CORPORATE TAX - SWITZERLAND

Fundamental changes to Swiss withholding tax on interest payments

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On 26 June 2019 the Federal Council announced its intentions to resume the temporarily suspended Swiss withholding tax reform and set out the general framework to introduce a paying agent tax system with regard to interest payments.

Background

In Switzerland, interests from bonds issued by Swiss entities or customer deposits held with Swiss banks are subject to Swiss withholding tax at a rate of 35%. Swiss withholding tax is currently collected in accordance with the so-called 'debtor principle'. This means that the Swiss obligor of interest deducts the Swiss withholding tax and deposits it with the Swiss Federal Tax Administration. The investor receiving the net amount of 65% of the interest payment can reclaim the Swiss withholding tax based on Swiss domestic tax law (in case of Swiss resident persons) or on the basis of the provisions of a double taxation agreement (in case of persons resident outside Switzerland).

However, on the international capital market, interests on bonds are not commonly subject to a deduction of tax at source and, as a consequence, Swiss groups often avoid the tax by issuing bonds through foreign companies. In order to strengthen the Swiss debt capital market, the government intends to switch from the current debtor principle to a paying agent principle and restrict the Swiss withholding tax to individuals resident in Switzerland.

In June 2019 the Federal Council mandated the Federal Department of Finance to prepare a consultation draft bill on the withholding tax reform which is expected for Autumn 2019 and set out the following key parameters.

Key parameters

Abolishment of Swiss withholding tax on interest paid to Swiss corporate and all foreign investors
To create a competitive framework and facilitate the raising of debt capital within Switzerland, investors residing outside Switzerland and corporate investors residing in Switzerland will be exempt from Swiss withholding tax on interest on bonds.

Expansion of paying agent system to foreign interest income received by Swiss individuals
Under the current system, interest on foreign bonds is not subject to Swiss withholding tax. In order to extend the safeguarding function of the tax and combat tax evasion, the withholding tax regime will be expanded to include foreign interest income received by Swiss individuals. On the other hand, the Federal Council stated that dividends on foreign equities should remain exempt from Swiss withholding tax as this exclusion helps to reduce the complexity of the new system.

Transitional rules for too-big-to-fail instruments
The new paying agent system will also apply to existing too-big-to-fail instruments such as contingent convertible bail-in and write-off bonds, which are currently exempt from Swiss withholding tax. Thus, one of the key parameters is the introduction of transitional rules for such too-big-to-fail instruments.

Legal basis to apply Swiss withholding tax to substitute interest and dividend payments

The Federal Council intends to introduce a statutory basis to apply Swiss withholding tax to passed-on and manufactured payments. Such payments replicate interest on bonds, dividends and suchlike and arise, for instance, in connection with securities financing transactions (securities lending and borrowing or repo transactions) or derivatives and structured products. Due to this measure, investors receiving a dividend or interest equivalent payment that substitutes a dividend or interest payment are equally treated as investors receiving the original dividend or interest payment subject to withholding tax.

Provisions regarding administrative burden and liability risk

The remaining key parameters that need to be implemented by the Federal Department of Finance in the consultation draft bill refer to the administrative burden and liability risk of Swiss paying agents and have no structural impact on the Swiss withholding tax regime as such.

Additional instructions to Federal Department of Finance

The Federal Council has instructed the Federal Department of Finance to examine whether:

- direct and indirect (typically through funds) interest investments can be treated in the same way – specifically, in order to eliminate existing tax disadvantages for Switzerland as a fund centre; and
- the Swiss equity capital market can be strengthened by:
  - amending corporate income tax rules with regard to the participation exemption, and
  - exempting Swiss debt securities from Swiss securities transfer tax.

Comment

A change from the debtor to the paying agent system in the area of interest is a welcome measure that allows a more targeted tax collection and improves the safeguarding function of the tax. The withholding tax will be levied on individuals resident in Switzerland and will cease to apply for all other investors with a lesser degree of urgency of safeguarding. In this way, the position of Switzerland as an international finance and treasury centre will be significantly strengthened and the raising of capital via bond issuances within Switzerland will be facilitated as adverse withholding tax consequences can be prevented.

As the Federal Council's communication did not contain any details, it remains to be seen how the reform will be set out in the draft bill expected in Autumn 2019 and how it will affect paying agents and investors.

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