



MERGERS AND ACQUISITIONS

Switzerland

Taxation of Cross-Border
Mergers and Acquisitions

2010 Edition

TAX

Switzerland

Introduction

The Swiss economy was once dominated by small and medium-sized enterprises (up to approximately 500 employees) mainly active in the domestic market.

Because of the increasing globalization of markets and the creation of a single European market, Swiss enterprises have been expanding significantly into foreign markets by setting up foreign production facilities or by mergers and acquisitions (M&A). Foreign strategic and financial investors have also significantly increased 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 double tax treaties (DTTs) offers 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 will be assumed if 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; and
- there is co-operation between the seller with the acquirer.

If the above conditions are met, the tax exempt capital gain for the seller will be re-classified as a taxable dividend in the amount of the lower of the capital gain or distributed reserves. Sellers, therefore, usually request the insertion of an appropriate clause in the share purchase agreement to restrict the acquirer from distributions that might trigger such a re-classification.

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 (that is, write down of receivables).

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

The corporate tax reform II enacted in 2008 contains beneficial changes; privileged taxation of qualifying dividend income for personal shareholders, tax reliefs for the liquidation or sale of entrepreneurial businesses, and 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 WHT and from taxation on 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, whereas sellers usually prefer share deals, which usually produce tax-exempt capital gains.

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 will be stepped up to their fair market value and an excess amount is booked as goodwill. If the acquired business includes shares, the allocation of the purchase price to shares and other assets will have important tax implications for the seller and purchaser, and should be agreed on in the purchase agreement.

Goodwill

When 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 must normally be depreciated in the Swiss statutory accounts of the acquirer. The depreciation allowed for tax purposes is usually either 40 percent per year for five years on a declining balance basis (the remaining balance being taken in the last year), or 20 percent per year on a straight-line basis. This corresponds with the treatment of intangible property generally. There is, therefore, no disadvantage in allocating a part of the purchase price to goodwill. Given that the rate of depreciation is high, it may even be advantageous to allocate purchase price to goodwill. If economically justified, it may be possible to accelerate the rate of depreciation.

Depreciation

Depreciation for tax purposes generally follows the accounting rules and a safe haven depreciation table has 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 (such as for participations). The depreciation of shares is generally tax-deductible, but the shareholder is required to revalue qualifying shares (at least 20 percent [10 percent as of 2011] shareholding) in case the value has increased.

Tax Attributes

The tax effect of an asset purchase is that the purchased asset has a new cost basis in the hands 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

acquirer 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 (VAT)

Where assets are transferred individually, those items that are within the scope of VAT are subject to the normal VAT rules for goods or services at the standard rate of 7.6 percent (8 percent as of 2011) or reduced rate of 2.4 percent (2.5 percent as of 2011). However, the notification procedure must be applied if assets are transferred between two VAT-registered parties and:

- the VAT would exceed CHF 10,000;
- the assets are transferred as part of an intercompany asset transfer; or
- in the case of reorganizations under the merger act/tax-neutral reorganizations.

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

Transfer Taxes

Stamp duty is payable on the transfer of any taxable securities (such as bonds and shares), if a registered securities dealer acts on its own account or as an intermediary in such a transfer. Swiss securities dealers within the meaning of the Swiss stamp duty legislation include companies not performing a banking-type function (that is, Swiss companies whose assets include taxable securities with a book value higher than CHF 10 million). Stamp duty is 0.15 percent on Swiss securities and 0.30 percent on foreign securities.

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

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. It should be noted that a reduction in value is tax-deductible for the Swiss acquirer, whereas a subsequent increase in the value of participations of at least 20 percent (10 percent as of 2011) triggers a taxable revaluation (claw-back provision). Goodwill cannot be separately recognized in the balance sheet.

From a seller's perspective, a share deal is usually preferred, because the Swiss corporate seller can

usually benefit from a tax-exempt capital gain (provided that shares of at least 20 percent [10 percent as of 2011] which have been held for at least one year are sold). Swiss individual sellers holding the shares as private assets usually achieve a tax-exempt capital gain, provided the restrictions under the IPL rules (see earlier) are complied with. Individual sellers holding the shares as business assets and selling qualifying shares (at least 10 percent) may benefit from a privileged taxation.

Tax Indemnities and Warranties

All historic 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 seven years, but are 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 above, tax liabilities remain with the Swiss target entity and will crystallize on this company's level.

With respect to Swiss withholding tax (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 WHT on dividends of more than 0 percent. If, due to a change in ownership, the net WHT would be reduced to a lower rate than before the transaction, the Swiss tax authorities may argue that the distributable reserves are still earmarked at the higher WHT rate and that, in the event of a future dividend distribution, they would grant a refund up to this higher rate only. The amount subject to the previous WHT rate is usually the lower of retained earnings and the non-business relevant assets at the time of the change in ownership .

Pre-Sale Dividend

A Swiss seller will not usually wish to pay out pre-sale dividends. A purchaser can, however, request such dividends to mitigate its WHT exposure under the old-reserves theory (see earlier in the chapter) or if the

seller imposes post-closing restrictions under the IPL regime on the acquirer.

A dividend can only be distributed on the basis of (audited) annual accounts no more than six-months old. Thus, a later dividend distribution of retained earnings may require an (audited) interim balance sheet, not more than six-months old at the time of the distribution. Interim dividends (that is, dividends from current year earnings) cannot be paid out under current Swiss corporate law.

Transfer Taxes

If the seller or the purchaser qualifies as a securities dealer (such as, a bank, or Swiss company with more than CHF 10 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 if the shares are sold as part of a restructuring (such as a 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 the acquirer wishes to submit pre-closing for the Swiss target entity usually require authorization by the target and seller.

Choice of Acquisition Vehicle

The acquisition of a Swiss business or Swiss target company should be carefully structured, because the choice of acquisition vehicle will influence 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, and this also enables a tax-neutral merger with the target (such as if required by the financing banks).

Under Swiss tax law, a holding company is defined as a company which 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 the earnings from

investments, the holding 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 full taxation at the federal level.

For companies not qualifying for a privileged taxation on the cantonal level, dividend income from qualifying participations (20-percent shareholding or a fair market value of at least CHF 2 million [10-percent shareholding or a fair market value of at least CHF 1 million as of 2011]) 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 5-percent lump-sum 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 in case the value has increased again, which would result in taxable income.

Interest expenses for financing the acquisition can be set-off against taxable income. If there is insufficient taxable income, the expenses will increase the holding'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 push-down can usually only be achieved for strategic buyers, or by careful structuring.

Foreign Parent Company

An acquisition by a foreign parent company should reflect the existing DTTs or the application of the Swiss-European Taxation of Savings Treaty, 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 three years. The federal tax authority usually reviews the treaty entitlement of the foreign shareholder, focusing particularly 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 addition, 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 25 percent held for at least two years will benefit from a full reduction of withholding at source (0-percent WHT). The same applies to intra-group interest payments. Royalties are not subject to Swiss WHT under domestic law. Payments into Switzerland benefit from the same treatment.

A foreign shareholder selling its Swiss subsidiary is not subject to Swiss income tax based on domestic law (that is, irrespective of a DTT) (exceptions for real estate companies may apply).

Non-Resident Intermediate Holding Company

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

Local Branch

A foreign corporation, acting as the headquarters of a Swiss branch, will be subject to Swiss income and capital tax with respect to the Swiss branch's income and capital. The allocation of the acquired target to the Swiss branch should be carefully structured, because participations are usually allocated to the headquarters for tax purposes.

Swiss branches are taxed in the same way as companies and can, therefore, qualify for the holding company privilege (see earlier). The DTT between Switzerland and the headquarters' country 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 Ventures

The taxation of joint ventures depends on their legal form, whether they are corporations (see comments on holding companies above) 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 for the partners can be limited and the allocation of profits and the application of DTTs is clearer.

Choice of Acquisition Funding

The funding of the acquisition, either with debt, equity, or hybrid instruments, must be considered from a Swiss tax point of view 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 fund raising 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 DTT may be possible). Interest on ordinary loans is not subject to WHT.

It should be noted that for Swiss WHT and stamp duty purposes:

- a loan qualifies as a bond if the aggregate number of non-bank lenders (including sub-participations) to a Swiss entity under a facility agreement exceeds 10 (under equal conditions); and
- the debtor qualifies as a bank if the aggregate number of non-bank lenders to a Swiss entity under all of its interest-bearing indebtedness, facilities, and/or private placements (including intercompany loans) exceeds 20 (variable conditions) and the total amount of the relevant debt exceeds CHF 500,000.

Deductibility of Interest

Interest expenses are in general 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).

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

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

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, 2009

For finance companies, the liabilities allowed are usually six-sevenths of total assets (finance branch ten-elevenths). As mentioned earlier, these guidelines are only safe haven rules. The company can diverge from them, if 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 will result in a re-classification of part of the 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 does not qualify as third party debt for thin-capitalization purposes.

Withholding Tax on Debt and Methods to Reduce or Eliminate

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

- deposits with banks;
- profit distributions by resident companies or investment trusts (the term distribution also covers hidden profit distributions); and
- bonds and other similar negotiable debt instruments issued by a Swiss-resident borrower.

For WHT purposes, the terms bank and bond are defined very broadly, and can include deposits made with resident finance companies and any other corporate or individual person accepting customer deposits. Generally speaking, deposit-takers are treated as banks for WHT purposes if they attract a minimum number (depending on the situation, 10 or 20) of interest-bearing customer deposits (see also earlier). Since interest on private loans (non-bonds) or on intercompany loans is in general exempt from WHT, taxpayers should ensure the thresholds for qualification as bank or bond are not exceeded.

The WHT rate may be reduced under a DTT 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, triggering stamp duty and WHT?

Equity

Some equity financing may be required to meet debt-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 CHF 1 million, which is tax free. Other contributions as well as a share 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 double tax treaty or the Swiss-European Taxation of Savings Treaty. Dividends from at least 20-percent shareholdings in a Swiss subsidiary to a Swiss corporate shareholder can be distributed without payment of WHT.

Reorganizations

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

The capital contribution principle (effective for capital repayments after 1 January 2011) will impact the current rules on tax-neutral reorganizations (mergers, de-mergers, intra-group asset transfers, drop downs) and an updated circular is expected to be published. Under the capital contribution principle, not only share capital, but also contributions (such as capital surplus, capital contributions) made to a company after 31 December 1996 may be repaid without triggering 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 handed over 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 undertaking 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 in general income tax neutral; that is, any hidden reserves should be transferable tax-free if 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 if 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, if 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 on security transfers does not apply either.

If the surviving entity of a merger uses treasury shares 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, de-mergers and transfers of assets. As opposed 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 de-mergers 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, de-mergers, and transfers of assets carried out in foreign jurisdictions.

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

If a Swiss business is transferred outside Switzerland, the tax consequences are significant. Being a deemed liquidation, the same tax consequences are triggered as in a statutory liquidation process; that is, the hidden reserves become subject to income and WHT. If 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 international cases, the applicable double 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 the more flexible alternative to statutory mergers, as, for example, risks and liabilities of the target are kept isolated and the administrative and operational burden may be lower (international mergers).

A strong argument for privately-held targets to prefer a share-for-share deal is that a cash consideration of up to 50 percent of the transaction value is permissible and is in principle 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 statutory merger if the absorption occurs within a five-year waiting period. Swiss private shareholders who might be facing taxable income in case of a subsequent merger are likely to insist on 'hold harmless' clauses in the transaction agreements.

De-Merger

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 take over the assets.
- In a spin-off, the transferring entity continues operations after the transfer and shareholders receive shares of the entities that take over assets.

De-mergers are in general income tax neutral; that is, any hidden reserves should be transferable tax-free if the following conditions are met:

Taxation of Cross-Border Mergers and Acquisitions 7

- 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 if 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 alignment or need to be transferred due to anti-trust reasons, and target groups can be more easily tailored to meet the market's expectations. The requirement of continuing businesses in both entities, however, 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 (at least 20 percent) 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 if they provide services to third parties or affiliated entities and if they have at least one full-time employee. For non-operating entities, a de-merger might prove difficult due to the stringent requirements on the business quality and, therefore, other means of transfer may be preferable, such as the transfer of assets (discussed later). Particularly if a group with mixed business entities is to be divided into two or more separate parallel groups, the de-merger of the common holding and intellectual property entities requires special attention.

The de-merger should not trigger any WHT consequences if reserves and retained earnings of the transferring entity are transferred to – and remain with – the acquiring company. If reserves and retained earnings are converted into share capital (and from 2011, potentially also capital contributions), 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 (de-merger) is usually not subject to

stamp duty. Stamp duty on security transfers tax does not apply either.

Intra-Group Transfer of Assets

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

The waiting period in practice will mainly be relevant for transfers of individual assets such as real estate or intellectual property. The transfer of businesses should qualify under the de-merger rules and, therefore, not be subject to a waiting period.

If the transferee breaches the waiting period, hidden reserves are realized and taxed in the transferor entity and a dividend is deemed 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 subject to Swiss taxation is tax neutral. Except for qualifying participations, the drop-down of assets is subject to a five-year waiting period. The waiting period applies to both the transferred assets and the participation in the transferee entity.

Hybrids

Debt will usually only be re-classified as equity if thin-capitalization is an issue. In all other circumstances, instruments having the form of debt will be accepted as such and will follow the Swiss accounting principles.

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, 2009

It should be noted that the Swiss participation deduction or privileged taxation of dividend does not apply to (dividend) payments treated as tax-deductible for the payer.

Discounted Securities

An acquisition of securities at a discount generally results in a taxable gain, if 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 does not generally 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 should generally 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. A seller with tax losses close to forfeiture may, however, be willing to agree on an asset deal. Sellers also tend to prefer a share deal, because the historic 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 particular type of entity best suits their needs. Tax issues may play an important part when reaching such 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 CHF 100,000
- Restrictions with regard to acquisition of own shares

Limited Liability Company (LLC) – Gesellschaft mit beschränkter Haftung (GmbH)

The LLC is a hybrid between a corporation and a partnership. For Swiss tax purposes the LLC qualifies as a corporation. The LLC is becoming more widespread in Switzerland. 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 CHF 20,000

Other forms of business entity admitted by the Code of Obligation (none of these forms are corporate bodies) are the following:

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, as well as 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, in principle, 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 its own tax return.

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

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

- A balance sheet total of CHF 10 million
- Revenues of CHF 20 million
- An average annual number of employees of 200

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

- the company has outstanding bond issues;
- the company's shares are listed on a stock exchange; and
- 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, such as written agreements concluded in advance, compliance with these agreements, arm's length conditions determined on the basis of functions and risk, can serve as general guideline for Swiss tax purposes. 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 is in Switzerland, or their actual management is in Switzerland. Thus, corporations with their statutory seat outside of Switzerland, but whose day-to-day business is managed in Switzerland, or those with their statutory seat in Switzerland, but actual management abroad, qualify as Swiss-resident. 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 DTT.

Foreign Investments of a Local Target Company

Switzerland has no formal controlled foreign companies (CFC) rules and applies the participation deduction on dividends irrespective of any minimum taxation requirements. The participation deduction regime is explained above (see Local Holding Company) and 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.

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 historic tax liabilities (except for VAT, social security, and employee WHT, and in the case of reorganizations).
- No deferred tax liabilities on retained earnings.
- It is possible to acquire only part of a business.
- Interest expenses for the acquisition can generally 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 effectively 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 will involve 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 (such as on real estate and securities).
- The 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, therefore price is likely to be lower (if 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.

Withholding Tax Rate Chart

The table below summarizes the WHT rates under the current double tax treaties with Switzerland. A full WHT exemption may apply under the EU-Swiss Taxation of Savings Treaty for qualifying dividends and certain intra-group licenses and interest. The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest ¹ (%)
	Individuals, Companies (%)	Qualifying Companies ² (%)	
Albania	15	5	5
Algeria ²⁴	15	5 ³	0/10 ⁴
Anguilla ⁵	.6	.6	.6
Antigua ⁵	.6	.6	.6
Argentina ²³	15	10	12
Armenia	15	5 ⁷	0/10 ⁸
Australia	15	15	10
Austria	15	0 ³	0
Azerbaijan	15	5 ⁹	5/10 ⁸
Barbados ⁵	.6	.6	.6
Belarus	15	5	5/8 ⁸
Belgium	15	10	10
Belize ⁵	.6	.6	.6
British Virgin Islands ⁵	.6	.6	.6
Bulgaria	15	5	10
Canada	15	5 ¹⁰	10
China (People's Rep.)	10	10	10
Croatia	15	5 ¹⁰	5
Czech Republic	15	5	0
Denmark	0	0	0
Dominica ⁵	.6	.6	.6
Ecuador	15	15	10
Egypt	15	5	15
Estonia	15	5 ³	0/10 ¹¹
Faroe Islands ¹²	0	0	0
Finland	10	0 ³	0
France	15	0 ¹⁰	0
The Gambia ⁵	.6	.6	.6
Germany	15	0 ³	0
Greece	10	10	10
Grenada ⁵	.6	.6	.6
Hungary	10	0	0/10 ²⁵
Iceland	15	5	0
India	10	10	10
Indonesia	15	10	10
Iran	15	5 ¹³	0/10 ⁸
Ireland	0	0	0
Israel	15	5 ¹⁰	5/10 ⁸
Italy	15	15	12.5
Ivory Coast	15	15	15
Jamaica	15	10 ¹⁰	0/5/10 ¹⁴
Japan	15	10	10
Kazakhstan	15	5	10
Korea (Rep.)	15	10	10
Kuwait	15	15	10
Kyrgyzstan	15	5	5
Latvia	15	5 ³	10
Liechtenstein	.6	.6	0/- ¹⁵
Lithuania	15	5 ³	10
Luxembourg	15	0/5 ¹⁶	0/10 ¹⁷

Country	Dividends		Interest ¹ (%)
	Individuals, Companies (%)	Qualifying Companies ² (%)	
Macedonia	15	5	0/10 ⁸
Malawi ⁵	.6	.6	0
Malaysia	15	5	10
Mexico	15	5	0/10/15 ¹⁸
Moldova	15	5	10
Mongolia	15	5	0/10 ⁸
Montenegro ¹⁹	15	5 ³	10
Montserrat ⁵	.6	.6	.6
Morocco	15	7	10
Netherlands	15	0	5
New Zealand	15	15	10
Norway	15	0 ³	0
Pakistan	20	10 ³	10
Philippines	15	10 ¹⁰	10
Poland	15	5	10
Portugal	15	10	10
Romania	10	10	10
Russia	15	5 ²⁰	5/10 ⁸
St. Kitts and Nevis ⁵	.6	.6	.6
St. Lucia ⁵	.6	.6	.6
St. Vincent ⁵	.6	.6	.6
Serbia ¹⁹	15	5 ³	10
Singapore	15	10	10
Slovak Republic	15	5	0/10 ⁸
Slovenia	15	5	5
South Africa	7.5	7.5	10
South Africa (New treaty) ²⁴	15	5 ³	5
Spain	15	0 ²¹	0
Sri Lanka	15	10	5/10 ⁸
Sweden	15	0	5
Thailand	15	10 ³	10/15 ⁸
Trinidad and Tobago	20	10 ¹⁰	10
Tunisia	10	10	10
Ukraine	15	5	0/10 ⁸
United Kingdom	15	0 ¹⁰	0
United States	15	5 ¹⁰	0
Uzbekistan	15	5 ³	5
Venezuela	10	0	5
Vietnam	15	7/10 ²²	10
Zambia ⁵	.6	.6	0

Notes

- Many treaties provide for an exemption for certain types of interest, such as 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.
- 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 of the Swiss company.
- This rate applies if the recipient company owns at least 20 percent of the capital of the Swiss company.
- The lower rate applies to interest paid by a public body and to interest paid to a bank.
- Extension of the 1954 tax treaty with the United Kingdom.
- The domestic rate applies; there is no reduction under the treaty.
- 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 CHF 200,000.
- The lower rate applies to interest paid to a bank.
- This rate applies if the Azerbaijani company directly owns at least 20 percent of the capital of the Swiss company and has made investments equal to at least USD 200,000 in Switzerland.
- This rate applies if the recipient company owns at least 10 percent of the capital or voting power of the Swiss company.
- The lower rate applies to interest paid by public bodies.
- Extension of the 1973 tax treaty with Denmark.
- This rate applies if the recipient company owns at least 15 percent of the capital of the Swiss company.
- The zero rate applies to interest paid by a public body. The 5-percent rate applies to interest paid to a bank.
- The zero rate applies to interest on loans secured by immovable property. Otherwise, the domestic rate applies.
- The 5-percent rate applies to dividends in respect of a 25-percent capital holding. The zero rate applies if the 25-percent capital holding has been held for at least two years.
- The 10-percent rate applies to interest on bonds and other similar securities and to interest paid on bank deposits.
- The zero rate applies to interest paid by a public body. The 10-percent rate applies to interest paid to a bank.
- The treaty concluded between Switzerland and the former Serbia and Montenegro.
- This rate applies if the Russian company directly owns at least 20 percent of the capital of the Swiss company and the invested capital exceeds CHF 200,000 at the moment the dividends become due.
- This rate applies if a 25-percent capital holding has been held for at least two years.
- The 7-percent rate applies if the Vietnamese company owns at least 50 percent of the capital of the Swiss company. The 10-percent rate applies in the case of a participation of at least 25 percent, but less than 50 percent.
- The treaty with Argentina was provisionally implemented from 1 January 2001.
- Effective from 1 January 2010.
- The 0-percent rate applies to interest to non-resident companies.

KPMG in Switzerland

Peter Uebelhart
KPMG AG
Badenerstrasse 172
Zurich
CH-8026
Switzerland

Tel. +41 44 249 2679
Fax +41 44 249 2754
e-Mail: puebelhart@kpmg.com

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2010 KPMG AG, a Switzerland corporation, is a subsidiary of KPMG Europe LLP and a member of the KPMG network of independent firms affiliated with KPMG International Cooperative (KPMG International), a Swiss entity. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International Cooperative ("KPMG International"), a Swiss entity.