by a resident engaged in the operation of ships or aircraft in international traffic to the extent that such interest is paid on funds connected with such activity.
31. The 5 percent rate applies to payments for services.
32. This rate applies if the recipient company owns at least 15 percent of the capital in the Swiss company.
33. This rate applies if the beneficial owner is (i) a company (other than a partnership) that holds at least 10 percent of the capital in the company paying the dividends; (ii) a pension scheme; or (iii) the central bank.
34. The zero rate applies to interest paid by a public body. The 5 percent rate applies to interest paid to a bank.
35. For royalties paid for the use of, or the right to use, any industrial, commercial or scientific equipment, the taxable base shall constitute 60 percent of such royalties.
36. The 5 percent rate applies in respect of a 10 percent capital holding that has been held for 6 months. The zero rate applies in respect of a 50 percent capital holding that has been held for at least 6 months. The zero rate also applies to dividends paid to a pension fund or pension scheme.
37. The zero rate applies to payments made to certain financial institutions.
38. The zero rate applies if the Kazakh company owns at least 50 percent of the capital in the Swiss company and the invested capital, which is secured by the state, amounts at least USD1 million; the 5 percent rate applies if the Kazakh company owns at least 10 percent of the capital in the Swiss company. The zero rate also applies to dividends paid to a recognized pension fund or pension scheme.
39. The lower rate applies as long as one of the contracting states does not, according to its domestic law, levy a withholding tax on royalties paid to non-residents.
40. The zero rate applies to interest on loans secured by immovable property. Otherwise, the domestic rate applies.
41. The 5 percent rate applies to dividends in respect of a 10 percent capital holding. The zero rate applies if the 10 percent capital holding has been held for at least 2 years. The zero rate also applies to dividends paid to a recognized pension fund or pension scheme.
42. The 10 percent rate applies to interest on bonds and other similar securities and to interest paid on bank deposits.
43. The 5 percent zero rate applies to interest paid to a bank or an authorized securities dealer or an insurance or a reinsurance institution, and to interest derived from bonds or securities regularly traded on an authorized securities market by a public body. The 10 percent rate applies to interest paid to a bank.
44. The treaty concluded between Switzerland and the former Serbia and Montenegro.
45. The zero rate applies (i) if the recipient company owns at least 10 percent of the capital of the Swiss company; (ii) the beneficial owner of the dividends is a pension fund; or (iii), as far as Switzerland is concerned, the beneficial owner of the dividends is a social security scheme.
46. The zero rate applies if (i) the recipient company has held at least 10 percent of the capital of the Swiss company for an uninterrupted period of 24 months; or (ii) the beneficial owner of the dividends is a pension fund.
47. The zero rate applies if the recipient is a company (other than a partnership) associated with the paying company.
48. The 5 percent rate applies if the beneficial owner is a company (other than a partnership) that holds at least 25 percent of the capital in the company paying the dividends. The zero rate applies, inter alia, to dividends paid to (i) a central bank; or (ii) a related company that holds at least 25 percent of the capital in the company paying the interest for at least 2 years prior to the payment of the interest.
49. The zero rate applies, inter alia, to interest and royalties paid to a related company that holds at least 25 percent of the capital in the company paying the royalties for a period of at least 2 years.
50. The lower rate applies if the dividends are paid to an individual who holds directly at least 10 percent of the capital in the Swiss company.
51. This rate applies if the beneficial owner of the dividends is (i) a company that directly holds at least 10 percent of the capital in the Swiss company (ii) a pension fund; (iii) the other contracting state; or (iv) the Central Bank.
52. The 5 percent rate applies if the Russian company directly owns at least 20 percent of the capital in the Swiss company and the invested capital exceeds CHF200,000 at the moment the dividends become due. The zero rate applies if the beneficial owner of the dividends is (i) a pension fund; (ii) the government or subdivision thereof of the other contracting state; or (iii) the Central Bank.
53. The zero rate applies to copyrights of literary, artistic or scientific work (including films, etc.). The 5 percent rate applies to industrial royalties (instead of 10 percent) as long as Switzerland does not, according to its domestic law, levy a withholding tax on royalties paid to non-residents.
54. This rate applies if the beneficial owner is (i) a company (other than a partnership) that holds at least 25 percent of the capital in the company paying the dividends; or (ii) a pension scheme.
55. The zero rate applies, inter alia, to interest paid (i) by a bank to another bank; and (ii) to a related company that holds at least 25 percent of the capital in the company paying the interest.
56. The zero rate applies, inter alia, to royalties paid to a related company that holds at least 25 percent of the capital in the company paying the royalties.
57. This rate applies if (i) a 10 percent capital holding has been held for at least 1 year; or (ii) the beneficial owner of the dividend is a recognized pension fund or scheme.
58. The 5 percent rate applies to copyright on literary, artistic or scientific work (excluding films, etc.). The 10 percent rate applies to any patent, trademark, design or model, plan, secret formula or process.
59. The lower rate applies to industrial royalties.
60. The 7 percent rate applies if the Vietnamese company owns at least 50 percent of the capital in the Swiss company. The 10 percent rate applies in the case of a participation of at least 25 percent but less than 50 percent.

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