

# Welcome relaxation of Swiss withholding tax rules on foreign bonds guaranteed by Swiss parent company

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## Introduction

The Swiss Federal Tax Administration (SFTA) has relaxed its practice under which bonds that are issued by foreign resident issuers, but guaranteed by their Swiss resident parent company, are requalified as domestic issuances which trigger Swiss withholding tax on interest payments.

In Switzerland, interests on bonds are subject to withholding tax at a rate of 35%. As a result, Swiss multinational groups incline towards issuing bonds through foreign subsidiaries, which are often guaranteed by the direct or indirect Swiss parent company. The SFTA does not consider this conduct abusive if, broadly speaking, the proceeds raised under such foreign issuance do not flow back to Switzerland. However, if, on the other hand, the proceeds from the issuance are not used outside Switzerland, the SFTA requalifies a bond issued by a foreign subsidiary and guaranteed by the direct or indirect Swiss parent company as a domestic issuance. As a consequence, the Swiss parent company that provides a downstream guarantee must pay the SFTA Swiss withholding tax at a rate of 35% (or 53.8% if grossed up) on any interest payment under the foreign bond.

## Previous SFTA practice

Until now, the issuance of a bond by a foreign subsidiary has been economically equivalent to a direct issuance by the Swiss parent company and thus re-characterised as a domestic issuance subject to withholding tax if:

- the bond issued by the foreign subsidiary is guaranteed by a direct or indirect Swiss parent company through a downstream guarantee. However, there is no withholding tax risk when a Swiss company provides upstream or cross-stream guarantees as Swiss corporate law limits the validity of such guarantees to the amount of the Swiss company's freely distributable reserves;
- the bond proceeds or a part thereof are directly or indirectly on-lent to Swiss group companies (dividends, even if leveraged, are not harmful). A direct link between the foreign issuance and the on-lending to Switzerland is not required for a requalification of the bond, as even pre-existing on-lending to Switzerland may have a potentially detrimental effect; and
- such on-lending to Switzerland exceeds the equity of the foreign issuer at the end of the financial year. Therefore, any on-lending to Swiss group companies which is repaid before the year end is disregarded.

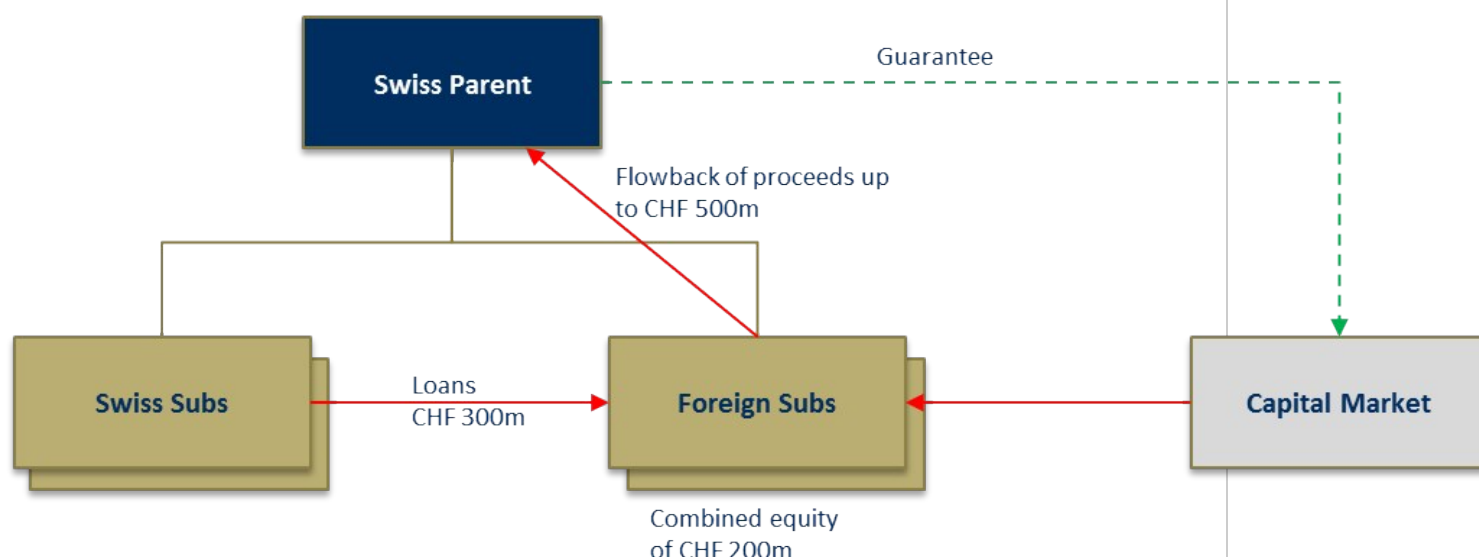
## New rules

The new rules, which entered into immediate effect on 5 February 2019, extend the scope of the third criterion above. Under the revised rules, a flow-back of proceeds from a foreign bond issuance to Switzerland is allowed up to the sum of:

- the combined equity of all non-Swiss subsidiaries directly or indirectly controlled by the Swiss parent company (if a non-Swiss subsidiary is not fully owned, its equity is taken into account on a pro-rata basis) (the so-called 'equity method'); and
- the aggregate amount of loans provided by the Swiss group companies to non-Swiss group companies (the so-called 'offsetting method').

Therefore, the revised rules significantly increase the permissible use of proceeds in Switzerland, particularly as it is possible to combine the two methods.

For instance, a bond is issued by a foreign subsidiary and guaranteed by the Swiss parent company through a down-stream guarantee. Assuming that the combined equity of all foreign subsidiaries amounts to Sfr200 million and the aggregate sum of outstanding loans provided by the Swiss group companies (to include the Swiss parent) to the foreign group companies totals Sfr300 million, a flow-back of proceeds from the foreign bond issuance to Switzerland is allowed up to Sfr500 million without triggering any Swiss withholding tax on the interest payments under the foreign bond.



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According to the SFTA's revised practice, taxpayers intending to apply one or a combination of the above methods are required to file an advance tax ruling request with the SFTA. Due to the principle of continuity, the chosen method must be maintained by the taxpayer.

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