Tax developments in the Swiss M&A market

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About five years ago a new merger law (the 'Merger Law') entered into force in Switzerland. The Merger Law substantially changed and facilitated certain corporate transactions. The law regulates the civil law aspects of mergers, demergers and changes of corporate form in a broad, comprehensive legal framework. The Merger Law has also a direct impact on mergers and acquisitions in Switzerland.

The federal tax administration took the opportunity of the entering into force of the Merger Law to adapt the tax rules applicable for tax neutral corporate reorganisations. With issuance of the Circular Letter No. 5 of June 1, 2004 a comprehensive guideline for tax neutral reorganisation measures was published.

After the first years of application of the Merger Law and the accompanying Circular Letter No. 5 the authors of this article point out some practice experiences made with the new regulations.

Simplified and cost efficient spin-off of participations to Switzerland

A merger or acquisition transaction may require either before or after the transaction the transfer of a participation in a subsidiary to a Swiss parent company. Such participation transfer will normally take place either by a sale of the participation to or by a contribution into the equity of the new Swiss parent company. A sale may trigger tax consequences for the disposing company and may also cause financial obstacles. By choosing for a contribution of the participation into the equity of the Swiss company, the possible negative consequences of a sale can be avoided. Making a contribution into the equity of a Swiss company may cause, however, civil law issues as well as stamp duty issues. Under Swiss law a formal capital increase must be done by way of a public deed. If such formal capital increase is made by a contribution in kind (contribution of the participation), it is further required to obtain a valuation report by a qualified auditor confirming the value of the participation to be contributed. Finally, a capital increase in a Swiss company triggers a one-time stamp duty of 1% of the increased amount (at fair market value). Notary fees, the costs for the valuation report as well as the stamp duty may therefore cause considerable additional expenses. As the formal capital increase must be registered with the commercial register, which results in a publication in the Official Gazette, the caused transparency by the publication may not be wished by the parties involved.

The tax rules introduced together with the Merger Law allow the contribution of participations into the equity of a Swiss company without triggering the before mentioned civil law and tax consequences by making a contributions in kind into the reserves of the Swiss company. No formal capital increase shall take place, but the contributing company simply makes a contribution in kind into the reserves of the Swiss intermediary parent company. The Swiss company will capitalise the received participation rights as assets; on the liability side of the balance sheet, the contribution will be booked into the (free) reserves. As a contribution into the reserves does not result in a formal capital increase, no public deed is required for such contribution and, as a consequence, no publication in the Official Gazette and no registration in the commercial register must be done. A contribution agreement is sufficient for the capital contribution into the reserves of a company. Furthermore, as Swiss law only requires a valuation report if a formal capital increase takes place, a contribution (in kind) into the reserves of a Swiss company will not require such report by a qualified auditor.

Subject to Swiss stamp duty is, in principle, each creation or increase of the nominal amount of capital in a Swiss company, independently from whether such creation or increase of capital takes place against consideration or not. According to the stamp duty law contributions by a shareholder to a company, for which the shareholder does not receive any consideration in return, and which do not result in a formal capital increase in the commercial register, are considered to be legally equal to the creation of participation rights. Thus, any contribution into the equity of a Swiss company is therefore in principle subject to the one-time stamp duty of 1% in Switzerland.

Under the stamp duty law the creation or increase of participation rights as a consequence of a merger or an economically equal transaction is, however, not subject to stamp duty. Under a spin-off of participations rights under Swiss law a company transfers to its subsidiary participation rights in another company. The transfer of at least 20% of participation rights in subsidiaries by way of a spin-off to a Swiss intermediary holding company is considered to be economically equal transaction as a merger and qualifies therefore as a tax neutral restructuring under the stamp duty law.

As from January 2011, the contribution into the (free) reserves will also result in a Swiss withholding tax advantage. Simplified, the equity of a Swiss company consists of formal capital, contributed surplus and profits (carried forward). Under the Swiss withholding tax law currently in force, only the repayment of formal capital by a Swiss company to its shareholders is possible on a withholding tax free basis. The reduction of formal capital requires the shareholder approval stipulated in a public deed. The (re-)payment of contributed surplus as well as of profits (carried forward) is still subject to withholding tax at a rate of 35%, unless a lower rate under a tax treaty applies. As of January 1, 2011, however, also contributed surplus can be repaid to shareholders on a withholding tax free basis. A distribution into the reserves of a Swiss company without receipt of consideration will qualify as a contribution surplus. The repayment of such contribution surplus to its shareholders will, in addition to the repayment of formal capital by way of a formal capital reduction, be exempt from Swiss withholding tax as of January 1, 2011. As the shareholder decision on the repayment of contributed surplus does not require the shareholder minutes to be written down in a public deed, a repayment of contributed surplus will be easier to be implemented than a formal capital reduction.

Summarised, a spin-off of participations by way of a contribution in kind into the reserves of a Swiss company will not lead to a formal increase of the nominal capital of the Swiss company, will qualify as stamp duty exempt reorganisation under the stamp duty law and will, as a consequence, not trigger Swiss stamp duty. The transfer of participation rights to a Swiss intermediary holding company by way of a contribution in kind into the reserves of the Swiss intermediary holding company is a cost efficient reorganisation measure, which can be implemented straight forward. As of January 1, 2011 contributed surplus resulting from the contribution in the reserves without receipt of consideration can be repaid to its shareholders on a withholding tax free basis.

Corporate immigration into Switzerland

In the last few years several multinational companies immigrated to Switzerland. We noticed various reasons for the relocation of foreign companies to Switzerland. Where in the past specific countries, e.g., the US were the core markets for a group of companies, these core markets have lately become less critical as the market focus has become more global. Switzerland as a business location is still considered to offer a long-term optimal legal, financial and political stability. Furthermore, Switzerland is used by various international companies as location for their financing, trade activities, royalty exploitation and investment related services. Finally, Switzerland has concluded about 90 tax treaties with other countries, which offers a solid basis for structuring business investments all over the world. With the European Union Member States Switzerland has concluded the so-called Savings Directive, under which intra-group dividends, interest and royalty payments are no further subject to withholding tax in the source state. All these reasons may have an impact on the decision for a corporate immigration to Switzerland.

Corporate immigration is, from a Swiss point of view, rather simple. In principle, one can immigrate with every foreign company into Switzerland. Swiss law, however, requires that the foreign country, out of which the company is planning to emigrate, also allows under its domestic laws the immigration and emigration of companies without liquidation (reciprocal right). Furthermore, the legal form of the immigrating company must be adjustable to a Swiss company form, which is the stock corporation or the limited liability company. As in the course of a corporate immigration the immigrating company is not liquidated, existing contractual relationships and ownership rights are not affected by a corporate immigration.

Except with respect to stamp duties Swiss tax law does not contain any specific tax regulations regarding the immigration of foreign companies to Switzerland. When immigrating with a company into Switzerland, the equity of the new registered Swiss company is not subject to stamp duty. The stamp duty law explicitly exempts corporate immigrations from stamp duty. Highly capitalised entities may therefore immigrate into Switzerland without triggering the stamp duty costs. Furthermore, before immigration into Switzerland it is advisable to consider under the laws of the emigration country the valuation of the assets of the immigrating company in order to optimise the depreciation basis and to verify that such valuation will be accepted in Switzerland. From a Swiss point of view, a valuation of the assets at fair market value will, of course, not trigger any problems.

As mentioned herebefore under the explanations to the spin-off of participation, in addition to the possibility of a withholding tax free repayment of formal also contributed surplus can be repaid to its shareholders as from January 1, 2011 without triggering

Swiss withholding tax. For an immigrating company it is therefore attractive to have either a high formal capital or a high contributed surplus before immigrating to Switzerland in order to be allowed to repay formal capital and/or contributed surplus without triggering Swiss withholding tax consequences and without raising questions regarding the (entitlement of the) application of tax treaties. To the extent possible under the laws of the emigration country a company immigrating to Switzerland should therefore review and clearly qualify its equity position as formal capital, contributed surplus or profits (carried forward) before the immigration into Switzerland takes place. If an immigrating company increases its formal capital time closely before the immigration to Switzerland with the idea to benefit in future from the possibility of withholding tax free repayment of formal capital the Swiss tax administration may not accept all formal capital to qualify for a withholding tax free repayment. Furthermore, the tax administration may want to investigate the origin of the contributed surplus in order to avoid an abusive re-qualification of profits (carried forward) into contributed surplus before the immigration into Switzerland took place. In order to avoid such possible uncertainties regarding the possibility of the withholding tax free repayment of formal capital and contributed surplus it is advisable to obtain an advance ruling on the acceptance of the formal capital and the contributed surplus under Swiss tax law and the possibility of the withholding tax free repayment of such equity positions. After January 1, 2011 a company may then make distributions to its shareholders in the form of formal capital reductions as well as of repayments of contributed surplus, both of them may then be made free of Swiss withholding tax.

Real estate related transactions

The acquisition of Swiss real estate is restricted under the Federal law of December 16, 1983 on the acquisition of real estate by persons abroad (so-called 'Lex Koller'). In the past, the initially very tight restrictions have been steadily liberalised. Currently political discussions are ongoing about a further modification or even a total abolishment of the Lex Koller. Today, the restrictions still apply to individuals which are neither Swiss, EU/EEA nor EFTA citizens or which do not hold a Swiss residence permit C, as well as to legal entities domiciled abroad or to foreign-controlled legal entities incorporated in Switzerland. Commercial real estate (i.e., business premises), however, can nowadays be acquired by foreign nationals without any approval requirement. Non-commercial (residential) real estate, even if commercially used (i.e., dwellings, private houses, apartments, etc.), are still subject to approval that is in practice granted very seldom.

The liberalisation of the Lex Koller, combined with the fact that Switzerland has been discovered by international real estate investors as an interesting niche market, resulted in a significant number of transactions involving Swiss real estate. The financial crisis certainly had its impacts on the financing and structuring of the deals, but real estate related transactions are nevertheless still going on.

Transactions involving Swiss real estate or Swiss real estate companies need a careful review and planning, especially with respect to the cantonal real estate capital gains taxes and real estate transfer taxes: a transfer of real estate located in Switzerland may trigger a cantonal real estate capital gains tax and/or a cantonal real estate transfer tax. Not only the direct sale of real estate (asset deal), but also the indirect sale of real estate by disposal of shares in a real estate company (share deal, with underlying Swiss located real property) may trigger the real estate capital gains tax and the real estate transfer tax due to an economical change of ownership in the underlying real estate.

Income taxes on the cantonal level, including the real estate capital gains tax, are to some extent harmonised in the 26 cantons of Switzerland by the introduction of the Tax Harmonisation Law in 2001. The real estate transfer taxes are, however, not dealt with in the Tax Harmonisation Law but have been harmonised between the cantons when the Merger Law was implemented. The Merger Law stated that after a five-year transitional period no cantonal real estate transfer tax shall become due in the event of a reorganisation under the Merger Law. The transitional period granted to the Swiss cantons for adapting their cantonal tax laws expired on June 30, 2009. Based hereon, the cantonal Swiss real estate transfer taxes are now abolished for qualifying reorganisations.

Under the federal and cantonal tax laws, real estate transactions are supposed to be tax neutral if such transactions qualify as tax exempt reorganisations. The classical forms of such reorganisations (mergers, de-mergers, conversions and transfers of assets and liabilities) have been defined in the Merger Law. It is evident from recent real estate transactions that, despite the harmonisation, the federal and cantonal corporate income tax laws have adopted a broader interpretation of the tax neutrally allowed reorganisation forms than the Merger Law. It is common sense (and in principle covered by the tax laws) that a 'share to share deal', where a merger is economically achieved by a shareholder exchanging his shares in the target company for shares in the acquiring company, qualifies as a tax neutral reorganisation for income tax purposes.

Some tax authorities, however, tend to qualify share to share deals differently for income tax (including real estate capital gains tax) or real estate transfer tax purposes. This non-harmonised interpretation for the different taxes in the different cantons can result in a situation where a share to share deal qualifies as a tax neutral reorganisation in one canton for all taxes, while another canton denies the tax neutrality for the real estate transfer tax. Even though the real estate capital gains taxes and real estate transfer taxes should have been abolished for qualifying reorganisation in Switzerland, practice has shown that a full harmonisation has not been achieved between the cantons. It is therefore strongly recommended to carefully investigate for each canton involved the tax situation, the resulting tax consequences and planning opportunities prior to the implementation of a real estate related transaction.

In international inbound transactions into Switzerland cantonal real estate capital gains taxes can be optimised by well considered tax planning measures. Article 13 of the OECD Model Tax Convention on Income and on Capital previews that gains derived by resident of a Contracting State from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State. In most of the double tax convention Switzerland entered into such a provision is, however, not previewed. In cases where a double taxation convention without a provisions similar to Art. 13 of the OECD Model Tax Convention applies (e.g., between Switzerland and Luxemburg) Switzerland has to treat gains resulting from the sale of a Swiss real estate company like gains from the sale of moveable property. This means that the right to tax the gain is exclusively allocated to the residence state of the seller and, as a consequence, no cantonal real estate capital gains tax can be levied in Switzerland.

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