

Tax Newsletter

Swiss Federal Council to request Parliament to abolish withholding tax on bonds - once unthinkable, but the 10/20 non-bank rules may be history in the not too distant future



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Withholding tax on bonds and other collective debt financings

Unlike many countries, Switzerland does not levy any withholding tax on interest paid on private and commercial loans (including on arm's length inter-company loans). However, 35% federal withholding tax is 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.

International capital markets typically do not respond too well to bonds subject to withholding tax. Therefore, it is common for Swiss multinational groups to issue bonds through a foreign subsidiary. The Swiss Federal Tax Administration (SFTA), however, will reclassify such foreign bonds into domestic bonds if the amount of proceeds used in Switzerland exceeds certain thresholds (i.e., (i) the combined accounting equity of all non-Swiss subsidiaries of the Swiss parent company and (ii) the aggregate amount of loans granted by the Swiss parent and its Swiss subsidiaries to non-Swiss affiliates).

In order to prevent federal withholding tax from being imposed on normal loans (in contrast to bonds triggering such a tax anyway), credit facility agreements entered into by a Swiss borrower, or by a non-Swiss borrower under a guarantee from a Swiss parent company, need to contractually restrict free transferability and syndication by invoking the so-called **10/20 non-bank rules** and stating that:

- i. the lenders must ensure that whilst the loan in question is outstanding, no assignments, transfers or relevant sub-participations of loan tranches shall be made, as a result of which the number of 10 non-bank lenders would be exceeded; and

- ii. the borrower must ensure that it will at no time have more than 20 non-bank lenders under any of its borrowings (in both cases generally disregarding any affiliated lenders).

Fundamental changes envisaged by the Swiss Federal Council

The Federal Council will, in response to its consultation document, submit a request to Parliament that withholding tax on bonds be abolished. The corresponding message to the Swiss Federal Assembly will likely be issued in the second quarter of 2021.

On 3 April 2020, the Federal Council opened the consultation process for the withholding tax reform. The purpose of this proposal is two-fold. On the one hand, the Swiss debt capital market should be strengthened. Companies domiciled in Switzerland should be given the opportunity of raising debt capital from within Switzerland on competitive terms and conditions. To this end, Swiss entities and all foreign investors should be exempt from withholding tax on interest.

On the other hand, the safeguard purpose of the Swiss withholding tax should be extended on the domestic level. For natural persons resident in Switzerland, withholding tax on interest should continue to be levied (as a backup tax) and should also be imposed on foreign bonds and other securities. Technically, this would have required a change to the so-called "paying agent principle", under which the paying agent (usually a bank) levies the due withholding tax, in accordance with the investor's status.

During the consultation process, the economic policy objectives of the reform

were backed. Many participants in the consultation process support the desired strengthening of the Swiss debt capital market and the necessary exemption of domestic legal entities and foreign investors from withholding tax. However, there was some controversy surrounding withholding tax as a means of securing taxes due from natural persons living in Switzerland. The Federal Council's proposal was deemed to be administratively burdensome by various parties, especially in the area of foreign collective investment schemes. These parties advocated a solution that was easier to administer.

On 11 September 2020, the Federal Council changed its course and set out its policy. It decided to go ahead with the reform and to continue strengthening the Swiss debt capital market. In the light of the consultation process, the Federal Council has, however, decided to discontinue its backup withholding tax system in relation to interest on bonds and other collective debt financings paid to individual persons resident in Switzerland. Rather, it has requested Parliament to abolish withholding tax on interest in its entirety on bonds and suchlike (excluding bank deposits of natural persons resident in Switzerland).

The Federal Council is expected to present its dispatch to Parliament in the second quarter of 2021. Once this has been adopted, it will also decide on the remaining key issues of the reform. This concerns the abolition of securities transfer tax on domestic bonds, which was also proposed during the consultation.

Switzerland such as raising capital via bond issuances, crowdfunding platforms, asset-backed security (ABS) structures and other capital market transactions will be facilitated as adverse withholding tax consequences can be prevented. This fundamental change of the Swiss withholding tax regime is expected to come into force no earlier than January 1, 2022.

The Walder Wyss Newsletter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this Newsletter should seek specific advice on the matters which concern them.

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Comments

The abolition of Swiss withholding tax on bonds and other collective debt financings is a welcome measure that allows Switzerland to significantly strengthen its position as an international finance and treasury centre. All types of financing and refinancing activities within