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Cross-border post-acquisition possibilities under Swiss tax law

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Cross-border post-acquisition possibilities under Swiss tax law

Rolf Wüthrich from burckhardt describes various cross-border post-acquisition reorganisation possibilities that can be implemented tax efficiently under Swiss tax law

So far, many parts of the Swiss economy have remained remarkably unaffected by the various global economic crises of the last number of years. Switzerland's stable political and economic situation, first-class infrastructure and straightforward tax rules make it an attractive choice for headquarter and operating companies alike. In view of the increasing readiness of Swiss banks to finance transactions, it is not surprising that M&A activities involving Swiss companies are increasing and are predicted to increase even more in the near future.

Swiss tax law has undergone significant modifications which offer attractive investment opportunities for non-Swiss shareholders. As a result of the legislation implemented over the last few years, Switzerland is ready to facilitate cross-border transactions which increases the attractiveness of the country. Investments normally also cause post-acquisition measures, some of which are described below.

Principle of contributed capital and immigration of entities

Since January 1 2011, Swiss law recognises the principle of contributed capital. According to this principle, contributed capital other than formal capital may be repaid without triggering Swiss withholding tax. The principle applies to any premium payment or contribution into the reserves made after December 31 1996. However, to take advantage of the new rules, special bookkeeping measures are required until the end of 2011 and reporting obligations must be fulfilled until mid-2012 at the latest. It is therefore advisable to review carefully acquisitions of Swiss companies as well as premium payments and contributions made to Swiss companies made after December 31 1996 to determine if they qualify for withholding-tax free repayment under the new principle. Even if a withholding-tax free repayment may not bring any benefit to the shareholder of a Swiss company, for example, due to an applicable tax treaty or because a foreign tax credit is granted for non-refundable withholding tax levied by Switzerland, this situation may change in the future, for example due to structural reorganisations.

Capital contributions and premium payments made between December 31 1996 and December 31 2010 should therefore still be booked as reserves from capital contributions to ensure the possibility of making future withholding-tax free repayments of contributed capital. The contributions must be booked under the separate balance-sheet position 'reserve from capital contribution' in the closing balance sheet of the business year ending in 2011. It may be cumbersome and time-consuming to work out possible contributions by the former owner of a Swiss company acquired from unrelated parties, however the exercise may still be worthwhile.

Swiss law allows companies incorporated abroad to move into Switzerland, a step often considered in the course of structural reorganisations of business activities. Companies incorporated abroad may move to Switzerland without losing their corporate identity and without contractual relationships with third parties being affected. When a company immigrates into Switzerland its equity will, for tax purposes, be qualified either as formal capital, reserve from capital contributions or other reserves. Any immigrating company will be interested in having contributed capital being recognised by the Swiss tax administration as equity not subject to withholding tax in case of repayment. For this qualification it will be decisive how the reserves were created when the immigrating company still was a non-Swiss entity. To obtain certainty about the qualification it is advisable to submit the qualification to the Swiss tax administration for pre-approval before the immigration takes place.

Cross-border mergers

After an acquisition, a new shareholder may wish to simplify the post-acquisition structure by eliminating acquired companies. Instead of undergoing formal liquidation proceedings, a cross-border merger may lead to the same results. When implementing an emigration merger, the various formal requirements under Swiss law may easily require a reorganisation period of eight to 10 months. Despite this, an emigration merger may still be faster and more efficient than the formal liquidation of an acquired company and may, under certain circumstances, also result in tax benefits for the absorbing non-Swiss company. The timing of the merger process is however decisive. Swiss corporate law requires that the signing of the merger agreement takes place within six months from the closing date of the Swiss financial statements based on which the merger is implemented. In cross-border mergers Swiss law requires the absorbed Swiss company to publish a call for creditors in the Swiss Official Gazette, announcing the cross-border merger; with this publication a period of two months starts running during which creditors may file their claims against the Swiss company. During this waiting period the Swiss company may hold its ordinary shareholders' meeting to approve the (audited) financial statements based on which the merger and the merger agreement can be signed between the absorbing and the absorbed company.

Upon expiration of the two months' waiting period, an authorised auditor must prepare a report regarding the claims filed by creditors, if any. Once this report has been prepared, the merger documents may be filed with the competent authority in the country of the absorbing company; the foreign authorities must then issue a certificate confirming that (i) the absorbing company is duly incorporated and existing under the laws of the state in which it is incorporated, (ii) under the laws of the absorbing company a company may absorb a foreign company by way of merger and (iii) the cross-border merger has become effective according to the law of the absorbing company. Upon receipt of this certificate the Swiss authorised auditor will issue a second auditor report. Once the merger agreement, the two auditor reports and the foreign certificate are available, the merger can be registered with the Swiss commercial register. However, timing is not only of importance for corporate law purposes, but also for tax law purposes.

For Swiss corporate income tax purposes a merger can take place retroactively as of the date of the last audited financial statements, provided the merger documents are filed with the Swiss commercial register within six months after the closing date of the financial statements. Even if for corporate law purposes the merger only becomes effective with the filing of the merger documents with the commercial register, retroactivity for tax law purposes means that tax liability in Switzerland will end as of the closing date of the financial statements. If the merger documents are not filed with the register within this six months' period, the merger will – for tax purposes – not be accepted on a retroactive basis and new financial statements must be issued covering the period from the last closing date to the registration date of the merger. Tax liability will in this case continue until the date of the filing of the merger documents. Practice has shown that due to all the various formalities to be fulfilled in a cross-border merger it is hardly possible to file the merger documents within the required six months' period with the commercial register in Switzerland. It is therefore important to agree with the tax administration before the merger agreement is signed how the cross-border merger will be treated for tax purposes. One

Biography

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Rolf Wüthrich is an international tax lawyer focusing his areas of expertise on national and international tax planning, inbound and outbound transactions between the US and Switzerland, corporate restructuring and acquisitions as well as general corporate secretarial services.

burckhardt provides its clients and their businesses with comprehensive, tailored advice on national and international tax planning issues and structuring, offers corporate secretarial and notary services, supports clients with professional expertise and broad international experience on restructurings, mergers and joint ventures, advises on inbound and outbound investments and in all matters related to employment, trade and transport law.

possibility is to agree that retroactivity will still be accepted by the tax administration for corporate income tax purposes if the merger agreement is signed within the six months' period as of the closing date, even if the merger documents will not be filed within this period with the commercial register.

Swiss withholding tax issues must also be considered. A cross-border merger is deemed to be a liquidation of the company for Swiss withholding tax purposes. The equity less the formally paid in capital and less recognised reserves from capital contributions, if any, will therefore be considered as a final dividend and be subject to Swiss withholding tax of 35%, unless a tax treaty applies. If the absorbing foreign company is the parent in a treaty country, then the reduced withholding tax for qualifying shareholders may be applied. However, to be allowed to apply the reduced treaty rate directly the reporting procedure in Switzerland must be respected. Under the reporting procedure the request to apply the reduced withholding tax directly must be filed before the dividend distribution takes place, that is, before the merger documents are filed with the commercial register. If the Swiss subsidiary wants to be sure that the reporting procedure will be accepted by the Swiss federal tax administration it is therefore necessary to file the reporting procedure request at least eight to 10 months before the merger shall be registered in Switzerland as the decision by the tax administration on the application of the reporting procedure often requires a considerable period of time. If the absorbing foreign company is a non-Swiss sister company (merger between sister companies), then the reporting procedure cannot be applied and the 35% withholding tax must be paid on the distributable and hidden reserves. If a tax treaty is applicable, a refund under the treaty can be requested (normally 20%).

Cross-border share-to-share deals and contributions into the capital

In the case of a cross-border share-to-share deal (a non-Swiss entity contributes shares in a (Swiss or non-Swiss) subsidiary to a Swiss company against issuance of shares by the Swiss company) the difference between the contributed shares and the formal value of the shares issued by the Swiss company can be booked by the Swiss company as a reserve from capital contribution. If cross-border share-to-share deals took place after December 31 1996 it might be advisable to verify if such contributions qualify as a reserve from capital contributions which can be repaid to the shareholder of the Swiss company without triggering withholding tax. Cross-border share-to-share deals require a formal increase of capital in the Swiss company. The formal capital increase and a possible future capital reduction involve formalities and cause considerable costs. Finally, in principle each creation or increase of the nominal amount of capital or of the reserves in a Swiss company is subject to Swiss stamp duty of 1% of the contribution . If certain conditions applicable to reorganisations are met, however, no stamp duty is due on the formal capital increase. It is therefore important to structure a share-to-share deal in line with the Swiss reorganisation rules to avoid Swiss stamp duty.

While a share-to-share deal requires an increase of the formal capital of a Swiss company, the same economic result can be achieved by a contribution without consideration of the shares in a Swiss or a non-Swiss subsidiary into the reserves of the Swiss company, as long as the transaction does not lead to a change in allocation of shareholder rights. 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. 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 the rules on a tax-neutral contribution of shares under Swiss law a company may transfer participation rights in another company to its subsidiary. The transfer of at least 20% of participation rights in subsidiaries by a spin-off to a Swiss intermediary holding company is considered to be a transaction which is economically equal to a merger and therefore qualifies as a tax-neutral restructuring under the stamp duty laws. In addition, as the contribution into the reserves qualifies under the newly introduced principle of contributed capital as a reserve from capital contribution, the contribution value booked in as reserve from capital contribution can be repaid without triggering withholding tax.

Recapitalisation measures

During or after the acquisition of a company and to ensure the ongoing concern of the target it may be necessary to take recapitalisation measures because the acquired company is overindebted. For tax law purposes a company is overindebted if it shows a loss in its financial statements and no open or hidden reserves exist to cover such loss. In the course of a recapitalisation third parties as well as shareholders often agree to give loan and debt waivers. Swiss tax law distinguishes two types of recapitalisation contributions:

- Actual recapitalisation contributions: Such contributions (for example, write-off of a claim or a premium payment into the reserves against no consideration) are either made by independent third parties or at arm's length by related parties. Actual recapitalisation contributions are considered to be taxable income for a recapitalised company and can be set off with tax losses carried forward. Losses realised by a company can normally be carried forward for tax purposes for a period of seven years to be set off with future profits. In case of recapitalisation due to overindebtedness, however, tax losses older than seven years can also be set off with actual recapitalisation contributions if such losses were not yet used in the past; or

- Deemed recapitalisation contributions: A deemed recapitalisation contribution is made by a related party and would not have been made by an unrelated party under the same circumstances. An example would be that a parent company makes a premium payment into the reserves of the overindebted subsidiary against no consideration, has granted a loan to its overindebted subsidiary which qualifies as hidden equity or grants a loan to its subsidiary at a moment a third party would no longer have granted such a loan and, in a second step, contributes the loan into the reserves of the subsidiary to recapitalise the subsidiary. Deemed recapitalisation contributions are not considered to be taxable income for the receiving company and are not set off with tax losses carried forward. Under the new principle of contributed capital, deemed recapitalisation contributions only qualify as reserves from contributed capital if they are not used for the recapitalisation, that is, if they are no set off with the commercial loss.

Actual recapitalisation contributions are considered to be justified business expenses and are booked tax efficiently in the profit and loss account of the contributing company. Deemed recapitalisation measures are tax neutral and increase the acquisition costs of the recapitalised company in the books of the contributing company. For stamp duty purposes actual recapitalisation measures have no consequences as they are considered as taxable income for the receiving company, while deemed recapitalisation contributions are considered to be capital contributions subject to stamp duty of 1% of the contributed amount. However, in case of recapitalisation two exemptions apply under which stamp duty is not due on deemed recapitalisation contributions:

- Exempt amount of SFr10 million ($10.8 million): Every company has the right to a lump sum stamp duty exemption of SFr10 million meaning that the SFr10 million of recapitalisation contributions will not be subject to stamp duty. The recapitalisation can take place in the course of a year or be spread over the period of several years; or
- Establishment of a hive-off company: If a new company is established to take over an existing business from a company which is overindebted, the capital contributed to the new company is exempt from stamp duty.

In the case of an upstream merger the absorbing parent can take over the tax loss carried forward by the subsidiary. In addition, a possible loss resulting for the absorbing parent (book value of absorbed subsidiary in the books of the parent company is higher than the asset surplus of the absorbed subsidiary), such realised loss will be accepted for tax purposes if it can be shown that the absorbed subsidiary did not dispose of any hidden reserves. As it will often be difficult to demonstrate that the absorbed subsidiary did not dispose of hidden reserves or goodwill, the tax administration is rather restrictive with granting this loss double-dip. In case of a merger between sister companies the absorbing company can only take over the tax losses of the absorbed overindebted sister company if the absorbing company carries on the business of the absorbed company. Should the absorbing company cease the business activities of the absorbed company within due time after the implementation of the merger, then the tax carryover will not be recognised as the merger will be considered tax driven (saving of tax losses) and therefore abusive.

Flexibility

The latest changes in Swiss tax law have increased the attractiveness of Switzerland as a business location. Swiss law offers a lot of flexibility, in particular for cross-border reorganisations. To benefit from the latest modifications companies are, however, requested to participate actively in the required reporting process. The reporting requirements in connection with the newly introduced reserves from contributed capital may challenge corporations as the company history for the last 15 years is in many cases no longer available.

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