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Swiss Withholding Tax and Securities Transfer Tax Reform to Strengthen the Swiss Debt Capital Market

On 17 December 2021, the Swiss Parliament decided to abandon levying withholding tax on bond yields and on interest income of Swiss funds. Moreover, trades in domestic bonds and certain sales transactions in qualifying participations will be exempt from securities transfer stamp tax.

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Withholding Tax on Swiss Bonds

Background

Unlike many countries, Switzerland does not charge withholding tax on interest paid on private and commercial loans (including at arm's-length inter-company loans). However, 35% withholding tax is currently levied on interest paid to Swiss or foreign lenders on bonds and similar collective debt instruments issued by or on behalf of Swiss resident issuers as well as on interest paid by Swiss banks.

Since capital markets tend to stay away from bonds subject to withholding tax, Swiss multinational groups frequently resort to issuing bonds through a foreign subsidiary. However, the Swiss Federal Tax Administration (SFTA) will reclassify such foreign bonds into domestic bonds if the resulting proceeds used in Switzerland exceed certain thresholds (namely the combined accounting equity of all non-Swiss subsidiaries of the Swiss parent company and the aggregate amount of loans granted by the Swiss parent and its Swiss subsidiaries to non-Swiss affiliates).

In order to avoid withholding tax on regular loans (as distinct from bonds, which are subject to said tax anyway), credit facility agreements entered into by a Swiss borrower or a non-Swiss borrower under a guarantee from a Swiss parent company must contractually restrict free transferability and syndication by invoking the so-called "10/20 non-bank rules" and stating that:

- the lenders must, for the entire duration of the loan, prohibit assignments, transfers or significant sub-participations of loan tranches that would lead to the involvement of more than 10 non-bank lenders; and
- the borrower must always ensure that the number of non-bank lenders will not exceed 20 in respect of all its borrowings (affiliated lenders do not fall under the provisions in both cases).

Fundamental changes

The present reform is primarily aimed at facilitating the withholding tax-free issuance of domestic bonds and hence at strengthening the Swiss capital market. This objective will be met by abolishing withholding tax on bond yields, as proposed by the Federal Council on 14 April 2021. Previous reform proposals centred around the introduction of a paying agent tax, which is no longer on the agenda.

It must be noted that Parliament significantly deviates from the Federal Council's position on one point by limiting the abolition of withholding tax to new issues. The Federal Council's version dated 14 April 2021 had foreseen the abolition of withholding tax on all interest payments from 1 January 2023 onwards, which would have covered interest on bonds already issued as well.

However, on account of a strictly formal approach as to what constitutes a new issue and an old issue, it should be feasible to replace a current foreign issue with a domestic issue. In addition, a relocation of the registered office of a foreign financial company to Switzerland does not imply that the bonds issued by that company prior to 1 January 2023 will be subject to withholding tax. The same holds true for the repatriation of a foreign issue that goes along with a change of issuer.

Withholding Tax on Swiss Funds

The Federal Council's proposal of 14 April 2021 did not include any material changes as regards levying withholding tax on domestic collective capital investment schemes. To eliminate the discrimination against domestic collective capital investment schemes compared to foreign collective capital investment schemes, Parliament has reworked legislation. Income from bonds from collective capital investment schemes that is reported separately shall now be exempt from withholding tax.

Changes to Securities Transfer Stamp Tax

Securities transfer stamp tax on domestic bonds is to be abolished with a view to enhancing trades in domestic bonds in the secondary market. Primary market transactions involving domestic bonds, as well as the return of securities for redemption, are already exempt from securities transfer stamp tax.

During the course of the parliamentary consultations, a further amendment was introduced, exempting the brokerage or purchase and sale of domestic or foreign participations of at least 10% of the share capital or nominal capital of other companies by a securities dealer within the meaning of the Federal Stamp Tax Act from securities transfer stamp tax, on condition that the participation was deemed to be a fixed asset. However, said exemption does not extend to the acquisition and disposal of investments held in the short term, considered current assets.

Comment and Outlook

The abolition of the Swiss withholding tax on bonds and the remaining proposed changes to the Swiss withholding tax and securities transfer stamp tax regime are expected to boost Switzerland's position as an international finance and treasury centre. All types of financing and refinancing activities in Switzerland (e.g. raising capital via bond issuances, crowdfunding platforms, asset-backed security structures and other capital market transactions) will be facilitated as adverse withholding tax consequences can be fended off.

The abolition of the Swiss withholding tax on bonds is expected to come into force on 1 January 2023 even if the referendum that has already been called takes place, should the voters approve the proposal. The referendum period, which is about to expire, ends on 7 April 2022. A public vote could thus take place in autumn 2022. The Federal Council will decide on the enactment of the remaining changes to the Federal Withholding Tax Act as well as to the Federal Stamp Duty Act.