



Taxation of cross-border mergers and acquisitions

Switzerland

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Introduction

As part of the ongoing trend of globalization, Swiss enterprises are expanding significantly into foreign markets by setting up foreign entities or by M&A transactions. At the same time, foreign strategic and financial investors are increasing 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 tax treaties offer attractive structures for M&A activities. This report addresses the Swiss tax aspects of typical deal structures in Switzerland, the choice of acquisition vehicle and tax-efficient financing arrangements.

Recent developments

On 5 June 2015, draft legislation for an upcoming tax reform was published that will implement the following changes that may affect M&As:

- elimination of privileged Swiss tax regimes, including the holding company, mixed company, principal company and finance branch regimes
- introduction of step-up mechanisms for corporate tax purposes on the elimination of privileged tax regimes and tax neutral step-up and subsequent amortization of hidden reserves in case of an immigration into Switzerland
- introduction of new incentive rules for R&D activities
- introduction of other tax incentives, including a general reduction of corporate income tax rates at cantonal / communal level, reduction of capital tax basis relating to certain assets (participations and intangible property), and introduction of a tax credit scheme for permanent establishments in Switzerland.

The draft legislation is still subject to change in the course of the parliamentary approval process and would further be subject to a public vote in the likely case of a referendum. The new legislation will not enter into force before January 2017. The government is expected to grant a 2-year transition period to give taxpayers time to adapt their structures to the new legislation.

Asset purchase or share purchase

Whether an acquisition takes place in the form of an asset or a share deal has 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 book value. Sellers often prefer share deals, which usually generate capital gains subject to privileged taxation.

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 are reported at their fair market value and an excess amount is booked as goodwill. If the acquired business includes participations, the allocation of the purchase price to participations and other assets has important tax implications for the seller and acquirer, as outlined below. Thus, the allocation should be carefully analyzed and agreed on in the purchase agreement.

Goodwill

In case of the purchase price exceeding the fair market value of the net assets of the business acquired, the exceeding amount of the purchase price would be allocated to goodwill. In accordance with Swiss accounting rules, goodwill is depreciated at the level of the acquirer. The depreciation allowed for tax purposes is usually either 40 percent per year for 5 years on a declining-balance basis (the remaining balance being considered in the last year) or 20 percent per year on a straight-line basis. This corresponds with the general accounting treatment of intangible property. Therefore, there is no disadvantage in allocating a part of the purchase price to goodwill. Given the high rate of depreciation, it may even be advantageous. If economically justified, it may be possible to accelerate the rate of depreciation.

Depreciation

Safe-haven depreciation rates published by the Swiss tax authorities generally follow Swiss accounting rules. Tangible assets can be depreciated either on a straight-line or declining-balance basis. Once a depreciation method has been chosen, that method must be applied consistently, unless an amendment is economically justified. It is possible to use different methods for different assets and to apply extraordinary depreciations in certain situations (e.g. for participations).

The write-off of participations is generally tax-deductible, but the shareholder is required to revalue qualifying participations (shareholding with a share quote of at least 10 percent) up to the initial book value if the fair market value is going to increase.

Tax attributes

In case of an asset deal, the acquirer cannot use the tax loss carried forward of the acquired business (except for reorganizations under the Merger Act, such as spin-offs and transfers of shares). At the level of the acquirer, depreciation of the purchased assets reduces the income tax basis. Special cantonal/communal rules may apply on transfers of real estate (i.e. real estate gains tax).

Value added tax

Where assets are transferred, items that are within the scope of value added tax (VAT) are subject to VAT at the standard rate of 8 percent or reduced rate of 2.5 percent. A notification procedure must be applied where assets are transferred between two parties that are registered for Swiss VAT purposes and the following conditions are met:

- The VAT liability would exceed 10,000 Swiss francs (CHF).
- The assets are transferred as part of an intercompany asset transfer.
- The assets are transferred in a reorganization under the Merger Act or a tax-neutral reorganization.

In this case, no VAT needs to be paid, only declared, and the acquirer assumes the VAT position of the seller. Where assets are transferred abroad, the applicable VAT rate is 0 percent.

Transfer taxes

Securities transfer tax is payable on the transfer of any taxable securities (e.g. bonds, shares) where a registered securities dealer acts on its own account or as an intermediary in the transaction. According to Swiss stamp duty legislation, Swiss securities dealers also include companies not performing a banking-type function (i.e. Swiss companies whose assets include taxable securities with a book value higher than CHF10 million).

The rate of securities transfer tax is 0.15 percent on Swiss securities and 0.30 percent on non-Swiss securities.

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

Purchase of shares

The purchase price is fully attributed to the participations acquired. The book value of participations cannot be written off at the level of a Swiss acquisition company, unless the investment's fair market value decreases. A reduction in value is tax-deductible at the level of the Swiss acquirer, whereas a subsequent increase in the fair market value of participations with a share quote of at least 10 percent

triggers a taxable revaluation (clawback). Goodwill cannot be separately reported, neither in the balance sheet nor for tax purposes.

Sellers generally prefer a share deal because a Swiss corporate seller can usually benefit from a tax-exempt capital gain (provided that a share quota of at least 10 percent, which has been held for at least 1 year, is sold). Swiss individuals selling shares as private assets usually achieve a tax-exempt capital gain, subject to compliance with restrictions under the indirect partial liquidation rules (see next section). Individuals selling shares as business assets and selling qualifying shareholdings (share quota of at least 10 percent) may benefit from a privileged taxation.

Indirect partial liquidation

Individuals selling their shares as private assets generally benefit from fully tax-exempt capital gain, whereas dividend income is subject to income tax. In order to avoid abusive transaction schemes, the practice of the so-called 'indirect partial liquidation' is assumed if the following conditions are met:

- A Swiss-resident individual sells privately held shares to a company or an individual who is going to hold 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 (consolidated approach).
- Distributable reserves are available in the target (from a commercial law point of view).
- Dividends are distributed within a 5-year period after signing.
- There is a certain cooperation between the seller and the acquirer.

If these conditions are met, the tax-exempt capital gain of the seller is reclassified into a taxable dividend in the amount of the lower of the capital gain or distributed reserves linked to non-business-related assets. Therefore, sellers usually request the insertion of an appropriate indemnity clause in the share-purchase agreement to restrict the acquirer from distributions that might trigger such a reclassification.

Loans or guarantees granted by the target company in connection with the acquisition do not qualify as direct or indirect distributions, provided the financial arrangements comply with the arm's length principle and do not result in a write-off of receivables.

Post-acquisition reorganizations, such as a merger between the target company and acquisition vehicle, generally qualify as direct or indirect distributions and trigger an indirect partial liquidation. The distribution of future profits does not qualify as an indirect partial liquidation.

Tax indemnities and warranties

In the case of a share deal, tax liabilities and tax risks remain with the Swiss target company. Thus, a tax due diligence is highly recommended to assess potential exposures.

The acquirer usually claims contractual tax indemnities and warranties from the seller to shift the target company's tax exposures of pre-closing periods to the seller. Such indemnities are essential for non-quantifiable tax risks arising in case of tax audits.

Tax losses

Tax losses can be carried forward for a period of 7 years but are usually not approved by the tax authorities until the date of use. With the exception of special cases, such as the transfer of shares in an inactive company, Swiss law does not restrict the use of tax loss carried forward in a target company after a change of ownership.

Crystallization of tax charges

As stated earlier, tax liabilities and tax risks remain with the Swiss target company and crystallize at this company's level.

With respect to withholding tax (WHT) on dividends, the acquirer needs to consider the so-called 'old reserves' theory established by the Swiss tax authorities. This practice applies to distributable reserves subject to a non-refundable WHT on dividends. If, due to a change in ownership, the non-refundable WHT is reduced to a more beneficial rate than before the transaction, the Swiss tax authorities may argue that distributable reserves remain subject to the higher non-refundable WHT rate, irrespective of the future shareholder or tax treaty applicable. Distributable reserves qualify as 'old reserve' to the extent that non-business relevant assets are available at the time of the change in ownership.

Pre-sale dividend

A Swiss seller usually does not wish to pay out pre-sale dividends. However, an acquirer can request such dividends to mitigate its WHT exposure under the old reserves theory or if the seller imposes post-closing restrictions under the indirect partial liquidation rules on the acquirer (see prior sections).

A dividend can only be distributed on the basis of (audited) annual accounts not more than 6 months old. Thus, a later dividend distribution of retained earnings may require an (audited) interim balance sheet. Interim dividends (i.e. dividends from current-year earnings) cannot be paid out under Swiss corporate law.

Transfer taxes

Where the seller or acquirer qualifies as a securities dealer (e.g. a bank or Swiss company with more than CHF10 million in shares or securities reported as asset in the statutory balance sheet), a securities transfer tax applies of 0.15 percent on domestic shares and 0.3 percent on foreign shares. Exceptions may apply if the shares are transferred as part of an intercompany restructuring (e.g. merger, spin-off or intercompany transfer of qualifying shares).

Tax clearances

Advanced tax rulings are possible and common in Switzerland. They can usually be obtained quickly, within 4 to 6 weeks. 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 Swiss tax authorities. Rulings that the acquirer wishes to submit pre-closing for the Swiss target company usually require authorization by the target company 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 has a significant impact on the overall tax rate.

Local holding company

Due to the absence of a group taxation in Switzerland (except for VAT), a Swiss target company does not necessarily need to be acquired by a Swiss acquisition vehicle. However, a Swiss acquirer may benefit from a preferential tax regime or enable a tax-neutral merger with the target company (e.g. if required by the financing banks).

Under Swiss tax law, a 'holding company' is defined as a company that conducts no business activity in Switzerland but simply holds and manages participations. Provided at least two-thirds of the company's assets are represented by participations and/or earnings from participations, the holding company may benefit from a privileged taxation of generally 7.8 percent corporate income tax, achieved by an income tax exemption at the cantonal and communal level, and ordinary taxation at the federal level.

Note that the taxation regime for holding companies will likely be abolished in the course of the ongoing tax reform (see previous section).

For companies not qualifying for a privileged taxation at the cantonal level, dividend income from qualifying participations (share quota of at least 10 percent or with a fair market value of at least CHF1 million) benefits from a participation deduction scheme at the federal level. This scheme 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 financial expenses and a lump-sum deduction of 5 percent for administration expenses, resulting in the participation income being virtually tax-exempt.

For corporate shareholders, a depreciation of shares due to a lower fair market value is tax-deductible, but the shareholder is required to revalue qualifying participations for tax purposes up to the initial book value if the fair market value increases in the future.

Interest expenses borne in connection with the funding of the acquisition can be offset against taxable income. Where taxable income is insufficient, the expenses increase the holding company's tax losses carried forward. Pushing debt down by merging the acquisition vehicle with the target company is unlikely to be accepted by the Swiss tax authorities for anti-abuse reasons. According to a current practice, a debt pushdown can usually only be achieved for strategic buyers or by careful structuring.

Foreign parent company

An acquisition by a foreign parent company should take into account existing tax treaties or the application of the Swiss-European Taxation of Savings treaty in order 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 Swiss tax authorities, which is valid for 3 years. The Swiss tax authorities reviews the treaty entitlement of the foreign shareholder, focusing on substance and beneficial ownership. A ruling stating the facts for the shareholder's entitlement is therefore generally recommended.

On approval of the application, only the net applicable treaty tax rate is payable (i.e. WHT of 35 percent is not paid and later refunded). In any case, all relevant WHT declaration forms need to be filed to the tax authorities within 30 days after the due date of the dividend distribution. If the forms are late-filed, the right to apply a reduction at source is forfeited and the ordinary refund procedure applies.

In addition to tax treaties, similar rules to those 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 at least 25 percent held for at least 2 years benefit from a full reduction of withholding at source (i.e. WHT rate of 0 percent). The same applies to intragroup interest payments and royalties.

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

Non-resident intermediate holding company

The comments earlier in this report on a foreign parent company also apply for non-resident intermediate holding companies. The holding company needs to meet the requirements of the Swiss tax authorities in terms of substance and beneficial ownership in

order to benefit from a tax treaty or from the Swiss-European Taxation of Savings Treaty (see earlier in this report).

Local branch

A foreign corporation acting as the head office of a Swiss branch is subject to Swiss income and capital tax with respect to income and net assets allocated to the branch. The acquisition of a target company by a Swiss branch should be carefully structured because participations are usually considered to be allocated to the head office for tax purposes.

Swiss branches are taxed in the same way as companies, so they can qualify for the holding company privilege (see prior section). In the case of dividend distributions from a Swiss target company, the tax treaty between Switzerland and the country of the foreign head office usually applies, but this should be reviewed case-by-case.

Joint venture

The taxation of joint ventures depends on their legal form, whether they are corporations (see earlier comments on holding companies) or partnerships, which are usually considered as transparent for tax purposes. 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 preferred because the joint venture partners' liability is limited and the allocation of profits and application of tax treaties are less complex.

Choice of acquisition funding

The funding of the acquisition with debt, equity or hybrid instruments must be considered from a Swiss tax perspective to achieve a tax-efficient funding structure.

Debt

No stamp duty is levied on the issue and transfer of bonds (including cash bonds and money market instruments).

In general, interest on ordinary loans is not subject to WHT. However, WHT of 35 percent is levied on interest due on bonds and other collective fundraising schemes as listed below, whereas a refund applies in accordance with Swiss domestic tax law or tax treaty, if applicable:

- A loan qualifies as a bond where the aggregate number of non-bank lenders (including sub-participations) to a Swiss company under a facility agreement exceeds 10 (under equal conditions) or 20 (under variable conditions), and the total amount of such debt exceeds CHF500,000.
- Debt without fixed maturity date (e.g. cash pooling) is not usually relevant for a Swiss company as debtor (i.e. the company does not qualify as a bank for Swiss tax purposes), where the aggregate number of its non-bank lenders does not exceed 100 and the total amount of such debt does not exceed CHF5 million.

As interest on private and intercompany loans is generally not subject to WHT, taxpayers should ensure that they do not to exceed the above thresholds and that they comply with Swiss anti-abuse rules.

Deductibility of interest

Arm's length interest is generally tax-deductible. However, deduction of interest paid to affiliates may be subject to limitations. The Swiss tax authorities publishes annual guidelines on the interest rates considered appropriate on CHF and foreign currency borrowings (safe haven minimum and maximum interest rates).

The Swiss tax authorities have also issued thin capitalization guidelines (safe haven rules), which define the level of related-party debt generally accepted from a Swiss tax perspective.

Based on these guidelines, Swiss companies can leverage the acquisition of assets up to the following debt-asset ratios:

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, 2016

For finance companies, the safe haven debt ratio is usually 6/7 of total assets (finance branch: 10/11). As mentioned earlier, these guidelines are only safe haven rules. The company can diverge from them, provided 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 commercially justified results in a reclassification of part of the related-party debt into equity (subject to capital tax) and of interest being qualified as a non-tax-deductible deemed dividend 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 qualifies as related-party debt for thin capitalization purposes.

Withholding tax on debt and methods to reduce or eliminate it

In general, arm's length interest on loans is not subject to WHT. However, in case of funding arrangements qualifying as bond or collective fundraising scheme, WHT of 35 percent is levied at source, i.e. Swiss-resident borrower.

In an international context, WHT may be refunded or credited in accordance with a tax treaty or the Swiss-European taxation of Savings treaty, if applicable.

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 for Swiss tax purposes?

Equity

Some equity financing may be required to meet debt-to-equity requirements of financing banks or to strengthen the equity position of the acquiring company.

Stamp duty at the rate of 1 percent is payable on the issue of shares, whereas a one-time exemption applies on CHF1 million. Other contributions as well as a capital surplus are also subject to stamp duty. Exemptions may apply to restructurings.

Dividends are generally subject to a WHT of 35 percent. Refunds or reductions of the applicable WHT rate may be available under a tax treaty or the Swiss-European Taxation of Savings Treaty. Dividends from a shareholding of at least 20 percent from a Swiss company to a Swiss corporate shareholder can be distributed without payment of WHT.

Under the capital contribution principle (effective as of 1 January 2011), the repayment of share capital and reserves derived from qualifying equity contributions made by direct shareholders (e.g. capital surplus, contributions) can be distributed without being subject to WHT and without being subject to income tax for Swiss individuals holding the shares as private assets.

Reorganizations

Transactions and reorganizations are generally tax-neutral if the net assets remain subject to taxation in Switzerland, the tax book values remains unchanged and the transferred business is a going concern or business unit.

Statutory merger

The Merger Act provides for two kinds of statutory mergers:

- *Merger by absorption*: Assets and liabilities are transferred 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 absorption of two or more corporations. The shareholders of the combined corporations receive shares in the new company in exchange for their shares in the combined corporations.

Mergers are generally income tax-neutral (i.e. hidden reserves should be transferable without taxation) where 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).
- Net assets remain subject to Swiss income taxation. This requirement is met even if after the merger the net assets are allocated to a permanent establishment in Switzerland.

In general, the absorbing company takes over the tax attributes of the absorbed company. Any tax loss carried forward of the absorbed company can be used by the absorbing company, unless the transaction is qualified as a tax avoidance scheme.

The merger should not trigger any WHT consequences where reserves and retained earnings of the merged entity are transferred and remain subject to Swiss WHT in case of a distribution.

A share capital increase in the context of a qualifying reorganization (merger) usually is not subject to stamp duty. In addition, the transfer of securities (e.g. shares) is usually exempt from securities transfer tax, if applicable.

Where the surviving entity of a merger uses treasury shares, which were previously repurchased from shareholders, to compensate the shareholders of the absorbed company, any gain is considered taxable income of the absorbing company. For private Swiss shareholders receiving such shares, the difference between nominal value (and, as of 2011, potentially proportionate capital contributions) and fair market value is subject to income tax. Hence, a private shareholder may 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 subject 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, demergers and transfers of assets. In contrast 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 demergers 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, demergers and transfers of assets carried out in foreign jurisdictions.

Immigration merger

Basically, the same tax principles apply as for a domestic merger. However, from a legal perspective, foreign legislation needs to allow an immigration merger.

Emigration merger

Where a Swiss business is transferred outside Switzerland, significant tax consequences may arise. Qualifying for Swiss tax purposes as a deemed liquidation, an emigration merger triggers the same tax consequences as a statutory liquidation (i.e. hidden reserves are subject to income taxes and any deemed liquidation proceeds subject to WHT). To the extent that net assets are allocated to a permanent establishment of the foreign absorbing company in Switzerland, the emigration merger does not trigger income tax consequences. With regard to the WHT liability, a refund or reduction of the WHT rate may apply, depending on the domicile of the shareholders of the absorbed Swiss company and, in an international context, the applicable tax treaty or EU-Swiss Taxation of Savings Treaty.

Share-for-share transactions involving Swiss target company and/or Swiss investors (quasi-merger)

In exchange for their shares, the shareholders of the contributed company are compensated with 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. They are often a more flexible alternative than statutory mergers because, for example, risks and liabilities of the target company are kept isolated and the administrative and operational burden may be lower than in case of a cross-border merger transaction.

Private shareholders of target companies may prefer a share-for-share deal anyway. Cash consideration of up to 50 percent of the transaction value is permissible and,

in principle, is tax-free for a private Swiss shareholder, 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 company. Based on the substance-over-form rule, such transaction would qualify as a statutory merger if the absorption occurs within a 5-year period. Swiss private shareholders who might be facing taxable income on a subsequent merger are likely to insist on hold-harmless clauses in transaction agreements.

Demerger

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

Demergers are generally income tax-neutral. Any hidden reserves should transfer 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).
- Net assets remain subject to Swiss income taxation. This requirement is met even if the net assets are allocated after the merger to a permanent establishment in Switzerland.
- Separated entities to operate own business 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 that are not in line with their strategic plans or need to be transferred for anti-trust reasons. Additionally, in principle, the business of a target company can be restructured tax neutrally in order to meet the market's expectations.

However, the requirement of continuing businesses at the level of both separated entities 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 in active companies and that the holding companies perform true group management functions with their appropriate personnel. Finance and intellectual property companies qualify as businesses if

they conduct transactions with third parties or affiliated entities and have at least one full-time employee engaged in the operations. For non-operating entities, a demerger might prove difficult due to the stringent requirements on the business criteria. Other means of transfer may be preferable, such as the transfer of assets (discussed later). If a group with mixed business entities is to be divided into two or more separate groups, the demerger of the common holding and intellectual property entities requires special attention.

The demerger should not trigger any WHT consequences if reserves and retained earnings of the transferring entity are transferred and remain subject to Swiss WHT in the case of a distribution.

If reserves and retained earnings are converted into share capital or capital contribution reserves, 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 case-by-case.

A share capital increase in the context of a qualifying reorganization (demerger) may not be subject to stamp duty. In addition, the transfer of securities (e.g. shares) is usually exempt from securities transfer tax, if applicable.

Intragroup transfer of assets

In principle, the intragroup transfer of qualifying participations (i.e. share quota of at least 20 percent), businesses or parts of businesses, and business assets at tax book value is tax-neutral. The tax-neutrality of the transfer of assets is subject to a 5-year blocking period applying to the assets transferred and the common control of the Swiss legal entities involved (e.g. if the Swiss transferor and transferee have a common parent company). Evidence of common control has to be provided annually, or the blocking period is considered to be breached.

In complex group structures, the ownership of the participation needs to be closely monitored to satisfy these requirements. If a blocking period is breached, the Swiss entities under common management at that time are jointly and severally liable for taxes due.

In practice, the blocking period is mainly relevant for transfers of individual assets, such as real estate or intellectual property. The transfer of businesses should qualify under the demerger rules, so no blocking period applies.

If the transferee breaches the blocking period, hidden reserves are taxed at the level of the transferor entity and a dividend is deemed to be paid to its shareholders. The deemed dividend is subject to WHT, which is levied at source at the level of the target company and may not be fully recoverable by foreign shareholders.

Asset drop-down

The contribution or sale at tax book value of businesses, business units, fixed assets or qualifying participations (i.e. share quota of at least 20 percent) to a subsidiary that is subject to Swiss taxation is tax-neutral. Except for the transfer of qualifying participations, the drop-down of assets is subject to a 5-year blocking period. The blocking period applies to both the transferred assets and the shares held by the transferee entity in the subsidiary.

Hybrids

Debt is usually only reclassified as equity if thin capitalization is an issue. In other circumstances, instruments having the form of debt are accepted as such and follow 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, 2016

Regarding income derived from hybrid instruments, the Swiss participation deduction and privileged taxation of dividend do not apply to (dividend) income treated as tax-deductible by 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 case-by-case.

Deferred settlement

A deferred settlement of interest generally does not 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 generally should be treated as part of the capital gain for the seller and subsequent acquisition costs for the acquirer. 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 the shares as private assets) usually prefers a share deal to benefit from a privileged taxation of capital gain.

A seller with tax losses close to forfeiture may be willing to agree to an asset deal. However, sellers usually prefer a share deal because the historical 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 type of entity best suits their needs. Tax issues may play an important part in these 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 for 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 CHF100,000
- restrictions on the acquisition of own shares.

Limited liability company – *Gesellschaft mit beschränkter Haftung (GmbH)*

The limited liability company (LLC) is a hybrid of a corporation and a partnership that is becoming more widespread in Switzerland. For Swiss tax purposes, the LLC qualifies as a corporation. 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 CHF20,000.

Other, non-corporate forms of business entity admitted by the CO are as follows.

Partnership – *Kollektivgesellschaft*

The main features of partnerships are:

- partners must be individuals
- no legal personality
- partners have unlimited liability
- transparent for tax purposes.

Limited partnership – *Kommanditgesellschaft*

The main features of limited partnerships are:

- 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*

The main features of simple associations are:

- registration in the commercial register is not possible
- contractual arrangement in the nature of a joint venture
- corporations and 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 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 tax returns on its own.

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

The company is exempt from the duty to prepare consolidated statements if, together with its subsidiaries, it does not exceed two of the following thresholds in any 2 successive fiscal years:

- a balance sheet total of CHF20 million
- revenues of CHF40 million
- an average annual number of employees of 250.

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

- The company has outstanding bond issues.
- The company's shares are listed on a stock exchange.
- 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

Today, most countries have adopted their own national transfer pricing regulations and documentation rules. Although national transfer pricing regulations can differ in detail, they are usually based on the 'arm's length principle', as defined by the Organisation for Economic Co-operation and Development (OECD) transfer

pricing guidelines and in Article 9 of the OECD model tax treaty.

Switzerland is a member of the OECD and has accepted the OECD guidelines without reservation. On 4 March 1997, the Swiss tax authorities issued a circular letter instructing the cantonal tax authorities to adhere to the OECD guidelines when assessing multinational companies.

Swiss tax law does not contain specific documentation requirements. However, the taxpayer is obliged to provide the tax authorities with the necessary information regarding its own tax position as part of its normal obligation to cooperate. In this regard, Swiss tax authorities can request information on transfer pricing. Generally, OECD-compliant transfer pricing documentation is recommended and should be accepted by the Swiss tax authorities.

Although Switzerland does not have specific transfer pricing penalties, general tax penalties can be assessed in severe cases of non-arm's length arrangements, ultimately assessed as abusive or even fraudulent. In such cases, taxpayers are advised to provide full disclosure of all available information to counter the assessment and avoid penalization.

Dual residency

Companies are subject to Swiss income tax if their statutory seat or actual management is in Switzerland. Thus, companies whose statutory seat is outside of Switzerland but whose day-to-day business is managed in Switzerland qualify as Swiss-resident, as do those with their statutory seat in Switzerland but actual management abroad.

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 tax treaty.

Foreign investments of a local target company

Switzerland has no formal controlled foreign company (CFC) rules and applies the participation deduction on dividends irrespective of any minimum taxation requirements. The participation deduction regime (see this report section on local holding companies) also applies to capital gains on the sale of qualifying participations held for a minimum of 1 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 7-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 historical tax liabilities (except for VAT, social security, employee WHT or in case of reorganizations).
- No deferred tax liabilities on retained earnings.
- Possible to acquire only part of a business.
- Interest expenses for the acquisition generally can 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 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 involves 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 (e.g. on real estate and securities).
- 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, so the 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.

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