Switzerland – Important changes in Swiss tax law remove chains on capital transfers

by Daniel Dillier, Partner and Thomas Ziegler, Partner, Ludwig + Partner Ltd

Among other actual important changes in Swiss tax law, the Corporate Taxation Reform II introduced the transition from the nominal value to the Capital Contribution Principle with effect as of January 1, 2011. Furthermore, Switzerland recently changed tax rules for intragroup financing activities. Those modifications allow new tax planning opportunities in transactions and corporate financing and make Switzerland an even more attractive place for international players.

Introduction of the Capital Contribution Principle

The old nominal value principle

According to the so-called nominal value principle regime that was in force until December 31, 2010, a Swiss registered company could only repay the nominal value of its registered share capital to its shareholders without any Swiss withholding and income tax consequences.

Other equity repayments, i.e., the repayment of paid-in share premium or other contributions that have been made by shareholders to the company were subject to the 35% Swiss withholding tax - like the distribution of profits (carried forward) of the company. Repayments made to Swiss resident shareholders triggered Swiss income tax consequences. Repayments to non-Swiss resident shareholders (in international structures) also triggered the Swiss withholding tax, whereas the shareholder was entitled to a refund or reduction of the Swiss withholding tax only if a double taxation treaty applied.

The new Capital Contribution Principle

On January 1, 2011, the Capital Contribution Principle entered into force. This transition from the nominal value principle to the Capital Contribution Principle was - *inter alia* - an important element of the so-called Corporation Taxation Reform II in Switzerland. Under the Capital Contribution Principle the repayment of capital contributions made after December 31, 1996 by shareholders are treated in the same way as a repayment of nominal share capital.

In comparison with a reduction of the registered nominal share capital under Swiss corporate law, which requires a formal procedure (shareholders' approval stipulated in a public deed, change of articles of association, involvement of the commercial register), the repayment of share premium can be resolved much more easily in a simple shareholders' resolution.

Requirements and compliance

The Swiss Federal Tax Authorities (FTA) published the circular letter no. 29 regarding the new Capital Contribution Principle on December 9, 2010. The requirements as defined in the tax law and the circular letter must be observed in order to make tax-free repayments of capital contributions.

The main requirements can be summarised as follows:

- Only capital contributions made after December 31, 1996, can be repaid tax-free. The term 'capital contribution' is understood as cash payments, share premium payments or other contributions to the reserves of the company without any congruent increase of the registered nominal share capital of the company.
- Only capital contributions directly made by the shareholders (not contributions of related parties (e.g., sister companies)) qualify for tax-free repayments.
- The receiving company has to differentiate in the balance sheet between 'reserves from capital contribution' and other reserves in its statutory accounts. The reserves from capital contribution need to be booked openly. Therefore, hidden contributions (e.g., the transfer of assets from the shareholder to the company under fair market value) do not qualify for a tax-free repayment. A share premium or another contribution that was set-off in the past against losses of the company can no longer be repaid tax-free.
- Capital contributions made after December 31, 1996 must be disclosed in the balance sheet of the business year 2011 at the latest and have to be reported to the FTA (within 30 days after the approval of the corresponding balance sheet by the shareholders' meeting) by using a specific form (Form 170). This forces most of the Swiss registered companies to react.
- Capital repayments are only tax-free if they are

made out of the reserves from capital contributions. The wording of the shareholders' resolution approving such a repayment has to state clearly that a "repayment out of reserves from capital contributions" is resolved. Without such wording, payments are treated as taxable distributions of other reserves and trigger Swiss withholding and income tax consequences. Hidden dividend distributions do not qualify as tax-free repayments of capital contributions.

- In special cases, especially in which reserves are resulting from former restructurings, mergers, demergers, etc., a careful review with regard to the impact and application of the new principle is necessary. The circular published by FTA still leaves a bunch of open questions with respect to certain details.

Tax-planning opportunities

Provided that the above mentioned requirements can be met, the Capital Contribution Principle introducing the possibility of tax-free repayment of share premium opens attractive tax planning and structuring opportunities.

A lot of Swiss listed companies have substantial share premium. Instead of the distribution of the operating profit by way of classical dividend distribution (remaining subject to the 35% Swiss withholding tax), such contributed share premium can now be repaid tax-free to the shareholders.

Switzerland becomes more attractive as a location for international companies. A foreign based international company that decides to relocate to Switzerland can create substantial share premium prior to its relocation (an increase of nominal share capital or share premium of a Swiss registered company still triggers the 1% Swiss issuance stamp duty) and repay the share premium in the years after the relocation instead of paying a dividend subject to Swiss withholding tax.

The Capital Contribution Principle is also of interest for Swiss resident private shareholders. Under the above-mentioned requirements, such individuals are no longer subject to income tax on the repayment of capital contributions by a company, independent of whether the repaying company is a Swiss or a foreign registered company.

Changes for intragroup financing activities

Limitation of 10/20 non-bank lender rule

Switzerland has a worldwide reputation as a financial centre and offers sophisticated banking services for private as well as commercial and investment banking. Furthermore Switzerland is well known for its competitive tax rates for corporates and individuals and its unique climate of mutual respect of the tax client and the tax authorities which grants easy access to the authorities and offers the opportunity to achieve certainty regarding the future tax treatment for intended structures by advanced tax rulings.

Despite the attractive banking services available and the favourable tax climate, Switzerland was never in a position to attract intragroup financing activities of Swiss and international business groups such as treasury and cash pooling centres. Since August 1, 2010, however, the regulations for such intragroup financing activities have changed.

As a general rule, loans granted, including loans from related parties to Swiss corporate entities and interest paid on such loans are neither subject to Swiss issuance stamp duty on the amount of the loan granted nor subject to the Swiss withholding tax of 35% on the interest paid on such loans. According to the applicable regulations and a long standing practice of the FTA, the Swiss issuance stamp duty and the Swiss withholding tax is imposed on Swiss corporate entities in all cases such debt instruments qualify as collective fund raising systems such as bonds and medium term notes. Furthermore the Swiss transfer stamp duty is levied on the transfer of such debt instruments effectuated by Swiss registered securities dealers. Debt instruments are qualified as fund rising systems as soon as the number of participants in the system exceeds the threshold of 10 (bonds) or 20 (medium-term notes). The taxation system is well known as 'the Swiss 10/20 non-bank lender rule' and was in fact not suitable to attract group financing activities of national and international players.

Relief for intragroup financing

The Swiss Government recognised that the described tax system discouraged international groups to concentrate their cash management in Switzerland and has taken action. With effect per August 1, 2010 the Federal ordinances on Swiss withholding tax and Swiss issuance stamp duty/Swiss transfer stamp duty have been amended in such a way, that existing and future intragroup financing activities over Swiss treasury centres and physical cash pooling activities generally will not trigger Swiss withholding tax and Swiss issuance stamp duty consequences any longer. The exemption, however, will not be applicable for groups where the Swiss corporate entity guarantees bonds and medium-term notes issued by foreign group companies.

In addition to the new tax regime for debt instruments, Switzerland offers tax privileges for treasury centre and cash pooling activities which lead to a profit tax burden of approx. 10 % or even less.

Recommendations and conclusion

In order to be prepared to benefit from future tax-free repayments of capital contributions, Swiss registered companies should take the following steps:

1. Provide for a separate accounting of capital contributions made after December 31, 1996 in the statutory accounts.
2. Notify the FTA about reserves from capital contributions between 1997 and 2011 by using the Form 170 (no later than 30 days after acceptance of the financial statements by the general meeting of the shareholders).
3. Notify the FTA about all future changes in reserves from capital contributions.

With regard to future transactions, the due diligence process should also cover the existence and the review of the FTA declaration as well as the treatment of the 'reserves from capital contribution' in the statutory balance sheet of the target.

In any case it will be necessary to plan future distributions to shareholders (dividend payments compared to repayment/formal reduction of nominal share value or repayment of capital contributions).

The introduction of the Capital Contribution Principle is a substantive change in Swiss tax law, offering tax planning and structuring opportunities that makes Switzerland as a business location even more attractive and competitive.

The excellent banking services available, combined with the effect of the new Swiss tax regime for debt instruments for intragroup purposes and the favourable tax privileges available for such corporate entities now qualify Switzerland as an attractive and competitive location to establish treasury and cash pooling activities for national and international groups.

More changes (the removal of tax burden, e.g., abolition of Swiss issuance stamp duty) will most likely be included in the Corporation Taxation Reform III that is already in a planning stage.

Authors:
Daniel Dillier, Partner
Attorney at Law
Swiss Certified Tax Expert, TEP
Tel: +41 (61) 204 0240
Email: daniel.dillier@ludwigpartner.ch

Thomas Ziegler, Partner
Attorney at Law
Swiss Certified Tax Expert, TEP
Tel: +41 (61) 204 0220
Email: thomas.ziegler@ludwigpartner.ch

Ludwig + Partner Ltd, Attorneys
St Alban Vorstadt 110
PO Box 419
CH-4010 Basel
Switzerland
Tel +41 (61) 204 0202
Fax +41 (61) 204 0222
Email: info@ludwigpartner.ch
Web: www.ludwigpartner.ch