Memorandum

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To
Interested Parties

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Structured Financing and Asset Securitization
- Swiss Withholding Tax and Stamp Duty Aspects

I Introduction

Asset securitizations and similar forms of structured financing are a well-established financing technique in the Anglo-Saxon world. In Switzerland, however, such financing techniques have gained some practical importance in the past few years only. Securitization schemes generally involve the bundling of specific, generally income-producing assets (such as loans, credit card receivables, claims under lease agreements, etc.) of an enterprise (the „originator") in a pool and a re-financing of such asset pool through an issue of (usually debt) securities by an entity separate from the originator (the „issuer"), whereby the payment of interest and principal under the debt securities is funded by the income from, and the realization of, the assets assembled in the pool.

Whereas so far, it was felt in Switzerland that the re-financing of the asset pool through a placement of debt securities in the capital market should be unproblematic from a Swiss withholding tax and capital stamp duty point of view, if the debt securities are issued by a foreign-resident entity separate from the Swiss-

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resident originator, an article (hereinafter: the „Article“) recently published by a member of the Service of Legal Affairs at the Department for Withholding Taxes and Stamp Duties of the Federal Tax Administration (FTA)[1] indicates that the FTA has begun to examine securitization projects submitted to it under the aspect of tax avoidance, i.e., whether the financing of a Swiss originator is sufficiently separated from the re-financing activity of the foreign issuer.

The Article starts from the basic assumption that the Swiss resident originator requires a financing, which it obtains from a foreign finance vehicle, which refinances itself by a placement of debt securities (bonds or notes) in the capital market. The issuer is often structured as a single purpose vehicle (SPV) and usually organized in an off-shore jurisdiction.

A distinction between two basic securitization models is drawn in the Article:

- The „ordinary“ securitization whereby the originator takes out a loan financing from the issuer. The issuer refinances itself by issuing debt securities (bonds, notes) to Swiss and/or foreign investors.
- The „asset securitization“ which is characterized by a continuous sale of income-producing assets (in particular claims/receivables) of the originator to the SPV, which again refinances the purchase price through a placement of debt securities in the capital market.

The general taxation principles set out in this paper for securitization schemes can be assumed to be applicable by analogy to other structured financing schemes as well.

II Swiss Capital Stamp Duties and Interest Withholding Taxes on „Debentures“

1 General, Tax Definition of “Bonds” or “Debentures”

Both securitization models involve an issue of debt securities to investors. The issuance of bonds, notes and similar „debentures“ is subject to Swiss federal capital issuance stamp duty at the rate of 0.12 % for each full or broken year of the instrument’s maximum term (or 1/360 of 0.06 % for each day of the instrument’s term if the latter does not exceed 12 months), if the issuer is qualified as a person „domiciled in Switzerland“. Under the same condition, 35 % Swiss federal withholding tax must be withheld by the issuer from any payments of interest on „debentures“.

[1] Thomas Jaussi, Emissionsabgabe und Verrechnungssteuer bei strukturierten Finanzierungen, in: Der Schweizer Treuhänder, Vol. 6-7/97, p. 571 et seq.

An issuer is deemed to be „domiciled in Switzerland“ if he has his legal domicile in Switzerland, resides on a long-term basis, has a statutory registered office or is registered as an enterprise in the commercial register. If a company’s registered office is abroad, it will nevertheless be considered as being domiciled in Switzerland if it is effectively managed and has an activity in Switzerland.

Taxable debentures are defined as written acknowledgments of indebtedness of fixed amounts issued in multiple instruments with a view of obtaining collective financing from investors at large, or of creation of collective investment opportunities, or of consolidation of liabilities, in particular bond issues, including bonds guaranteed by a mortgage pursuant to Art. 875 of the Swiss Civil Code, annuity bonds, mortgage bonds, notes, certificates and debt register claims. Debentures also include

- bills of exchange, acknowledgments of indebtedness assimilated with bills of exchange and other discountable commercial papers issued in multiple instruments destined to be placed in the public;

- certificates evidencing sub-participations in claims arising from loans;

- debt register claims issued in multiple instruments with a view of obtaining collective financing from investors at large.

- Debentures with a fixed term of no more than 12 months are designated as „money market papers“. The practice of the FTA treats as taxable debentures any debt instrument consisting of different issues of similar conditions which attract more than 12 interest-bearing loans and expect to attain the number of 20 deposits within a 3-year period. 10 different interest-bearing loans are sufficient to be characterized as a taxable debenture if their conditions are identical.

2 Tax Treatment of the „Ordinary“ Securitization (Loan Model)

As the bonds/notes issue is typically made by a foreign (off-shore) resident issuer or SPV and not by the Swiss resident originator, it would normally appear that no Swiss capital issuance stamp duty is owed and no Swiss withholding tax is due on interest paid on such bonds or notes, provided that the issuer cannot be regarded to be domiciled in Switzerland.

However, the FTA apparently suspects that the combination of a series of generally tax-neutral transactions (achieved by the inter-position of a third party, the foreign issuer) is aimed at avoiding Swiss stamp duties and withholding taxes otherwise payable on bonds/notes of a Swiss issuer.

According to the constant practice of the Federal Supreme Court, a legally valid transaction (or a series of transactions) of the taxpayer may be disregarded for tax purposes and the tax payer may instead be treated as if he had chosen a different legal form that more appropriately reflects the economic substance of the transaction, if the following conditions are cumulatively met:

i) The legal form chosen by the tax payer is „unusual“ or inadequate to achieve the purported goal and contrary to ordinary business practice;

ii) the taxpayer’s primary motive for choosing such legal form is to achieve substantial tax savings; and

iii) the taxpayer would, in fact, realize considerable tax savings if the legal form chosen were accepted by the tax authorities.

2.1 Loan Model Securitization Through a SPV

In order to determine whether a loan model securitization constitutes an unusual or inadequate legal structure, the FTA uses as criterion the quality of the issuer. On that basis, the FTA has established 3 sub-categories of loan model securitization:

- The issuer is a (typically off-shore resident) SPV. The equity participations in the SPV are typically held by a charitable trust and the loan to the originator usually constitutes the only legal and economic link between the SPV and the Originator.

- The issuer is a foreign subsidiary of the originator.

- The issuer is a *bona fide* third party (i.e., neither a SPV nor a subsidiary).

The FTA considers the loan model securitization involving a SPV to be an unusual construction, as the re-financing of the SPV in the capital market solely serves the financing needs of the originator. The FTA treats the loan financing of the originator and the re-financing of the SPV in the capital market as an economic unity, i.e. as a capital market financing transaction of the originator. The FTA sees no reason for the splitting of the originator’s financing transaction into a 2-step transaction other than the intention to construct a foreign bond issue, which would be exempt from the Swiss capital stamp duty and the income from which would not be subject to Swiss withholding tax, if recognized by the tax authorities.

The FTA takes the view that it is of no relevance whether the originator can in fact influence the SPV’s decision as to its re-financing. Furthermore, the FTA does not differentiate between secured and unsecured credits used in a loan model securitization. In both cases, the FTA sees no true business purpose of the interposition of the SPV as a vehicle for the capital market financing, but only the prevailing tax avoidance purpose. Hence, the capital market financing is deemed to be obtained by the Swiss originator directly.

2.2 Loan Model Securitization Through a Foreign Subsidiary

If a foreign subsidiary of a Swiss resident company issues a bond or note and, at the same time, grants a loan to its Swiss parent company, generally no Swiss capital stamp duties and withholding taxes become due. However, this general rule is in the view of the FTA subject to two exceptions:

a) If the Swiss parent company guarantees the payment of interest and/or principal by its foreign subsidiary to the investors, the bond/note is subject to Swiss capital stamp duty and withholding tax if proceeds from the bond/note flow directly (in particular as a loan) or indirectly back to the Swiss parent company. The Swiss tax exemption applies only if the entire proceeds of the bond/note are invested abroad.

b) The bond/note is taxable in Switzerland if the foreign subsidiary is a SPV. In that case, the bond/note issue is deemed to be made directly by the Swiss parent company (see above).

2.3 Loan Model Securitization Through a Third Party (non-SPV or "Conduit")

No Swiss capital stamp duties or withholding taxes become due if the issuer of the bonds/notes is a (foreign) bank or finance company which extends loans to multiple borrowers and refinances itself through issuance of debt securities in the capital market, if such refinancing is made in the issuer's own, independent discretion and in the course of its ordinary business activity. The relevant criterion for the FTA is a reasonable separation of the financing activity of the originator from the refinancing activity of the issuer, adapted to the economic facts and circumstances of the concrete case.

So-called „conduits" - SPVs whose main or sole business activity is providing structured financing which, however, is made available to multiple originators - are treated as normal financial institutions and, therefore, as „genuine" third parties, provided that the originator in question has no factual nor legal possibility to influence the decision making and particularly the decisions on the re-financing of the conduit. Indications for an influence of the originator on the conduit are, in particular, the nomination of directors of the conduit by the originator, contractual decision making rights of the originator and additional financial relationships between the conduit and the originator.

3 Tax Treatment of the Asset Securitization (Sale Model)

The Article sets forth that the FTA in its previous practice accepted asset securitizations with an assignment of claims and receivables from a domestic enterprise to a foreign SPV only under the following (cumulative) conditions:

i) The debtors of the assigned receivables had to be non-Swiss;

ii) the business activity of the SPV had to include a separate, independent activity; it did not have to be limited to the purchase of the originator's claims and receivables; and

iii) the SPV had to have full discretion in deciding how to refinance its business activities.

If either of these conditions was not met, the FTA assumed the presence of a tax avoidance purpose.

However, the FTA now appears to have changed its mind as to the relevant criterion for a valid business purpose versus a tax avoidance purpose of asset securitization schemes. The FTA does no longer use the criterion of the quality of the issuer, but rather the quality of the legal relationship between the originator and the issuer. The FTA now makes the recognition of asset securitizations dependent upon whether the assignment of claims and receivables by the originator to the issuer constitutes a „true sale". Indications for a true sale are the transfer of ownership in the assigned assets and, in particular, the transfer of associated risks. The issuer must assume all risks associated with the assigned assets (in particular, the issuer must not have any recourse to the originator due to defaults on the assigned claims and receivables). Further conditions are:

- The sale of assets (receivables, etc.) must be made at arm's length conditions.

- The assignment of assets must be duly reflected in the accounts of the originator (i.e., the assigned receivables are replaced on the originator's balance sheet by the consideration received from the issuer).

- The transfer of the receivables and the associated risks to the issuer must be final and irrevocable (i.e., the originator must not undertake to reassume any assigned receivables).

If all these conditions are met, the FTA will not assume a disguised debt financing of the originator in the capital market, even if the foreign issuer does refinance itself through an issue of debt securities. In summary, if the transfer of assets from the originator to the issuer constitutes a true sale, no Swiss capital stamp duty nor withholding tax will become due regardless of whether the issuer is a SPV, a subsidiary of the originator, a third party financial institution or a conduit.

In the personal view of the author of the Article, the FTA should not generally require a notification of the assignment of receivables to the debtors, as the validity of the assignment under Swiss law does not depend upon such notification (although the *debitor cessus* is released from his obligations by a *bona fide* payment to the assignor if he was not notified of the assignment). The Article suggests, however, that if the originator continues to be responsible for the administration and the collection of the assigned claims under a service agreement with the issuer, all cash flows from the assigned receivables, i.e., the receipt of collected amounts and their subsequent transfer to the issuer must be booked on a separate, specifically designated account of the originator.

4 Summary

The FTA distinguishes between two basic types of structured financing, namely securitized loans and asset securitizations involving a sale of income-producing assets to a foreign issuer.

Whereas securitized loans are not subject to Swiss capital stamp duty and withholding tax if the foreign issuer is a third party financial institution, a conduit or a subsidiary of the originator (unless the subsidiary is a SPV), the FTA will assume a primary tax avoidance motive and, for withholding tax and stamp duty purposes, collapse the two transactions into one (i.e., assume a direct capital market financing of the originator), if the issuer is a foreign SPV, created solely for the purpose of re-financing the originator's financing needs in the capital market.

Structured financings in the form of asset securitization are treated as non-taxable transactions for Swiss withholding tax and capital stamp duty purposes, if the transfer of assets from the originator to the foreign issuer constitutes a true sale. If there is a true sale, it is not relevant whether the foreign issuer is a SPV, a foreign subsidiary of the originator, a third party financial institution or a conduit.