Market Intelligence

PRIVATE EQUITY 2021

Global interview panel led by Simpson Thacher & Bartlett LLP

LEXOLOGY
Getting The Deal Through

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Switzerland

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1 What trends are you seeing in overall activity levels for private equity buyouts and investments in your jurisdiction during the past year or so?

Deal activity in Switzerland declined in the first six months of 2020 due to the covid-19 pandemic and was down by approximately 25 per cent on a year-on-year comparison (72 transactions in H1 2020 compared to 95 transactions in H1 2019). The decline in deal activity then continued into the third quarter of 2020, only to recover in the fourth quarter, resulting in a moderate overall decline in deal volume of 4.6 per cent for 2020 compared to 2019.

The increase that was observed towards the end of 2020 then continued in the first half of 2021, resulting in high deal activity with heavy involvement of Swiss small and medium-sized enterprises (SMEs). On a year-on-year comparison, transaction volume has increased by 62.5 per cent (117 transactions in H1 2021 compared to 72 transactions in H1 2020) and the Swiss market appears to have recovered from the covid-19 pandemic.

In view of the returning confidence in the economy, Swiss SMEs continued to be attractive targets for investors in H1 2021, especially for European buyers (81 per cent, with the remainder being primarily North American and Asian buyers) and we expect private equity investors to continue to be very active in Switzerland in H2 2021 with a focus on SMEs in the industrial, TMT and consumer goods sectors (furthermore, approximately 80,000 SMEs in Switzerland need to deal with succession planning in the coming years). While 2020 already saw a high level of involvement of private equity investors in Switzerland, with financial investors being active as buyer or seller in approximately 44 per cent of the deals, this trend continued in H1 of 2021.

2 Looking at types of investments and transactions, are private equity firms primarily pursuing straight buyouts, or are other opportunities, such as minority-stake investments, partnerships or add-on acquisitions, also being explored?

Private equity firms active in Switzerland follow a wide range of strategies, including control and non-control deals, club deals and joint ventures with corporates. In the past few years, we have seen many transactions where a seller wishes to keep a certain minority stake in the target company. Such sellers often prefer straightforward Swiss structures, which also take into account the tax situation of the seller in case of a full exit at a later point in time (which is often governed in a separate shareholders' agreement). Accommodating these preferences may give a bidder an important competitive advantage in an auction process. As Swiss law does not

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"Swiss SMEs continued to be attractive targets for investors in H1 2021."

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prevent or restrict the participation of two or more private equity investors in a club or group deal, several private equity transactions were syndicated (eg, the sale of Leoni Schweiz AG to a consortium of buyers led by a former board member and Helvetica Capital AG, an independent investor, in April 2021). Typically, private equity players taking non-control positions seek protection via shareholders' agreements, which usually not only restrict the transferability of the shares, but also include board appointment rights as well as provisions regarding voting undertakings for certain or even all board or shareholders' resolutions. In this respect, Swiss law provides great flexibility and Swiss market practice has, in recent years, reached a high level of sophistication. Additionally, private equity investors are increasingly pursuing a buy-and-build strategy, purchasing different companies in the same or similar industries and therefore driving portfolio company activity in Switzerland. A good example of high portfolio company activity in recent years is Swiss IT Security Group, which expanded its presence into Benelux via acquisitions in the past 18 months and was acquired at the beginning of H2 2021 by private equity investor Triton.

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3 | What were the recent keynote deals? And what made them stand out?

The public takeover of the Swiss target Sunrise Communications AG by Liberty Global Plc for US$7.2 billion marked the largest M&A transaction in 2020 in Switzerland. Other big-ticket transactions with Swiss involvement in 2020 include Insight Partner's acquisition of Veeam Software AG from Canada Pension Plan Investment Board, valued at US$5 billion, and the public takeover of Pargesa Holding SA by Parjointco NV with a deal value of US$2.6 billion.

In 2021, noteworthy transactions include the acquisition of Franke Water Systems AG, an international manufacturer of intelligent water solutions for residential bathrooms, residential kitchens and commercial washrooms by Equistone Partners Europe; the sale of Unilode Aviation Solutions (the global market leader in specialty aviation infrastructure) from EQT Infrastructure II fund to Basalt Infrastructure Partners; as well as the above-mentioned acquisition of the Swiss leading cybersecurity service provider Swiss IT Security Group by Triton Fund V from Ufenau Capital. The Swiss IT Security Group deal can be seen as an example of high activity in the TMT sector.

Other notable private equity deals in H1 2021 included the US$250 million investment of CVC Capital Partners in Acronis, the global operator in cyber-protection, and the partnership of CVC Capital Partners with the International Volleyball Federation.

4 | Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal? How are those challenges evolving?

Cross-border private equity M&A deals have always been a major pillar in an overall busy M&A market in Switzerland. The importance of cross-border M&A for Switzerland has also been underlined by the Swiss legislator, which so far has refused to introduce investment restrictions for foreign investors despite an international trend in this direction.

Cross-border transactions create challenges for the legal advisers involved, as coordination and communication become the key success factors. Thus, getting all legal advisers on the same page, by assigning clear responsibilities and committing to strict deadlines from kick-off to closing, is critical, in particular where coordination has to take place between different law firms that are dispersed over different time zones. Although such transactions are not always without friction, the major Swiss law firms are experienced in handling multi-jurisdictional M&A transactions and dealing with fast-paced private equity dealmaking.

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5 What are some of the current issues and trends in financing for private equity transactions? Have there been any notable developments in the availability or the terms of debt financing for buyers over the past year or so?

Due to ongoing negative interest rates, banks are more inclined towards financing transactions and the financing conditions remain favourable for funding investments in Swiss companies. This is the reason why there often was and again is an oversupply of interested investors. Bidders looking to invest are very flexible with regard to transaction financing. This is due to the fact that Swiss corporate law only stipulates limited restrictions on a company's debt-to-equity ratio (however, from a Swiss tax law perspective, de facto limitations exist due to thin capitalisation rules). Securing bank financing can be challenging, as banks are still cautious and require specific collateral when lending funds to borrowers. However, with the current (partially still negative) interest rates, banks have indeed become more inclined to provide financing. It is standard market practice that pledges are taken by the financing institutions to protect their rights under the financing agreements. It is not unusual that both the shares in the portfolio company and the shares in any of its material subsidiaries are pledged. Additionally, financing providers secure the financing by requiring that existing debt is refinanced, and that existing securities will be released and used as collateral. Various restrictions apply to upstream and cross-stream guarantees, as well as to other security interests granted by the target to the parent or an affiliate (other than a subsidiary). As Swiss corporate law requires the shareholders' approval in addition to that of the board of directors, structured financial planning is very important. In fact, this planning is a responsibility of the board that cannot be delegated. Should the company go bankrupt because of excessive debt incurred, personal liability of the board members ultimately is possible. Further, the articles of association of the company may have to be changed before it is able to grant security interests, as the company's purpose according to its articles of association must provide the basis for the granting of security interests and therefore need to contain a financial assistance clause.

6 How has the legal, regulatory and policy landscape changed during the past few years in your jurisdiction?

As of 1 May 2021, bearer shares were largely abolished in Switzerland. Since the effective date, bearer shares are only permitted for listed companies or if the bearer shares are structured as intermediated securities. If companies had not converted their bearer shares into registered shares by 30 April 2021, they were compulsorily

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converted by law. Shareholders holding bearer shares and failing to notify the company about such bearer shares by 1 May 2021 are not allowed to be entered into the company's share register. As a consequence, the membership rights of these shareholders are suspended and the property rights forfeited. However, such shareholders have until 31 October 2024 to be entered in the share register by court order. After this deadline, their bearer shares will become null and void. From a company perspective, the abolishment of bearer shares has, among others, the implication that companies must ensure that shareholders who failed to notify the company are prevented from exercising their shareholder rights. Furthermore, the company's articles of association must be amended and companies must consider whether the transferability of the converted shares will be restricted or not.

In recent years, financial regulation has increasingly become a central strategic dimension. The complexity of the regulatory environment – and thus the requirements and costs for the market participants – are growing.

As briefly mentioned in question 4, to date, there is no general investment control for foreign direct investments in Switzerland, though there are certain sector-specific limitations and requirements (eg, in telecommunications, radio and

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TV broadcasting, nuclear energy and aviation, as well as in the financial sector). However, at the beginning of 2018, a parliamentary motion was submitted that aims to create a legal basis for investment control of foreign direct investment in Swiss companies, among other things, by establishing an approval authority for transactions subject to investment control. In June 2019 the motion was approved by the Council of States and in March 2020 by the National Council. The Federal Council now has a two-year deadline to submit a corresponding draft bill to the parliament, although it is unclear when the draft will be submitted. Thereafter, it will still have to be approved by the parliament.

Even though Switzerland is not a member of the European Union, the European directives and regulations still have an important impact on Swiss policymaking. Two new federal acts entered into force on 1 January 2020: the Federal Act on Financial Services of 15 June 2018 (FinSA) and the Federal Act on Financial Institutions of 15 June 2018 (FinIA), subject to a phasing-in period of up to two years. The new laws were created with the goal of enhancing customer protection in the financial sector, and the FinSA in particular is to a significant extent modelled on the EU MiFID/MiFID II directives (albeit with various differences). The FinSA also introduced a new prospectus regime for public offerings of securities in Switzerland (including public offerings in Switzerland by foreign issuers). It sets out the required content of prospectuses, bringing the requirements in line with international standards and those historically applied by SIX Swiss Exchange for listing prospectuses under the old regime, and replaces the outdated rules of the Swiss Code of Obligations, which only required very limited disclosure. The new regime also includes a duty to have the prospectus reviewed for completeness, coherence and comprehensibility by a private reviewing body authorised by the Swiss Financial Market Supervisory Authority (FINMA) to act this capacity. On 28 May 2020, FINMA published a media release to inform market participants that it had granted licences as prospectus reviewing bodies to SIX Exchange Regulation AG and BX Swiss AG, effective 1 June 2020.

The duty to publish a FinSA approved prospectus took effect on 1 December 2020. Given the new rules, if, for example, in the context of a public tender securities are offered as consideration in Switzerland, it should be reviewed whether such offer might trigger the FinSA prospectus requirement and, if yes, whether an exemption is available. The FinSA provides for several exemptions from the duty to publish a prospectus requirement, including with respect to takeover situations if information that is equivalent to that contained in an issuance prospectus is otherwise available.

Another example of EU regulations affecting the regulatory landscape in Switzerland is the General Data Protection Regulation (GDPR). Even though Switzerland is not a member of the European Union, the guidelines are directly

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applicable to all Swiss-based companies doing business in the European Union, as the scope includes all businesses processing the personal data of EU data subjects (eg, employees) or organisations that monitor the (online) behaviour of EU data subjects (eg, customers). In addition, EU companies are asking its Swiss business partners to be GDPR compliant. Therefore, the GDPR has a major impact on numerous Swiss-based companies.

In June 2019, Swiss parliament passed the federal act on the implementation of the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes. This act is a step towards increasing transparency and preventing money laundering as well as tax evasion in relation to the legal and beneficial ownership of shares in Swiss legal entities, and marks the continuation of implementations of the Financial Action Task Force's recommendations. The key duty, stated in article 697(j) of the Swiss Code of Obligations, refers to any person that by itself or acting in concert acquires 25 per cent or more in the share capital or voting rights of a non-listed Swiss company having to disclose to the beneficial owner of this position to the company. If the person acquiring the 25 per cent stake is a legal entity, its beneficial owner is defined, under the new law, as the individual

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exercising control by analogy with the consolidation rules under Swiss statutory accounting rules. In this context, an individual is considered to control a legal entity if it holds, directly or indirectly, a majority of votes in the ultimate management body; if it directly or indirectly has the right to appoint or remove a majority of the members of the supreme management or administrative body; or if it is able to exercise a controlling influence based on the articles of association, a contract or comparable instrument. If there is no such individual, the person acquiring the 25 per cent stake is required to make a negative declaration to the company. To ensure effective compliance with the transparency obligations and the associated record-keeping duties, criminal sanctions apply to relevant violations under the Swiss Criminal Code, in addition to the corporate law effects of failing to comply with disclosure duties (in particular, suspension of voting and dividend rights).

In practice, with regard to standard private equity structures where, typically, the general partner takes the relevant decisions regarding the fund and its portfolio companies, the individuals controlling the general partner (respectively controlling the ultimate shareholder of the general partner) should be disclosed as beneficial owners. If such individuals cannot be determined, a negative declaration should be submitted to the company.

On 19 June 2020, after over a decade of preparatory work, Swiss parliament finally approved a general corporate law reform amending the Swiss Code of Obligations (the Corporate Law Reform). The Corporate Law Reform seeks to modernise corporate governance by strengthening shareholders' and minority shareholders' rights, and promoting gender equality in boards of directors and in senior management. It also replaces the provisions of the Ordinance on Excessive Compensation (Minder-Ordinance) that is applicable to listed companies, with only a few changes. Furthermore, the Corporate Law Reform aims to facilitate company formation, makes capital rules more flexible and revises the rules on corporate restructurings. Pursuant to this revision, the board of directors is required to monitor a company's liquidity and is further obligated to take measures to ensure solvency. Beyond this, the revision modernises the way general meeting of shareholders may be conducted as it allows for the holding of virtual meetings that may also take place abroad and universal meetings can also be held in written or electronic form. Finally, it introduces certain disclosure requirements for commodity firms (report of payments made to public authorities).

The effective date of the Corporate Law Reform has not yet been determined, although it is not expected to come into force before 2023. After coming into force, companies will have two years' time to make any necessary amendments to their articles of association and organisational regulations.

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7 What are the current attitudes towards private equity among policymakers and the public? Does shareholder activism play a significant role in your jurisdiction?

As the political system in Switzerland is organised as a direct democracy, the Swiss voters are ultimately the policymakers. Therefore, public opinion is often at the forefront of new regulations and laws. Public opinion in Switzerland in relation to large corporations – especially in the finance sector – has been fairly negative since the financial crisis. However, it seems that public opinion is again shifting back to a more pro-business approach but with a clear focus on corporate responsibility, as was shown by the initiative on corporate responsibility. The initiative was approved by the Swiss people by a narrow majority in November 2020, but was ultimately rejected by the Council of States because of the initiative's strict provisions. However, due to the rejection, the counterproposal was approved, which also aims to improve the protection of people and environment, but in a more business-friendly way. Also noteworthy is the initiative to suspend (albeit temporarily) an exemption clause in the Act on the Acquisition of Real Estate by Persons Abroad (the Lex Koller), which exempted the sale of business premises to a foreign buyer from the permit requirement. Up-to-date real estate that is not used for residential purposes is not subject to an approval by the competent authority. Such a temporary suspension might have had a far-reaching impact on the private equity market and transaction structuring, and was luckily rejected in the legislative process.

Public opinion in Switzerland is generally also positive towards foreign investors, which has been shown in past years by the high number of cross-border transactions. As a consequence, there is no regulatory framework specifically targeted at such transactions. Even though some politicians favour investment restrictions for critical infrastructure in Switzerland (for example in power supply, oil supply, natural gas supply, and district and process heat), no such restrictions are currently in force nor being planned by the Swiss government.

While the number of campaigns by activist shareholders in Switzerland is still relatively low compared to the United States for example, activist shareholders also played an important role in the recent past and shareholder activism has risen significantly in recent years. This trend can be expected to advance, as activist shareholders are becoming more sophisticated and better funded. In 2020, a group of shareholders around Veraison Capital AG, a Swiss activist shareholder, and Cobas Asset Management, a Spanish investor, pushed at an extraordinary general meeting aiming to replace five of the board members, including the CEO of ARYZTA AG. As a

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result, two board members resigned voluntarily and the chairman of the board held out the prospect of his resignation.

8 | What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

The conditions under which a private equity investor has the ability to exit its investment depend very much on the terms of the shareholders' agreement (if the private equity investor is invested in a target jointly with another party). Contractual arrangements regarding transfer restrictions and exit rights are specifically decisive. In particular, the right to force other shareholders to a sale (drag-along) or to unilaterally request an initial public offering (IPO) can facilitate the exit of the private equity investor. Ultimately, the terms agreed upon are a direct reflection of the parties' negotiation leverage. The most prominent exit routes are certainly trade sales and sales to other private equity investors. Exits through an IPO on SIX Swiss Exchange (or a foreign stock exchange) are still less common but became more attractive in the recent past. We are also observing a trend towards dual-track

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"Major tax issues include limitations on the acceptance of debt push-downs, rules regarding indirect partial liquidation for acquisitions of shares from Swiss resident individuals, rules in relation to management participation, and potential tax consequences of non-compete undertakings and earn-out or deferred payment provisions in the context of transactions."

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processes to increase deal certainty, specifically in times of volatile and unpredictable markets, and maximise valuation, despite the inherent complexity in running simultaneous IPO and M&A processes.

9 Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

Because interests in (foreign) private equity funds typically qualify as collective investment schemes under Swiss law (in particular, the Collective Investment Schemes Act (CISA) and its implementing ordinances), fundraising in Switzerland is subject to compliance with the relevant rules, which in particular affect the scope and framework within which private placements can be conducted. The CISA has been substantially revised in the wake of new Swiss financial services legislation under the FinSA that entered into force on 1 January 2020 (see question 6). Essentially, the CISA has been relegated to the specification of fund and product-level requirements. Separately, any point-of-sale duties in connection with the offering of collective investment schemes in Switzerland are now governed by the FinSA. Broadly speaking, the revised CISA/FinSA regime is subject to transitional rules under which the new regulatory duties are phased in over a period of up to two years until 31 December 2021.

The revision of the CISA abolished the former concept under which both product-level requirements and point-of-sale duties were linked to a broad notion of distribution of a collective investment scheme with very limited exceptions, limiting the possibilities of foreign private equity funds to raise funds in Switzerland without triggering regulatory requirements. The current regime is more closely integrated into general financial instruments regulation and enables the offering of foreign investment funds to a broader audience of 'per se' qualified investors (including, for instance, regulated financial institutions and insurance companies, but also large corporates, occupational pension schemes and other companies or investment structures with professional treasury operations) without having to seek approval of the fund by the Swiss regulator FINMA, and without having to appoint a Swiss paying agent and representative. The new regime thus extends the potential scope of and facilitates fundraising activities of sponsors in Switzerland. That said, if the sponsor intends to offer fund interests also to high-net-worth individuals who have elected to be treated as professional clients and qualified investors (ie, not 'per se' qualified investors), the appointment of a Swiss representative and paying agent for the fund is still required.

Furthermore, the licence requirement for (domestic) distributors of collective investment schemes was abolished with the revised CISA. However, instead, activities in or into Switzerland aiming at the purchase of fund interests by Swiss investors

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(which may in certain cases also include marketing activities in the context of road shows) may qualify as a financial service, triggering point-of-sale duties and other requirements under the FinSA even if conducted on a cross-border basis from abroad into Switzerland. Private equity fund houses might therefore still prefer to use specialised placement agents to market to Swiss investors and ensure compliance with the FinSA. The main duties of financial service providers under the FinSA are (1) registration requirement for client advisers (an exemption applies to client advisers of foreign financial service providers subject to prudential supervision in their home jurisdiction if they exclusively provide financial services to professional or institutional clients in the meaning of the FinSA); (2) requirement to conduct client segmentation; (3) rules of conduct and information duties at the point of sale (subject to exemption or waiver in the case of professional or institutional clients); (4) organisational rules including rules on conflicts of interests and disclosure of third-party remunerations; (5) duty to label marketing materials; and (6) duty to join an ombudsman's office (an exemption applies if only professional or institutional clients are approached).

10 Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your jurisdiction?

In Switzerland, private equity funds typically seek to raise capital in private placements of interests in accordance with exemptions from the CISA approval requirement with regard to the fund. While the new concept of 'offering' under the FinSA that has replaced the CISA concept of 'distribution' is narrower, regulatory requirements may already be triggered by mere marketing activities, which is why careful consideration of the investors to be approached and the methods used is required. Marketing materials have to be labelled as such and their content must conform to the prospectus, private placement memorandum or other documents of the fund. Furthermore, care needs to be taken to only make such materials available to eligible investors (including by way of access restrictions to websites).

Generally speaking, private equity fundraising is effected by one-on-one presentations by general partners to investors, often set up by specialised placement agents. These presentations typically involve the distribution of a private placement memorandum or other marketing documents. Although it is not a requirement under Swiss law, it is advisable and considered best practice to include specific Swiss disclaimer and selling restriction language in all offering or marketing materials. In any case, legal advice should be sought from local counsel before any Swiss investors are contacted. Furthermore, fundraising, even if limited to qualified investors,

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is subject to certain legal and regulatory requirements, some of which are outlined in question 9.

11 | How closely are private equity sponsors supervised in your jurisdiction? Does this supervision impact the day-to-day business?

Under the FinSA and FinIA regime, there is no longer a distributor licence, meaning that distribution of funds is no longer an activity subject to a licence requirement in Switzerland. However, the offering of fund interests to investors in Switzerland, even on a cross-border basis, in many cases qualifies as a financial service in the sense of the FinSA, requiring the persons and entities engaged in the fundraising process to comply with the various duties set out in the FinSA (see question 9). Furthermore, in particular, fund management companies as well as investment managers of collective investment schemes are subject to a licence requirement and ongoing prudential supervision by FINMA, requiring compliance with organisational and capital requirements as well as fit-and-proper requirements for the members of senior management and supervisory boards as well as major shareholders.

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> "The CISA has been substantially revised in the wake of new Swiss financial services legislation under the FinSA that entered into force on 1 January 2020."

12 | What effect has the AIFMD had on fundraising in your jurisdiction?

Switzerland is not a member state of the European Union, nor part of the European Econonic Area, and therefore has no obligation to implement the AIFMD. However, certain EU directives have had a significant impact on Switzerland. Swiss domestic laws, in particular in the financial sector, are often modelled to some extent on foreign regulation. Furthermore, AIFMD and its implementation in the various EU member states also has an impact on the prerequisites for Swiss investment managers to be able to manage portfolios of foreign or EU funds. At the local Swiss level, investment managers of collective investment schemes are subject to a licence requirement under the FinIA and to ongoing prudential supervision by FINMA. This applies also to investment managers in Switzerland that intend to act as delegated portfolio managers for foreign funds. In line with AIFMD, there are simplifications for Swiss-based investment managers if the total assets of the funds they manage do not exceed 100 million Swiss francs (including assets acquired through the use of leveraged finance) or 500 million Swiss francs (if they do not include leveraged financial instruments), respectively, and if all investors in the funds are qualified investors in the meaning of the CISA (*de*

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minimis rule). *De minimis* fund managers are exempt from the licensing requirements as a manager of collective assets but are required to obtain a FINMA licence as portfolio manager under the FinIA, with ongoing supervision by a private supervisory organisation (and subject to transitional periods of the FinIA depending on when the activity is started).

13 | What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment potentially changing in the near future?

Major tax issues include limitations on the acceptance of debt push-downs, rules regarding indirect partial liquidation for acquisitions of shares from Swiss resident individuals, rules in relation to management participation and potential tax consequences of non-compete undertakings and earn-out or deferred payment provisions in the context of transactions. Switzerland has no tax consolidation for income tax purposes and dividend income from subsidiaries is virtually tax exempt for a Swiss company. The consolidation of financing expenses of a Swiss acquisition company with the operating profits of a Swiss target company can generally be achieved by merging these companies (debt push-down). Mergers in Switzerland may generally be conducted in a tax-neutral way if the tax liability remains in Switzerland, and the assets and liabilities are transferred at their (tax) book value. However, based on the tax-avoidance doctrine, Swiss tax authorities often deny, during a five-year period following a merger, the tax-effective deduction of interest against the target's taxable income upon a merger of a pure acquisition vehicle with the target where the acquisition vehicle could not have used the interest deduction itself due to the lack of taxable income. As a consequence of this practice, alternative debt push-down strategies, such as cascade purchases, leveraged dividends and equity to debt swaps, can be an option to secure (at least partially) tax-effective deduction of interest. As a Swiss particularity, indirect partial liquidation taxation generally applies in the event that Swiss resident individuals sell at least 20 per cent shares in a Swiss or foreign company held as private assets to an acquirer holding the shares as business assets if the target company has distributable reserves and non-business required assets at the time of the transfer, and such assets are distributed within five years of the share transfer. If an indirect partial liquidation event is triggered, the sale proceeds are reclassified from tax-free capital gains into taxable dividend income in the hands of the individual selling shareholder to the extent that the target company distributes its non-business required substance existing at the time of the sale to the acquirer. In principle, any distribution out of distributable reserves existing at closing (ordinary or construed dividends, including merger proceeds) caused by the buyer (generally

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during the first five years after the disposal) is considered harmful if, and to the extent that, the target group had non-operating assets at the time of disposal. Although such income tax arises with the seller, it typically results in a liability for the buyer as the seller will ask for an indemnity in the sales and purchase agreement in case the buyer triggers such an indirect partial liquidation event post-closing.

The Swiss tax provisions on employee participations, together with the corresponding circular letter by the Swiss federal tax authority, provide a legal basis for the taxation of financial benefits derived from employee participations. It regulates, inter alia, the taxation value of employee shares, the taxation point of employee stock options and the treatment of artificial employee participations, which do not provide for an allocation of ownership rights. Management participation programmes generally aim to obtain a tax-exempt capital gains for the Swiss resident managers upon exit. However, depending on the individual terms, (part of) the income may qualify as fully taxable employment income, generally also subject to social security charges for the employing entity (ie, the target). The cantonal tax practices on the taxation of management participations vary significantly and it is therefore recommended to obtain certainty in an advance tax ruling. There is no special taxation rate applicable to carried interest in Switzerland: Swiss resident managers can generally only benefit to a certain extent from a tax-exempt capital gains or privileged dividend income if they hold at least 10 per cent of the shares, provided that no part of the carried interest is deemed employment income. The taxation of such privileged dividends currently ranges between about 1 per cent and 30 per cent, depending on the domicile in Switzerland.

In the past few years, the Swiss tax authorities have been stricter regarding the taxation of deemed considerations for earn-out proceeds of private sellers of shares. In short, if a person sells his or her shares in a company, the capital gains is considered tax-free capital gains. Nevertheless, if in connection with such a sale the person enters into an earn-out agreement where the earn-out is dependent on the continuation of the employment activity of the seller, the Swiss tax authorities may requalify part of the sales proceeds into income subject to income tax. A qualification of income as employment income generally also triggers social security contributions (currently about 12 per cent in total for employee and employer). Swiss individual sellers often opt for a share deal to ensure their tax-free capital gains, often leading to restrictions for the buyer under the indirect partial liquidation clause in the sale and purchase agreement. Regarding a future exit, the IPO of a Swiss target is an interesting option in the current environment, in particular since capital contribution reserves of a Swiss target may be repaid without being subject to Swiss withholding tax (and income tax for Swiss individuals as shareholders), with certain limitations for Swiss listed companies. For trade sales, it is important to ensure that the seller of the Swiss target benefits from a full dividend withholding

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tax exemption under a double tax treaty with Switzerland, since otherwise a latent dividend withholding tax burden may be inherited by a buyer (and deducted from the purchase price). The later topic is particularly relevant for private equity funds, since the full withholding tax refund entitlement of intermediate holding companies, for example, in Luxembourg, is increasingly scrutinised by the Swiss federal tax administration. Based on a recent anti-abuse practice introduced by the Swiss federal tax administration, withholding tax may also apply to dividends from the Swiss target to a Swiss acquisition company (extended international transposition) if the Swiss acquisition company is held by the fund directly or a shareholder not benefiting from a full withholding tax entitlement. It is important to clarify this point, for example, by providing economic reasons for the structure in an advance tax ruling.

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14 | Looking ahead, what can we expect? What might be the main themes in the next 12 months for private equity deal activity and fundraising?

After a decrease in M&A deal activity in 2020 by roughly a quarter compared to the same period of 2019, induced by the covid-19 pandemic, a recovery of the economy

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could already be observed towards the end of 2020. This recovery and upward trend continued through H1 2021, which led to an increase in deal activity with Swiss SMEs involved by more than 60 per cent. Due to the inflow of liquidity into the private equity sector and other favourable circumstances such as ongoing negative interest rates, it can be expected that the observed upswing in the M&A market will continue. The catch-up of several transactions that were postponed or suspended because of the covid-19 pandemic had a further positive effect and is likely to continue. With regard to certain sectors, we expect the TMT, consumer goods and healthcare sectors to experience an ongoing popularity for outbound transactions, and as for inbound transactions, increasing deal activity in the TMT, consumer goods and industrial sectors are expected. This is, of course, all conditional upon the covid-19 pandemic not worsening again and thereby creating more uncertainty, and financing banks not becoming less accommodating in financing transactions due to the covid-19 pandemic.

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The Inside Track

What factors make private equity practice in your jurisdiction unique?

Switzerland's stable political system, globally oriented and liberal economy, highly skilled workforce, and efficient legal environment as well as a traditionally mild tax regime and relatively low bureaucracy create an excellent environment not only for private equity, but also as a business environment in general.

What should a client consider when choosing counsel for a complex private equity transaction in your jurisdiction?

Competence, deal experience, accessibility and pragmatism are certainly the most crucial factors for successfully completing complex private equity transactions.

What interesting or unusual issues have you come across in recent matters?

Every deal, of course, raises interesting and unique questions. A very interesting topic we have come across in a recent matter was the involvement of a foundation as selling shareholder, which ultimately required intense exchange with and approval by the competent foundation authority.

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