Memorandum

An
file

Von
Peter Reinarz and Marcel R. Jung

Datum
Zürich, 5 February 2008

Betrifft
Swiss Holding Tax Memo

Swiss Holding Company - Taxation Regime

1 Introduction

1 The Swiss holding company taxation regime offers some unique advantages for holding companies. These include:

- an exemption from income taxes at the cantonal and communal level,
- a relief for dividends and capital gains at the federal level;
- tax deductibility of losses and depreciation on investments;
- 7.83% tax rate on other income (interest, royalties, service fees etc.) at the federal level;
- the lack of a CFC regime (controlled foreign corporation regime);
- an extensive tax treaty network;
- indirect access to the EC Parent Subsidiary and Royalty Directives through Article 15 of the Switzerland-EC Savings Tax Agreement

Bär & Karrer
Rechtsanwälte

Zürich
Bär & Karrer AG
Brandschenkestrasse 90
CH-8027 Zürich
Tel. +41 (0)58 261 50 00
Fax +41 (0)58 261 50 01
zuerich@baerkarrer.ch

Genf
Bär & Karrer
12, quai de la Poste
CH-1211 Genève 11
Tel. +41 (0)58 261 57 00
Fax +41 (0)58 261 57 01
geneve@baerkarrer.ch

Lugano
Bär & Karrer SA
Succursale di Lugano
Via Vegezzi 6
CH-6901 Lugano
Tel. +41 (0)58 261 58 00
Fax +41 (0)58 261 58 01
lugano@baerkarrer.ch

Zug
Bär & Karrer AG
Zweigniederlassung Zug
Baarerstrasse 8
CH-6301 Zug
Tel. +41 (0)58 261 59 00
Fax +41 (0)58 261 59 01
zug@baerkarrer.ch

London
Bär & Karrer Ltd
London Branch
1 Pemberton Row
GB-London EC4A 3BG
Tel. +44 20 7583 1940
Fax +44 20 7583 1941
london@baerkarrer.co.uk

www.baerkarrer.ch

2 Corporate Taxes

2.1 Cantonal and Communal Level: Holding Privilege

2.1.1 Principle

2 Holding companies are exempted from corporate income tax at cantonal and communal level, except for income derived from real estate located in Switzerland. Holding companies pay an annual capital tax on the equity, usually at reduced tax rates compared to "ordinary" companies.

2.1.2 Criteria to Qualify for Holding Company Status

3 Cantonal holding company status is granted subject to the following conditions:

a) the main purpose of the holding company is holding and managing substantial corporate equity investments;

b) at least 2/3 of the assets must consist of, *or* 2/3 of the income must be derived from, qualifying equity investments;

c) a holding company may not be actively engaged in commercial activity in Switzerland.

4 Condition (a) may be met already with one substantial equity investment, e.g. an investment in a Swiss or foreign subsidiary.

5 The assets/income test as per condition (b) is an alternative one. When applying the assets test, the fair market values (not just the book values) are relevant. The cantonal tax laws generally do not provide for a minimum equity stake in order to be considered "substantial".

6 Condition (c) excludes any commercial or industrial activities (such as manufacturing, trading and service activities) being conducted in Switzerland. However, such activities may be conducted abroad. In addition, certain activities on behalf of the company itself and its subsidiaries are accepted even when conducted domestically, such as

- managing the company itself and the investments;
- providing services on behalf of the consolidated group;
- debt financing of subsidiaries;
- holding and exploitation of intellectual property to a certain degree.

2.2 Federal Level: Relief for Qualifying Dividend Income and Capital Gains

7 The federal tax system does not provide for a full income tax exemption of holding companies. However, the "participation relief" indirectly exempts divi-

dends and capital gains derived from substantial equity investments ("participations") in Switzerland and abroad. There is no "subject to tax" or activity requirement for the underlying company or its profits. Hence, investments in tax haven companies may be eligible.

2.2.1 Qualifying Dividend Income

8 Dividends received by a Swiss corporation qualify for the "participation deduction" if the underlying shares constitute a "participation", i.e., represent a holding of least 20% of the share capital of another Swiss or foreign corporation, or an aggregate market value of at least CHF 2,000,000. This régime is designed to promote international investments (including those which represent a small fraction of the voting or nonvoting shares but a significant value) through Swiss based companies.

9 Eligible dividends include ordinary and extraordinary dividends, constructive dividends, liquidation surplus and any other attribution of profits or reserves to shareholders. The tax relief is available to the extent that the distribution received does not give rise to a depreciation of the underlying participation in the accounts of the receiving company.

2.2.2 Qualifying Capital Gains

10 In order to qualify for the "participation deduction", a capital gain must be derived in respect of a “participation” which represents at least 20% of the share capital of the underlying company. The eligible gain corresponds to the sale proceeds minus the acquisition cost.

2.2.3 Tax Computation

11 The "participation deduction" is a reduction of the income tax - which in a first step is computed on the company’s overall net income (including qualifying dividends and gains) at the standard rate of 8.5% – in the proportion of the "net participation income" in the total net income. The "net participation income" is defined as follows:

- gross "participation income" (qualifying dividends and gains), minus
- any non-refundable foreign withholding taxes;
- a proportional share of financing costs (proportion of participation assets to total assets); and
- a lump-sum allocation of administration/management costs to the "participations". The default allocation is 5% of the gross participation income received.

2.2.4 Deduction of Interest, Depreciation and Losses

12 Financing interest (including arm's length interest on shareholder loans), depreciation on "participations" and capital losses are generally tax deductible expenses. However, interest expense reduces the eligible "net participation income" in the proportion of the "participation" assets. Depreciation in connection with a substantial distribution received disqualifies the distribution from the "participation deduction".

2.2.5 No Tax Consolidation

13 Group or consolidated taxation is unknown in Swiss direct corporate taxation.

2.2.6 No CFC Rules

14 Switzerland has no CFC tax rules and there are currently no plans to introduce such rules. Under very exceptional circumstances, profits of a foreign subsidiary may nevertheless be attributed for tax purposes to a Swiss parent company. Such may be the case in particular, when the Swiss parent itself does not respect the separate legal personality of the foreign subsidiary (e.g. by interfering with the daily management of the subsidiary's affairs by its executive bodies) and in cases of obvious tax avoidance.

3 Capital Taxes

15 Holding companies pay an annual capital tax on their equity at the cantonal/ communal level. The tax rate is usually reduced compared to ordinary taxed companies and amounts to 0.01 to 0.20%, depending on the relevant canton and commune.

4 Issuance Stamp Duty

16 Switzerland levies a 1% issuance stamp duty on contributions of equity to Swiss companies in excess of the first CHF 1,000,000. Certain in-kind contributions of substantial "participations" are treated as corporate reorganization and are as such exempt from stamp duty. The legal migration of a foreign holding company into Switzerland is also exempt from stamp duty.

5 Securities Transfer Stamp Duty

17 The transfer of ownership for consideration of shares, bonds, notes etc. by, to, or through the intermediation of, "Swiss securities dealers" is subject to transfer stamp duty at a rate of 0.15% for Swiss, and 0.30% for foreign securities. "Securities dealers" include inter alia any Swiss company which, according to its last balance sheet, holds taxable securities of an aggregate value exceeding CHF 10,000,000. Swiss holding companies often meet that test. The law provides for

a variety of tax-exempt transfers, such as the issuance and the return for cancellation of taxable securities.

6 Value Added Tax

18 Switzerland levies a value added tax (VAT) on the domestic supply and the importation of goods and services. The standard VAT rate is 7.6%. Proceeds from dividends and interest are VAT-exempt turnover (without input VAT credit). Exceptionally, a holding company may also derive royalties, fees and other turnover which is subject to VAT (or exempt with credit, if derived from services deemed rendered abroad).

7 Federal Withholding Taxes

19 Switzerland imposes a 35% WHT on dividends, bond interest and bank deposit interest paid by a Swiss resident. Interest on commercial loans, royalties etc. are not subject to this tax. Foreign resident beneficiaries may be entitled to partial or full relief, normally through refund, based on international tax treaties. Companies holding a substantial equity interest in a Swiss company may obtain a full relief from the Swiss dividend WHT under certain treaties such as with Germany, the Netherlands, Luxembourg, France, Spain, Austria, Denmark, Sweden, and Norway.

20 More importantly, Art. 15 of the Switzerland-EC Savings Tax Agreement provides full relief to corporations resident in any EC Member State that hold a capital interest of at least 25% in the Swiss company for at least two years. Such corporate EC shareholders will principally be exempt from Swiss dividend WHT (subject to any national or tax treaty based anti-abuse rules).

8 Relief fro Foreign Withholding Taxes

8.1 Principle

21 Swiss tax law treats holding companies as fully resident despite of their privileged tax regime. Hence, holding companies may principally claim benefits under Swiss double tax treaties in respect of income derived from other tax treaty jurisdictions. Art. 15 of the Switzerland-EC Savings Tax Agreements provides additional benefits to Swiss holding companies that hold capital interests of at least 25% in an underlying EC resident company for at least 2 years (full exemption from withholding taxes on dividends, subject to national and tax treaty based anti-abuse rules).

8.2 Unilateral Anti-Treaty Shopping Rules

22 As other companies, Swiss holding companies are subject to Swiss unilateral anti-treaty shopping rules, which *inter alia* limit the use of treaty benefited foreign dividends, interest and royalties for tax-deductible payments to foreign resi-

dents to 50% and require a minimum dividend distribution of 25% of the treaty benefited income, if the Swiss company is foreign-controlled. However, "pure" holding companies which do not have any ancillary activities are exempt from the 50% expense limitation and the 25% minimum distribution requirement.

8.3 Treaty-Integrated Anti-Treaty Shopping Rules

23 The Swiss double tax treaties with Germany, Belgium, Italy and France contain anti-abuse rules similar to the Swiss unilateral treaty-shopping rules. In addition, these treaties impose a "subject to full tax" requirement in respect of interest and royalties, which is normally not met by a Swiss holding company, unless the company waives the cantonal/communal holding privilege in respect of interest and royalties. More far-reaching and complex provisions are included in the "limitation on benefits" clause of the Swiss-US income tax treaty of 1996.

9 Conclusion

24 Switzerland is a very competitive international holding company location, thanks to the extensive Swiss double tax treaty net and attractive domestic tax features. Of particular attraction are:

- the full exemption from tax of income from loan financing and ancillary activities at the cantonal/communal level, while such income is taxed at a modest effective rate of 7.83% at the federal level;
- the availability of the cantonal holding privilege and the federal "participation relief" irrespective of double tax treaties and irrespective of whether the profits of the underlying companies are subject to any corporate tax; and
- the general income tax deductibility of financing interest, depreciation and capital losses on eligible investments.

25 Negative points are the rather high withholding tax on outbound dividends (which can, however, be substantially reduced or eliminated under a number of double tax treaties and the Switzerland-EC Savings Tax Agreement) and the possible stamp duty implications.

Annex: Examples

Ordinary Taxed Companies

- **Zug**

  The canton of Zug applies a non-proportional corporate income tax rate ("*Stufentarif*): the first CHF 100,00 of the taxable income is taxed at a rate of 4% and the amount that exceeds this threshold is taxed at a rate of 7%. Those statutory corporate income tax must be multiplied with the annually adjusted cantonal/communal multiplier. For the city of Zug, this multiplier is approx. 153% for the fiscal year 2008. The multiplier varies from commune to commune of the canton.

  Equity is taxed at a proportional corporate capital tax rate of 0.05% which must also be multiplied with the cantonal/communal multiplier.

- **Berne**

  As in the canton of Zug, the canton of Berne also has a non-proportional corporate income tax rate: the first 20% of the taxable income is taxed at 1.55%, the next CHF 50,000 is taxed at 3.1%, and the exceeding income is taxed at 4.6%. Again, these corporate income tax rates have to be multiplied with the cantonal/communal multiplier. For the city of Berne, the multiplier is 479.19% for the fiscal year 2007. The applicable multiplier for 2008 has not yet been published.

  Equity is taxed at a proportional corporate capital tax rate of 0.03% which also has to be multiplied with the cantonal/communal multiplier.

Holding Companies

- **Zug**

  As mentioned above, the canton of Zug levies a proportional corporate capital tax rate. The applicable tax rate is 0.002% and has to be multiplied with the cantonal/communal multiplier of approx. 153% for the city of Zug and the fiscal year 2007.

- **Berne**

  The canton of Berne levies a non-proportional corporate capital tax rate. Equity up to CHF 1,000,000 s taxed at a rate of 0.02%. This tax rate must be multiplied with the cantonal/communal multiplier.