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Abolition of issuance stamp duty on equity partially strengthens Swiss business location

Rolf Wüthrich of burckhardt law firm summarises the impact of the envisaged abolition of the Swiss issuance stamp duty and explains why further reform would make Switzerland even more attractive as a business location.

Switzerland is often chosen as hub for international headquarters, holding companies, treasury centres, special purpose vehicles in M&A transactions or for family offices. Such entities are often highly capitalised, be it by way of equity capital or of debt capital.

Stamp duties are taxes levied by the Swiss federal tax administration on certain legal and capital transactions. The levying of these duties is linked to the creation of participation rights and premium payments (equity capital; issuance stamp duty), securities trading (security transfer duty) or premium payments for certain types of insurance (duty on insurance premiums). Basis for the levy of these duties is the Swiss federal stamp duty law.

Especially the issuance stamp duty and the transfer stamp duty have been considered for a long time as a negative factor for the promotion of Switzerland as a business and security trading location as these duties lead to additional tax costs in international comparison with other business locations. A duty on the issuance of equity is harmful to the economy and clearly counterproductive, especially in economic crises.

In June 2021, the Swiss parliament finally approved the abolition of the issuance stamp duty. The decision to abolish this duty was long overdue and is clearly welcomed by the business community. Further steps to abolish the security transfer duty or the duty on insurance premiums have been postponed.

The abolition of the issuance stamp duty can, in principle, enter into force per January 1 2022. However, certain political representatives have already announced a referendum. Should the 50,000 signatures required for a referendum be collected, then the Swiss population will have to vote about the abolition of the issuance stamp duty and a possible entry into force of the abolishment will at least be delayed until 2023. Therefore, should an investor plan in due course higher equity investments in Swiss companies, it should be clarified in advance when exactly the abolition of the issuance stamp duty will enter into force.

Until the abolition enters into force, the Swiss company may, as a temporary measure, be financed by way of debt capital, whereby the thin capitalisation rules must be considered from a Swiss tax law perspective. Only after entering into force of the abolition of the issuance stamp duty, the debt capital should be converted into equity capital. Such a temporary debt financing and postponed equity capitalisation will result in the saving of the 1% issuance stamp duty on planned capital contribution.

Promotion of Switzerland as hub for international headquarters, holding and treasury companies

Switzerland is well known for its moderate tax system, a wide tax treaty network, a stable political and legal system and a high living standard offering an international environment. Its presence as a hub for international activity is not only for tax purposes, but also for other business reasons and reasons like the living standard and the social environment for the employees.

Nevertheless, the levy of Swiss issuance stamp duty is an extra cost position is considered by foreign investors often as an adverse factor in international comparison. Even if the issuance stamp duty can be avoided in many situations by implementation of certain tax neutral reorganisation measures or by corporate immigration of a non-Swiss company into Switzerland, capital contributions in cash, be it by way of a formal capital increases or by way of a contributions into the reserves without a formal capital increase, trigger issuance stamp duty of 1% and result therefore in additional costs. This might be hurtful for a legal entity or a start-up, especially if a shareholder makes a capital injection to recapitalise an over-indebted company. Having to pay tax on a capital contribution is understandably incomprehensible for many investors and discourages them accordingly.

To avoid such negative impact, the Swiss parliament has finally decided in June 2021, after the decision was pending for an eight-year period in one of the chambers, the abolition of the Swiss issuance stamp duty.

Current system of issuance stamp duty no longer competitive

Issuance stamp duty is currently levied by the Swiss federal government on the issuance of participation rights in Swiss companies. It is, *inter alia*, levied on the issuance of and increase in the nominal value of participation or quota rights in Swiss stock corporations or limited liability companies, of profit sharing certificates and participation certificates of Swiss companies and on the contribution against no consideration into the reserves of a company.

The issuance stamp duty is 1% of the amount paid, but at least of the (increased) nominal value. Upon payment of the capital in the course of the establishment or a later formal capital increase, an exemption of CHF1 million (approximately $1.08 million) applies, i.e. on a total capital up to CHF1 million (formal capital and premium payments) no stamp duty is levied. Only the accumulated capital payments more than CHF1 million are subject to issuance stamp duty. Not the shareholder, but the company receiving the capital contribution is liable for payment of the issuance stamp duty.

Participation rights created or increased in the course of certain tax neutral reorganisation measures (e.g. as a result of a merger, conversions, push down or split) and in the course of a corporate immigration into Switzerland are exempt from the issuance stamp duty. Furthermore, to strengthen the stability in the finance sector, certain stock and conversion capital has been exempt from issuance stamp duty in the past.

Abolishment of issuance stamp duty to strengthen business location

The income realised by the Swiss federal government from the collection of the issuance stamp duty is of minor relevance. On the other side, the levy of the duty is, for various reasons, harmful to the Swiss economy, which is why Swiss business community and the Swiss Federal Council have supported its abolition for many years. As mentioned before the Swiss parliament finally approved the abolition of the issuance stamp duty in June 2021. The decision to abolish this tax was long overdue and is clearly welcomed.

As the issuance stamp duty is levied on equity contributions by shareholders to its companies, it hinders the capitalisation of Swiss companies with sufficient equity capital. Rather, companies have often been financed by debt capital, which does not trigger the issuance stamp duty, but which allows the levy of interest on the debt as deductible expense for the Swiss company. However, too high debt capital in ratio to the equity capital will lead to the application of the Swiss thin capitalisation rules, which in return may result in the (partial) requalification of the debt into hidden equity. Even if hidden equity does not trigger the levy of the issuance stamp duty of 1% (as hidden equity is, from a civil point of view, debt capital and not equity capital), such requalification might have corporate income tax and withholding tax consequences. If a part of the interest paid is requalified into excessive interest paid, such excessive part might be added back to the taxable profit. Next to such profit adjustment, the excessive interest paid might be considered as hidden dividend distribution triggering the 35% Swiss withholding tax on hidden dividend distributions.

However, not only for thin capitalisation purposes, but also in loss situations a solid equity basis is of importance for a company. In the absence of sufficient equity, companies are subject to an increased risk of bankruptcy in the event of losses. The Swiss commercial law states that the board of directors of a company must without delay convene a general meeting and propose financial restructuring measures where the last annual balance sheet shows that one-half of the share capital and the legal reserves are no longer covered.

If there is good cause to suspect over-indebtedness, an interim balance sheet must be drawn up and submitted to a licensed auditor for examination. If the interim balance sheet shows that the claims of the company's creditors are not covered, whether the assets are appraised at going concern or liquidation values, the board of directors must notify the court unless certain company creditors subordinate their claims to those of all other company creditors to the extent of the capital deficit. The notification of the court can thus only be avoided (i) if the company is recapitalised, which will, subject to the CHF10 million issuance stamp duty exempt recapitalisation amount, trigger the 1% stamp duty, or (ii) if the shareholder subordinates loans in the amount of the capital deficit (plus the amount necessary to cover the expected loss of the ongoing business the current business year).

In practice, the loan subordination alternative, even if this alternative does recapitalise the company, but only avoids the notification of the court, is often the preferred alternative compared to the recapitalisation alternative, which triggers the 1% issuance stamp duty. The abolition of the issuance stamp duty will hopefully contribute to more sustainable capital contributions and less subordination measures in the future.

It should also be noted that capital contributions can be repaid to the shareholder free of withholding tax if such contributions are not offset against the reported loss in the balance sheet, but been accounted as for separately as a capital contribution reserve. Thus, a recapitalisation injection can in future be contributed issuance stamp duty neutral and can at a later moment, when the company is again in the position to distribute dividends, be repaid withholding tax free to its shareholder. Thus, recapitalisation measures can, in principle, be implemented tax neutral in the future.

There are various other reasons for abolishing the issuance stamp duty to strengthens Switzerland as business location:

Issuing new equity capital

In general, the abolition of the issue stamp duty has a positive effect on all companies that issue new equity capital. This applies in particular to (newly established) companies with major investment projects and, as a consequence, with large capital needs.

Improving financing neutrality and stability

The abolition also contributes to improving financing neutrality, since equity financing, which is currently the most expensive form of financing for Swiss tax reasons, is no longer additionally burdened with the issuance stamp duty. Especially with the current low interest rates on debt capital, debt capital seems to be more attractive compared to equity financing and companies have an incentive to replace expensive capital with cheap debt capital. By abolition of the issuance stamp duty, the equity financing will get more attractive again.

A solid equity base of a company secures financial and personnel (employees) stability of a (Swiss) companies.

It is expected that the abolition of the issuance stamp duty will result in additional taxes on profits and equity after only a few years, which will then more than compensate for the losses made by abolishment of the issuance stamp duty.

Benefits for SMEs

Small and medium-sized enterprises (SMEs) will most likely benefit more than subsidiaries of large companies. Most companies pay issuance stamp duty only when they suffer a loss, when they have to carry a major investment for which the accumulated equity is not sufficient, or when they are in the start-up phase.

By abolishment of the issuance stamp duty, stumbling stones for a (re-)capitalisation in the form of stamp duties are moved out of the way. The more, due to the COVID-19 pandemic, many entities in Switzerland suffered and still suffer losses and must be recapitalised. The past has shown that the issuance stamp duty hits companies the hardest when the economy is in recession and some of the companies are dependent on equity capital injections to survive.

It was in the crisis years of 2001 (CHF375 million) and 2008 (CHF365 million) and 2009 (CHF331 million) that the issuance stamp duty withdrew the most funds from companies. Debt capital can be used to bridge liquidity bottlenecks but does not help companies to absorb losses. Only equity capital can do so. It can be assumed that in the years 2021 and 2022, a considerable number of companies will be dependent on equity capital contributions from their shareholders to avoid an over-indebtedness and to ensure the survival. To the extent that the exemption amount of CHF1 million is exceeded, the issue tax of 1% is payable on equity capital contributions, unless the recapitalisation exemption can be applied.

Under the recapitalisation exemption, an exemption from the levy of the 1% issuance stamp duty is granted for recapitalisations up to CHF10 million if the following requirements are fulfilled: (i) the capital contribution is used to book out existing commercial losses, and (ii) the contributions of the shareholders do not exceed a total of CHF10 million.

The CHF10 million exemption for the elimination of over-indebtedness is clearly helpful for many SMEs, but for large companies it is often only a drop in the ocean. Furthermore, the requirement to set off the loss with the capital contribution will lead to the loss of the possibility to repay the capital contribution withholding tax free to the shareholder. Under the current law, one must decide whether the loss shall be offset with the contribution or whether the loss and the contributions shall be booked separately as different equity positions without an offset:

- If the contribution is offset with the loss, no issuance stamp duty is due on a contribution amount up to CHF10 million. However, once offset the contribution can no longer be repaid to the shareholder free of withholding tax; or
- If the loss and the contribution are not offset, but are shown as separate equity positions, the contributions are subject to issuance stamp duty of 1%, but can be repaid to the shareholder free of withholding tax (35%) at a later moment.

The complete abolition of the issuance transfer duty will therefore contribute to the overcoming the economic consequences of the COVID-19 pandemic and possible future recessions not only for SMEs but also for large corporations with substantial losses to be covered.

Reducing tax burdens

On July 1 2021, the OECD Inclusive Framework published key parameters for the future taxation of large companies that operate internationally. Switzerland, in general, supports these, while maintaining certain reservations and conditions. The key parameters provide for a moderate shift of the taxation rights between the jurisdictions and for a global minimum tax rate of at least 15%.

The envisaged global minimum tax rate will most likely lead to a corporate income tax increase in Switzerland as in may cantons, the latest since the entry into force of the corporate tax reform in 2020, the effective income tax rate (federal, cantonal and municipal) is below 15%. The abolishment of the issuance stamp duty may not compensate for possible corporate income tax increases because of the introduction of the 15% minimum tax rate, but it will certainly represent a welcomed reduction of the all-over tax burden suffered in Switzerland.

Excurse: Security transfer duty

As mentioned at the beginning of this article, the Swiss federal stamp duty law does not only regulate the issuance stamp duty, but also the security transfer duty.

Security transfer duty is levied on purchases and sales of Swiss and foreign securities by domestic securities dealers. Simplified, Swiss banks and legal entities with securities exceeding a book value of CHF10 million, including participation rights in subsidiaries, are, *inter alia*, considered as Swiss security dealers for security transfer duty purposes. The security transfer duty amounts to 1.5‰ for domestic securities and 3‰ for foreign securities. The tax is calculated based on the consideration paid, i.e. on the price paid for the purchase or sale of a security.

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Rolf Wüthrich is an international tax lawyer at burckhardt Ltd. He has expertise in national and international tax advisory, and inbound and outbound transactions, particularly between the US and Switzerland. He is an expert on corporate restructuring and acquisitions, as well as on general corporate secretarial services. He also specialises on the drafting, coordinating and the implementation of group internal restructurings.

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In order to make the Swiss financial centre attractive, the provisions concerning the security transfer duty have already been revised several times in the past. However, for Swiss financing companies of international groups no sufficient measures have been taken yet. Especially for companies that manage excessive liquidity of a group by investing such excessive funds on an ongoing basis in publicly traded shares and/or bonds and that turn the security portfolio on a regular basis, the security transfer duty may result in an extremely high additional expense, which will, in international comparison, make Switzerland an unattractive and uncompetitive location for a group internal finance company, and which will, as a consequence, exclude Switzerland in the international competition as possible business location for group internal financing companies.

By abolishing the issuance stamp duty, a first step in the right direction has been made by the Swiss parliament to put Switzerland in a more attractive light for group internal finance companies. The abolishment will allow shareholders to equity finance Swiss subsidiaries in a highly flexible way as no issuance stamp duty expenses result and, as a consequence, to move away from the often not preferred debt financing of a Swiss finance subsidiary. Flexibility will be available as a parent company can make capital contributions without triggering issuance stamp duty and request repayment of the contributed capital without triggering Swiss withholding tax of 35%.

In 2020, the abolishment of the security transfer duty was also discussed, but the abolition was finally rejected due to the expected shortfall of security stamp duty income.

The author is of the opinion that the attractivity of the Swiss business location could be highly increased not only for large, but also for SMEs if not only the issuance stamp duty, but also the security transfer duty would be abolished or if at least group internal finance companies would be exempt from security transfer duty or would not qualify as security dealer.

A Swiss branch of a non-Swiss foreign entity does, for example, already today not qualify as a Swiss security dealer and is therefore not subject to security transfer duty. If not only group internal Swiss finance branches, but also group internal Swiss finance companies would no longer qualify for payment of the security transfer duty, then this would encourage investors and large groups to establish Swiss finance companies and to manage excessive liquidity on a short or long term basis as equity contribution out of the Swiss finance companies and to invest such contributions in security investment.

Due to the abolishment of the issuance stamp duty and the security transfer duty no additional transaction costs would arise and the income realised from the investments that would be taxed as attractive income tax rates, which are currently in various cantons between 11% and 15%. The author is of the opinion that, in case of a reform of the security transfer duty in favour of Swiss finance companies, the additional income and capital taxes collected from newly settled finance companies would by far compensate possible security transfer taxes collected today from the currently existing finance companies.

Entry into force of planned abolition of issuance stamp duty

The abolition of the issuance stamp duty can, in principle, enter into force on January 1 2022. However, it was announced by certain political representatives that a referendum shall be taken up against the abolition. It must be expected that the 50,000 signatures required for a referendum can be collected in time and that the Swiss population will ultimately have to vote about the abolition of the issuance stamp duty. As such a referendum is not likely to take place before 2022, the entry into force of the abolition of the issuance stamp duty is likely to be delayed until 2023 (subject to the approval by the Swiss population in a possible vote).